



# PAYSYS REPORT

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## IFR: A debit card is “definitely” not a credit card

(hg) According to Art. 17 of the Interchange Fee Regulation (IFR – EU/2015/751), the Commission was required to submit a report on the application of this Regulation to the European Parliament and to the Council on 9 June 2019 at the latest. In March of this year, the Commission tendered a study to provide the basis for the required review. The subject of this study is a comprehensive evaluation of the effects of the regulation on the evolution of the EU card payments sector, based on quantitative and qualitative market information.

Most of the required information could be available somewhere in the data warehouse of Mastercard and Visa, who are not obliged to disclose this information. Therefore, availability of data may be a big problem for the reviewers and the study will be a hazardous business for serious consultancies. If the response rate of the market players is too low (which could be a realistic scenario) the

Commission would stop the study. It is not surprising, that many consultancies have kept out of this.

However, not all data are confidential. Card market figures for most of the 28 Member States are available in the public domain, collected by Central Bank statisticians and published by the ECB in its data warehouse. These data are valuable since the quantitative market effects of price regulation for debit and credit cards by the IFR (IF-caps of 0.2% for debit and 0.3% for credit cards) are an essential part of the review.

There is, however, a statistical and methodological problem: debit and credit card transactions as defined in the ECB statistics diverge from the legal definitions of the IFR. These deviations not only affect the quality of the study but also invite card issuers to circumvent the IFR. This will be discussed in the last section of this Report.

## Our Comment:

The different caps on the Interchange Fees according the IFR of 0.2% respectively 0.3% for debit card transactions (including those with prepaid cards) and credit cards (delayed debit cards and credit cards with revolving credit) requires a demarcation of debit cards and credit cards. To find out the key differences, we have to analyze the distinguishing features of **debit vs. delayed debit** card transactions.

Firstly, the caps (according to Art. 3 and 4) are applying to **transactions**, not to a card or to a card payment application. A payment card could generate different legal types of transactions (debit or credit), even if the card is single-badged with one payment brand. These hybrid cards can e.g. offer the cardholder to make a button-choice at the POS to go for credit or debit ("combo-card").

Secondly, the (legal) definition is only linked to the **payment transactions** (sales) made by the card. The option of ATM-transactions and its procedure of settlement have no relevance for the IF-relevant transaction flagging. All articles of the IFR are focusing on card-based purchase transactions only. In this respect it is curious and confusing that the Regulation (Art. 1 Par. 3) makes Chapter 3 (business rules) also relevant for ATM-transactions.

### ECB-Definitions

In the methodological notes to its payment statistics<sup>1</sup>, the ECB specifies the essential distinctions between debit and delayed debit cards for statistical recording. The distinguishing features of a debit card are – according to the ECB - the linking to a current account and the direct and immediate settlement. The delayed debit card is linked to a card account, which is charged immediately too, however the settlement (in full) is "*at the end of a pre-defined period*".

Which period is supposed to be pre-defined in the contractual agreement between cardholder and card issuer? This period (not further explained by the ECB) is obviously the period of credit, which starts at the moment when the issuer has to transfer funds into the card clearing & settlement system and ends at the moment when the cardholder pays the due amount to the card issuer. A period is usually defined by a start and an end date. As a minimum, this credit period should be pre-defined regarding the end date, so that the cardholder knows when he has to settle the debt.

Typically, the issuer of a delayed debit card sets a fixed calendar month date for settlement (e.g. 15<sup>th</sup> of each month) of all transactions made before this date (often cumulated into one amount). In this case, the duration of the pre-defined period is not the same for

	Card with a	
	debit function	delayed debit function
Account for charging	Current account (funds or overdraft facility, which is not card-related)	Card account (no funds, negative balance up to authorized spending-limit)
Account held at	Card issuer or other entity (decoupled debit card)	Card issuer
Moment of account charging	Directly/immediately	Directly/immediately
Card-related credit line	No	Yes
Moment of settlement	Directly/immediately by funds on current account (account charging = settlement)	Negative balance of card account is settled (in full*) "at the end of a pre- defined period". No requirement for the way of settle- ment defined by the cardholder (current account, credit transfer etc.).

Table 1: Definitions according the ECB for statistical reporting

\* Card with a credit function: availability of an extended credit (no settlement in full at the end of the pre-defined period)

each transaction. The issuer could also offer a settlement twice a month or a settlement every odd day etc. As alternative option, the issuer could offer a fixed duration, e.g. settlement of each transaction x days after the moment of charging the card account. A creative issuer could start a card portfolio, where the transactions would be settled in the moment where the accumulated transactions are reaching a certain amount (e.g. 100 Euro).

## The IFR-definition offers an interesting loophole for traditional debit cards to escape the 0.2%-cap.

All such cards should be classified as "cards with a delayed debit function" if the debt incurred has to be settled in full. However, these definitions are not compliant with the legal definition according the IFR.

### IFR-Definitions

The fathers of the IFR have struggled with a sound definition of the debit card. In its initial proposal of July 2013, the Commission started with a time-based criterion of 48 hours between initiation and settlement of a transaction (< 48 h = debit; > 48 h = credit).

At the end of the day (2015) negotiations resulted in a negative definition:

*"debit card transaction' means a card-based payment transaction, including those with prepaid cards that is not a credit card transaction." (Art. 2, Par. 4).*

It was probably easier to define a credit card:

*"credit card transaction' means a card-based payment transaction where the amount of the transaction is debited in full or in part at a pre-agreed specific calendar month date to the payer, in line with a prearranged credit facility, with or without interest." (Art. 4, Par. 5).*

The decisive criterion is a **pre-agreed calendar month date** for debiting the value of the transaction. Recital 17 added that this date is usually once a month, but is not mandatory. However, the frequency of settlement days (as calendar month dates) should offer some kind of credit facility, even if the credit period is very short. Therefore the minimal frequency would be at least two days. Card transactions, which will be settled every odd day of the month, would be very close to traditional debit transactions but from a regulatory point of view they will be credit transactions which can be prived with the 0.3%-IF-cap. In this case, a de facto debit card would be de jure a credit card. The IFR-definition offers an interesting loophole for traditional debit cards to escape the 0.2%-cap.

On the other hand, settlement agreements of card transactions which are definitely based on a credit line, should be flagged as debit card transactions if the date of settlement is not a pre-agreed specific calendar month date (see table 2)

By definition, it is open whether all the transactions of a credit card cumulated until the specified calendar month date are settled in a cumulated amount (which

Settlement of card transaction	ECB-Definition	IFR-Definition	Conflict
15 <sup>th</sup> of each month	delayed debit	credit	No
Every odd day of the month	delayed debit	credit	No
30 days after transaction date	delayed debit	debit	Yes
After accumulation to 100 €	delayed debit	debit	Yes

Table 2: Conflicting definitions (ECB vs. IFR)

## It was probably easier to define a credit card

The decisive criterion is a pre-agreed calendar month date for debiting the value of the transaction:

is usual for a charge card without revolving credit) or for each transaction. In consequence, all card-based payment transactions without a pre-agreed specific calendar month date for settlement are debit card transactions and subject to the 0.2%-cap.

It is not comprehensible, why the ECB did not amend

its definitions according to the new definitions of credit and debit card transactions of the IFR to prevent confusion. Meanwhile, most issuers will probably report their figures based on the required electronic and visible identification of the card-based payment instruments according Art. 10 Par. 5 of the IFR.

# IFR: Relevance of “Universal Cards”

(hg) IF-caps are related to the specific kind of transaction and not to the card (or app) as generator of the card-based transactions. Of course, a debit card usually generates debit card transactions and a credit card usually generates credit card transactions. But not all payment card products can be neatly separated into one of the two IF-categories “debit” or “credit”.

With the same card, a cardholder could make a debit and a credit transaction, depending on his decision made before, after or at the moment of the purchase transaction. Not in all cases can the transaction technically be flagged with the correct interchange fee. How could the merchant refuse a transaction which is post-labeled as credit card transaction, if he only accepts debit cards? For this kind of hybrid cards (called “Universal Cards”), the IFR provides a specific regulation (Art. 16 of the IFR).

## Our Comment:

Art. 16 Par. 1 (IFR) states, that if a transaction cannot systemically or technically be flagged with the correct IF (according the legal definition) the transaction should be considered as a debit card transaction (0.2% IF-cap):

*“For the purposes of this Regulation, in relation to domestic payment transactions that are not distinguishable as debit or credit card transactions by the payment card scheme, the provisions on debit cards or debit card transactions are applied.”*

This is a clear statement and it is understandable why the regulator is opting for the lowest IF-cap:

*“Taking into account the need to preserve the functionality of the existing business models while avoiding unjustified or excessive costs of legal compliance and, at the same time, considering the importance of ensuring an adequate level playing field between the different categories of payment cards, it is appropriate to apply the same rule provided by this Regulation for the debit card transactions to such domestic ‘universal cards’ payment transactions.”* (Recital 25).

By the way, it is remarkable and pretty embarrassing that the official translation of this Article is incorrect in the national languages of two Member States (French and Romanian). According to these translations, there

would be an optional choice for applying credit (0.3%) or debit (0.2%) - instead of the application of debit only - in cases of Universal Cards (UC).

In the text, two points raise eyebrows. First, why should a **card scheme** distinguish transactions to be debit or credit. According to Art. 3 and 4 (IFR), not the schemes, but the payment service providers (issuer and acquirer) are the addressees and the obligated parties to implement the correct IF.

Secondly, why should the rule only apply to **domestic** payment transactions without considering cross-border transactions? These strange passages could only be explained from the genesis of this article, which was brought into the IFR by France (see box).

### Are UC transactions still relevant?

Even though in France obviously all UC cards have been migrated to clear debit or credit cards, the “Lex France” is still relevant. Art. 16 should be seen as a result of French intervention to solve a local problem, rather than a result of farsightedness of the Commission to include innovative card products, for which transactions cannot be flagged with the correct IF.

What about market relevance? Apart from proper debit cards, delayed debit cards and (revolving) credit cards, the ECB offers further categories for hybrid cards in its

### Lex France

Before December 2015, the IF of the national card scheme "Cartes Bancaires" (CB), applicable to domestic transactions was uniform without specifications for debit or credit. Issuers received the same IF for all domestic card transactions, which could be prepaid, debit, delayed debit or credit. Within the CB scheme, there was no necessity to flag cards and transactions as being debit or credit, which would be a requirement for the implementation of the IFR.

During the legislative process, the French issuers at the last minute postulated a transition period of 18 months in order to implement the clear identification

of each CB-card in the chip and in back-office systems. The transition period was honored by the Commission in Art. 16 Par. 2. For this transition period, the Member State could define a maximum share of 30% of domestic 'universal cards' payment transactions which are considered as being equivalent to credit card transactions.

Only France used this derogation from the specific IF-caps with an IF of 0.23% for UC-transactions until 5 December 2016 (a "mixed" IF of 30% credit and 70% debit). After the transition period all still existing UC-transactions should be flagged as debit card transactions (0.2% IF-cap). French market experts told me, that meanwhile all UC were abandoned.

payment statistics. These categories should be used for cards based on contracts (between issuer and cardholder), where the contract offers two functions, irrespective of whether the cardholder actually makes use of the offered function. The ECB offers two categories for these hybrid cards: "debit and/or delayed debit" and "credit and/or delayed debit".

charge purchases to his credit facility (credit) or directly to his current account (debit).

In France, banks like Crédit Agricole and Société Générale are offering combo-cards in the combination "debit/delayed debit" and "debit/credit". A smart and innovative product is the French card, where transactions made until the 20th of each month are directly linked to the current account, any transactions between the 20th and the end of the month are settled after crediting the monthly salary.

These hybrid cards are relevant regarding the application of the correct IF. As consequence of the gaps in the ECB statistics we have no figures about the combo-card "debit/credit".

According the ECB payment statistics (2016) only the category "debit/delayed debit" includes figures in some Member States, like France (5.8 m), Netherlands (7.8 m) and Portugal (18.1 m). In Portugal, almost all payment cards seem to have both functions. Obviously, Portuguese banks do not issue proper debit cards, which seems to be questionable.

It is also not clear where the 7.8 m Dutch hybrid cards come from. Based on a statement of the Dutch Central Bank, who is the originator of the Dutch country tables of the ECB-statistics, such hybrid cards are not existing in the Netherlands and therefore not being reported to the ECB. Somewhere on the way to the ECB they must have popped up, for whatever reasons.

**Even though in France obviously all UC cards are migrated to clear debit or credit cards, the "Lex France" is still relevant.**

The third category is missing: "debit and/or credit". However, this is not a theoretical construction. Such cards are popular in Finland, France and probably also in other Member States. For example, the Nordea Bank issues in Finland a so called "combination card". The cardholder can choose at the POS terminal whether to

Two conclusions can be drawn from above:

- we have no hard facts regarding market relevance,
- take ECB figures with a pinch of salt.

#### **Are all hybrid cards Universal Cards?**

First, the UC criterion might only be relevant for the hybrid card categories "debit/credit" or "debit/delayed debit" as consequence of the two diverging IF-caps according to IFR.

Second, the transactions are not distinguishable as debit or credit card transactions at least by the acquirer (the distinction by payment card scheme is not crucial):

*"The choices made by the cardholder are unknown to the payment card scheme and to the acquirer"*  
(Recital 25).

As a consequence, it would not be possible to apply the correct IF. If the decision "debit or credit" is made by the cardholder at the POS (provided the merchant accepts both categories), the transaction can be flagged correctly by using a specific button or by selection a brand which is permanently linked to the functionality (in case of co-badged cards). According Art. 10 Par. 5 (IFR), the card should be identified with both labels "debit card" and "credit card".

However, some issuers offer the cardholder the option to make the choice "credit or debit" before or after the moment of the POS-transaction. In this case, the choice made by the cardholder is not known to the merchant or its acquirer. How should the transaction be flagged? For such card portfolios the UC-criterion would apply: the transaction is a debit card transaction and the provisions on the debit card are relevant (e.g. optical and technical identification of the card as a debit card).

Outside France probably no attention was paid to the "French" UC-paragraph. Issuers in other Member States would be able to issue cards which are de jure UC. In this case the cards and their transactions are incorrectly labelled by the issuer as credit card and priced with 0.3% IF. These banks unintentionally violate the law.

However, "ignorantia legis non excusat". We will discuss such existing "credit card" portfolios in the German market in the next chapter.



**Issuers in other Member States could issue cards which are de jure UC. These banks unintentionally violate the law.**

The IFR should be reviewed by the Commission in June 2019 at latest, probably accompanied by a legislative proposal for amendments. We suggest to delete Art. 16 Par. 2 and to amend Art. 16 Par. 1 in order to get rid of the outdated specific French context:

*"For the purposes of this Regulation, in relation to domestic payment transactions that are not distinguishable as debit or credit card transactions by the payment card scheme payment service providers, the provisions on debit cards or debit card transactions are applied."*

Last but not least, we will check the translations ☺

# IFR: Violations by German card issuers?

(hg) As a consequence of the lowering of Interchange Fees for consumer debit and credit card transactions by Regulation (IFR), the PSD2 prevents surcharging these transactions by the merchant (Art.62 par. 4). This surcharging prohibition is in force after implementation into national law, since January 2018 at the latest. In Germany the "Wettbewerbszentrale" (competition center of the German industry) installed a complaints office for consumers. Since January about 200 complaints have been registered. In some cases the Wettbewerbszentrale initiated legal proceedings against merchants.<sup>2</sup>

At the end of July 2018, the Payment Systems Regulator (PSR) in the UK announced the start of a market review of the UK acquiring business.<sup>3</sup> The RPS says, "*the concerns raised with us that acquirers are holding on to the savings they made from the IFR interchange fee caps could indicate that some merchants – especially smaller merchants – are suffering significant harm because competition in the supply of card-acquiring services is not working well.*"<sup>4</sup>

It seems to be that the **acquiring side** of the market is increasingly in the focus of regulators. They are examining possible violations and not-intended negative effects of the IFR. But what about the **issuing side**? For the moment the authorities seem to be inactive. But such a laissez-faire policy of the local competent authorities is explicitly ruled out by the IFR:

*"Member States shall require the competent authorities to monitor effectively compliance with this Regulation, including to counter attempts by the payment service providers to circumvent this Regulation, and take all necessary measures to ensure such compliance."* (Art. 13 Par. 6 IFR)

Until now, we are not aware of any actions of Member State authorities against violating issuers. Merchants and acquirers should be alerted, because regulators probably need time to get used to their new surveillance activity. However, in Germany some action (by the BaFin as the competent authority) would be appropriate.

## Our Comment:

Let us start with the most obvious suspicion of violation.

A small, but very innovative digital bank issues a card with two brands: Mastercard and Maestro. According to the agreement between issuer and cardholder, all transactions are directly and immediately debited to the current account. No doubt: all transactions, regardless of the brands used, are debit card transactions according the IFR. However, the card is visually marked with "credit/debit" and the Mastercard transactions are prized with the credit card IF of 0.3%.

The **second case**: a leading remote bank offers its standard current account product in combination with two cards, the domestic debit card "girocard" and a Visa card. The number of Visa cards issued by this bank is estimated at more than 2 million. In its terms of service the bank states: *"purchases made with the card will be debited to the card-linked current account with a delay of 3 days after the date of receipt (booking day)".*

As we analyzed in part 1 of this report, such a card (and its transactions) would be a delayed debit card according to the ECB-definition, but not a credit card according to the IFR. The crucial criterion of the legal definition

is missing: a pre-agreed specific calendar month date for settlement. Purchase transactions with this card should be flagged as debit card transactions according to the IFR. However, the card is marked as being "credit" and consequently with a price label of 0.3%.

The **third case** is more challenging.

The case is related to some banks, which are issuing co-branding cards, branded with Visa or Mastercard, in cooperation with partners in transportation, retail etc. In co-branding card business, the cardholder has usually its current account at another bank. In most cases, the card product is constructed basically as delayed debit card, like most of the Visa and Mastercard issued in Germany. The settlement (in full) is once a month at a fixed calendar day.

However, several card issuers are offering the possibility of a transfer of funds to its card account to create a positive balance. In this case, the funds in the card account are from a legal point of view bank deposits. Depending on additional functionality offered by the bank (e.g. credit transfer service), the account would thus be transformed into a current account, or at least to a payment account.

## The probably unjustified IF-revenue would be about 10 m Euro p.a.

The motivation of the cardholder for cashing-in to his card account could be an attractive interest rate, a higher card spending-limit (which would make sense if he planned extraordinary purchases on holiday etc.) or a lower fee for ATM-transactions. The issuer could set a limit for crediting the account (e. g. 30,000 Euro). If the card-related account shows a credit, the card transactions are directly and immediately debited to this account until the credit balance is zero. Without topping-up by the cardholder, further transactions

would be cumulated and settled in one amount at the specific calendar date. The hybrid card could be categorized as "debit/delayed debit" or more precisely as "prepaid/delayed debit".

Are these cards "Universal Cards" (see part 2 of this Report) from a legal point of view?

As cardholder I transferred 500 Euro by credit transfer to my card account (with zero balance) during the day. The same evening, I will pay a bill of 500 Euros at the restaurant after having invited my friends. The transaction will be debited the day after directly to my pre-paid card account. The transaction is definitely debit and should be flagged with 0.2%. If I don't fill up my account, my card transactions of the next days will be credit transactions, to be settled at a specific calendar date. I could even shift my cumulated not-settled transactions of the past into debit transactions, if I cash-up my negative balanced card account.

The issuer would see my account-related activities, which determine the legal status of my transaction, before or after the transaction occurred. The transactions could not be distinguishable as debit or credit card transactions by the acquirer. All the transactions made by these UC are in my opinion subject to Art. 16 Par. 1 IFR and should be prized as prepaid and therefore as debit card transactions (0.2%) at least for domestic transactions.

It should not come as a surprise that all issuers of these co-branding cards have marked these cards as credit cards with a 0.3%-revenue for each purchase transaction.

Besides the co-branding segment, another leading remote bank and card issuer in Germany (not the bank of case 2) is offering the prepaid facility (with an attractive interest rate of 0.2%) to its not-co-branded "credit" cards too.

### What could be the consequences?

The total number of credit card issued in Germany, which are - according to the IFR - legally debit cards is roughly estimated at 7 m cards with a yearly domestic sales volume of approx. 10 b Euro. The probably unjustified IF-revenue would be about 10 m Euro p.a. (0.1% of 10 b Euro).

This amount is intended to wake up German acquirers and merchants. If the BaFin as the competent authority would follow our conclusions, the affected issuers

would probably change their card products to maintain the 0.3%. I guess, the prepaid facility of the UC is not a crucial card feature.

The bank of the second case (see above) could change its settlement date to every odd or even day (instead of 3 days after booking day), which would still be a "near-debit card", however legally a credit card, compliant with the IFR.

Merchants could consider regression claims for the period between December 2015 and today. Acquirers with blended rates in their merchant service contracts would enjoy windfall profits if the card issuers are urged to revise the applied IF.

Last but not least:

Somebody could ask, why do we have this misery of diverging IF rates for debit and credit card transactions? Remember, it was the result of negotiations between the Commission and the two leading 4-party card schemes Mastercard and Visa. In retrospect, the two rates were justified by the so called "Merchant Indifferent Test" (MIT). However, the outcome of these cost studies were not convincing (see our Report of February 2014).

**Notes**

- 1 <https://sdw.ecb.europa.eu/servlet/desis?node=1000004051>
- 2 [https://www.wettbewerbszentrale.de/de/aktuelles/\\_news/?id=3037](https://www.wettbewerbszentrale.de/de/aktuelles/_news/?id=3037)
- 3 [https://www.psr.org.uk/psr-publications/consultations/mr18\\_1.1\\_draft\\_tor\\_card\\_aquiring\\_services](https://www.psr.org.uk/psr-publications/consultations/mr18_1.1_draft_tor_card_aquiring_services)
- 4 RPS: Market review into the supply of card-acquiring services, draft terms of reference, July 2018, p. 5.

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