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## 1. Competition between debit cards schemes in Belgium
(by Robert Wastyn[1])

Introduction: Since 2007, the business model and the cost of acceptance of a debit card has been the basis for long discussions. Belgian issuing banks decided to migrate their entire debit card base carrying the Bancontact service to one single SEPA compliant brand, namely Maestro. Moving from a kind of 3-party system to a formal 4-party model had significant implications, and merchants saw the threat of increased prices because of the introduction of interchange (part of current 4-party business model). The merchant community heavily protested, resulting in the withdrawal of the banks' decision to move nationally to Maestro.

Current situation: Belgium has been regarded as one of the cheapest countries for debit card acceptance together with the Netherlands and Denmark. Since Atos Worldline (formerly Banksys) was the sole acquirer for their product Bancontact/MisterCash and also the issuing processor, there was no formal interchange set for domestic debit transactions. However there was another form of retribution for the issuers (5.6 cents per transaction).

The European Commission has, with the introduction of the SEPA & PSD rules, requested the markets to adapt the systems to allow competition to enter:

- allowing new acquirers and new issuers, without any barriers
- unbundling of services: splitting terminal services, acquiring services and processing services.

This required Atos Worldline to open up their network for new players.

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The new rules became effective in January 2009. The result is that an acquirer/merchant can now decide to accept a card under the Bancontact rules & conditions or under the international conditions (Maestro) since the card carries both services.

However, up to now, there still has been another barrier for Maestro acceptance: merchant pricing. Bancontact is priced at +-12 cent per transaction for the merchant. For a merchant to accept Maestro under the international rules the price was between 1,00% and 1.50% per transaction. The Maestro card had to be accepted under the intra-regional interchange, since there was no Belgian domestic fall-back interchange rate agreed. Now since last month, a fall-back interchange has been agreed between the Belgian banks and Maestro for Belgian domestic transactions, in- line with the current Bancontact/MisterCash issuer kick-back; namely 5.6 cent/transaction.

It will be published on the MasterCard website by the 1 July 2009, since this was one of the requirements of the EC DG Competition as part of the settlement agreement between both parties. This means another hurdle has been taken away which will allow to increase competition and to provide choice to a merchant.

### *Our Comment*

*Opening up domestic markets takes time and even if some barriers have been taken away, others will remain. In Belgium, there were a lot of barriers, since all processes related to cards were integrated into one system and one provider.*

*We have come already a long way.*

- *On the terminal side: the market is already open since a couple of years, but only two providers have been able to compete with Atos and have gained significant market shares.*
- *Only recently, merchants received the choice to process Belgian debit cards as Bancontact/MisterCash or Maestro cards.*
- *In the coming months (effective 1 July) the pricing of Maestro domestic will become competitive with the domestic solution.*

*It probably will make a difference for large international merchants who can start streamlining their debit card acceptance in different countries. But will a small to medium sized merchant understand the difference and have a real benefit?*

*Additionally, how is the Belgian national Maestro interchange to coexist with the new (interim) cross-border interchange of Maestro effective July 1 at a level of 0.20% (weighted average)?*

*There are two inconsistencies:*

- *It contradicts the principle that there is only one domestic market within the EU-zone.*
- *There is a price difference based on geography within the EU-zone: A higher price for intra-European transactions. It will have an impact on the “honour all cards rule” and the “surcharge rules”, since the merchant will be able to accept Maestro domestic cards, but refuse or surcharge Maestro international if there are price differences.*

*For merchants to accept Maestro under different conditions (domestic and international) with different pricing (if there is no bundling) will not be an easy message to pass. And what will the consumer perception be?*

*How will these domestic interchanges evolve in the different countries when the markets become more and more open? How can one sustain large differences between the EU cross-border interchange and the different applicable domestic interchanges?*

*We believe this situation makes it even more difficult to build an investment business case for issuers. You can make a decision based on today’s situation, but looking at this instable situation, this can change overnight, requiring you to take into account different scenarios. However, we are convinced that these differences will only be allowed for a limited period (our estimate: 3 years) by the EC.*

## 2. EU finds (temporary) compromise with MasterCard and sends Statement of Objections to Visa

MasterCard Europe reaches a new deal with the European Commission regarding its cross-border default Multilateral Interchange Fees (MIFs) for consumer credit and debit cards announced at April 1.[2] The new maximum weighted average MIF (effective from July 2009) are 0.3% for credit cards and 0.2% for debit cards, based on a new methodology.

The agreement is not just about prices. It also covers a wide range of other issues relating to the acquiring side of the market.[3] Merchants’ rights are further strengthened and acquirers will have to provide more information to merchants in the future. Table 1 provides an overview of the provisions recently agreed between the European Commission and

[2] See http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/515&format=PDF&aged=0&language=EN&guiLanguage=en

[3] See http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/143&format=PDF&aged=0&language=EN&guiLanguage=en

MasterCard. MasterCard says that the agreement is just an interim solution because it pursues its appeal at the European Court of First Instance against the Commission´s decision of December 2007 which found MasterCard´s MIFs to be illegal.

**Table 1: Main Elements of the Agreement**

| | |
|---|---|
| New rates | Credit: 0,3% (weighted average) |
| | Debit: 0,2% (weighted average) |
| The increases of acquirer fees of 2008 are repealed. | |
| Information | Acquirers have to inform merchants |
| | - that they may accept either MC or Maestro |
| | - that they are allowed to surcharge |
| Un-blending | Acquirers have to offer unblended rates |
| | - as an option as of 31. Dec. 2009 |
| | - as default as of 31. Dec 2010 |
| | ("default": unless merchants explicitly chose blended rates) |
| Surcharging | Differentiated rates per program are allowed.* |
| Processor choice | Option for merchants to have different processors for MC, MC debit, Maestro |
| Publication of rates | - cross-border MIFs |
| | - domestic MIFs |
| Commercial cards | Must be visibly identifiable by end 2010 |

*: MC consumer, MC commercial and/or Maestro

***Our comment:***

*For some observers, including PaySys Consultancy, the agreement comes as a surprise. The decision of the EU Commission from December 2007, in particular its heavy use of the example of "interchange-free" national debit systems, seemed to leave little room for compromise.*

*This compromise may become extremely important because market observers believe that these new interchange levels could be a benchmark for national anti-trust authorities regarding the far more relevant domestic MIFs. It also can be seen as the likely outcome of the proceedings against Visa (see next section). So, given that the European Court of Justice does not overrule the EU Commission's verdict against interchange fees, for the years to come, the April agreement could well define the level of interchange fees in the entire European Union.*

*The proposed weighted average of 0.2% for Maestro comes close to the price level implied by the Maestro SEPA interchange, announced in December 2006.*[4] *This "old" SEPA Maestro rate consisted of a two-part tariff with the following rates:*

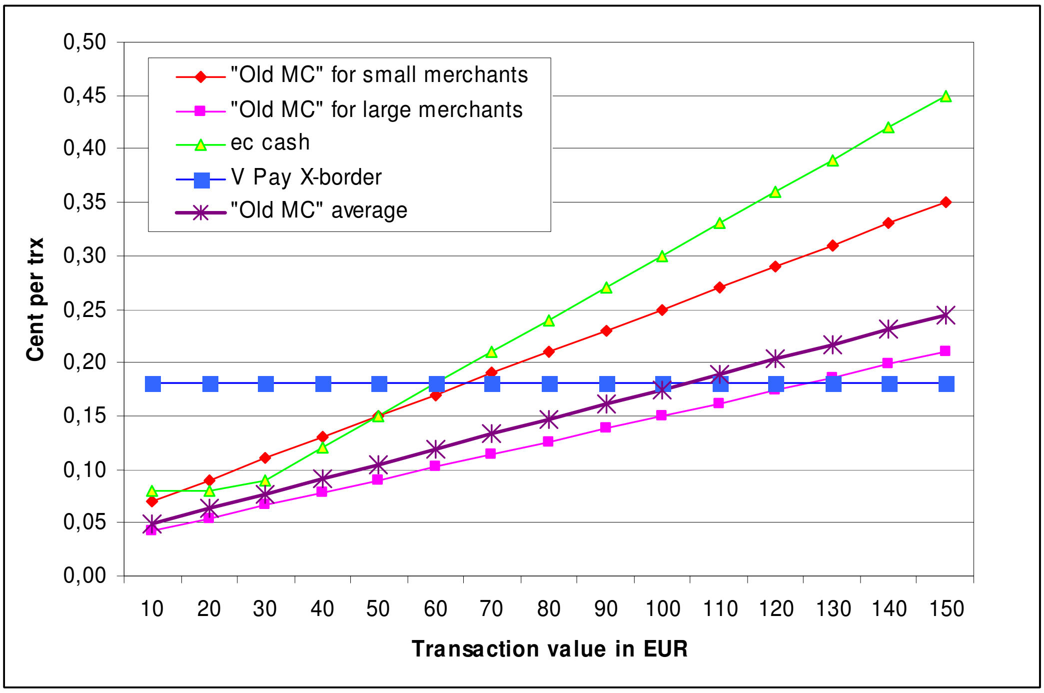
[4] See our SEPA Newsletter from Dec. 2006. The announced interchange rates were due to take effect in 2008. They were, however, repealed by MasterCard in May 2007.

| | ad valorem fee | fixed fee |
|---|---|---|
| small merchant | 0,20% | 0,05 |
| large merchant | 0,12% | 0,03 |

*Calculating the average percentage for a 50 EUR transaction (close to the EU average) yields 0.3% for small merchants and 0.18% for large merchants. We do not know the exact split of transactions between small and large merchants. However, large merchants usually have a big part of the market. For a 75-25 split between large and small merchants, the market average would be 0.21%. Thus, the new agreement basically re-instates the old Maestro SEPA interchange.*

*It is still open, however, whether the new fee structure will consist of a two-part tariff and if there will be different prices for large and small merchants. However, it seems unlikely that the model chosen in 2006 will be radically changed. Thus, it is likely that the debit interchange will consist of a two-part tariff with a fixed fee per transaction and a variable in per cent of the transaction value. So, MasterCard would come out in the middle between schemes like ec cash with an ad valorem fee of 0.3% and V-Pay which has a x-border rate of 18 cents.*

**Chart 1: Comparison of different interchange rates**




"Old MC": the Maestro SEPA interchange proposed in 2006

"Old MC" average: calculated assuming 75% large and 25% small merchants.

*Whatever, the precise fee structure, it is likely to be a threat for ec cash on the acquiring side. However, given that the MasterCard agreement will become a benchmark for European regulators, there will be pressure in Germany and other countries with higher rates, to reduce interchange to comparable levels.*

*The European retail organisation EuroCommerce criticized the ad-valorem price deal for debit cards of MasterCard. Its secretary Durieux says that there is no reason why fees should be expressed in a percentage of the amount of the transaction. Of course, the precise fee schedule is not yet known, but from a cost-based perspective, he is correct.*

*Another point worth mentioning is the slight interchange difference of only 10 basis points between debit and credit cards. In comparison with the past, this difference has diminished substantially. But given that both systems (debit and credit cards) will be based on EMV chip and PIN, the interchange-relevant costs of credit cards will come very close to the costs of debit cards which should be fixed per transaction! Traditional and historical differences between debit and credit cards will diminish!*

*The other provisions of the agreement will, first of all, require acquirers and processors to do some extra work. In particular, billing systems will have to be up graded. Whether and to what extent merchants will actually take advantage of unbundled billing is an open question. For many merchants, "card payment" is a commodity and they prefer a single price. Processor and acquirer choice sure is a good thing but whenever markets were opened up and dual acquiring was introduced, merchants opted in the opposite direction: both brands from one acquirer.*

*Surcharging has been allowed by MasterCard already before the April agreement. Moreover, with falling interchanges, the incentive to surcharge is declining.[5] However, the agreement states that merchants may also differentiate between different card programs. Since MasterCard also needs to make commercial cards identifiable, it will be interesting to see whether merchants will start surcharging expensive commercial cards.*

*Finally, MasterCard now also needs to publish national interchange rates – not just the EU x-border rate. This will be an interesting read for everyone with a stake in the card industry.*

## 3. Visa Europe: Unwelcome letter from Brussels

On April 3rd, just two days after the announcement of the MasterCard agreement, the European Commission sent a formal Statement of Objections to Visa Europe against its

5 Allowing surcharging and regulating interchange looks a bit like fixing the same (alleged) problem twice.

cross-border MIFs which could infringe European anti-trust rules.[6] Visa had an exemption deal with the Commission from 2002 until 2007. In 2008 Visa made further reductions from an average 0.7 to 0.61% for credit cards and 0.28 to 0.18 € for debit cards. However, the European Commission was not satisfied with these changes. Thus, in spite of recent optimism by Visa Europe that it would be possible to find an agreement with the Commission, the bilateral talks have not been successful.

Having received the Statement of Objections, Visa now has the opportunity to defend its conduct. After that, the EU Commission will make a decision. The Statement of Objections itself does not preclude the final outcome of the procedure.

***Our comment:***

*In our view it was always something of a mystery why Visa official thought that they might get a better deal than MasterCard. To be sure, the EU Commission is a "political beast". But it has to abide by the law and its decisions can be challenged in court. Moreover, it published a 242 pages long decision that set out the reasons for its decision. Thus, it seemed to be clear that Visa would get the same treatment as MasterCard.*

*Given the terms of the MasterCard agreement, it seems fairly straight forward what Visa will have to offer in order to escape a formal ruling. In the end, the Visa rates will have to settle at a comparable level, i.e. 0.3% for credit and 0.2% for debit (weighted averages!). If one wants to speculate, one could also see a potential for a temporarily higher interchange for V Pay, in order to promote its introduction as a new scheme. Whether this would help, is a different matter, though, because it would make things more difficult for V Pay on the acquiring side.*

## 4. French banks delay SEPA Direct Debit (SDD) by one year

The French National SEPA Committee has issued a statement that French banks will be able to offer SDD only by November 2010.[7] The Committee which is chaired by the French Banking Association and the Banque de France (the French Central

[6] See http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/170&format=HTML&aged=0&language=EN&guiLanguage=en

[7] Press release (in French): http://www.sepafrance.fr/files/Cte_nat_29_avril_%2009_-_Cque_presse.pdf.

Bank) cites the slow progress in PSD implementation in member states and the ongoing debate about interchange fees as reasons for the delay.

***Our comment:***

*Given the strong commitment of the ECB and the European Commission to an SDD start in November 2009, the announcement must be seen as a severe set-back. Particularly noteworthy is the fact that the Banque de France as co-chair of the French SEPA Committee is backing the announcement. Thus, one of the large members of the European System of Central Banks is not backing the ECB in its insistence of November 2009 as start date.*

*As an outsider one can only speculate about the motives of the Banque de France. One possible explanation is that the delay was the price to get the French banks to setting a date for the introduction of SDD: After all, not long ago, the French banks threatened to stop all investments into SDD.*[8] *So, from the point of view of the Banque de France it may already have been a success to get French banks to commit themselves. However, the commitment is not unconditional because the press release cites the need to clarify the consequences of recent interchange regulations. As a consequence, it no compromise on interchange can be found, SDD might be delayed even more. Thus, once again, interchange fees are the focal point of conflict.*

[8] See „SEPA headache of French banks“ in the Nov./Dec. 2008 edition of this newsletter.

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