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2. **Developments in SEPA Standardisation Efforts** **(by Gérard de Moura¹)**

The ISO 20022 Registration Authority has issued on its Web site (www.iso20022.org) the very first series of ISO 20022 card payment standards to be used between a merchant and an acquirer for card-initiated payment transactions².

EPASOrg is the developer and official submitter of this CAPE³ (EPAS) series of messages. EPASOrg promotes the widespread acceptance of the EPAS protocols, a series of standards to ensure interoperability between card acceptance and acquiring solutions, integrated retail and terminal management systems. The further deployment of common protocols is seen as a major milestone in the realisation of the Single Euro Payments Area (SEPA) in Europe. Cardholders, retailers, acquirers, issuers and technology suppliers will all benefit from this important standardisation initiative.

This said, the ECB in its last (7th) progress report on SEPA recognizes that, “*although the development of implementation specifications has been progressing, further efforts towards their broad implementation are necessary.*”

Comment

Several initiatives have been active for years to promote possible European standards in different domains (card-to-terminal, terminal-to-acquirer, acquirer-to-issuer, and certification

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² Source: EPASOrg press release – November 18, 2010.

³ Card Payment Exchanges.

and type approval). However, it remains unclear whether these standards will be enforced or even supported by Payment Schemes throughout Europe.

As noticed by the ECB in its latest report, implementation of emerging standards is not planned by any Scheme, neither a well-established domestic Scheme nor an emerging pan-European Scheme. When EU authorities are calling for standardisation in Europe, they deliver a mid-term vision where the implementation of common specifications would have lowered the global cost of payment systems. Possibly so. But in the meantime, these new standards will clearly draw additional costs. The move from ISO 8583 so-called bitmaps to XML messages will clearly bring flexibility in the message implementations. Depending on the estimates, it will also multiply by 5 to 10 the volume of exchanged messages. In other words, payment systems would have to increase their bandwidth to offer almost the same service: the business case is at least arguable!

The EPC, through the SEPA “Cards Standardisation Volume”, is endorsing the standardisation objective of the SEPA “requested” by both the Commission and the ECB. But, the strength of the standardisation efforts is arguable too: resources are disparately assigned by the industry to such initiatives and target dates are moving with time. Part of the industry is also disputing the relevance of some technical options (e.g. XML for the Acquirer protocol) or the financial consequences of the security certification framework. To tell the truth, an analysis of the efficiency of a “strong” standardisation in payment systems provides conflicting conclusions. With respect to the card-to-terminal interface, the EMV standard has widely proven its ability to bring both interoperability and competition at a worldwide scale. A similar example is missing when considering protocol implementations. Countries where acquiring protocols are implemented in a unique harmonised way, like France, Belgium, Portugal and a few others, have never been regarded by the Commission as examples of a competitive market. On the opposite, the US market is said to be highly competitive in the acquiring business, and there is no protocol standardisation at all in this domain!

However, standardisation is a way of driving the convergence of the technology in a market and thus to favour interoperability. To that extent, the endorsement of EPAS CAPE messages by the ISO 20022 authorities denotes a significant progress towards a European (and eventually worldwide) harmonization of payment protocols. But such a standard does not address implementation issues. In the “Volume”⁴, the EPC indeed states that “[...] EPC

⁴ Version 4.0 - 2009-12-18 – Page 6.

standards will represent foundation stones on which market participants will be able to develop implementation standards to meet the specific needs of the various market segments, and allow for competition.” *Market players shall understand the consequences of such a sentence: there could be several (many?) implementation “standards” which would be market-driven.*

So there is clearly no role claimed by the EPC in implementation issues. And thus, it is hard to foresee an EPC role with respect to functional certification of implementations. In such a context, interoperability is likely to be at stake. Furthermore, Payment Schemes are willing to be SCF-compliant and therefore have been or are unbundling their infrastructure. This may prevent the Schemes from mandating any implementation standard, although the landscape has not changed so far and domestic barriers are still in place.

On the opposite, the desire to carry out pilots or proof-of-concept projects implementing new standards happens to have emerged very recently. A meaningful example of such proof-of-concepts is the OSCar (Open Standards for Cards) project, where the German ZKA and the French Cartes Bancaires have teamed up to initiate a consortium. OSCar will provide a payment terminal implementation combining SEPA-FAST (“Financial Application Specification for SCF Compliant EMV Terminals”⁵) and EPAS protocols to address the requirements of both the German and French Schemes, and beyond. The consortium also intends to implement a terminal certification process consistent with the certification infrastructure being considered in the SEPA “Cards Standardisation Volume”. Considered as a market-driven implementation, such an initiative may be paving the way to a European harmonisation of card acceptance and should be closely considered.

Security certification is also under scrutiny with an additional European initiative covering “Open standards for Security and Certification” (OSeC⁶). Although disputed by several players, it is again an initiative aiming at concretely implementing standards.

So there is still a long way to go and the destination is not (yet?) clearly defined. But further developments are expected soon and many actors are on the road again.

⁵ Standardisation initiative from the CIR (Common Implementation Recommendations) Technical Working Group, an open standardisation initiative of EMV implementers in Europe (www.cir-twg.org).

⁶ OSeC (www.open-standards.eu).

3. EU Commission Proposal for an End-date Regulation

On December 16, 2010 the EU Commission has published a proposal for a Regulation “establishing technical requirements for credit transfers and direct debits in euros”.⁷ This Regulation contains end-dates for schemes that are non-compliant. For credit transfers the proposed deadline is 12 months after the entry into force of this Regulation, for direct debits it is 24 months. As the Commission points out *“the adoption delay means that the stakeholders will have approximately 30 months to prepare for migration to SCT and 42 months to migrate to SDD from the date of adoption of the Commission proposal”*.

Compliance criteria are listed in the Annex of the Regulation. They contain standards like IBAN and ISO 20022, rules such as that there may be no minimum amount and that schemes may limit the maximum to below EUR 1 billion, information that has to be provided by the parties involved and contained in the payment message. In general it seems to be tailored to SCT and SDD but does not name any of these schemes. Thus, there is no explicit obligation to use SCT and/or SDD.

The proposal contains a reachability clause for both, credit transfers and direct debits. The reachability obligation for direct debits contained in Regulation (EC) No 924/2009 is thus integrated into the new Regulation.

Multilateral interchange fees for standard direct debit transactions are prohibited. But there may be multilateral interchange fees for transactions that cannot be properly executed (“R-transactions”). Such interchange fees have to be cost-based.

The Proposed Regulation does not only apply to payment schemes, payments systems and PSPs but also to payment service users. Payers using credit transfer *“shall not refuse to make credit transfers to payments accounts with payment service providers which are located in another Member State”*. Similarly, payees using direct debits *“shall not refuse to receive direct debits from payments accounts with payment service providers which are located in another Member State”*.

In general, the proposed Regulation only applies to direct debits and credit transfers. But if a card payment results in a credit transfer to or direct debit from a payment account identified by BBAN or IBAN, it is in scope! Member States are allowed to waive the end-date regulation, however only for up to 60 months after entry into force of the regulation.

⁷ See http://ec.europa.eu/internal_market/payments/docs/sepa/com_2010_775_en.pdf

Our comment

Finally, the EU Commission has come up with a proposal for a Regulation regarding end-dates. SCT and SDD, the two EPC schemes, are not mentioned once in the proposal. However, the technical requirements seem to be defined in such a way to guide the industry to these two schemes and leave little room for other schemes. Thus, the “essential requirements” approach – coupled with highly specific requirements – basically can be seen as way to get around anti-trust concerns against mandating SCT and SDD outright. The idea that there could also be scheme competition seems to have vanished.⁸ In a way, this does not come as a surprise. Time and again, SEPA has been described as a market-driven approach. But, in fact, it always has been a policy-driven approach. Thus, it seems only logical that policy should have the final say and not the market.

Thus, the basic approach taken does not come as a surprise. Still, some elements merit a closer look. From the point of the card industry, the most important point is the partial inclusion of card payments. The proposed Regulation implies that card transactions are in scope if they result in a direct debit “from a payment account identified by BBAN or IBAN”. This is particularly important for debit card schemes with a direct flow of funds from a card holder’s bank account to the bank account of the merchant. As far as we understand the text, for these systems, the rules for one-off direct debits would have to be applied. If the transaction amount flows into a clearing account of the card issuer, the rules for recurring direct debits would have to be applied and the two parties involved would be card holder and card issuer. Thus, card schemes will have to take the Regulation into account. However, the period they may operate in the traditional way is extended from 24 months to 60 months (if national governments make use of the waiver).

If the Regulation is adopted, this rule will have strange consequences. First, national direct debit schemes will have to be discontinued 24 months after the entry into force of the Regulation. But, in some countries, the schemes may be continued for the processing of card payments for another 36 months. If the costs of running parallel systems is as high as always claimed by the Commission, this rule implies high additional costs.⁹

⁸ Such a possibility was mentioned in the Discussion paper published in March 2010. See: European Commission: SEPA Migration End-date. Discussion paper, 15.3.2010

⁹ In Germany, keeping the national direct debit scheme alive after the 24 months deadline would imply that banks continued to provide the necessary infrastructure for the unloved ELV scheme. They may well choose not to do so.

Second, the Commission claims that “it is not appropriate at this stage to cover card transactions, since common standards for Union card payments are still under development” (recital 6). But subsequently it does regulate card payments. If the proposal is passed, it will have a significant effect on rules, regulations and processing of card payments.

The proposed Regulation also deals with multilateral interchange fees (MIF). It simply prohibits MIF for standard direct debit transactions. That must come as a blow for banks in countries such as France that have, so far, had a MIF for direct debits. For these banks, the business case for switching to SDD does not look rosy. The Commission does however allow a MIF for R-transactions. Thus it adopts a model currently in use in Germany. However, the MIF for R-transactions comes with stings attached: It has to be cost-based – to name just one of the conditions made in the Regulation. Therefore, it seems questionable whether the level of MIF for SDD R-transactions will be as high as the current German level (3 EUR).

Another aspect that merits special attention is the fact that payment users are also subject to the provisions made in the Regulation. On a technical level, the regulation not only covers the PSP-to-PSP interface but also the User-to-PSP interface. Moreover, payment service users are obliged to make / accept payments irrespective of where the payee and the payee’s PSP reside (in the home country of the user or somewhere else within the EU). That implies, for instance, that a company accepting direct debits has to accept direct debits coming from anywhere in the EU.

The EU Commission calls this “standardisation” and points to the cost-efficiencies that can be gained. But on close inspection this increasingly looks like central planning.

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