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Special topic: Setting an end-date: the discussion continues

Setting an end-date: the discussion continues

In his address to the EPC Plenary on 23 June 2010, EU Commissioner Michel Barnier (DG Internal Market) announced that he plans to propose a Regulation on "SEPA Migration End-Dates" in September 2010.¹ However, the content of such a regulation is still subject to debate.

The EU Commission has issued a "Discussion Paper"² and a "Working Paper"³. The Discussion Paper looks at possible ways to set end-dates and discusses the pros and cons. The Working Paper can be interpreted as a first step towards a proposal for a regulation. The suggested approach is to define common standards that have to be used and essential requirements that have to be met.

The standards that should be observed are:

- Use of IBAN by payment service providers and service users
- Use of ISO20022 by payment service providers

Essential requirements are fairly detailed and are provided in an annex of the Working Paper. They closely follow rules set out in the rulebooks for SDD and SCT – however, with some deviations.

The Commission proposes separate deadlines and transition periods for direct debits and credit transfers – subject to consultation with stake holders.

In addition, the Commission considers a "reachability obligation" for credit transfers (similar to the one for direct debits contained in Regulation 924/2009), a waiver for niche products and some other measures.

¹ See Herman Segers: SEPA Market Uptake, Facing the Facts in July 2010, in: The EPC Newsletter, 19.07.10.

² European Commission: SEPA Migration End-Date" (PSMEG/002/10), 15 March 2010. See also our newsletter from April/May 2010.
http://www.europeanpaymentscouncil.eu/documents/PSMEG00210_EC%20Discussion%20Paper%20End%20Date.pdf

³ European Commission: Working Paper on SEPA Migrations End-Date, 2.6.2010.
http://ec.europa.eu/internal_market/payments/docs/sepa/end-date_migration_en.pdf

Interested parties were invited to comment on the Working Paper until June 23, 2010. 50 comments of interested parties have been submitted and can be found on the Commission website:⁴

- 21 from banks or banking associations
- 4 from central banks
- 4 from SEPA or payment associations (incl. banks and other stake holders)
- 7 from governments
- 2 from PSPs
- 12 from payment users

The institutions and individuals that have commented on the working paper come from 18 different countries. Moreover, a number of pan-European or international institutions have commented.

Table 1: The nationality of consultation participants

Austria	1	Italia	2
Belgium	2	Latvia	1
Czech Republic	2	Netherlands	3
Germany	12	Poland	1
Denmark	1	Romania	1
Spain	1	Slovakia	2
EU / International	9	Slovenia	3
Finland	1	Sweden	1
France	2	U.K.	4
Hungary	1		

In addition to these comments, there is also an official comment of the EPC, published on the EPC website.⁵

Overall, there is a wide spectrum of comments – from the affirmative to the highly critical. Basically, they can be divided in three groups

- those who think that SDD and SCT need stronger political support
- those who think that the whole process should be more market-driven
- those who are more or less happy with the proposal

From the outset, the EPC has been highly critical of the approach taken by the Commission. EPC chairman Gerard Hartsink has heavily criticised the EU Commission.⁶ He demands

⁴ http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/sepa_migration_end-date&vm=detailed&sb=Title

⁵ http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=415

definite end-dates for legacy systems. His demand is supported by the EPC plenary that approved of the official EPC response.

Most of the banks / banking associations broadly support the EPC approach. They favour the introduction of an EU regulation mandating end-dates (some favouring a single end-date for both products). In most cases, they oppose a detailed formulation of essential requirements and would prefer a reference to SDD and SCT rulebooks.

Many of the payment users and some of the governments favour a more cautious regulatory approach. Most of the users are from Germany and they are particularly concerned that SDD may not be an improvement for them. Therefore, they demand more time and testing, in order to make sure that SDD is as efficient as existing direct debit schemes. Moreover, they point out to the issue of migrating existing mandates that still has not been resolved. Two of the governments (Czech Republic and Germany) are against mandated end-dates altogether.

There are also some comments with respect to card payments. The different treatment of cards versus CT/DD is noted by some commentators. The German Ministry of Finance does not see any reason to treat cards (as well as m-payments and remittances) differently. The Italian consumer protection agency is in favour of setting end-dates for card schemes and remittance schemes. The Hungarian SEPA Association sees regulation of card payments and e-banking as a logical consequence of a regulation mandating end-dates for CTs/DDs. Finally, PayFair is opposed to shutting down direct debit schemes that are currently used as cards' clearing mechanisms and proposes a SEPA Card Clearing scheme as well as a migration end-date for such an instrument. Swedbank wants a migration end-date for cards after which all cards have to comply with the SEPA Cards Framework.⁷

Some commentators are highlighting the issue that an end-date regulation and the definition of essential requirements needs to be consistent with other regulations such as the PSD and Regulation 924/2009. One commentator, the German Ministry of Finance, argues that "essential requirements" would have to be integrated into the PSD.

⁶ On Payments and Light Bulbs - Commission ready to write off SEPA via EU legislation? Commentary on Commission services' Working Paper 'SEPA Migration-End Date' of June 2010 (EPC Newsletter) 19.07.10 and On SEPA and US Health Care Reform: The EC paper 'SEPA Migration End-Date': a commentary, (EPC Newsletter) 30.04.10

⁷ One should mention that, in the field of card payments, an end-date has been set by self regulation. So, the demands for government regulation in this field seem to suggest that self-regulation is deemed insufficient.

Our Comment

1. General remarks on the “essential requirements” approach

Setting end-dates proves more complicated than anticipated by many market participants and regulators. This becomes evident with the publication of the EU Commission’s Discussion Paper.

To understand the current situation it is perhaps best to start with those approaches which the Commission does not want to use:

- a) Simply enumerate the schemes that have to be shut off.
- b) Simply mandate the exclusive use of particular schemes (like SCT and SDD).

The first option seems impractical because it would be easy to sideline via simple re-branding. The second option is addressed in the Discussion Paper. The main drawback the Commission sees is that it would “de facto grant[s] a private monopoly to the EPC” (p. 3). Therefore, in the Working Paper, the Commission proposes a different strategy:

- c) Define common standards that have to be used and essential requirements that have to be met.

What is the EU Commission’s motivation behind the Working Paper? There may be a change in the regulatory approach towards emphasising scheme competition (as in the field of card payments). But it may also be the case, that the Commission, in particular DG Internal Market, views direct mandating of SDD and SCT as infeasible⁸ and uses “essential requirements” as a way to mandate SDD and SCT implicitly.

EPC chairman Gerard Hartsink seems to think that the former is true and that there has been a shift in emphasis. In the EPC newsletter, he criticises the EU Commission using strong wording: “If endorsed by EU lawmakers, the legislative act currently envisaged would effectively derail the entire SEPA project ...”⁹

Other interested parties, however, have stressed the fact that the essential requirements are fairly close to the SDD and SCT rulebooks and that all that needs to be done is to make the correspondence even closer. However, as some commentators have noted, incorporating detailed scheme descriptions into an essential requirements approach has severe drawbacks

⁸ A potential show-stopper could be concerns of DG Competition.

⁹ Gerard Hartsink: On Payments and Light Bulbs. Commission ready to write off SEPA via EU legislation? EPC Newsletter, 21.7.2010.
http://www.europeanpaymentscouncil.eu/article.cfm?articles_uuid=D64C090B-E077-D2DD-5977F6E2C6BE7148

- any change would have to go through the legislative process and would therefore be time consuming
- the essential requirements may have to be included in the PSD

Therefore, some commentators argue that an “essential requirement” should consist of broad principles and should not contain any scheme details.

So, overall, the essential requirements approach has received a mixed reaction. For some participants, such an approach does not go far enough, for others, it goes too far. Finally, some commentators seem to be unaware of the fact that the Commission is unsure whether it would be feasible to mandate SDD and SCT outright.

2. Setting end-dates: two alternatives

- Self-regulation

Most commentators agree with the EU Commission that self-regulation does not work. This is puzzling because self-regulation is applied in the field of cards. In the SCF, one can find the following paragraph:

„After end 2010, all general purpose payment cards in circulation and issued by SEPA banks and payment institutions will be SCF compliant. The period between 1 January 2008 and end 2010 is referred to as the ‚transition period‘.“ (p. 10)

Even if it is unlikely that **all** cards will be SEPA compliant by 1.1.2011 one cannot deny that the industry has made big progress in achieving this goal. Thus, if self-regulation works for cards, why not for CTs or DDs?

- The ECB as regulator

Defining essential requirements via EU regulation involves potential problems with anti-trust law and may have drawbacks in terms of practicability. However, there is a regulator that does already perform the role of rulemaker in the payments market: the European Central Bank (ECB). The ECB has formulated “Terms of Reference” (ToR) for card payments as well as “infrastructures”. In a way, these ToRs can be interpreted as “essential requirements”.¹⁰ The ToRs for infrastructures regulate (inter alia) that SEPA compliant infrastructures have to comply with the SCT and SDD rulebooks. So far, however, the ToRs do not include any explicit clauses concerning end-dates. But this could be changed.

¹⁰ The legal status of these ToRs is not quite clear, though.

3. *Card payments versus credit transfers / direct debits: the role of competition*

So far, the approach towards card payments has been quite distinct from the approach towards credit transfers (CTs) and direct debits (DDs). Time and again, the authorities stated that they wanted at least three card schemes¹¹, one of them European, in order to have competition. However, they were content with just one DD scheme and one CT scheme. Maybe, there are good reasons for this unequal treatment but nobody ever made this explicit. With the approach suggested in the Working Paper, the regulatory approach towards credit transfers / direct debit seems to move closer to the card model. The EU Commission proposes to use standards and essential requirements as a tool to promote the migration to SEPA products. As the Commission rightly points out, the essential requirements approach “would retain the possibility for new¹² competing credit transfer or direct debit schemes”. Thus, the regulatory approach envisioned for direct debits and credit transfers looks more like the approach taken for cards.

So far, the treatment of CT/DD and card payments has been very different. The EPC has defined a CT and a DD scheme and a framework for the clearing and settlement of CTs and DDs. Nothing comparable exists for card payments where the EPC confined itself to defining some broad standards and scheme rules (“essential requirements”) in the SCF. Apparently, all actors, the EPC, the EU Commission and the ECB have always assumed that there should be scheme competition in the card world and uniform (“monopoly”) schemes in the world of CTs and DDs. Within the essential requirements approach there suddenly seems to be scope for scheme competition in the field of CTs and DDs. But the question whether CTS and DDs should be treated differently from card payments has never been explicitly addressed.

So, before proceeding in its regulatory initiative, the Commission should answer this question. It is closely related to the question why it has been seen as necessary that there are competing card schemes but not competing CT/DD-schemes. Once this question has been answered, it is possible to proceed with a uniform or differentiated regulatory framework.

¹¹ According to current definitions a scheme has to be interpreted as a set of rules like, for instance, the SDD rulebook. In the field of card payments the equivalent would be, for instance, the Maestro Operating Rules. Unfortunately, most documents concerned with card payments use the term „scheme“ as applying to Visa Inc. and MasterCard Inc. To keep the terminology consistent, organisations such as Visa, MasterCard and the EPC will be referred to as „Scheme Management Entities“ (a term used by the EU Commission, see EU Commission: Consultative paper on SEPA Incentives, Brussels, 13 February 2006, p. 9

¹² The Commission only mentions „new“ schemes. But the „old“ schemes could also try to fulfill essential requirements.

4. *Competition and reachability*

In the field of cards, there has always been the demand for competing schemes (and, one should add, competing “scheme management entities”).¹³ However, once there is no single scheme, the idea of 100% reachability (with respect to cards: “any card at any terminal”) seems unrealistic. Should one really force users to accept all schemes? In the field of cards, the answer was, of course, that this is not feasible.

If there can be many schemes, obviously the old legacy schemes try to become SEPA compliant. Thus, looking around today, we see that almost all legacy card systems have declared themselves “SEPA-compliant”.¹⁴ The same questions now emerge with respect to credit transfers and direct debits – even if most protagonists still seem to be unaware of them.

Thus, the EU Commission proposes a paragraph on reachability for credit transfers that equals the one for direct debits in Regulation 924/2009:

“Reachability: A payment service provider of a payee reachable for a national credit transfer transaction on the payment account of that payee should be reachable for credit transfer transactions initiated by a payer through a payment service provider located in any Member State.” (Working Paper, p. 4)

The meaning seems to be fairly clear if one considers just one (monopoly) credit transfer scheme. But what does “reachable for credit transfer transactions” mean if there are many credit transfer schemes – reachable for credit transfers of a particular scheme or reachable for all credit transfers?

To use, the card world as an example, “reachable for any card” could mean:

A) If a merchant has a contract with a Visa acquirer he must be able to accept Visa cards from anywhere in the EU.

or

B) If a merchant has a contract with a Visa acquirer he must be able to accept all payment cards issued in the EU. Basically, this would imply that there are only “card acquirers” (instead of “Visa acquirers” or MasterCard acquirers”).

A) implies that 100% reachability is not guaranteed – unless Visa is the only scheme in the market. If there are competing schemes, it is possible that a Visa card holder will encounter a MasterCard merchant and payment will not be possible. This problem is usually limited by

¹³ See footnote 11.

¹⁴ See our issue August/September 2009.

“multi-homing” – merchants usually accept more than one brand. However, in this case the percentage of merchants that can be reached with the card of one brand is the outcome of market forces – not of legally binding rules.

Moving back to credit transfers – if interpretation A) is correct 100% reachability would be guaranteed only if there were one single CT scheme. But if there are competing schemes, this would no longer be assured. If the EU Commission wants to make sure that there is 100% reachability (option B.) it has to mandate that PSPs participate in all SEPA credit transfer schemes and that all customers are connected to all types of credit transfers. Of course, the question may be asked whether a reachability regulation would be required in a situation with competing schemes.

5. Concluding remarks

Even if it is annoying for the EPC, the EU Commission rightly hesitates to mandate EPC schemes. Such an act would transform the EPC into a semi-public body. Questions of governance and public control would become even more pressing as they are already today. Apart from banks and payment institutions other stakeholders and regulators would also sit at the table – hardly a blueprint for future innovation. Finally, such a legislative act may be hard to swallow for DG Competition. Thus, it is not even clear whether the option to mandate particular schemes actually exists.

The EPC seems to have taken public regulation for granted and is heavily criticising the perceived policy shift. It is worthwhile to quote EPC chairman Gerard Hartsink at some length:

“Last but not least, one must assume that DG Internal Market and Services only very recently bothered finding out whether the Directorate-General Competition would sign off on EU legislation stipulating mandatory migration to the single set of SEPA Schemes developed by the EPC. Apparently, DG Internal Market and Services failed to make the case for market integration with their colleagues next door. DG Competition, at the same time, seems unaware of the assessment reached by the European Competition Network; namely that standardisation in network industries generates scale and scope advantages for users. This is the only possible explanation why now DG Internal Market and Services suddenly issues statements effectively equating the EPC with Microsoft.”

Hartsink’s frustration is understandable. But the point on standardisation in network industries is not fully valid. Apparently, he sees the EPC schemes as standards for the European payment industry on which banks and PSPs can build competing payment

products. While it is true that a single scheme would help to exploit economies of scale to a maximum there are also costs that have to be considered. If the preferences of users are heterogenous it may still be preferable to have more than DD and CT scheme. The EPC itself has developed two DD-schemes: SDD and the SEPA Business to Business Direct Debit Scheme.

Detailed scheme definitions restrict the potential amount of product differentiation and many market participants fear that they will not be able to build the products they want on the basis of SDD (SCT seems to be less of a problem). PayFair, for instance, in its comment to the Working Paper, demands a DD-Scheme for card clearing. Being Germany-based, it feels a bit awkward for the authors of this newsletter to make this point but we never-the-less think it should be mentioned: As the comments on the Commission Working Paper show, the resistance in Germany against SDD continues. Germany is by far the largest user of direct debits in the EU. Thus, there seems to be a strong demand for product differentiation that is not compatible with the existing EPC scheme.

This brings us back to the question why CTs and DDs on the one hand and card payments on the other are treated differently. The main reason may be history. CTs and DDs have usually been non-branded products designed by national banking communities. The same is true for some of the European debit card schemes. These payment devices were treated like basic (or “essential”) infrastructures. Credit cards, and sometimes debit cards, are branded products offered by for-profit organisations. These two models have been automatically applied to the SEPA world. The question is, however, whether this makes sense.

For credit transfers the basic infrastructure model seems to work fairly well. The credit transfer is a relatively simple product and the scope for product differentiation is limited. In the case of direct debits, things are different. Direct debits are more complex due to the issue of risk. Moreover, existing direct debit schemes are very different and general usage also differs hugely between European countries. Therefore, it can be questioned whether it was a good idea to apply the basic infrastructure idea to direct debits. Moving towards a model with branded direct debits may be a better solution – even if this implies that 100% reachability is not guaranteed.

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