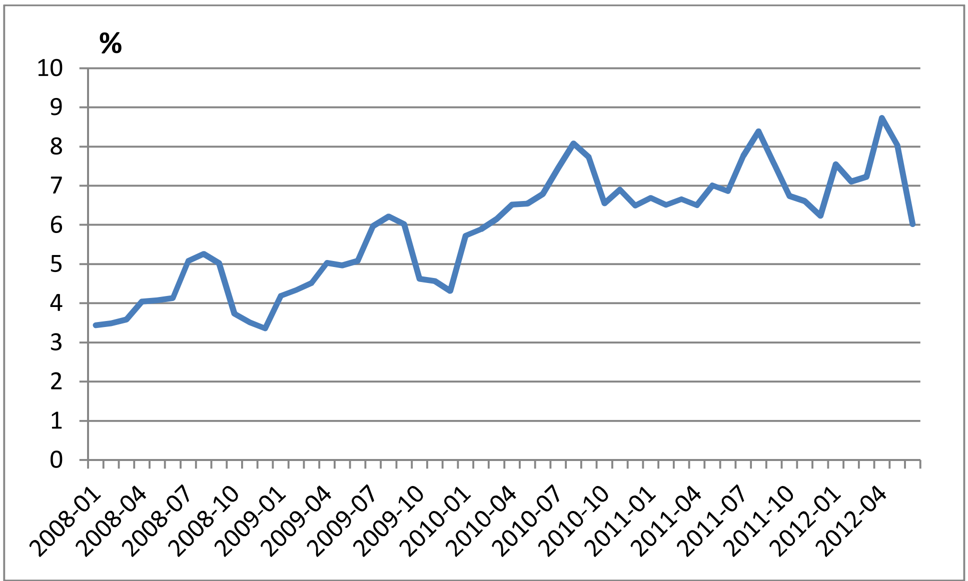
Topics of this issue:

1. Intra-EU x-border eCommerce: Another "SEPA success story"?

The ECB's SEPA indicator for card payments suggests that the increase of x-border transactions has come to a stand-still. After strong increases in 2010, the share of x-border transactions has been oscillating around 7%.

Figure 1: Cross-border transactions in the euro area (as a percentage of total purchase transactions)



Source: ECB (http://www.ecb.int/paym/sepa/about/indicators/html/index.en.html)

Data from individual issuers, however, provide a different picture. One large German issuer has shared credit card payment data with PaySys Consultancy (see Table 1). The data show a continuing increase of x-border transactions, in particular of intra-regional transactions. The share of intra-regional sales has increased from 21.9% (2010) to 25.9% (2012). This growth is mainly driven by the increase in intra-regional online sales. When looking at the segment of online sales, the share of intra-regional sales has increased from 47.2% to 54.4%.

Table 1: A large German issuer: The evolution of intra-regional online sales

	Online in % of total sales	Intra in % of total sales	Online intra in % of intra sales	Online intra in % of online sales
2010	21,80%	20,30%	50,70%	47,20%
2011	24,10%	23,00%	53,60%	51,10%
2012	27,70%	25,90%	58,20%	54,40%

Source: A large German issuer

Thus, it seems that in the online segment the volume of intra-regional transactions is higher than the volume of domestic transactions.

Other issuers have confirmed that they also experience the same trend. As one issuer put it „*We have been watching this development for years. It is the main reason for our steadily falling interchange revenues.*"

Our Comment

On the face of it, the high and rising share of intra-regional transactions looks like a "European dream come true". At least in the online world European borders no longer seem to matter. However, such a conclusion would be premature. A recent survey of consumers revealed that German online shoppers mostly buy in German shops: only 15% have made purchases in other EU countries.[1] *This result seems hard to square with the figures of the German credit card issuers. Of course, there are some payment instruments that are still mostly confined to national transactions. So, obviously, for payment instruments that can be used internationally, the share of foreign transactions should be higher. But this can still not explain a share of intra transactions of over 50%. Something else must be at work.*

What seems to at work is a kind of "interchange arbitrage". Large international e-tailers like Amazon use their legal presence in Luxembourg to flag all transactions carried out with consumers from outside Luxembourg as x-border. In this case, the lower intra-European MIF applies rather than a national MIF. So, for a German consumer, a purchase carried out on

[1] See Maria Klees, Malte Krüger and Aline Eckstein „Der Internet-Zahlungsverkehr aus Sicht der Konsumenten in D-A-CH" (IZV11), Ausgewählte ECC-Studien, Band 33, Köln 2013.

the German website of Amazon looks like a domestic transaction. But as far as the card rules are concerned, Amazon converts it into a x-border transaction.

What are the consequences?

First, x-order figures are likely to be inflated. At least, they do not only include what one would conventionally understand as a "x-border" but also domestic transactions.

Second, national MIF rates are circumvented. Given the strong criticism of MIF, this effect may actually be welcomed by regulators.

Third, what regulators may dislike (and also many market participants) is the unequal treatment of merchants. Some merchants with an international presence may circumvent national MIF, others – in particular small ones – are not able to do so. And merchants selling over the internet may find it easier to circumvent national MIF than merchants selling at the POS.

However, even at the POS things may change, as the next topic shows.

2. The success of the "m-terminal"

In the US, the business model based on the mobile phone (with an attached card reader) used as a mobile card terminal ("m-terminal") has become an impressive success.[2] Square, the American PSP that has pioneered this model, is serving 3 million customers (individuals and businesses).[3] In August 2012, Square could even win Starbucks with its 7,000 stores in the United States. Currently, the company is processing $10 billion in transactions. A recent financing operation valued Square at almost $3.3 billion.[4]

In Europe, the Square business model has been copied by a number of companies such as iZettel, SumUp, Payleven und Streetpay. iZettel is active in Britain, Spain and Germany. In Germany, last year, the company started to co-operate with the German co-operative banks and Deutsche Telekom. SumUp is offered in 10 European countries, Payleven in 5 European countries and Brazil.

Apart from these newcomers, established German PSPs are also offering apps that allow merchants to accept card payments via smart phones.

[2] See also " M-Payments: the acquiring side" in the August 2011 edition of this newsletter.
[3] See www.squareup.com.
[4] Jessica Guynn: Square taps into the mobile payment business, Los Angeles Times, February 1, 2013 (http://www.latimes.com/business/la-fi-square-dorsey-20130201,0,5416478.story)

Our Comment

The idea to use a smart phone as payment terminal in order to replace expensive dedicated payment terminals has an immediate appeal. Coupled with a lean sub-acquiring model, it opens the door to potential card acceptance clients that would never be interested in a conventional acquiring contract with a conventional terminal. As the experience of Square in the US shows, this segment can be large. So, understandably, expectations for Europe are also high. Whether such expectations will be fulfilled remains to be seen. For the moment, data on the customers and transactions is hard to come by. But it can be safely inferred that Europe is substantially lagging developments in the US.

It also remains to be seen whether the Square business model can be implemented one-to-one in Europe. Europe is an EMV area. So, card-present transactions should be chip and PIN. Moreover, EMV will not provide any benefits in terms of safety if sensitive payment data can be typed in on any smart phone. Thus, it is not surprising that Visa insists that card readers come with a secure keyboard for typing in the PIN.

Chip card readers with secure pin pad – that does not sound like a cheap solution. But Europe also has exiting possibilities to offer – at least as long as current interchange differential persist. Even though transactions take place at the POS, they are treated as card-not-present (CNP) transactions and – based on the residence of the PSP (not the merchant) – they are processed as x-border transactions. Thus, for most transactions, only the relatively low XB-intra- or interregional MIF has to be paid. In the words of a market player: "There is a creeping interchange erosion in the internet and in slowly moves on to mPOS and mobile phones."

However, this may change. First, regulation may progressively equalize interchange fees. Second, in all likelihood, an EMV transaction, complete with Chip and PIN, will be a POS transaction (card-present).

Thus it remains to be seen whether the new European upstarts can replicate the success of Squire.

3. EU payment regulation: What comes next?

For readers of this newsletter it does not come as a surprise that more payment regulation is in stock. We have already commented this issue many times. So far, the Commission has published versus "road maps". Now, it seems a bit clearer what form the new regulation will take: "*the Commission is planning to publish a proposal for directive and a proposal for regulation, with their respective Impact Assessments by April 2013. The proposal for directive will cover the issues raised in the Green Paper and which pertain to the review of the Payment Services Directive, which was announced for the end of last year, but still not presented by the Commission. The proposal for Regulation will cover Interchange Fees for Payment Card Transactions and related aspects*."[5] Within the Commission it is expected that this timetable is not realistic anymore. There will probably be a delay of 2 months.

Our comment

So, by April there will be more clarity. What can be said already today is that the PSD will be amended by a new Directive. Still, the issue remains that European law has to be transposed into national law and that this may lead to differences in regulation. Interchange will be regulated in a Regulation. A Regulation immediately applies in member states without national elbow-room. So, once the Regulation has been passed there is no room for lobbying at the national level. We do not yet know what the maximum permissible interchange rate will be. But anything that differs from zero would surprise us. Like the regulation of the MIFs of SEPA Direct Debits (SDD) there will be probably a transition period of 5 years (2018).

Even more important than the rate will be the scope of this Regulation. The MIF-Regulation of SDD applies to "transactions denominated in euro within the Union where both the payer's payment service provider and the payee's payment service provider are located in the Union" *(Art. 1.1).*

[5] DIRECTORATE GENERAL FOR COMPETITION, Management Plan 2013, p. 39.

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