In this issue:

1. Denmark: Domestic card scheme under pressure?
2. Update of Reg. 924: Card issuers, wake up!

Contents

1. Denmark: Domestic card scheme under pressure?

Payment card observers expect growing competition for the traditional card schemes at the POS and in e-commerce by so-called "alternative payments": non-card based payment instruments, which are directly linked to the bank account. Based on the current figures of the Danish domestic debit card scheme "Dankort", our guest author Henning Jensen analyses the threat for the incumbent card schemes.

2. Update of Reg. 924: Card issuers, wake up!

The proposal for amendment of the Regulation 924 on cross-border payments (as proposed by the Commission in March 2018) just enters the legislative trilogue-process after the Council and the European Parliament have expressed their positions. These amendments include the requirements of price equality for non-euro transactions and price transparency at the POS and ATM for currency conversion services (DCC). The Council improved the initial proposal of the Commission regarding technical and commercial feasibility of DCC in June 2018. The card industry was reassured.

However, the latest position of the European Parliament is anything but re-assuring. It suggests extending the equality of charges for domestic and cross-border payment transactions to all XB-payments in the EU - including transactions in domestic currencies of the Member States (yearly negative revenue effect of approx. EUR 1 billion). In addition, it considers card issuers (besides DCC-providers) as the basic providers of currency conversion services at the POS and ATM. Issuers should make prices and the applied exchange rates transparent for each transaction in foreign currency - prior to its initiation. A trilogue compromise between the contrary positions of the Council and the Parliament is hard to imagine.

Denmark: Domestic card scheme under pressure?

We invited Henning N. Jensen as guest author. Henning is since 2004 owner and managing director of the payment consultancy PlusCON, our Danish EPCA-member in Copenhagen.

He was General Manager in FDB/Coop Denmark 1997-2003, CEO in Danmont Ltd. 1991-97, Vice President for Sales and Innovation in PBS/Nets 1984-91 and on overseas assignment for East Asiatic Company in Saudi Arabia and Thailand 1977-83.
He is educated with a Master in Economics and Political Science and have completed Executive education at Stanford, USA and INSEAD, France. He has also been appointed to several Danish Governmental committees on Payments.

(hj) There are several statistical sources which indicate that the local Danish debit card scheme "Dankort" is weakening, despite the enormous success since it was launched in 1983.

Today the scheme processes 1.3 billion transactions in Denmark, a country with 5.8 million inhabitants. Thereby it is one of the most utilized debit card schemes in the world with app. 226 transactions per inhabitant per year.

However, recent statistics from the Danish Central Bank have shown decreasing growth (see Table 1).

Table 1 Growth in transactions using the Danish payment card Dankort in Denmark

Per cent, year-on-year	Q1 2017	Q2	Q3	Q4	Q1 2018
Total	7.9	8.5	8.4	7.5	-0.1
E-commerce, etc.	25.4	30.5	27.0	20.0	- 19.7

And the latest monthly statistics from Nets - the Dankort scheme owner - about the Dankort use in October is :

	2018	2017	Growth
Total number of payments (in mill.)	107.1	105.2	1.85%
Total turn over (in billion DKK)	29.4	29.5	- 0.30%

Our Comment:

On the surface, the changes in these statistics might look strange and could be explained as "technical changes". But these two sets of data are worth investigating a little bit further, since they reveal quite a change in the underlying infrastructure.

First of all it must be mentioned as a fact that the Danish economy and consumer confidence for the time being is very robust and positive, so there should have been a considerable growth potential in both the POS and e-commerce figures.
The negative tendency in the figures must therefore be explained by other factors like:

1. Since Q4 2017, the Danish mobile P2P payment service “MobilePay” (launched by Danske Bank in 2013) has been a huge success and has today a monopoly in mobile P2P payments) slowly converted the payments from card scheme bases payments to instant account-to-account based payments, whereby Dankort has “lost” transactions. Furthermore, MobilePay has had particular success with e-commerce transactions which often have a larger value than POS-transactions, and this “hits” the turnover at Dankort more than the number of transactions.

2. Since January 1, 2018 it has no longer been legal to surcharge international debit and credit card transactions in Denmark. Before 2018 this surcharging has limited the Danes use of international cards, but now these cards are increasing their use in retail outlets and in e-commerce. This is a “double hit” to Dankort, since Dankort loses transactions and these transactions are very often of a higher value.

3. Furthermore, new payments wallets, like Apple Pay and Google Pay, have been launched in Denmark under considerable PR-campaigns. Even though they might not have been that big a success, these new products are using account-to-account instant payment systems, which are harming Dankort growth.

Conclusions:

The payment card market is breaking up. New products are launched and the old card payments systems are under attack.

The greatest challenge and change might be coming from the new mobile payment services, which are using account-to-account instant payment systems.

The success of contactless payments in Denmark (Dankort now has over 60% of all POS payments as contactless) may strongly limit the success of mobile payments, but there is no doubt that as services like MobilePay get better acceptance in retail outlets, this will further limit the growth potential of Dankort.

Still, with a growth rate of 1.85% per month circumstances are not too bad for Dankort and the Danish card scheme will continue to fight fearlessly for its market leader position. But there will be casualties. This year Diners has already announced that they are withdrawing from the Danish market. Who is next?

Update of Reg. 924: Card issuers, wake up!

(hg) In our report of May 2018 (Issue 2-3) we commented in detail on the European Commission's proposal to amend Regulation 924 on cross-border (XB) payments of March 2018. The core element of the regulation that has existed since 2001 (Regulation 924 replaced Regulation 2560) is the prescribed equality of charges for domestic and cross-border payment transactions in euro. Currently, approximately 44% of all cross-border transactions in the EU (according to Commission calculations) are affected by this regulation. Keep in mind: 90% of the relevant XB transactions are card payments (POS/ATM). Regulation 924 will therefore mainly affect card payments!

The proposed amendments currently under discussion relate to two areas:

1. Price Regulation of charges for cross-border transactions

The first proposal includes the extension of price regulation to euro transactions initiated by payers from the eight remaining non-euro member states (equality of charges with domestic payments in local currency). This extends the regulation of fees to a further 28% of cross-border transactions. In our commentary, we compared the intended advantage of a reputational benefit for the Commission with the serious disadvantages of price regulation for the market. Our viewpoint: price transparency and competition would be better than hidden prices and thus less competition. Unlike the Commission, we continue to believe in the market mechanism. We have also shown that the changes will mainly affect the card business of UK issuers. Depending on which Brexit-agreements are made for the maintenance of the European passport for British PSPs, this effect could fizzle out.

2. Price transparency for currency conversion services

The second proposal comprises a Europe-wide uniform regulation concerning currency conversion services (CCS), which will be offered in particular at the POS or ATM (keyword: DCC; Dynamic Currency Conversion). In our former Report we discussed the understandable criticism of consumer organisations, the technical feasibility of the required price transparency at the POS or ATM, and the interests of acquirers to get a bigger slice of the cake.

In the meantime, the legislative process at EU level has progressed further. Much has happened since the first draft of the Commission (March 2018). Both the Council (presidency compromise in June 2018) and the European Parliament (November 2018) have published their positions.[1] The DCC issue is at the centre of the discussion. Trilogue discussions are currently underway. The EP continues to assume 1 January 2019 as the date on which the regulation is to be applied. In our opinion, this is very unrealistic, since the positions of the three instances are far apart.

Our Comment:

What are the most important discussion points for both topics?

Price Regulation of charges for cross-border transactions

The overall vision behind Regulation 924 is a borderless Europe-wide efficient payment infrastructure and payment market with one currency, where the terms "cross-border payment" and "currency conversion" have disappeared. All payments would be "EU-domestic" and denominated in euro. The existence of the border of a Member State (MS) could no longer be a justification of different charges for payment transactions. The extension of the principle of equal charges for domestic and XB payment transactions to all cross-border transactions denominated in euro or in the remaining national currencies within the whole EU is only a matter of time.

This far-reaching option has been discussed in the run-up to the Commission's proposal. However, when deciding to extend Regulation 924 to the non-euro zone, the Commission limited the principle of equal charging to XB euro transactions (excluding other MS currencies). This restraint has been explained by arguments of political feasibility of the proposal.

The existing Regulation 924 is covering 44% of all XB transactions, the new proposal of the Commission would include another 28%. The next step of covering all MS-currencies - envisioned by the Commission - could be taken in a few years (2022 or later). All that is required is yet another amendment of Regulation 924. XB transactions in other non-EU currencies (like USD, CHF etc.) will still be out of scope. But such transactions account to only about 10% of the XB transactions within the EU.
It is interesting to see that the Commission predicted in March that the European Parliament (EP) will not be satisfied with this step-by-step approach.[2] Exactly that has been observed. While the Council leaves the restriction to euro payments unchanged, the EP demands the extension of price equality to all currencies in the EU. In its draft report of June 2018 the EP agrees with the extension as necessary step in the future "*which must be preceded by a thorough analysis of the real effects of the provisions proposed hereunder as well as a detailed impact assessment.*"

The first issue of the price equalization could tackle the second issue of the proposal related to the currency conversion services.

It could be the collateral damage of the exceptionally hot and dry European summer that the Committee on Economic and Monetary Affairs (rapporteur: MEP Eva Maydell) changed its mind by demanding the extension to all EU currencies without a "*thorough analysis*". The main drivers of this momentous amendment are conservative MEPs from Poland.
A few initial thoughts about the impacts:

Card issuers in the whole of the EU will lose revenues stemming from charges for card transactions at the POS and ATM whenever the transaction currency is not the currency of the card account (except for charges which are related to the CC service). All intra EU XB non-euro card transactions of all issuers would

Requirements for transparency for CCS

	Commission 3/18	Council 6/18	Parliament 11/18
Transactions (€ or MS currency)	XB	XB & domestic	XB
Type of transaction	no differentiation	no differentiation	differentiation between card-based transactions and credit transfers
CCS offered at	in particular: POS, ATM and online payments	POS & ATM	POS & ATM and "context of credit transfers"
Obliged parties	PSPs of the payment service users (issuer and other CCS-provider)	CSS provider, which is not the PSP of the payer (= issuer)	CSS provider (issuer & "alternative" CCS provider)
Price transparency	X-rate applied foreign x-reference rate total amount of all charges for cc	X-rate applied variable charges (expressed as %-difference between x-rate used and the latest available ECB X-rate) all fixed charges as single amount per transaction	for card-based transactions: total amount of all charges for cc (expressed as %-difference between x-rate used and the latest available ECB X-rate and as total amount)
Implementation of price transparency	DEF of regulation + 36 months	deleted	deleted
Additional requirements for card issuer			cardholder option of blocking of CCS offered by alternative providers (which could be changed easily)
Other requirements			payment in local currency should always be available
RTS	to be developed by the EBA for transparency at POS and ATM	deleted	deleted
Price cap	set by EBA as maximum amount for all CCS charges during transitional period	deleted	deleted
Transitional period	period between DEF of RTS and DEF of transparency requirements	deleted	deleted
To apply from	1 January 2019	DEF of regulation + 6 months	1 January 2019

Abbreviations:

CCS = Currency Conversion Services
DEF = Date of entry into force
EBA European Banking Authority
XB = Cross-Border
X-rate = Exchange rate
MS = Member State
PSP = Payment Service Provider
RTS = Regulatory Technical Standards

be affected. The charges are up to 2.9% (e.g. in the UK) of the transaction amount (not including any income from currency conversion). Based on average charges, the total loss of revenue can be roughly estimated at a value of EUR 1 billion. These charges are paid today by consumers paying for goods and services outside of their home country (e.g. tourists). Tomorrow all cardholders would probably pay additional annual fees compensating the loss of their issuers as result of the price regulation. A better and fairer result?

Another impact:

Even without extending the price equality to non-euro transactions (as required by the EP), the amendment of Regulation 924 will affect only charges of XB card transactions where the amount of the transaction will be converted into another currency. If the fees of the card issuer will become zero or very low, the currency conversion service of a third party (DCC) at the POS or ATM will become less attractive. If the issuer fee for XB- transactions (with currency conversion) is zero and transactions are converted at a reasonable exchange rate, DCC providers have no business case in a market with "enlightened" consumers. The first issue of the price equalization could tackle the second issue of the proposal related to the currency conversion services. Is it part of the hidden agenda of the regulators?

The EP adds an interesting issue to the discussion regarding access of PSPs to the interbank clearing and settlement systems. Based on the figures of the Commission´s Impact Analysis (March 2018), the EP states that 80% of the XB payment transactions initiated in the non-euro zone are denominated in euro. A reason for the relatively high charges could be the limited access of the PSPs in these countries to the euro-based interbank clearing schemes TARGET2 and STEP. The EP requires (in a new recital):

"Therefore, the authorities managing the TARGET2 and STEP systems, namely the ECB and the EBA, should facilitate access to those platforms for payment services providers across the Union, regardless of whether or not the payment service providers are located in the euro area."

According the rules of these systems, currently only credit institutions can participate directly. Payment institutions and e-money institutions have no direct access as participants. Most of the interbank payment systems are excluded from the access right as required in Art. 35 of the PSD2. The non-bank PSPs need the clearing account of a partner bank as bridge to the interbank system. These bridges are usually not toll-free. Based on the experiences of these "second class" PSPs, many credit institutions put additional obstacles on the way to the bridge. This is surely a competitive disadvantage for the non-bank PSPs. However, the question is not euro-zone versus non-euro-zone as the EP is indicating. The essential criterion is the status of PSPs: bank or non-bank. In addition, the EP amendment is not explicitly demanding direct access for all PSPs.

The Commission´s proposal is not in line with Article 59 of the PSD2

Price transparency for currency conversion services

According the initial proposal of the Commission, the price transparency for CCS at the POS or ATM is required for both providers: the card issuer and the alternative CCS provider (acquirer or other provider; usually designated as DCC). Otherwise, the cardholder would not have the required transparency, which allows "*for a quick and clear comparison between those different currency conversion options*" (recital 5). This requirement is not in line with Article 59 of the PSD2, which ultimately is the basis for the new rules of Reg. 924:

"Where a currency conversion service is offered prior to the initiation of the payment transaction and where that currency conversion service is offered at an ATM, at the point of sale or by the payee, the party offering the currency conversion service to the payer shall disclose to the payer all charges as well as the exchange rate to be used for converting the payment transaction." (Art. 59 (2) of the PSD2).

The cited article is clear and unambiguous: only the

Time for card issuers to wake up!

DCC seems to be no longer only an acquirer topic.

party which is offering the CCS prior to the initiation of the payment transaction should deliver price transparency. Referring to this article of the PSD2, the amendments made by Council remove the ambiguity of the Commission´s proposal. The application of the transparency requirements is only relevant for the CCS provider, which is not the PSP of the payer (issuer).

However, the Council did not consequently delete the requirement of the clear and quick comparison of both alternatives at the POS or ATM of recital 5. The assumption of a cardholder who knows the issuer charges and the reference exchange rate to be applied by the card issuer after the transaction, is not very realistic. By the way, if the amendments of the Reg. 924 will be realized, as suggested by the EP, the issuer charges would normally be zero. This would free the cardholder's mind from such mental exercises at the terminal.

The question who are the obliged parties is likely to be the main issue of dispute between the trilogue parties.

The Council has deleted the necessity for the EBA to develop regulatory technical standards and the setting of a maximum price for CCS during a transitional period as suggested by the Commission. The Council also makes it clear that the requirements apply not only to authorized/registered PSPs but to all CCS providers. Alternative CCS providers should offer the pricing information to the cardholder at the POS or ATM in a clear and comprehensible manner:

- the amount of the transaction in the currency of the payer's payment instrument,
- the exchange rate used for converting the payment transaction,
- all the variable charges expressed as a percentage difference between the exchange rate used for converting the payment transaction and the latest available reference exchange rate of the ECB,
- and all fixed charges as a single amount per transaction.

That seems to be a realistic and acceptable requirement in contrast to the latest position of the EP (November 2018). Supplementing the Commission's original proposal, the EP makes it clear that there are at least two committed parties offering CCS in case of card-based transactions: the issuer and the "alternative" CCS provider, who is defined as

"alternative currency conversion services' means currency conversion services disclosed by a payment service provider as being available in relation to a non-initiated cross-border payment transaction, including where those services are provided by an entity other than the payment service provider, its affiliates or a non-regulated provider."

Both CCS providers should be obliged parties regarding the required transparency at the POS and ATM according to the position of the EP. "*That information shall be presented simultaneous for all currency conversion options*". If there is no alternative CCS provider, only the issuer is offering the CCS. The issuer is obliged to convert the local currency, otherwise the transaction cannot be cleared and settled. The requirement postulated by the EP, every CCS provider should "*always provide the option of payments in the local currency*" is superfluous regarding the existing rules of the international card schemes. Even in this case (lack of alternative CCS provider), the issuer should always provide price transparency at the POS or ATM by providing the total amount of all charges according the amendments suggested by the EP!

The question who are the obliged parties is likely to be the main issue of dispute between the trilogue parties. Here, a compromise is hard to imagine.

Depending on the outcome of the trilogue-process, it could be an option to deliver CCS only to American, Chinese and other tourists paying with cards issued outside the EU.

Anyway, if the issuer fees for XB transactions will come down to zero within the EU (now or in a few years), it will be a hard job for DCC providers to offer lower prices for currency conversion for EU cardholders compared to the charges of the issuers (if they do not use the loophole of relabeling the XB charges as CC charges).
DCC (CCS) seems to be no longer only an acquirer topic. The EP calls for further commitments of issuers. Issuers should provide cardholders the option of blocking the use of currency conversions services offered by alternative CCS providers, which should be easily changed "*through the means of technical tools put at their disposal*" by the issuer. The EP obviously thinks about a button on the issuer´s website, where the cardholder simply can change his mind to opt for DCC or to exclude this option after issuance of the card. How should this information reach the POS or ATM prior to the initiation of each payment transaction?

All in all there are many tricky issues. Substantial revenues are at risk. But until now, we don´t see any lobbying activities of card issuers regarding Reg. 924. The legislative procedure of Reg. 924 is already at an advanced stage of development. Time for card issuers to wake up!

Notes
1 All the in this article cited documents can be downloaded at: https://eur-lex.europa.eu/legal-content/EN/HIS/?uri=CELEX:52018PC0163
2 See Executive Summary of the Impact Assessment (SWD(2018) 85 final)

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