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1. Italian Antitrust Authority reduces Multilateral Interbank Fees (by Francesco Di Salvo¹)

On the 5th October 2010, the Italian Banking Association (ABI) and the Bancomat Consortium reached an agreement on the reduction of Multilateral Interbank Fees (MIFs).² The documents approved by the Italian Antitrust Authority finally brought to an end two inquiries opened in 2009 to verify whether the determination of MIFs was based on agreements restricting competition. These reductions apply to ATM withdrawals, POS transactions, direct debits (utility direct debits) and cash orders (payments with electronic receipt). As final step of this collaborative process, ABI and the Bancomat Consortium have to propose, within one month, a roadmap to implement antitrust obligations. We have to highlight that it is not the first time that Italian Antitrust Authority have enforced a MIF decrease in the last 5 years.

As underlined by the Italian Antitrust Authority this is an important measure, which might have direct repercussions on the determination of economic conditions offered by banks to clients. Thus, it represents the first step towards the introduction of economic benefits for customers. At present, consumers will not benefit from these cuts unlike acquiring banks, which will experience transaction fees reductions ranging from 3% to 36%.

The Italian Antitrust Authority assures that new fees were determined on the basis of the economic efficiency principle by setting levels, which could never be increased. The value of the Pagobancomat fees has been defined considering the:

- the costs of service providers;

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² See: Italian Antitrust Authority Act 724, Act 725 (<http://www.agcm.it/>)

- the benefits for merchants (e.g. cost saving opportunity, attract new customers, security and reliability) and consumers (e.g. convenience, speed, security, innovation and reliability)

The reductions in detail:

- 1) The debit POS (PagoBancomat) transaction interchange fee is reduced, thanks to the commitment taken by the Bancomat Consortium, by more than 4% of the average transaction value (the fixed component of MIF is reduced from 0.13 to 0.12 euro per transaction). The Consortium moreover committed itself to recheck the fees according to the results of the ongoing study conducted by the European Commission and Eurosystem;
- 2) The ATM withdrawal fee is reduced by 3.4% (from 0.58 to 0.56 euro);
- 3) MIFs on direct debits (RID) are cut by 36%, up to 0.16 euro. In line with the European regulation, from 1 November 2012 on, they will be reduced to zero. The value-added service offered by the Italian banks “Electronic Database Alignment” (SEDA) is excepted (the fee equals 0.071 euro). The fee on fast direct debits decreases from 0.35 to 0.26 euro per transaction;
- 4) The fee on cash orders collection mandate is reduced by around 20%, from 0.57 to 0.46 euro.

The Italian Banking Association (ABI) and the Bancomat Consortium are satisfied with the outcome and reaffirm the will to follow the orientation outlined within the European Union, “aimed at promoting the progressive control of these fees”.

Table 1 Interchange fees on Debit POS Transactions³

Scheme	Transaction type	Fee
PagoBancomat	Magstripe	0.1579%+0.12 Euro
V PAY	Chip	0.13%+0.17 Euro
Visa Debit	EMV Chip	0.26 Euro
Maestro	Chip	0.35% +0.05 Euro

The Bancomat consortium has agreed to evaluate the EU Commission’s and Eurosystem’s tourist test results on MIFs within 6 months from its publication. Following the analysis, it has

³ Sources:
www.agcm.it
http://www.visaeurope.com/en/about_us/what_we_do/fees_and_interchange/interchange_fees.aspx,
<http://www.mastercard.com/us/company/en/whatwedo/interchange/Country.html>,
http://www.bancomat.it/it/Press_e_Media/listanews/dettaglionews.html?page=1&idnews=ff8080812ba004fe012bbec047ca0014&archive=0

committed itself to define again the interbank fees based on these test outcomes. In the light of the evolutions of competition and of European provisions, the Italian Authority will be committed in a steady and punctual activity to avoid any irregularity.

Comment

The regulation of MIFs is the expression of the Government's will to increase the level of control over the national payments market. It reflects the policy of the EU Commission which wants to have stronger control of the sector.

In a market, such as the Italian one, still not ripe for electronic payment instruments, the reduction of MIFs by the Authority, even if focused on transaction cost reductions, could introduce a breaking element to conspicuous investments by banks, slowing down a further development of these instruments.

It also has to be considered that the risk of slowing the electronic payments sector is not balanced by a perceptible decrease in consumer prices. Even with the upcoming unbundled acquiring pricing offer, retailers will not take any advantages from the reduction in merchant discount fees, nor subsequently will consumers, unless a very strong pricing competition among acquiring banks and merchants is triggered.

Consumers Associations have different opinions. Codacons seems to be sceptical by affirming that the capability of these reductions will never be a real profit for consumers and that "it is quite difficult that banks will transfer these reductions to clients". But Federconsumatori, Adusbef and Movimento dei Consumatori are more optimistic.⁴

2. The ECB's 7th SEPA Progress Report

In October 2010, the ECB has published its 7th SEPA progress report entitled „Beyond Theory into Practice“.⁵ The ECB points out that a lot of progress has been made on the road to SEPA but it also highlights areas of concern. It does not come as a surprise that „SEPA for Cards“ is one of these areas.

In particular, the report emphasises five card-related topics that require action:

⁴ See <http://www.federconsumatori.it/ShowDoc.asp?nid=20101005163921&t=news>, <http://www.adusbef.it/> and <http://www.movimentoconsumatori.it/news.asp?id=4408#BANCHE-CONSUMATORI--BENE-L'ANTITRUST-SUL-TAGLIO-DELLE-SPESE-BANCOMAT>

⁵ European Central Bank: Single European Payments Area. 7th SEPA Progress Report. Beyond Theory into Practice, October 2010.
<http://www.ecb.int/pub/pdf/other/singleeuropaymentsarea201010en.pdf>

- a. the necessity of a European card scheme
- b. the separation of scheme and processing
- c. the self-assessment of card schemes
- d. a framework for card processing
- e. cards standardisation and certification

“Separation of scheme and processing” is the topic that receives the largest space in the cards chapter. In the past, it has not always been evident what this exactly means. In the new progress report, the ECB makes it clear, however, that it favours a very far reaching interpretation. *“Card scheme participants should be free to choose their processors and clearing and settlement service providers.”* (p. 24; highlight by PaySys)

At the corporate level, the separation of the scheme management function and the processing function should be understood to include (p. 24):

- operational separation,
- information separation,
- financial/accounting separation,
- commercial separation and
- legal separation

This far-reaching separation is referred to as “ideal scenario” and the ECB notes that it *“may be costly and difficult to implement for existing organisations”*. It does not say, however, to what extent deviations from the ideal scenario may be acceptable.

These provisions apply mainly to 4-party systems. Exempted from these separation provisions are *“card schemes which undertake both issuing and acquiring processing within their own entity and three-party card schemes with licensees”*. Licensees should, however, be allowed *“to work with the issuing or acquiring processor of his/her choice”*⁶ and *“by the end of 2013 at the latest, licensees should no longer be restricted to single countries or regions but allowed to be active in the entire SEPA.”* (ECB. 7th SEPA Progress Report, p. 26). Thus, 3-party model may also have to adopt their business models.

At the end of the report, the ECB once again has drawn up a long list of „Milestones“ for market players and regulators. A glance over these milestones shows that the industry still has plenty of homework to do.

There is also a chapter on “Migration” in the Progress Report. The ECB favours clear deadlines for SDD and SCT, proposing end-2012 as end-date for the migration of credit

⁶ The scheme should only be allowed to restrict authorisation, clearing and settlement to itself.

transfers and end-2013 as end-date for direct debits. The ECB does not yet envision a particular end-date for cards. But it notes that payment cards are an “area of concern”. (p. 41)

Table 2 ECB Milestones for SEPA for Cards

Deadline	Topic	What	Who	Stakeholder
Q2 2011	Framework for card transaction processing	Framework (documentation) finalised	EPC and/or card processors	Banks, other payment service providers, processors, infrastructures, card schemes
Q2 2011	Charging principles for cards	Guidance to the payment industry	European Commission	Card schemes, issuers, acquirers and card holders
End-2011	“Implementation specifications” for SEPA cards and terminals	Finalisation of the “implementation specifications” for cards and terminals	Standardisation initiatives	Card issuers and acquirers, processors, card and terminal manufacturers
End-2011	Compliance of “Implementation specifications” for SEPA cards and terminals with the “Volume”	Design of a process to identify cards standardisation initiatives and to assess the compliance of their specifications with the “Volume”	EPC	Standardisation initiatives, card issuers, acquirers, processors, card and terminal manufacturers
Start-2012	Magnetic stripes on cards	All cards by default issued as chip-only cards	Banks, other payment service providers	National SEPA fora, card schemes
End-2012	Online “card-not-present” transactions	Implementation of and migration to state-of-the-art authentication	Payment service providers	Consumers
End-2013	SEPA-wide licensing	Card issuing or acquiring licensees free to be active in the entire SEPA	Card schemes, acquirers, issuers	Retailers

Source: ECB, 7th progress report, p. 49-50

Our Comment

In this comment, we would like to focus only on the end-date debate and, in more detail, on the requirement of separation of scheme and processing. We will address other topics in the next newsletter.

The far-reaching separation of scheme management and processing envisioned by the ECB moves the architecture of card payment systems closer to the one known from credit transfers and direct debits. But it does not do so entirely. Whereas in the field of credit transfers and direct debits there is just one scheme in each field, in the field of cards there will be more than one. Thus, there could be MasterCard, Visa and one or more European schemes. However, each of these schemes would be obliged to separate any processing activities. In the past, the schemes have interpreted “separation of scheme and processing” to imply that issuers and acquirers should be free to chose an issuing or acquiring processor.

According to this interpretation, clearing and settlement as well as switching would not have to be separated. However, in the latest Progress Report “processing” is defined in an all-inclusive way:

“..., in addition to the separation of scheme management functions from issuing and acquiring processing, card scheme management functions should also be separated from central transaction processing.” (p. 24) *The term “central transaction processing” is defined in a footnote: “Switching, clearing and settlement, as well as value-added services related to these functions.” (footnote 21, p. 24) Combined with the statement, already quoted above, that scheme participants should be free to choose their processor, this would imply a major overhaul of existing card schemes. Units in charge of scheme management would resemble more or less the EPC and processing units would resemble the Clearing Houses (ACHs) that provide clearing services in the field of direct debits or credit transfers (like Equens or VocaLink). It seems questionable that a processing unit of, say, MasterCard, could confine itself to processing only MasterCard transactions. It would probably have to become a “cards processor” (for all schemes) or maybe even a “payment processor” for cards, credit transfers and direct debits. Thus, the resulting structure would be as depicted in Figure 1.*

Figure 1 Separation of Scheme⁷ and Clearing & Settlement in SEPA

	Scheme	Clearing&Settlement
Credit transfer (target model)	One scheme SCT	Many systems 
Direct debit (target model)	One scheme SDD	Many systems 
Cards (status quo)	Many schemes Visa MasterCard Others	One system each Visa MasterCard Others
Cards (target model)	Many schemes Visa MasterCard Others	Many systems 

⁷ Payment Scheme: “A set of interbank rules, practices and standards necessary for the functioning of payment services.” ECB: Payments and markets glossary, <http://www.ecb.int/home/glossary/html/act6p.en.html#631>

If put into practise, the ECB's requirements would cause a major overhaul of the industry. But there is some uncertainty. The ECB uses the term "ideal scenario" to describe a situation with full compliance with its separation requirements. It is not clear, therefore, to what extent schemes may deviate from these requirements.

As far as the end-date discussion is concerned, it comes as no surprise that the ECB favours setting fairly tight deadlines for migration to SCT and SDD. It is somewhat disappointing, however, that the ECB does not make a single reference to the recent discussion between the EU Commission, the EPC and others about the correct way of setting these end-dates. Reading the Progress Report, one might gain the (false) impression that setting end-dates is a simple and straight-forward matter.

3. To compete or not to compete – the „scheme“ as the Hamlet of the SEPA drama

In the latest SEPA newsletter Javier Santamaría (Assistant General Manager with Banco Santander and SEPA Payment Schemes Working Group Chair) draws on Homer and the Odyssey. So we may be forgiven when using another famous drama to analyse the current evolution of SEPA. Recent publications on SEPA have, once more, underlined the fact that card payments, on the one hand, and credit transfers and direct debits, on the other hand, are treated differently. The reasons for this difference of treatment have never really been spelt out.

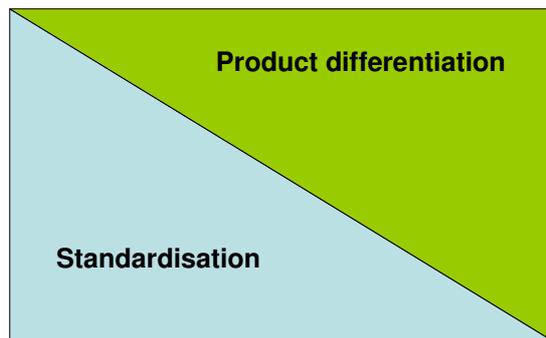
When it comes to credit transfers and direct debits we are told that standardisation via a single scheme is the pre-condition for effective competition. This point is made crystal clear by the EPC's Gerard Hartsink: „*Standardisation at the scheme level is the very precondition for increased competition and diversity of PSPs at the services and product level.*“⁸ But when it comes to payment cards, the EU Commission and the ECB want „scheme competition“. Thus, in the latest progress report, the ECB, once more, stresses the virtues of having a European scheme competing with Visa and MasterCard: „*It could enhance competition between card schemes, between processors and between banks, thus providing choice for cardholders, merchants and banks.*“ (p. 22-23)

⁸ Gerard Hartsink: So what's in a Name? Explaining payment schemes, instruments and systems, EPC Newsletter, Issue 8, October 2010, p. 4.

Our comment

To be fair, the question whether the Hamlet in our drama, the „scheme“, should compete or not does not have an obvious answer. Therefore, it is not surprising that it has been answered in different ways. The main problem is that these differences are never really spelled out - they are not even acknowledged.

Figure 2 Trade-off between standardisation and product differentiation



One approach to tackle the problem may be a look at the costs and benefits of standardisation. Gerard Hartsink is right to point out that standardisation of rules and technology leaves some room for designing individual product propositions. But standardisation also limits the possible extent of product differentiation. If everything is standardised there is basically only one type of product. Thus, there is a trade-off.

If the market requires a lot of differentiation and if there is scope for rapid innovation, standardisation comes at a high cost because standardisation reduces the scope for product differentiation and makes it difficult to implement innovative solutions.⁹ In this case, competition is to be preferred. But if there are little gains from product differentiation and if the scope for innovation is limited, standardisation makes sense. So, one could argue that credit transfers are a candidate for standardisation and card payments belong to a group of products requiring innovation and product differentiation. Another point is reachability. For credit transfers 100% reachability seems to be a political goal, but not for cards. Seen in this way, the differential approach towards these two products may be justified. However, the question may be asked where direct debits belong. As far as we can see, there seems to be a fairly wide demand for product differentiation. So, maybe direct debits should be treated more like cards?

⁹ There may be exceptions, but in general interbank ventures have not been known to be quick movers. Given the rising pressure to include all stakeholders when setting payment standards, speed is unlikely to improve in the future.

4. EU Commission schedules hearing on migration end-date

The EU Commission has announced on its website that it plans a public hearing under the heading "Towards Full SEPA migration". The hearing takes place in Brussels on 17 November 2010 "to assist the Commission in the finalisation of its proposal for an EU Regulation establishing end-dates for migration to SEPA credit transfers and direct debits." Interested parties are invited to register on the website of DG Internal Market (link: <http://ec.europa.eu/yourvoice/ipm/forms/dispatch?form=sepa2010>)

Our comment

The issue of setting end-dates for migration to SEPA products proves to be more difficult than anticipated. The first proposal for an end-date regulation had been scheduled for October 2010. With the hearing in mid-November, the proposal is unlikely to be published before December or even early 2011.

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