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- 1. IF-Regulation – comments of the EP committees**
- 2. IF-Caps: Retailer benefits of 6 billion € per year?**

1. IF-Regulation – comments of the EP committees

Two committees of the European Parliament (EP) are designated to deal with the EU Commission’s proposal for the regulation of interchange fees (IF). Both, ECON¹, the responsible committee, and IMCO², the committee providing an additional opinion have drafted and published their respective documents. In addition, the EESC³ adopted an opinion on 11 December. The main topics of the three documents are:

	ECON	IMCO	EESC
Recital 17 “Transition period”		Reduced to 10 months	Introduction at the national level within 6 months from the adoption of the Regulation, but by one year at the latest
Recital 18 “Caps”			Lower caps preferred including zero cap for debit
Recital 23 “Prohibition of circumvention”	Clarification that only scheme fees in direct relation to payment transactions shall be considered		
Recital 29 “Abolishment of HACR”	Deleted		
Recital 30 “Identification of categories of cards”	Limited to “electronically identifiable”		
Article 1 “Scope”		Includes commercial cards	Includes commercial cards with same caps as for consumer cards

¹ ECON: Committee on Economic and Monetary Affairs
 <<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fNONSGML%2bCOMPARL%2bPE-522.956%2b01%2bDOC%2bPDF%2bV0%2f%2fEN>>

² IMCO: Internal Market and Consumer Protection
 <<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fNONSGML%2bCOMPARL%2bPE-522.852%2b01%2bDOC%2bPDF%2bV0%2f%2fEN>>

³ EESC: European Economic and Social Committee
 <http://www.toad.eesc.europa.eu/ViewDoc.aspx?doc=ces%5cint%5cint711%5cEN%5cCES5238-2013_00_00_TRA_AC_EN.doc&docid=2958583>

	ECON	IMCO	EESC
Article 2 "Definition of 'cross border'"	Deletion of the criterion that a transaction is considered to be "cross border" when issuer and acquirer are established in different member states		
Article 3 and 4 "Caps on interchange"	Caps apply to weighted average rather than to each transaction		
Article 4 "Cap for all transactions"		Reduced period of 10 months (rather than 22 months)	
Article 7 "Separation of scheme from processing"		Member states may waive this provision for newly established schemes	
Article 8 "Co-badging and choice of application"	Deleted		
Article 10 "Abolishment of HACR"	Deleted. Visual identification of category deleted. Electronic identifiability of category retained.		

Besides these points, a couple of corrections and clarifications are proposed. Also important is that the ECON draft proposes materially longer implementation time for some business rules (Article 7: Interoperability and Article 10 electronic identifiability)

Our Comment

1. Transition period and related issues

Not surprisingly, the issue of the transition period is a controversial point in some of the opinions of lobby groups: Issuer organizations request a longer period to postpone fee reductions as long as possible whereas merchant organizations want to profit from decreased fees as early as possible and therefore request a shorter period. It appears that these controversial views are also reflected in the drafted documents. Whereas IMCO and EESC ask for shortening the transition period, ECON does not mention this issue but asks

for the deletion of the cap on interchange for cross border acquired transactions. This would help to keep rates at current levels until the end of the transition period.⁴

The transition period has been proposed by the EU Commission to protect issuers of an immediate change of their business model. But we have already mentioned that the proposed amendment in the definition of “cross border transaction” will provide a way for large merchants and acquirers to circumvent domestic transactions and profit from lower cross-border fees – even for transactions that have traditionally been regarded as “domestic”. The Commission appears to welcome this effect in so far as it recognized that cross border acquiring will exercise pressure on national banking organizations to drive down domestic interchange rates during the transition period. However, as mentioned, for instance, in the opinion of the EESC, regulators seem to fear that only large merchants would be able to circumvent domestic transactions whereas small merchants would be tied to domestic fees during the transition period. Overall, there are conflicting objectives and overlapping proposals with regard to the transition period and it is not clear what the final outcome will look like.

After the publication of the initial proposal of the EU Commission we already wondered why the EU Commission attempted to regulate domestic interchange fees, at all. After all, the regulation of domestic fees could give raise to concerns about subsidiarity. Not surprisingly, one national legislator, the French Senate took up the issue, arguing that the Commission was violating the principle of subsidiarity.⁵ The EU Commission might have avoided such opposition if it had trusted more in the power of market forces to drive down domestic interchange rates.

Basically, with its approach of regulating cross-border IFs and widening the definition of “cross-border” the EU Commission could have achieved its objective of lower domestic IFs. In this way it would have prevented arguments about transition periods and subsidiarity. With its new definition of “cross-border” transactions the Commission would also have covered domestic transaction (given the necessary adjustments of acquirers). Such a move would have triggered much less opposition because interchange fees for cross-border acquired transactions are obviously within the scope of the EU regulation. However, the EU Commission chose to propose a regulation of domestic IFs, as well.

⁴ As we have argued before, the regulation of cross-border fees coupled the new definition of “cross-border” would immediately drive down IFs for national transactions. See our article “The proposed Regulation on Interchange Fees” in the August edition of this newsletter.

⁵ <http://www.ipex.eu/IPEXL-WEB/dossier/files/download/082dbcc5420d8f4801425b07a8b05a19.do>

To summarize, while we see a trade-off between regulation of cross-border acquired transactions (according to the new definition) and the direct regulation of domestic transactions, the EU Commission put both options together. So, now it faces the problem that different pressure groups are requesting contradicting amendments to the proposal. The question is whether this will ultimately lead to a more consistent approach.

2. HACR and commercial cards

The ultimate objective of the proposed abolition of the honour all cards rule (HACR) is to allow merchants to refuse acceptance of expensive commercial cards and other premium cards. But regulators do not want to give merchants the right to selectively refuse some consumer cards. Obviously this rationale only makes sense if commercial cards are actually more expensive to accept for merchants, i.e. if there is a higher (unregulated) IF for commercial cards than for consumer cards:

Now IMCO and EESC propose to include commercial cards in the scope of the interchange regulation. EESC explicitly requests to cap interchange fees for commercial cards at the same level as interchange fees for consumer cards. If this amendment would be adopted, the rationale for abolishing the HACR would no longer exist.

The EU Commission makes a distinction between an “honour all issuer rule” (HAIR) and an “honour all products rule” (HAPR). Whereas the HAIR is considered as necessary for a sound card system, the HAPR is considered to be an act of unlawful tying. However, if interchange fees for commercial cards were capped, the HAPR would not have any negative effect. Accordingly, we wonder why IMCO and EESC do not propose to delete Art. 10 (Abolition of HACR). Interestingly, ECON does just that. But, ECON does not ask to cap interchange fees for commercial cards. ECON argues (and we agree entirely) that card usage would become confusing for consumers and that there would be a bad user experience if merchants did not accept all cards with the same brand. In addition, ECON mentions the high costs of card replacements that should be avoided.

There is no discussion in the report about the primary objectives of the EU Commission. Moreover, ECON does not propose the deletion of the entire Article 10 but retains the requirement that card “categories” must be electronically identifiable. If merchants do not have the right to decline some of the cards of a certain brand what use does electronic identifiability have? We cannot think of any. To summarize, we consider both ECONs and IMCOs views on the HACR-issue as inconsistent.

Whatever the final outcome will be, we urgently recommend that regulators adopt a regulation which balances merchant interests, user experience and complexity in processing – an issue we discussed in our last newsletter.

2. IF-Caps: Retailer benefits of 6 billion € per year?

According to the proposed IF regulation all consumer card interchange fees (not only the IF for intra-regional cross-border transactions but also the much more significant domestic IFs) will be subject to the 0.2% resp. 0.3% caps (debit respectively credit cards). What would be the cost savings for retailers in Europe if the Commission's proposal would be adopted? In its Memo of 24 July 2013⁶ the Commission estimates savings of **6 billion € per year** in the EEA-region.

Our Comment

The calculation of the Commission, published in the Impact Assessment⁷, is based on public figures of the ECB statistics of the value of credit and debit card transactions in the EEA in the year 2011 and Commission's estimates of the average IF in each member state. The estimated total volume of IF paid by retailers to card issuers in 2011 comes down to 10.3 billion € (4.6 b € for debit cards and 5.7 b € for credit cards). In its Impact Assessment, the Commission takes the same card volumes multiplied with the proposed IFs of 0.2 and 0.3%. In this way, the Commission derives an IF-reduction of 58%, respectively 6 b € (2.5 b € for debit cards and 3.5 b € for credit cards).

In contrast to these estimates, EuroCommerce claims (without providing further evidence) that "the commerce sector pays out some € 25 billion in interchange fees every year."⁸ Even if the estimates of EuroCommerce are based on 2012 figures, the estimates of the Commission seem to be more realistic. Still, as the analysis below shows, the figures of the Commission are dubious, as well.

The calculation of the Commission is based on the following assumptions:

- *acquirers will pass the IF-reductions in full to retailers,*
- *the new IFs are, on average, identical with the proposed caps,*

⁶ http://europa.eu/rapid/press-release_MEMO-13-719_en.htm?locale=en

⁷ [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SWD:2013:0288\(52\):FIN:EN:PDF](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SWD:2013:0288(52):FIN:EN:PDF) (p. 203)

⁸ <http://www.eurocommerce.be/policy-areas/payment-systems.aspx>

- issuers in member states with current below-cap IFs will not increase the fees to the cap-levels,
- commercial cards and cards issued by three-party schemes (whose transaction volumes are explicitly included in the ECB figures) are also subject to the proposed IFs,
- the proposed caps are relevant for all card transactions, including POS-transactions which are made outside Europe (inter-regional transactions),
- the ECB figures relating to card volumes are reliable.

First, transactions which are not in scope (three-party schemes, commercial cards and interregional transactions), should not be considered. Secondly, the Commission should consider the IFs of the (still existing) domestic debit card schemes, which are relevant for the majority of card transactions within a member state. The Commission argues that these rates are not publicly available in many cases. Therefore, in its calculation, the Commission has used published domestic IF-rates of the international schemes regardless of their actual relevance in these countries. The Commission seems to be aware of this problem, pointing out that “the value of debit IFs might be overestimated for some countries.”⁹ But it does not try to estimate the size of this effect. So, we will try to do just that.

Based on the same ECB figures used by the Commission,¹⁰ we re-calculate the impact of the proposed IF-caps – using Germany as example. According to the Commission, the IF-reduction will be worth 1.1 billion € for retailers (almost 20% of the estimated IF reduction in the whole EEA region). Although the issuer remuneration in the German debit card scheme “ec cash” is well known to the authorities¹¹ (official rate of 0.3%¹²), the Commission takes the domestic IF of MasterCard debit cards of 0.49% as basis for its calculation. This MasterCard IF-rate has no quantitative relevance in Germany. Moreover, it is also used for ELV-transactions, which are included in the ECB-figures. It should be well known by the Commission that this debit card system, initiated by retailers, has no IF at all.

On the credit card side, as well, the Commission’s estimates are too high. First, the volume of credit card transactions will be approx. 18% lower after deducting transactions of American Express/Diners Club and commercial cards of Visa and MasterCard, which are

⁹ Impact Analysis, p. 202

¹⁰ Whether or not the ECB figures for credit cards in Germany are correct will not be discussed here.

¹¹ For example: ECB, Interchange Fees in Card Payments, Occasional Paper No. 131, September 2011, p. 39.

¹² The effective rate is probably lower.

both out of scope. Second, the credit card IF of 1.8% used by the Commission (an estimated average of all transactions - domestic, intraregional and interregional) is much too high. Domestic transactions do have an average IF of 1.4%, intra-regional IFs are down to 0.3% (also well-known to the Commission as consequence of its own agreements with the international schemes) and the inter-regional IFs have no relevance.

Figure 1: Impact of IF-Reduction for Germany (Commission versus PaySys)

Card Issuing Germany	211 ECB statistics	EU COMM			PaySys		
		MIF-today	MIF-new	MIF-reduction	MIF-today	MIF-new	MIF-reduction
debit cards	139,142	0.49%	0.20%	407.6	0.25%	0.17%	117.9
- thereof ec cash	117,875				0.30%	0.20%	117.9
- thereof ELV*	21,267				no MIF		
credit cards (incl. delayed debit)	48,489	1.80%	0.30%	725.4	0.83%	0.30%	294.1
- thereof 3-party schemes	4,509				no relevance		
- thereof commercial cards 4-party	4,398				no relevance		
consumer credit cards (4-party)	39,582						
- thereof domestic	25,728				1.40%	0.30%	283.0
- thereof cross-border EU	11,083				0.40%	0.30%	11.1
- thereof cross-border outside EU	2,771				no relevance		
Total MIF-reduction (m €)				1,132.9			412.0

The total volumes of card transactions (in m €) used by the European Commission are based on ECB statistics.

* In this figure the ECB is including about 30% of the German ELV transactions. Cross-border debit card transactions and transactions of the few debit cards, issued by the international schemes could be included too.

Instead of 1,133 m € (as estimated by the Commission) the reduction of the IF in Germany will be about 412 m €. Thus, there are good reasons for doubting the correctness of the overall figure of 6 b € as pecuniary impact of the IF-regulation for retailers in Europe.

The presentation of “hard figures” is meant to suggest that the Commission follows a sound approach of rational decision-making based on thorough empirical analysis. This is laudable since the proposed IF-regulation would have a huge impact on the European card market. However, as has been shown, the IF-regulation deserves a much more thorough impact analysis.

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