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- 1. SEPA for Cards: Next stop Falkenstein?**
- 2. SEPA for Cards: Time to pay fair?**
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1. SEPA for Cards: Next stop Falkenstein?

With respect to SEPA for Cards the goal has been well defined: „at least three card payment schemes in the EU“. And at least one of these schemes should be “European” (whatever that means). The candidates are also well known Visa, MasterCard and the EAPS. MasterCard clearly is a U.S. company, Visa International as well. However Visa Europe looks pretty European. Still, regulators do not seem to be entirely at ease with the concept of Visa Europe. So, there remains the EAPS, and in fact regulators have been highlighting the significance of this initiative, over and again. They even have been prepared to stretch the definition of “SEPA-compliant” in order to make life easier for the EAPS. Yet, even when it comes to EAPS, they are not entirely satisfied because the EAPS looks very much like a “scheme of schemes” not really like a truly unified scheme. Thus, in the end, it may serve to prolong the existence of different national standards.

All in all, things look pretty bleak for those wishing to see a truly European scheme covering more or less the entire SEPA area. However, there is hope: a secret fourth contender – the “Falkensteiner Runde”. This Falkensteiner Circle has been a ghost appearing here and there in speeches and articles. The rumour was launched by the Lafferty Group in May 2007: “A group of European Banks – ABN AMRO, Allianz Dresdner, ING, Rabobank, UniCredit, Deutsche Bank, Société Générale and Commerzbank – are reportedly considering establishing their own debit scheme in Europe”. The Lafferty Group claims several of the banks cited as clients. The journal European Card Review reports rumours that the Falkensteiner Group may co-operate with V Pay. But in that case, there is not really a new option. We would be back in the Visa/MasterCard world. Others who referred to the Falkenstein Circle or to a “group of large banks” are the European Card Review¹ and the World Payment Report 2007.² Equally, ECB’s Jean-Michel Godeffroy referred to this group of

¹ www.europeancardreview.com/CardNotes/CardNotes_01.html

² http://www.capgemini.com/resources/thought_leadership/world_payments_report_2007/

“major banks” in a speech in Paris in October 2007.³ On the yearly ZKA conference⁴ the member banks have been officially informed by the ZKA that EAPS is not the only strategy of the German banks. Besides the EAPS some German retail banks are still discussing another solution together with other big banks in Europe.

Our comment:

For quite some time already, there has been talk about the Falkensteiner Runde. Much of this talk seems to be speculative in nature. Who is exactly involved in the group? Nobody seems to know for sure. Based on our own research, the following can be said about the Falkensteiner circle:

*It seems to be that the driving person behind the Falkensteiner Runde is Hermann-Josef Lamberti, board member of the Deutsche Bank, supported by McKinsey consultants. He is a strong supporter of the German ec cash system as one of the best-in-class debit card schemes in the Eurozone. In **November 2007** Lamberti said the EAPS-construction of linking existing national schemes is too shaky as basis for a new debit card scheme in competition with Maestro and V PAY⁵. He favoured a genuine new card scheme initiated by Germany and France. In this context it is interesting to note that until now Cartes Bancaires and also individual French banks are not part of the EAPS initiative.*

*In **January 2008** on the ZKA conference the ZKA representative Ibrahim Karasu indicated that the initiative, supported by big banks from German, France and the Netherlands, is still relevant as alternative to EAPS. (Another ZKA representative said - something nebulous - that this initiative could be a further stage of EAPS.) The initiative is now operating under the working title “EPCS” (European Payment Card Solution), which sounds more European than “Falkensteiner Runde”.⁶*

So, the following can be said about the Falkensteiner Runde:

- *The “Falkensteiner Runde” is not just a rumour. It is still alive and active.*

³ www.ecb.int/paym/sepa/pdf/telecom_jmg_071026.pdf

⁴ ZKA conference “SEPA card strategy” in Berlin on 15 January 2008 (www.zka.de)

⁵ See: Financial Times Deutschland of 20 November 2007.

⁶ Using the name “EPCS” makes it all the more confusing because the German banks already set up a new company with exactly the same name as German shareholder of the new company “EAPS”, founded in Brussels in November 2007. Moreover, another emerging initiative for a European Card Scheme is also linked to a company named European Card Solutions (EPS; see next chapter).

- *Some European (big) banks are still involved in the design of a new European card scheme as alternative to Maestro, V PAY and EAPS.*
- *Obviously not the whole German banking community is convinced that EAPS is the best solution.*
- *.Internal card experts and divisions of the member banks seem to be not involved at this stage. Expertise of card business is probably delivered by external consultants.*

The outcome of this high-level top-down approach is still speculative. Many important questions remain:

- *Are French banks willing to follow an obviously German initiative by terminating the most successful card scheme within the Eurozone (Cartes Bancaires)?*
- *Is the new card scheme only debit focussed or is it a scheme covering all types of payment cards?*
- *How does the system solve the interchange dilemma after “12/19”? Would it be a copy of the German ec cash scheme as three-party-system without formal interchange fee between acquirer and issuer?*
- *Is the market proposition probably more merchant-focussed (compared to the issuer-focussed scheme like Maestro, V PAY and EAPS) taking into consideration the corporate market activities of the banks behind?*
- *If the project still can maintain such high level of secrecy in early 2008, when can we aspect the roll-out – in 2012?*

2. SEPA for Cards: Time to pay fair?

The Falkensteiner Group is not the only group pondering the option of a new European payment scheme. On January 28th 2008 at a conference in Brussels attended inter alia by representatives from the European Commission and the ECB a scheme was discussed called “Payfair”. It is an initiative of “European Payment Solutions” (EPS) a Brussels based small privately held company. The CEO of this company is Dominique Buyschaert, a former Carrefour (Belgium) manager. Expertise comes from Jean-Pierre van Wayenberge a former Banksys manager.

Payfair aims to be a win-win-win solution for consumers, retailers and banks. The term “fair” is referring to EPS’ analysis of current payment card schemes as being unfair in sharing benefit and cost between the stakeholders. The payfair-approach is promising, to “bringing balance into electronic payments”. The new product is briefly described as follows:⁷

- Merchant oriented debit payment scheme
- Volumes based flat fees
- Guaranteed payment (instant debit)
- Lowest cost product structure
- Merchant community supported product
- Pan European future proof scheme (focus on € zone for first implementation)
- EMV product (SEPA Card Framework compliant)
- Easy implementation process
- Designed to protect legacies (as far as possible)
- Ability for future developments (mobile, Internet, ...)

According to announcements, it will be activated in the 3rd quarter of 2008 with a focus on Belgium, France and the Netherlands. Implementation would follow a 3 stage approach:

stage	issuers	authorisation	guarantee
1	payfair issued by retailers on private label cards	off line payment authorisation	payment risk for merchant but optional payment guarantee insurance
2	payfair issued by retailers on private label cards	on-line or off-line payment authorization: merchant’s choice	payment guarantee by bank when on-line payment authorization
3	payfair issued by retailers and by banks	on-line or off-line payment authorization: merchant’s choice	payment guarantee by bank when on-line payment authorization

⁷ See www.europaysol.eu or www.payfair.eu

Our comment:

There clearly is a strong political will to support a European scheme and there also is a long standing struggle between merchants and banks over payment fees. So, the idea to come up with a merchant-centric European payment scheme has its charms. Payfair is addressing a couple of the European Commission's key concerns and objectives, namely the reduction of cash, competition between platforms, chip&PIN security etc., which could make an attractive proposition.

However, for the moment, there is too little material known to make a fair assessment of the concepts, the business case and ultimately the chance to succeed as a late comer. The most important questions we have are:

- 1. Is it a good idea to build a new payment card scheme from the scratch, having in mind that highly successful domestic schemes like BC/MC in Belgium and PIN in the Netherlands did not see a business case in transforming themselves into European schemes?*
- 2. How will authorisations and payment guarantees be obtained from banks for cards issued by retailers? Moreover, is a "fair price for payment authorisation" that much different from the conventional interchange fee?*
- 3. How will fair cost for merchants and lowered fees for consumers translate in cost recovery for processors and issuers? Is it all about loyalty and partnership marketing?*
- 4. What about acquiring? Will there be a role for acquirers, besides self acquiring of large retailers?*
- 5. What is the idea behind piloting the scheme in those countries where merchants already pay a relatively low fee for accepting debit cards? How can a new scheme compete with a flat fee of 5 to 10 cents of the bank debit cards in Netherlands and Belgium?*

3. VAT treatment of financial services in the EU

On November 28, 2007 the EU Commission has proposed a Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services.⁸ The objective is to increase legal certainty and reduce the impact of hidden VAT. In order to achieve this

⁸ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2007:0747:FIN:EN:PDF>

- rules governing the exemption from VAT for insurance and financial services are clarified,
- the existing option for taxation is transferred from the Member States to the economic operators and
- a “cost-sharing group” is introduced.

Our comment:

From the point of view of payment service providers, the most important point seems to be the option to opt-in or opt-out of VAT taxation. In some countries, including Germany, options exist already. The Commission wants to broaden and harmonize this practise. Depending on circumstances, both options, opt-in and opt-out, can be interesting. If services are provided to consumers or tax-exempt institutions, an opt-out is interesting. If, for instance, the customer is a tax-exempt bank, it is better for an outsourcer to be tax-exempt as well, because VAT increases the costs. If services are provided to taxable institutions, it is better to opt-in. While adding VAT to the bill does not hurt the customer, it allows to recover the VAT paid to suppliers.

Please note:

9th PaySys Breakfast-Meeting in Frankfurt

Friday, March 14th 2008, from 8:00 to 10:00 a.m.

Edwin Latter (LINK Scheme Director) will address the topic
„The evolving SEPA ATM model: Lessons from the UK ”

Attendance fee: 80,- Euro (includes a breakfast buffet)

To register, please call Ms. Susanne Hollingsworth-Palfrey +49 69 9511 7710
or send us an email.

Should you have any questions or comments please contact

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