



Groupement des Cartes Bancaires CB

EXPECTED IMPACT OF THE PROPOSED LEGISLATION ON CARD TRANSACTIONS IN EUROPE

Regulation on Multilateral Interchange Fees (MIF Regulation)

Review of the Payment Services Directive (PSD 2)

POSITION PAPER

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FOREWORD

The current document outlines the views of Groupement des Cartes Bancaires CB on the legislative package set out on 24 July 2013 by the European Commission proposing a revised Payments Services Directive (PSD 2)¹ and a Regulation on Multilateral Interchange Fees (MIF Regulation)².

As one of the major European card schemes, CB wholeheartedly supports the viewpoint expressed by Commissioner Barnier³ that **“Retail payments have a major contribution to play in Society in general and in the Single Market in particular, and that it is essential that retail payment services are accessible, secure and transparent, as well as being competitive and innovative”**.

Examination of some of the key principles in the Commission’s proposals however show that unless enhanced they :

- would have the opposite effect to the Commission’s desired goal of establishing a competitive single market in the field of payments,
- are not in the interest of the European Citizen as a Consumer since they would increase the cost of “card payments”, including card based payments and those made by mobile and other devices for internet payments, and moreover
- would adversely impact the Sovereignty of the European Union and the Independence of Member States.

The document includes concrete proposals to address the above issues

¹ Proposal for a Directive of the European Parliament and of the Council on payment services in the internal market <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0547:FIN:EN:PDF>

² Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0550:FIN:EN:HTML>

³ See Commissioner Barnier's speech at the European Central Bank / Banque de France Conference "Retail payments at a crossroads: Economics, strategies and future policies", 21/10/2013 http://ec.europa.eu/commission_2010-2014/barnier/headlines/speeches/2013/10/20131023_fr.htm

APPLICATION SELECTION

The Commission proposes that: **"Where a payment device offers the choice between different brands of payment instruments, the brand applied to the payment transaction at issue shall be determined by the payer at the point of sale"**⁴

This proposal to systematically request the cardholder to select the brand at the point of sale would result in a number of perverse and undesirable effects such as:

1. increase costs of use and acceptance of cards in Europe,
2. reinforce the current MasterCard / Visa duopoly,
3. negatively impact European Sovereignty & rights of EU citizens.

1. INCREASE IN THE COST OF THE USE AND ACCEPTANCE OF CARDS IN EUROPE

The Commission's proposal would inevitably lead not only to a reduction in competition in Europe but also an increase in costs both for merchants and consumers, and more importantly the overall costs of payments within the Union.

This is because it would produce a phenomenon called "inverted competition" whereby the **best known but more expensive brand would be chosen by the cardholder**, to the detriment of lesser known but less expensive domestic brands, simply because of brand recognition and notoriety even though such a choice would result in a more expensive payment transaction.

The MIF Regulation explains quite correctly that it is the merchant who pays for the acquiring payment services through Merchant Service Charges and that these vary depending on the different categories of card or brands used for the transaction⁵. It is therefore both reasonable and logical that the merchant (i.e. the payee) should have a say in the choice of brand/application at the time of the transaction.

This reasoning is supported by the fact that for the majority of transactions with co-branded cards in Europe the brand/application used for the transaction doesn't affect the consumer / cardholder in any way (e.g. a transaction made with a CB/Visa card or a Girocard/Maestro card have the same cost and offers an identical experience and level of protection to the consumer no matter which brand / application is used). The sensible approach therefore is to leave the choice of the brand / application to the merchant, for whom the differential costs of competing applications and schemes is a material consideration.

Furthermore, in the interests of efficiency, the merchant should be allowed to use a default brand / application negotiated in their contractual agreement with their payment service provider.

Usage of contactless cards which are convenient for "tap and pay" payments would be limited if a pre-determined choice of brand or application was forbidden as proposed in the MIF Regulation⁶

Unless there exists a default choice of application which the merchant should be allowed to negotiate with their Payment Service Provider (acquirer) and which is to be used when there is no consumer / merchant preference, a further unintended effect would be an increase in checkout and queuing times at certain points of sale and motorways, especially during rush hours, vacations and peak sales periods such as weekends and Christmas.

2. REINFORCE THE CURRENT MASTERCARD / VISA DUOPOLY

The proposal put forward by the Commission would by design encourage each and every card system (CB, Girocard, MasterCard, PagoBancomat, Visa,...) to constantly resort to **ever-increasing publicity campaigns to improve brand recognition and encourage cardholders to select their brand** at the time of payment ... at a cost of **millions of dollars each year**.

Indeed, if the choice of the brand/application is left solely to the cardholder in this way, brand recognition will become the first and main driver for the choice instead of cost-efficiency. It will then intrinsically benefit those card schemes which are able to finance multi-million dollar advertisement and incentive campaigns, namely MasterCard and Visa, to the detriment of domestic European card schemes.

If the European legislators endorse such a policy it would be tantamount to giving an irreversible advantage to MasterCard and Visa which are today two of the most notorious brands worldwide (20th and 9th respectively⁷) while condemning the possibly more cost-efficient but lesser known domestic card systems (Bancontact / MisterCash, CB, Girocard, MultiBanco, PagoBancomat, Servired, ...) which do not have the resources for such onerous advertising campaigns. Indeed, lacking the financial resources to acquire the necessary brand recognition to compete with more well-known players, they will be forced to disappear over time (as has been shown with the disappearance of Laser in Ireland, Pankkikortti in Finland, PIN in the Netherlands, and the current threat to Dankort in Denmark).

⁴ See MIF Regulation Article 8 Co-badging and choice of application alinea 5

⁵ As proposed in MIF Regulation Article 9 Unblending

⁶ See MIF Regulation Article 8.19 "Payment card schemes, issuers, acquirers and payment card handling infrastructure providers shall not insert automatic mechanisms, software or devices on the payment instrument or at equipment applied at the point of sale which limit the choice of application by the payer when using a co-badged payment instrument."

⁷ See Business Insider Review May 2013 www.businessinsider.com/the-20-most-valuable-brands-in-the-world-2013-5?op=1

3. NEGATIVELY IMPACT EUROPEAN SOVEREIGNTY AND THE RIGHTS OF EUROPEAN CITIZENS

A further consideration is that, in the view of National Security Authorities in certain Member States, favouring non-European brands in this way would represent :

- a menace to European Sovereignty since it would present an underlying threat of future restriction of payment card services in Europe by a non-EU authority, as has happened in the past⁸,
- a danger to the European citizen in terms of privacy and data protection, as illustrated by the SWIFT / PRISM case whereby the NSA is accused of unauthorised access to data from credit card networks and the Swift interbank payment network⁹, and
- a risk of misuse of card transaction and cardholder data, for example for commercial purposes. This is due to the fact that data linked to the usage of applications owned by American enterprises could be considered to fall under the American legal regime which is more permissive than that of the European Union.

PROPOSALS ON APPLICATION SELECTION

Most of the above concerns could be resolved by **allowing the brand which is applied to the payment transaction to be determined by the merchant.**

The **merchant should be allowed to negotiate a default brand** with their Payment Service Provider (acquirer).

DEFINITIONS OF DEBIT CARD AND CREDIT CARD

The proposed Regulation proposes to introduce an artificial segmentation to differentiate between credit cards and debit cards¹⁰, which does not reflect the existing distinctions in every payment card scheme and is likely to be problematical in its implementation.

Indeed, the proposed definition only reflects that used by two systems, MasterCard and Visa, where the distinction between a debit card transaction and a credit card transaction is based on debiting the account and settlement within 48 hours.

Segmentation between credit cards and debit cards does not exist in systems other than MasterCard and Visa, and such segmentation does not correspond to common practice in any of the European card schemes such as CB, Girocard, MultiBanco or Servired, which have rules and regulations for a single type of card.

As regards the proposed levels of caps for interchange fees, the proposed Regulation is also based on the specific figures (0.2% and 0.3% of the transaction amount) initially proposed by MasterCard and Visa in their commitments made to the competition authorities.

In taking the above approach, the Commission is unwittingly favouring the MasterCard / Visa duopoly.

To adopt the practices, language, definitions, product segmentation and standards of MasterCard and Visa will, with a lasting effect, put the European card schemes at a competitive disadvantage, even though they are currently more cost effective for users, in relation to these two already dominant actors.

Indeed, an approach which would turn internal rules of two market players into European law would force the other competitors to adapt to the new rules, with all the implied costs, while the two players in question would continue conducting their business without extra cost.

Introducing legislative measures based on practices of the two systems which have a quasi duopoly of the worldwide and European markets would thus reduce the diversity, competition and level playing field for card payments in Europe.

⁸ for example blocking of payments using cobranded Visa and MasterCard cards issued by European domestic card schemes... purportedly at the behest of the U.S. Government <http://www.reuters.com/article/2013/07/03/iceland-wikileaks-idUSL5N0F93IX20130703> and <http://rt.com/news/wikileaks-lieberman-king-mastercard-visa-709/>.

⁹ See Statement by Home Affairs Commissioner Cecilia Malmström to MEPs on 24/9/2013 <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+IM-PRESS+20130923IPR20604+0+DOC+XML+V0//EN>

¹⁰ See MIF Regulation Article 2 Definitions alineas (4) and (5)

'debit card transaction' means an card payment transaction included with prepaid cards linked to a current or deposit access account to which a transaction is debited in less than or 48 hours after the transaction has been authorised/initiated.

'credit card transaction' means an card payment transaction where the transaction is settled more than 48 hours after the transaction has been authorised/initiated.

It should also be noted that, conversely to the European Commission's proposals, National Competition Authorities (for example in France¹¹) did not find it relevant to take into account the definitions and segmentation used by MasterCard and Visa.

In fact the Authorities considered it to be unnecessary and irrelevant in achieving their goal (which was to reduce the interchange fee) to make the distinction between two types of cards which does not exist in the CB system in France.

The proposed Regulation would in fact place the two non-European players at an unfair advantage compared with their European competitors, since the systems operated by MasterCard and Visa already apply this distinction today, meaning that they would be the only schemes which could apply the provisions of the Regulation throughout Europe within the time limits stipulated by the Regulation.

PROPOSALS ON THE DEFINITIONS OF DEBIT CARD AND CREDIT CARD

In order to address the above concerns and to create a level playing field in the European Union, "debit card transaction" and "credit card transaction" must be better defined in the MIF Regulation to correspond to the European Central Bank's definition of credit card¹².

The following definition would achieve this :

"A Debit Card Transaction is one which allows the payment account of the cardholder to be debited immediately. All other card transactions are Credit Card Transactions."

DEFINITIONS OF INTERCHANGE FEES AND MERCHANT SERVICE CHARGES

There is a need to clarify definitions such as Interchange Fee and Merchant Service Charge and avoid building expensive and unmanageable systems to calculate MIFs on a per transaction basis.

The proposed Regulation defines the Interchange Fee as a fee paid for each transaction directly or indirectly (i.e. through a third party) between the payment service providers of the payer and of the payee involved in a payment card or a payment card-based transaction¹³.

This definition is incomplete since it makes no mention that the interchange fees correspond to the remuneration for a service provided by the payer's PSP (the card issuer) to the payee's PSP (the acquirer), among which the guarantee that all card transactions will be honoured, even in case of fraud or lack of funds on the customer's account. This mechanism is indispensable for the functioning and economic stability of domestic card schemes in Europe.

Furthermore, the proposed Regulation is misleading in its treatment of Merchant Service Charges¹⁴ (paid by the merchant to the acquirer) and Interchange Fees (paid by the acquirer to the card issuer).

The preamble of the proposed Regulation creates confusion between these Interchange Fees, which are transparent inter-PSP (interbank) fees forming the cornerstone of economically efficient domestic card schemes, and other fees from schemes themselves.

Remuneration for services provided by one PSP to another allows for the efficient, secure and cost-effective operation of European domestic card schemes, such as Bancontact / MisterCash, CB, Girocard and PagoBancomat.

Local Competition Authorities in some EU Member States, for example France¹⁵, have already issued decisions on the proposed commitments by European Card Schemes on interchange fees based on an *annual weighted average* of the total number of transactions made.

Because of this, any calculation of the interchange fees per transaction¹⁶ is fundamentally different to the commitments made by domestic card systems and accepted by national competition authorities.

¹³ See MIF Regulation Article 2 Definitions alinea 9

¹⁴ See MIF Regulation Article 2 Definitions alinea 10 : 'merchant service charge' means a fee paid by the payee to the acquirer for each transaction comprising the interchange fee, the payment scheme and processing fee

¹⁵ See <http://www.autoritedelaconurrence.fr/pdf/avis/11d11.pdf>

¹⁶ See MIF Regulation Articles 3 and 4 Interchange fees for consumer debit or credit card transactions

¹¹ See <http://www.autoritedelaconurrence.fr/pdf/avis/11d11.pdf>

¹² www.ecb.europa.eu/home/glossary/html/glossd.en.html : "debit card (card with a debit function) is a card enabling its holders to make purchases and/or withdraw cash and have these transactions directly and immediately charged to their accounts, whether these are held with the card issuer or not".

Obliging the domestic systems to modify their current business model in this way will:

- increase the cost for cardholders,
- reduce the efficiency of providing universal card transaction services,
- negatively impact the capacity for card systems to invest in innovation and security, by removing the possibility of incentivising more secure and efficient transaction types with the ensuing risk that European industry may miss out on key developments in the fast changing payment industry and engender an increase in fraud.

PROPOSALS ON THE DEFINITIONS OF INTERCHANGE FEES AND MERCHANT SERVICE CHARGES

In order to address the above concerns and to create a level playing field in the European Union:

Interchange Fee should be clearly defined to mean “a fee determined by the card scheme and paid by the PSP of the Payee as remuneration for services provided, for each operation, by the PSP of the Payer. In particular, the security, guarantee of payment and processing costs for the transaction are included in such services”.

In addition, **the caps of 0.20% and 0.30 % should not be based on a per transaction basis but be based on an annual weighted average of the total number of transactions made between members (PSPs) within a given card scheme.**

So that there can be no confusion between MSC and MIF, the definition of **Merchant Service Charge** should be clearly defined to mean “a fee which is freely negotiated between the acquirer and the payee as a remuneration of services provided by the acquirer so that the payee can accept card payment transactions. In particular, the security of the transactions, as well as their collection and presentation for clearing are included in such services”.

SMALL VALUE PAYMENTS

The European Commission's proposal to cap interchange fees on debit card transactions and credit card transactions as a percentage, with a figure of 0.2 % and 0.3% respectively¹⁷, will mean that “Low Value Payments” would not be commercially viable for card issuers. Indeed, since the maximum interchange allowed by the Regulation would not cover the typical costs of processing such transactions, it would therefore inhibit innovation and the development of business models to facilitate the replacement of cash for low value payments.

Unless this fact is taken into account in the MIF Regulation, the use of cash for low value purchases will not be replaced by more modern and efficient technologies such as contactless payments.

PROPOSAL ON SMALL VALUE PAYMENTS

The way forward would be to introduce a specific provision for interchange fees for low value payments (for example for transactions for less than 20 euros).

¹⁷ See MIF Regulation Articles 3 and 4 Interchange fees for consumer debit or credit card transactions

ENTRY INTO FORCE

The MIF Regulation stipulates that provisions regarding cross-border (intra-EU) consumer debit or credit card transactions will come into force two months after the date of entry into force, which in itself is 20 days after publication in the EU Official Journal¹⁸.

Maintaining a distinction between cross-border (intra-EU) transactions and transactions within a Member State for an interim period is incompatible with the objective of creating a single market.

Furthermore application of the dispositions of the Regulation in such a short transition period of 2 months will create an asymmetrical situation which is biased against smaller retailers and payment schemes in favour of larger players who may have greater margin to manoeuvre. This will distort the market. In addition it may encourage merchants to relocate geographically to take advantage of the cross border provisions, which will also have a potentially distorting effect.

It will be impossible in such a short period of time for all Payment Service Providers and all European Card Schemes to meet the required obligations, regarding, for example :

- modifications to processing systems to identify credit and debit card transactions¹⁹, and for the application of new formulae to calculate interchange fees²⁰, ...
- new requirements for visual and electronic identification of card products in order to adapt to the new *honour all cards rule*²¹, which in practice would probably mean the re-issuance of the majority of cards in Europe,
- provide detailed information to merchants, as required by the Regulation²².

PROPOSALS ON THE ENTRY INTO FORCE

The way forward would be to:

- apply the same date for the effect of the MIF Regulation for both cross-border transactions and all transactions in the EU (i.e. 2 years after publication in the EU Official Journal),
- apply the same date for the entry into force for both the MIF Regulation and the PSD2

¹⁸ See MIF Regulation Article 3.1 and Article 3.2

¹⁹ See MIF Regulation Article 2 Definitions (4), (5)

²⁰ See MIF Regulation Article 3 and 4 Interchange fees for consumer debit or credit card transactions

²¹ See MIF Regulation Article 10 Honour All Card rules

²² See MIF Regulation Article 12 Information to the payee on individual payment transactions

AUTHENTICATION OF CARD PAYMENT TRANSACTIONS

Although the PSD 2 includes a definition of “authentication”²³, it is limited to “... a procedure ... to verify the identity of a user of a specific payment instrument ...”.

As such it is insufficient and misleading since it is not possible to verify the identity of the user of a specific payment instrument but only to verify that the specific payment instrument has been used.

The current definition would condone a reduction in security compared to the current practices for card payments and not achieve the purpose of the procedure.

This is because **transactions made today using a physical card are authenticated at 3 levels** that go beyond the identity of a user of the payment instrument. These are :

- authentication of the physical payment instrument (the card) using cryptographic techniques (SDA - Static Data Authentication, DDA - Dynamic Data Authentication, CDA - Combined Data Authentication),
- authentication of the use of the card by verifying the confidential PIN code, supposedly entered by the legitimate cardholder, and
- authentication of the transaction data using an electronic signature.

PROPOSAL ON AUTHENTICATION OF CARD PAYMENT TRANSACTIONS

To avoid a negative impact on the security of card payments and corresponding increase in counterfeit or fraudulent transactions using a card, **the definition of authentication in the PSD 2 must be reinforced by including the 3 levels of authentication for payment operations where the card is physically present.**

Furthermore a generic definition of security requirements for all payment instruments is impossible without reducing the level of security currently attained by some of them, such as cards. To avoid this risk, **a distinction must be made in the PSD 2 between card transactions and operations made with other payment instruments such as direct debits and credit transfers.**

²³ See PSD 2 Article 4 Definitions (21) ‘authentication’ means a procedure which allows the payment service provider to verify the identity of a user of a specific payment instrument, including the use of its personalized security features or the checking of personalised identity documents.

SEPA GOVERNANCE

It is known that in the spring of 2013, the European Commission was considering including in the PSD 2 a section describing the Establishment and Functioning of a European Retail Payments Board, indicating that the Board would be made up of representatives of the relevant stakeholders from both the supply side and the demand side in retail payments.

Although the text describing the establishment of the ERPB is no longer in the PSD 2, in a meeting of the SEPA Council on 23rd September 2013, the ECB committed to establish and chair the Euro Retail Payments Board (ERPB) as successor of the SEPA Council and the European Commission committed to actively participate therein²⁴.

The stated objective of the ERPB is to contribute to and to facilitate the creation of an integrated, competitive, innovative and level-playing field market for euro retail payments in the EU.

The initial list of organizations which will be invited to participate in the ERPB includes :

- European Consumers' Organisation - BEUC,
- Eurocommerce & ERRT,
- E-commerce Europe,
- EACT & BusinessEurope,
- European Association of Small and Mid-sized Enterprises - UEAPME,
- EU Financial Services Committee,
- European Payments Council (EPC),
- European Association of Cooperative Banks (EACB),
- European Banking Federation (EBF),
- European Savings Bank Group (ESBG),
- Association of Payment Institutions (to be defined),
- Association of E-money Institutions (to be defined).

At this stage there is no mention of the European card schemes being invited to participate in the ERPB.

PROPOSAL ON SEPA GOVERNANCE

Although this commitment to establish a sound SEPA Governance is welcomed, the following issues need to be addressed:

- **Domestic card schemes should be included in the key stakeholders which participate in the ERPB,**
- **The stated objective of the MIF Regulation and the PSD2 to create an integrated, competitive, innovative and level-playing field for payments in the European Union will be difficult to achieve if the ERPB focuses only on euro retail payments.**

²⁴ See http://www.ecb.europa.eu/paym/sepa/pdf/SEPA_Council_statement_6th_meeting.pdf

ABOUT GROUPEMENT DES CARTES BANCAIRES CB



Established in 1984 to provide a universal and interoperable card payment and ATM cash withdrawal scheme in France, Groupement des Cartes Bancaires CB is a non-profit organization acting as the governing body of the CB payment scheme.

As of 30 September 2013, CB has 126 members, comprising both banks and payment institutions worldwide.

CB is responsible for the system's overall architecture, inter-member rules & procedures and risk management. CB also defines technical and security standards, and ensures that manufacturers and vendors whose products and services are used in the CB system comply with these standards.

Furthermore, CB operates an information system, providing its members with high performance data mining tools and countermeasures in the fight against fraud.

CB is one of the largest card payment schemes in the European Union with

61 million cards, more than 58,500 ATMs, 1.8 million merchants and a very significant activity, both in terms of transaction volumes and value as shown by the 2012 figures: 9.6 billion CB transactions for a total value of 507 billion euros.

For further information, visit www.cartes-bancaires.com or contact

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