PAYSYS REPORT

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1. Pandemic and card business: the hoped-for V-curve

What changes in the card business has Covid triggered so far? Several national central banks collect and publish card-related data on a quarterly basis for card payments at POS-terminals, in e-commerce (CNP) and for cash withdrawals at ATMs. For 5 Member States (Denmark, Hungary, Ireland, The Netherlands and Spain) we analysed the quarterly changes of this year (to the quarterly data of 2019). It is striking how the statistical curves of these countries converge. It looks like credit cards and the ATM business are the current losers.

2. IFR: Idiosyncratic interpretations by the Commission

In its Review Report on the application of the Interchange Fee Regulation (IFR – 2015) the European Commission added two remarkable new exegeses of the existing law:

1. IF caps are relevant for remuneration to co-branding partners and agents,
2. Consumer rights based on the co-badging rules are also applicable for mobile wallets.

The objectives may be justified, but they probably cannot be achieved without amending the IFR.

Pandemic and card business: the hoped-for V-curve

(hg) Much has already been reported about the consequences of the pandemic on card-based payments. The virus has given a powerful boost to the existing trend towards cashless payments at the expense of cash. Secondly, old and new card payers prefer to use the card at the POS terminal contactless (plastic card or virtual card via mobile phone). The share of contactless payments at the POS should have increased leaps and bounds. Third, e-commerce is booming and with it card payments as a popular online payment medium. Most market observers assume that this Covid-related change in payment habits is permanent.

The above effects are based on a variety of market research, polls and published figures of a few card schemes and PSPs (issuers and acquirers) in selected countries. For complete data of the entire euro area or the whole EU, we will have to wait for the ECB's 2020 figures, which will be available in spring 2021, at the earliest. However, this data only will allow for an analysis on a year-to-year-basis.

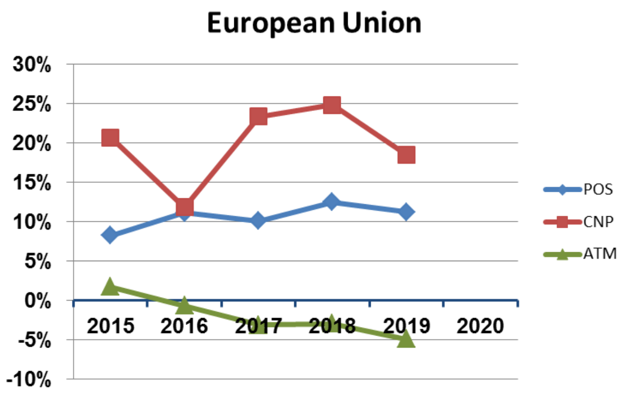
Let us first take a look at 2015 – 2019 payment data. In the central bank payment transaction statistics, card payments (at the physical POS and card-not-present/CNP) are recorded, as well as cash withdrawals at ATMs. Based on these core figures, we see the following trends in the EU for the period 2015-2019 (see Fig. 1):

- POS payments are growing steadily at around 10% p.a.,
- CNP shows higher growth (approx. 20% p.a.), but is much more volatile,
- Card-based cash demand (ATM) has been steadily declining since 2016 (approx. -3% p.a.).

Without Covid or other "external" shock events (such as a similar banking crisis of 2008), one could have assumed that these trends would continue for 2020.

The economic crisis triggered by the last banking crisis only caused a dent in the growth curve in the card business, but no structural effects. Will Covid 19 also only cause a temporary dent or a change in the long-term trend? It is difficult to make a forecast, as the main drivers of card payments, so far, have been consumption and usage of competing means of payment, like cash at the POS or other digital payment instruments in e-commerce. Both drivers can be sustainably influenced by the pandemic and the ensuing economic crisis. But it is as yet unforeseeable what the enduring effects will be.

Fig. 1 Annual percentage changes of card-based payments



and cash withdrawals[1]
Source: ECB Statistical Data Warehouse

What changes in the card business (POS, CNP, ATM) has Covid triggered so far? Fortunately, there are several national central banks that collect and publish card-related data on a quarterly basis. For statistical reasons, it is regrettable that the lockdown in spring and the gradual easing until the second lockdown in autumn 2020 were imposed across quarters.

Nevertheless, the published quarterly figures of some member states show a consistent development. Even more revealing are the unique monthly statistics of the Bank of Ireland, which even record card payments by acceptance sector.

Our Comment:

The national central banks of Denmark, Hungary, Ireland, The Netherlands and Spain have published quarterly data of card-based transactions for 2020, at least for Q1 and Q2. For these five countries, we have compiled the data of card-based POS and CNP payments as well as ATM withdrawals (where available).

It is not surprising that consumer spending is already falling in Q1. Many households have voluntarily cut back their spending in view of the change in the economic climate. From mid-March onwards, there was a state-enforced restriction on consumer spending due to the closure of brick-and-mortar acceptance points and travel restrictions, which was handled differently by each country.

The reduction of these types of consumer spending could only partly be offset by a shift from the physical POS to e-commerce. These two effects led to a sharp decline in card and cash consumer spending in Denmark, Hungary, Ireland and the Netherlands in Q2 at the latest (sum of card-based payments and cash withdrawals on a value basis in % compared to the same quarter last year). See Fig. 2

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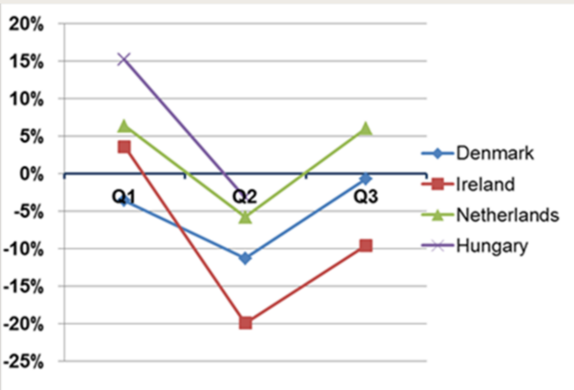

Fig. 2: Total value of card-based payments and ATM withdrawals (percentage changes compared to the same quarter in 2019)

Sources: Payment statistics of the national central banks

Assuming that there would have been high growth at least in POS and CNP without Covid (see trends in Fig. 1), the percentage decline is much higher. In contrast to the other countries, Hungary largely refrained from a lockdown in spring 2020, which makes the country perform relatively better than the other countries.

In Q2 at the latest, card sales at the POS fall sharply compared to the same quarter in 2019, at least in Spain, Denmark and Ireland (See Fig. 3.). Ireland is hit the hardest with minus 21%. The Netherlands and Hungary probably still achieve a slight plus (4% and 2%, respectively) due to the less strict or lack of lockdown restrictions.

Without Covid, however, growth would have been much higher. In Q3, card payments at the POS have recovered significantly. In the Netherlands and Spain, growth rates in Q3 (18% and 9% respectively) are even higher than in Q1 (12% and 2% respectively). In Ireland, however, card payments in Q3 are still far below the level of the same quarter last year.

Amsterdam December 2020.
Lockdown holiday-ration: Contactless payed?*

It is commonly assumed that e-commerce is the winner of the crisis. However, in the segment of remote card payments (CNP), the increases in Q2 are much lower than in Q1. The growth rates are still positive in Hungary (35%) and Ireland (11%) and stagnating in Denmark. The Dutch figures for CNP (-3%) are not very representative, as cards play a minor role in ecommerce in this country. Debit cards which dominate POS payments cannot be used for remote payments. Instead, the Dutch use online credit transfers (iDEAL) in e-commerce. But even for this payment method, the growth rate in Q2 (27%) is significantly lower than in Q1 (36%).

In both Denmark and Ireland, a significant Covid-related shift from card-present payments to non-card-present payments is not discernible. Now, in e-commerce, the card competes with other payment instruments such as PayPal (if there is no funding via cards), Amazon Pay, bank transfers, etc. The additional e-commerce demand may have been intensified by

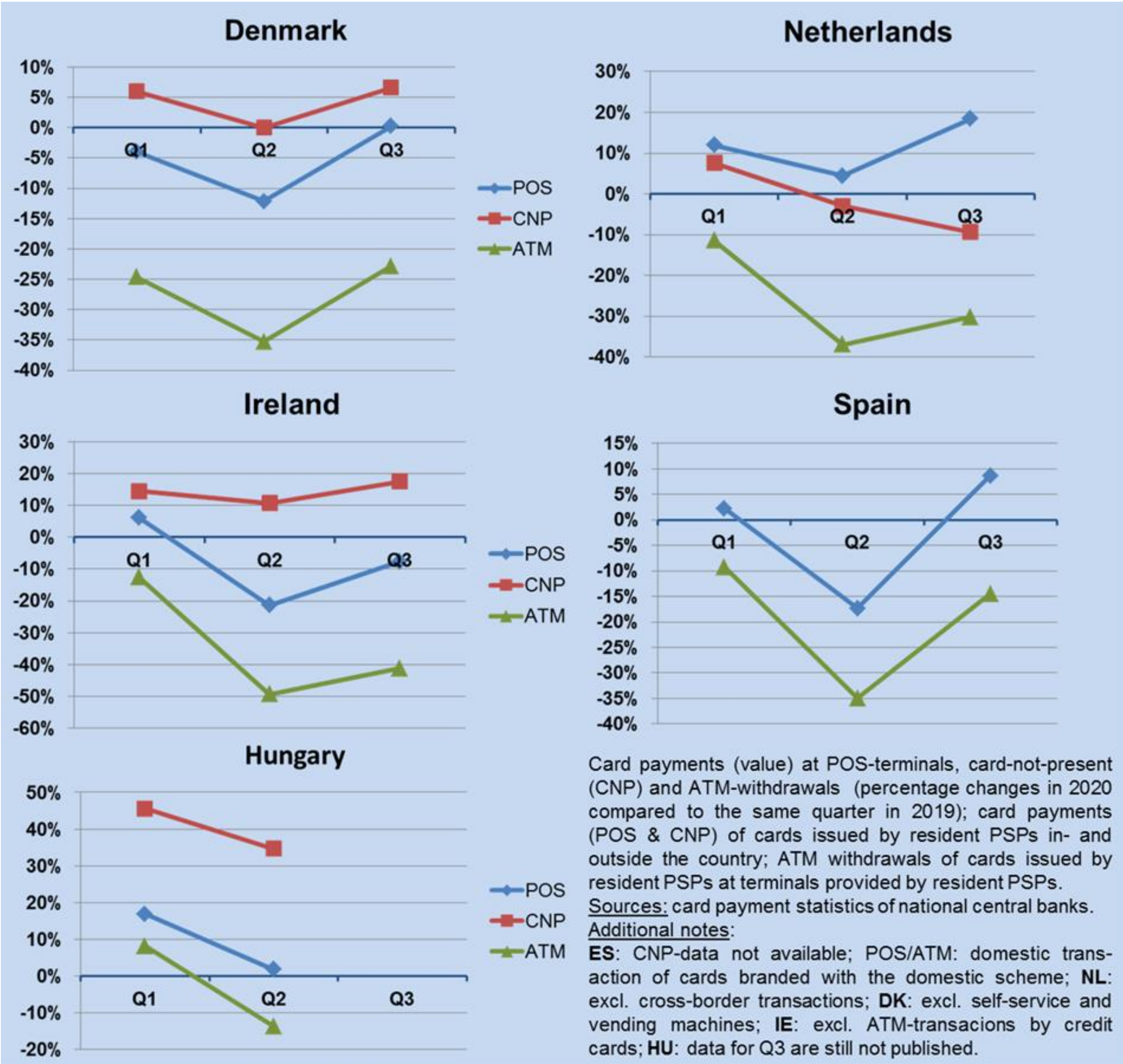

Fig 3: Value of card-based payments (POS & CNP) and ATM withdrawals (percentage changes compared to the same quarter in 2019)
Sources: Payment statistics of the national central banks

these other payment instruments. On the other hand, there is obviously no pandemic-related reason for a change of payment habits in ecommerce.

At the POS, however, this looks quite different. Like POS payments, ATM withdrawals also show a V-curve, but with some significant differences. Except in Hungary, the change compared to the same quarter last year is already negative. Second, the decline is much higher in Q2 than for POS payments. Thirdly, in Q3, the decline decreases, but there is no recovery to the expected pre-Covid level.

In particular, in Ireland and the Netherlands, the decrease compared to Q3/2019 is extremely high: -41% and -30% respectively. It is a clear indication that also in the recovery phase cash payments were substituted by card payments at the POS.

Despite the “all-clear” from several central banks that the risk of contagion from cash has been proven to be very low (comparable to touching a shelf or product in a supermarket), consumers seem to be susceptible to rumours and fake news and behave inconsistently in these uncertain times. There are a few consumers who wear gloves in the supermarket. The development in Q3

Will Covid 19 also only cause a temporary dent or a change in the long-term trend?

The development in Q3 points to a lasting change in payment ha-bits at the physical POS to the disad-vantage of cash.

points to a lasting change in payment habits at the physical POS to the disadvantage of cash.

A sustainable change, however, presupposes that the new card payers rate the benefit of a card payment higher than the use of cash, even after the crisis.

Many observers have stressed the rising use of contactless payments. Unfortunately, only the Dutch Central Bank has published data on contactless payments at the POS. As of Q1 2020, the volume (value based) of contactless debit card payments shows a surge (see Fig. 4). However, the Corona-effect looks a bit like a one-off. But it requires more data of the Netherlands and other countries to confirm this first impression.

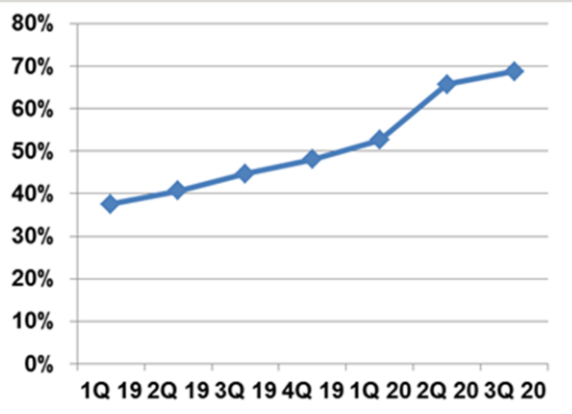

Fig. 4: Share of contactless debit card payments at the POS (value based)
Source: Dutch Central Bank (DNB)

The extreme decline in ATM withdrawals may or may not imply a reduction in cash demand. For Germany, the Bundesbank reports a 12% increase in the volume of banknotes in circulation for March 2020[2]. Consumers started to hoard not only toilet paper but also other, more-coloured paper as a safety net.

Crisis-related cash hoarding often leads to increased demand for banknotes in higher denominations (e.g. 200 euro notes).[3] Since these notes do not usually come into circulation via ATMs, one would have to additionally consider the demand for cash at the bank counter, which we refrain from doing in this analysis. In any case, the reduction in ATM withdrawals reflects the lower demand for cash for transaction purposes.

Only the Bank of Ireland is publishing monthly data. Here we can see what happened after the easing of the restrictions step-by-step after May 2020 (see Fig 5):

- We see a strong increase of card payments at the physical POS. The volume after a few months is again at the level before the lockdown.
- At the same time, cash demand was growing too, however it remains at a lower level than before the crisis.
- Card payments in e-commerce are more or less at the same level as before (not included in Fig. 5). We see the same effect in Denmark.

Other interesting consequences of the pandemic can be derived from the quarterly payment card data of the respective central banks. In spring, a German card issuer told me that his credit card sales had dropped by almost 40% in one month. Apparently, this is not an isolated case.

The pandemic and the lockdown hit the credit card business.

Based on the data of the central banks, the sales turnover in Denmark, the Netherlands and Ireland can be divided into debit and credit cards (credit cards incl. delayed debit cards). The picture here is consistent: the pandemic and the lockdown hit the credit card business in particular, with a massive drop in sales in Q2 of up to 44% (Denmark) compared to Q2/2019 (See Fig. 6). In Q3 there is some recovery again, but in contrast to debit cards, sales remain far below the level of the same quarter of the previous year. The development here is similar to that of ATM withdrawals.

Several reasons can be assumed for this massive decline:

- The lockdown particularly affects the market segments in which the credit card is preferred (travel & entertainment).
- The debit card enables timely liquidity and budget control. In addition, the looming economic crisis leads to a lower demand for consumer credit via credit card.
- In general, the share of sales abroad of the credit card is much higher than that of the debit card. The restrictions on travel are therefore hitting the credit card much harder.

It is striking how the statistical curves of the countries under consideration here converge. It looks like credit cards and the ATM business are the current losers. In a few months, when the 2020 figures of all EU member states are available, we will see whether the development in these five countries is representative for the entire EU.

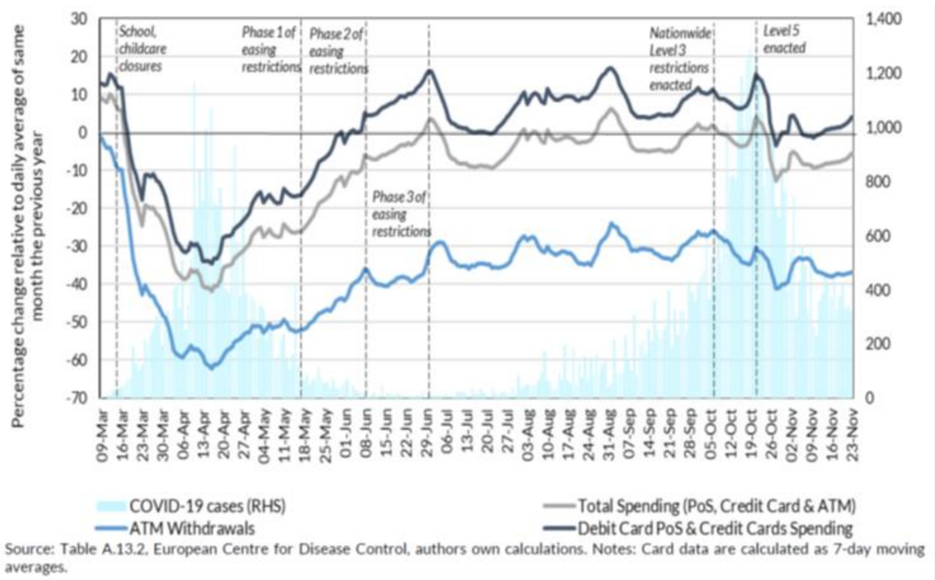

Fig. 5: Change in card spending and cash withdrawals compared to the daily average in the same month the previous year
Source: Central Bank of Ireland[4]

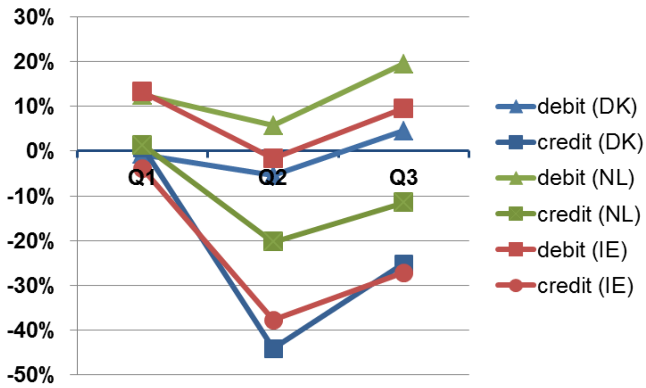

Fig. 6: Value of card-based payments (POS & CNP) (percentage changes compared to the same quarter in 2019)
Sources: Payment statistics of the national central banks

IFR: Idiosyncratic interpretations by the Commission

(hg) According to statements made by the EU Commission, there will be no new Interchange Fee Regulation (IFR) in the foreseeable future. In its Review Report of the Regulation (EU) 2015/751 of 29 June 2020[5], the Commission said that *"further monitoring and data gathering including over a longer period are necessary... to decide on the necessity of a legislative proposal to review the IFR*" (p. 2).

But that does not necessarily imply that the regulatory framework for interchange fees will remain unchanged.

The Review Report largely refers to the findings of EY's market investigation on the impact of the IFR. In our Pay-Sys-Report no.3-4 (May 2020) we examined the results in detail and in part critically. In addition, in several places the Review Report contains idiosyncratic interpretations of existing IF regulations, which are certainly open to discussion. Since a new version of the IFR is not politically opportune at present, these interpretations seem to be used as a way to change existing regulations. While these interpretations are interesting, they are in no way legally binding for the main addressees of the IFR (issuers, acquirers and card schemes) unless the courts would follow the Commission in its interpretation. But that seems doubtful because, as will be argued below, they are not in line with existing EU law.

In this article we would like to take a closer look at two remarkable interpretations by the Commission:

1. IF caps are relevant for remuneration to co-branding partners and agents,

2. Co-badging rules are also applicable for mobile wallets.

Our Comment:

It is actually a pity that the Review Report was not accompanied by a new IFR. The thresholds would not have had to be changed, but at least many technical errors and ambiguities could have been eliminated. Some examples of open questions:

- Is the IFR relevant for non-card based transactions? The definition of a card-based payment instrument according to Art. 2.20 indicates a fallback for all payment instruments other than direct debits and credit transfers.

- Is chapter III (business rules) relevant for cash withdrawals (see Art. 1.3)?

- Why is the IFR cap of 0.2% only relevant for domestic transactions with a "Universal Card"[6] (see Article 16.1)? How to handle cross-border transactions with these hybrid cards, which could be debit or credit?

- Why is the consideration of scheme fees and other payments asymmetrical (only applies to the issuer, not to the acquirer; see Art. 2.11)?

- Why does the definition of a "cross-border payment transaction" in the IFR (Art. 2.8) differ from the definition in other EU Directives and Regulations?

- Why does the IFR allow the establishment of a domestic MIF which puts foreign acquirers at a competitive disadvantage and is therefore in blatant contradiction to Art. 6?[7]

One reason for not revising the IFR is probably the European Payments Initiative (EPI). The business case (if there is one at all) should probably not be jeopardised by further reductions in IF caps. An acquaintance involved in the EPI project (who does not want to be mentioned by name) told me about a gentlemen's agreement between the Commission and the EPI stakeholders that the IFR would remain unchanged in the coming years.

While all of these issues have remained open, the Commission has used the Review Report for some "clarifications". However, properly interpreted, these "clarifications" amount to an extension of current regulations. In our view, such an extension would require an amendment to the text of the Regulation. We would like to take a closer look at two interpretations below.

1. Relevance of the IF caps for remuneration to co-branding partners and agents

Co-branding (not to be confused with co-badging[8]) is a widespread phenomenon in the card business. In Germany, about 15% of cards with international brands (Amex, Mastercard and Visa) are issued as co-branded cards. Co-branding allows an issuer to attract new customers, who often do not have a current account with the issuer ("decoupled cards"). The co-branding partner (CBP), e.g. an airline or automobile club, acts as a distribution partner and takes over the acquisition of customers within its customer base.

Where there are no IFs flowing, there are no IF caps.

The card is branded by the brand of the CBP and by the payment brand (e.g. Visa). The issuer usually pays a remuneration to the CBP for its sales activities. This remuneration may be linked to various factors, such as per new customer acquired or per card sales volume (CBP's share of the issuer's IF revenues). Visually, the card focuses on the CBP brand and the payment brand (e.g. Visa). The legal issuer often appears only in the small print. CBP or another sales agent takes over the tasks of the issuer without being a legal issuer itself.

Probably for this reason (de facto issuer role of CBP) the IFR (Art. 1.5 and 2.18) states that when a 3-party scheme issues card-based payment instruments with a CBP or through an agent, it should be considered to be a 4-party scheme.

This is one of the reasons why Amex is considered in the EU as a 4-P scheme for the application of IFR. This means that any IFR that would flow under this de facto 3-P scheme would be subject to the ceilings. However, no IFs flow between the acquirer and the issuer, as both functions are performed by the same entity. The simple conclusion is that where there are no IFs flowing, there are no IF caps.

It could now be argued that the payments of the de facto 3-P scheme to a CBP (or to an agent) to remunerate its issuer services would be comparable to the IF payment from an acquirer to a genuine (legal) issuer. Logically, CBP's remuneration would also have to be subject to the IF caps.

The Commission is now following this logic. It even goes a step further and claims that this also applies to genuine 4-P schemes. Accordingly, all payments made by a scheme or an issuer to a CBP (or to an agent) are subject to the IF caps. *"The IFR caps apply indifferently to 3PS or 4PS when issuing cards with a co-branding partner or agent."* (p. 12). As with the "*normal*" IF, the net principle from the CBP's (or agent's) point of view should be applied (net compensation according Art. 2.11).

This strange interpretation by the Commission cannot be deduced at any point in the text of the IFR. According to the definition, the IF is a *"fee paid for each transaction directly or indirectly (i.e. through a third party) between the issuer and the acquirer involved in a card-based payment transaction"* (Art. 2.10). Art. 5 states: *"For the purposes of the application of the caps referred to in Articles 3 and 4, any agreed remuneration, including net compensation, with an equivalent object or effect of the interchange fee, received by an issuer from the payment card scheme, acquirer or any other intermediary in relation to payment transactions or related activities shall be treated as part of the interchange fee."*

The IF or an equivalent object is always a payment to the issuer. The addressees for compliance with the IF caps pursuant to Articles 3 and 4 are payment service providers (PSP). A CBP (as being not a PSP) and an agent, acting on behalf of the issuer, are definitely not an issuer according to the IFR.

Applying the IF caps to the remuneration of CBPs or agents would lead to a strange constellation where a card-based transaction in a 4-P scheme results in two different IFs: The acquirer's payment to the issuer and the issuer's payment to a CBP or an agent.

In practice, it will be rare that an issuer in a 4-P scheme will pay its CBP an amount in excess of its IF income. However, it is conceivable that an issuer may also transfer part of the cardholder fees to a CBP if the CBP in return incentivises card sales (e.g. in the case of a loyalty program).

CJEU: Amex Case (2018)

For this remarkable exegesis the Commission refers to the so-called Amex case of the European Court of Justice (CJEU) in 2018.[9] In that judgment, the Court concluded that, in a 3-P scheme, it is not inconceivable that a payment to a CBP or agent could be classified as an "implicit IF" under recital 28 of the IFR (paragraph 71).

The term "implicit IF" only appears in Recital 28 of the IFR. In addition to joint issuing with a CBP or agent, there is a further prerequisite for the classification of a 3-P scheme as a 4-P scheme. This is the case if a 3-P scheme cooperates with one or more PSPs as licensing partners on the acquiring or issuing side (Art. 2.18). In contrast to a traditional 4-P-scheme, the scheme itself acts as an issuer or acquirer. In this case there is by definition an issuer and an acquirer, which are not identical.

Any remuneration from the acquirer to the issuer in connection with a card payment is called an "implicit IF" in this constellation. For the "*creation of a level playing field*" this constellation is to be classified as a 4-P-Scheme.

Accordingly, a payment between the acquirer and the issuer is subject to the IF caps, even if it is not explicitly referred to as IF. Explicitly or implicitly, an IF is in both cases a payment between the acquirer and the issuer and thus in accordance with the definition of an IF.

CJEU now notes in a subsidiary sentence (Par. 71) that even in the case of a 3-P scheme (issuer and acquirer are identical), certain payments to a CBP or agent may constitute an implicit IF according to recital 28. It remains unclear what conditions must be met for this to happen. This statement is incomprehensible as recital 28 clearly refers only to the case where in a "semi" 3-P scheme a payment can actually take place between an acquirer and issuer.

The CJEU statement can therefore only be understood to mean that a certain payment to a CBP or agent could have the same effect as an implicit IF. However, it is not an IF, neither explicit nor implicit, as the crucial prerequisites are missing.

Actually, this judgment was about a different issue. Contrary to Amex's view, the Court made it clear that the content of the activity of CBPs or agents in issuing (whether or not they are authorised as PSPs) is irrelevant for the purposes of classifying a 3-P scheme as a 4-P scheme. An agreement with a CBP or an agent would be sufficient. However, the requirement of the existence of an IF and thus the IF caps requires a "real" issuer (as being a PSP according to Art. 2.2 of the IFR) and as receiver of the fee.

The Commission's conclusion that payments to CBPs or agents in 3- and 4-P schemes are subject to IF caps is therefore based on a very shaky interpretation of a questionable statement by the CJEU. It cannot be a binding interpretation of community law. The Commission has announced that it will increase its collection of data on payments to CBPs and agents and monitor compliance with the rules in the market.

Market relevance?

Irrespective of the question of whether this interpretation is legal without amending the IFR, the question arises as to whether it makes sense. A semi 3-P scheme could pay a CBP a higher remuneration for the distribution cooperation than the issuer of a 4-P scheme whose IFR income is capped by the IFR. If this remuneration were not subject to the IF caps, the 3-P scheme could gain a competitive advantage.

Payback co-branding cards in Germany (Amex & Visa)

We see this in the German market, for example. Here there is both a Visa card from the issuer BW Bank and an Amex card with the loyalty scheme Payback as CBP. With Amex, the cardholder receives 1 bonus point for every €2 turnover, whereas with BW Bank the bonus point is paid for every €5 turnover. Neither issuer charges an annual fee. On the other hand, the competitive disadvantage of the Visa issuer could possibly be compensated by the better acceptance of the Visa card - due to the IF caps. It is questionable whether Amex really has a competitive advantage in the co-branding market due to the IFR.

In the same review report, the Commission reports that the market share of 3-P schemes has remained stable after the introduction of the IFR (p. 4). However, if one takes a closer look, Amex has even slightly lost market share in the EU in the credit cards segment (2014: 5.3% and 2016: 4.9%; see p. 25). This finding suggests that the alleged competitive advantage is limited.

Has Amex really a competitive advantage in the co-branding market due to the IFR?

2. Relevance of co-badging-rules for mobile wallets

An important point in the IFR is the issue of co-badging. Co-badging occurs when two or more payment brands or two or more payment applications of the same brand (e.g. Visa debit and Visa credit) are included in a card-based payment instrument (Art.2.31). By means of co-badging the IFR aims at intensifying competition between the domestic and the international card schemes.

The holder of a co-badged card should be able to select the brand or application at the POS terminal. If necessary, he should be able to override the priority selection of the retailer (Art. 8.6).

In the Member States with a domestic scheme, around 95% of debit cards are co-badged. However, in practice, this application selection is rarely used by cardholders. The Commission gave the following reasons: "*limited transparency, awareness and a lack of incentives in the absence of price differences*" (p. 16). Was the whole regulatory action for nothing?

The background to the co-badging rules under Art. 8 of the IFR was the world of physical (debit) cards provided by issuers in countries with domestic schemes. Are the same rules applicable for mobile wallets too? If so, under which conditions and in what cases?

At first glance, co-badging for virtual cards in a wallet is superfluous. As examples, we take the case of two brands. For physical cards, the issuer has the option to give the cardholder either two cards with different brands or one card with two brands. The latter option is space-saving for the cardholder and more efficient for the issuer. In the case of a wallet the alternative does not arise.

In a wallet two virtual cards can be loaded, each with a different brand. At the POS, the wallet holder can select brand A or brand B. If the issuer provides both virtual cards to the wallet holder, the wallet is co-badged.

The alternative in the form of two wallets is pointless. But it does not seem to be that simple. According to the Commission, the co-badging rules regarding the rights of the consumer (payer) vis-à-vis the issuer are relevant for two cases (p. 15):

1. the choice of which payment application can be uploaded on a mobile wallet,
2. the choice of a wallet, which can be uploaded on a payment instrument (here a smart phone).

Unfortunately, the Commission does not provide any further explanation of these consumer rights, which it derives from the co-badging rules. It cannot be a general right of choice, but only a right of the customer (payer) vis-à-vis the issuer of the payment instrument.

In the **first** case, an issuer could, for example, issue plastic-based payment applications of different brands (two cards or as a co-badged card), but only one of both brands as a virtual card downloadable on a wallet. Does the customer have the right to use both brands in his wallet? Does it matter who provides the customer with the wallet? The issuer or a third party (Apple Pay, Google Pay & Co)?

The **second** case (choice of wallet) probably alludes to the current discussion about Apple Pay. Apple is accused of only accepting Apple Pay, but no other competing payment wallets, on its smartphones (keyword: access to NFC antenna)[10].

Co-badging: consumer rights

Anyone who is familiar with the IFR will put a big ques-

Does the iPhone owner now have a claim against Apple or its issuer to install a competing payment wallet?

The IFR is a blunt weapon for this purpose.

tion mark at this point. To answer the question, we need to take a closer look at the IFR on the subject of co-badging and the consumer right of choice (Art. 8.2):

"*When entering into a contractual agreement with a payment service provider, the consumer may require two or more different payment brands on a card-based payment instrument provided that such a service is offered by the payment service provider.*"

"Such a service" refers to the co-badging offer of two or more different payment brands on a card-based payment instrument. If an issuer offers two product variants for a particular card category (e.g. a debit card with brand A and a co-badged debit card with brand A and B), the issuer cannot refuse the co-branded card to the consumer if the conditions for a contractual relationship to obtain the single-branded debit card are met.

It cannot be inferred from the provision that the consumer may request a co-branded card if the issuer offers the relevant brands only on single-branded cards. Otherwise we would already have a unique super card with the two brands Mastercard and Visa in the European market.

It is also understandable that this right does not apply to co-badged products, which include two categories (e.g. debit and credit). If a customer classifies himself only for "debit" due to his creditworthiness, he is not entitled to a co-badged card "debit and credit", even if the issuer would offer such cards.

It is therefore a matter of choosing between a single-branded and a multiple-branded (co-badged) card-based payment instrument, if both are offered by the issuer.

What is a "*card-based payment instrument*"? According to the IFR, it "*means any payment instrument, including a card, mobile phone, computer or any other technological device containing the appropriate payment application which enables the payer to initiate a card-based payment transaction which is not a credit transfer or a direct debit as defined by Article 2 of Regulation (EU) No 260/2012" (Art. 2.20)*".

A plastic payment card is clearly a payment instrument. Both the physical plastic (including chip) and the embedded payment application are issued and provided by a payment service provider (issuer) to the payer. A payment instrument should be a personalized device and/or set of procedures provided by a PSP based on an agreement between the issuing PSP and user (Art. 2.2 and 2.19).

A mobile phone or a computer is usually not provided by a PSP as issuer of the payment application. In this case, the mobile phone or computer is only the technical means by which the payment transaction is executed. It is not a personalized payment instrument. With a wallet there are both cases. The wallet can be issued and made available by an issuer to the user (e.g. banking app) or by a third party (e.g. Apple Pay, Google Pay etc.) as a digital wallet for virtual cards issued by a PSP.

In the latter case the card-based payment instrument is only the virtual card loaded in the wallet. The wallet is only a technical or virtual container, which is not provided by a PSP. Accordingly, any selection rights with regard to co-badging according to the IFR can only be asserted against the issuer of the virtual card and not against a third-party wallet provider.

The choice of payment brands in mobile phones

In which cases could the right of choice of brand for a card-based transaction using a mobile phone now be given? Let us look at some cases.

<u>Case 1:</u> A bank offers a banking app (wallet) and virtual cards of a certain category (e.g. debit) with different brands that can be loaded into the wallet. The cardholder can load the card with brand A and/or brand B. In the latter case the wallet is co-badged. The wallet owner has the choice. The issuer cannot stop his customer from using both cards in his smartphone if both cards (of the same category) are offered by the issuer as virtual cards.

<u>Case 2:</u> An issuer issues a physical co-branded card with brand A and B. As a virtual card, the issuer only provides brand A in his wallet. In this case, no right of the user can be implied that the issuer must also provide the virtual card with brand B. The prerequisite for

Art. 8.2 is that the issuer should offer this service. In the case of some brands (e.g. Maestro), there are currently systemic problems in implementing a virtual card (existing card numbering, tokenisation etc.).

Case 3: An issuer offers virtual cards with brand A and B that can be loaded into wallets provided by third parties. The issuer concludes an agreement with one wallet provider (e.g. Apple Pay) only for the brand A virtual card, and with other wallet providers for the use of both cards. Can the user force his issuer or his wallet provider to also make the virtual card with brand B available in this third-party wallet? The answer is no.

According to the IFR, he may only have the right of choice vis-à-vis the issuer and the latter only offers the service "Card with brand A for wallet X". No obligation to contract between the issuer and a third party provider can be derived from the right of choice.

The choice of payment wallets in mobile phones

The right of choice according to article 8.2 refers to the choice of payment brands vis-à-vis the issuer of a card-based payment instrument. The additional right of choice required by the Commission on the basis of this IFR article refers to the choice of the wallets to upload on a smartphone.

It further assumes that the smartphone is a payment instrument. As explained above, smartphones are almost never issued by PSP as a card-based payment instrument. A smartphone is therefore not a payment instrument. A wallet in technical combination with a payment application is only a payment instrument if it is issued by a PSP. A wallet without a payment application is not a payment instrument. The core card-based payment instrument is the virtual payment card issued by a PSP.

The question of the consumer and smartphone owner can demand the use of any wallets from the smartphone provider is not answered by the IFR. Even from a benevolent point of view, there is no basis for this interpretation by the Commission. Art. 8.2 of the IFR only governs any claims of the user of a card-based payment instrument against the PSP as issuer of the payment instrument.

A smartphone provider could be identical with a payment wallet provider, like Apple or Samsung. Such a provider could technically prevent the download of competing wallets on its smartphones (Apple case) or not offer certain issuers of virtual cards the right to use its wallet. Such behaviour of a market-relevant provider should probably be viewed critically in terms of competition law. However, the IFR is a blunt weapon for this purpose.

It is therefore surprising that in the recently launched investigation by the Dutch competition authority ACM[11] regarding the lack of access of payment apps to the NFC antenna of smartphone providers, the ACM also invokes a possible violation of the IFR. "*This European Regulation stipulates that consumers have the right to be able to choose their method of payment in brick-and-mortar stores.*" Obviously, the ACM refers to Art. 8.6:

"Payment card schemes, issuers, acquirers, processing entities and other technical service providers shall not insert automatic mechanisms, software or devices on the payment instrument or at equipment applied at the point of sale which limit the choice of payment brand or payment application, or both, by the payer or the payee when using a co-badged payment instrument."

The prerequisite for this requirement is the use of a co-badged payment instrument. A co-badged wallet would be a wallet with virtual cards of different brands or cards of different categories of the same brand. If this requirement is met, the user should have a choice at the POS. Even after a lot of thought and imagination, I am unable to deduce from this a forced opening of the iPhone for wallets other than Apple Pay. Dear reader, do you have an idea?

Both with regard to the application of the IF caps for remuneration to CBPs or agents and with regard to the application of the co-badging rules for smartphones, the Commission is skating on very thin ice. In any case, it is astonishing that an executive exceeds its competence by interpreting an existing law. The objectives may be justified, but in my opinion, they cannot be achieved without amending the IFR.

Notes

1 Based on: transactions of cards issued by resident PSP; ATM: transactions at ATMs provided by resident PSPs. POS/CNP: excluding Estonia, Malta, Slovakia, UK, Czech Republic, Sweden, Croatia and Poland, where data are not complete or missing for the whole period.

2 See Johannes Beermann, Mehr als nur ein Zahlungsmittel, 15 October 2020 https://www.bundesbank.de/de/presse/gastbeitraege/mehr-als-nur-ein-zahlungsmittel-847974.

3 See Gerhard Rösl and Franz Seitz, SARS-Cov-2 und Bargeld: Wie ein Virus die weltweite Bargeldnachfrage fördert", Regensburg Papers in Management and Economics, No. 5, November 2020.

4 Central Bank of Ireland, Statistical Release, Credit and Debit card statistics of 30 November 2020, p. 1

5 Commission Staff Working Document, report on the application of regulation (EU) 2015/751 on interchange fees for card-based payment transaction, SWD(2020) 118 final of 29.06.2020

6 Card-based payment transactions that are not distinguishable as debit or credit card transactions by the acquirer (e.g. transactions with a delayed debit card with a prepaid facility).

7 We discussed this issue in our PaySys-Report No. 6 (2020), *Netherlands: Market foreclosure by Interchange Fee agreements.*

8 "*Co-branding means the inclusion of at least one payment brand and at least one non-payment brand on the same card-based payment instrument*" (Art. 2.32); "*co-badging means the inclusion of two or more payment brands or payment applications of the same brand on the same card-based payment instrument*" (Art. 2.31)

9 We discussed this judgement C-304/16 in detail in our PaySys-Report No. 1 (2018).

10 See ongoing antitrust proceedings of DG Competition (case AT.40452) regarding Apple Pay https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1075.

11 https://www.acm.nl/en/publications/acm-launches-investigation-users-freedom-choice-regarding-payment-apps-smartphones

* Screenshot of YouTube Video "Gechillt" durch die Pandemie-Zeit? Niederländer stehen Schlange für Cannabis vor Coffeeshops": https://www.youtube.com/watch?v=dG801b20xhw

We wish all our readers a Merry Christmas!

Should you have any questions or comments please contact:

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