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## **1. Three-Party Systems in the SCF**

Initially, the SEPA Cards Framework did not cover three-party schemes. However, the new version (SCF2.1) contains a number of provisions for such schemes. It generally rules that three-party schemes have to become SCF-compliant if they are offering payment products that are in scope of the SCF. Subsequently, the SCF distinguishes between three-party card schemes with or without licensees. Schemes without licensees are exempted from a number of provisions of the SCF, namely

- open access to the scheme
- separation of scheme governance, management, and processing
- cross-border issuing and acquiring

Other requirements, such as technical standards, do apply, however.

For three-party systems with licensees, the SCF provides the following rules:

- a transparent licensing policy
- SEPA-wide licenses for issuing and acquiring<sup>1</sup>
- processor choice for licensees
- technical standards

Such tree-party schemes are exempted form the provision to separate scheme governance, management and processing and may restrict authorisation, clearing and settlement to themselves.

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<sup>1</sup> Exclusive national licences that have been granted prior to 2008 have to be transformed into SEPA-licences by 2013.

Finally, there is a provision that national central banks may exempt a three-party scheme with less than 5% market share (based on numbers of transactions) or less than 250 million transactions.

### ***Our comment***

*In the past, it was not clear to what extent SCF rules also have to be applied to three-party systems. The new version of the SCF provides some clarification of this issue. Its new provisions mainly follow the the chapter on three-party systems in the 6<sup>th</sup> progress report of the ECB. Unfortunately, these rules also raise a new set of problems. The SCF 2.1 makes the distinction between three-party systems with and without licensees. But it is not clear what the EPC has in mind. In section 3.2 (Scheme's rules requirements) there is a sub-section on licensing. In this section it is stated that "a licence for a SEPA country gives a bank or payment institution the right to issue or acquire in any other SEPA country or countries or region(s)." (SCF2.1, p.14). Thus, a licensee would be the one that makes a contract with cardholders and/or merchants. According to this interpretation, Amex or Diners would be schemes without licensing because they are the contractual counterparty for card holders and merchants. From a legal point of view, co-operating banks are distribution partners not licensees. Thus the question emerges, who does the EPC have in mind when it makes provisions for three-party schemes with licensees. In fact, one might ask whether a "three-party scheme with licensees" really is a three-party scheme. After all, it looks like a four-party scheme.*

*Another puzzeling feature of the section on three-party systems is the proposed waiver. One question that immediately emerges is why there is a waiver only for small three-party systems and not for small four-party systems, as well. In addition, the provision that a national central bank may exempt a scheme from the provisions of the SCF once again points to the ambiguous meaning of SEPA as a "market driven" process and the SCF as an act of "self regulation". Finally, it is also unclear what the waiver implies. The SCF requires issuers only to issue general purpose cards from schemes that are SCF compliant. If this is interpreted in a narrow way, issuers would not be allowed to issue cards of a waived scheme.*

## 2. Principles for Interchange Fees in the SCF

The section “Principles for Interchange Fees” has not been changed. It is the same as in the SCF version 1.0. Still, it is well worth reading, in particular, the following paragraph: *“In the case where, and as long as, at local or national level, participating banks of a SEPA scheme establish multilateral interchange rules that differ from that scheme’s SEPA-wide default multilateral interchange, any SEPA bank operating in that country will be eligible for that local or national multilateral interchange fee.”* (SCF2.1, p.16) The important phrase in this paragraph is “will be eligible”. According to standard interpretation of the term “eligible” this means that a SEPA bank has an option between the national MIF and the SEPA fall-back rate.

### **Our comment**

*Reading the new version of the SCF we also came across a section that had already been in the older version 1.0 of the SCF. However, so far, we somehow failed to notice its significance. What the EPC probably had in mind when it wrote this paragraph is that foreign acquiring banks should have the right to apply national interchange rates if these are below x-border fall-back rates. But what this section actually says is the following: “any SEPA bank” (supposedly as issuer or acquirer) has the right to opt for a national MIF (if existing) or the SEPA MIF. If our interpretation is correct, current interchange rules with binding national rates are not SEPA compliant and would thus have to be changed until the the end of 2010. Such a change would have severe consequences because national MIFs would be no longer tenable under SEPA rules. For, whenever there is a choice, acquirers will opt for the lower MIF and issuers will opt for the higher MIF. Suppose, the national MIF is higher than the SEPA MIF. In this case, an issuer would opt for the national MIF and an acquirer would opt for the SEPA-MIF. What is to be done in such a case? The option clause could be applied in an asymmetrical way (issuer decides, or, acquirer decides) that would mean for one side of the market there is no option. Another possibility would be for the scheme to cover the resulting deficit (hardly a viable option). Finally, the situation could be resolved by abolishing the national rate. Given that the SCF really is meant to provide both sides of the market with a choice, the last option seems the only viable one.*

### 3. New European Card Schemes: Round Table of Candidates at Frankfurt Conference

Who will be the next European Card Scheme in SEPA? The necessity of a truly European card scheme besides the two “American” schemes is still a main topic on the priority list of the Eurosystem and DG Competition. Meanwhile the regulators have learned from the French market to avoid the addendum “debit” if they are demanding an additional card scheme. But in the market place the debit card is still the main focus of the candidates who are trying to fill the position next to Mastercard and Visa. At the ninth Kartenforum, organised by Atos Worldline and B+S Card Service (10 February 2010 in Frankfurt), four new initiatives were invited to show present themselves next to the well established “American” player Maestro: EAPS, PayFair, Monnet and V PAY. *(Our comment: The other “American” debit scheme, the “hidden” market leader in the European debit card market, was not present although 75% of all card transactions branded with VISA (not V PAY) are generated by debit cards in Europe. Another huge SEPA card scheme which assessed itself as SCF-compliant, was also missing on the stage: Cartes Bancaires. If this missing candidate is included we do already have a “third” card scheme in Europe which does not have its origin in America. However, the approximate 600 conference participants did not dwell too much on this point. They were curious about the four newcomers in the arena).*

Although it has been announced by the Deutsche Bank that a **Monnet** project company would be set-up in October 2009<sup>2</sup>, Monnet still looks like a paper tiger. But there is some progress. The negotiations with the European Commission about interchange and SEPA-compliance are finished now, Dr. Stephan Schuster (Deutsche Bank) said. European banks will be invited to participate as shareholder of the new set-up company in the next months. Banks could also join the Monnet-initiative at a later stage as licencees. The main reasons behind the Monnet-initiative are independence of the “American” duopoly and the governance and ownership by European banks. The silhouette of the new scheme is still shadowy: a pan-European authorisation network, central fraud-management and “plain vanilla” transactions which could be enriched by the issuer with value added services. The Monnet card should be issued by the bank where the current account of the cardholder is held. The focus of Monnet is still on debit cards. But Schuster expects that cards will be phased out and replaced by new payment instruments. Cash will be the loser. Within the next 5 years, the ATM business will be affected dramatically.

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<sup>2</sup> See our Newsletter of October 2009

Progress within the **EAPS** Group is still modest for POS transactions. Until now 90 millions cards are involved (German debit cards and a few Italian cards). The often cited number of 140 millions is the market potential if EAPS is implemented in the Italian market. Peter Blasche, Vice-Chairman of EAPS, said that the still pending interchange regulation is one of the main reasons why other domestic schemes are hesitating to join EAPS. (*Our comment: Until now, one of the rationales behind EAPS has been the conservation of the domestic MIFs in national schemes!*). Since 2010 EAPS has widened its membership to individual organisations, like acquirers in countries where no domestic EAPS-scheme exists. As Blasche pointed out, in this case, EAPS has to tackle the interchange issue. (*Our comment: EAPS could solve this problem by a set of bilateral interchange agreements between the acquirer and the EAPS schemes, or to agree on a SEPA default MIF for cross-border transactions*).

Ottmar Bloching, who represented **V PAY** at the Round Table, told the audience about the frustration at Visa Europe because of the attitude of the European regulators who still do not perceive V PAY as a European card scheme. Bloching imagined that the reason behind this misunderstanding could be the dominance of representatives of the former eurocheque-countries within EU regulatory bodies. The former eurocheque-countries still perceive Visa as an “American” scheme. (*Our comment: If the regulators are talking about “American schemes” they probably have the two debit card brands, Maestro and Visa, in mind which are still dominating the European debit card market. To understand the regulators, it could make sense to differentiate between the two debit card brands Visa as market leader in Europe and V PAY as newcoming European debit card scheme*).

Last but not least **PayFair**. Its CEO Dominique Buyschaert stressed the characteristic of PayFair being not a bank-owned or bank-controlled scheme nor a merchant-driven initiative, but a neutral scheme.

A topic that came up in the subsequent discussion was co-branding. Will co-branding be still state-of-the art in SEPA in 2015? Buyschaert answered affirmatively. His strategy is co-branding of international schemes with PayFair, which could replace the former national brands on the card. Blasche’s vision of 2015 is the end of co-branding by establishing EAPS as a Europe-wide scheme.

#### 4. Anti-trust Issues in the Canadian Card Market

The Canadian Competition Bureau has decided not to allow Interac, the institution running the ATM and POS debit card system, to switch its status from not-for-profit to for-profit.<sup>3</sup> Interac's request was triggered by plans of Visa and MasterCard to enter the Canadian debit card market. Interac feared that as a not-for-profit company it would not be flexible enough to react to the new competition. However, given Interac's current dominant position in the market, the Bureau saw no reason to change its regulatory approach. The main provisions of the "Consent Order" which provides the regulatory framework for Interac, remain unchanged.<sup>4</sup> Thus, Interac is basically treated as a regulated "essential facility".

Prior to this decision, the Canadian card market had already entered the political discussion. The Senate Committee on Banking, Trade and Commerce investigated the card market and came out with a report – including a number of recommendations on how to regulate the market.<sup>5</sup> They include (inter alia)

- provision that surcharging must be allowed
- prohibition of the "honor-all-cards" rule
- interchange fees only as flat fees per transaction
- a three-year period with zero interchange fees
- brand selection by card holders (no priority routing)

These recommendations are currently discussed.

#### **Our comment**

*The plans of MasterCard and Visa to enter the Canadian debit card market have caused quite some ripples in Canada. Merchants, in particular, are concerned that the two schemes will offer issuers high interchange fees to provide an incentive to switch from Interac to one of the international brands. The Canadian situation is in many ways similar to the current situation in Europe. In Europe, as well, the incumbent debit card systems (often not-for-profit) face competition by MasterCard and Visa. Judging from the proposal of the Senate Banking Committee, regulators on both sides of the Atlantic come up with fairly similar ideas on how to regulate card payments: prohibition of "no-surcharge" rules, prohibition of "honor-all-cards"-rules, interchange regulation and brand choice by consumers.*

<sup>3</sup> See: Commissioner of Competition Announces Decision in Response to Interac's Request to Vary Consent Order (<http://competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03198.html>)

<sup>4</sup> See Bank of Montreal v. Commissioner of Competition, 2003, Comp. Trib. 3, File no.: CT1995002.

<sup>5</sup> Transparency, balance and choice: Canada's credit and debit card systems, Report of The Standing Senate Committee on Banking, Trade and Commerce, June 2009.

*But there is also a difference. Canadian anti-trust authorities are more focussed on the incumbent player. In Europe, the focus has been more on Visa and MasterCard. So, for the moment, the European incumbents have more room to manoeuvre than their Canadian counter-part.*

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