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## **1. Three-Party Systems in the SCF: Correction and Extension**

In our February edition we reported on the provisions of the SEPA Cards Framework version 2.1 for three-party schemes. The SCF2.1 distinguishes between three-party systems with and without licensees. In our article we commented:<sup>1</sup> *“According to this interpretation, Amex or Diners would be schemes without licensing because they are the contractual counterparty for card holders and merchants. From a legal point of view, co-operating banks are distribution partners not licensees. Thus the question emerges, who does the EPC have in mind when it makes provisions for three-party schemes with licensees.”* This was not correct. Since three-party schemes such as Amex and Diners are also using a license model, they would clearly belong to the group of three-party schemes with licensees. Consequently, the list of SCF-provisions for three-party systems with licensees have to be applied.

In the same article we continued with the statement: *“In fact, one might ask whether a “three-party scheme with licensees” really is a three-party scheme. After all, it looks like a four-party scheme.”* This statements may be true as far as the number of participating issuing and acquiring institutions is concerned. However, the legal structure of a three-party system may still be quite distinct from a four-party system. This is particularly the case, if the three-party system with licensees involves only bi-lateral contracts between the scheme and its licensees but no contractual relationships between the licensees and no role for licensees in scheme governance. In this case, all agreements, most importantly, all price agreements, are strictly bi-lateral in nature.<sup>2</sup>

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<sup>1</sup> See „Three-party Systems in the SCF“, EPSM Market Research Newsletter, February 2010.

<sup>2</sup> In fact, such a three-party system with licensees has much in common with the five-party system with interchange trader that we proposed some time ago. See „Preserving interchange: from explicit to implicit MIF“, European Card Review, January/February 2008, 21-24.

Both Amex<sup>3</sup> and Diners<sup>4</sup> have published SEPA statements in order to clarify how they are planning to apply the provisions of the SCF and the PSD. Both are stressing that their license policies are such that they are falling under the exemption provisions of Article 28(2)(c) of the PSD. Thus, in their view, Article 28(1), prescribing non-discriminatory access to payment schemes, does not have to be applied. Most of the other provisions, such as technical provisions (EMV, interoperability), fraud prevention, data delivery will be applied, however. Perhaps the most challenging point of the SCF is the principle of SEPA-wide licenses. Currently, licenses are defined for a certain region. However, both Amex and Diners allow passive acquiring of merchants outside that region. Moreover, they are planning to discuss the transition to SEPA-wide licenses with their partner institutions from 2013.<sup>5</sup> For the moment, it is difficult to predict the implications of such SEPA-wide licenses.

## **2. EU Parliament and EU Commission Pressing for an End Date**

On Monday, 8 March 2010 there was a debate on the implementation of SEPA in the European Parliament in Strasbourg.<sup>6</sup> Various speakers addressed the floor, including Sharon Bowles (Chair of the Economic and Monetary Affairs Committee), Michel Barnier (Internal Markets Commissioner) and Jean-Paul Gauzès (former Chair of the Economic and Monetary Affairs Committee). Sharon Bowles, was particularly outspoken in demanding “a binding end-date be fixed for no later than 31 December 2012”. She expressed, however, concerns regarding the safety of direct debits and demanded “extra safeguards around the setting-up of direct debits”. Moreover, she demanded that the problem of continuing legal validity of existing direct debit mandates be solved and that a solution for the multilateral interchange fee problem has to be found. Most other speakers of the EU Parliament supported the setting of an end date. Commissioner Barnier commented that he was “very struck by the unanimity expressed in favour of setting a deadline”. He pointed out that the Commission is currently investigating all options and that one of the options is a legislated end date. The results of the evaluation of all options would be ready by next spring. He left the question open whether the deadline should, indeed, be end of 2012. In any case, he pointed out that there should be

<sup>3</sup> See „American Express and the Single European Payments Area“, November 2008.  
[http://home3.americanexpress.com/corp/sepa/sepa\\_declaration.pdf](http://home3.americanexpress.com/corp/sepa/sepa_declaration.pdf).

<sup>4</sup> See “SEPA Compliance Position Statement of Diners Club International LTD”, June 2009.  
<http://www.dinersclubinternational.com/sepa-position-statement.html>

<sup>5</sup> The SCF requires SEPA-wide licenses by the end of 2013.

<sup>6</sup> <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+CRE+20100308+ITEM-018+DOC+XML+V0//EN>

a period of adjustment (possibly 12 months for credit transfers and 24 months for direct debits).

### **Our Comment**

*Getting on with SEPA is a worthy goal. Never-the-less, in payments – as in other economic areas – the question remains whether European integration should be achieved by mandating the use of “European” products or by removing impediments to market integration and letting market forces work. SEPA was meant to be a “market driven” process. However, it is transforming itself to central planning – with all its back draws. No longer is quality or “user friendliness” the decisive criterium. SEPA Direct Debit (SDD) is a case in point. When looking at the use of direct debits in Europe, three countries stand out with usage per capita far above the European average: Austria, Germany and the Netherlands.*

**Table 1 Per capita use of direct debits**

Euro area	51,47
EU	40,76
Austria	95,16
Germany	97,2
The Netherlands	74,55

Source: ECB, Blue Book

*These three countries have build direct debit products with a focus on “ease of use”. This may not be optimal from a security point of view. But apparently, users found the trade off between ease of use and security compelling enough to use these products. In fact, they are used much more than other, safer variants. Thus, it is difficult to understand why SDD stresses security rather than convenience and why the representative of the EU parliament demands even more security. It is also difficult to understand why successful products should be shut off. The chicken-and-egg problem that is often cited in this context, is not really convincing. If there is a superior product, there are ways to get around it. After all, no one forced us to move from vinyls to CDs. This simply happened because CDs offered clear benefits.*

**Table 2 Payment transactions (billions)**

	Credit transfer	Direct debit	Cards at POS	Cards at ATM
Euro area	14.88	16.60	17.94	7.16
EU	21.72	20.31	29.46	11.81

*Source: ECB, Blue Book*

*From the point of view of the card market, "ease of use" would also imply a convenient use of direct debits for cards clearing – a principle already used in some EU countries. In its current shape, SDD is not well suited for cards clearing. That implies that a huge potential for creating synergies is left untapped. As Table 2 shows, the combined volume of card transactions at the POS and the ATM is about twice the size of direct debits. It is quite sobering that none of these arguments played any role in the debate in Strasbourg.*

### **3. The Bankruptcy of E-Clear**

On December 16<sup>th</sup> 2009 Globespan, the largest Scottish airline, terminated operations and entered into administration. PricewaterhouseCoopers (PwC), the administrator for Globespan, calculated that E-Clear, a UK payment processor, is holding back £35m. According to PwC, this is much more than can be justified by charge back risks.<sup>7</sup> E-Clear could not demonstrate that it held sufficient funds and was put into administration in January 2010. Since then, the search for the money has started. So, far this search has revealed only increasing debts but few assets. BDO, the E-Clear administrator, has been notified of £82 million worth of claims, excluding the £35 million of Globespan.

E-Clear operated as a quasi-acquirer and had many customers in the travel industry. It was processing online card payments and the money was passed to merchants via E-Clear accounts. Typically, E-Clear would delay payment in order to reduce risks. However, in 2009 it seems to have increased the period it held on to payments and thus produced liquidity problems of its customers. Some of the customers ended their relationship with E-Clear, others finally went bust: Allbury Travel Group, XL Leisure Group, Zoom Airlines and SkyEurope. As things stand, creditors can expect to see very little of their money. The

<sup>7</sup> See "E-Clear as mud. Company failures raise questions about an unregulated paying agent", Jan 7th 2010, The Economist print edition.

Serious Fraud Office (SFO) has expressed that it was “very interested” in E-Clear's business dealings, but it has not committed to a full investigation.

***Our comment***

*Travel is a risky business for acquirers. Average tickets are high and often, payments are made well in advance of delivery. If a large operator or airline goes bust, acquirers are confronted with a wave of charge backs. In order to contain risks, acquirers usually delay payments. This practise is often criticised by the travel industry but given the charge back rules acquirers have to use some kind of risk management. In the case, of E-Clear, the roles have been reversed. It was not a bankruptcy of an airline that caused problems for an acquirer, rather, the insolvency of an acquirer caused the bankruptcy of an airline.*

*One question that emerges in this case is what was the exact status of E-Clear. Apparently, it was not a licensed credit card acquirer. Thus, neither the schemes nor the financial regulators seem to have felt responsible. With the implementation of the PSD, entities like E-Clear will fall under regulatory oversight, hopefully. This may help to prevent such cases in the future. Whether the card organisations need to react, remains to be seen. But it cannot be in their interests that a case of sub-acquiring, probably not in line with rules and regulations, turns sour. Furthermore, the case raises questions about the role of the sponsoring acquirer. Until the end of 2008, the German acquirer Pago worked with E-Clear but decided to terminate the co-operation. It is not known who has been sponsoring E-Clear since then.<sup>8</sup>*

*More generally, there remains the question whether current card payment rules are suitable for large advance payments. From the point of view of card holders, the safety provided by current charge back rules is definitely a plus. But on the acquiring side, the model creates huge problems. Indeed, it may have been the reluctance of established acquirers to deal with airlines which are perceived as risky that may have driven the latter into deals with players like E-Clear.*

#### **4. Payment Institutions in the EU**

At the PSMG meeting 18 March 2010, the EU Commission presented an overview over registration of Payment Institutions in Europe. The statistics show that the UK is the clear

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<sup>8</sup> The attempt to become an acquirer failed. E-Clear boss Elia Elia bought a controlling stake in the German bank Nordfinanz Bank but the German Banking supervisor (BaFin) did not allow him to own a German bank and put the bank into the hands of a trustee.

front runner in terms of authorised and waived payment institutions. 58 of the 72 authorised payment institutions are UK based and 466 of 467 waived institutions are UK based.

**Table 3 Registered Payment Institutions in the EU**

	Authorised	Waived
Bulgaria	4	
Czeck Republic		1
Denmark	1	
Ireland	7	
Luxembourg	1	
Slovakia	1	
UK	58	466
Total	72	467

Thus history seems to repeat itself. After the passing of the e-money directive, most registered e-money institution were based in the UK. Now, the same happens with payment institutions.

#### **Our Comment**

*The figures are astonishing. Almost 100% of the waived institutions and over 80% of the authorised payment institutions are based in the UK. It is difficult to explain this difference. After all, a payment institution is defined much more broadly than the (pre-PSD) e-money institution. It covers a whole range of services offered in all of the EU countries. Thus, one should have expected a much more even distribution of payment institutions. Therefore, over the year 2010 we should see a substantial rise in registrations in the other countries. Thus the main explanation of current differences seems to be speed. It would be easy to equate a speedy registration process with a "lax" authorisation practise. However, we would like to point out that speed may also be the result of an efficient, "customer-oriented" approach. When looking at the FSA website, the amount of information provided, the ease of use and the whole "look and feel" are striking. A visitor will find headlines like "Doing business with the FSA" and "Do I need to be authorised?". This seems to mirror an approach that is well aware of the fact that regulatory compliance is costly and that such costs need to be optimised. Maybe, one or the other regulator in other countries could learn a thing or two from the FSA.*

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