Response to the Green Paper of the European Commission „Towards an integrated European market for card, internet and mobile payments“ (of 11 January 2012)

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Preliminary remarks

PaySys Consultancy is a Germany based neutral and independent consultancy firm specialised in card business and retail payment systems, operating in the European market since 1993. Our comments to the EC Green paper are neutral, not representing the dedicated interests of a side of the payment market or a group of stakeholders. They are only based on the core principals of a free market economy, driven by competition, innovation and less regulation (if necessary) and our knowledge and expertise of the card market. Our comments are covering a selection of the questions of the EC stated in the Green Paper of 11 January 2012.

Questions 1 - 3

- *1. Under the same card scheme, MIFs can differ from one country to another, and for cross-border payments. Can this create problems in an integrated market? Do you think that differing terms and conditions in the card markets in different Member States reflect objective structural differences in these markets? Do you think that the application of different fees for domestic and cross-border payments could be based on objective reasons?*
- *2. Is there a need to increase legal clarity on interchange fees? If so, how and through which instrument do you think this could be achieved?*
- *3. If you think that action on interchange fees is necessary, which issues should be covered and in which form? For example, lowering MIF levels, providing fee transparency and facilitating market access? Should three-party schemes be covered? Should a distinction be drawn between consumer and commercial cards?*

Our Comment:

It is well known that shopping habits and payment habits of consumers are varying widely across member states. The same applies to the structure of the banking sector and retail sector in different member states. The balance of interests between issuers and acquirers (which is reflected in the interchange fee) is impacted by all of the above. These structural issues drive usage of cards in relation to issued cards and accepting merchants and the costs to accelerate the usage significantly. Even, if processing costs for card payments could be driven to a common European level via SEPA, the above mentioned structural differences

may persist. As card payments are a part of every day live, the overwhelming share of card payments is executed domestically i.e. by cardholders at their local merchants. Therefore in our view it is justified it to maintain dedicated MIF-rates for domestic payments. Only when an approach to set MIF is applied which focuses purely on processing costs (e.g. tourist test methodology), one could argue that differing domestic MIFs are not justified. However, we think that MIF should also reflect market dynamics as outlined above.

Legal clarity of course is of high importance for all stakeholders. However, any ruling which is clear but lacks a thorough economic justification may damage the card business in the long term. Also, too restrictive ruling causes particular risks of unintended consequences. Legal clarification should focus on procedures of establishing and setting MIF in accordance with competition law rather than on actual rates.

We do not think that action on interchange fee is necessary. In particular we are warning to focus on absolute MIF levels.

Questions 4 – 5:

- *4. Are there currently any obstacles to cross-border or central acquiring? If so, what are the reasons? Would substantial benefits arise from facilitating cross-border or central acquiring?*
- *7. How could cross-border acquiring be facilitated? If you think that action is necessary, which form should it take and what aspects should it cover? For instance, is mandatory prior authorisation by the payment card scheme for cross-border acquiring justifiable? Should MIFs be calculated on the basis of the retailer's country (at point of sale)? Or, should a cross-border MIF be applicable to cross-border acquiring?*

Our Comment:

Cross-border acquiring or central acquiring is common practice in both of the international bank cards schemes since the end of the 1990s. As far as we know also the three party schemes are centrally acquiring large multi-national corporates.

Obstacles to cross-border acquiring / central acquiring, if any, are in the field of terminal standardisation etc., an issue which is addressed in other sections of the green book.

Referring to No. 7 of the FAQ of the green paper, we think that statements like *"Furthermore, merchants can often not benefit from lower fees in other Member States as they cannot use the services of an acquirer established in another country. Finally, companies cannot appoint a single acquirer for their transactions across several countries, which would result in administrative efficiencies and cross-border competition on Merchant Service Charges (MCSs)."* are misleading. Actually, merchants ***can*** select acquirers from other countries to benefit from economies of scale (lower prices for the services of an acquirer).

We do not see a reason to facilitate further cross-border / central acquiring by any regulatory means as it is a proven business model since many years. Regarding interchange fee we argued above that domestic interchange - where "domestic" refers to the cardholder's home and the merchant site - is fully justified.

Questions 6 – 7:

- *6. What are the potential benefits and/or drawbacks of co-badging? Are there any potential restrictions to co-badging that are particularly problematic? If you can, please quantify the magnitude of the problem. Should restrictions on co-badging by schemes be addressed and, if so, in which form?*
- *7. When a co-badged payment instrument is used, who should take the decision on prioritisation of the instrument to be used first? How could this be implemented in practice?*

Our Comment:

Co-badging was part of the SEPA discussion as a model to achieve broader acceptance of a card by placing two brands - each as complement of the respective other brand - on one card. Particular for new schemes or schemes with only national reach, co-badging as a way to achieve European reach was considered. This model of co-badging is used by the European banking industry since many years whereas cards with national debit brands have been co-badged with an international brand. All considerations to regulate the issue of "application selection" or restrictive rules of schemes are originating from this discussion and focus on the issue of fragmented markets and entry barriers.

However, there is a second proposition for co-badging. For instance one could put a debit and a credit brand on a card and actually access two accounts via two brands on one piece of plastic. In this alternative co-badging model both brands on the card need not to be complementary by any means but simply serve different payment needs of the card holder. In some member states (e.g. Finland) this kind of card is already established in the market.

So we identified two compelling but different product propositions, which both make use of co-badging; and we cannot exclude that further propositions of co-badging will evolve. Both of the above mentioned propositions can provide value to cardholders and merchants and both models are proven and actually used. Obviously answers to questions 6 and 7 are completely different depending on which proposition for co-badging one has in mind.

Put it another way, any legal regulation in the field of co-badging bears the risk that an alternative product propositions which make use of co-badging (alternative to the one which is primarily addressed by the regulation) is negatively affected. We cannot decide which model would provide more value than the other and hence we are not able to balance potential assets and drawbacks of a regulation. Our personal view is that in a competitive environment the industry will find the right way to exploit the value which co-badging can provide and accordingly that no regulation is needed at all.

Question 13:

Is there a need to give non-banks access to information on the availability of funds in bank accounts, with the agreement of the customer, and if so what limits would need to be placed on such information? Should action by public authorities be considered, and if so, what aspects should it cover and what form should it take?

Our Comment:

In the question and the preliminary remark, non-banks are explicitly mentioned. However the issue applies to banks as well. Consider for instance issuing of decoupled debit cards. A bank offering a decoupled debit card presumably would have the same strong interest in some kind of information service as a payment institution offering a decoupled debit card.

Obviously an information service could provide several features:

- simple confirmation that an account exists,

- confirmation that a particular amount is available at a given point in time,
- information about account balance,
- authorisation and payment guarantee.

Depending on the features such a service would provide particular value and would facilitate the provision of various "decoupled payment services" from banks / payment institutions.

Up to 2006 the German debit card system offered a similar service (POZ): Network operators could request (for a small fee) whether a card was existing or blocked, but received no authorisation (payment guarantee) like in the electronic cash scheme. It appears that network operators developed advanced risk control capabilities which were superior compared to the poor information provided via POZ. In consequence the usage of POZ stagnated whereas usage of ELV was strongly growing. The service was terminated in 2006.

This brief example shows that the value of the above mentioned information service is a question of costs and value and ultimately of availability of alternative solutions for the potential users of the service. So, besides questions of security, risk and technical implementation, it is anything but obvious, how a compelling business case can be made.
Accordingly we rather see a demand than a need for such services. Also we do not see a case for intervention by public authorities.

Question 15:

Should merchants inform consumers about the fees they pay for the use of various payment instruments? Should payment service providers be obliged to inform consumers of the Merchant Service Charge (MSC) charged / the MIF income received from customer transactions? Is this information relevant for consumers and does it influence their payment choices?

Our comment:

The background of these questions is the concern of the EC that the micro-economic behaviour of the users of payment instruments (merchants and consumers) could yield to a macroeconomic sub-optimal result. *"The real cost of these payment services is often opaque, both for consumers and for merchants, which leads to higher payment costs in the EU*

economy." (Green Paper 4.2.). The main goal of the actions proposed under 4.2 (transparency and steering practices) is – in compliance with one of the core objectives of SEPA - the reduction of the total costs of payments in the economy.

Within this context the EC is using the expression "cost-effectiveness", "cost-effective pricing" (4.2. respectively Question 17) or "cost-effective electronic payment instrument" (Question 16). As result of this proposed **cost-effectiveness approach**, the most efficient payment instrument would be the instrument with the lowest total costs to the economy. *"Consumers are generally not aware of the costs of using specific payment instruments. This hampers competition between payment schemes and hinders market entry from cheaper card schemes."* (FAQ to Green Paper; Memo 12/6). *"Due to hidden costs, often the most expensive payment method is used and costs are indirectly passed to all consumers through increased prices. By contrast, an integrated and transparent market would steer consumers towards the most efficient payment instruments."* (1.). An example often mentioned is the usage of commercial cards, which is considered as an "expensive" payment instrument due to the higher MIF compared to other payment cards or the usage of cash.

But normally, cost-effectiveness is not only measured in costs but also in effects (gains, benefits or outcome)! A cost-effectiveness approach of economic assessment is only taken if it is inappropriate to measure the effects or benefits in monetary value, e.g. within health economics where health effects (benefits) of an intervention can be expressed in life-years gained. A narrow focus on costs solely – like the Commission´s view - is only adequate if the effects of the analysed products or measures are equally or slightly inferior.

This brings us to an important underlying assumption of the Commission, which is not explicitly mentioned in the Green Paper: ***each payment transaction is generating more or less the same benefit for all users***. The only effect is the transportation of an amount from payer to the payee. Therefore payment instruments in general appear to be considered by the Commission as **homogeneous** goods.

One could defend this assumption within the payment instrument categories of a core direct debit and credit transfer (without added values). A credit transfer service, offered by Bank A is - from a user´s point of view - more or less the same product as offered by Bank B. For homogeneous products distributed within a network, like water, gas or credit transfers,

competition is usually reduced to pricing. Competition by product features is possible, but usually not an automatic outcome of the market. The result of the EU end date-regulation (no. 260/2012) will be a de facto monopoly of the EPC systems for credit transfers and direct debits and no competition between two or more SEPA-schemes, although scheme competition would be viable and desirable.

However, the Green Paper is not focussing on direct debits or credit transfers but on card, internet and mobile payments. Within these market segments we undoubtedly do have **heterogeneous** products and there is intensive competition between payment schemes (e.g. American Express, MasterCard, Visa, Maestro, V PAY, PayPal, iDeal, Giropay, Sofortueberweisung, Clickandbuy, Paysafecard etc.). A true cost-effectiveness approach (if applicable here for economic evaluation at all) must consider both sides: costs and effects (benefits) of the users of these heterogeneous products. The cost-only approach of the EC is with a view to card, internet and mobile payments not appropriate and would lead to wrong conclusions.

To mention an example from another industry: The application of the cost-only approach for evaluation of the passenger transport industry would result in the preference of a walking or bicycle tour as cheapest way of transportation from A to B. Persons who are travelling by plane or car (or even within the segments, persons who are driving premium cars or are flying business class) will generate higher costs within the EU economy, like the users of “expensive” payment instruments…

More transparency (for consumers) of the costs by using specific payment instruments, which are allocated to other market parties (like retailers), will not or hardly influence the choice of the instrument which is based on a private cost-benefit-ratio of each user. In a competitive market (choice of products, free pricing, free contracting, etc.) every user (consumer and merchant) is free to decide on a specific payment instrument (using or accepting) or not. By using it, his individual cost-benefit-ratio must be positive. The consumer must conclude that the acceptance of a specific payment instrument will generate net-benefits to a merchant otherwise he is not willing to accept it. Vice versa the same conclusion would be correct.

So what is the additional value for consumer being informed about the costs of a specific payment instrument of a retailer? Why not also being informed about the benefits? With the same rational somebody could argue that the merchant should be informed about the costs (and benefits!) of the usage of a payment instrument by the consumer (e.g. annual fee of a credit card). It makes no sense and leads to useless data overload.

Question 16:

Is there a need to further harmonise rebates, surcharges and other steering practices across the European Union for card, internet and m-payments? If so, in what direction should such harmonisation go? Should, for instance:

- *certain methods (rebates, surcharging, etc.) be encouraged, and if so how?*
- *surcharging be generally authorised, provided that it is limited to the real cost of the payment instrument borne by the merchant?*
- *merchants be asked to accept one, widely used, cost-effective electronic payment instrument without surcharge?*
- *specific rules apply to micro-payments and, if applicable, to alternative digital currencies?*

Our Comment:

Due to the optional clause of the PSD surcharging can still be banned by payment schemes in several EU countries. Any surcharging, rebates and other incentives or disincentives generated by the use of a payment instrument should be generally authorised as instrument of each user and provider to differentiate their prices. It is an essential element of free pricing within a competitive market economy. There should be no legal limitations on surcharging or other incentives/disincentives like regulated in Art. 19 of the new Consumer Rights Directive. Once competition between merchants is working, it will prevent overcharging.

An exception of free surcharging for a “widely used, cost-effective payment instrument” will discriminate certain instruments from others and therefore impair competition. By the way, which instance would be able to indicate which payment instrument would be cost-effective? A market-steering committee of the EU or EPC? See our comments (Question 16) to the no-sense of cost-effectiveness approach of the EC, which is excluding the different effects (benefits) of payment instruments.