

Topics of this issue:

- 1. UK government plans new payment regulator**
- 2. SEPA-compliant or SCF-compliant: to be or not to be?**
- 3. Another European e-purse scheme is shut down**

1. UK government plans new payment regulator

In the UK, far reaching changes in the regulation and oversight of payment systems and payment service providers are under way. As of 1 April 2013, a new regulatory structure will take effect with three main regulating bodies: the Bank of England's Financial Policy Committee, the Prudential Regulation Authority¹ and the Financial Conduct Authority (FCA). The FCA succeeds the Financial Services Authority (FSA) which has been abolished.² In the future, the FCA will be the competent authority for Authorised Payment Institutions and registered Small Payment Institutions. For the moment, the Office of Fair Trading (OFT) will remain in charge of anti-trust issues related to the payment system.

However, the UK government plans to introduce a new utility-style regulator for retail payments.³ This regulator will be in charge of the cheque clearing systems; automated payments systems (Chaps, Bacs, Faster Payments); the LINK ATM network; and three and four-party card schemes. Initially, the government contemplated the following two options:

- self-regulation
- a new Payments Strategy Board (PSB)

However, in the consultation published in March 2013, it considers extended regulatory powers, either given to

- a new stand-alone regulator;
- the Financial Conduct Authority (FCA); or,
- one of the existing economic regulators.⁴

¹ The Prudential Regulation Authority (PRA) is the UK's prudential regulator for banks, building societies, credit unions, insurers and major investment firms. It is part of the Bank of England.

² These changes are based on the Financial Services Act of 2012.

³ See HM Treasury, Opening up UK payments, March 2013.

⁴ Like, for instance, Ofcom, Ofgem, or Ofwat.

The government has not yet decided which route to follow but has indicated that it favours options 2 and 3.

The treasury document defines the powers of the new regulator as

- *“promoting the interests of current and future end-users of payment systems,”*
- *“promoting competition and innovation, and”*
- *“to ensure that the payment systems are adequately funded to achieve it.” (Treasury 2013, p. 16)*

The competition powers include

- the power to *“enforce the prohibitions on anti-competitive agreements and abuse of dominant position and,”*
- *“the power to refer the market, or a subsection of it, to the Competition Commission for a full Market Investigation.” (Treasury 2013, p. 16).⁵*

Furthermore, operators of payment systems and their direct members will be required to obtain a licence of the new payments regulator. As licence-holders, they will be required to observe the following principles (Treasury 2013, p. 17):

- *“Efficient and transparent pricing*
- *Non-discriminatory access*
- *Good governance*
- *Maintaining and developing the payment system*
- *Co-operation.”*

In order to enforce these principles, the payment regulator may:

- gather information of regulated institutions
- remedy a breach of licence conditions
- impose financial penalties for breach
- share information
- create advisory bodies
- levy the regulated population to fund its own activities
- amend the licence conditions (Treasury 2013, p. 18-19)

The government even argues that *“the regulator must be in a position to end the ownership of payment systems by their users, if it sees this as the most appropriate and proportionate way to tackle any problem it believes it must address.” (Treasury 2013, p. 20)*

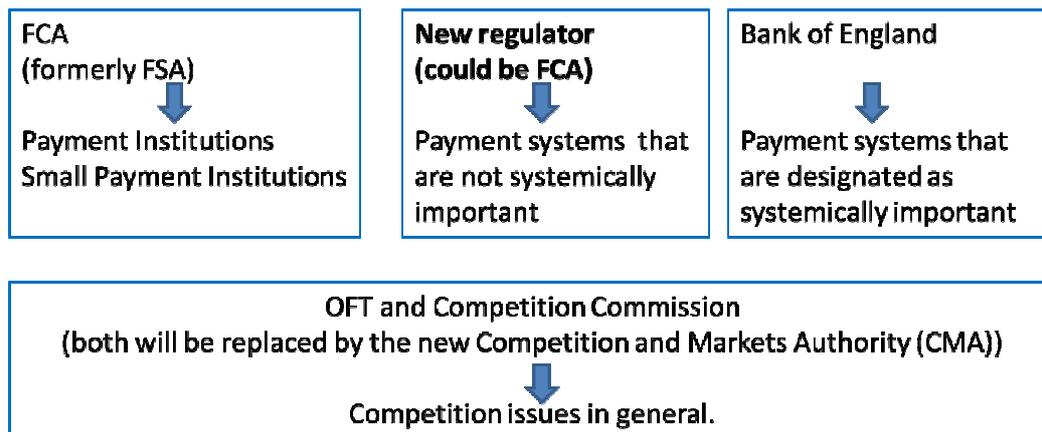
⁵ The OFT will remain in charge of overall competition in financial services. (But the functions of the OFT and Competition Commission will be moved to the new Competition and Markets Authority (CMA)).

So, on the whole, the UK government has presented a model of a very powerful regulatory body for payment systems. The proposal comes in the form of a “consultation document”. However, the wording strongly suggests that on many key points the UK government has made up its mind, already.

Our Comment

The UK government seems to be determined to reform the regulation of retail payment systems. Not surprisingly, it wants to introduce a model that has been used in other network industries for many years. In fact, a commission chaired by Don Cruickshank has already proposed in 2000 to introduce a utility-style payment regulator (“PayCom”).⁶ The new regulatory structure envisioned by the Treasury may look about as sketched out in Figure 1.

Figure 1 Proposed payment regulation in the UK



Source: PaySys Consultancy based on Treasury 2013.

While it looks plausible to regulate the retail payments network in a similar fashion as, for instance, telecommunications, it is somewhat less clear why this move comes today. The UK government cites as main reason the Payment Council’s decision to discontinue cheque payments by 2018. The Payments Council is an industry body mainly representing the banks. It is argued that this decision reflects the interests of the banks and does not sufficiently take into account the interests of other stake holders. There may be some truth in this. But it is also true that cheques are generally seen as expensive and inefficient. Therefore, for instance, the European Commission does not see any need to include

⁶ Cruickshank, Don (2000): Competition in UK Banking. A Report to the Chancellor of the Exchequer, Norwich: The Stationary Office, p. XVI.

cheques in its endeavours to create a Single Euro Payments Area (SEPA). So the Payment Council's decision against the cheque can be seen as being in line with the government policy in many countries. Thus, it seems a strange example of narrow self-interested practise of the UK banks.

Nevertheless, the new plan fits a current trend in the regulation of retail payments. In the past 20 years, retail payments have increasingly become the focus of regulatory action. The range of issues addressed by regulators has been impressive: x-border payments in the EU, e-money, payment services in general, competition issues, excess to basic payment services, anti money-laundering (AML), anti terrorist-financing (ATF), security, data protection, lack of innovation, etc. Over the years it has become clear, that governments are viewing the retail payment system as an important infrastructure that is indispensable for the functioning of the economy. In other words, they see it as an "essential infrastructure" like the transport network or the electricity network.

For the payment industry, being treated more or less like an essential infrastructure has not always been a blessing. Regulatory pressure has been rising and added to the costs of doing business. At the same time, regulators have called traditional business models into question. Compliance has been made difficult by having to deal with various regulatory bodies with objectives that have been difficult to reconcile. For instance: data privacy versus AML/ATF, creating SEPA schemes versus complying with anti-trust rules, low costs versus high security, etc.

Against this background, the proposals of the UK government should be seen as an interesting model not only for the UK but also for the EU as a whole. So far, industry representatives seem to have been loath to use the term "essential infrastructure". They probably feared that as an essential infrastructure they would face even more regulation. However, given the current number of regulators and the sometimes conflicting regulations a unified approach with one powerful regulator may be preferable. After all, this enhances the chance to face a consistent regulatory approach. Thus, the UK approach could serve as a role model for Europe.

*There are some caveats, however. **First**, a notable feature of the UK regulator model is that the regulators "must be independent of government, in order to provide certainty and stability for market participants." (p. 15) It is not clear to what extent it would be possible to implement such independent regulators in other member states of at the EU level.*

***Second**, it is not clear to what extent a regulator may be capable of actively promoting innovation. The Treasury cites the development of Faster Payments System (FPS). It argues*

that FPS was only developed due to regulatory pressure and that things could have gone much faster if a regulator could actually oblige payment systems and members to invest. Maybe this is an example where regulation made a difference and where a more powerful regulator could have speeded things up. But in general, rivalry and competition seems to be much more powerful sources of innovation. A case in point is the field of m-payments where the Treasury would also like to see more innovation. Here, one may still ask where the problem is that m-payment products are supposed to solve. In 1999/2000 a lot of money has been wasted on m-payments. Do we really need a regulator that obliges market participants to sink more money in this field?

Third, it is not clear at all, what type of schemes should be covered by the regulatory umbrella. The treasury names the following types of schemes: “cheque clearing systems; automated payments systems (Chaps, Bacs, Faster Payments); the LINK ATM network; and three and four-party card schemes.” (Treasury 2013, p. 15) Anyone with a special interest in card business will note that not only Visa and MasterCard would be covered but also Amex and Diners. But an open question is whether the regulatory regime should be restricted to three-party card systems. A three-party card system manages accounts of cardholders and merchants and allows cardholders to transfer money to the accounts of merchants. They do so with the help of plastic cards (or “virtual cards”) which represent payment accounts. This model does not differ very much from systems like PayPal or Skrill/MoneyBookers. So, one may well ask whether such systems should also be included.

Fourth, at the moment it is unclear how e-money issuers will be regulated.

Fifth, the inclusion of three-party systems raises the question to what extent the principles of “efficient and transparent pricing”, “non-discriminatory access” and “co-operation” will also be applied to these systems. Does the Treasury expect the payment regulator to “open up” these systems?

Sixth, in general, the question arises whether the new regulator should be in charge of the basic infrastructure (the inter-operator-space and the operator-member space) or also for individual payment products delivered from members to end-users? As far as we can judge, the “all encompassing alternative” (including end-user products) risks being the death of innovation rather than its cradle.

2. SEPA-compliant or SCF-compliant: to be or not to be?

Within SEPA “from 31 December 2010 onwards all general purpose cards, whether co-branded or not, in circulation must be issued under SCF-compliant schemes” (SCF, 1.3.2., No. 6). Two years after the start of SEPA for Cards the ECB is listing 12 card schemes, which have published self-assessments on their websites. All of them are stating that they are SEPA-compliant⁷. SEPA-compliance is based on the Terms of Reference (ToR) for the SEPA-compliance of card schemes. These ToR are based on the criteria of the SCF and additional requirements of the ECB. Based on this definition a SEPA-compliant card scheme is automatically SCF-compliant.

The schemes listed are: Activa (SI), American Express, Bancomat / PagoBancomat (IT), Cartes Bancaires (FR), Euro 6000 (ES), Girocard (DE), JCB, MasterCard, Multibanco (PT), Servired (ES), Sistema 4B (ES) and Visa. Besides the international card schemes MasterCard, Visa, JCB and American Express, all the schemes are “former” domestic-only schemes of the **euro**-zone. Obviously, no domestic card scheme outside the euro-zone assessed itself as SEPA-compliant! Except JCB, all the schemes were already listed here as SEPA-compliant in October 2010 before full implementation of the SCF. However, 3 schemes were taken off this list: PIN, the Dutch debit card scheme which was terminated at the end of 2011 and replaced by Maestro and V PAY and very recently (in March 2013) Karanta (SI) and LaserCard (IR).

Our comment:

Should all card schemes in SEPA be SCF-compliant?

SEPA for Cards is an act of self-regulation which commits the EPC members (SEPA-banks and payment institutions) to issue general purpose cards for POS payments and cash withdrawals which are SCF-compliant. “After end 2010, all general purpose payments cards in circulation and distributed and issued by SEPA banks and payment institutions will be SCF compliant.” (SCF, 2.2.2.).

Interestingly, the scope of SEPA within the context of the SCF is not restricted to the euro-zone, but it consists of all EU-members (27) plus other EEA member states (5). A SCF-compliant card is a card issued by an issuer within a SCF-compliant-scheme (or schemes) and capable of handling euro transactions (SCF). Schemes in non-euro SEPA countries therefore need to be SCF-compliant not only because of handling euro transactions but also

⁷ <https://www.ecb.int/paym/sepa/elements/compliance/html/index.en.html>

because the commitment of their local banks as issuers and EPC members. Even if the local schemes outside the euro-zone opt for co-branding (here understood as two payment brands), in order to handle euro-transactions, both schemes should be SCF-compliant.

Who assesses the compliance of a scheme?

Being SCF- or SEPA-compliant is still the result of a self-assessment by the schemes. The schemes have to publish the self-assessment on their websites with a notification to the relevant local central bank. Then the local central bank will report it to the ECB and it will be published on the ECB-website. If the rules of the scheme were amended, the assessment should be repeated. However there is a kind of check of the self-assessment by the ECB (before or after publication on its website?). Schemes should explain the reasons for any deviations from the compliance criteria to the ECB.

Although the last version of the SCF (December 2000) stated that the EPC would establish and maintain mechanisms to monitor the implementation of the SCF by card schemes, we currently do not see an active role of the EPC in this assessment-process.

Are card schemes missing on the ECB-list?

Yes, they are! E.g. Diners Club, LINK (UK), Dankort (DK), Payfair and EAPS. The schemes LINK and Payfair state on their websites their "SCF-compliance", EAPS says "EAPS is SEPA-compliant". But why should LINK and Payfair be SCF-compliant but not SEPA-compliant (ECB-criteria)? And why does the ECB not list EAPS?

Danske Bank and the other banking members of the Finansradet (Danish Bankers Association) commit themselves as EPC members to issue SCF-compliant cards of SCF-compliant schemes. These EPC-members either have not fulfilled their commitments or Dankort is a SCF-compliant scheme that does not publish its self-assessment. We asked Dankort about this and we will come probably back to this issue in our next newsletter. Diners Club International stated that the scheme is not willing to fulfil all the SCF-requirements.⁸ While Diners Club is explicitly not SCF-compliant, the scheme is handling euro-transactions and some of its issuers/acquirers are EPC-member (UniCredit).

What about the schemes deleted from the ECB-list in March 2013?

⁸ <http://www.dinersclub.com/sepa-position-statement.html#>

Both Laser Card (Ireland) and Karanta (Slovenia) were listed as SEPA-compliant schemes on the ECB-list from October 2010 to March 2013. Both schemes are still active.

*About 3 million **Laser Cards** are issued as debit cards, co-branded with Maestro, by the Irish retail banks AIB (Allied Irish Banks) and Danske Bank (who acquired the former National Irish Bank). Laser Card started with the implementation of chip & PIN (EMV) already in 2002. Laser Card Services is as scheme member of IPSO (Irish Payment Services Organisation), who is EPC-member. Danske Bank as Laser Card issuer is also EPC-member. So both scheme and issuer are EPC-members but somehow the scheme seems to have lost its qualification as “SEPA-compliant” after 2 years. This is puzzling and we hope to get an explanation from the scheme owners of Laser Card.*

*We find the **Slovenian situation** also hard to understand.⁹ The card scheme **Activa** is still marked as SEPA-compliant on the ECB-list, although Banka Koper as scheme owner declared that the scheme does have areas of non-compliance e.g. by still issuing a domestic-only Activa card, which can only be used in Slovenia. In September 2010 the card scheme **Karanta** (owned by the bank Nova Ljubljanska) presented its position that the Karanta scheme would not be made SCF-compliant lacking the EMV-upgrading. It took almost 30 (!) months before the ECB deleted this scheme from the list. The Nova Ljubljanska Banka is still issuing these domestic-only cards as member of the ZBS (Bank Association of Slovenia), which is EPC-member. Obviously another EPC-member is considering its SEPA-commitment in a more “flexible” manner. It is remarkable to read, that the Central Bank of Slovenia (a member of the Eurosystem!) supports this position with a reference to the general delay of the SEPA for Cards in Europe (no Third Pan-European Card Scheme, no definitive cards standards...). “Thus, there is no reason to expect the Karanta scheme to cease to exist only on account of its non-compliance with the SEPA compliance criteria”¹⁰. A more creative solution to solve the requirement of being SCF-compliance was found by the third local card scheme “**BA**” (co-branded with Maestro) in Slovenia. The result of the self-assessment of the scheme was the conclusion that BA card scheme is not a scheme at all by lacking some criteria of being a scheme. No scheme, no compliance-requirements!*

Overall, it looks as if market players do not consider the SCF-document as a core document for the implementation of SEPA for Cards anymore. Even the EPC lost its interest to produce

⁹ See the Second Progress Report of the Slovenian Central bank (Banka Slovenije) of March 2012 for more information about the SEPA-implementation of Slovenian card schemes, p. 18-24.

(<http://www.bsi.si/en/payment-systems.asp?Mapald=1507>)

¹⁰ Ebenda, p. 19.

a new and improved version (following version 2.1 of 2009) which was announced for 2010. The document is still a draft version with a lot of inconsistency, ambiguity and therefore plenty of room for interpretation. The European Commission picked up the issue in its Green Paper¹¹ last year. Summarising the feedback statements it notes that “the majority of card schemes and banks did not find it necessary to review the SCF at this stage”¹² and “the majority of payment schemes, banks and non-bank payment service providers considered that no decision on the non SCF compliant market players should be taken for the time being”¹³. May be the Commission will come back with a proposal for a neutral European body which should monitor the SCF-compliance and could impose effective sanctions?

3. Another European e-purse scheme is shut down



**HIER GEEN
CHIPKNIP MEER**

Hier kunt u niet meer met Chipknip betalen. Chipknip was er vooral voor kleine betalingen, maar die kunt u ook gewoon pinnen. Pinnen is snel, veilig en gemakkelijk. Wij willen graag dat u pinst! Hoe minder contante betalingen, hoe beter.

WAAROM STOPPEN MET CHIPKNIP?
Het aantal Chipkniptransacties neemt elke dag af. Nog maar enkele klanten gebruiken de Chipknip. Maar iedereen die wil pinnen krijgt via de betaalautomaat wel standaard de vraag of hij wil pinnen of een Chipknipbetaling wil doen. Dit kost tijd, brengt verwarring en is onevenredig duur.

KLEIN BEDRAG? PINNEN MAG!
De gemiddelde Chipknipbetaling bedraagt € 2,50. Tegenwoordig kunt u zo'n bedrag - en zelfs lager - prima pinnen. Graag zelfs. Pinnen is voor ondernemers in de loop van de jaren steeds goedkoper geworden, terwijl de kosten voor contant geld stijgen. Maar minstens even belangrijk: pinnen is veiliger en gemakkelijker voor iedereen.



**KLEIN BEDRAG?
PINNEN MAG!**

The prepaid e-purse product of the Dutch banks “Chipknip” will be terminated after its 17-years of existence at the end of 2014¹⁴. The retailers will stop its acceptance already this month. Transactions with Chipknip (a chip-based application on the debit card) should be replaced by debit card transactions, which are promoted by the banks to be used also for low-value payments. The scheme lost 14% transactions last year (2011: 171.7 m; 2012: 148.2 m). Chipknip was mainly used for parking, vending machines and meals in canteens, but even in these typical “e-purse” market segments Chipknip lost volume. As Currence (the scheme owner) says, additional investments in the scheme would be necessary due

to the SEPA-harmonisation. Banks were not willing to make these investments.

¹¹ “Towards an integrated European market for card, internet and mobile payments”, Question 12

¹² Feedback statement, p.11.

¹³ Feedback statement, p. 12.

¹⁴ See press release of Currence of 27 March 2013.

Our comment:

In the middle of the 1990s, e-purses as stored-value chip cards were the hype in the European payment industry. At that time, only a few pessimists doubted that this technology-driven innovation would not be accepted by consumers and merchants, although the initial pilot projects were not successful. Experts expected that e-purses would drive out cash in the low-value area. The national banking communities started e-purse applications as mass products. Even cross-border usage was prepared. Millions of euros were invested for marketing campaigns to convince the potential users. But after 15 years most of the national products were phased out without ever being a success. A few years ago the Belgian banks stopped their investments in the Proton-Scheme, which was the flagship of the European e-purse schemes.

Now another bastion fell. With about 50% of all e-purse transactions in Europe (2011), the Dutch Chipknip scheme was the market leader. Dutch inhabitants used the card 10 times a year for low-value e-purse transactions, twenty times as often as Germans use their GeldKarte (only 0.5 times a year). In Europe, the remaining national schemes are in Belgium (phased out too), Austria (Quick), France (Moneo as student card) and Germany (GeldKarte). In 2011, their total transaction volume was only 170 m. It is hard to believe that these schemes could be profitable. In Germany, the GeldKarte-volume has been constantly decreasing since 2008. The technical upgrade of GeldKarte with a contactless application (with the new brand "girogo") has not been very successful, so far.

Are banks in Austria, Germany and France riding dead horses with their out-of-time products? Any lessons learnt regarding the today's hypes based on technological driven payment products? Dial "M" for "Murder the pessimists"!

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