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1. The ECB's 6th SEPA Progress Report

Besides stressing the advantages of SEPA and urging banks to be more energetic in their attempts to implement SEPA and sell it to their clients, the sixth progress report¹ contains a number of interesting points.

First: Problems with SDD are acknowledged but the launch-date (November 1, 2009) is reconfirmed. In order to support the implementation of SDD, the ECB proposes a maximum cross-border MIF for direct debit of 8.8 cents – to be *“applied for a defined period which provides banks sufficient time to adapt to the long term financial model for SDD.”* (p.17)

Second: The ECB makes the case for setting an end-date for SEPA migration. Moreover, it proposes *“incremental ways to implement an end-date”* (p. 20):

- *“IBAN could be made mandatory for payments;*
- *SEPA message standards could be made mandatory for euro payments;*
- *clearing of non-SEPA credit transfers and direct debits with domestic proprietary standards could be phased out; or*
- *banking communities could agree to migrate their national payment schemes to SEPA.”*

The ECB sees 4 ways to implement these measures:

- self-regulation by the banking industry,
- national legislation,
- community legislation or
- an ECB regulation.

¹ ECB/Eurosystem: Single European Payments Area. Sixth Progress Report, November 2008.
<http://www.ecb.int/pub/pdf/other/singleeuropaymentsarea200811en.pdf>

Third, the Euro-system would like the EPC to be more active with respect to cards. *“The EPC could reconsider the position it has taken with regard to the SEPA for Cards, i.e. its choice not to create a SEPA scheme for card payments, but instead only to develop a SEPA Cards Framework.”* (p. 25)

Fourth: The Euro-system is considering developing SEPA compliance criteria for card schemes and corresponding Terms of Reference.

Fifth: The EPC is urged to consider ISO 20022 as a standard for card messages.

Sixth: Three party system should fall under the SCF. Thus, according to the Eurosystem, three party systems would also have to be SEPA compliant. But the Euro-system proposes, that three party systems should be exempted from the SCF requirements regarding

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

However, in a license model, licensees should be able to freely choose an issuing or acquiring processor. From 2013 on, licenses should be for the entire SEPA region.

Seventh: The Euro-system observes that, in many countries, card processing has been (and still is) carried out by other systems and institutions than the processing of direct debits and credit transfers. It questions the logic of this separation and urges the EPC either to develop a PEACH/CSM Framework for card processing or amend the current framework accordingly.

Eighth: The Euro-system prompts the EPC to *“further develop into a more effective, accountable and transparent organisation. In particular, the EPC should focus on becoming the voice of the European payments industry on all payment issues.”* (p. 32)

Our Comment

The sixth progress report reflects the growing concerns of the Euro-system that SEPA might fall short of the initial plan. It also highlights its determination to remove whatever obstacle is in the way. Thus, it does not come as a surprise that the Euro-system vigorously supports an end date. The Euro-system even considers stepping in as payment regulator and set an end date. Such a regulation could be based on Article 22 of the ECB Statute which states: “the ECB may make regulations, to ensure efficient and sound clearing and payment systems within the Community”. Still, provided national systems were still widely used, one wonders whether Article 22 really would provide a basis for shutting off national systems. After all,

such a move would constitute a severe interference with private contracts between banks and their clients.²

The Euro-system's comments on card payments are particularly interesting. They can be found in chapter 2 (SEPA for Cards) and chapter 3 (SEPA for Infrastructures). In chapter 2, the EPC is urged to become more active in the field of cards. In chapter 3 it is suggested, that cards could be processed via the processing systems for giro payments (direct debits and credit transfers). Surprisingly, the Euro-system mentions the separation of card processing from giro processing, observed in some countries, and not the example of other countries where card clearing makes use of the giro clearing system. In countries like Belgium, Holland and Germany, national debit cards are cleared via the normal direct debit clearing process. In France, debit card transactions are a third category besides direct debits and credit transfers. But they are processed by the same processor. In order to adopt a similar approach in SEPA, it would be necessary to either define an "SDD for Cards" or formulate a Rulebook for card payments as a third type of payment transaction. Such an idea is not new. Indeed, EAPS members are pushing for a "SEPA Cards Clearing" framework.³ If implemented, it would make it much easier for European initiatives to come up with a new European card scheme.

2. The meaning of "cross-border: A clarification of the ECB

In the September issue of our newsletter⁴ we pointed out that the term "cross-border" can be interpreted in two ways: according to the residence of the bank accounts involved or according to the residence of the payer and the payee. In its Progress Report (see also article above) the ECB has clarified this matter: "the payment accounts are the basis for deciding whether a transaction is considered domestic or cross-border (e.g. by the country codes in the two IBANs or BICs)." (p. 17)

Our Comment

As pointed out in our article, given the definition proposed by the ECB, there may be opportunities for companies to switch direct debit transactions to foreign countries. This is

² Interestingly, the EU Commission does not mention the possibility of ECB regulation in its proposed "SEPA action plan".

³ See http://www.berlin-group.org/documents/BG_SEPA_Clearing_ve12.pdf

⁴ See article: The proposed SDD interchange fee and the meaning of "x-border".

always the case, when the national interchange is higher than the cross-border interchange (net of differences in processing costs).

3. SEPA headache of French banks

The French National SEPA Committee has published its first migration report. This report is remarkable – not so much for the description of the current state of SEPA in France but for its clear expression of frustration with recent decisions regarding interchange fees. French banks are criticising the MasterCard decision of the EU Commission as well as recent indication with respect to a temporary MIF for SDD:

“However, it is regrettable that no clarification has been provided with respect to the business model for payment cards. Thus, the European Commission decision of 19 December 2007 on MasterCard reflects a questioning of interchange fees, but does not give a clear indication of what is legally permitted. Accordingly, it is difficult to initiate investments to expand existing networks or develop new systems.”⁵ (our translation)

“Following the launch of the SEPA credit transfer on 28 January 2008, the success of the Single Euro Payments Area in terms of direct debits and payments by card now depends on the clarification that the European authorities have to make regarding the invoicing principles that will be accepted, particularly for interbank services. Until these rules are cleared up, French banks (along with many other European banks) are unable to commit to either the project itself or the provisional timetable. Like any other company, a bank has to know the economic and legal risks it is facing.”⁶

Thus, French banks are threatening to stop the SEPA project unless they see a clear business case for cards and direct debits. This is likely also to affect the joint Franco-German card project “Monnet”.

Besides interchange, PSD transposition is also seen as problematic. French banks are concerned that the PSD transposition into national law will lead to different regulations within Europe. In their view, a full harmonisation is another pre-requisite for a successful implementation of SEPA (see also article 5 in this newsletter).

⁵ National SEPA Committee: 1st migration report, 25 November 2008. p.8.

⁶ Press release of the French Banking Association FBF

([http://www.fbf.fr/Web/internet/content_europe.nsf/\(WebPageList\)/European+payment+instruments++economic+models+must+be+clarified+before+SEPA+project+continued?Open](http://www.fbf.fr/Web/internet/content_europe.nsf/(WebPageList)/European+payment+instruments++economic+models+must+be+clarified+before+SEPA+project+continued?Open))

Our comment:

Somewhat ironically, the EU Commission finds itself in the same position as MasterCard two years ago when it announced a Maestro SEPA interchange rate. After its publication on Dec. 4th, 2006, MasterCard received criticism from both sides of the market. In those countries that had lower debit card fees (like Belgium) merchants were furious and in those countries with higher rates banks (like Germany,) banks threatened to withdraw the Maestro brand from their cards. Now, the EU Commission – jointly with the ECB – has tried its luck and fixed debit card interchange fees to zero and proposes a temporary direct debit interchange of x cents (possibly 8.8 cents – see article above) and a long run interchange of zero. As in the case of MasterCard, market participants are not happy. The card interchange of zero has been criticised by banks (and hailed by merchants) but banks have so far not responded in any other way. After the announcement with respect to a direct debit interchange, the reaction has been more forceful. French banks, based in a market with a national direct debit interchange fee, are suspending their work on SEPA. They argue that without interchange, there is no business case to carry out the necessary investment. Harsh critique has also come from the German Savings Banks Association (DSGV).⁷ The other side of the market has remained relatively silent, so far. Companies in countries with zero direct debit interchange have not been very vocal. But this may simply reflect their trust in the durability of national debit schemes (at least up to the point where the SEPA SDD interchange is lowered to zero).

The EU Commission finds itself in a very uncomfortable position. Of course, it could make a compromise with French banks. But this would only strengthen the opposition on the other side of the market. Accepting a permanent positive interchange fee for direct debits would make it even more difficult to establish SDD in countries like Germany that do not have a direct debit interchange at the moment. Large users of direct debits, including government agencies, would be strictly opposed to using SDD.

4. The SEPA vision of the Dutch competition authority

The Netherlands Competition Authority (NMa) has published a "SEPA vision document" which provides an interesting read for anyone interested in the future of European debit card schemes.⁸ It is worthwhile to quote the NMa at some length (page 3): "*National and SEPA*

⁷ Many private banks with large corporate customers do not support an SDD interchange, however.

⁸ http://www.nmanet.nl/Images/SEPA%20Vision%20document%20NMa_tcm16-116625.pdf

payment products will co-exist during the migration period to SEPA. The demand side of the market should determine which products ultimately survive, in the opinion of the NMa. Dutch banks and Currence have already announced that certain national products, such as payment brand PIN, will not exist under SEPA. The NMa considers this to be a threat to competition. Agreements between competitors to collectively restrict products offered while demand remains, may contravene the prohibition on cartels. This poses a considerable threat under competition law, not least when end dates are agreed in advance. In addition to direct methods to control demand through supply, there are also indirect methods which banks can use to promote migration to the new payment products, such as the choice whether or not implementing PIN [the Dutch debit card brand]⁹ on the EMV chip. Collective agreements about such indirect measures may also contravene the Competition Act.” Thus the NMa comes out with a clear statement against setting a closing date for national payment systems. Moreover, with respect to card payments, the NMa points out that a joint decision by banks to discontinue the Dutch PIN scheme might be viewed as a breach of competition law.¹⁰ Only if demand should fall below a certain threshold level would it be permissible to jointly shut off national systems.

Our comment:

When interpreting the NMa comments, it has to be taken into account that

- *national competition authorities within the EU coordinate their policy approaches, including their approach towards SEPA*
- *the NMa chairs the Financial Services Subgroup*
- *the NMa as chair of this group has been the first to address competition problems raised by SEPA.*

Thus, it can be assumed that its views are shared by some if not most of the other national competition authorities. In Germany, for instance, banks are not prepared to speculate in public about end dates because they fear that this will be viewed as anti-competitive collusion by the German cartel office.

⁹ Explanation in brackets added by PaySys Consultancy.

¹⁰ The NMa also criticises the SEPA Credit Transfer because the use of IBAN does not allow for number portability (NMa: SEPA vision document, p. 11-12.)

*The SEPA vision of the NMa highlights the growing concerns of competition authorities with respect to the SEPA process¹¹. In its essence, SEPA is a political process. Banks have taken joint action because they were pressed by the EU Commission (DG Internal Market). Little by little, it becomes evident that such an approach has its draw-backs from the point of view of competition policy. Neelie Kroes was the first to voice her uneasiness regarding the current card strategy.¹² “Retailers and consumers share the Commission's concern that banks will feel compelled to migrate to the existing international schemes and abandon efficient and cheap national systems.” (p. 3) *The Netherlands Competition Authority goes one step further, it not only voices concern, it threatens regulatory action. Possibly, other national competition authorities will follow. What does this mean for “SEPA for Cards”? On the one hand, the ECB and the EU Commission want SEPA-wide debit card systems (at least three of them), and on the other hand, competition authorities warn banks not to shut down national ones. The outcome of such a contradictory policy is difficult to predict. What seems clear, by now, is that many of the current national schemes will live – with minor modifications – beyond 2010. This conclusion is underpinned by a statement of Mr. P. Kalbfleisch (Chairman of the NMa) who recently said: “As confirmed last week by our minister of finance, we have the best, the cheapest and the most efficient payment system in the world.”¹³**

What is less clear is what this means for the competitive situation in the card market. On the one hand, there may be a tug of war, each scheme more or less sticking to its traditional home market. On the other hand, competition between national schemes (and Visa/MasterCard) may heat up. In particular, reciprocal agreements, such as currently undertaken within EAPS, may trigger strong competition. If schemes are interoperable, merchants in high-fee countries will be tempted to stop accepting national brands.

The NMa's vision raises general doubts about the setting of deadlines for national payment products. In theory, such an end-date could be set by the competent authorities (EU, ECB) or by the banks. However, - at least with respect to cards - the NMa rejects joint actions by the banking community. So, the choice remains between a regulatory approach and a demand-

¹¹ It is noteworthy that the NMa addresses the problem of setting an end-date only in the context of card payments. It would be interesting to know, how the NMa sees the problem in the context of credit transfers and direct debits.

¹² See Neelie Kroes: Key challenges and trends for Europe's retail payment systems, EUROFI Conference, European Parliament, Brussels, 3rd December 2007.
<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/780&format=PDF&aged=1&language=EN&guiLanguage=en>

¹³ “Eén betaalmarkt, meer concurrentie?”, Speech van Mr. P. Kalbfleisch Voorzitter van de Raad van Bestuur van de Nederlandse Mededingingsautoriteit t.b.v. 9e jaarcongres Toekomst van Betalingsverkeer, 29 mei 2008.

driven approach. The latter would imply that national systems could continue until customers (corporates and consumers) voluntarily switched to SEPA products.

Meanwhile, the Euro-system and the EU Commission have underlined their position that a joint decision by banks to discontinue national schemes would be a viable option. Thus, the ECB writes in its latest progress report "It can be argued that since payment instruments were collectively introduced by banks, these could be collectively phased out and replaced by similar instruments providing SEPA-wide reach ..."¹⁴

5. PSD implementation far away from full harmonisation: surcharging, payment accounts, ...

One of the reasons for the French banks to put SEPA on ice (see chapter 3 of this newsletter) is the threat of an incomplete harmonisation of the Payment Services Directive (PSD). After publication of the drafts for national legislation in several member states one can see remarkable differences.

The French Banking Federation FBF notices, for example, 23 optional clauses where member states can apply their own rules and 96 issues of different interpretation. Regarding the prudential regime for payment institutions, the FBF criticized especially the lack of own funds requirements for credit granting activities of payment institutions and the lower requirements for the personal skills of the management of payment institutions compared to credit institutions.

At EU level, there is also a discussion about the national PSD-option to prohibit the widely existing no-surcharging rules for sales transactions with payment cards. A spokesperson of EU Commissioner McCreevy is cited: *"The PSD is surcharging neutral, meaning that each member state can apply its own rule. This had been one of the compromise solutions necessary to pass the directive through the legislative process."*¹⁵

Our Comment:

The outcome could be a colourful European patchwork of regulation and a competitive disadvantage for players in member states with restrictive interpretation of the PSD. With a European passport, payment service providers will go to the most liberal member state. We have already seen this by-passing strategy of e-money-issuers who preferred the regulator

¹⁴ ECB, Sixth single euro payments area (SEPA) progress report, November 2008, page 20.

¹⁵ <http://www.euractiv.com/en/financial-services/eu-rules-hamper-card-payments/article-177491>

with the most liberal e-money regime: 70% of the e-money-institutes (20) within the EU have their licences from the English regulator FSA! This could occur with the new payment institutions in the same way, although it is not clear yet which country will have the lowest level of prudential supervision. Opt-in paragraphs of the PSD are deliberated consequences of compromises between member states, but not due to basically different interpretations of given requirements. In our last Newsletter (October 2008), we discussed the expected regulatory uncertainty of funds held on a payment account run by a payment service provider. Do these accounts with a positive balance constitute a deposit, an e-money-account or a payment account which could be run by a payment institution? What are the criteria to classify these funds? After discussing this issue with some regulators, we expect a remarkably divergent interpretation in different legislations.

The PSD (Articles 9 and 16) says the following about payment accounts and funds held at payment institutions:

- *Usage exclusively for payment transactions*
- *Received funds shall not constitute a deposit or e-money*
- *Funds cannot be used to finance the payment activities of the payment institution or for granting credit*

Payment accounts run by payment institutions are more or less working accounts for payment transactions. The funds can be held only for a very short-term – mainly bridging the time lags due to standard periods of execution. Basically, the maximum execution time (D+3 and D+1 after January 2012) limits the period of holding funds of users in a payment account. The deliverance of the funds to the payee has to be made by a transfer into an account of a user - usually run by a credit institution (for storage) or to another payment service provider. If significant balances are maintained on the payment account of a payment institution for a medium term the funds may constitute deposits or e-money. That is the common interpretation of the PSD by regulators at the Commission and in the UK.

Within the explanation of the governmental proposal of the new German law ZAG (“Zahlungsdienste-Aufsichtsgesetz”; implementation of Part I and II of the PSD) we see a much more liberal (!) position in Germany. Payment institutions are permitted to keep customer funds for a medium-term in a payment account. These accounts are more or less like traditional current accounts with a few restrictions. It will be very difficult to separate these accounts from traditional giro accounts run by the banks. To draw a clear line, the German legislator forbids payment institutions to pay interest on funds held in these payment accounts. A payment institution in Germany could therefore offer, for example, a debit card

linked to a current (interest-free) account at the same institution; in the UK, payment institutions could only offer a debit card linked to an current account run by (another) credit institution (decoupled debit card). If implemented, this would result in sensationally divergent regulations. The German prudential regime is – until now – well-known to be very restrictive. Without harmonisation of these diverging positions between the member states the German regulator BaFin could be the supervisor of the majority of payment institutions in Europe.

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