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1. Surcharging partly allowed in Denmark (by Henning N. Jensen)[1]

On October 1st this year The Payment Card Act was changed in Denmark. Previously the Law only allowed the retailers to surcharge the cardholders if they were paying with a credit or a debit card not issued in Denmark. The benefit for the retailers was very limited, but the tourists were very angry, when they found out that Danes using their payment cards did not get surcharged.

Legally it was a bigger problem for the Danish Government that the EU did not like the discrimination between Danish and foreign issued debit and credit cards. After a long period of negotiations the EU finally in 2010 opened a legal case against Denmark at the European Court and now something had to happen.

The Danish Ministry of Economic and Business Affairs started negotiations with all interested parties, including but not limit to: The Retailers Organization, The Consumer Association, The Bankers Association, Nets – the major Danish acquiring and infrastructure company owned by the banks - the international credit card organizations and other issuers/acquires of debit and credit cards.

After long and detailed negotiations where the invited parties were not able to agree on very much, The Ministry – after consultations with the EU – ended up suggesting that surcharging would be allowed for all credit cards – both Danish and international issued – whereas it would not be allowed for debit cards – no matter whether they were Danish or internationally issued. By this rather unusual split the Danish Government was still promoting the

[1] Senior partner at PlusCON, a Copenhagen based payment consulting company and an EPCA-partner.

nationwide very accepted and used Dancard – a local on-line debit card with PIN issued since 1984 - and used app. 150 time per year per card.

The Retailers and The Consumer Associations were extremely pleased by this suggestion whereas the Bankers Association disliked it just as much and made it public that The Bankers Association hereby also terminated the joint agreement from 2005 between the Government, The Retailers, The Consumer Association and the Banks about retailers' payment for accepting the Dancard. In this agreement The Bankers accepted to charge merchants a fee covering only 50% of all cost of operating the Dancard scheme. [2]

Our Comment

What will now happen in Denmark on October 1st after all this discussion is a big question. First of all The Bankers Association have made it very clear that there will be no further technological development of the Dancard scheme without a prior agreement with the retailers on charges covering the full costs of this coming development. One consequence of this statement is that now when all Dancards are re-issued with an expiry date in 2015 there will be no contactless facilities on these cards.

Another consequence of the new Law is that everybody was expecting Nets/Teller would make one common acquiring service fee for debit and credit cards around 2 – 2.25%, but just two days before the October 1st deadline Nets/Teller announced that they would keep the present individual service fees, which is app 0.75% for debit and 2.5 – 3.5% for credit cards. This seems to be the direct opposite of the purpose of the new Law, but the Danish Competition and Consumer Authority have just announced, "that Nets/Teller is not doing anything illegal. In the future the fee of the debit and credit cards individually must just correspond to the cost and a reasonable profit, which the authorities will monitor closely and if necessary intervene". (JyllandsPosten 30/09/2011)

A third consequence is that the Swedish Bankers Association has complained about the discrimination to the EU, so now the case can start all over again. For all practical purposes all issuers and card expects in Denmark are looking for the potential fourth consequence - to what degree will surcharging of credit cards get the cardholders to switch from using credit cards to using debit cards – in particular the Dancard. The answer to this question will most likely be visible for everybody after the Christmas shopping season.

[2] See „The 25th anniversary of the Dancard-scheme" in the August 2008 edition of this newsletter.

Conclusion: What in Denmark is called "the Debit and Credit card war" is not over and with a new more leftist (and consumer oriented) Government taking office during the first days of October everything can be up for further discussions in the coming months.

2. A question of governance

PayPal has threatened European customers with account closures if they do not comply with the US embargo towards Cuba.[3] This has hit retailers selling such "classical" Cuban merchandises like rum or cigars. Retailers were not only asked to stop accepting PayPal as payment for Cuban cigars, rum, etc. but they were asked to completely remove Cuban products from their (virtual) shelves. Not surprisingly, retailers have not been amused. Rossmann, a German health and beauty retailer that operates a web shop and 2,390 retail shops in six European countries reacted swiftly and terminated its contract with PayPal.[4] Others have threatened to sue.

Our Comment

Obviously, the whole issue is not in PayPal's interest. But as the company and its parent eBay are arguing, they have to comply with US laws. So, here we have a US-based payment service provider that has to decline transactions within Europe that are perfectly legal according to European laws. This makes the whole story interesting also from the point of view of the payment card market.

When it comes to "SEPA for cards", the European Commission and the ECB have always maintained that Europe needs at least three schemes and that one of these schemes should be European. One of the reasons for demanding a European scheme has been governance. European regulators – and also a large number of banks - did not like the fact that rules for card schemes might be decided on the other side of the ocean. Given the high degree of mutual trade and capital flows between the US and the EU this argument always seemed a bit far fetched. However, the current row between PayPal and its customers shows that European regulators may actually have sound reasons for stressing the importance of

[3] See Paypal wants to foist US Cuba embargo on Europe. http://e-commercefacts.com/news/2011/07/paypal-cuban-embargo/. Similarly, eBay seems to have closed a number of shops on its German platform. See Benedikt Fuest, Ebay blockt deutsche Rum-Händler, 29.07.2011 http://www.welt.de/print/die_welt/wirtschaft/article13514228/Ebay-blockt-deutsche-Rum-Haendler.html
[4] See http://www.heise.de/newsticker/meldung/Lassen-uns-nicht-erpressen-Rossmann-schmeisst-Paypal-raus-1340041.html

governance. And the same applies to European banks. They would be hard pressed, for instance, if they had to explain card holders that they cannot use their cards on a holiday trip to Cuba.

3. Regulation of debit card interchange fees in the US: A first casualty

Tempo, the US decoupled debit scheme has announced that it is going out of business.[5] The move comes after the introduction of the Federal Reserve's regulation of interchange fees. The Fed's imposition of a maximum fee of 21 cents per transaction plus 0.05% has been killing Tempo's business case. Before the regulation went into force, Tempo received 44 cents per transaction.

The drastic cut in interchange fees has led the company to react immediately. Apparently, clients have already been advised that the company will be wined down and part of the work force has been laid off.

Our Comment

It's an old wisdom in economics that regulatory interventions may often have unintended consequences. Thus, we should not be surprised that the new interchange regulation provides yet another example of this rule. Still, it comes as a surprise, how fast these consequences have become visible. More importantly, these unintended side effects can hardly be what the Fed or the law makers in Congress wished for. The demise of Tempo implies that a potential competitor of the dominant schemes Visa and MasterCard vanishes. Thus, as a first consequence of the new regulation, there is less competition – not more. This verdict has to be put in perspective, though. According to its chief executive, Mike Grossman, Tempo had issued "hundreds of thousands of cards". This is not an awful lot.

Years ago, Tempo (initially "Debitman") and its concept of "decoupled debit" was widely praised.[6] Capital One started co-operating with Tempo and the company and the new concept received a lot of attention in the payment press. However, the subsequent years did not witness a take-off. Thus, it is not clear whether regulation has killed a successful

[5] See „Blaming the Fed's Durbin Rule. Tempo Payments Prepares to Shut Down", Jul. 11, 2011 (http://www.digitaltransactions.net/news/story/3118)
[6] See „Consumers approve of decoupled debit", Cards International, 27 March 2008.

business model or whether it has simply hastened a development that would have occurred anyway, sooner or later.

4. DG Competition keeps pressure on banks

At the Next Generation Cards and Payment Conference in Brussels (12 October 2011) Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy, delivered a speech on the future of the European payments market.[7] In this speech, he particularly focussed on card payments.

After underlining the fact that progress has been made on the road to SEPA, Commissioner Almunia turned to a number of deficiencies. First, he noted a lack of innovation, complaining that "*all major recent global initiatives are non-European*". In this context he cited PayPal, Google Checkout, Amazon Simple Pay and Alipay.

In order to foster innovation he contemplates to change the regulatory model. *"We have probably reached the limits of strict self regulation in the development of a Single European Payment Area; now we need to change tack and, most of all, speed.*"

As critical issues from a regulator's point of view he identified

- interchange fees,
- access to payers' accounts and
- standardisation.

He defended the approach toward interchange to regulate these fees without prohibiting them. Turning to the issue of "access to accounts", he highlighted that new payment systems often need the co-operation of banks to verify payers' accounts. The subsequent remark that such co-operation was not always forthcoming, can probably be interpreted as a warning to banks that DG Competition is not happy with this situation.

Finally, he turned to standards, stressing the fact that standards can foster competition but that they can also be used to restrict access. In this context, he mentioned the case against the EPC's standardisation efforts with respect to e-payments. When banks are setting such standards, they should not discriminate against players not controlled by a bank.

[7] Joaquín Almunia, Building Europe's future payments market, Next Generation Cards and Payments conference, Brussels, 12 October 2011 (SPEECH/11/659)
http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/11/659&format=HTML&aged=0&language=EN&guiLanguage=en

Concluding, he demanded more transparent and cheaper payment transactions.

Our Comment

The card payment market is a complex market and determining how it should be regulated is by no means easy. Given our current state of knowledge, it is not clear what the "optimal" regulation of card payments should look like. Still, even when admitting that regulators have to act under the veil of uncertainty, the regulatory approach should at least be consistent.

Commissioner Almunia diagnoses a lack of innovation in Europe and contrasts this with developments in the US or China. In order to foster innovation, he wants more standardisation. However, the examples he cites, PayPal, for instance, or Google Check Out, lend little support to the medicine he prescribes. Both are not based on a "round table approach" where all market players sit together and decide about standards. Rather, they developed their own proprietary systems and went ahead. Thus, they are better suited as example of innovators as "creative destructors"[8] rather than the Eurocrat's vision of "level playing field innovations".

The Commission's stance on interchange is well known. The Commission does not want to abolish interchange fees but it wants them to be low. There may be sound reasons for such an approach. However, it is not clear whether a downward regulation of interchange fees will, indeed, lead to more competition and market entry of new comers. Commissioner Almunia seems to believe this. However, when looking further west, to the U.S., we find a very recent example where the immediate effect of a reduction of debit card interchange fees has been the demise of the relatively new scheme Tempo.[9]

An issue of particular importance is the question to what extend banks need to let other payment service providers access payers' accounts. Commissioner Almunia touches this issue only briefly. But for banks as well as non-banks it would be highly relevant to learn more on regulators attitudes regarding this aspect. In the past, there have been remarks here and there,[10] but a coherent framework is yet to emerge.

[8] The term „creative destruction" was coined by Joseph Schumpeter, an Austrian economist.
[9] See the August edition of this newsletter.
[10] See, for instance: Access to payment schemes: An opinion from the ECB, in the June 2009 edition of this newsletter.

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