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IMPACT ASSESSMENT

Accompanying the document

Proposal for a directive of the European parliament and of the Council on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/UE and 2009/110/EC and repealing Directive 2007/64/EC
and
Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions

{COM(2013) 547 final}
{COM(2013) 550 final}
{SWD(2013) 289 final}

Annexes

Annex 1: Glossary

Term	Definition
Acquirer (card acquirer)	In point-of-sale (POS) transactions, the entity (usually a credit institution) to which the acceptor (usually a merchant) transmits the information necessary in order to process the card payment. In automated teller machine (ATM) transactions, the entity (usually a credit institution) which makes banknotes available to the cardholder (whether directly or via the use of third-party providers).
Authorisation	The consent given by a participant (or a third party acting on behalf of that participant) in order to transfer funds or securities.
Automated teller machine (ATM)	An electromechanical device that allows authorised users, typically using machine-readable plastic cards, to withdraw cash from their accounts and/or access other services (allowing them, for example, to make balance enquiries, transfer funds or deposit money).
Card (payment card)	A device that can be used by its holder to pay for goods and services or to withdraw money.
Cardholder	A person to whom a payment card is issued and who is authorised to use that card.
Card issuer	A financial institution that makes payment cards available to cardholders, authorises transactions at point-of-sale (POS) terminals or automated teller machines (ATMs) and guarantees payment to the acquirer for transactions that are in conformity with the rules of the relevant scheme.
Card scheme	A technical and commercial arrangement set up to serve one or more brands of card which provides the organisational, legal and operational framework necessary for the functioning of the services marketed by those brands.
Cheque	A written order from one party (the drawer) to another (the drawee; normally a credit institution) requiring the drawee to pay a specified sum on demand to the drawer or a third party specified by the drawer.
Consumer	Any natural person who requests and makes use of a payment account for purposes other than his trade, business, craft or profession.
Credit card	A card that enables cardholders to make purchases and/or withdraw cash up to a prearranged credit limit. The credit granted may be either settled in full by the end of a specified period, or settled in part, with the balance taken as extended credit (on which interest is usually charged).
Credit institution/ bank	A credit institution is a company duly authorised to carry out banking transactions on a regular basis (i.e. to receive deposits from the public, carry out credit transactions, make funds available and manage means of payment).
Credit transfer	A payment service for crediting a payee's payment account, where a payment transaction or a series of payment transactions is initiated by the payer on the basis of the consent given to his payment service

	provider.
Cross-border payment	A payment where the financial institutions of the payer and the payee are located in different countries.
Debit card	A payment card not allowing payment transactions which exceed the balance of the account.
Direct debit	Direct debit is a payment service that allows a payee (e.g. an electricity company or a mobile phone operator) to instruct its bank to collect (to debit) varying amounts directly from a customer's account. The transaction is initiated by the payee (the company in the example provided) on the basis of the payer's (consumer's) consent given to the payee or to the payer's own service provider.
Electronic money	A monetary value, represented by a claim on the issuer, which is: 1) stored on an electronic device (e.g. a card or computer); 2) issued upon receipt of funds in an amount not less in value than the monetary value received; and 3) accepted as a means of payment by undertakings other than the issuer.
Electronic money institution	A term used in EU legislation to designate credit institutions which are governed by a simplified regulatory regime because their activity is limited to the issuance of electronic money and the provision of financial and non-financial services closely related to the issuance of electronic money.
EMV	An acronym describing the set of specifications developed by the consortium EMVCo, which is promoting the global standardisation of electronic financial transactions – in particular the global interoperability of chip cards. “EMV” stands for “Europay, MasterCard and Visa”.
Interchange fee	A transaction fee payable between the payment service providers involved in a transaction.
Four-party card scheme	A card scheme where the stakeholders involved are: 1) the issuer; 2) the acquirer; 3) the cardholder; and 4) the card acceptor. By contrast, in a three-party card scheme, the issuer and the acquirer are always the same entity.
Governance	Procedures through which the objectives of a legal entity are set, the means of achieving them are identified and the performance of the entity is measured. This refers, in particular, to the set of relationships between the entity’s owners, board of directors, management, users and regulators, as well as other stakeholders that influence these outcomes.
Interoperability	The set of arrangements/procedures that allows participants in different systems to conduct and settle payments or securities transactions across systems while continuing to operate only in their own respective systems.
Means of payment	Assets or claims on assets that are accepted by a payee as discharging a payment obligation on the part of a payer vis-à-vis the payee.
Merchant Service Charge	A fee paid by the acceptor/merchant to the acquirer.

Mobile payment	A payment where a mobile device (e.g. a phone or personal digital assistant (PDA)) is used at least for the initiation of the payment order and potentially also for the transfer of funds.
Money remitter	A payment service provider that accepts funds from a payer for the purpose of making them available to a payee, without necessarily maintaining an account relationship with the payer or payee.
Payer	A natural or legal person who holds a payment account and allows a payment order from that payment account, or, where there is no payment account, a natural or legal person who gives a payment order.
Payee	A natural or legal person who is intended recipient of funds which have been the subject of a payment transaction.
Payment Initiation Services (PIS)	These services facilitate the use of the consumer's online banking platform to initiate immediate internet payments (typically on the basis of credit transfers) to the accounts of retailers, providing added value for consumers (easy to use, no possession of a credit card is required) and merchants (low cost, payment initiation confirmation, payment reconciliation).
Payment institution	A legal person that has been granted authorisation, in accordance with Article 10 of the Directive 2007/64/EC on payment services in the internal market, to provide and execute payment services throughout the Union.
Payment instrument	A tool or a set of procedures enabling the transfer of funds from a payer to a payee. The payer and the payee can be one and the same person.
Payment scheme	A set of interbank rules, practices and standards necessary for the functioning of payment services.
Payment service provider	Any of the categories referred to in Article 1(1) of Directive 2007/64/EC and the legal and natural persons referred to in Article 26 of that Directive, but excludes those institutions listed in Article 2 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions benefiting from a Member State waiver exercised under Article 2(3) of Directive 2007/64/EC, to which belong: – credit institutions/banks; – payment institutions, e.g. GSM companies, bill payers, money remittance institutions, etc.; – electronic money institutions; – post office giro institutions; – other payment services providers, e.g. public authorities or national central banks (in some cases).
Payment service user	A natural or legal person making use of a payment service in the capacity of either payer or payee, or both.
Payment transaction	An act, initiated by the payer or by the payee of transferring funds, irrespective of any underlying obligations between the payer and the payee.

Payment system	It refers to the set of instruments, banking procedures and interbank funds transfer systems which facilitate the circulation of money in a country or currency area.
PIN (Personal Identification Number)	A personal and confidential numerical code which the user of a payment instrument may need to use in order to verify his/her identity. In electronic transactions, this is seen as the equivalent of a signature.
Pre-Paid Card	A card on which a monetary value can be loaded in advance and stored either on the card itself or on a dedicated account on a computer. Those funds can then be used by the holder to make purchases.
Refund	In the field of direct debits, a claim made by a debtor for the reimbursement of debits effected from its account (with or without a specific reason being indicated by that debtor).
Remote payment	A payment made from a distance, without the payer and payee being present at the same physical location.
Retail payment	These payments are typically made outside of the financial markets and are both initiated by and made to individuals and non-financial institutions.
Reverse competition	In the context of card payments, reverse competition means that card schemes compete with each other by offering higher MIF revenues to banks that issue their cards. This results in higher fees for card payments in general, which are passed on merchants and, ultimately, consumers (rather than lower fees which would be the case under normal competition). As a result there is a welfare loss for merchants and consumers and a restricted market entry for new players, as ever increasing levels of MIFs are considered as a minimum threshold by banks that issue cards.
Single Euro Payments Area	A process initiated by European banks and supported, inter alia, by the Eurosystem and the European Commission with a view to integrating retail payment systems and transforming the euro area into a true domestic market for the payment industry.
Third Party Provider (of payment services)	Payment initiation services (see above), and account information services are usually provided by third party providers (TPPs) i.e. providers different than the bank that holds the account of the consumer.
Three-party card scheme	A card scheme involving the following stakeholders: 1) the card scheme itself, which acts as issuer and acquirer; 2) the cardholder; and 3) the accepting party. This contrasts with a four-party card scheme, where the issuer and the acquirer are separate entities and are separate from the card scheme itself.
Value date	The date on which it is agreed to place a payment or transfer at the disposal of the receiving user. The value date is also used as a point of reference for the calculation of interest on the funds held on an account.

Annex 2: Table of Abbreviations

AML	Anti-Money Laundering
ATM	Automatic Teller Machine
CEN	Committee for European Standardisation
CRD	Consumer Rights Directive
E-payments	Internet payments
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
ESO	European Standardisation Organisation
ETSI	European Telecommunications Standards Institute
GDP	Gross Domestic Product
HACR	Honour All Card Rule
IF	Interchange Fee
IT	Information Technology
M-payments	Mobile payments
MIF	Multilateral Interchange Fee
MSC	Merchant Service Charges
NDR	Non-Discrimination Rule
NFC	Near Field Communication
PI	Payment Institution
PSD	Payment Services Directive
POS	Point of Sale
PSP	Payment Services Provider
PSU	Payment Services User
SCT	SEPA Credit Transfer
SDD	SEPA Direct Debit
SEPA	Single Euro Payments Area
TPP	Third Party Provider

Annex 3: Main findings of the consultations on the Green Paper and the PSD review

The extensive consultation processes, carried out by the Commission, have allowed for the identification of a number of key messages from all stakeholder categories (supply side, demand side and other participants of the payments market, including public authorities), which are summarised below.

First, in response to the Green Paper, the most significant points included:

Consistent cross-stakeholder support for the legal clarity concerning MIFs for card payments and for higher transparency of rules and conditions concerning MIFs on the market.

Wide support for facilitating and removing all potential obstacles to cross-border acquiring of card payments by demand side, public authorities and many of the supply side stakeholders.

Large majority of stakeholders across all categories considered it important to extend the regulatory framework and adequate supervision to service providers offering online-banking based payment initiation services in the market and, in the wider context, to clarify the issue of access of third party providers to the information on the availability of funds in the payment accounts – with the consent of the payment service user.

Clear majority of stakeholders across most categories expressed the view that surcharging should be banned or else fully harmonised across EU and limited to the actual cost borne by the merchant. If surcharging was retained in the future, it should become possible on all payment means, including cash or cheques, according to many stakeholders from supply side and public authorities.

As regards mobile payments, most stakeholders from all groups believed it important to establish technically neutral and open common standards as soon as possible. For internet payments, market participants acknowledged that, based on the common platform of the internet and its established protocols, technical standardisation does not have to start from scratch. However, the risks inherent to the use of the internet call for common security requirements for online-banking based payment initiation services, which have to be developed.

A number of important findings follow also the consultations and studies undertaken in the process of the review of PSD and of Regulation 924/2009, including during the meetings of the Commission's advisory committees (PC, PSMEG). Some findings mirror and reinforce the messages gathered in the consultation on the Green Paper, most notably the issue of access to the information on payment accounts and the feedback on surcharges. Others are related to the existing regulatory provisions in the PSD.

The most important points include:

Clearly expressed need for changes in the scope of the PSD (including both the geographical scope and the so-called negative scope – limitations to the exclusions from the application of the directive) by many stakeholders from all categories, Calls for further harmonisation of the prudential requirements and of supervisory practices, in particular on passporting rules (including the use of agents) for payment institutions (PIs), expressed by both authorities and payment service providers,

Need for further precision and harmonisation as regards certain rights and obligations of users and providers, in particular on surcharging and rebating practices, liability for unauthorised payment transactions and on refund rights, expressed by authorities and demand side of the market,

Need to provide a coordinated and consistent legal framework for payments and not to concentrate on isolated issues, was expressed by all stakeholder categories.

The table below summarises the position of different stakeholder categories on the key aspects discussed in this impact assessment.

Area	**Stakeholders**		
	Supply side: (1) banks (2) card schemes (3) technical payment providers (4) internet and mobile payment providers (5) other PSPs	**Demand side:** (6) merchants/retailers (7) consumers	**Other market** participants: (8) public authorities (9) consultants, academics, think-tanks
Governance and standardisation issues			
Establish a formal governance body (European Retail Payments Council)	Divided Some support for clear governance leadership by (1) (2) (3)(4) and (5) Preference for self-regulation rather than a formal governance body by majority of (1)	Strong support by (6) and (7) to involve end-users and give a leading role to the Commission/ECB	Support for clear governance structure and greater role of the end –users by (8)
Standardisation of card payments by payments governance framework (European Retail Payments Council) using existing industry-led projects	Divided Support for industry-driven standardisation by (1) and (2) Support for greater involvement of end-users in standardisation by some (2)(3)(4) and (5) Support for better implementation and enforcement of existing standards by some (3)(4)	Strong support to fully involve end-users in the card standardisation process by (6) and (7) Strong support for better implementation and enforcement of existing standards by (6) and (7)	Strong support to fully involve end-users in the card standardisation process by (8) Strong support for better implementation and enforcement of existing standards by (8) and (9)

	and (5)		
Standardisation of mobile payments by European Standardisation Organisations (ESOs)	Divided Preference for no intervention by ESOs and natural market development by most (1) and (2) Support to greater involvement of ESOs by some (3)(4) and (5)	General support to greater involvement of ESOs by (6)	Neutral/ No views expressed
Interchange Fees (IFs)			
Regulation of cross-border IF (first phase) N.B the issue was discussed together with cross border acquiring	Divided Cross-border IF regulation opposed by majority of (1) and (2), IF harmonisation across borders should be achieved by natural market development and voluntary integration Cross-border IF regulation supported by most (4) and (5)	Cross-border IF regulation supported as an ancillary solution by some (6) Clear preference for pan-European regulation based on maximum common caps or a complete ban on IF supported by a great majority of (6) General support for pan-European harmonisation of IF levels by (7)	Cross-border IF regulation supported by some (8), no clear views expressed by others General support for pan-European harmonisation of IF levels by (8)
Maximum caps on IF for debit and credit cards , domestic and cross-border (second phase)	Regulation of IF levels generally opposed by (1)(2)(4) and (5).	Regulation of IF on the basis of a common EU-wide cap supported by (6) and most of (7). Both (6) and (7) call for basic card payment functionality or debit card without IF.	Divided Support of many (8), in particular competition authorities for IF regulation/limitation of MIF. Support by some (8) to limit IF taking into account national criteria. Support by some (8) to ban IF for some payment instruments (debit cards, internet or mobile payments)

			Preference for no IF regulation and competition enforcement only by some (8)
Exemption of commercial cards and third party card schemes from IF regulation *N.B. the issue was discussed without taking into account the IF flanking measures discussed in this impact assessment*	Divided Support for the same IF rules for three and four party schemes by most (1) and (2) Different rules for three party schemes supported by few (1) and (2), including three party card schemes Some (1) and all (2) support different rules for commercial cards. Some other (1) opposed to make the distinction between consumer and commercial cards.	Support for the same rules for three and four party schemes by (6) and (7). Support for the same treatment of consumer and commercial cards by (6) and (7)	Support for the same rules for three and four party schemes by (8) Support for the same treatment of consumer and commercial cards by (8)
IFs - flanking measures			
Cross-border acquiring	Preference for market – driven initiatives over regulation. Support for the removal of obstacles to cross-border acquiring of technical or standardisation nature by the majority of (1) and (2) Some (1) and (2) claim that no obstacles to cross-border acquiring exist. Domestic card schemes and three-party schemes indicate that rules of four-party schemes are a significant obstacle to cross-border acquiring. In contrast, (4) and (5)	Strong support to facilitate the cross-border acquiring through the regulatory intervention by (6) and (7). Both (6) and (7) identify numerous obstacles to cross-border acquiring, in particular the rules of both international and domestic card schemes.	General support for cross-border acquiring by (8). Some (8) identified card scheme rules (international and national) as the main difficulty, others indicated problems of technical and standardisation nature. Neutral/no expressed opinions on the regulatory approach

	claim that both international and domestic scheme rules make cross-border acquiring very difficult.		
Prohibition of Honour All Cards Rule	Divided Most (1) and (2) opposed to the abolishing of Honour All Card Rule Some (2) and most (4) and (5) in favour of the prohibition	Most (6) in favour of abolishing Honour All Car Rule Most (7) cautious about the prohibition. They support the principle but are afraid of the negative impact on the choice of payment methods if no other measures are taken	Support for the prohibition by most (8), including all competent authorities.
Ban on surcharging for IF-regulated instruments *N.B: the issue was discussed separately from the IF regulation*	Prohibition of surcharging supported by most (1)(4) and (5) A limited number of (1)(4) and (5) in favour of surcharging as a steering mechanism	Surcharging discussion seen as secondary to the decision on IF. Strong support of (7) to the prohibition of surcharging. Divided opinions among (6) – some considered as a useful tool for steering, some considered as damaging for relations with consumers	Divided The views of (8) reflected national decisions on surcharging, with some authorities supporting the idea, others rejecting it, and some taking a neutral stance
Scope of the PSD			
Allow access to the information on the availability of funds by TPPs provided data protection requirements are met	Divided Most (1) and (2) opposed to granting access. At the same time, many (1) would accept access to information by TPPs if contracts between banks servicing the accounts and TPPs were signed and a suitable financial compensation was offered. Most (4) and (5) in favour of granting access	Both (6) and (7) in favour of granting access preferably through the EU-wide legal framework. Focus of (7) on obligation of banks servicing the account to grant access if consumer consent is given.	Most (8) and (9) in favour of extending the scope of the PSD to TPPs and of granting them access to the information on the availability of funds. Some (8) in favour of unconditional access if criteria set in the legislation are fulfilled, some other see the role for contracts between banks and TPPs.

	through the regulatory intervention, including on security and confidentiality aspects of the access.		
Define rights and obligations of TPPs	Strong support for defining rights and obligations of TPPs, including security and confidentiality of data in the legislation by (1)(4) and (5). Many (1)(4) and (5) call also for clear definition of liabilities between bank and TPP	Support for defining rights and obligations of TPPs by (6) and (7). Focus of (7) to grant TPPs access only to the information that is strictly necessary to perform the transaction.	Strong support for defining rights and obligations of TPPs, including security and confidentiality of data in the legislation by (8) Many (8) call also for clear definition of liabilities between bank and TPP.
Update and clarify the scope of exclusions (commercial agents, limited networks)	Most (1)(4) and (5) support the clarification of scope for commercial agents exclusion Many (1)(4) and (5) support the clarification and the narrowing of scope for limited network exclusion. Some call for its deletion, though.	Most (7) are in favour of deleting the commercial agent exclusion. (7) are more divided on limited network exclusion, some calling for its deletion, some supporting the clarification and the narrowing of scope.	Support of (8) to clarify the scope of commercial agent exclusion Most (8) support the clarification and narrowing of limited network exclusion
Delete the exclusions (independent ATMs, telecom exemption)	Most (1)(4) and (5) support the deletion of telecom exclusion. The deletion is opposed by telecom operators. Very few mixed opinions expressed on ATM exemption; however independent ATM providers are in favour of the deletion.	Support of (7) for the deletion of telecom exclusion. Support for the deletion of independent ATM exclusion by (7); clear concern about pricing of ATM withdrawals if independent ATM providers remain unregulated.	A clear need for change of the current text expressed by (8) Some (8) support the deletion, indicating that the narrowly defined telecom related payments will still enjoy the limited network exemption. Some other (8) argue for a deep revision and narrowing of the scope of the exemption. Very few, mixed opinions expressed on ATM exemption
Extension of certain PSD rules to one-leg	Most (1) opposed to the extension of any PSD	Support of (7) for the extension of PSD rules to	Support of (8) for the extension of PSD rules to

transactions and to all currencies	rules to one-leg and all currencies transactions. Some (4) and (5) in favour of the extension.	one-leg and all currencies transactions.	one-leg and all currencies transactions. *N.B. 13 Member States already apply some or all PSD rules to one-leg transactions and, to some extent (information obligations) to all currency transactions.*

N.B. Some stakeholder groups expressed their opinions only on selected topics

More detailed information on the position of particular stakeholder groups may be found in the Green Paper feedback statement[1] and in the minutes from the meetings of the Commission advisory committees.[2]

Annex 4: Background on market actors and payment methods

Main actors in the market

The demand side of the market is basically comprised by two categories of **Payment Service Users** (PSUs). The typical purchasing transaction for the payment methods discussed here consists of a **consumer** making a payment and a **merchant** accepting it. Merchants can be distinguished between those having only a physical presence (**bricks-and-mortar merchants**), the ones exclusively operating on the internet (**web merchants**) and the growing number of merchants combining both approaches.

On the supply side of the market, there are a number of different classes of **Payment Service Providers** (PSPs). **Retail banks** historically dominate the payments market. However, for the payments methods discussed here, many intermediaries or new players have emerged.

Card payments are enabled through **card schemes** at domestic and cross-border level. A distinction can be made between **debit card schemes** and **credit card schemes**. In many cases, payment cards are provided to the consumer by the **issuing bank**. On the acceptance side, merchants usually have one or several **acquiring bank**(s). More details on the card market are provided in Annex 5.

Internet payments are currently still most often performed with payment cards. However, there are different types of dedicated **e-payment providers** as well as **wallet solutions**, combining different payment methods, such as cards and **pre-paid accounts**. Internet payments can also take the form of credit transfers based on the consumer's online banking platform, for example through bank controlled e-payment schemes or so-called third-party **payment initiation services**.

1 http://ec.europa.eu/internal_market/payments/docs/cim/gp_feedback_statement_en.pdf
2 http://ec.europa.eu/internal_market/payments/advisory_groups/index_en.htm

The situation for mobile payments is similar as the one for internet payments, with the addition of some other payment-relevant key market actors, in particular **Mobile Network Operators** (MNOs) and **handset manufacturers**.

Independent of the payment methods above, the PSD has established non-bank **Payment Institutions** (PIs) which can be licensed at European level under certain prudential requirements. Generally, the technical execution of payments is often, but not always, performed by dedicated **payment processors**.

Illustration of card, internet and mobile payments

Card payments can be made with debit of credit cards. **Debit card** payments imply a "near-time" deduction of the funds for the individual transaction from the cardholder's account. **Deferred debit or credit card** transactions are aggregated for some period of time and settled on the cardholder account at regular intervals, for example monthly. When cards are used for payment transactions at the point-of-sale (POS) this usually implies the existence of a payment or card terminal. Cards, especially credit cards, are also often used for purchasing transactions on the internet in which case the cardholder needs to authenticate and validate the payment online.

Internet payments take place in the context of e-commerce, i.e. the purchasing of a good or service at a web merchant. In many cases, these payments are actually card payments but there are other "non-card" internet payment methods. Examples include payments based on the **online-banking** facilities of the consumer, in which case they mostly take the form of credit transfers or payments on the basis of **pre-funded accounts (E-money)**. So called internet **wallet solutions** combine several of the above mentioned payment methods.

Mobile payments are initiated and validated with the mobile phone of the consumer. Such payments can, for example, be made by using the web browser of the mobile phone for making the payment in which case they would also qualify as an internet payment. But many other forms of mobile payments exist. These can be **remote payments**, for example through the consumer sending a text message to a pre-determined phone number upon which a payment is initiated. Or they take place as so-called **proximity payments**, requiring some form of interaction between the phone and a tag or terminal at the point-of-sale, e.g. through so-called Near Field Communication (NFC) technology, or bar / QR code scanning. Next to purchasing transactions in shops or supermarkets that are equipped with the necessary technology, typical use cases of mobile payments currently include public transport or parking spaces.
The above classification implies that the line between card, internet and mobile payments is often blurred. A transaction which is initiated on a mobile phone by using its web browser for making a card-based payment in principle qualifies as a card, internet and mobile payment at the same time. Nevertheless, card, internet and mobile payments can each have specific characteristics in the context of the problems described further below.

Annex 5: General background on the payment card market (including MIF theory and competition proceedings)

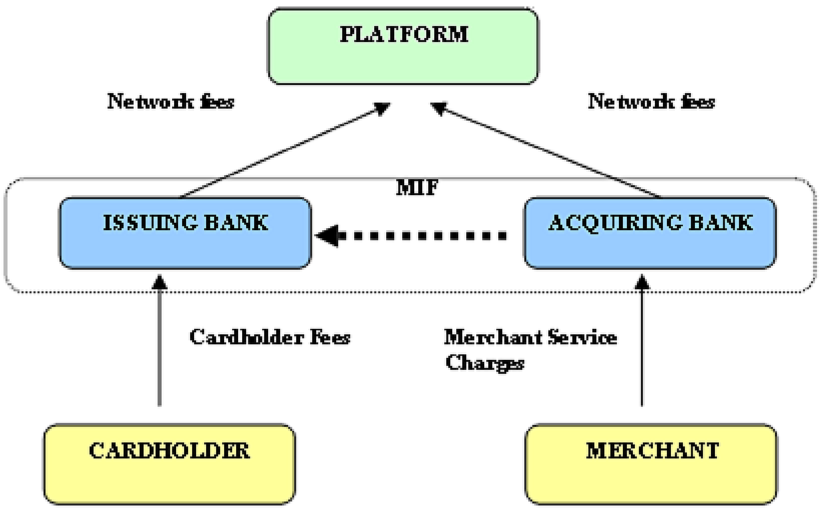
Payment card networks operate in a two-sided market, under which two sets of agents (consumers + issuers / retailers + acquirers) interact through an intermediary or platform. The decisions of each set of agents affect the outcomes of the other set of agents.

Four- vs. three-party schemes

The most common type of card scheme is the so-called 'four party' or 'open' scheme (for example MasterCard and Visa), under which usually a collectively agreed inter-bank fee or Multilateral Interchange Fee (MIF) is in place between the acquiring leg (i.e. the PSP of the merchant) and the issuing leg (i.e. the PSP of the cardholder) of the payment.

Interchange fees for such schemes are retained by the issuing PSP on transactions carried out with cards it has issued. The issuing PSP pays to the acquiring PSP the amount of the transaction after deduction of the MIF. The MIF along with other fees (a scheme fee and a fee for the acquiring PSP) is passed on by the acquiring PSP to the merchant through the Merchant Service Charge (MSC). Hence, when a customer uses a payment card to buy from a merchant, the acquiring PSP pays the merchant the sales price after deduction of the MSC. Merchants have difficulty negotiating MSCs below the level of the MIF. MIFs thus act as a collective 'floor' in MSCs. The interchange fee effectively determines to a large extent (in general 50 % or more) the price charged by PSPs to merchants for card acceptance. It restricts price competition between acquiring PSPs at the expense of merchants and subsequent purchasers.

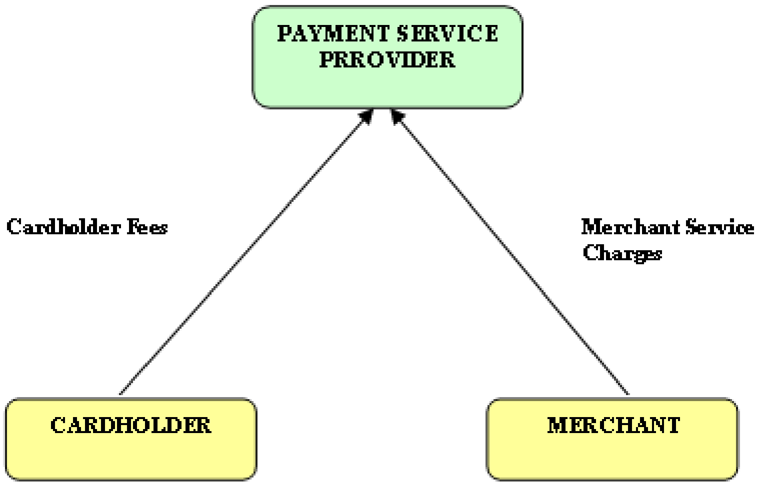
Figure 7 - Illustration of the operation of a four-party scheme, including the transfer of the IF



A second type of card scheme model is the so-called 'three party' or 'proprietary' scheme (e.g. American Express, Diners Club). In the case of a three-party scheme, only one PSP is involved, being at the same time the issuer and the acquirer. However, in some cases three party schemes issue licences to several PSPs for the issuing of cards and the acquiring of transactions. In this case the scheme is not a 'pure' three-party scheme but resembles a four-party system. 'Pure' three-party schemes do not have a MIF explicitly agreed between PSPs. There are only the fees paid by the cardholder (annual fees, fees per transaction, etc.) and Merchant Services Charges paid by the retailer. Nevertheless, the scheme may use the collected fees to subsidise one 'leg' or the other (i.e. the merchant or the cardholder), resulting in an implicit MIF. Even if three party schemes use an issuing and an acquiring PSP (Diners Club model), there is no direct financial link (MIF) between the two PSPs.

These schemes typically operate in certain sectors that attract a large number of corporate clients (e.g. travel or leisure). Here the scheme itself acts as an issuer and acquirer without the explicit involvement of banks in this function. Three party schemes are often more expensive to accept for merchants. Even though three party schemes do not have explicit IFs, they do charge proportionately higher fees to merchants than to cardholders. It can therefore be said that these schemes have an implicit IF, as one side is 'overcharged' for the service.

Figure 8 - Basic operation of a three-party scheme



Generally, the justification for charging a MIF has been to stimulate the card issuing business by increasing their revenues from card payments. Issuing banks often use part of the revenues from these inter-bank fees to incentivise the use of payment cards through bonuses (air miles, etc.). In principle, the higher the inter-bank fees the more card use is stimulated by issuing banks. Cardholders are therefore encouraged by bonuses and other rewards to use cards that generate higher fees.

On the cardholder side, typically the direct cost of using the payment instrument is often not apparent unless merchants are ready to convey the information about the costs weighing on them to consumers, for instance through differentiated price signals (steering). Merchants tend to refrain from giving such signals for fear of losing business and prefer to pass on to all their customers the costs of accepting card payments through the pricing of their goods and services. Also, merchants generally are reluctant to turn down payment instruments which are costly to them (and ultimately to their subsequent purchasers) for fear of losing business.

The bank of the cardholder (the issuer) typically charges an annual fee for holding an account at the bank. This annual fee is a package (blended) fee covering all sorts of costs related to the account, often including debit or credit card issuing and usage. Sometimes banks also charge additional dedicated annual fees for cards.

Debit vs. credit and corporate vs. consumer cards

Debit cards, when used at a Point of Sale (POS) withdraw money directly from a cardholder's current account provided there are sufficient funds in the account or an overdraft facility is granted by the issuing PSP. Debit cards are the most widely used type of payment card for consumers worldwide. Credit cards or 'deferred debit' cards do not immediately withdraw funds from the current account, but charge the cardholder for all the transactions at a fixed date, usually once a month. Credit cards may also have a wider credit facility attached to them.

Corporate or business cards are issued to corporations or small businesses and are intended for 'business related transactions' whereas consumer cards are intended for general use. In practise the difference is not always clear.

Three-party schemes mostly issue credit cards both for corporate clients/small business owners and for consumers. These credit cards are subdivided into a number of different categories that offer certain additional 'benefits' to the users. On the merchant side, the cost of acceptance differs between the various 'brands' within the same scheme. Card brands offering more cardholder benefits (e.g. air miles, (cash) rebates, and member points), are more expensive to accept on the merchant side.

Four-party schemes in addition to issuing credit cards, also issue debit cards. Within the MasterCard and Visa schemes, the number of sub-brands is virtually limitless. Just like three party schemes, the cards offering higher 'benefits' to cardholders are more costly for merchants to accept.

Transparency issues

Within the scheme rules that apply to all members (issuers/acquirers), there are a number of rules related to the IF that restrict the ability for merchants and consumers to identify the true cost paired with a specific payment instrument.

Under the Honour All Card Rule (HACR), imposed by Visa and MasterCard schemes, merchants are obliged to accept all cards within the same brand, from the cheapest credit card to the most expensive, commercial or premium credit card[3].

As a result of blending only an average fee for card payments is charged to merchants, without information on the real cost of accepting a particular card category.

In addition to the HACR, card schemes impose a Non-Discrimination Rule (NDR). Under the Non-Discrimination Rule merchants are prohibited from directing consumers towards the use of the payment instrument they prefer through surcharging, offering rebates or other forms of steering. Consequently, merchants are unable to charge consumers more for high-cost payment cards such as the premium cards and therefore have different costs but a single price and pass on these costs to all consumers through higher prices for the goods and/or services they offer.

High MIFs also form barriers to entry for cheaper and more efficient schemes – not only card schemes but also other means of payment – that offer lower inter-bank fees and have difficulty convincing issuing banks. In the SEPA context, MIF is the main factor causing issuing banks to stop issuing cards from low MIF or no MIF national schemes and prefer issuing cards from the two international schemes MasterCard and Visa.

Payment card market in figures[4]

In 2011, 727 million payment cards were issued in the EU, 63% of which were debit cards. This figure implies on average 1.45 payment cards per citizen (0.9 debit; 0.54 credit) – that is including children. In the same year, the value of payment card transactions exceeded 1.9 trillion EUR (62% of which was through debit cards). France and the UK alone was responsible for more than 50% of the EU card transaction value, the share of the top 7 Member States in this regard (France, Germany, Italy, Netherlands, Spain, Sweden, the Netherlands) was above 82% of the total. The value of payment card transactions in the EU increases continuously, not only in absolute terms (more than doubled in the last decade), but also as a percentage of the EU GDP. In 2011 the total value of payment card transactions amounted to 15.2% of the EU GDP, as compared to 9.5% in 2001. In 2011 consumers could pay with their payment cards at close to 9 million POS terminals in the EU.

The EU payment card markets overall are dominated by the two major international four-party payment card scheme, Visa and MasterCard. Their market share in issuing in 2008 was

3 The two international schemes apply the HACR cards for the acceptance of cards with the same brands (such as 'MasterCard credit/ debit cards'); both of them do not apply an HACR between debit and credit cards belonging to their scheme but issued with different brands (such as MasterCard credit cards and Maestro debit cards).

4 Figures internally gathered by the Commission Services of DG Competition.

41.6% (Visa) and 48.9% (MasterCard) respectively5. Other international payment card schemes were far behind the two market leaders; the following American Express had a mere 1.6% share, while Diners stood at 0.3%. Certain national debit card schemes still have significant market shares in particular countries (examples are France, Belgium, Germany, the Netherlands, Italy, Denmark), but not in others, and lately there is a clear trend of replacing national payment card schemes by Visa and MasterCard (recent examples are the UK, the Netherlands, Austria, Finland Ireland) in the SEPA process.

The merchant service charges (MSC) paid by the retailers to acquirers for payment card acceptance adds up to an amount of app. 13 billion EUR annually in the EU6. Close to 70 % of these charges, app. 9 billion EUR is transferred to issuers as MIFs, although a large share of this corresponds to credit cards, and expensive ones in particular (e.g. premium). MIF levels show significant variation, their weighted average levels range between 0.1-0.2% to 1.4-1.5% among various Member States7. The country average MSC rates naturally follow the variations in MIFs and range between 0.3 - 0.4 % up to 1.9 %. MSC rates also vary between merchants within the same Member State. Smaller merchants may end up paying average MSCs of up to 3–3.5% of the transaction value.

Table 27: Card payments in the EU (2011)

Member State	Number of payment cards issued per capita	Number of card transactions per capita[8]	Average value of card transaction per card (EUR)	Number of POS transactions per card[9]	Annual value of POS transactions per card (EUR)
Belgium	1.82	106	55	58	3 164
Germany	1.60	37	63	23	1 438
Estonia	1.33	148	16	111	1 778
Ireland	1.32	75	70	57	3 990
Greece	1.22	6	84	5	418
Spain	1.50	48	44	32	1 419
France	1.27	121	50	95	4 742
Italy	1.11	29	82	26	2 127
Cyprus	1.52	43	83	28	2 314
Luxembourg	3.27	124	74	38	2 810
Malta	1.74	33	74	19	1 406
Netherlands	1.82	146	40	80	3 160

5 The source for these figures, the RBR report classifies co-branded domestic debit cards as either Visa debit or Maestro cards; hence the market share of Visa and MasterCard is overestimated.
6 Figures in this paragraph are Commission estimates based on partly confidential information.
7 See also Annex 9.2.
8 Excludes e-money card transactions.
9 Point-of-sale transactions; includes transactions at terminals located in the Member State and outside it.

Austria	1.31	39	50	30	1 493
Portugal	1.89	117	45	62	2 774
Slovenia	1.60	58	37	36	1 336
Slovakia	0.98	21	37	21	772
Finland	1.45	204	34	141	4 731
Euro area sub-total	**1.42**	**65**	**52**	**46**	**2 412**
Bulgaria	1.07	4	48	4	193
Czech Republic	0.93	25	41	27	1 115
Denmark	1.36	181	45	133	6 008
Latvia	1.13	51	20	45	914
Lithuania	1.21	34	18	28	502
Hungary	0.89	24	46	27	1 247
Poland	0.84	27	25	32	799
Romania	0.63	6	37	9	335
Sweden	2.15	185	36	86	3 119
United Kingdom	2.35	157	59	67	3 929
Total EU27	**1.44**	**72**	**52**	**50**	**2 596**

Source: ECB Payment Statistics, September 2012

Brief overview of the recent economic litterature on interchange fees[10]

Over the last decade, several contributions to the economic literature on payment cards have aimed at improving the analytical framework, to understand better the impact of indirect network externalities and market power on the interchange fee under different hypotheses in relation to issuing and acquiring markets and merchants' and cardholders' behaviours . This has fostered an intense debate among economists not only on the potential impact of an antitrust intervention but also on the right way to intervene, if any. As a result, today regulation based on issuing banks' costs has been put into question[11].

The starting point was Baxter's[12] analysis of payment cards and the welfare effects of collectively determined interchange fees which included indirect network externalities. The interchange fee is seen as necessary to balance the demand of consumers and merchants for card services and the costs among issuers and acquirers as the total demand is determined by consumer and merchant demands

10 A review of the economic literature had also be conducted under for instance the '*Interim Report I Payment Cards Sector Inquiry under Article 17 Regulation 1/2003 on retail banking*' of 12 April 2006, p.6 to 12

11 Julian Wright, "The Determinants of Optimal Interchange Fees in Payment Systems," Journal of Industrial Economics, vol. 52, no. 1, 2004, pp. 1-26. It should however be noted that the conclusions on the optimality of intervention reached in the economic literature often rest on a different welfare test than the legal test applied under competition rules and Article 101 (3) TFEU. Therefore the lessons to be drawn from the analysis of economic litterature cannot be readily transposed to a more holistic analysis under competition rules.

12 William F. Baxter, "Bank Interchange of Transactional Paper: Legal and Economic Perspectives", Journal of Law and Economics , vol. 26, no. 3, 1983, pp. 541-588

jointly and by the total cost for card services which includes both issuer and acquirer costs. As a consequence, the equilibrium price and quantity of card services occur when the joint demand for card services equals the joint cost of providing those services. Because acquirer and issuer costs and consumer and merchant demands are not usually symmetric, the interchange fee that balances them will most likely not be zero. Furthermore, given that banks in card schemes are competitive, they cannot influence the price structure but only the number of transactions. As a result, banks set the MIF that maximizes output by letting users who value the card service more pay more. Baxter thus finds that banks set a MIF at the level that maximizes output and such privately set fee maximizes both total and consumer welfare.

The analysis however relies on three strong assumptions. First, it is assumed that issuers and acquirers are perfectly competitive, i.e. they have no market power, and make no profit respectively in the issuing and acquiring market. As a result, card schemes are indifferent towards the level of interchange fees and the structure of the cardholder fee and merchant service charge does not matter. As in reality the structure of the issuing and acquiring markets is different, Baxter's result cannot be used under a positive analysis of interchange fees. The same is true for the second assumption under which merchants do not accept cards for any strategic purpose (in particular, they do not accept cards to attract customers from rival merchants who do not accept cards). In other words, Baxter neglects the business stealing motive for accepting cards, which can have an important bearing on the level of both the privately optimal and the socially optimal interchange fees. Thirdly, in working out the interchange fee implied by his analysis, implicitly it is assumed there is no variation in the benefits that merchants get from accepting cards. This leaves unanswered how interchange fees should be set given heterogeneity across merchants.

Only during the last decade economic doctrine has seen substantial changes, with Baxter's strong hypotheses being progressively relaxed to guarantee a more reliable and refined representation of the underlying dynamics of the payment market, and especially Rochet and Tirole (2002)[13] providing the basis for the current welfare analysis on interchange fees.

By relaxing Baxter's assumptions on perfect competition in the acquiring and issuing markets and by including competition between merchants, a more rigorous and comprehensive framework for a normative welfare analysis could be provided. Rochet and Tirole (2002) find that the privately set interchange fee either is socially optimal (but only total welfare has been analysed) or it is too high leading to an overprovision of card services. The strategic nature of merchants who are willing to pay more for card services as long as they anticipate that consumers are likely to choose among shops on the basis of card acceptance is central to this result. In particular, merchants are then willing to accept cards gain a competitive edge, even if by doing so they support a monetary loss. Card systems can exploit such merchants' eagerness leading in equilibrium to overprovision of cards. On the other hand, issuers have market power thus the exploitation of merchants' eagerness can also offset the underprovision of cards by incentivizing issuers to issue more. This can lead to privately set interchange that maximizes social welfare.

The paper also analyses the case when the no-surcharge rule is lifted and merchants can price differently according to the means of payment selected by the purchaser. In this case, the interchange

[13] Jean-Charles Rochet and Jean Tirole, "Cooperation among Competitors: Some Economics of Payment Card Associations", RAND Journal of Economics, vol. 33, no. 4, 2002, pp. 549-570

fee no longer affects the level of card services, the merchant's price for cardholders is increased and that for non-cardholders is decreased, and there is a lower diffusion of card services. The welfare consequences of this depend on whether there is overprovision or underprovision of card services under the no-surcharge rule, a question that is ultimately linked to the degree of market power on the issuing side.

Using this framework, the economic literature has developed in different directions bringing constantly new results. Non-exhaustively, it is worth mentioning Wright (2004)[14], Rochet and Tirole (2011)[15] and Guthrie and Wright (2007)[16].

Wright (2004) introduces heterogeneity among merchants by way of establishing different industries with different relative transactional benefits across means of payments. The paper illustrates that the privately set interchange fee can be higher or lower than the socially optimal one, and can involve more or fewer card transactions. In the paper, two sources of divergence between the privately set interchange fee and the social optimum are investigated. On one hand, privately set fees can be too high if merchant fees increase with interchange fees but issuers do not pass-on (e.g. via rebates or bonuses) the additional interchange fee revenue to cardholders. In this case, modifying the balance between merchants and cardholders fees by increasing the interchange fee is a way to increase profit by charging more the side where profits are least competed away (i.e. the issuers' side), resulting in a restriction of output. On the other hand, socially optimal interchange fees may be higher or lower than the profit maximizing interchange fee because of an asymmetry in inframarginal effects. This reflects the fact that the privately optimal interchange fee is set to balance extra card transaction on the cardholder's side following a higher interchange fee with the loss in card transaction due to lower merchants' acceptance. However, a cardholder's decision to use cards has an impact on the benefit of merchants who accept cards, and conversely, a merchant's decision to stop accepting cards has an impact on the surplus of cardholders who can no longer use cards in its store. Thus the usage decision of each type of user affects the transactional benefits obtained by inframarginal users of the opposite type, and if there is any asymmetry in these inframarginal effects, the socially optimal fee structure should reflect this, whereas the scheme’s private choice of interchange fee would not take this into account.

Based on the framework they had developed, Rochet and Tirole (2011) examine welfare issues to respond to Vickers (2005)[17] who from a policy perspective argues that cards are "must take" and merchants accept to pay high fees because turning down cards would impair their ability to attract consumers. Rochet and Tirole (2011) argues that it is not obvious that merchants' internalization of cardholder surplus is detrimental for social welfare. Much depends on the difference in average versus marginal consumers benefits across the two sides. To illustrate this, they identify two opposite cases. Under merchants' homogeneity and absence of platform competition the privately set interchange fee

[14] Julian Wright, "Determinants of Optimal Interchange Fees in Payment Systems", Journal of Industrial Economics, vol. 52, 2004, pp. 1-26 (ID 7620)

[15] Jean-Charles Rochet and Jean Tirole ,"Must Take Cards: Merchant Discounts and Avoided Costs", Journal of the European Economic Association, vol. 9, n. 3, 2011, pp. 462-495

[16] Graeme Guthrie and Julian Wright, "Competing Payment Schemes", Journal of Industrial Economics, vol. 55, no. 1, 2007, pp. 37-67

[17] John Vickers, "Public Policy and the Invisible Price: Competition Law, Regulation, and the Interchange Fee", p. 234, Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities? (2005).

exceeds the short term socially optimal level. On the contrary with heterogeneous merchants and platform competition (multihoming) the privately set interchange fee is lower. Thus it is difficult to establish the direction of the bias. In this context, they discuss extensively the so-called tourist test and its relevance as an indicator of "excessive interchange fees" from the point of view of total user (cardholders' plus merchants') welfare. The tourist test caps the MIF at a level at which the payment system cannot exploit the internalization effect to make merchants accept cards even when their net cost of card transactions is positive. They conclude that in the short-run the tourist test is a proper and practical tool when issuers' margins are constant and merchants are homogeneous. However, under cost amplification, for long-run considerations and with heterogeneous merchants they also argue that the tourist test may yield false positive, i.e. it may result in interchange fees that are lower than the value that maximizes total user surplus.

Guthrie and Wright (2007) building on Rochet and Tirole (2002) and Rochet and Tirole (2003)[18] include competition between two identical payment schemes. The results obtained in this paper very much depend on the extent of multi-homing (the affiliation to more than one scheme) of different cards by cardholders and on the heterogeneity of merchants. Guthrie and Wright (2007)'s main results is obtained in the context of single-homing and heterogeneous merchants, i.e. elastic merchants' demand. In this case, they find that competition between payment schemes may lead to merchants being charged more and consumers less, which means higher interchange fee relative to what a single scheme would set. As a consequence, they conclude that competition between schemes is not necessarily more likely to yield a socially optimal interchange fee than when card services are provided by a single network.

Economic doctrine on payment card continues to evolve. In particular, one stream of literature finds that privately set interchange fee are too high. Wright (2012)[19] challenges the conclusion that the bias in the privately set interchange fee can be either way (i.e. too low or too high) by showing that instead there is a systematic and unambiguous upward bias. In the model, a monopoly card network sets a fee structure that is systematically biased against retailers, resulting in excessive usage of payment cards and inflated retail prices to the detriment of cash customers. As a result, a small decrease in fees to retailers offset with an equal increase in cardholder fees would increase consumer surplus, total user surplus and welfare, and decrease retail prices and card transactions, although customers paying by card would end up paying more.

The paper observes that contrary to previous literature the bias does not depend on the relative level of cardholders and retailers benefits from different payment instruments nor on assumptions on asymmetric market power in the issuing and acquiring market. The result stems from the fact that first merchants post prices that do not depend on the means of payments and second they are quite insensitive to changes in the price structure given that they internalize cardholder benefits by charging higher final retail prices (and consequently taxing cash payers). This is ultimately the driving factor for creating a bias in the interchange fee against retailers.

In recent years economic literature has also been considering more prominently the issue of whether regulatory intervention could be an appropriate tool to deal with the competition and welfare issues

18 Jean-Charles Rochet and Jean Tirole, "Platform competition in two- sided markets", Journal of the European Economic Association, vol. 1(4), 2003, pp. 990–1029

19 Julian Wright, “Why payment card fees are biased against retailers”, RAND Journal of Economics, Vol. 43 n°4 Winter 2012

raised by collectively set interchange fees in payment markets, notably the 'inflated' interchange fees as explained above. Based on the fact that the privately set interchange fees might be systematically excessive from a social optimum perspective, Rysman and Wright (2012)[20] argue that further entry resulting would not address such distortion since it tends to result in greater upward pressure on interchange fees due to intersystem competition. Also banning the no-surcharge rule would be unlikely to be effective since in reality few merchants do surcharge when they have the possibility to do so. More importantly, whilst pointing at the complexities in devising such a possible regulation and in finding an appropriate cap level, when discussing the rationale for IFs in open system, Rysman and Wright (2012) contrast privately set IFs in monopoly and competitive markets with socially optimal IFs. Distortions could exist due to asymmetries in the way issuers and acquirers compete, due to merchant internalization or due to the inability of merchants to perfectly steer consumers to their preferred means of payments.

The competition proceedings

Whilst economic doctrine has shed light on the market mechanisms surrounding interchange fees and they sometimes have been or are the subject of legislative action, such fees have also been the object of a number of competition proceedings at European or national level. Recent developments with respect to the European Commission's actions regarding interchange fees and related arrangements under the European competition rules can be summarized as follow.

The Commission’s Decision of 19 December 2007[21] ('the Prohibition decision') is particularly important. This prohibits MasterCard’s multilateral intra-EEA fall back interchange fee for cross-border payment card transactions made with MasterCard and Maestro branded debit and consumer credit cards. It states that the MasterCard's MIF restricts price competition between acquiring banks by artificially inflating the basis on which these banks set their charges to merchants and effectively determining a floor under the merchant service charge below which merchants are unable to negotiate a price. In addition, MasterCard had not demonstrated that they were covered by the exception in Article 101(3).

The Commission's view was that MIFs are a restriction of competition by effect. MIFs arguably also restrict competition by object as they reduce the level of uncertainty on the market for acquiring banks and they have an impact on MSCs, as the Commission argued in its subsequent case against Visa[22]. It was established in the MasterCard decision that they anyway restricted competition by effect between acquiring banks by artificially inflating the basis on which these banks set their charges to merchants and effectively determining a floor for the merchant service charge below which merchants are unable to negotiate a price.

According to the Decision, it is in principle not excluded that MIFs may be justified under Article 101(3) but the burden of proof is on the scheme. The main argument brought forward by MasterCard was based on the efficiencies created by encouraging the issuing and use of

20 Marc Rysman and Julian Wright, "The Economics of Payment Cards", 29 November 2012

21 Case COMP/34.579, *MasterCard*, Commission Decision of 19 December 2007. http://ec.europa.eu/competition/antitrust/cases/dec_docs/34579/34579_1889_2.pdf

22 Case COMP/39.398, *Visa MIF*, Commission Decision of 8 December 2010.

cards to match greater demand from merchants to receive card payments ('scheme optimisation'). The Commission however challenged these efficiencies and the indispensability of MIFs to achieve them and held that in any case under Article 101(3) the MIFs must be set at a level that allows merchants overall to receive some of the benefits of these alleged efficiencies.

In 2009, MasterCard offered Undertakings to reduce its cross-border consumer MIFs to 0.2% for debit cards and 0.3% for credit cards[23] (this latter category including deferred debit cards); it introduced a number of changes to its scheme rules to facilitate competition in the card payments markets; and it repealed the increases in its scheme fees to acquirers which could have had a similar effect on the market to MIFs. The Commissioner for competition at the time stated that, in light of the Undertakings, she did not intend to open proceedings against MasterCard for non-compliance with the Decision[24].

In the light of the MasterCard decision and following the expiry of the Visa II exemption decision[25], the Commission opened an antitrust investigation against Visa Europe, Visa Inc. and Visa International Service Association. In 2009 the Commission issued a Statement of Objections ("SO") to Visa for all the MIFs it sets in the EEA (cross-border MIFs and the MIFs for domestic transactions in eight Member States). In 2010 Visa Europe offered commitments, very much based on the MasterCard Undertakings, but the MIF reduction only covered debit transactions (reduced to 0.2%) and not credit. These commitments were made binding in December 2010[26].

In May 2012, the General Court rejected MasterCard's appeal against the Decision, supporting the framework of assessment under the competition rules applied by the Commission[27]. The General Court confirmed in particular that MIFs are not objectively necessary for the operation of a four party payment scheme. There are examples of four party payment schemes operating without a MIF. According to the Court it was also perfectly conceivable that banks operate within a payment system without a MIF or, if necessary, with

23 After the 2007 Decision concerning MasterCard's MIFs and following discussions with the Commission, the Merchant Indifference Test ("MIT") formed the basis for the MasterCard Undertakings of 2009 and the Visa Commitment Decision of 2010. Under the MIT, the cost incurred by the merchant when a customer uses its card should not exceed the cost for receiving a cash payment. This requires detailed estimates for the costs to merchants of handling cash and card payments, of the average size of these payments and the fees charged to merchants for both cash and card handling by third parties (principally banks but also others such as cash handling companies). Finally, it is also necessary to estimate the average level of the acquirer margin and scheme fees to estimate the maximum level of the MIF. These calculations are explained in more detail in the Commission Decision of 8 December 2010 on Visa Europe's commitments, paragraphs 57-68.

24 http://europa.eu/rapid/press-release_MEMO-09-143_en.htm?locale=en

25 In the Visa I Decision, the Commission found that a number of the Visa scheme rules (excluding the MIF rules) did not appear to restrict competition under Article 101(1) at that time. In 2002 in the Visa II Decision, the Commission found that the Visa cross-border MIFs were a restriction of competition by effect but exempted the MIFs provided they were reduced to 0.70% for credit transactions and €0.28 per debit transaction until the end of 2007.

26 Case COMP/39.398, *Visa MIF*, Commission Decision of 8 December 2010

27 General Court 24 May 2012, Case T 111/08, MasterCard and others *vs* Commission, nyr.

a less restrictive default, such as the prohibition of *ex post* pricing. In Australia a significant reduction in MIF levels had not led to a decrease in card use. And in general banks save costs from card issuing (eg the use of debit cards reduces the need for cash handling by banks) and receive additional revenue from card issuing (eg interest on credit card balances). According to the Court it was therefore unlikely that banks would stop issuing cards if MIFs did not exist and the argument that MIFs were indispensable for the functioning of a payment card system was rejected.

MasterCard appealed the judgment to the ECJ[28].

In July 2012 the Commission issued Visa a supplementary SO covering its MIFs for credit card transactions. The 2009 Visa SO and the 2012 Visa supplementary SO express the preliminary concern that Visa's MIFs restrict competition by object and by effect and Visa has not demonstrated that they fall within Article 101(3). In the supplementary SO sent to Visa in 2012, the Commission also expressed the preliminary concern that Visa's rules on the conditions on which merchants could make use of the services of acquiring banks established in other Member States ('cross border acquiring rules') were an infringement in their own right of the competition rules[29]. Such rules may for instance require all acquirers, even if they are based in another country, to apply the domestic MIF of the country of the merchant.

In April 2013 the Commission opened further proceedings against MasterCard, this time addressing MasterCard's MIFs applied to so-called inter-regional transactions (*ie* payments made to merchants established in the EEA with cards issued outside the EEA, for instance by American tourists in Europe) and MasterCard's cross border acquiring rules[30].

A number of competition proceedings have also covered interchange fees at Member State level, following the approach under the MasterCard case. The French Competition Authority for instance made binding the commitments from the *Groupement des Cartes Bancaires* – the domestic card scheme- on 7 July 2011 to reduce its interchange fees on payment cards by 20 to 50%, to level equivalent to the ones agreed by MasterCard and Visa for their cross-border transactions. Proceedings are on-going in a number of other Member States[31], including in the UK, Germany and Italy.

In addition to addressing the level of MIFs and exclusionary behaviour, the Commission has examined the business rules of card schemes. In the MasterCard Decision of 2007 the Commission found that some of MasterCard's business rules reinforced the effect of the MIFs on competition. In response, MasterCard included a number of changes to its business rules

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28 OJ C 319 from 20.10.2012, p.4.

29 http://europa.eu/rapid/press-release_IP-12-871_en.htm?locale=en

30 http://europa.eu/rapid/press-release_IP-13-314_en.htm?locale=en

31 For a more detailed overview see for instance the - Information paper on competition enforcement in the payments sector of the banking and payments subgroup of the European Competition Network (ECN) of 20.03.2012 at http://ec.europa.eu/competition/sectors/financial_services/information_paper_payments_en.pdf

in its Undertakings of 2009. Similarly, Visa's commitments of 2010 modified its business rules.

Under the MasterCard Undertakings and Visa Commitments, the card schemes modified their business rules to promote competition and transparency:

- Honour All Cards Rule (HACR) and unbundling. The card schemes would only apply the HACR within a brand and not across brands. For example, a merchant could accept Maestro cards but not MasterCard cards. Merchants could also have separate acquirers for different brands of card if they wanted.

- Non-discrimination. Merchants would not be prohibited from steering their customers to different payment means. This issue was addressed under the Payment Services Directive for surcharging and rebating (see below) and so there was no justification for the schemes to impose their own rules.

- Unblending and publication. The acquiring banks would offer unblended prices (eg MIF+ pricing) by default to merchants, so merchants would benefit from the use of cheaper cards by their customers. The card schemes would publish all their MIF rates.

Commercial cards: The schemes would ensure that commercial cards issued in the EEA are visibly and electronically identifiable at POS terminals if the terminal has the necessary capability.

Annex 6: Main impacts of the PSD to date

Prior to the adoption and implementation of the PSD, payment services markets were highly fragmented along national lines. Technical and legal barriers were hindering the creation of an integrated, efficient and reliable EU market.

In this context, the PSD aimed to impact the retail payments market firstly by generating more competition. A new type of payment was established and a passporting regime was introduced to guarantee fair market access across the EU (Title 2 PSD). The PSD also aimed to provide a simplified and fully harmonised set of rules regarding the information requirements (Title 3 PSD) and the rights and obligations in relation to the provision and use of payment services (Title 4 PSD). The objective was to ensure high level consumer protection whilst improving efficiency and reducing the costs for payment services providers.

The Payment Services Directive has now been in place for the last three years. Substantial positive developments in the payment services market clearly demonstrate that the Directive has significantly improved the environment for providers and users[32]. The PSD created the legal foundation for the creation of an EU-wide single market for payments by establishing a comprehensive set of rules applicable to payment services in the European Union. The provision of payment services across the EU has become easier notably with the creation of the new Payment Institutions, next to banks and e-money institutions, and with the definition of a common framework on conduct of business rules for payment services. According to London Economics and iff, in France, Greece, Hungary, Ireland, Luxembourg and Norway, the Payment Institutions created during the transition years[33] and the post PSD period[34] account for 50% or more of all the PIs which exist currently in each of these countries[35]. In Germany for instance, about 38% of the PIs were not regulated before implementation of the PSD[36] and where service providers did exist before, they could not benefit from the wider European market. Sound and proportionate requirements were established for these new Payment Institutions and by meeting these requirements the authorised PI is able to passport its licence to any other EEA country without the need to apply for any further authorisation in any other country. It hence makes it easier for businesses to become established in other markets, including those that were previously extremely difficult to enter. Also passporting provides PIs with a means to expand in other markets without the high market entry costs and

32 L. Isaacs, C. Vargas-Silva and S. Hugo *EU Remittances for Developing Countries, Remaining Barriers, Challenges and Recommendations* (July 2012) p27 and London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p ix

33 Between 2007 and 2009.

34 After 2009.

35 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p192

36 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p194

having to operate under multiple regimes and authorisations. About 600 payment institutions have been licenced up to now which provides a wide range of payment services across the EEA via simple "passports"[37] and in total, the value of transactions undertaken by authorised PIs undertaking money remittance, transfers and retail foreign exchange activities, foreign exchange brokers and card acquirers was € 594.5 billion in 2010[38].

Table 28 - Value and number of transactions of different API groups - 2010		
Group of APIs	**Value of transactions (in billions of €)**	**Number of transactions (in millions)**
Money remittance, transfers and retail foreign exchange activities	30.7	113.6
Foreign exchange brokers	24.7	
Card acquirers	458.6	8792.5
Three-party card schemes	78.8	592.0
Specialised internet payment service providers + general service providers - turnover	1.7	

Source: Nilson Report, London Economics and PaySy[39]

Many authorised PIs indeed sought a large number of passports. Although analysis has shown that PIs asking for 27 passports (or more) typically were only providing services in 3 or 4 EEA States outside their home Member State[40], this shows the extent to which passporting could develop and create competition in the future. Lastly, according to the London Economics and iff study, there is a broad consensus among the innovative payment institutions consulted as regard to the positive impact of the PSD as far as innovation is concerned. This is mainly because the Directive opened new business opportunities both domestically and abroad[41]. It should also be added that competent authorities also benefit from the PSD passporting regime in the sense that they save resources which otherwise

37 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p29

38 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p38

39 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p38

40 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p176

41 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p x

would have to be dedicated to authorising payment institutions which already have been assessed and authorised by a competent authority in another Member State[42].

The PSD also provides for a Member State option to introduce a "lighter regime" for so-called "small payment institutions". They are also being registered at national level but they do not get a full licence with an EU passport. The requirements to become an authorised PI are more stringent than those to become a small PI and thus proportional to the operational and financial risks faced by such institutions. Seven Member States have introduced the category of small PIs and in these countries, the establishment of small PIs overall has been widely welcomed by users and providers as this is shedding light on otherwise dark areas of the market. About 2,000 small PIs have been registered so far in the EEA[43].

As regard to the information requirements and the rights and obligations of users and providers, the PSD has improved the environment for the all the market players. The PSD ensures that consumers have full information about their transactions[44] which ultimately mean that they can make informed decisions in the payment market. The PSD also creates increased transparency for rates and charges as well as consistent execution times and customer protection. According to London Economics and iff, the majority of credit institutions are of the view that that is has become easier to offer cross border payment services as a result of the harmonisation[45]. For a study on behalf of the European Commission, consumer associations were asked about the main benefits to consumers derived from the PSD; costs, efficiency, executions times, safety, liability, access and flexibility were mentioned[46]. Indeed for instance as regard to execution time, the PSD provides that all credit transfers without any currency conversion must be carried out at the latest by the end of the next business day which is very beneficial for users.

However, although the PSD has had a positive impact of the payment services market, some shortcomings can also be identified. For instance, while the PSD's general approach is one of full harmonisation, some of its provisions provide for a high level of flexibility in the form of options offered to Member States. In addition, a number of activities were excluded from the scope of the PSD, these being notably cheques and cash transactions. Payment transactions, where either a non-EU currency was involved or where one of the payment service providers

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42 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p173

43 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p31

44 L. Isaacs, C. Vargas-Silva and S. Hugo *EU Remittances for Developing Countries, Remaining Barriers, Challenges and Recommendations* (July 2012) p27

45 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p264

46 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) Annex – p8

involved in the payment transaction was located outside the EU, were also excluded. Furthermore, the Directive does not apply to a number of specific payment transactions as listed in the so-called negative scope. The PSD approach to a number of issues, including the ones mentioned above, could be considered as shortcomings. In addition, while the PSD did bring significant improvements in many areas a number of specific regulatory failures and gaps remain. These are described in more details in Section 3.2 (problem definition).

Annex 7: Additional background on the identified specific problems

Problem 3.2.2.1 – Market fragmentation

Card payments: As illustrated below there are domestic debit card schemes in 9 EU Member States, amongst which four out of the five largest in terms of population (Germany, France, Italy and Spain). Unless debit cards issued under these schemes are 'co-badged' with an international payment scheme, these cards are not accepted in other EU countries.

Table 29 – Domestic card schemes

Member State	Domestic scheme
Belgium	Bancontact / Mr Cash
Bulgaria	Borica
Denmark	Dankort
France	Carte Bancaire
Germany	Girocard
Italy	Bancomat
Portugal	Multibanco
Slovenia	Karanta / BA
Spain	Euro6000 / ServiRed / Sistema 4B

Moreover, the different national schemes apply non-interoperable standards and messaging protocols in the different domains of a card transaction, mainly in the terminal-to-acquirer and the acquirer–to–issuer domains.

Table 30 - Overview of the different protocols between the POS and the acquirer

Member State	Terminal to acquirer protocols in place
Austria	APSS protocol
Belgium	C-TAP
Bulgaria	Information not available
Cyprus	Information not available
Czech Republic	SPDH and ISO8583
Denmark	ORTS
Estonia	Information not available
Finland	FBA
France	CB2A
Germany	ZVT, GICC
Greece	SPDH
Hungary	SPDH and ISO8583
Ireland	APACS, ELAVON
Italy	CB1, CB2
Latvia	Information not available
Lithuania	Information not available
Luxembourg	C-TAP

Malta	Information not available
Netherlands	C-TAP
Poland	Depending on acquirer: APACS, SPDH, ELAVON
Portugal	SIBS proprietary
Romania	Information not available
Slovakia	Information not available
Slovenia	Information not available
Spain	PRICE/PUC (ISO8583)
Sweden	SPDH
UK	APACS 30, 40, 70

Similarly, card acceptance terminals are subject to different, often national, certification procedures in order to comply with obligatory security criteria. The table below shows an overview of the different processes and certificates currently in place. Merchants with European operations hence need to comply with up to seven different certification procedures even if they use the same type of terminal in all countries.

Table 31 – Security certification by Member States

Member State	Security certification
Austria	PCI PTS
Belgium	PCI PTS
Bulgaria	PCI PTS
Cyprus	PCI PTS
Czech Republic	PCI PTS
Denmark	PNC SAC
Estonia	PCI PTS
Finland	PNC SAC
France	PCI PTS
Germany	GBIC/DK
Greece	PCI PTS
Hungary	PCI PTS
Ireland	PCI PTS
Italy	Consorzio Bancomat
Latvia	PCI PTS
Lituania	PCI PTS
Luxembourg	PCI PTS
Malta	PCI PTS
Netherlands	Currence (PCI+) and now CAS+ based on PCI PTS+ additional tests
Poland	PCI PTS
Portugal	PCI PTS
Romania	PCI PTS

Slovakia	Information not available
Slovenia	PCI PTS
Spain	PCI PTS
Sweden	PNC SAC
UK	UK Cards Common Criteria

There have been important achievements by several European market initiatives regarding the development of standards in different domains of the card transaction chain. These include:

EMV, standing for Europay, MasterCard and Visa, is a global standard for inter-operation of Chip & PIN cards, POS terminals and ATMs, for authenticating credit and debit card transactions.

SEPA-FAST, developed by the payment card industry and based on EMV technology, describes the financial software application on a POS terminal.

EPAS (Electronic Protocols Application Software) is a non-commercial European cooperation which aims at developing common data protocols for terminals, retailers and acquirers to be applied at the POS environment.

ATICA (Acquirer-to-Issuer Card Messages) and the Berlin Group are industry cooperations aiming at the harmonisation of protocols between card issuers and acquirers of card payments.

The OSeC initiative has the objective to establish a certification Framework aiming at a single scheme for security in POS terminals and multiple recognition of security certification by card schemes and banking organizations across Europe.

Table 32 - Overview of these initiatives in the different card transaction domains

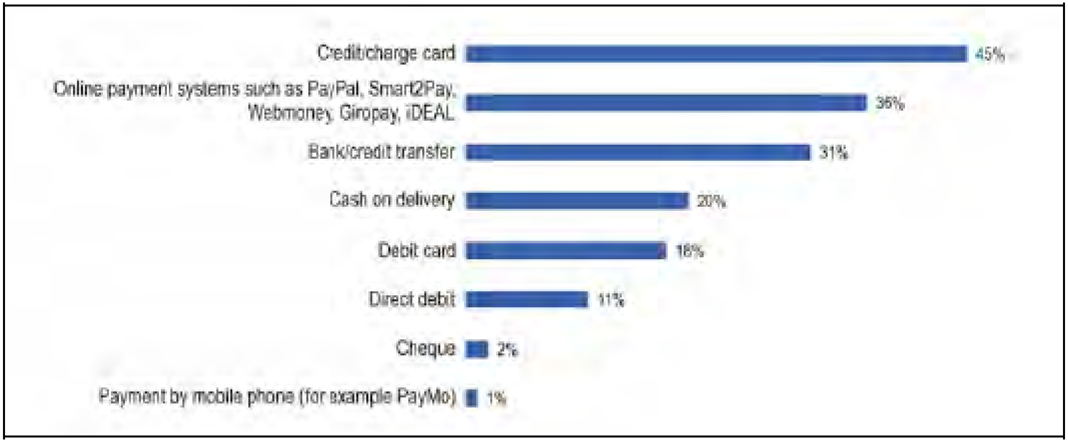
Domain	Card to terminal	Terminal application	Terminal to acquirer	Acquirer to issuer	Certification
Standard initiatives	EMV (chip & pin)	SEPA-FAST	EPAS	ATICA / Berlin Group	OSeC

Some of these standards, for example EMV, already achieved critical mass uptake. For other initiatives however (e.g. EPAS for acquiring protocols or OSeC for a common security certification approach), the adoption and implementation of these standards across the market represents a major challenge and national protocols and approaches therefore still prevail. As a consequence, merchants consistently complained during public consultations that they suffer from inefficiencies due to missing possibilities for cross-border or central acquiring.

Internet payments: In the context of e-commerce, credit cards are currently still the most widely used payment instrument as shown by the survey results below.[47]

[47] Civic Consulting - Consumer market study on the functioning of e-commerce and Internet marketing and selling techniques in the retail of goods, p. 25 (September 2011)

Figure 8 - Consumer survey – Which of the following payment methods have you used for your online purchases over the last 12 months?

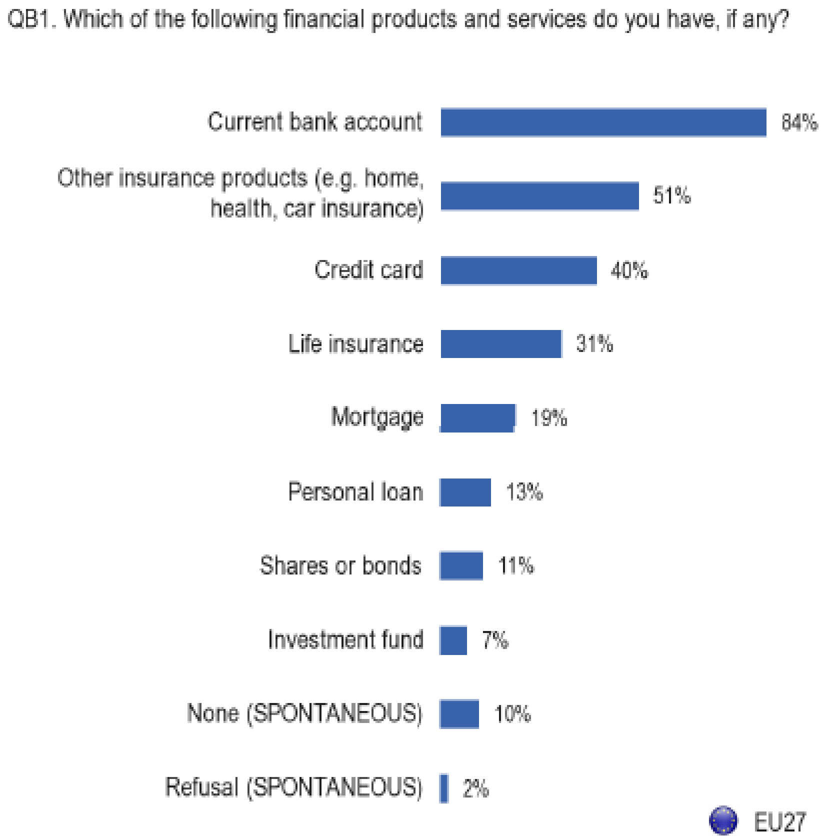


Note: Based on online shopper subsample (N=25940)

On the other hand, as shown below a recent survey undertaken by the Commission indicates that less than half of the citizens in the EU own a credit card while more than 80% of EU citizens have a bank account.[48]

Figure 9 - Consumer survey – Which of the following financial products and services do you have, if any?

[48] 2011 Eurobarometer on Retail Financial Services, p. 9



In many cases, current bank accounts can be used for online banking and hence could also be used for making online credit transfers for the purposes of e-commerce purchasing transactions. The initiation and confirmation of such payments requires online banking based payment solutions. However, such solutions are not yet available at a pan-European level.

A few of the existing solutions have been established directly or indirectly by banks while others are operated through third-party providers, some of which are not licensed as payment institutions under the PSD.

However, there is currently no clearly defined and common set of non-discriminatory security requirements for the necessary access to the consumers' payment account by such online banking based solutions.

Mobile payments: As illustrated in 3.1.1., mobile payments are the payment method with the highest growth potential. In developed markets, this is driven by the massive proliferation of smartphones in recent years and by emergence of applications with additional functionalities, which change consumer behaviour. Smartphones account for 63% of all handsets on the US market and 51% of handsets on selected European markets.[49] However, while certain solutions, such as Near Field Communication (NFC), currently seem to emerge as possible

49 http://thenextweb.com/mobile/2011/11/29/report-smartphones-account-for-just-27-of-all-mobile-phones-worldwide/

lead technologies for proximity m-payments, common standards for m-payments at the POS are either not existing or in their very early stages of development. As a consequence, the current landscape for proximity m-payments remains fragmented and is characterised by applications for niche users and a limited number of pilot projects, mostly at domestic or even local level.

Table 33 - Exemplary and non-exhaustive list of examples for mobile payment initiatives[50]

Europe	
Austria - Paybox	Netherlands - Rabo SMS betalen
Belgium - M-Banxafe	Norway - Telenor
Belgium - Proximus M-Pay	Norway - Mobile Axept
Belgium - Proximus SMS	Poland - MPay Wallet
Belgium - Ping.Ping	Portugal - MB Phone
Czech Republic - Czech Telefonica O2	Romania - ING - MasterCard trial
Estonia - Cinemon Cinemas Ticketing	Romania - Good.bee
France - Disneyland Paris NRC trial	Spain - Mobipay
France - Payez Mobile	Spain - Banamex SMS Banking
France - TreiZen	Spain - NFC Telefónica
France - Tag Pay	Spain - Presto Park&Go
Germany - MobilZahlen	Spain - Banco Popular Español
Germany - NetBank	Swizerland - PostFinance SMS Banking
Germany - RMV mobile ticketing	Swizerland - Epay24
Germany - StarMoney Handy	UK - AvantixMetro
Germany - T-Mobile Streetgiggs	UK - Mobile theatre ticketing service
Germany - Touch&Travel	UK - Monilink
Germany - 12Pay	UK - Payforit
Hungary - MobilFizetés	UK - RingGo Mobile
Italy - PosteMobile	UK - Trinity Mobile
Netherlands - Beep! Mobile Tickets	UK - MoBank
Netherlands - Rabo Mobiel: mobile banking & NFC	Europe - Atlas Interactive SMS billing

In those regions outside Europe where m-payments are more successful they are typically based on initiatives that were launched by MNOs, often on the basis of inter-operability agreements.[51] Agreements on a business model have been reached in some of these cases (e.g. the so-called 'Weve' joint-venture between the three largest mobile network operators in the UK), but in many cases discussions are still on-going amongst all or a subset of the key market actors (mobile network operators, banks, other payment service providers, mobile

50 Innopay: Mobile Payments 2010, p.74

51 Examples include: M-Pesa, a mobile money transfer initiative which was launched in Kenya and Tanzania and is now rolled-out to several other countries. Osaifu-Keitai, an m-payment solution launched in Japan which is now entering into inter-operability agreements with providers in South Korea. The Isis joint venture, established by AT&T, T-Mobile and Verizon Wireless in the US.

phone manufacturers). A lack of standards and inter-operability is identified as one of the key obstacles for mobile payments by numerous studies.[52] [53] [54] [55]

Problem 3.2.2.2 – Ineffective competition

In the area of cards there are several restrictive business rules and practices that lead to a situation of ineffective competition. One of these rules applied by card schemes is the Honour All Cards Rule (HACR). There are two relevant aspects to the Honour All Cards Rule. The first is that the rule requires merchants to accept cards regardless of which bank or financial institution issued the card (Honour All Issuers Rule). The second is that the rule requires merchants to accept all products issued under the same brand (Honour All Products Rule), even if the fees related to them are not the same. For example, in the case of so-called premium cards, the higher cost of the card associated with individual extra benefits for the card holder is borne by the merchant having the obligation to accept the card on the basis of the HACR[56]. The difference between the fees paid for a basic card and those for a premium card can be quite substantial. In Belgium for example we find that the lowest interchange fee applied by a certain card scheme for a credit card payment is 0.55%, compared to the highest fee of 1.90% for a credit card of the same brand.[57] This results in fee that is almost 3,5 times higher for the premium card than the one for the basic card. The difference is even bigger

52 Journal of Payments Strategy & Systems Volume 5 Number 3: The increasing adoption of mobile payments in Europe — and remaining challenges to growth: "The large number of interested parties to the ecosystem, the lengthy discussions about standards and security, but also negotiations about revenue sharing for the provision of NFC services have been the main bottlenecks." and "A further obstacle is the lack of standards.[…] So far, the industry has come up with a large number of mostly standalone and competing mobile payments trials to enable consumers to transact with their mobile devices. This fragmentation process, however, has led to a tangled web of hardware and software certification standards.[…] For mass market adoption of mobile payments in Europe, there is a need to develop and adopt standards and controls that would allow interoperability between mobile payment players to develop revenue models and revenue sharing opportunities.

53 e-Service Journal Volume 6 Issue 2: Exploring Merchant Adoption of Mobile Payment Systems: An Empirical Study: "High costs, lack of standards, and lack of wide enough acceptance are among the most significant barriers to merchant adoption. These factors are evident in the results of both the qualitative and quantitative studies. […]Different providers, such as mobile operators and financial institutions, also need closer cooperation and joint standardization efforts to overcome the barriers of low acceptance rates and lack of standards.

54 Consulting firm Booz and Company estimates that a standardised environment would lead to 62% more proximity m-payment transactions in Western Europe in 2016 (versus a fragmented environment).
http://www.gsma.com/publicpolicy/wp-content/uploads/2012/03/mp12simbasednfc.pdf

55 Innopay paper – Mobile Payments 2012: "NFC-powered mobile payments still face significant challenges when it comes to mass-market deployment and adoption. While many market players – phone manufacturers, banks and MNOs - are enthusiastic about its undeniable potential, mobile NFC adoption has been lagging behind expectations. Some of the main causes for this are the lack of a supporting infrastructure, the existence of a complex ecosystem of stakeholders and the lack of unified standards."

56 The two international schemes apply the HACR cards for the acceptance of cards with the same brands (such as 'MasterCard credit/ debit cards'); both of them do not apply an HACR between debit and credit cards belonging to their scheme but issued with different brands (such as MasterCard credit cards and Maestro debit cards).

57 http://www.mastercard.com/us/company/en/whatwedo/interchange/Country.html

when comparing debit and credit card fees. In the United Kingdom we find that the lowest debit card fee of a certain card scheme is a fixed amount of 0.08 GBP whereas the highest fee for a credit card of the same brand is 1.90%. For a payment of £100, this results in a fee that is almost 24 times higher. According to card schemes applying the rule, it assures consumers that their cards will be accepted anywhere in the world if the logo on the card is displayed, and therefore the rule is a cornerstone of the card schemes' payment system[58]. However merchants incur higher costs because of the rule and these are passed on to consumers, also those consumers using cash, or payment cards with lower costs for the merchant. Additionally it prevents merchants from negotiating lower fees for the more expensive cards as they have to accept them if they wish to accept lower cost cards.

In addition to the HACR, card schemes impose a Non-Discrimination Rule (NDR). Under the Non-Discrimination Rule merchants are prohibited from directing consumers towards the use of the payment instrument they prefer through various forms of steering. Consequently, merchants are unable to steer consumers away from high-cost payment cards such as the premium cards and therefore they have an incentive to pass on this cost to all consumers through higher prices for the goods and/or services they offer. However, even if retailers would have the choice to refuse certain high-cost payment cards, several other obstacles stand in the way. The first one is card identification. If a merchant cannot visually or electronically identify which kind of card is presented, he will be unable to determine whether he wishes to accept this card. In order to assess the cost related to the specific payment card, merchants would also need to receive information in real time about the MSC to be charged per transaction. This leads to another obstacle, which is the practice of blending. Blending occurs when the acquirer offers the retailer a single rate for all card payments, thus neutralizing competition between the various brands, as the rule restricts the ability for merchants and consumers to identify the true cost paired with a specific payment instrument. A related issue concerns the choice of application for co-badged cards. Co-badged cards often contain a mechanism in the chip which determines automatically in what order the brands on the card will be used. This mechanism is inserted by the issuing bank, therefore the brand given priority may be the one generating the highest MIF (and thus the highest MSC). The problem will become even more relevant with the mobile wallets, combining several payment applications.

As indicated in the problem drivers, the way Multilateral Interchange Fees (MIFs) are applied today also causes market failure. This is because of several reasons, one of them being the current existence of reverse competition resulting in high interchange fees and MSCs. Consumers are generally unaware of the costs borne by merchants for the use of the cards, unless merchants are ready to convey this information, for instance through differentiated price signals. Merchants may refrain from giving such signals for fear of losing business – or because of restrictive business rules imposed by schemes- and pass on to all their customers the costs of accepting card payments through the pricing of their goods and services. From a

[58] http://www.mastercard.com/us/company/en/newsroom/honor_cards.html

consumer's perspective, this raises an issue of cross-subsidisation: as retailers charge the same price regardless of the payment instrument used by the consumer, those not using expensive means of payment implicitly subsidise the ones using them. Also, merchants – with few exceptions - are reluctant to turn down payment instruments which are costly to them (and ultimately to their subsequent purchasers) again for fear of losing business.

A large part of the merchant service charge paid by the retailers to acquirers for payment card acceptance ('MSC') is determined by the interchange fee. MSCs in the EU add up to an amount of app. 14 billion EUR annually[59]. Close to 70 % of these charges, app. 10 billion EUR is transferred to issuers as MIFs, although a large share of this corresponds to credit cards, and expensive ones in particular (e.g. premium). MIFs made up 60% of MSCs in Czech Republic in 2003, 60% in Italy in 2003 and 73% in Belgium in 2002[60]. These estimated figures would include the amounts corresponding to interregional fees, whose average weighted levels are considerably higher for both debit and credit card transactions than for intra EU cross border debit and credit transactions, i.e. when the retailer and the cardholder are from different countries in the EU. In spite of the limited share of inter-regional transactions in the total of transactions, the annual MIF amounts involved could be estimated at around 0.5 billion €.

Since interchange fees are set by card issuers themselves or by a card system, they are hardly negotiable as those paying for the service cannot influence their levels (the retailers) or are unaware of their existence (the consumers)[61]. In addition, cardholders are encouraged by issuing banks through bonuses and other rewards –using part of their revenues from interchange fees - to use cards that generate higher fees. Competition in payments currently results in sub-optimal market outcomes and relatively high prices, with the ECB estimating the total social cost of payments at €156 billion per year in the EU or 1,2% of GDP[62]. The ECB also estimates that revenue from payments represents about 25% of total bank revenue in the EU[63].

59 Figures in this paragraph are Commission estimates based on partly confidential information.

60 See: Case COMP/34.579 MasterCard, COMP/36.518 EuroCommerce and COMP/38.580 Commercial Cards, section 7.3.2.1.3. (paras 426-439).

61 Under the MasterCard case, so-called multi-lateral interchange fees (MIFs) between the bank of the card holder (issuing bank) and the bank of the merchant (acquiring bank) have been found to restrict competition by object and/or effect and this has been confirmed by the General Court. In the Commission's view, MIFs restrict competition by object as they reduce the level of uncertainty on the market for acquiring banks and they have an impact on MSCs. They also restrict competition by effect between acquiring banks by artificially inflating the basis on which these banks set their charges to merchants and effectively determine a floor for the merchant service charge below which merchants are unable to negotiate a price. The restrictive effect in the acquiring markets is further reinforced by the effect of the MIFs on the network and issuing markets as well as by other network rules and practices, namely the Honour All Cards Rule (the 'HACR'), the No Discrimination Rule (the 'NDR') and blending.

62 This includes households' costs.

63 Gertrude Tumpel-Gugerell, Member of the Executive Board of the ECB, at the conference "The future of retail payments: opportunities and challenges" Vienna, 12 May 2011.

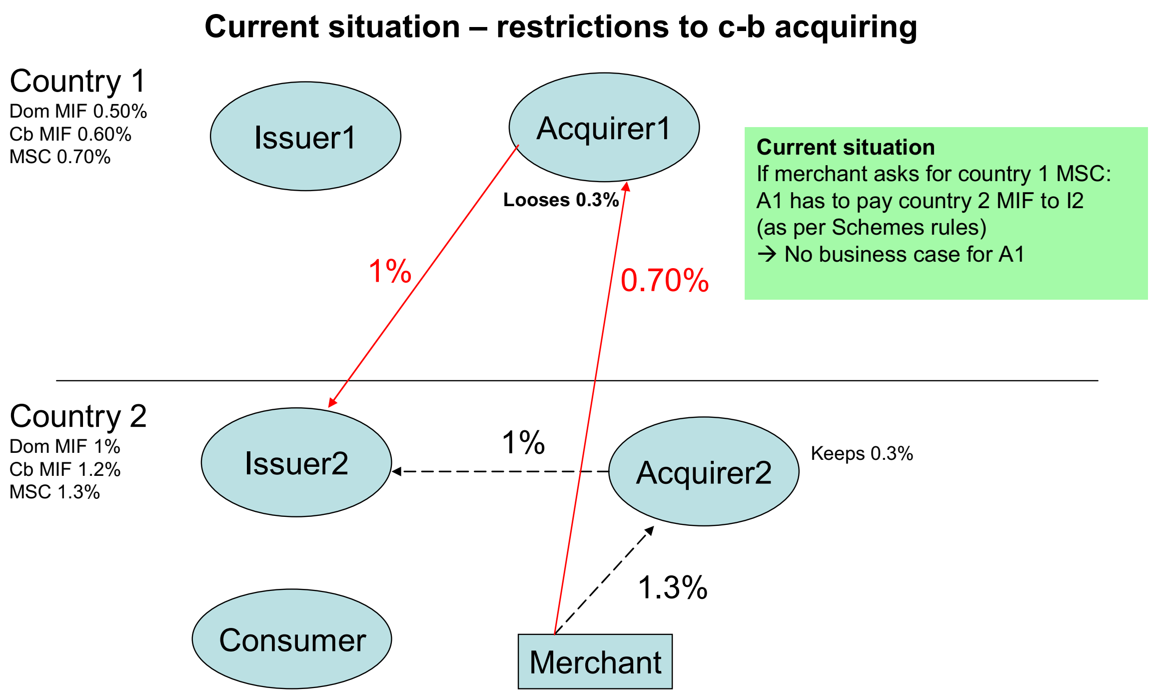
In addition to reverse competition we also find a high variety of interchange fees and a lack of market integration. The ability of merchants to resist high IFs – to exert some form of countervailing power - is not only hindered by rules that limit their ability to differentiate their prices according to the cost of a given means of payment (no surcharge, non-discrimination rule), or force them to accept all cards of a given brand (honour all cards/products). In the current situation, scheme rules also force acquiring banks to apply the interchange fees applicable in the country in which the merchant is located even if the acquirer is based in a different country with a potentially lower domestic MIF level. Cross-border acquiring takes place when an acquirer recruits, for card acceptance, merchants based in a different country from the acquirer. This allows merchants to have their transactions acquired in a country other than their country of residence. It also allows merchants who operate in several countries to centralize their card processing activities. Since the MIF accounts for a major share of the merchants' service charge (MSC), the rule prevents merchants from benefitting of lower MIF-levels and consequently lower MSC-levels offered by acquirers in other Member States since it is the merchants' location that determines the fees, not the location of the acquirer. This rule therefore hinders the development of cross-border acquiring by making it much less attractive for merchants.

The European merchants' vision of how cross-border acquiring should function is as follows, as explained by their European association, Eurocommerce:

> "The following simple example illustrates a situation with only 2 countries[64]. In each country, we assume different cross-border and domestic MIFs, but there is only one MSC per country (in order for the acquirer to respect Regulation 924/2009).

[64] http://www.eurocommerce.be/content.aspx?PageId=41803

Figure 9 – Situation with 2 countries



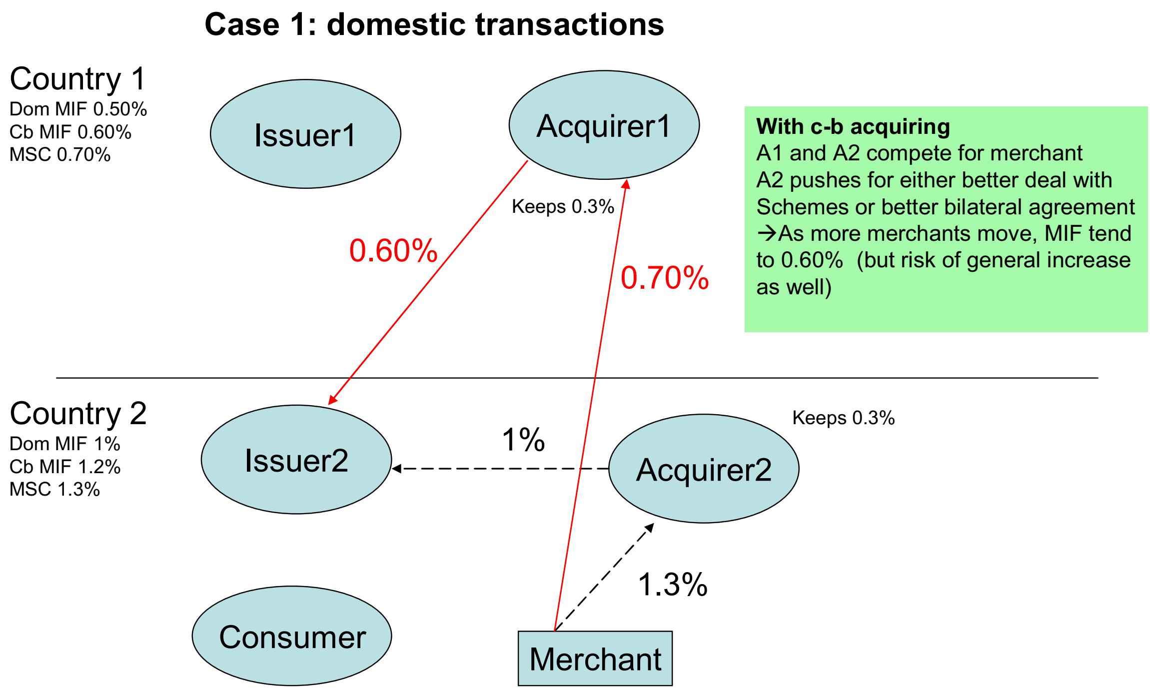
Nowadays, with the current restrictions on cross-border acquiring, the merchant in Country 2 pays the MSC to the acquirer 2 (the 0.3% margin being the only part of the cost that the merchant can potentially negotiate). Acquirer 2 has no other choice than to pay the domestic MIF (1%) to the issuer bank I2.

It must be noted that, because of the MIF's 'upward pressure on price' effect, any competition between issuers at national level makes the situation worse. Indeed, in order to attract consumers to apply for and use their card, issuers have incentives to push for ever increasing MIFs (because the benefits to cardholders are not paid by cardholders but by merchants).

The merchant located in country 2 would like to have his transactions acquired in country 1, where the rates are lower. He is able to negotiate a lower MSC (0.70% in this example) with Acquirer 1, but Acquirer 1 is obliged, according to Visa and MasterCard's rules, to pay the MIF of Country 2 to Issuer 2, i.e. 1%. On the other hand, Acquirer 1 has to respect Regulation 924/2009, i.e. offering the same MSCs for domestic and cross-border transactions. Therefore, Acquirer 1 will lose money on each transaction presented to him by the merchant. There is no business case for any acquirer to acquire card payments from more expensive countries.

'Real' cross-border acquiring would be when banks would be allowed to apply the interchange fee applicable in the country in which the acquiring banks are located. In case 1, the consumer is located in the same country as the merchant.

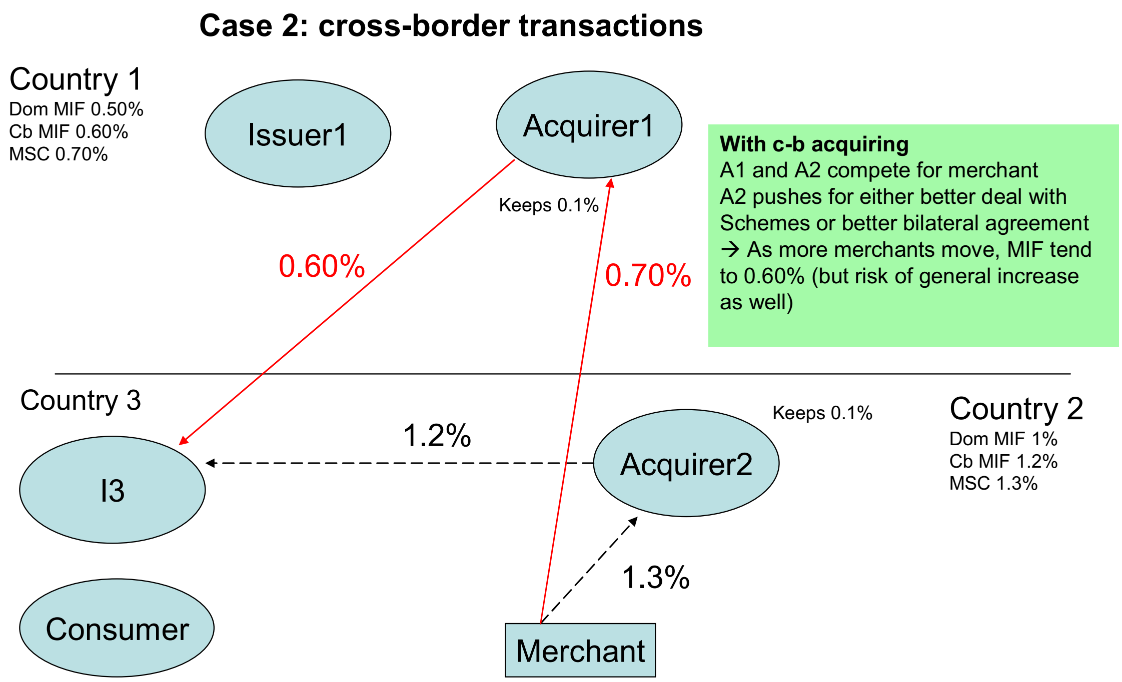
Figure 10 – Case 1: Domestic transactions



If restrictions to cross-border acquiring were lifted (the situation is depicted with the plain red arrows), the merchant in country 2 could go to acquirers in country 1 and negotiate for a better price. While Acquirer 2 would (potentially) lose a merchant, Acquirer 1 would gain one. Being faced with some real competition, Acquirer 2 would have an incentive to lobby for a lower MIF towards the card schemes. Similarly, the profit of issuer 2 would be reduced, but certainly not to a level where issuing that card would cease to be profitable (if issuing such a card is profitable in Country 1, why wouldn't it be profitable in Country 2?). There is, however, a risk of a general increase. Given that MIFs are set by card schemes, there is a high likelihood that schemes would much prefer to increase MIFs in Country 1 to the rates of Country 2.

In case 2, the consumer is located in a third country. The conclusions are similar.

Figure 11 – Case 2: Cross-border transactions



In merchants' ideals, the acquirer would apply the same fees level across Europe, leading to substantial cost savings on top of considerable scale efficiencies. Feedback from Groupe Auchan SA[65] suggests estimated savings of €90 million on a yearly basis for the 8 countries in the EU Member States where they are present. This estimated saving is calculated on a yearly basis, and only based on the MIF optimisation[66]. As the number of transactions has increased since the calculation of these estimates, and European acquiring would improve the bargaining power of the merchant, this estimate is a minimum saving. Real savings are likely to be even higher."

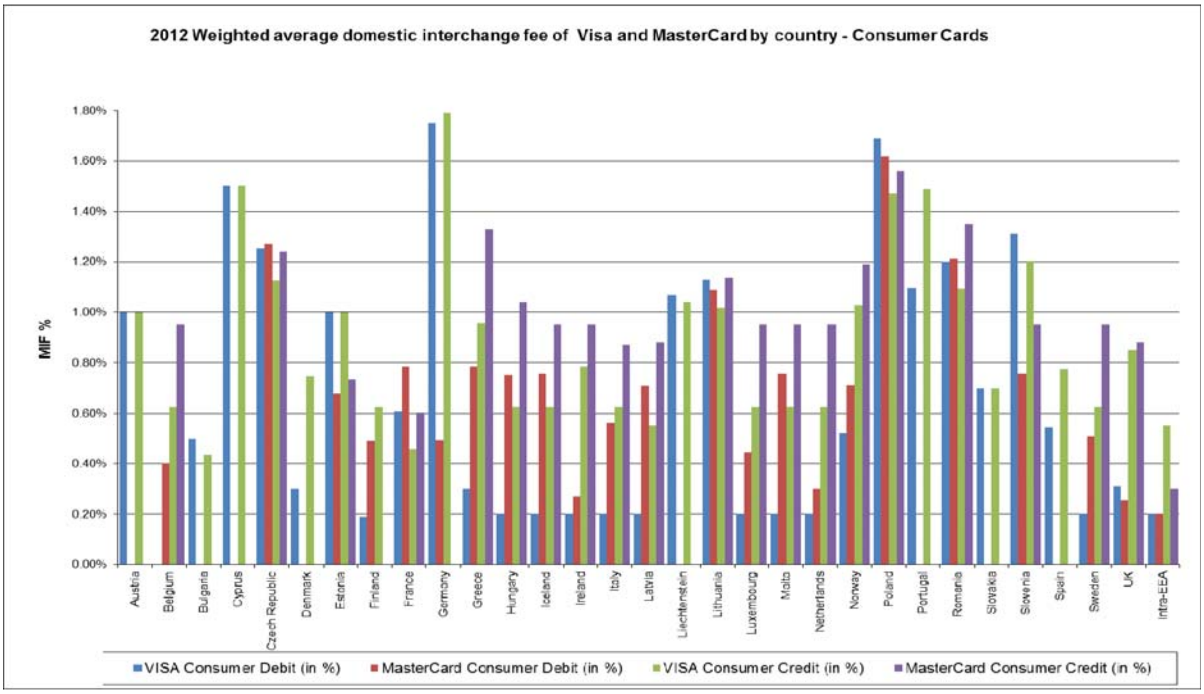
In addition to the POS rule, rules of domestic schemes often prescribe national messaging protocols and specific authorisation regimes or certification procedures which also hinder the development of cross-border acquiring. Therefore, absent scheme rules, the delays in the adoption and implementation of harmonized technical standards at a pan-European level limit the possibilities of cross-border acquiring to big merchants who are ready and willing to invest in making cross-border acquiring work. In any case, this absence of arbitrage results in

65 French international retail group present in 12 countries (8 in EU).

66 Numbers for 2011, with the hypothesis that European acquiring is possible (= European MSC (Merchant Service Charges) based on the European MIF + an estimated acquirer cost for all transactions).

a lock-in effect, under which merchants located in one country are forced to pay the fees applying in this country instead of being in a position to benefit from the Internal Market.

Figure 12 - Average domestic MIF levels in the Member States, 2012



The above graph illustrates that MIF levels show significant variation among member states. When looking at consumer card transactions, their weighted average level range between 0.1-0.2% to 1.4-1.5% among various Member States. Country average MSC rates range between 0.3-0.4% to 1.9%. MSC rates also vary between merchants within the same Member State, smaller merchants may end up paying average MSCs of up to 3–3.5% of the transaction value.

Next to the lack of arbitrage, the limited legal certainty is fuelling a lack of level playing field. The ruling of the General Court of 24 May 2012[67] on MasterCard's appeal against the Commission's decision prohibiting MasterCard's multilateral interchange fees (MIFs) that apply to cross-border transactions with consumer cards rejected the appeal confirming that MasterCard's cross border MIFs restricted competition in the cards payment market and were not justified for efficiency reasons. However, MasterCard has appealed the judgement, and the ruling still leaves the question of the appropriate level of MIFs open, even if it the General Court endorsed the Commission's assessment that debit cards generate important commercial benefits for banks apart from interchange fees, and therefore questioned the necessity of a MIF for debit cards[68].

In a context of competition law enforcement carried out by the different National Competition Authorities - in close cooperation with the Commission- against the various national banking communities operating under the 'umbrella's' of the MasterCard and Visa systems it is unlikely that there will be a coherent and consistent outcome across the EU

67 Judgment of the General Court (Seventh Chamber) of 24 May 2012, case T-111/08 - MasterCard and Others v Commission.

68 Cf. The analysis for option 15 under 9.2.1.4 below

sufficiently fast to ensure market entry, innovation and competitiveness of the European payments market at a global level. Also, competition between payment card schemes is based on offering *higher* fees to convince issuing banks to issue their cards. Consequently, it is difficult for individual schemes to reduce their fees in order to align with the General Court's assessment in the MasterCard judgment, since this would risk 'leaving the market to their competitor(s)'. Arguably, only an 'across the board' lowering of fees by all market players, for instance on the basis of regulation, could assure such alignment with the assessment in the judgment.

On top of maintaining the status quo for incumbent card schemes, high MIFs also form barriers to entry for cheaper and more efficient schemes that offer lower inter-bank fees and have difficulty convincing issuing banks. This results in limited innovation and market entry.

Another problem causing ineffective competition, concerns information on the availability of funds. In many business models for third parties (e.g. new card schemes) providing payment services, prior information on the availability of funds on the consumer's payment account, is a key element. It is both necessary for the authorisation and the payment guarantee of a specific payment transaction. So far, PSPs are not obliged and may be reluctant to share information on the availability of funds on a payment account regardless whether the cardholder agrees or not. Given the importance of the security of the payment transaction and confidence in the payment system in general, such refusals may be justified in some cases. However, PSPs have a commercial incentive to refuse to cooperate with third parties, even if there is no justified security concern. The restriction of this information could hamper the emergence of new schemes for card, internet or mobile payments. While there are many concerns about third party services, they have a very strong potential for true innovation on the payment market[69]. Closely linked to the information on availability of funds is the access to payment account information for e-payment initiation by third party providers. This is discussed under 3.2.2.4.

Finally, due to the exemption of payment systems designated under the Settlement Finality Directive from the general PSD provisions[70] on access to payment systems, Payment Institutions (PIs) are often not allowed under the Settlement Finality Directive to participate ‘directly’ in designated payment systems. As a result, in most Member States, PIs participate in payment systems only ‘indirectly’, using the service of a ‘direct’ participant who initiates the payment orders on behalf of the PI in the system, carrying the legal and credit risk, against remuneration. In some countries, PIs do not opt for indirect access either, but simply participate as ‘customers’. While this is also the case for smaller credit institutions unable/unwilling to fulfil the access criteria of designated payment systems or that have

[69] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p108

[70] Directive 2007/64/EC Of The European Parliament And Of The Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC – Article 28(2)

simply decided, for commercial reasons, against direct participation, PIs are not given this freedom of choice, and possibly suffer from a competitive disadvantage[71].

Problem 3.2.2.3 – Diverse charging practices

A surcharge is a charge that is added by merchants on top of the requested price for goods and services when a certain payment method (usually a card) is used by the consumer. The PSD explicitly empowers merchants to use surcharging and rebating for the use of a given payment instrument in order to steer consumers to the most cost efficient payment instrument. However, Member States may still prohibit or limit surcharging (but not rebating) under certain conditions at national level. According to the official notifications from the Member States, surcharging is allowed in 12 Member States, 14 other EU countries opted to prohibit the use of surcharges and 1 Member State has prohibited surcharging for the use of debit cards but allowed it for credit cards. Nonetheless, even in some of those Member States prohibiting surcharging, the practice is sometimes still applied. The table below gives an overview of all Member States and which ones prohibit or allow surcharging.

Table 34 - Surcharging in EU Member States

Countries, which prohibited surcharging	Countries with different surcharging rules for credit and debit cards	Countries allowing for merchant surcharging
Austria	Denmark (prohibition for debit cards, no prohibition for credit cards)	Belgium
Bulgaria		Estonia
Cyprus		Finland
Czech Republic		Germany
France		Ireland
Greece		Malta
Hungary		Netherlands
Italy		Poland
Latvia		Slovakia
Lithuania		Slovenia
Luxembourg		Spain

71 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p213

Portugal Romania Sweden		UK

Source: European Commission[72]

It should be noted, however, that the UK Office of Fair Trading has recently announced that it was forcing airlines to eliminate surcharges for the use of a debit card to pay airline tickets bought on-line[73]. At EU-level, The Consumer Rights Directive will prohibit above-cost surcharges in most retail sectors for all types of payment method by the Directive's June 2014 deadline.

In order to better assess the phenomenon of merchant surcharging the Commission asked its consultant, London Economics-iff, to investigate surcharging practices in detail, in the framework of the study on the impact of the PSD and Regulation 924/2009[74].

The surcharging survey was run in 9 Member States: Belgium, Denmark, Finland, France, Germany, Ireland, Netherlands, Spain and the UK. It should be noted that France, officially a Member State where surcharging is prohibited, was included in the survey as various sources from the payments industry indicated that merchants were applying surcharges despite the legislation.

The table below suggests that surcharging is well present, but not a wide-spread practice in countries allowing surcharging.

Table 35 - Proportion of merchants that apply surcharges on credit cards, by country

Country	No surcharge	Surcharge
Belgium	93%	7%
Denmark	91%	9%
Finland	99%	1%
France[1]	96%	4%
Germany	91%	9%
Ireland	86%	14%
Netherlands	90%	10%
Spain	92%	8%
UK	86%	14%

72 See London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p70

73 See OFT (2012), Press Release - Airlines to scrap debit card surcharges following OFT enforcement action, 58/12, 5 July 2012.

74 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p70-92

Source: Study on the impact of the PSD and Regulation 924/2009 for the European Commission[75]

Detailed survey results from the London Economics and iff study show that surcharging practices in 2012 are more predominant than in 2009. The best example to illustrate this is the surcharging practices of merchants in Denmark as 9% of merchants are surcharging in 2012 but only 5% did so in 2009. While surcharging was not a widespread practice in general, ranging from 1% of all merchants in Finland to some 15% in Ireland , it was concentrated in some sectors of the economy, above all in travel, hotel and hospitality industry, recreation and entertainment and, to a much smaller extent, in catering and restaurant business. It is in these sectors that 'expensive' cards are being used most, such as commercial cards, third party credit cards and premium credit cards. This may explain why these sectors are at the forefront of using surcharges. The study confirmed also the expansion of surcharging practices in all but two of these nine Member States in comparison to 2009 situation (before the entry into force of the PSD).

The average surcharge across sectors and countries ranges from 1% in the travel/hotel/hospitality sector in Belgium and entertainment/recreation sector in Ireland in to 4.1% in the same sector in Spain. Across all sectors and all countries, the average surcharge is 2.7%.

Table 36 - Average surcharge, by country and sector (%)

Country	Catering/ Restaurants	Entertainment / Recreation	Retail	Travel/Hotel/ Hospitality	Other
Belgium				1.0%	%
Denmark	2.6%		1.6%	1.7%	2.1%
Finland				1.0%	0.4%
France	3.0%	2.2%	3.3%	3.5%	3.4%
Germany	3.9%	3.7%	2.5%	2.7%	2.9%
Ireland	2.8%	1.0%	2.6%	2.4%	2.7%
Netherlands	2.7%	2.7%	3.0%	3.0%	2.0%
Spain	3.3%	4.1%	2.6%	3.0%	2.5%
UK	3.9%	2.3%	2.2%	2.6%	2.7%

Source: Study on the impact of the PSD and Regulation 924/2009 for the European Commission76

75 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p73
Note: Surcharging is not allowed in France
Source: Analysis of surcharge survey

It is important to note that not all sales of merchants applying surcharges attract such surcharges as some sales may involve payment instruments not subject to surcharges. The average proportion (in a particular sector) of sales subject to the surcharging ranges from 0.1% in France (catering/hospitality) to 26.9% in the UK (travel).

Table 37 - Average share of total annual sales subject to surcharge, by country and sector (%)

Country	Catering/ Restaurants	Entertainment / Recreation	Retail	Travel/Hotel/ Hospitality	Other
Belgium				0.8%	0.0%
Denmark	9.7%		0.6%	2.6%	1.2%
Finland				0.7%	1.7%
France	0.1%	1.4%	1.5%	2.2%	0.5%
Germany	0.8%	3.0%	1.1%	8.4%	1.9%
Ireland	3.6%	3.3%	3.2%	34.8%	2.4%
Netherlands	18.5%	2.9%	1.5%	10.0%	4.0%
Spain	1.7%	11.0%	4.1%	10.2%	3.4%
UK	1.6%	4.0%	4.8%	26.9%	5.3%

Source: Study on the impact of the PSD and Regulation 924/2009 for the European Commission77

The results of the calculation of the monetary value of the surcharge are shown in the table below. The largest monetary value of the surcharges is observed in the travel/hotel/hospitality sector in the UK, reflecting a relatively high surcharge rate and a high incidence of surcharging. Altogether, the monetary value of the surcharges in these countries stands at €731 million.

Table 38 - Total value of the surcharge (EUR millions), by country and sector

Country	Catering/ Restaurants	Entertainment / Recreation	Retail	Travel/Hotel/ Hospitality
Belgium				0.24
Denmark	4.44		0.31	0.79
Finland				0.10
France	0.05	2.38	3.44	5.17
Germany	2.46	17.70	5.92	49.45
Ireland	2.19	0.14	1.53	42.69
Netherlands	12.16	3.06	1.63	19.87
Spain	4.16	21.24	9.80	60.07
UK	5.53	11.64	22.70	398.59

76 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p74
Source: Analysis of surcharge survey

77 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p74
Source: Analysis of surcharge survey

Source: Study on the impact of the PSD and Regulation 924/2009 for the European Commission[78]

It is important to note that the surcharge cost does not reflect the savings that consumers may make in the absence of surcharging as the merchants applying surcharges to compensate for the costs of accepting certain instruments would then increase their retail prices to recoup the costs they incur.[79] Obviously, the precise response of merchants in such a situation will depend on the state of competition of the sector in which they operate and whether the surcharge reflected the costs faced by merchants when accepting a card payment or was at least in part a source of profit for merchants.

Surcharging was originally devised as a steering mechanism. In practice, however, most merchants, in particular in the traditional retail sector, were reluctant to adopt them, mostly because of fears of losing customers to competition, but also because certain categories of merchants are not often faced with 'expensive' cards, or because small merchants, in a face to face environment, prefer to turn to cash instead of having to accept debit cards because of their relatively higher marginal costs as compared to bigger merchants. Another effect was that, at least some merchants saw surcharging as a 'threat' they could use in negotiations with their acquirers in order to decrease their MSCs. Moreover, the practices of some merchants and business sectors were criticised as surcharging was used to generate extra revenues, in particular when other forms of payments than cards were not accepted or not practical. Furthermore, undifferentiated surcharging (e.g. to apply the same surcharge for all credit card brands, even if there might be differences in the MSC), lowers the steering effect towards cheaper brands within one type of payment instrument. At the same time, at least in the "brick and mortar" trade, it has been argued that surcharging cards was stimulating the use of cash. When London Economics and iff surveyed competent authorities of Member States who chose to prohibit surcharges, the prohibition was justified on the grounds of encouraging consumers to switch away from cash-based transactions to more efficient payment instruments. A 2008 study in the Netherlands for instance showed that "consumers do react to payment fees and adapt their payment behaviour accordingly. Effectively, consumers try to avoid the extra surcharge, mostly by resorting to cash". On the other hand, surcharging may lead to increased card acceptance from merchants in particular for transaction amounts above

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78 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p75 Source: Analysis of surcharge survey

79 For example, Sveriges Riksbank (2012). note the following in its 'Response by Sveriges Riksbank to consultation regarding the European Commission' Green Paper on card, internet and mobile payments', Financial Stability Department, Dnr 2012-141-STA, March': *The Riksbanks favours the approval of surcharges and these should as far as possible reflect the actual costs of a certain payment instrument. At present, the merchant pay fees to the banks for cash and for card payments, but are not able to price these services directly to their own customers. This results instead in a general surcharge on goods and services. Such a situation does not give the consumers any indication of the costs of different payment instruments and thus risks counteracting the efficient use of these instruments. The differences in the costs of different instruments should instead be as transparent as possible. It should be up to the merchants to determine whether a fee should be charged for a certain payment instruments, and if so the level of the fee. However, the Riksbank would like to make it clear that it should be possible to charge fees for all types of payment instruments*' p.2.

a threshold under which alternative payment instruments (e.g. cash) are less costly. In a 2011 study by the Dutch Central Bank[80], it was concluded that surcharging has contributed to **debit card acceptance** in the Netherlands.

The problem lies in the divergence of the charging practices as well as in the limited effects it had in the way it was intended. Because of the divergence, it is often unclear for consumers whether merchants can surcharge them. Especially in the case of e-commerce this can be confusing as merchants located in a country where surcharging is allowed can offer products and services in countries where it isn't and in this case surcharge the consumer. Therefore the lack of harmonisation in this regard is a problem in itself. In addition, the concept of surcharging which was intended to allow merchants to steer consumers to the most cost-efficient payment method, has not led to the intended results. Many merchants cannot or prefer not to surcharge. One of the difficulties for merchants to efficiently steer consumers follows from the HACR. Merchants are obliged to accept all cards within a brand and often fees for the use of these cards are blended so that it is unclear for merchants which cards are most expensive.

Transposition of the Consumer Rights Directive and the surcharging

The issue of surcharging has been recently addressed also in Directive 2011/83/EU on consumer rights, adopted on 22 November 2011 by the European Parliament and by the Council. The Directive should be transposed by the Member States by 13 June 2014.

Article 19 (Fees for the use of means of payment) modifies effectively provisions of Article 52(3) of the PSD that allow surcharging without any specific criteria. It states that "Member States shall prohibit traders from charging consumers, in respect of the use of a given means of payment, fees that exceed the cost borne by the trader for the use of such means". In other words, the provision aims at limiting the surcharge to the actual cost of a payment instrument for the merchant and tries to put an end to the practices of some merchants, who use surcharge as an additional source of revenues.

The drafting of the Article does not provide a detailed definition of the costs borne by the trader. The Commission's services are currently working with national authorities to reach a convergence on the criteria to be applied in assessing real cases.

A risk associated with such defined limitation of surcharges is that in some cases, cardholders (consumers) using their cards in a cross-border context within the EU could be subject to significantly higher surcharges by merchants. This is because card acquirers may decide to charge different rates of MIF and MSC for cards issued nationally and those issued in other Member States. Consequently, a surcharge based on such costs could lead to different surcharge amounts for cards issued nationally and in other Member States. This phenomenon

[80] See: http://www.dnb.nl/en/binaries/working%20paper%20300_tcm47-254378.pdf

could be already observed in Denmark, the first Member State that has transposed Article 19 of the Consumer Rights Directive.

Problem 3.2.2.4 – Legal vacuum for certain payment service providers

Third party providers for payment initiation services, account information services and other equivalent services

Typically, payment service providers (PSPs) as defined by the PSD issue and operate payment accounts to initiate and receive payments. Since the PSD was passed in 2007, new services have emerged in the area of internet payments where so called third party providers offer e-merchants specific payment solutions which do not necessarily require customers to open accounts with the third party provider. For example, there are systems/software's which collect and consolidate information on the different bank accounts of a consumer in a single place ("account information services"). These will typically also allow a consumer to make payments from these different bank accounts. To access these services a consumer typically stores their log in and other secure identifiers for the different bank accounts on their device or on a website/'cloud'. In addition, there are third parties who facilitate the use of online banking to make internet payments ("payment initiation services"). They help prepare online credit transfers, transmit consumer's security codes (typically one-time codes that can only be used for this transaction) to their bank with the credit transfer and inform the merchant that the transaction has been initiated.

The account information services consist in the consolidation of the information of different accounts a customer may have with different banks and the presentation of this information in a user-friendly way and in single place. The payment initiation services are designed mainly for e-merchants and offer them less-costly payment solutions as an alternative to the card-based payments. In order to provide these two types of services, the third party providers need to access the accounts of the customers, using the existing account infrastructure put in place by banks and the costumers' credentials. This access is sometimes refused by banks which invoke security and liability reasons, as well as intellectual property rights, protection of property and possible reputational risks. The existence of a contract between the third party provider, the bank and the customer (or alternatively framework contracts) and the payment of a financial compensation could be seen as a condition for the access to the payment accounts. But this approach raises serious competition concerns.

These new services are in most cases not addressed by the EU legal framework on payment services as they never enter into possession of the funds transferred. The fact that these new services and their providers are not covered by the existing legal framework has raised a wide range of concerns amongst banks and certain Member States (ranging from consumer protection, security, competition and data protection concerns) and triggered legal proceedings in one Member State (case under analysis by the German courts)[81]. Furthermore, as these service providers are typically not licensed, they are in most cases neither supervised nor overseen by any competent authority. Regulation of these activities would help to ensure the security of these transactions, consumer trust in these providers and possibly help to address any liability issues that could arise.

The European Forum on the Security of Retail Payments[82], SecuRe Pay, a voluntary cooperative initiative established by the European Central Bank between authorities aimed at facilitating common knowledge and understanding – in particular between overseers and supervisors of payment service providers – of the issues at stake in the field of retail payments security. In its plenary composition, SecuRe Pay is composed of EU overseers and supervisors of payment service providers, the European Banking Authority and, as observers representative of EEA countries, the European Commission and Europol and it is chaired by the European Central Bank. SecuRe Pay has identified several potential security risks related to payment account access, if no action was taken by the third parties themselves or by regulators:

third party providers may not be subject to supervisory requirements,

the risk of weak (technical and/or organisational) access controls for systems,

the risk of handling of sensitive payment data without appropriate controls and/or use of sensitive payment data without informed approval by the user,

the risk of a loss of control over online banking/ payment session by user and/or PSP,

81 In 2010 the Bundeskartellamt received a complaint by Payment Network AG (today: Sofort AG), a company offering an online credit transfer service called Sofortüberweisung.de. The company complained that it was being barred by the German banks from offering its online credit transfer services to merchants and payers. Among other measures, this included a lawsuit by Giropay GmbH (a joint venture of Postbank and companies from the savings bank group and the cooperative bank group) against Payment Network AG. Giropay claimed that Payment Network AG was inducing bank account customers to use their online-banking credentials on websites that had not been authorized by their banks. The clauses on using credentials are part of the general terms and conditions that are developed by Deutsche Kreditwirtschaft and are generally adopted by the banks. Banks only allow using these credentials on their own website or on websites of Giropay as a bank-owned online service.
After a preliminary assessment, the Bundeskartellamt came to the conclusion that the general terms and conditions for online banking most likely constitute an infringement of Article 101 TFEU and Section 1 of the German Competition Law (Act against Restraints of Competition – ARC) because the exclusion of online credit transfer services from all but specific (bank-owned) service providers was not deemed indispensable for guaranteeing a secure online banking system – as had been claimed by the plaintiff in a civil case and by Deutsche Kreditwirtschaft in the administrative proceedings initiated by the Bundeskartellamt. The Bundeskartellamt was of the opinion that other measures could be taken in order to safeguard the online banking system, such as the development of a certification procedure comparable to existing certification procedures in other areas of banking services. It submitted a corresponding amicus curiae statement to the competent court. The court decided in March 2011 to stay its procedure until the administrative proceeding was concluded.
In August 2011 Deutsche Kreditwirtschaft issued a first model for a certification procedure for non-bank online banking service providers. While the certification requirements proposed seemed to be acceptable, discussions are still ongoing regarding the need of bilateral contracts with each customer bank, as well as issues of liability. The case is still pending.

82 http://www.ecb.int/press/pr/date/2012/html/pr120420.en.html

the accountability risk and the risk that allocation of liabilities in case of problems is more difficult,

the risk of inducing potentially unsafe customer behaviour.

Table 39 - Existing market participants identified and consulted by SecuRe Pay on the risk analysis

Company name	Service name	Country of headquarter
STUZZA	eps	AT
Buhl Data Service GmbH	finanzblick HD Lite	DE
Giropay	Giropay	DE
Haufe-Lexware GmbH & Co. KG	Quicken	DE
Kontoblick GmbH	Kontoblick	DE
Payment Network AG	Sofortbanking	DE
Star Finanz GmbH	StarMoney	DE
stoeger it GmbH	iOutBank	DE
Eurobits Technologies		ES
Safetypay	Safetypay	ES
Balancion		FI
Suomen Verkkomaksut	Suomen Verkkomaksut	FI
Boursorama	Money Center	FR
EBA Clearing	MyBank	FR
Fiduceo SAS	Moneydoc	FR
Linxo	Linxo	FR
PERSPECTEEV	Bankin’	FR
Currence	iDEAL	NL
Centrum Elektronicznych Usług Płatniczych eService	eService	PL
Dotpay S.A.		PL
eCard S.A.		PL
Krajowa Izba Rozliczeniowa S.A. (KIR S.A.)	PayByNet	PL
PayU S.A.	PayU	PL
Trustly	Trustly	SE

Although most of the third party providers are not licensed as payment service providers, few of them obtained such a licence for the provision of other services.

Considering the limited number of exiting services providers, this is to be seen as a niche market.

Problem 3.2.2.5 – Scope gaps and inconsistent application of the PSD

Negative scope of the PSD

Certain exemptions in the PSD, discussed more in detail below, lead to very divergent interpretation and application of this law across Member States. First, the definitions and exemption criteria set out in the directive appear sometimes to be too general. Second, the exemptions seem in some cases too generous, outdated or unreasonable, in particular when technological and business developments in the payments industry are taken into consideration. Third, the interpretation of these provisions by the competent authorities varies from one Member State to the other.

The inconsistences are amplified by the fact that some Member States may have apparently decided to change the wording or scope of exemptions in comparison to the originally agreed text and that despite the fact that PSD is a maximum harmonisation directive. Furthermore, there is a lack of general harmonisation or individual guidance on exemptions by the competent authorities of the Member States.

A further challenge is that the to-be-exempted service providers do not consult authorities on whether their activities are covered by the PSD but instead rely on their own assessments. Some exemptions may have even been used by PSPs to redesign business models so that the offered payment activities are on purpose "outside scope" of the PSD[83].

These divergent applications of the PSD imply risks for PSUs and a lack of a level playing field for PSPs which is not conducive to a competitive market. Four following exemptions should be in particular mentioned:

Commercial agents: Under the current PSD, certain payment transactions are exempted if done through a commercial agent on behalf of the payer or the payee. While the provision is formulated rather narrowly, evidence suggests[84] that it is being interpreted very differently between Member States. The exemption is e.g. used by some e-commerce platforms[85] that act as commercial agents on behalf of individual consumers and offer escrow-type services (a third party between a buyer and a seller – e.g. a consumer and a company – who receives the funds from the buyer and keep them until buyer receives the goods or services from the seller) outside the protection of the general PSD framework. The exception should possibly

[83] See section 3.2.3 Effects and corresponding part in Annex 8

[84] Feedback from the Member States authorities as well as London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p123

[85] E -commerce platform is basically an online retail solution that enables transaction via the internet and gives to a retailer a set of tools, allowing to identify, engage and retain customers. It includes often not only the traditional web store, but also offline, mobile and social media channels capabilities. Examples of large, international e-commerce platforms are e.g. Groupon, E-bay (through a subsidiary, Magento), Amazon (Amazon Marketplace) or Yahoo (Yahoo Store).

be clarified and updated to better comply with new e-commerce business models. It currently risks distortions of competition in the market and increases risks for consumers.

Limited networks: Examples of limited network payments are e.g. store cards, member cards, public transportation cards, petrol cards, restaurant vouchers or virtual wallets allowing for shopping on specific websites. The provision exempts payment activities which take place in the context of a limited network without however defining, for instance, the notion of what is a 'limited' network and what is a ‘limited range of products/services'. As a result, feedback from the market suggests that the activities covered by this exception often comprise massive payment volumes and values and hundreds or thousands of different products and services, which has nothing to do with the original limited network concept. This implies uncertainties for market actors and greater risks for PSUs.

Telecom exception: The provision exempts certain payment transactions by means of any telecom or IT device where the network operator does not only acts as an intermediary in the delivery of digital goods and services through the device, but adds value to them. Key examples of exempt digital network payments are payments for ring tones, apps, games, etc. However, beyond traditional ring tones and wallpapers, mobile operators increasingly provide access to various services that combine the digital and physical worlds, thus going beyond the scope of the exemption. Specific cases of such products with "offline" characteristics are, for example, vouchers and ticketing services. This market segment is growing quickly. The mobile network operators also sell content provided by third parties, acting as a normal intermediary or an online shop. The scope of the exception appears therefore unclear, too vague and risks leading to distortions of competition in the payments market.

Independent ATM providers: The current framework does not cover payment services offered by providers of ATM services independent from banks or other PSPs. Originally devised as incentive to install stand-alone ATMs in remote and poorly populated areas e.g. by pub or shop owners86, the provision did not foresee the arrival of independent ATM providers with networks comprising hundreds or even thousands of ATMs, covering one or more Member States87. The rationale for this exemption raises many controversies, as it leads to non-application of the PSD provisions for a growing part of ATM market. There are indications that some PSP-operated ATM networks are seriously considering the use of this exemption to redesign their business model and charge extra fees directly on the consumers, while terminating their current contracts with card schemes or card issuers. This solution has been in fact already introduced by most bank-owned ATM networks in Germany in 2010 and

86 The stand-alone ATM is exempted from the PSD rules and therefore is outside any contractual agreement on fees between the PSP (card issuer) and PSU (cardholder). Consequently, a fee of any value can be imposed by the ATM owner on the PSU, creating an incentive to install ATMs in places, where it would not be commercially viable otherwise (so the theory), within the PSD framework. Technically, the fee could be qualified as a surcharge on a withdrawal, added to the normal charge applied by the PSP that issued the card.

87 For example, Euronet Worldwide operates a network of thousands of ATMs in 9 EU Member States.

is known as "direct charging"88. While consumers having payment accounts with the owner bank still enjoy access to ATMs on the basis of their contracts, all agreements on ATM use with other banks have been terminated. Instead of a previous, limited fee on withdrawal charged only by the bank of the PSU, "direct charging" by the ATM owner has been applied. This has lead to a huge increase of charges for ATM withdrawals for clients of other banks. As a consequence, the ATM charges in Germany are currently the highest in Europe, with one-off charges for withdrawals in non-own networks ranging often between 5 EUR as a minimum up to 12,50 EUR. In the UK, when independent ATM deployers own as much as 47% of all ATMs, only 5% of all withdrawals in terms of numbers and 3% in terms of value are made through them89. Additional charges demanded from PSUs by independent ATM deployers have a clearly limiting effect on the ATM usage. Furthermore the exemption raises concerns in the context of charges applied on consumers for cross-border ATM transactions in euro and may lead to breaches of Regulation 924/2009.

Table 40 - Number of independent ATMs in selected countries of the EU

	Total No of ATMs in the country	**No of ATMs installed by independent ATM deployers**	**ATMs installed by independent ATM deployers as % of total No of ATMs**
Netherlands	7,800	800	10%
Poland	17,500	3,500	20%
Sweden	3,200	650	20%
UK	65,646	30,835	47%

Source: ATM Industry Association (ATMIA)

It should be noted that the impact of the discussed exemptions is not always negative. The reason for the exemptions was to exclude from the PSD these payment services and providers, for which the PSD regulatory regime would be excessive. Such services and providers would otherwise need to change their offer (including price, availability) or may even disappear from the market to the detriment of competition. However, the scale of positive impacts appears to be relatively minor in qualitative terms, in comparison with the adverse effects created by the exemptions.

"One-leg" transactions and payments in non-EU currencies

Currently, the most important parts of the PSD from users perspective – Title III and IV (rules related to the transparency of conditions and information requirements and those related to rights and obligations of PSUs and PSPs) - do not apply for all payment transactions. When one of the PSPs involved in the transaction is located outside the EEA

88 Direct charging is further possible in Sweden and the UK.
89 Source http://www.ukpayments.org.uk

(i.e. when one "leg" of the transaction is international, e.g. located in Switzerland or USA) the rights and obligations as well as transparency and information requirements become suddenly different than in the case of purely intra-EEA transactions[90]. This leads to much confusion and, in many cases, to the detriment for the PSUs. For example, non-sufficient information on all applicable charges and less favourable liability rules for incorrectly executed transactions may apply. Additional complexity, in particular for businesses, is added by sometimes completely different national rules for such one-leg transactions. In effect, instead of harmonised EU rules for all transactions, a patchwork of national approaches exists.

Another area, where a very similar situation occurs, are payments in non-EU currencies. Titles III and IV of the PSD apply only to payments in euro or in the national currencies of the Member States outside the euro area. As a result transactions in other currencies, such as US dollar, Swiss franc or Japanese yen remain outside the scope of the legal protection, whether the transaction takes place entirely or partly within the EEA. As in the case of "one-leg" payments, this gap weakens the protection of PSUs and leads to the adoption of different national rules.

Table 41 - Approach to two-leg and one-leg transactions in the EU Member States

Member State	two-leg rule (understood as:)		one-leg rule	comment to one/two leg	currency scope	comments to currency
	EU	EEA				
Austria			+	National approach, i.e. either PSP or payment service user is located in Austria.	all	Provisions concerning value date are applicable only to EEA currencies.
Belgium		+	partially covered	Provisions concerning value date and prohibited clauses are applicable when either payer's or payee's PSP is located in Belgium. Provisions concerning liability for non-authorised payments are applicable if the payer's PSP is located in Belgium.	EEA	Provisions concerning liability for non-authorised payments are applicable to all currencies.
Bulgaria	+			Either both payee's and payer's PSPs or the sole PSP are/is located in the EU.	not enacted	Legislation does not directly mention the application to certain currencies, however, the application to the currencies of the EU/EEA States can be inferred.
Cyprus	+		partially covered	A list of provisions applicable in one-leg approach is provided in National Implementing Measure e.g. derogation from information requirements for low-value payment instruments, consent and withdrawal thereof for a	EU	A list of provisions applicable to all currencies is provided in the National Implementing Measure e.g. derogation from information requirements for low-value payment instruments, consent and withdrawal thereof for a payment transaction.

90 It can be argued that some rules from Title III and IV of PSD cannot be easily applied to one-leg transactions –e.g. those on charges or execution times. However, most of the user protection rules can be easily applied to one-leg payments.

Member State	two-leg rule (understood as:) EU	EEA	one-leg rule	comment to one/two leg	currency scope	comments to currency
				payment transaction.		
Czech Republic			+	There is a possibility of contractual derogation from some of the provisions in respect of one-leg transactions, e.g. PSP's liability for unauthorised payment transactions, execution time and value date.	all	There is a possibility of contractual derogation from some of the provisions in respect of transactions in currency of non-EU State, e.g. PSP's liability for unauthorised payment transactions, execution time and value date.
Denmark		+	partially covered	A broad list of provisions applicable in one-leg approach is provided in National Implementing Measure, e.g. PSP's liability for unauthorised payment transactions, execution time and value date. As a consequence, the one-leg approach seems to prevail.	EU	According to TIPIK's comments, the relevant provisions cover currencies of EEA States as well, however it does not stem from the wording of the National Implementing Measure's translation. A list of provisions applicable to all currencies is provided in the National Implementing Measure e.g. PSP's liability for unauthorised payment transactions, execution time and value date.
Estonia			+	National approach, i.e. provisions of the National Implementing Measure are applicable to entities established and acting in Estonia as well as to Estonian activities of foreign entities unless foreign law provides otherwise.	not enacted	It is not specified to which currencies National Implementing Measure is applicable, thus it should apply to all currencies.
Finland		add on	+	A list of provisions applicable in the one-leg approach is provided in National Implementing Measure, e.g. value date, liability of respectively the payer and the payee for an unexecuted or incorrectly executed payment order.	all	A list of provisions applicable only to EEA currencies is provided in the National Implementing Measure, e.g. value date, liability of respectively the payer and the payee for an unexecuted or incorrectly executed payment order.
France		+			EU	The provisions apply if the PSPs of the payee and the payer are located in the territory of metropolitan France, in overseas departments, St. Barthélémy, Saint-Martin, Mayotte and Saint Pierre and Miquelon and if the transaction is conducted in euros as well as in the territory of metropolitan France, in overseas departments, Saint Martin r St. Barthélémy, the other on the territory of metropolitan France, in overseas departments, St. Martin, St. Barthélémy or in another Member State of the European Community or in another State Party to the Agreement on the European Economic Area, and if the transaction is conducted in euros or the currency of a Member State which is not part of the euro area.
Germany			+	Minister of Finance is	all	The scope of PSP's duty to inform users

Table 41 - Approach to two-leg and one-leg transactions in the EU Member States						
Member State	two-leg rule (understood as:) **EU**	**EEA**	**one-leg rule**	**comment to one/two leg**	**currency scope**	**comments to currency**
				empowered to decide that the rules are applicable to PSPs who are located outside the EEA. The scope of PSP's duty to inform users according to relevant provisions is limited to payment services which are provided within the EEA.		under the relevant provisions is limited to payment services which are provided in currency of one of EEA states.
Greece	+				EU	
Hungary		add on	+	Provisions concerning PSP's duty to inform users under the relevant provisions, and commissions, fees and other payment obligations charged by the PSP are applicable to payment transactions within the EEA.	all	Provisions concerning PSP's duty to inform users according to relevant provisions and commissions, fees and other payment obligations charged by the PSP are applicable to payment transactions in a currency of one of EEA states.
Ireland	+				EU	
Italy	+				EU	
Latvia		+	partially covered	According to the Latvian Financial and Capital Market Commission, the exception refers to one-leg transactions, where the payer's PSP is located in the EEA and the payee is located outside the EEA.	EEA	
Lithuania		add on	+	Law on Payments, Art. 3(1) "*This Law shall apply to payment transactions executed within the Republic of Lithuania, and to and from other Member States and foreign states.*" Foreign state means the state outside the EU and EEA.	not enacted	The National Implementing Measure does not limit the scope of applicability to particular currencies, so it is considered to be a reference to all currencies.
Luxembourg		+			EEA	
Malta		add on	+	Application of some provisions is excluded in respect of one-leg transactions e.g. currency conversion services, applicable charges, derogation for low-value payment instruments and electronic money.	EU	The Maltese implementing measure refers only to "currency of a Member State", whereas e.g. in Para. 2(2)d it differentiates between "Member State" and "EEA State".
Netherlands	partially covered	+		Art. 4:22 which implements Title IV of PSD (Rights and Obligations in Relation to the Provision and Use of Payment Services) is applicable only when both payer's and payee's PSPs or the sole PSP is located in the	EEA	

Table 41 - Approach to two-leg and one-leg transactions in the EU Member States						
Member State	two-leg rule (understood as:)		**one-leg rule**	**comment to one/two leg**	**currency scope**	**comments to currency**
	EU	**EEA**				
				Community.		
Poland		+			EEA	
Portugal	+				EU	
Romania	+				EU	
Slovakia		+			all	Application of provisions implementing Titles III and IV of PSD (rights and duties of payment services provision, commercial terms and conditions and information provision on payment services and dispute resolution through the permanent arbitration court) is limited to payment transactions in currencies of EEA States.
Slovenia		+			EEA	
Spain	+			Credit institutions from Spain that responded the survey completed within the study report that Spain has extended PSD implementation to one-leg transactions.	not enacted	Legislation does not directly mention the application to certain currencies, however, the application to the currencies of the EU/EEA States can be inferred.
Sweden		+			EEA	
United Kingdom		+			EEA	

Source: London Economics and iff in association with PaySys[91]

Liability for unauthorised, non-executed or defectively executed transactions

The PSD intended to limit the liability for PSUs in case of unauthorised payment transactions so that PSUs are protected in all Member States in the same manner. The Directive differentiates between no-liability of PSUs in case of an unauthorised payment transaction, limited liability up to 150 EUR in case of the use of a lost, stolen or misappropriate used payment instrument and full liability of the user, notably in case of gross negligence[92]. In addition, it gives Member States the option to reduce the payer's liability further.

As the notion of gross negligence is not harmonised at EU level and the concept of limited liability and no liability is interpreted very differently, the legal situation of PSUs in the EU is very different from one to other Member State. For example, the amount of 150 EUR is sometimes treated as a fixed penalty (and not the extent of maximum consumer liability) independently of the circumstances and the true amount of a financial loss. What constitutes a gross negligence is in practice left to the discretion of PSPs, with a consequence that even clearly non-negligent cases, such as theft of a payment card from a coat pocket in a shop or

91 See London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p136-139

92 While not defined in the PSD, the concept basically indicates that the user of a payment instrument (e.g. of a card) did not take the efforts that could be reasonably expected from him to make the instrument secure.

restaurant is sometimes treated as gross negligence. Such interpretations are made possible by a too widely drafted PSD references to the contractual terms and conditions of the PSPs, which allows in turn the PSP to define on its own, what gross negligence and fraudulent behaviour is.

Table 42 - Liability arrangements in case of unauthorised or defectively executed transactions

Member State	"How many days does it typically take in your country for a defective or unauthorised transaction to be remedied so that a debited account is restored to the state in which it would have been had the defective payment transaction not taken place?"	"Is the time for remedying a defective or unauthorised transaction specified in national legislation, a regulation, guidance by the competent authority, voluntary guidelines of the national banking association?"
Austria	Immediately	Yes
Belgium	Unknown	No
Bulgaria	no information	no information
Cyprus	2	No
Czech Republic	1	Yes
Denmark	Immediately	Yes
Estonia	Immediately(1)	Yes
Finland	Unknown	Partly(2)
France	Varies depending on the complexity of the claim	No
Germany	Unknown	No
Greece	Same day(3)	Yes
Hungary	Same day	
Ireland	Unknown	No
Italy	Unknown	No
Latvia	Immediately	Yes
Lithuania	"Could not happen"	Yes
Luxembourg	Unknown	No
Malta	Same day	No
Netherlands	Unknown	In some cases(4)
Poland	Unknown	Yes
Portugal	Same day	No
Romania	2(5)	No
Slovakia	Immediately	Yes
Slovenia	Unknown(6)	No
Spain	1	No
Sweden	1-3	Yes
United Kingdom	Immediately	Yes

Source: London Economics and iff in association with PaySys [93]

Small payment institutions

The PSD provides the option for Member States to waive the application of all or some the PSD's provision to payment service providers (either legal or natural persons) with payments volume not exceeding EUR 3 million per month. Waived providers are subject to registration with competent authorities. But the payments service provider benefits of this derogation only if maintaining a limited scale of business. Furthermore it is not allowed to provide payment services in other EU Member States unless the Member States provides for further limitations. Waived providers denominated often as small payment institutions may employ agents and set up branches only in home market.

According to the study conducted by London Economics-iff, the waiver option is used only in 9 EEA States[94]. In a number of Member States, the waiver has been adopted, but with modifications that had not been foreseen by PSD. This is for example, the case with the upper threshold (set by the PSD at EUR 3 million monthly) which can be as low as EUR 100 000 per annum in Slovenia. In a number of Member States, waived entities may provide only selected payment services. In several Member States despite providing for waiver there are no providers registered under the waiver (Slovenia, Luxembourg)[95].

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93 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p255-256
No information means no response was received from national banking association; unknown means that the national banking association has no information on the number of days it takes to for a defective or unauthorised transaction to be remedied. 1. The Estonian Banking Association defines such cases as "extraordinary", so that there is no "typical" time, but reports that it tends to be immediate. 2. The Standard mentioned specifies the time; however, the PSD supersedes this Standard. 3. For defective or unauthorised transaction where the payer's or payee's payment service provider is liable same day (maximum next working day). For defective or unauthorised transaction where the payer's or payee's payment service provider is not liable, on request, make immediate efforts to trace the payment transaction and notify the payer of the outcome (minimum 10 working days after PSU request). 4. In only one instance there is a rule, and this is under the Dutch domestic direct debit scheme Incasso. The scheme rules stipulate that if a consumer states that he did not give a mandate (after the 56 day refund period of the PSD and before the end of the 13 month period, or in case of a non-refundable direct debit) for a direct debit the debtor and the creditor bank must investigate and where relevant reimburse the consumer within 15 working day, counting from the day the consumer has filed his case. 5. Maximum 2 days from the date of complaint. 6. This rarely happens as payments without the correct details cannot generally be processed. Therefore, there is little information. ***Source: special mini-survey of national banking associations***

94 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p207

95 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p207
"15 Member States have used the option allowing for a waiver of all or part of the procedure and conditions applying to API. However, so far, payment service providers have prevailed themselves of this option in only 9 countries."

In 2012, 2094 small payments institutions (SPIs), the so-called waived institutions under the PSD, were active in Austria, Czech Republic, Finland, Latvia, Netherlands, Norway, Poland and the United Kingdom, which is about 3.7 times the number of authorised payment institutions[96].

The waiver ensures the continued existence of many providers, which were offering niche services (including payment channels to very specific region or country of the world), which would not otherwise be able or ready (in terms of costs, resources, business scale, business concept) to upgrade their business to the level of an authorised payment institution.

This is especially important for small communities given the trend among credit institutions to reduce coverage of the territory with physical offices. A number of competent authorities noted in the survey conducted by London Economics-iff that, in the absence of the waiver, a considerable number of such providers might have continued to operate with no authorisation.

On the other hand, the waiver distorts the level playing field between authorised and waived institution in particular where the threshold of EUR 3 million per month has been preserved and where there are no major limitations on the scope of activities. Waived providers are free from most obligations including initial capital, own funds, funds safeguarding. This gives waived entities a strong comparative advantage over authorised providers. However, this advantage is limited to their home country as they cannot passport.

Moreover, the threshold does not prevent waived providers from effectively competing with authorised institutions on a large scale because they are not prevented from setting up multiple different legal entities, each one remaining under the threshold. This is for example, a possibility reported by one competent authority as a possible reason for the absence of any authorised payment institution in Latvia[97].

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[96] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p207

[97] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p208

Annex 8: Effects of the identified specific problems

Effect 3.2.3.1 - Unlevel playing field between service providers/payment institutions

Effects related to standardisation and interoperability gaps

Standardisation and interoperability gaps prevent competition among incumbents and create a significant **barrier to the market entry for new and innovative payment service providers**, in particular in online and mobile payments context. They also contribute to the fragmentation of the market along national boundaries. In such an environment, even already existing and successful payment solutions often face serious difficulties when they try to diversify their service offering into new areas or expand geographically.

Because of the existence of different technical standards and the lack of interoperability, payment service providers who wish to offer their services in more than one Member State will often face the necessity to adapt or redesign their existing solutions for each market in which they operate. This is usually expensive and time consuming, raises the issue of sunk costs and seriously limits opportunities for the economies of scale. Providers entering a new market will in effect often compete against incumbent PSPs on an unlevel playing field. They will be hampered by lack of standardisation and might, in addition, increase fragmentation of the market by making use of proprietary solutions. This may in turn result in a market competition of standards instead of competition based on common standards.

Effects related to inconsistent application of existing rules and to a legal vacuum

The regulatory inconsistences in the PSD, diverging licensing and supervisory practices as well as a legal vacuum, in which certain categories of PSPs operate, lead to a situation where **some market players are subject to authorisation and supervision by some Member States while others, operating on the same market and providing similar payment services, are not.** Thus, for instance, organisations offering payments within a vaguely defined limited network, through IT devices or offering payment initiation services in the online environment are in most cases excluded by definition from any regulatory and supervisory requirements, whereas their direct competitors, offering similar payment services, are not. This leads to very different costs and market access possibilities for regulated versus non-regulated players. Furthermore, the cross-border dimension adds another layer of complexity and inequalities on the market.

Key exemptions, which are limited acceptance payment instruments (used mainly in closed loop prepaid instruments and/or accounts), commercial agents (used in bill paying services, online trade and networking platforms), third party ATM services, and payments via network operators for purchases close to non-digital goods (vouchers, tickets), impact the market very substantially, leading to its considerable fragmentation. Given that exempt providers are bound neither by a requirement to seek authorisation nor by any specific conduct of business rules, the existing exemptions encourage providers to design or redesign their products to meet the exemptions criteria and, thus, fall outside the PSD scope. Fragmentation is detrimental to all stakeholders: it distorts competition among providers, deprives users of the protection offered by the PSD, and makes it difficult to apply rule of law and sanctions, where applicable, by the competent authorities.

Market intelligence suggests[98] that a substantial number of PSPs made use of the exemptions to redesign their current products and services to fall under exemptions and thus escape the PSD. Given that the majority of providers offer payment services for the consumer market, it may be assumed that those providers making use of exemptions decide to do so in order to save on the costs of PSD compliance. This is true not only for those PSPs that did not seek the authorisation (where the advantages are the most visible – no need to apply for and maintain the authorisation, no need to comply with the requirements of the PSD). For the authorised PSP, locating a product outside the PSD can equally easy decrease overall compliance costs (such as costs of raising and maintaining own funds, costs of safeguarding funds, costs of providing required information, structure and transparency of fees).

Moreover as a feedback from the Member States suggest, most providers decide about the applicability of exemptions without asking the opinion of the competent authorities. The providers may deem it more probable that they will escape sanctions for misunderstanding the exemption (which are usually instituted by bodies close to public prosecutors and not by competent authorities) than escape sanctions (including supervisory measures) for misconduct as an authorised provider.

Such exemption-seeking behaviour is already the case in a number of markets, in particular those with the highest number of authorised PSPs. To give an example, in the UK the exempt pre-paid cards market appears to be, according to the UK competent authorities, already be much bigger than the market for cards issued under the PSD and e-money directive. In some Member States non-regulated providers have developed into powerful competitors to authorised providers in their niche markets (pre-paid cards mentioned previously, independent ATM deployers, bill payment providers, currency exchange bureaus).

Even within the category of regulated PSPs the competitive playing field is far from being equal or harmonised across the Member States. There are **different authorisation and prudential requirements for PIs, including different national rules for registration of small, waived PIs.** Flexibility offered by the legislation and different approaches to authorisation and prudential supervision contributed to the creation of an EU market with as much as 40% of the authorised PIs (224 out of 568 in the EU) and 43% of e-money institutions (30 out of 70) registered in the UK. A similarly divergent approach to the possibility of creating a category of small, waived institutions (PIs with a limited, national only license) lead to the creation of 2094 small PIs in eight Member States, with the huge majority located again in the UK and Poland.

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98 See in particular London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013)

Yet another example of the unlevel playing field for PIs can be found in **inconsistent application of the PSD passporting rules** by the Member States and ambiguities surrounding the role of agents. Thus, some Member States grant numerous passports and allow for active provision of services by agents, while other Member States are much more reluctant in this respect.

Regarding the **indirect access to payment systems**, PIs end up in a weaker competitive position, as they have to depend on banks for the settlement of their payments.[99] This also impacts further on other aspects of their services, such as pricing and execution times. It should be also noted that the same difficulties in accessing payments system will be increasingly affecting market players offering mobile payments.

Effects related to ineffective competition and charging practices

On a more general level of analysis, the structure of the current payments market, most notably the two-sided nature of the payment cards market and the existence of the MIF-based pricing model, acts as a major factor against the introduction of new and alternative payment solutions. The incumbents – in particular banks issuing cards and card schemes - are vitally interested in protecting and, if possible, increasing the revenues from card payments, above all from MIFs. Card schemes competing with each other in order to get their cards issued lead to the paradoxical situation that competition gives rise to increasing MIFs (that encourage issuing banks to issue the cards concerned) instead of decreasing MIFs. Some indirect evidence of this push toward high(er) interchange fees can be seen in the trends regarding domestic card schemes, and the resulting increasing duopoly. The EU payment card markets overall are dominated by the two major international four-party payment card scheme, Visa and MasterCard. Their market share in issuing in 2008 was 41.6% (Visa) and 48.9% (MasterCard) respectively[100]. In the context of the implementation of SEPA technical standards, there has been a trend for national (low fee) card schemes to be abolished; in a number of Member States banking communities chose not to invest in the domestic payment card scheme to comply with SEPA. In this situation banks move to issuing cards of the two existing international payment card schemes, Visa and MasterCard, that offer higher fees to issuing banks than the domestic payment card scheme. Recent examples of this include the UK, the Netherlands, Austria, Finland and Ireland.

Any payment solution offering lower profit opportunities will be seen by banks as less interesting to implement from the commercial perspective. More importantly, if such an alternative payment solution, for example online or mobile payment based on SEPA credit transfer (SCT) or SEPA direct debit (SDD), would compete for the same transaction that is

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99 It should be noted that such dependence on other provider for the acess to payment systems exists, to some extent, between smaller and bigger banks. However, for PIs, whose business model is built exclusively around payments, such dependence has a completely different magnitude than for any small bank, for which payments are only one of several business activities.

100 The source for these figures, the RBR report classifies co-branded domestic debit cards as either Visa debit or Maestro cards; hence the market share of Visa and MasterCard is overestimated.

currently served by card payments based on MIF, it would also undercut the fees and profits that are now linked with such card payments. Many of such solutions rely on some form of access to the payment account hold by the consumer.[101] However, even if the payment solution in question opens substantial new opportunities in the payments market, PSPs will be very reluctant to offer access to the consumer payment accounts they hold, as they find themselves in the classical conflict of interest situation. As the market experiences already show, banks indeed expect to get remuneration from third party providers, for granting them access to the payment accounts of the consumers, at the level approximating their card payment revenues.

Therefore, e-payment solutions based on the online banking infrastructure that do not make use of a payment card often have stalled or simply not been developed in most Member States. With two notable exceptions (iDEAL in the Netherlands, Sofort Überweisung in Germany) even those systems that have been developed nationally are far from being widely accepted by merchants and consumers. A pan-European e-payment platform allowing for cross-border online payments has yet to emerge.

Similarly, issuing banks will in principle only issue cards of new schemes if they generate MIFs at least as high as the cards they already issue. This makes the emergence of 'new' pan European card players more difficult, to the detriment of potential economies of scale and scope and their resulting efficiencies.

In fact, any service provider offering payment solutions that endanger or make less viable the payment model based on MIFs encounters serious **difficulties in entering the market and in introducing its product onto the market**. MIFs applied in one payment method (*i.e.* cards or direct debit) not only affect competition within that method (*e.g.* difficulty for new card schemes to take off) but also more widely, across substitute payment instruments. Failing a level playing field in MIFs for cards (*i.e.* in the presence of high MIFs), banks seem reluctant to invest in/promote low or no MIF innovative/secure alternative solutions since they do not want their current MIF revenues to be 'cannibalised'. Alternative providers capable of offering more efficient payment methods at a lower price are unable to enter the market.

Table 43 - Effects of the identified problems (Unlevel playing field between service providers / payment institutions)

Effect	PSPs	Consumers	Merchants	Other stakeholders
Barriers to the market entry for new and innovative payment service providers	X (main impact)	X	X	X (businesses)
Some providers operating with no authorisation	X	X	X	X (waived providers,

101 For example, providers of payment initiation services or any new pan-European card scheme would entirely depend on such access to existing bank accounts.

and supervision by MS				other businesses))
Different authorisation and prudential requirements for PIs + Different registration requirements for small PIs	X (main impact)	-	-	X (authorities)
Different treatment of PIs as regards passporting to other MS	X (main impact)	-	-	X (authorities)
No direct access to payment systems by PIs	X (main impact)	X	X	X (businesses)

Effect 3.2.3.2 - Negative impacts on Payment Service Users

The problems described above result in a variety of negative impacts affecting all payment services users, but most importantly, consumers and merchants. These impacts may be further divided into several categories, related to one or more of the identified problems.

Effects related to inconsistent application of existing rules and to a legal vacuum

An important effect of the regulatory inconsistences in the PSD, diverging licensing and supervisory practices as well as the legal vacuum, in which certain categories of PSPs operate is the **limited or non-existent protection of PSUs for some categories of payment transactions**. Good examples of such transactions are one-leg payments between the EU and non-EU countries (including remittances of immigrant workers), payments in limited networks (for example by means of gift cards or meal vouchers) or all payments by means of IT devices, including mobile payments (such as the purchase of a digital movie ticket by using a non-card based payment application on a smart phone). The negative effects in such cases include, first of all, the lack of confidence of PSUs in different payment services and, as a consequence, a serious impact on the readiness to use the given payment service, which hits particularly hard against the new payment solutions. Furthermore, cases of unprotected insolvencies and other consumer detriments were reported in some Member States.

Another impact that affects payment service users is the **inconsistent application of the liability rules** by the Member States, often resulting in an **overly strict** liability regime for PSUs. The situation is sometimes also aggravated by contractual terms imposed by PSPs on PSUs. This concerns in particular the liability for an unauthorised transaction and responsibility for the use of lost, stolen or misappropriated payment instrument or credentials.

At the same time, when consumers are using a payment solution of a third party provider[102], some PSPs are treating access to the payment account by these providers as a breach of contract rules if there is no formal agreement between these third party providers and PSPs on fees. On such occasions consumers were reported to face a denied online access to their

[102] i.e. payment initiation services, account information services and other equivalent services enabling e.g. financial consolidation of data from different accounts

accounts, to be obliged to collect new online credentials in the bank offices or even to have their online payments repudiated. This could be seen as PSPs preventing market access or foreclosing markets, under the guise of security, anti-fraud measures or liability concerns.

Regarding **complex and intransparent information to consumers**, the consequence is that they are usually not able to compare PSP offers on even main payment conditions, as they are presented in a very different manner. Crucial information on charges is often not available or very incomplete online, further decreasing the transparency. This is in particular the case of many small PSPs (local co-operative banks, savings banks, credit unions) in some Member States. The situation is further aggravated by the fact that most of them also refuse to provide price information on the phone, requiring consumers to physically appear in the branch to learn them. The study on the economic impact of the PSD[103] found that almost 30% of PSP (69 out of 243) websites did not show any or only very incomplete information on pricing of the credit transfers and direct debits and 24% of the analysed websites (58 out of 243) showed insufficient information on debit and credit card payments. This creates an important obstacle for any consumer willing to look for the best offer on the market. In addition, similarly to 'incumbent' PSPs, also new innovative payment solutions providers do not always openly communicate on their terms and conditions, notably whether the services they offer are within the scope of the PSD.

Case Study - Access to information in Germany

German consumer association, vzbv reported that it was confronted with an issue of access to the information and pointed towards a document available on its website, concerning a full survey conducted in the Hessian Region in Germany.

The results of the survey conducted in March 2012 showed worrying levels of lack of PSD compliance with regards to access to consumer information, in particular in the case of savings banks, credit unions.[104] The survey found that the list of prices and services (Preis-Leistungsverzeichnis - PLV) was not published in 59% of the cases and the price display (Preisaushang) was not available in 52% of the examined websites. Even in those cases where the price lists were published on the websites, quite often the consumer could not find them easily. Moreover, the existence of two different price lists leads to confusion for consumers.

Source: London Economics and iff in association with Paysys[105]

103 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) Annex – Page 162 and subsequent analysis

104 See http://www.verbraucher.de/UNIQ134063320310606/link1042271A.html, accessed 25 June 2012.

105 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) Annex – Page 28

Further effects of inconsistent application include higher fees for payment services (affecting in particular one-leg transaction, and non-euro transactions[106], which are not subject to the rule of equal fees for corresponding payments under Regulation 924/2009), **little or no protection and redress possibilities in case of non-executed or incorrectly executed transactions** and lack of guarantees concerning execution times for transactions not included under the PSD.

Effects related to ineffective competition and charging practices

High and varied interchange fees are fuelling market segmentation. The lack of a level playing field ultimately results in high merchant charges, inflated retail prices, whilst market entry and innovation are limited.

The existence of high MIFs has a substantial impact on the costs of payments. The recent ECB study on the social costs of payment instruments[107] reveals some interesting data in this respect. The social costs of all retail payment instruments in 27 EU Member States are estimated at being close to 1% of the EU GDP or 130 billion EUR. Some additional 0.2% of the EU GDP or 26 billion EUR should be added if social costs of consumers and households are taken into account.

The average social costs per transaction in all 27 Member States taken together are estimated to be the lowest for cash, at 0.42 EUR, followed by debit cards at 0.70 EUR (however, in 5 out of 13 Member States covered by the study unit costs for debit cards were lower than for cash payments). These are followed by direct debits at 1.27 EUR per transaction and credit transfers, at 1.92 EUR per transaction. The most expensive payment instruments are credit cards at 2.39 EUR per transaction and cheques, at 3.55 EUR per transaction.

However, if the analysis is made on the basis of the transaction value the results are quite telling: the cheapest instruments are credit transfers and cheques (0.2 EUR per 100 EUR transaction), followed by direct debits (0.4 EUR) and debit cards (1.4 EUR). Cash comes next, at 2.3 EUR per every 100 EUR spent and the most expensive instrument is credit card, at 3.4 EUR.

It follows that the cost of a credit card payment is very high from the social and consumer point of view. It is certainly the most expensive low value payment instrument. As the MIFs are the most significant part influencing the cost of credit cards, these data show a strong rationale for reducing the level of MIFs across the EU. The ECB study find that retailers bear most of the costs of payments – although in the end consumers pay for these costs as they are reflected in retail prices.

106 Except payments in Swedish Krone

107 The social and private costs of retail payment instruments. A European perspective by Heiko Schmiedel, Gergana Kostova and Wiebe Ruttenberg. ECB Occasional Paper Series, September 2012

Debit cards appear to be, on the other hand, interesting from the EU policy point of view, as a low value payment instrument with a potential to partly replace cash as a much more efficient instrument for low value payments. As mentioned before, 5 out of 13 Member States who participated in the study were able to achieve lower unit costs of transactions with debit cards (and even despite the existence of MIFs for debit card payments) once a certain degree of maturity of electronic payments market is achieved (POS terminals and other electronic payments infrastructure, payment habits, consumer education etc.).

Credit transfers and direct debits offer the best efficiency for higher value payments and, with the migration to SEPA payments by 1 February 2014, offer also an opportunity to build new, innovative payment services on their basis also for lower value payments. Potential area of development could be in particular online payments (e-commerce) and mobile payments (e.g. web applications based on instant access to payment accounts).

Case study – savings to retailers and consumers from the replacement of credit cards by less expensive payment means – The Netherlands

Similar welfare results can be derived from the replacement of expensive card payments by cheaper payment instruments. In the Netherlands we can calculate the amount of cost savings to retailers (ultimately also consumers) realised by using the iDeal system instead of credit cards, using the average MSC charged by IcePay (an e-commerce PSP). Based on an average transaction value of 75 EUR,[108] the per transaction cost of accepting Visa or MasterCard online would be: (0.027*75 EUR)+0.25= 2.275 EUR per transaction. The average per transaction cost of accepting iDeal stands at 0.55 EUR. The difference reaches therefore 1.725 EUR per transaction. Based on the more than 93 million transactions completed through iDeal in the Netherlands in 2011, the total cost savings can be estimated at 162 million euros. Put otherwise under the assumption of a 100% cost pass through under a highly competitive market structure and *ceteris paribus*, online retail prices would be that much *higher* if iDeal or any other cheap alternative to credit cards would not have existed.

Reducing high IFs would allow for efficient payment systems such as iDeal to be exported into other (online payment) markets traditionally dominated by expensive credit card usage. This would also create further incentives for new entrants to expand on the European online retail payment market, resulting in (high) cost savings to retailers and consumers.

Another serious and negative effect for PSUs is limited acceptance of payment cards by merchants, or more broadly, **limited choice of payment instruments** that could be used for purchases. This could be attributed to a much extent to the ineffective competition in the cards market and to the resulting charging practices, most notably to the high level of MIFs which translate into **high Merchant Service Charges**. Another contributing factor is also the excessive complexity of card pricing models, which – especially for small businesses – may

108 See: http://www.emerce.nl/nieuws/ideal-52-miljard-euro-aan-betalingen-in-2010

often be too difficult to understand[109]. As a result many, in particular smaller, often family run merchants refuse altogether to accept payments with cards or refuse payments below a certain, minimum level[110]. It has to be noted that in the case of Visa and MasterCard merchants are not able under the HACR to refuse more expensive credit cards, including commercial and premium consumer cards and accept only cheaper, debit cards.

Where merchants accept cards, this brings about other effects. First and above all, merchants treat the costs of payments as any other costs category. This means that the cost of handling, processing and accepting payments in general have to be covered and reflected in the price of the goods and services. The higher the fees related to payment services, the more expensive those goods and services will become.[111] Secondly, as the cost of all payments, including the merchant costs of accepting even the most expensive cards are included in the general prices, the phenomenon of **socialisation of costs of most expensive payment instruments** takes place. In other words, all consumers, even those that do not use cards, are paying for the costs of using them through cross-subsidisation.

Finally, in some Member States, merchants may decide to accept cards but demand a charge, commonly called "a surcharge", on consumers using certain payment instruments. **Surcharges to consumers** are directly visible and therefore could be used to steer price-sensitive consumers towards cost-effective (for merchants and, implicitly, for society) payment solutions. However, the practical deployment of surcharging by merchants has led to a number of abusive practices by some merchants (e.g. when consumers face surcharges without a viable possibility to avoid them by choosing other payment instrument or when surcharges are disproportionately high compared to the cost incurred by the retailer for the transaction).

As a result, surcharging in its current form resulted in some financial detriment to consumers and may be seen as a source of problems in itself. At the same time, it only worked to some extent as a cost-effective steering tool for the society at large and, for various other reasons, discussed previously in this impact assessment, was not totally effective as a solution addressing the original problem – the high level of MIF/MSCs imposed on merchants. Moreover, widely differing choices and practices between Member States concerning surcharging confuse or irritate consumers travelling abroad or doing online shopping on a cross-border basis. Likewise, merchants establishing a presence in another EU country could be subject to different surcharging rules, making it difficult to streamline their operations.

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109 For example, MasterCard may charge over 200 different fees, depending on the type of the transaction and card used. Visa uses over 40 different fee categories.

110 For example an assessment for Poland, country with the highest level of average MIFs in Europe, indicates that only about 20% of all establishments accepts payment cards. Even some big retail chains (including the biggest discount supermarket chain in Poland with over 2000 stores) do not accept cards.

111 While the use of cash or cheques is also generating costs for merchants, all analysis and reports undertaken over the last years consistently indicate credit cards as by far the most expensive, from the social point of view, means of payment.

Article 19 of the Consumer Rights Directive (Directive 2011/83/EU) introduces a limitation based on costs to merchant surcharging possibilities. The Directive shall be transposed by Member States by 13 June 2014. However, surcharges based on costs could lead to different surcharge amounts for cards issued nationally and in other Member States, thus treating differently cardholders using their cards in a cross-border context.

Table 44 - Effects of the identified problems (High costs, limited choice and protection for Payment Service Users)

Effect	PSPs	Consumers	Merchants	Other stakeholders
Socialisation of costs of expensive payment instruments through prices for goods and services	-	X	-	-
Higher fees for payments through surcharges	-	X	-	-
High fees for payments for certain payment instruments (due to high MIFs/MSC)	-	-	X	-
Limited choice of payment instruments	-	X	X	X (businesses, administration)
Inconsistent and often overly strict liability rules	-	X (main impact)	X	-
Limited or no protection for some categories of payment transactions (one leg, limited networks, IT devices, payment initiation services)	-	X (main impact)	X	X
Complex, insufficient or intransparent information on charges	-	X	X	X

Effect 3.2.3.3 - Low cross-border activity

Effects related to ineffective competition and charging practices

A properly functioning cross-border acquiring would enable merchants to benefit from more competition on Merchant Service Charges (MSCs) received by acquirers. It would also make it economically more attractive for merchants to appoint a single acquirer for their transactions in a number of countries in which they operate, resulting in administrative efficiencies and cross-border competition.

The existing **barriers to cross-border acquiring** described above impede or make it less economically viable to use the services of an acquirer located in another Member State. Even large European retail companies find it, up to now, questionable, in terms of benefits, to use the services of acquirers located in another Member State. The cross-border acquiring barriers do not allow merchants to lower their cost of doing business, to exploit the possible economies of scale and to streamline their operations.

On the other hand, the same business and technical barriers block the possible expansion of successful and competitive acquirers into the new markets and prevent them from achieving greater volumes and therefore, lower their costs to the levels possible on a truly integrated market. This translates into **limited choice of payment service providers** and into lower or sometimes even no real competition in acquiring on a Member State level, with the usual, negative repercussions on the prices and conditions of service in the national markets for the merchants.

Effects related to standardisation and interoperability gaps

Online and mobile shopping widens the choice available to consumers, including beyond borders. Effective and efficient cross-border payment possibilities constitute therefore an essential element of the single market in payments, as they allow the payment service users to take advantage of the wide choice of products and services available throughout the EU at the best possible prices. However, consumers in all EU Member States often encounter **difficulties and limited possibilities of payment, both in the physical cross-border shopping and, to a much greater extent, when they shop on the Internet.**

The standardisation and interoperability gaps are, until now, the main difficulty when EU consumers travel to other Member States and try to use their payment cards in shops, restaurants and hotels. As a result, in some cases, only the use of locally issued cards (cards issued in accordance with the national technical specifications) or local payment applications is possible[112]. While the physical presence abroad allows the consumer to use cash, in practice it is sometimes not possible or entails significant additional efforts in order to get cash (e.g. at self-service petrol stations, public parking or at some hotels and restaurants located in isolated areas).

Arguably, in the case of physical presence abroad, the interoperability problem is gradually disappearing, at least within the euro area. According to the ECB data from June 2012 (SEPA migration indicators for cards), some 82% of all card transactions in the euro area where processed in accordance with the EMV standard[113] and some 93% of payment terminals where EMV compliant[114].

Table 45 - EMV migration levels in the Member States and SEPA area

112 For example, complaints received by the Commission indicate that local payment applications are the only payment option (no cash possible) on some public parking and at the vending machines in the Netherlands (including Amsterdam). Regular complaints are also filed against the impossibility to use international cards at the payment terminals of some petrol stations e.g. in France.

113 EMV standard should ensure interoperability between the chips on cards issued in the EU and point-of-sale terminals (POS terminals) or automated teller machines (ATMs). In order to be SEPA-compliant, card schemes must apply the EMV specifications and must require the use of PIN codes.

114 http://www.ecb.int/paym/sepa/about/indicators/html/index.en.html#EMV

Country	Cards	ATMs	POS terminals	Country	Cards	ATMs	POS terminals
AT	100.00	99.05	85.10	IT	69.78	80.00	81.00
BE	100.00	92.70	96.00	LT	82.09	39.00	45.00
BG	2.26	93.21	42.68	LU	100.00	100.00	100.00
CY	90.74	63.50	82.00	LV	91.45	52.21	88.55
CZ	94.05	100.00	99.93	MT	93.68	57.10	100.00
DE	93.29	96.00	85.00	NL	94.37	100.00	79.62
DK	92.11	100.00	100.00	PL	0.05	44.00	80.00
EE	89.76	100.00	92.54	PT	83.79	100.00	94.17
ES	48.70	99.62	91.40	RO	57.96	98.31	88.77
FI	93.06	100.00	70.00	SE	93.91	100.00	71.40
FR	100.00	100.00	99.50	SI	97.92	94.39	95.75
GB	100.00	100.00	100.00	SK	86.93	100.00	98.55
GR	58.23	99.88	70.59	EA-17	82.23	95.38	88.29
HU	38.26	97.00	91.00	SEPA	80.96	96.10	89.55
IE	99.99	100.00	99.99				

Source: EMV migration.
Note: ECB figures based on EPC data; Q4 2010.

This suggests that from the consumer perspective, at least in the euro area, the interoperability of cards will be soon achieved. However, on the supply side, the cost of compliance with multiply standardisation and certification procedures for cards will still constitute a barrier for a market integration, making the issuing, acquiring and processing of card transactions much more expensive and complicated than necessary.

For online sales, the effects of limited choice of payment instruments are much greater. Currently, from the consumer perspective, there appears to be no online payment solution that would be comprehensively available and accepted on a cross-border basis. **The possibilities for online payments offered by merchants on a cross-border basis are, in most cases, much more limited than for national payments** and often consists of one-only option – a credit card.

Cash on delivery is rarely offered in some Member States and in particular on a cross-border basis[115]. Debit cards are beginning to gain ground in online payments in some Member States, but they are limited almost exclusively to the national borders. The wallet-type solutions (such as PayPal or amazon payments) gained some ground in the cross-border context, but they do not seem to offer a real difference to credit cards in terms of acceptance by merchants, as the cost for merchants is similarly high. With the arrival of SEPA credit transfers some merchants in the euro area started to offer this option, not many consumers are ready to pay, in particular for physical goods, before they are safely delivered to their hands[116].

It is estimated that 60% of all European e-commerce transactions is done using cards. This method of payment is prevalent in France and in the UK. Some 20% is done using credit transfers and direct debits, including online banking e-payment solutions. These are in particular popular in Germany, Austria and the Netherlands. The remaining 20% is done

115 Even if offered, it typically comes with high fees for the payer.
116 A potential decision factor could be a more complicated refund procedure in case of e.g. failed delivery or low quality of received goods, in comparison to a credit card payment.

through other means (such as e-wallets, as Paypal) and payment on delivery.[117] Paypal is estimated to have some 35 million active accounts in Europe (some 80 million globally).

Accordingly, there is a **growing gap between the popularity of domestic and cross-border e-commerce.** In 2011, 34% of consumers in the EU27 ordered goods or services over the internet domestically, but only 10% of them did ordered some products on a cross-border basis[118]. While the popularity of cross-border shopping could be lower for some objective reasons, first of all the existence of a language barrier, according to the study of the Commission[119], 60% of attempts of cross-border online shopping orders fail due to technical and legal problems, such as the refusal of non-domestically issued cards. As evidenced by Eurostat Survey on ICT usage by Households and Individuals from 2009[120], the reliance of so many e-commerce sites on payment cards constituted an important obstacle for those consumers who finally abstained from online shopping. Around 13% of them indicated that they were discouraged because they did not possess a payment card and 35% quoted payment security concerns, related e.g. to the use of cards online.

In summary, a credit card is often the only available option to shop online abroad. This may be in itself a major obstacle for many consumers, as credit cards (including delayed debit cards) are not very proliferated in some Member States and not easily available for more economically vulnerable segments of the society.

The final effect of a restricted choice of payment instruments in cross-border context is the decision to **abandon the purchase** by some consumers once they realise at the end of a transaction that they do not have access to any of the proposed payment instruments.

Effects related to inconsistent application of existing rules and to a legal vacuum

While the PSD introduced the possibility of passporting for activities in other Member States, **cross-border provision of payment services by PIs is still very limited** and has a niche product character. In effect, differences in national passporting regimes (granting of passports to PIs), insufficient harmonisation of national passporting procedures, inadequate exchange of information and apparent resistance of some host Member State authorities (against provision of payment services without opening an office or through an agent) contributed to the much lower and narrower in scope provision of cross-border services than expected by the legislator.

Against the intentions, provision of payment services by PIs re-created the model of services limited by national borders that could be observed for payment services provided by banks. This means that one of the main competitive advantages of PIs – ability to provide unified

117 Blueprint for a Pan-European e-services solution, EBA, June 2011

118 http://epp.eurostat.ec.europa.eu/portal/page/portal/information_society/data/main_tables

119 "Report on Cross-Border E-commerce in the EU" Commission Staff Working Document, SEC(2009) 283 final, 5 March 2009

120 http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-QA-09-046/EN/KS-QA-09-046-EN.PDF

payment services across borders on the basis of much lighter authorisation and supervision rules than credit institutions – has remained largely theoretical. Consequently, there is no substantial increase in the choice of payment services or in the level of competition between different kinds of providers on the EU level.

Table 46 - Effects of the identified problems (Low cross-border activity)

Effect	PSPs	Consumers	Merchants	Other stakeholders
No genuine cross-border acquiring for retailers	X	-	X (main impact)	-
Limited choice of payment service providers	X	-	X (main impact)	-
Limited use of passporting by PI and hence limited provision of payment services across borders by PI	X	X	X	X
Limited possibilities for payments on cross-border basis, in particular in online context, frustrated cross-border payment attempts	-	X	X	-
Slower uptake of cross-border e-commerce	-	X	X	X (businesses)

Effect 3.2.3.4 - Dispersed and hampered innovation

Effects related to standardisation and interoperability gaps

Market fragmentation currently hinders the emergence of potential pan-European payment innovations in the areas of e- and m-payments and consumers can only benefit from these services in their own domestic market. Technical differences between national payment formats and infrastructures also represent a major hurdle for the supply side. New market entrants or existing payment providers who would like to start offering innovative services see their business case restricted to the national market which limits the scalability of the potential revenues and therefore discourages start-up investments. Similarly, market fragmentation **reduces potential economies of scale** on the cost side of these new initiatives and makes it difficult for existing schemes, interested in establishing interoperability, to justify this with a viable business case. More importantly, as innovative services mostly emerge at national level only, there is a risk that market fragmentation is increased and perpetuated.

The inevitable delay in the implementation of payment innovations (concerning both payment means and channels) at pan-European level could have potential, **negative repercussions on the competitiveness of the EU payments market** in comparison to other regions, such as North America or Asia. First, companies from such markets (not only the incumbent card schemes – Visa and Mastercard – or other players from the payments sector, but also corporates offering payments as an accompanying, value-added service, such as Facebook, Google or Amazon) would make forays into the EU market and offer innovative payment solutions in the absence of efficient EU payment alternatives, in particular in online and mobile payments. This would increase the risk of EU becoming a follower, not an innovator in the field of global payment services and consequently loose part of revenues and of highly specialised workplaces in the payment sector to other regions. Second, lack of efficient and best value for money, modern payment services, offering e.g. immediate settlement, reconciliation of payment and orders or e-invoicing, is harmful in particular for many small companies that are the backbone of the EU economy. The weak cash flow in such SMEs and microenterprises is one of the most frequent causes for their bankruptcy.

Table 5 - Effects of the identified problems (Dispersed and hampered innovation)

Effect	PSPs	Consumers	Merchants	Other stakeholders
Limited economies of scale for providers	X	-	-	-
Competitive disadvantage of EU vs. other regions	X	-	-	X (businesses)

Annex 9: Impact and comparison of policy options

Market fragmentation

1.1. Weak governance arrangements (operational objective 1)

1.1.1. Option 1 (No policy change)

The current informal status of the SEPA Council is not fully in line with the Treaty, as it lacks a proper legal base. The demands of both suppliers and end-users of retail payment for the Commission to address the weaknesses of the current SEPA Council would remain unanswered. Therefore, the governance of retail payments in Europe, particularly for payments in euro would remain sub-optimal. The EPC is currently re-examining its *raison d'être* and it might decide to decrease it level of involvement in standard-setting activities.

The status quo would translate in a much slower integration of the European retail payments market to the detriment particularly of end-users of payments.

1.1.2. Option 2 (Set up of self-regulatory body by market participants)

This market-driven approach would not satisfy all stakeholders, especially the consumer representatives, which clearly call for a strong guiding role of the Commission and the European Central Bank in the whole SEPA project. Moreover, all market participants are clearly in favour of a 'co-operative approach' between the respective stakeholders, national SEPA committees and the European Institutions.

This self-regulatory approach, where the SEPA Council would remain as it is, could give rise to risks of foreclosure vis-à-vis new market participants that would not be "founding" members. Lack of compliance with the new self-defined governance arrangements could not be excluded. All this might call for increased corrective measures by the Commission.

1.1.3. Option 3 (Formal body based on legal act of the co-legislators)

The SEPA Council, renamed as "the European Retail Payments Council", would see its composition, accountability and mandate clearly defined in EU law. The SEPA Council as a formal legalized body would de jure gain the legitimacy and credibility that stakeholders are calling for. In the public consultation on the Green Paper on payments market participants consistently asked for a more active involvement of public authorities. Option 3 would allow both addressing the market's call for a co-operative model and contributing to clarifying the role of the Commission and the European Central Bank as co-chairmen. The European Retail Payments Council would have greater accountability vis-à-vis the EU regulators.

Option 3 would contribute to defining the clear steer that all stakeholders are looking for on the direction that the European retail payments market should follow to ensure that tomorrow the EU has effective, efficient, innovative and cheap means of payments available across all Member States. Failing this, the emergence of such a market could take many more years to the detriment of payment's end-users and society at large.

Conclusion

A European Retail Payments Council as a formal legalized body will provide the necessary legal clarity as to the role and responsibilities of the different actors (industry, end-users and European institutions). By strengthening the retail payments governance as requested by all market participants, Option 3 would allow the delivery of the necessary steer, notably but not only with regard to standardisation of new means of payments, to ensure that tomorrow's integrated EU retail payments market becomes a reality for card, e- and m-payments.

Table 47 -Summary of the impact for options 1 to 3

Policy option	Description	Effectiveness	Efficiency
Option 1	Baseline scenario	0	0
Option 2	Self-regulatory body	(0)	(+)
Option 3	**Formal body**	**(+)**	**(+)**

Table 48 - Summary of the impact for main stakeholder categories (options 1 to 3)

Policy option	Description	Consumers	Merchants	PSPs
Option 1	Baseline scenario	0	0	0
Option 2	Self-regulatory body	(0)	(+)	(+)
Option 3	**Formal body**	**(+)**	**(+)**	**(+)**

1.2. Standardisation of card payments (operational objective 2)

1.2.1. Option 4 (No policy change)

As described earlier, genuine pan-European payment cards, in particular debit cards, are not yet a reality. A number of market initiatives have been established in the different domains of card transactions at European level to address this problem. However, despite having been launched several years ago in some cases[121], the broad-scale adoption and uptake of these initiatives have yet to materialise. This is mostly due to the limited scope of participation in the existing initiatives and the non-binding nature of the underlying commitments for market actors.

When estimating the time scale for migration to existing standardisation initiatives under a baseline scenario, the so-called EMV initiative can serve as a historic yardstick. The EMV standard was established to replace signature-based payment cards with magnetic stripes by "chip & PIN" cards. The first version of this standard was established in 1995 and by 2012 migration to EMV was nearly, but still not fully, completed in EU countries. It is therefore

121 For example, the EPAS initiative (terminal-to-acquirer) was established in 2006

not unreasonable to assume that European card standardisation initiatives could take 20 years or more for full migration if they are entirely left to the market.

The possible benefits for a fully integrated European card market are substantial. A study undertaken on behalf of the Commission in 2008 estimated that EUR 123 billion could be gained for the SEPA market as a whole if there was full integration for credit transfers, direct debits and payment cards over a period of six years[122]. These benefits mostly apply to businesses and consumers. While integration for credit transfers and direct debits will be accomplished in 2014 on the basis of Regulation (EU) No 260/2012 establishing technical and business requirements for credit transfers and direct debits in euro, integration in the card market has not made substantial progress since the time when the abovementioned study was published. While the study did not provide a break-down of the integration benefits for each payment instrument, even if only 20% of the total benefits were stemming from payment card integration, this would still constitute almost EUR 25 billion over six years.

Hence, a 'do nothing' approach on card standardisation could eventually lead to market uptake for existing European standardisation initiatives but only over a relatively long time span and possibly only by a limited group of market actors, delaying or even partially eliminating the possible economic benefits mentioned above.

1.2.2. Option 5 (Standardisation through governance framework for retail payments)

The governance framework for retail payments, in particular the SEPA Council established by the Commission and ECB, could serve as a platform to achieve consensus and endorsement of existing market initiatives by the relevant stakeholders at high level. In comparison to the baseline option, this would address the concerns of market participants on the payment users’ side. Corporates, SMEs, retailers and consumers consistently criticise a lack of adequate involvement in the development and implementation of standards for card payments in the current market setup.

The option would entail a broadening of scope beyond SEPA to a European Retail Payments Council (see previous section) to possibly include work related to standardisation and the addition of an 'implementation layer' in which stakeholder representatives at expert level would perform technical work, such as developing common standard implementation guidelines.

By lifting the stakeholder discussion from a purely technical to a strategic / political level this option would facilitate consensus building across market actors, thereby leading to a stronger degree of commitment by market actors and additional momentum for the adoption and take-up of the different standardisation initiatives.

In conclusion, this option could create benefits versus the baseline option, in particular an accelerated and more comprehensive adoption and implementation of existing standards by

[122] Capgemini: SEPA – potential benefits at stake, p. 19; http://ec.europa.eu/internal_market/payments/docs/sepa/sepa-capgemini_study-final_report_en.pdf

market actors. The option could therefore facilitate the realisation of the possible economic benefits mentioned under the baseline option. Incremental cost would be marginal and limited to the expense of organising additional stakeholder meetings in the context of the European Retail Payments Council. The level of regulatory intervention is relatively low and the option can be considered a "soft law" approach, given that there is a certain degree of morale persuasion by the fact that the European Retail Payments Council has been established by the Commission.

1.2.3. Option 6 (Mandate to European Standardisation Organisation)

Another possible "soft law" approach entails the involvement of a European Standardisation Organisation (ESO) officially recognised by the European institutions. For payment card related standardisation, either CEN or ETSI could play this role. Both organisations have a "facilitator" approach, meaning that they do not develop standards themselves but provide an inclusive and open platform for all interested market actors for the development of (non-binding) standards, technical specifications or implementation guidelines.

While CEN covers standardisation in practically all areas of economic activities, work on payment service related matters has been limited so far. For example, CEN has set up a technical committee working on personal identification standards, including for payment cards, but has previously not been active in the standardisation of card payment messaging protocols or certification procedures. ETSI is a more specialised body and covers standardisation work in the area of telecommunications. In this context, ETSI has previously carried out work related to m-commerce, including mobile payments, but not on card payments in a more comprehensive sense.

Possible work carried out through ESOs could be based on a specific mandate drawn up by the European Commission. However, the fact that neither CEN nor ETSI have previously been involved in card payment specific work may lead to a certain degree of scepticism by stakeholders, especially on the supply side, and hence less commitment. Such concerns were consistently expressed in stakeholder consultations.

In conclusion, this option could create benefits versus the baseline option. As in option 5 market uptake of standards would remain voluntary. The main benefit of this option versus option 5 (possibility for stronger steering role of the Commission) is more than offset by the fact that stakeholder participation in ESO work is always voluntary and at this stage, whilst some market-driven initiatives are already on-going, could be subject to limited participation by the supply side of the market based on stakeholder comments provided in the context of the public consultation on the Green Paper on payments. This option could therefore be less effective – at least under the current market situation – in accelerating the materialisation of benefits from standardisation in comparison with option 5. The costs for this option are marginal and comparable to the ones of option 5. Overall, this option is therefore less favourable than option 5. The possible involvement of ESOs could be revisited in the medium term if sufficient progress through option 5 is not achieved.

1.2.4. Option 7 (Establish mandatory technical requirements through legislation)

This approach would define binding requirements for all market actors for compliance within a pre-determined migration period. Technical requirements for retail payments have previously been established by the Commission in the area of credit transfers and direct debits.

The key benefit of this option versus all previous options is that it provides certainty regarding the timeframe for convergence towards common standards by all market actors. On the other hand, the possible basis for setting technical requirements for card payments is by far not yet as developed as it was the case for credit transfers and direct debits at the time when the Commission made its proposal. In the latter case detailed standardisation requirements had been established by the industry (represented in the EPC) in the form of specific SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) rulebooks to which banks voluntarily adhere. The technical requirements stipulated in the Commission proposal were largely based on these rulebooks. In contrast, for card payments such rulebooks have not been developed. The EPC has developed a SEPA Cards Framework but it is doubtful that technical requirements could be established by the Commission based solely on this framework. It should also be noted that a card payment transaction is significantly more complex than a credit transfer or direct debit and hence involves more market actors and technical interfaces.

Therefore, the main drawback of this option is that it removes the flexibility for market participants to jointly develop specific technical requirements that best serve the market as a whole. It could therefore entail significantly higher adaptation costs for stakeholders than the previous options. In conclusion, this option is therefore less favourable than option 5.

Table 49 - Summary of the impact for the standardisation of card payments (options 4 to 7)

Policy option	Description	Effectiveness	Efficiency
Option 4	Baseline scenario	0	0
Option 5	**Payments governance framework**	**(+)**	**(++)**
Option 6	European Standardisation Organisation	(+)	(+)
Option 7	Mandatory technical requirements	(++)	(-)

Table 50 - Summary of the impact for main stakeholder categories (options 4 to 7)

Policy option	Description	Consumers	Merchants	PSPs
Option 4	Baseline scenario	0	0	0

Option 5	**Payments governance framework**	**(+)**	**(++)**	**0**
Option 6	European Standardisation Organisation	(+)	(+)	(-)
Option 7	Mandatory technical requirements	(+)	(+)	(--)

1.3. Standardisation of mobile payments (operational objective 2)

1.3.1. Option 8 (No policy change)

The environment for proximity mobile payments in Europe is still fragmented with a myriad of small local initiatives and a few national pilot projects. At this stage, market participants seem to concentrate on proprietary and non-interoperable solutions. To some degree this is not unusual in an emerging market but it is hard to see how, in the absence of comprehensive and cross-border standardisation / inter-operability initiatives, a Single Market for m-payments can evolve reasonably fast.

While it is not excluded that pan-European initiatives emerge solely through market forces in the future, so far this has not happened and hence fragmentation is likely to persist over the short and mid-term in the absence of any additional impetus. As a consequence, the full economic potential related to proximity m-payments will not be reached.

For example, a recent study estimates that the annual volume of NFC-based m-payments in 2016 will be 19.1 billion in a standardised European environment versus 11.8 billion transactions if the environment remains fragmented.[123] This means that almost 40% of the market potential could remain untapped in a baseline scenario.

1.3.2. Option 9 (Standardisation through governance framework for retail payments)

Retail payment innovation is a topic which could be addressed under the payments governance framework and mobile payments have previously been discussed in the context of the SEPA Council, even if not at the same level of depth and frequency as 'traditional' payment instruments, such as credit transfers, direct debits and card payments.

Following the same rationale as for card payments, a new European Retail Payments Council (see previous section) could serve as a platform for stakeholders to drive standardisation and inter-operability of proximity m-payments across Europe. However, m-payment related work would require the involvement of a number of additional market participants who do not

[123] Consulting firm Booz and Company estimates that a standardised environment would lead to 62% more proximity m-payment transactions in Western Europe in 2016 (versus a fragmented environment). http://www.gsma.com/publicpolicy/wp-content/uploads/2012/03/mp12simbasednfc.pdf

necessarily have vested interests in payment issues outside the m-payment arena, for example Mobile Network Operators, handset manufacturers, and operating system providers.

In conclusion, the option could create possible benefits in comparison to the baseline scenario in terms of addressing proximity m-payments standardisation at European level under the participation of all relevant stakeholders. At the same time, the required changes in the composition and tasks of the European Retail Payments Council are substantial. Other costs related to this option are marginal.

1.3.3. Option 10 (Mandate to European Standardisation Organisation)

ESOs have carried out work in this field previously, for example a technical report on requirements for payment methods for mobile commerce.[124] ESOs have also developed technical specifications in relation to NFC, one of the leading technologies for proximity m-payments.

Possible work carried out through an ESO could be based on a mandate by the European Commission. This approach has been frequently applied in the past, for example in relation to the Directive on radio equipment and telecommunications terminal equipment and the mutual recognition of their conformity (1999/5/EC).

In conclusion, this option could create benefits versus the baseline option. The main benefit of this option versus option 9 (payments governance framework) lies in the considerable specific expertise of ESOs in running standardisation initiatives in the field of telecommunication and mobile commerce. The costs for this option are marginal and comparable to the ones of option 9. Overall, this option is therefore more favourable than option 9.

1.3.4. Option 11 (Establish mandatory technical requirements through legislation)

The definition of binding technical requirements for all market actors necessitates a certain maturity of the market in order not to undermine flexibility and innovation. For example, in the case of credit transfers and direct debits, where a 'technical requirement' approach was chosen by the Commission, a suitable basis for these requirements already existed in the form of technical rulebooks that had been developed by the industry.

The market for proximity m-payments is just emerging and pan-European standardisation initiatives comprising all relevant market actors do not exist. Most current pilot projects are based on proprietary solutions. Hence, there is even less of a market-proven basis for the setting of technical requirements available than it would be the case for payment cards. Under these circumstances, this option would create the significant risk to stifle innovation and is therefore discarded.

Table 51 - Summary of the impact for the standardisation of <u>mobile payments</u> (options 8 to 11)

[124] http://www.etsi.org/deliver/etsi_tr/102000_102099/102071/01.02.01_60/tr_102071v010201p.pdf

Policy option	Description	Effectiveness	Efficiency
Option 8	Baseline scenario	0	0
Option 9	Payments governance framework	(+)	(+)
Option 10	**European Standardisation Organisation**	**(+)**	**(++)**
Option 11	Mandatory technical requirements	(+)	(--)

Table 52 - Summary of the impact for main stakeholder categories (options 8 to 11)

Policy option	Description	Consumers	Merchants	PSPs incl. MNOs
Option 8	Baseline scenario	0	0	0
Option 9	Payments governance framework	(+)	(+)	(0)
Option 10	**European Standardisation Organisation**	**(++)**	**(++)**	**(+)**
Option 11	Mandatory technical requirements	(0)	(-)	(-)

Ineffective competition in certain areas of card and internet payments

2.1 Interchange Fees (IFs) for card payments (Operational objective 3)

In a large number of countries, the problems surrounding Interchange Fees (IFs) have already led to regulatory intervention or other measures from public authorities.[125] Regulatory caps have so far been introduced in the United States and Australia. In Spain caps introduced through a settlement after 'moral suasion' were subsequently made binding by public authorities. Other types of intervention (e.g on the basis of the competition rules) have also led to significant changes in the market for payment cards.

In the **US**, *Regulation II* (Debit Card Interchange Fees and Routing) introduced a cap on debit card interchange fees for large banks (holding more than $10bn in assets) in October 2011 at $0.21 + (0.05 * value of transaction), plus an additional 1-cent fraud adjustment if eligible.[126]

125 See for example: Bradford and Hayashi (2008), at: http://www.kansascityfed.org/publicat/psr/briefings/psr-briefingApr08.pdf, ECN Information Paper on Competition Enforcement in the Payment Sector (2012) at: http://ec.europa.eu/competition/sectors/financial_services/information_paper_payments_en.pdf

126 http://www.federalreserve.gov/paymentsystems/regii-about.htm

In addition, the legislation introduced measures to prohibit *network exclusivity* under which merchants must have the choice of at least 2 networks through which payments can be processed. Other measures include a prohibition of circumvention and net compensation, reporting requirements and administrative enforcement.

In **Australia** the Reserve Bank (RBA) initiated a payment card reform in 2003 for credit and in 2006 for debit, introducing caps over a period of time.[127] Before the reform, MC and Visa *debit card* IFs were around 0.95% of transaction value. This was reduced to a maximum of $0.12 per transaction. The domestic EFTPOS debit system operating on a ***reversed* IF model** (paid to the acquirer), was required to cap its *bilateral* IF to $0.05 per transaction, and the *multilateral* IF to $0.12. Visa and MC *credit card* IFs were reduced to 0.5% of the value of transactions. This exemplifies the RBA's conclusion that MIFs, regardless of the direction (issuer-acquirer or acquirer-issuer) are not (or no longer) necessary to 'promote' usage or acceptance in a mature market. Additional measures include a ban on *no-surcharge rules, HACR* (un-tying debit and credit)*,* and *no-steering rules*.

In the US[128] and Australia however, it has been decided to cover only two legs transactions, between a merchant from these countries and a cardholder from the same country. This has resulted however in no cap applying to the interchange fees for one-leg transactions, for instance with a US cardholder and a EU merchant.

In **Spain**, between 1999 and 2005, four series of measures were taken relating to IFs, aimed at progressively reducing them. All these events resulted in agreements (under the threat of intervention by public authorities). 129 On 24 September 1999 the Spanish NCA adopted a resolution to decrease IFs (From a max of 3.5% in 1999 to 2.75% in 2002).[130] In 2002 and 2003 the Spanish NCA this time using moral suasion, requested the payment card networks to provide information on the methodology used in setting MIFs and later refused to accept several proposals on proposed levels of interchange. In 2005 coordinated action between merchants, card schemes and the Ministry of Industry, Tourism and Trade resulted in commitments to further reduce credit and debit interchange fees on a 'cost based approach'

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127 TransAction Resources, *Review of the impact of Australian Payment Reform,* Federal Reserve System Docket Number R-1404. For a complete overview of Australian regulatory measures in the payment system, see: http://www.rba.gov.au/payments-system/reforms/current-reg-framework.html#debit

128 Federal Registry, Final Rule 'The Board proposed a definition of the term ''United States'' that is consistent with the EFTA's definition of ''State.'' The definition of ''account'' in § 235.2(a) is limited to accounts that are held in the United States and the definition of ''electronic debit transaction'' to those transactions accepted as a form of payment in the United States because the EFTA provides no indication (such as a conflicts of law provision) that Congress intended for Section 920 to apply to international transactions (i.e., those where the merchant or account debited is located in a foreign country). Accordingly, limiting the scope of this part to transactions initiated at United States merchants to debit accounts in the United States avoids both extraterritorial application of this part as well as conflicts of laws'. Cf. http://www.gpo.gov/fdsys/pkg/FR-2011-07-20/pdf/2011-16861.pdf

129 The investigations in Spain resulted in binding agreements or 'moral suasion' from the government (*i.a.* Ministry of Economy). See: 'Santiago Carbó Valverde, Sujit Chakravorti and Francisco Rodriguez Fernandez*, Regulating Two-Sided Markets: An Empirical Investigation*, Federal Reserve Bank of Chicago Working Paper No. 2009-11, revised April 2010, table 2 p. 31.

130 *Ibid*, p.8

(effective in November 2006).[131] During the course of the commitments, MIFs were reduced in a stepwise manner (credit card MIFs were reduced from 1.4% p.t. in 2006 to 0.35% p.t. in 2009 and debit from €0.53 in 2006 to €0.35 in 2009).[132] Additionally a forum was created designed to monitor, analyse and disclose information on the card payments system in Spain.[133] On 31 December 2010, the commitments expired and the parties were free to set IFs as long as they respect the competition rules, which is the default situation in Member States across the EEA in the absence of regulatory intervention or other measures from public authorities.[134]

At **EU level** in order to comply with competition rules the two international card schemes Visa and MasterCard have accepted weighted average Multilateral Interchange Fees of 0.20% and of 0.30% for cross-border debit and credit card transactions respectively.

The **French** domestic payment card scheme *Groupement des Cartes Bancaires* has accepted a weighted average fee of 0.30% for domestic debit and credit card transactions.

Monitoring is however very complex when weighted average caps are in place, as is the case regarding the current Visa commitments and MasterCard undertakings for which two trustees have been nominated. This is why under the regulatory options considered in the present document *per transaction* caps, directly visible to merchants, are favoured.

Duplication of the MIF model (or its 'bilateral' variation with similar effects) in the new, innovative payment services that are being rolled-out on the market or could be launched in the future should be avoided. This includes in particular any mobile payment applications and online payments (Internet) applications. A clear and unambiguous regulatory approach in this area appears necessary. Therefore, the IF regulation should apply to e- and m-payments based on cards (or MIF be banned as a business model in the new areas). This would mirror a similar provision in the SEPA End Date regulation as regards payment transactions based on the SEPA Direct Debit and Credit Transfer schemes.

2.2 Option 12 (No policy change)

This option involves no legislative or non-legislative action from the Commission. It would leave the issues raised by ineffective competition and lack of transparency in the payment cards market to competition enforcement actions to be undertaken by the Commission and/or National Competition Authorities, in particular on the basis of the MasterCard judgement.

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131 *Ibid.* See also: http://www.kansascityfed.org/publicat/psr/dataset/regulator-dev-interchange-fees.pdf p.6.

132 Santiago Carbó Valverde, Sujit Chakravorti and Francisco Rodriguez Fernandez, *Regulating Two-Sided Markets: An Empirical Investigation*, Federal Reserve Bank of Chicago Working Paper No. 2009-11, revised April 2010, p. 9-10.

133 See: ECN information paper (2012): http://ec.europa.eu/competition/sectors/financial_services/information_paper_payments_en.pdf

134 See: http://ec.europa.eu/competition/ecn/brief/01_2011/brief_01_2011.pdf p.14.

On 24 May 2012, the General Court rendered a judgment[135] on MasterCard's appeal against the Commission's decision prohibiting MasterCard's multilateral interchange fees (MIFs) that apply to cross-border transactions with consumer cards (commercial cards out of scope). The ruling rejected the appeal confirming that MasterCard's cross border MIFs restricted competition in the cards payment market and were not justified for efficiency reasons. It also gives a framework in which MIFs should be seen and assessed. Competition enforcement is however unlikely to be an efficient and effective instrument to achieve the objectives above.

First, MasterCard has appealed the judgement, as a consequence of which legal uncertainty regarding the assessment of MIFs will persist for some years to come. Secondly, the judgement still leaves the question of the appropriate level of MIFs open, even if it the General Court endorsed the Commission's assessment that debit cards generate important commercial benefits for banks apart from interchange fees, and therefore questioned the necessity of a MIF for debit cards[136]. Discussions with MasterCard and Visa will ensue on this, while the timing and the scope of the respective proceedings differ[137]. Finally, the likelihood of getting long-term, comprehensive commitments from both Visa and MasterCard in particular covering also domestic transactions and practices applying with respect to commercial cards and would seem relatively low, since neither of the schemes has an incentive to be a 'first mover' introducing lower fees; this would mean enabling its competitor to take over the market by continuing to offer higher fees to issuing banks.

Competition commitments based on fragmented competition law enforcement may not ensure a level-playing field, and may even lead to further legal uncertainties and distortions on the card payments market. For example, already now the fact that Visa committed to the weighted average MIF of 0.2% for debit transactions in some countries, while MasterCard did not, causes Visa to be pushed out of these markets since issuing banks prefer to issue MasterCard cards that can offer higher MIFs than Visa's. This is the case in Hungary, where after the Visa proposed commitments became public in 2010, Visa consumer card debit MIFs were lowered to a level of 0.20%. This led to the migration of debit card issuers from Visa to MasterCard, with Visa having lost 45% of its market share (more than a million cards) in the first semester of 2012 as compared to 2009.

Table 53 - Hungary - Number of consumer debit cards issued and corresponding market shares

	2008	2009	2010	2011	2012 1H
MasterCard Debit	4,334,090.00	4,342,645.00	4,855,935.00	5,531,507.00	5,668,506.00
Visa Debit	2,389,051.00	2,432,564.00	2,150,971.00	1,621,735.00	1,358,628.00

135 Judgment of the General Court (Seventh Chamber) of 24 May 2012, case T-111/08 - MasterCard and Others v Commission.

136 Cf. The analysis for option 15 under 9.2.1.4 below

137 The proceedings against MasterCard cover only MIFs for cross-border transactions, while the Visa proceedings cover also national MIFs in some countries. MasterCard's unilateral undertakings (expired on the day of the General Court's judgment) covered both debit and credit cards, while Visa's commitments (to expire in 2014) cover only debit cards and the investigation on credit cards is still open

Total Visa + MC Debit	**6,723,141.00**	**6,775,209.00**	**7,006,906.00**	**7,153,242.00**	**7,027,134.00**
MasterCard Debit Market Share	64%	64%	69%	77%	81%
Visa Debit Market Share	*36%*	*36%*	*31%*	*23%*	*19%*

Source: Hungarian National Bank

In addition, the EU proceedings against MasterCard and Visa cover only cross-border transactions in case of MasterCard and cross-border and domestic transactions in 10 Member States where multilateral arrangement are of relatively less importance in case of Visa. This leaves all the other domestic MIFs to be addressed by National Competition Authorities, in close cooperation with the Commission. While many of them are and have already been active in addressing MIFs and the MasterCard judgement should help them in this work, this would still be a very long and fragmented process, with no guarantees of ensuring full consistency across the EU, particularly given that the General Court's judgement still leaves the question of the specific appropriate level of MIFs open.

Even in the improbable case where all National Competition Authorities had the necessary resources to address domestic MIFs, they would do so at different speeds, depending on their specific priorities and competences and the different jurisdictional structure and appeal procedures in place. A regulation on MIFs would probably take less time to adopt and come into force than for the competition proceedings to come to an end and for the full force of their impact to be felt, considering for instance that the MasterCard decision was taken more than 5 years ago, and that MasterCard has just appealed the Court judgment.

Pure competition enforcement would in particular not address a range of market access issues that are currently blocking or disrupting the development of the Single Market in the area of card, mobile and internet payments, such as decentralisation of national acquiring silos and cross-border acquiring, separation of card schemes and processing – although it could address some transparency aspects, including the Honour All Cards Rule, unblending and the Non Discrimination Rule.

<u>General conclusions for Option 12</u>

<u>Even with the advent of the MasterCard judgement, the possibility for the Commission to work only under competition rules with National Competition Authorities is unlikely to deliver legal certainty and a level playing field in the markets for card, internet and mobile payments.</u>

2.3 Option 13 (Allow cross-border acquiring and regulate the level of cross-border interchange fees)

This option would make it easier for merchants to accept card payments through acquirers located in other Member States i.e. instead of the fee applicable in the country of the 'Point of Sale' a cap set for interchanges fee (IF) for cross-border acquired transactions would apply in the event merchants choose to make use of the services of an acquirer in another than their own Member State.

As such, the option leaves room for competition enforcement as discussed above and keeps untouched the domestic IF levels. It is also unlikely to require heavy monitoring as interested merchants and/or acquirers would proactively request or propose such possibilities and therefore contribute to the enforcement. It is therefore likely to compare favourably with the setting of (some) domestic IFs at a certain level, where the attempts for circumvention could flourish through increases of other fees pertaining to the MScs or so-called transparency measures imposed by schemes such as blending (cf. the discussion of option 15 below).

In terms of impact, banning or lowering IFs on cross-border acquired transactions could put a strong downward pressure on national IF levels, as the threat of merchants massively changing acquirer to one located in a 'cheaper' Member State could incentivise card schemes and banks to lower their domestic IF levels, It could then change the incentives of large acquirers' banks as regards the maintenance of high IF levels[138].

On the other hand, this option would not bring any immediate or medium term change in many domestic markets and, therefore, its effect on the level and variability of domestic MIFs would be limited.

First of all, existing legal and technical obstacles to cross-border acquiring, in the terminal to acquirer area (different technical hardware standards, different certification procedures for terminals, different software communication protocols) require at least a few years to be overcome[139]. This could slow down the rate of adoption of cross-border acquiring by most merchants. Paradoxically, this option may also create incentives for banks not to work constructively to remove barriers to cross border acquiring – as they would stand to gain more in any case from the status quo in terms of technical and otherwise obstacles.

Even without technical or legal obstacles, cross-border acquiring would make a significant difference only for big retailer networks, able to negotiate with their acquirers or to seek a 'central', unique acquirer. Small, individual merchants would most likely not see a compelling commercial reason or would not have the necessary knowledge, skills, negotiating power and financial resources to pursue such a solution. A reaction of card schemes and national acquirers when cross-border acquiring becomes practical could be to offer better conditions to large retail chains. Savings for big merchants would therefore amount to 3 billion Euros[140].

However, smaller merchants would probably not see a significant decrease in their costs. They could potentially experience an adverse impact if acquirers try to recoup lost revenues

138 This would be likely in particular if option 13 is considered in combination with option 15 under which a common EU-wide IF level cap is set, the latter possibly under a second phase but without any conditional review clause, see below.

139 Cf. Feedback statement of 27.06.2012 on the Green Paper "Towards an integrated European market for card, internet and mobile payments", part 3.3.1. Standardisation — cards, p.19-20

140 See the section on a quantitative assessment below.

through relatively higher fees, although in view of the limited revenues at stake this is likely to be limited. This will in any case not improve the acceptance of cards and cards based payment instruments among small merchants.

General conclusions for Option 13

Although modest in terms of likely impact in the short run, this option could be pursued in combination with one of the options identified below, as a trigger for market integration in particular when transition periods are considered for wider-ranging policy options.

2.4 Option 14 (Mandate Member States to set domestic IFs on the basis of a common methodology)

This option would mean adopting legislation on the methodology for setting interchange fees, and it would be up to each Member State to implement it. The disparity between national measures could in theory be reduced by supplementary use of caps or cap ranges, on top of the national solutions. Alternatively, this option could be also used as a temporary, phase-in solution before the common MIF is implemented, although the sheer complexity of setting up such a system only for it to be temporary would be controversial.

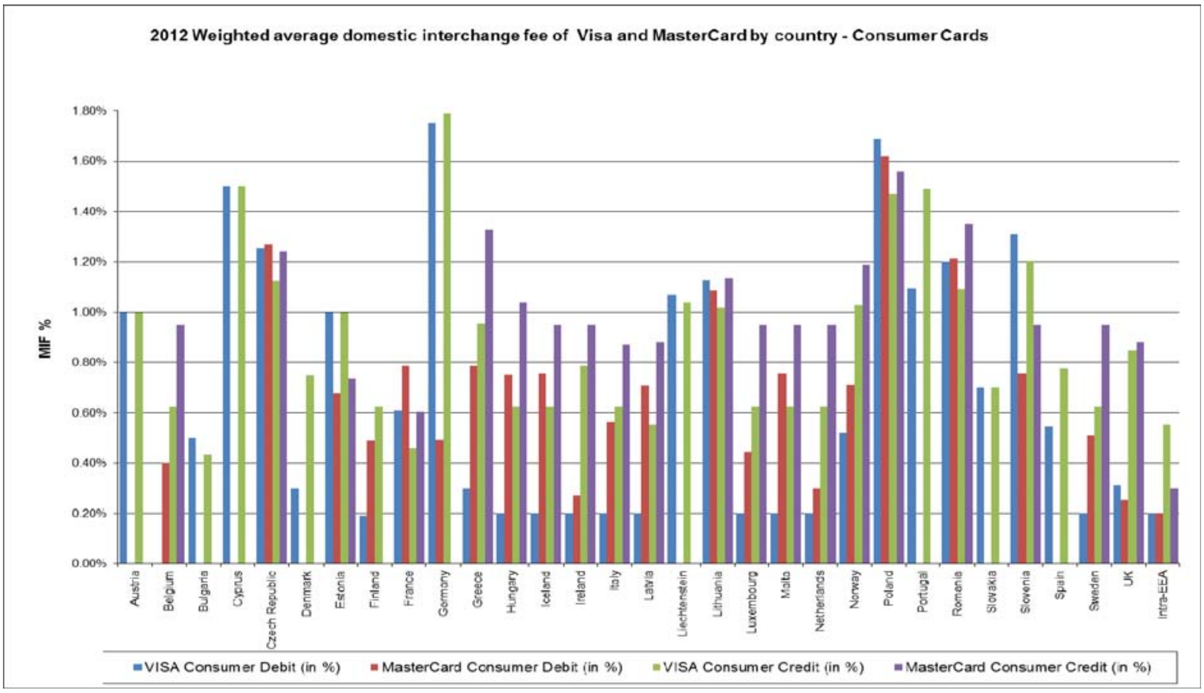
This option would address the issue of different maturity of card and payment markets in the Member States where different levels of card usage and acceptance (see table below) and different levels of cash usage prevail. It would allow national solutions to be developed, giving more leeway for purely 'domestic' card schemes or other payment solutions.

Table 54 – ECB Statistics on cards

ECB statistics	Number of payment cards per capita	Number per capita debit	Number of POS terminals per 1000 inhabitants	Number of transactions per capita	Transaction value per inhabitant	Value per GDP
	Cards		Cards	Cards	Cards	Cards
					EUR	%
	2011	2011	2011	2010	2011	2011
Hungary	0.891	0.766	8.49	23	643	6%
Bulgaria	1.071	0.940	8.64	4	150	3%
Germany	1.597	1.271	8.69	36	2,294	7%
Czech Republic	0.931	0.758	9.73	26	961	7%
Lithuania	1.206	1.080	11.84	33	608	6%
Latvia	1.130	0.887	12.02	55	1,138	12%
Austria	1.313	0.986	12.75	53	3,319	9%
Belgium	1.822	1.431	12.84	105	5,766	17%
Slovenia	1.600	1.219	16.65	59	2,210	13%
Netherlands	1.825	1.465	16.75	146	5,766	16%
EU (changing composition)	**1.445**	0.905	**17.58**	**74**	**3,808**	**15%**
Euro area (16 countires)	1.424	0.868	19.39	67	3,447	12%
Italy	1.109	0.618	20.65	26	2,018	8%
United Kingdom	2.347	1.376	21.69	158	9,219	33%
Sweden	2.147	1.087	21.74	207	8,983	22%
France	1.274	0.509	22.15	121	6,039	20%
Estonia	1.327	1.051	22.21	147	2,352	20%
Denmark	1.358	1.095	22.53	216	9,682	23%
Luxembourg	3.269	1.510	24.56	138	10,938	13%
Portugal	1.889	0.939	25.73	116	5,233	33%
Cyprus	1.524	0.877	28.21	45	3,829	19%
Malta	1.741	1.320	28.80	33	2,063	13%
Spain	1.495	0.587	29.55	52	2,326	10%
Greece	1.220	0.850	32.00	7	578	3%
Ireland	1.315	0.839	34.10	76	5,249	15%
Finland	1.452	0.778	37.68	203	6,701	19%

Under this option the issue of high MIFs resulting in high MSCs from the merchants' perspective could be addressed and the acceptance of card payments by merchants stimulated to some extent. It would however be addressed in a much more limited scope than option 15 below, as the likely outcome in terms of level of IFs is likely to be higher than a common cap. Depending on the methodology chosen the outcome under 14 is also likely to depend on the specific situation in a given Member State, including the current IF levels. As the levels of IFs vary greatly from one Member State to the next, as shown in the Graph below, a spectrum of national caps although based on a common methodology is likely to lead to a European arithmetic/weighted average above the level of the common European cap determined under option 15. In addition, the diversity of the national situations would make the emergence of 'new' pan European players more difficult, to the detriment of potential economies of scale and scope and their resulting efficiencies if pan European actors charging low MSCs could emerge. The latter would have to offer issuing banks as a minimum the highest level of interchange fee prevailing in the market they want to enter, which has a dramatic impact on the viability of their business model.

Figure 55 - Average domestic MIF levels in the Member States, 2012



In fact, this option would not result in a truly integrated card market but in a patchwork of national interchange fees across the EU. In addition to the effects identified above, this could hinder merchants from making use of cross border acquiring services, unless common rules are set on which IFs would apply in case of cross-border acquired transactions.

In addition, it would require a much more burdensome implementation than options 13 and 15, as there would be a complex system of various caps and a heavy involvement of national regulators would be required. It would also be difficult to set up a common methodology to a sufficient degree of details – to promote consistency, to monitor and enforce it at EU and national level.

Finally, there could be limited visible impact on consumer prices as a result of merchants' savings, especially as those savings are likely to be small. Whichever the level of pass-through of retailers' savings to consumers, the impact on pricing is likely to be marginal.

General conclusions for option 14
Although this option would in principle keep a degree of flexibility in terms of implementation at national level, its effects in particular in terms of interchange fees variability and market integration are likely to be limited. Consumers and retailers welfare gains are likely to be modest, and the heavy administrative resources to be invested in defining a concrete methodology for national regulators, in implementing it and in monitoring its implementation are likely to raise issues, in terms of the efficiency of this policy option.

2.5 Option 15 (Set a common, EU-wide IF level, based on a maximum cap)

On a global level, this option would promote the integration of the EU card market for consumers and merchants. The full harmonisation of the IF throughout the EU, together with an increased transparency of card rules in the EU, would achieve full transparency of the main cost elements in card and related e- and m-payments. Merchants would be charged for payments on the basis of one single IF cap across the EU. The resulting level playing field in terms of payments costs could help in increasing card acceptance - depending on the sub-option considered. This could be reinforced by the full harmonisation of charging practices for consumers on a national and cross-border basis, and – when fully implemented- the absence of a need for specific rules for cross-border payments.

This option would also result in the highest level of legal certainty on business models for existing card schemes and new entrants. A level playing field for competition in issuing and acquiring of cards would be set, all other elements being equal, the competition would be based on pricing, not other, non-price factors. New entrants would benefit from a solution to the IFs obstacles they face when trying to enter the market. In addition, the application of a common, EU-wide IF level, maximum cap to online and mobile payments together with rules on access to information on bank accounts by third parties (options 26 and 27) would be likely to stimulate innovation in payments and a wider choice of payment instruments. In turn, this would contribute to lower prices of goods and services in the economy as the lack of readily available payment instruments has been identified as one of the key obstacles to the development of e-commerce in Europe.[141]

In terms of possible drawbacks of this option, consumers might fail to see visible retail price decreases resulting from action on IFs. In spite of merchants' savings, isolating the impact of a specific cost element on the overall pricing policy of a retailer is difficult: many other factors might play a role in the evolution of prices. Besides, the level of competition in the relevant retail market segment impacts the degree of pass-through of retail savings to consumers. It can however be considered that the pass on of savings (decrease in Interchange Fees) to consumers is more likely coming from retailers than the pass on of interchange fees from banks to consumers, as competition is fiercer, the retail sector is less concentrated[142], pricing to consumers is more transparent, and there is no bundling. Customers' switching to another retailer for a one-time or recurring purchase is more common than the switch to another retail bank.

According to estimates by Massachusetts University Professor Nancy Folbre, the 2012 median retail profit margin in the US was 7% for discretionary consumer goods (8% for non-

[141] See Commission Communication "A coherent framework for building trust in the Digital Single Market for e-commerce and online services" January 2012 p11 - http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0942:FIN:EN:PDF

[142] According to Eurostat, of all the activities (NACE divisions), motor trades and repair (NACE Division 45), retail trade (NACE Division 47), and veterinary activities (NACE Division 75) had the lowest levels of concentration in 2009. Cf. http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Structural_business_statistics_at_regional_level

discretionary products), compared to a profit margin of close to 16% for financial services. This indicates a highly competitive retail market in which any reduction of costs would more likely lead to lower consumer prices than the pass on of interchange fess to cardholders in the retail banking sector[143] – although obviously a 100% pass through to consumers in the retail sector through reduced prices, increased quality, etc. would assume a very high level of competition, ceteris paribus.

In fact, a large US retailer (Home Depot) announced a reduction in price of more than 3000 products since October 2011 making a direct link with cost savings from the reduced interchange fees following *Regulation II*. According to the retailer, IFs are the third largest operating cost after real estate and wages and the reduction of prices is necessary to offer a competing edge against its nearest competitor (Lowe's).[144]

Measuring the *precise effect* of MIF reductions on retail prices is however very difficult given all the possible factors in the economy that contribute to pricing. The Reserve Bank of Australia (RBA) for example in its preliminary assessment[145] could only isolate a CPI (consumer price index) savings of around 0.1 percentage point as a result of IF reductions over the long term.[146] It is very difficult nevertheless to measure the *exact* impact of this specific MIF rule on final prices. Standard economic theory however suggests that ultimately changes in costs of merchants are reflected in retail prices (in a competitive market).[147]

There is widespread acknowledgement – in line with economic theory and basic market mechanisms- that merchants pass on the cost of MIFs (and all other costs) to consumers through increased retail prices. If historically there would have been no MIF, retail prices would therefore, in effect, be lower. Though not every reduction in costs would result in an *identifiable decrease in price* and the magnitude of the pass-through would depend on the level of competition in the retail sector considered, benefiting merchants might use these saving to make investments, innovate or improve their services in another way.[148]

As a second possible negative impact, consumers might fear increased fees in other banking services. Due to the widespread cross subsidisation in the banking sector, reducing IFs revenues for banks could result in an adverse pricing impact on other banking services. This (potential) negative impact may however not outweigh the benefit in terms of retail pricing, resulting in overall consumer welfare gains. Evidence from regulating MIFs in a number of

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143 http://economix.blogs.nytimes.com/2012/11/05/the-big-swipe/?src=recg

144 http://www.forbes.com/sites/greatspeculations/2012/06/18/lower-credit-card-fees-leads-to-cheaper-prices-at-home-depot/

145 2007/08 Review of the Reform of Australia's payments system at http://www.rba.gov.au/payments-system/reforms/review-card-reforms/pdf/review-0708-pre-conclusions.pdf

146 http://www.rba.gov.au/payments-system/reforms/review-card-reforms/pdf/review-0708-pre-conclusions.pdf p. 23

147 Cf. Federal Reserve Board in the US. See: http://www.federalreserve.gov/aboutthefed/boardmeetings/20110629_REG_II_FR_NOTICE.FINAL_DRAFT.06_22_2011.pdf p.277.

148 See: *Ibid*, section IV B.

countries and its impact on both retail prices and retail banking fees is discussed further in the Quantitative assessment section.

Finally, the possible circumvention of the Regulation, for example by raising non-MIF elements of fees, paid by merchants directly to the card schemes has to be considered. In the US, the Federal Reserve Board included an anti-circumvention rule to eliminate the possibility for a scheme or bank to undermine the functioning of the MIF cap on debit card transactions, stating that any attempts to circumvent the cap are illegal. At the same time the provision also prohibits issuing banks from receiving 'net compensation' (e.g. that it receives more payments or incentives than it pays to a payment card network)[149].

The coverage of inter-regional fees applying when the merchant is located in the EU but the card has been issued outside this area- could also be potentially considered to prevent circumvention of the Regulation, for instance through possible cross border issuing of cards. Currently, EU merchants would benefit more from the sole capping of inter-regional interchange fees than from the capping of intra-EU cross-border interchange fees (i.e. when the retailer and the cardholder are from different countries in the EU, as discussed in option 13) as their levels are considerably higher for both debit and credit card transactions than for intra EU cross border debit and credit transactions. In spite of the limited share of intra-regional transactions in the total of transactions, the annual MIF amounts involved could be estimated at around 0.5 Bio €. Currently, these interregional interchange fees and the usage of the definition of 'regions' in their 'rules' are already used by schemes to minimise the impact of IFs reductions. A drafting of definitions that would limit the risk of possible circumvention could therefore be considered.

Table 56 - Specific impact per sub-option

A distinction can also be made between four possible sub-options, depending on whether credit cards are covered or not, and on whether debit card IFs are capped or banned:

Option	Domestic Debit cards	Domestic Credit cards	Cross border debit cards	Cross border credit cards
15.1	0,2%	Not covered	0,2%	0,3% or acquirer's country
15.2	IFs forbidden	Not covered	IFs forbidden	0,3% or acquirer's country
15.3	0,2%	0,3%	0,2%	0,3%
15.4	IFs forbidden	0,3%	IFs forbidden	0,3%

149 See: Federal Reserve System, 12 CFR Part 235: Debit Card Interchange Fees and Routing; Final Rule

The caps indicated above (0.2% of the transaction value for debit cards and 0.3% of the transaction value for credit cards) are set on the basis of MasterCard/Visa commitments[150] and e.g. recently negotiated between French competition authorities and *Groupement des Cartes Bancaires*.

The option of banning IFs for debit cards is considered as it appears that a debit card without any IF would be viable from a commercial perspective without necessarily raising the costs of current accounts. Denmark for example has a zero-IF on its domestic debit scheme while an average account holder pays well below the EU average for a current account[151]. Moreover, initially all the European debit card schemes were working without an interchange, the practise was imported from the US later. The German card scheme Ec-Karte only introduced interchange fees in 2000.

This would also be in line with the MasterCard judgement, since the General Court endorsed the Commission's assessment that debit cards generate important commercial benefits for banks apart from interchange fees, by enabling them to reduce the number of cash and cheque transactions and, therefore, the costs that would otherwise arise in connection with the manual handling of such forms of payment. The Court held that the existence of such revenues and benefits made it unlikely that, without a MIF, an appreciable proportion of banks would cease or significantly reduce their MasterCard card issuing business[152].

Sub-option 15.1: caps on Ifs for debit cards, credit cards not covered

As compared to sub-options 15.3 and 15.4, this approach would appear more flexible as the effects of regulating debit card interchange fees could be examined and monitored under sub-option 15.1, before a decision is taken on whether or not to cover credit cards. It would however decrease the level of legal certainty regarding an acceptable business model for market players, as the absence of coverage of credit card transactions would only be re-assessed once evidence has been gathered about the regulation of debit card interchange fees.

Besides, the caps for interchange fees for credit cards would be in line with the ones of the MasterCard undertakings, the Visa commitments (on debit cards), and the Groupement Cartes Bancaires case in France. In spite of this, discussions may be raised on the methodology used and on the final figures. Different maturity of national card markets and national payment habits (based on historical developments) may lead to difficulties in finding one IF level acceptable and appropriate for most Member States. Banning certain business rules (i.e. banning interchange fees) is more straightforward and easier to implement. Also, it does not generate speculation on the future amount of the cap, which in itself is conducive to legal uncertainty about the current or future business models prevailing on the market

150 In the case of Visa, commitments cover cross-border MIFs for debit cards and national debit card MIFs in 9 (smaller) MS. In the case of MasterCard, commitments cover cross-border MIFs for debit and credit cards.

151 http://ec.europa.eu/consumers/strategy/docs/prices_current_accounts_report_en.pdf

152 General Court of the European Union, MasterCard judgment, pars 108-110.

Such a gradual approach could however be more attractive from the point of view of implementation by Member States since it allows for a longer flexibility as to the substantive result. However, capping IFs for debit cards instead of a ban would be problematic in the Member States in which there are currently no domestic IFs for debit cards in place or domestic IFs are below the envisaged cap level. It would result in these Member States in increases in level of MIFs, with negative consequences on merchants and consumers' welfare and on market entry of 'cheaper' payment solutions – with IFs below the envisaged domestic caps.

In addition, under such a sub-option, banks and scheme revenues from interchange fees for credit cards would be left untouched. Covering debit card IFs, without covering IFs for credit cards would have a more limited impact on banks and card schemes revenues. The Commission estimates that bank revenues from IFs in the area of 2.5 billion Euros would be called into question, cf. the quantitative assessment section below.

Obviously, across the entire EU, the impact of this option would be more modest in terms of decreased MSCs to merchants and of potential market entry and innovation than if IFs for credit cards were to be covered, and/or IF for debit cards are banned. Increased merchants acceptance and merchants/consumer welfare potential gains through any or both of these two 'channels' would be more limited. This is compounded by the fact that banks may well push for consumers to use more expensive credit cards instead of cheap(er) debit cards. Of all the sub-options, 15.1 is the one with the most limited impact.

In addition, the impact on the variability/level of interchange fees for credit cards would be even more dependent on the efficiency of transparency and steering measures, when the IFs for credit cards are not covered, as it would be the only venue through which they could be influenced.

Sub option 15.2: ban on Ifs for debit cards, credit cards not covered

Although to a lesser extent than 15.1, this approach would be more flexible than 15.3 and 15.4 as the effects of regulating –banning- debit card interchange fees would be examined and monitored before a decision is taken to cover credit cards. The level of legal certainty regarding an acceptable business model for market players on the credit card market would be less than under the more 'invasive' sub-options 15.3 and 15.4 though, as the absence of coverage of credit card transactions would be re-assessed once evidence has been gathered about the regulation of debit card interchange fees.

Regarding the ban on IFs for debit cards, most EU citizens have a current account today, which usually comes with a debit card (on average in the entire EU, there are 0.9 debit cards per capita, including children[153]). There might not be a need any longer to incentivise the issuing of debit cards by banks through an IF, as debit cards are already widespread. Also

153 ECB Statistical Data Warehouse: http://sdw.ecb.europa.eu/

debit card usage by cardholders is generally not incentivised – the use of more expensive credit cards is incentivised rather through various bonuses and rewards.

Encouraging cash avoidance is in line with many Member States' policy objectives. Several Member States are promoting electronic payment to limit tax evasion and the black market economy. Banning IFs for debit cards would also lead to increased card acceptance by (small) retailers to the detriment of cash, resulting in overall welfare gains for society[154].

Banning IFs for debit cards would also allow fears that SEPA results in higher IFs and costs structures to be defused, as some domestic debit schemes currently function without a MIF or with a lower MIF than 0.2 (Belgium, the Netherlands, Denmark, Finland, Ireland, Luxembourg, Sweden and the UK), and this would not be called into question under such a 'SEPA optimum' of banning IFs for debit cards.

Similarly to 15.1, banks revenues from interchange fees for credit cards would be left untouched. Banning debit card IFs, without covering IFs for credit cards would have a more limited impact on banks and card schemes revenues. In the estimates of the Commission, a ban on Interchange Fees on debit cards would result in total interchange revenue losses of circa 4.6 billion Euros, with IF revenues for credit cards amounting to circa 5.7 billion Euros[155]. In addition, it can be considered that higher card acceptance and usage at the point of sale could result in (acquiring) banks and card schemes collecting higher POS revenues which could compensate/overcompensate the revenues lost from banned IFs whilst issuing banks would save on the IFs amounts normally due to ATM acquiring banks as cash withdrawal would decrease and card use at POS increases (see also 15.4 below). Such a compensation/overcompensation would be more likely if IFs for debit cards are banned and credit card interchange fees are not covered – as IFs revenues for credit cards would be maintained whilst increased acceptance is likely to be high in the case of a ban on debit cards.

It has to be noted that in Norway for instance, the absence of IFs for debit cards is accompanied with very high level of usage and acceptance. The domestic debit scheme BankAxept more than doubled its number of transactions over the past decade (496.7mn in 2001 to 1207.7mn in 2011). In value this figure has grown from 291.8 billion NOK in 2001 to 507.6billion NOK in 2011[156]. Per capita this figure translates to 240 transactions per person per year completed with BankAxept (taking the entire population)[157]. Card acceptance has

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154 The European Central Bank has recently published a study on social cost of the various payment instruments. This study shows that per transaction the cash is the cheapest (42 cents), followed by debit card (70 cents) but credit cards are much more expensive (2.39€). But if the analysis is made on the basis of the transaction value, debit cards are the cheapest (1.4%) followed by cash (2.3%). Credit cards are more expensive, (3.4%). This last point allows concluding that there is a societal interest to replace cash by debit cards, but not by credit cards.

155 See quantitative assessment section below.

156 Norges Bank (2012) Annual report on Payment systems 2011, tables 10a and 14a.

157 See: http://www.norges-bank.no/pages/89034/Paymentsystem_2011.pdf

also been growing at a steady rate (from around 16 terminals per 1000 inhabitants in 2001 to over 27 in 2011)[158].

Denmark also has one of the highest card usage rates in the EU at 216 transactions per capita with a zero-MIF debit scheme. Debit card usage accounts for 80% of all card transactions. In debit usage, Dankort accounted for 790 million transactions in 2009, up from 691 million in 2008, which is a growth of 15 per cent (even in a mature market)[159]. Dankort is accepted by close to 90,000 retailers[160]. According to ECB data, the total number of POS terminals per 1000 inhabitants is at 22.5 (above the EU average of 17.58)[161].

In Switzerland, despite having a zero-IF on Maestro debit, the scheme grew in number of cards issued by 17.8% between 2006 and 2010.[162] In this same period the volume and value of debit card transactions, in general, grew by 36% and 42% respectively[163].

The Dutch PIN scheme has also traditionally operated without a MIF, although at a later stage very low MIFs in terms of nominal value were introduced (almost negligible compared to other countries). Despite this, PIN has grown strongly even in recent years. In 2011 2,285 billion transactions were made through the system, up 6.1% from the previous year. Also the number of PIN transactions under €10 grew by 100 million in 2009 and now amount to 25% of all transactions[164]. The average value of transactions has been decreasing steadily, replacing cash.[165] According to the Dutch central bank, in 2007 there were 5.2 billion cash transactions at retailers and 1.6 billion PIN payments. In 2010 there were 4.4 billion cash payments and 2.2 billion PIN payments.[166] Additionally, an agreement was reached between the retail sector and banks on substantially lowering fees on small ticket transaction to stimulate less cash usage.[167] The number of active POS terminals has also seen strong consistent growth over the past years. In 2011 this number grew to 279,612 (up 8.1% from 2010).[168] According to ECB data, the debit share in the market is at 80%.

The setting of ban on debit card IFs with the regulation not covering credit card IFs could also be considered attractive from the point of view of implementation as the need for resources to be dedicated to this would be more limited under such an option. There would be

158 See: Norges Bank (2012) Annual report on Payment systems 2011, chart 1.3, p. 7.

159 http://www.kfst.dk/fileadmin/webmasterfiles/publikationer/konkurrence/2012/The_Danish_Payment_Card_Market_2012.pdf

160 *Ibid*, p. 28.

161 See: ECB Statistical Data Warehouse 2011

162 RBR: Payment Cards in Western Europe (2012)

163 Ibid

164 'Klein bedrag?, pinnen mag' Translated this means: 'small amount? Use PIN' : See: http://www.effie.nl/cusimages/013_Brons_Pinnen.pdf

165 *Ibid*.

166 See: 'Cash payments counted': Contante Betalingen geteld: een Studie naar het Gebruik van Contant Geld in Nederland in 2010, DNB at: http://www.dnb.nl/binaries/DNB%20onderzoek%20Contante%20betalingen%20geteld%202010_tcm46-267292.pdf

167 Agreement with banks on small-ticket transactions:'Akkoord banken over pinnen van laagwaardige betalingen', 12 jan 2011 and 'Pinnen gaat het winnen van contant' by Currence-directorr Piet Mallekoote, in the 2009 annual report.

168 http://www.pin.nl/wp-uploads/2012/08/p_uk_key_figures_pinnen.pdf

no need to decide on the methodology to be used and on the final figures and their evolution for IFs for debit cards. Banning certain business rules (i.e. banning interchange fees) is more straightforward and easier to implement. Also, it does not generate speculation on the future amount of the cap, which in itself is conducive to legal uncertainty about the current or future business models prevailing on the market. However, similarly to 15.1, the level of legal certainty regarding an acceptable business model for market players as far as IFs for credit cards are concerned would be limited, as the absence of coverage of credit card transactions would be re-assessed once evidence has been gathered about the regulation of debit card interchange fees.

Obviously, the impact of this option would be more modest in terms of decreased MSCs to merchants and of potential market entry than if IFs for credit cards were to be covered, as under 15.3 and 15.4. There would however already be a sizeable impact on these aspects and an increased merchants' acceptance and merchants/consumer welfare potential gains through the ban on debit cards IFs. As an example, the econometric analysis conducted by Chakravorti et.al, following intervention on IFs in Spain finds strong evidence that a reduction in MIFs (subsequently MSCs) results in increased merchant acceptance[169]. For credit cards a similar trend is observed, where a 1% decrease of the average MSC results in 0.15% increased acceptance. The impact of each intervention is different, but the measures taken in Spain in 2002, 2003 and 2005 were positive (suggesting merchant acceptance increased with further reductions in MIFs).[170] According to data from the ECB[171], the number of POS terminals has grown from 802.698 in the year 2000 to 1.36 million in 2011. The empirical analysis carried out by Valverde et. al, suggests that especially in markets where acceptance is lagging behind reductions in IFs are beneficial to merchant acceptance (putting downward pressure on MSCs) and increasing card usage.[172]

Also in Australia when examining the longer term effects of regulation, the combined MSC on Visa/MC has fallen by 59 basis points, which is even larger than the decrease in MIF, increasing merchant acceptance[173]. However, banks may well try to incentivise consumers to use more expensive credit cards instead of cheap(er) debit cards through bonuses and rewards. (15.2 is an intermediary sub-option in terms of the highest impact).

Similarly to option 15.1, the impact on the variability/level of interchange fees for credit cards would be highly dependent on the efficiency of transparency and steering measures, when the IFs for credit cards are not covered.

169 Santiago Carbó Valverde, Sujit Chakravorti and Francisco Rodriguez Fernandez*, Regulating Two-Sided Markets: An Empirical Investigation*, Federal Reserve Bank of Chicago Working Paper No. 2009-11, revised April 2010, p. 5.

170 *Ibid.*

171 ECB Statistical Data Warehouse (2012) at: http://sdw.ecb.europa.eu/

172 Santiago Carbó Valverde, Sujit Chakravorti and Francisco Rodriguez Fernandez*, Regulating Two-Sided Markets: An Empirical Investigation*, Federal Reserve Bank of Chicago Working Paper No. 2009-11, revised April 2010, p. 8.

173 RBA Annual Report of the Payment System Board (2012) at: http://www.rba.gov.au/publications/annual-reports/psb/2012/html/dev-ret-pay-sys.html

<u>Sub option 15.3: caps on Ifs for debit cards and credit cards</u>

If both IFs for credit cards and for debit cards are covered under the Regulation, the impact on the variability and level of interchange fees would be more direct, resulting in a true Single Market. Flexibility in regulating would be less, as both debit and credit cards would be covered but the level of legal certainty regarding an acceptable business model for market players would be increased accordingly.

As indicated earlier, the caps for interchange fees for debit and credit cards would be in line with the ones of the MasterCard undertakings the Visa commitments (on debit cards), and the Groupement des Cartes Bancaires case in France.

Different maturity of national card markets and national payment habits (based on historical developments) may lead however to discussions about one IF level acceptable and appropriate for most Member States in particular when credit cards are covered – as they are less widespread and since debit cards tend to be part of current account packages. Banning certain business rules (i.e. banning interchange fees for debit cards) is more straightforward and easier to implement. Option 15.3 could therefore involve substantial (public) implementation resources, as two different caps would have to be implemented and monitored.

The magnitude of the effects identified would be higher if IFs for debit cards are banned (15.3 is an intermediary sub-option in terms of the highest impact) than under this sub-option. The impact of option 15.3 would be more modest in terms of decreased MSCs to merchants and of potential market entry and innovation than if IFs for debit cards were banned, as under 15.4. There would still be a sizeable impact in terms of these aspects, but the increased merchants' acceptance and merchants/consumer welfare potential gains would be more limited in the absence of the ban on debit cards – and might actually decrease in those Member States where domestic card schemes with lower IFs than the caps envisaged are in place.

Indeed, capping IFs for debit cards instead of a ban could be problematic in the Member States in which there are currently no domestic IFs for debit cards in place or domestic IFs below the level of the MasterCard undertakings the Visa commitments (on debit cards). It would result in these Member States in higher level of MIFs, with negative consequences on merchants and consumers' welfare and on market entry of 'cheaper' payment solutions.

Consumers, if credit card IFs are covered, may fear more of an adverse pricing impact on other banking services than if only debit cards IFs are covered, as these are subject to higher IFs, and the revenues at stake for card schemes and banks would therefore be higher. Due to the widespread cross subsidisation in the banking sector, a cap on credit card IFs could also result in an adverse pricing impact on other banking services. It has however to be considered that a mitigating factor in this respect would be the maintenance of a level of IFs for debit cards and credit cards, and hence of IF revenues for banks.

<u>Sub option 15.4: ban on IFs for debit cards, caps on IFs for credit cards</u>

The magnitude of the effects identified would be higher if IFs for credit cards are capped, and IF for debit cards are banned (15.4 is the sub-option with the highest impact).

Similarly to 15.3, If both IFs for credit cards and for debit cards are covered under the Regulation, the impact on the variability and level of interchange fees would be more direct, resulting in a true Single Market. Flexibility in regulating would be less, as both debit and credit cards would be covered but the level of legal certainty regarding an acceptable business model for market players would be increased accordingly. Contrarily to 15.1, the level of legal certainty regarding an acceptable business model for market players as far as IFs for credit cards are concerned would be clarified from the entry into force of the regulation – even if the cap applies only after a transition period. The coverage of credit card transactions would not have to be re-assessed once evidence has been gathered about the regulation of debit card interchange fees.

The setting of a ban on debit card IFs will also be more attractive from the point of view of implementation resources than setting a cap for interchange fees for debit cards. There would be no need to decide on the methodology to be used and on the final figures for IFs for debit cards. Banning certain business rules (i.e. banning interchange fees) is more straightforward and easier to implement. A cap would apply to credit card IFs, which would still involve some implementation resources and discussion on its evolution.

As explained under 15.3, the caps for interchange fees for credit cards would be in line with European and national proceedings. In spite of this, there could be discussions arising on the methodology used and on the final figures, due in particular to the different maturity of national card markets and national payment habits.

The impact on the variability/level of interchange fees for credit cards could be to some extent less dependent on the efficiency of transparency and steering measures, when the IFs for credit cards are covered. Besides, due to the cap on IFs for credit cards, banks might be less incentivised to push for consumers to use more expensive credit cards instead of cheap(er) debit cards – although they could turn to cards not covered under the ban and caps, which would still be covered under transparency measures. The resulting level playing field would promote innovation and favour market entry to a greater extent than 15.3 - and the other sub-options, especially if debit cards IFs are banned. In the Netherlands where surcharging is a common practice in online shops, and credit card usage is very low, consumers are reluctant to use credit cards for purchases due to the additional (surcharging) costs (in essence created by the IF). Currently 47% of online transactions are conducted through iDeal[174]. This new entrant was able to capture the market through offering low

[174] See: http://www.currence.nl/NL-NL/OVERONZEPRODUCTEN/COLLECTIEVEBETAALPRODUCTEN/IDEAL/Pages/iDEAL.aspx

merchant fees (0.5 Euros per transaction compared to 2.7%+0.25 Euros using credit cards[175]). Banning debit card IFs and capping credit card IFs would allow for equally efficient payment systems to be developed in other markets traditionally dominated by expensive credit card usage. This would create further incentives for new entrants to expand on the European online retail payment market, resulting in high cost savings to retailers and consumers.

As already discussed under 15.3, banning IFs for debit cards and capping the ones for credit cards would result in higher acceptance at the point of sale – although to a higher extent under 15.4. Such a sub-option could also result in lower retail prices ceteris paribus – i.e. if it is assumed retailers have a limited ability to absorb these savings/not pass them on to consumers due to sufficient competitive pressure from other retailers in the same market segment[176]. This will obviously depend on the level of competition in the retail sector considered, which will impact the degree to which effective pass-through of savings to consumers occurs. This same line of argumentation has been used in the US by the Federal Reserve Board as a justification for expected pass-through in retail prices[177]. In an econometric analysis by Shampine (2012) it was concluded that MIF reductions in Australia led to a 38 basis point reduction in the 'two-sided' price (measuring both effects on consumers and merchants). This translates into a 0.67 AUD reduction per purchase and a 77.19 AUD reduction per account per year[178].

At the same time, promoting card usage instead of cash would contribute to reducing transaction costs for the whole society, resulting in overall welfare gains. Costs of cash studies indicate that usually, above a certain threshold, debit cards are a more efficient payment method than cash (lower total social costs). The Portuguese Central Bank, for example, conducted a cost of retail payments study in 2007 where they conclude that for transactions with a value above €8, debit card usage would lead to gains in terms of the total costs of all payment instruments.[179] The Dutch Central Bank also comes to a similar conclusion and indicated that social costs of retail payments can be much lower if debit card usage can be increased (replacing cash and credit card transactions).[180] The same study indicates that reducing debit card costs is a significant tool in achieving this goal, as acceptance would increase at merchant POS.

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175 Based on transaction costs charged by IcePay (e-commerce PSP): http://www.icepay.nl/online-betaalmethoden-en-betaalsystemen

176 According to Eurostat retail trade had one of the lowest concentration levels in 2009. See: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Structural_business_statistics_at_regional_level

177 See: http://www.federalreserve.gov/aboutthefed/boardmeetings/20110629_REG_II_FR_NOTICE.FINAL_DRAFT.06_22_2011.pdf p.277.

178 Allan Shampine, *Testing Interchange Fee Models Using the Australian Example*, available at; http://www.bankofcanada.ca/wp-content/uploads/2012/09/allan-shampine-paper.pdf

179 See: http://www.bportugal.pt/SiteCollectionDocuments/DPG-SP-PUB-Instrumentos-Pagamento-Retalho-Est-en.pdf

180 http://www.dnb.nl/en/binaries/working%20paper%20300_tcm47-254378.pdf

Similarly to 15.3, banning IFs for debit cards would also allow fears that SEPA results in higher IFs and other costs to be defused, as some domestic debit schemes currently function without a MIF or with a lower MIF than 0.2 , and this would not be called into question under such a 'SEPA optimum'.

Also, consumers, in particular if credit cards IFs are covered, may fear an adverse pricing impact on other banking services. Due to the widespread cross subsidisation in the banking sector, a cap on credit card IFs could also result in an adverse pricing impact on other banking services. However, there might also not be a need any longer to incentivise the issuing of debit cards by banks through an IF, as debit cards are already widespread in the EU and usually form part of the 'basics' of a current account package, and debit card usage by cardholders is generally not incentivised. In fact, it can be considered that higher card acceptance and usage at the point of sale could result in banks and card schemes collecting higher revenues which could compensate/overcompensate the revenues lost from decreased or banned IFs. This would be more likely if IFs for debit cards are banned as acceptance would increase more than under a cap. A report on the impact of the Australian Payment Reform has highlighted that the growth rate of cardholder fees for credit cards prior to the reforms was higher than after (between 1997 and 2002: +218% and between 2003 and 2008: +122%)[181].

In fact, issuing banks receive interchange fee revenue from card usage at POS. At the same time these banks must pay fees to banks that 'acquire' ATM withdrawals. As the amount of transactions at POS and ATM withdrawals are interdependent, an increase in the use of cards at POS would reduce the number of times and/or the amount of cash withdrawn from ATMs. As a consumer uses a card for POS purchases and ATM transactions and has a cost constraint (e.g. a finite amount of funds) logically the more he uses the card for POS transactions, the less he will withdraw cash at an ATM. If all transactions were completed at POS instead of using cash from the ATM, banks would no longer incur any ATM costs. Issuing banks would also increase revenue through the volume of transactions at POS when interchange fees. A zero-interchange fee for debit cards and a cap on interchange fees for credit cards will significantly increase the ability for merchants to accept cards (reducing the MIF and as a result the MSC). Although the revenue from MIFs to issuing banks will decrease overall, the increased acceptance at merchants will stimulate card usage at POS by consumers. This would decrease the costs of issuing banks for completing ATM transactions, and increase the volume and value of POS transactions[182].

<u>General conclusions for option 15</u>

Option 15 is the only option delivering market integration and legal certainty, achieving a level playing field for merchants and for competition in issuing and acquiring of cards.

181 TransAction Resources, *Review of the impact of Australian Payment Reform*, Federal Reserve System Docket Number R-1404, p. 19.

182 See to that effect: Harry Leinonen, *Debit Card interchange fees generally lead to cash-promoting cross-subsidisation*, Bank of Finland Research Discussion Papers, no. 3. 2011, p. 27.

Whilst transparency measures are important to deliver the benefits associated with every sub-option, banning interchange fees for debit cards, whether or not credit cards interchange fees are capped appears to be the most beneficial to all stakeholders. This would contribute to increased card acceptance, to the likely benefits of retailer and consumers. The impact on banks and card schemes revenues would have to be considered. Transparency and steering measures are key in this context to prevent a heavy handed promotion of credit cards by banks. The level playing field and legal certainty would also be to the benefit of potential new entrants.

Sub-option 15.4 i.e. banning interchange fees for debit cards which would generate potentially higher benefits to merchants and consumers deserves further examination. This is to ensure that the maturity of markets in the EEA, in particular as regards debit cards issuance and usage, is such that there is no need for charging interchange fees to incentivise debit card payments. A review to this effect could therefore be conducted shortly after a legislative action on interchange fees has been taken. **Amongst the sub-options, 15.3 would therefore be currently favoured.**

2.6 Option 16 (Exemption of commercial cards and three party schemes)

It could be considered that in order to create a level playing field for all (card) payment providers, all types of cards and of card schemes should be covered.

It has however to be acknowledged that commercial cards (from all schemes) and (all cards from) three party schemes have limited market shares in the EU. In terms of card issuing in Europe in 2008, the market shares were as follows: Visa 41.6%; MC 48.9%; Amex 1.6%. Even in terms of commercial cards, where Amex is most successful, it only has a market share of about 13%[183].

Based on the experience in other constituencies (in particular Australia) we do not expect that either commercial cards or three party schemes could take over the debit and credit card markets in this situation by offering more advantages to consumers. After the reforms, the Reserve Bank (RBA) indicated a limited increased market share of three-party schemes from around 16% in 2003 to about 20% in 2011. In 2004, after the reforms, only a slight increase took place to about 17.5% market share, which remained more or less stable until 2009.[184] In 2009 American Express started to offer 'companion cards' (co-branded with MasterCard or Visa products) issued by the four major banks in Australia, resulting in a small bump in their market share. In total though, this increase in market share is marginal.

Due to downward pressure on Visa (and MC) IFs through caps and increased transparency measures (a ban on the no-surcharge rule, removing the HACR between debit and credit cards) both the MSCs on Visa/MC and three-party schemes decreased.[185] Though surcharging was slow to develop among merchants, by the end of 2010 almost 30 per cent of merchants imposed surcharges on credit card products.[186] The average surcharge on American

183 RBR: Payment Cards in Western Europe (2012)

184 See graph 8: http://www.rba.gov.au/publications/annual-reports/psb/2012/pdf/2012-psb-ann-report.pdf

185 See: http://www.rba.gov.au/publications/annual-reports/psb/2012/pdf/2012-psb-ann-report.pdf

186 See: RBA, Review of Surcharging: A Consultation Document, June 2012, p.2.

Express was 2.9% and for Diners club 4%, these surcharges being higher than the MSCs (1 percentage point for AmEx and 1.8 for DC).[187] The RBA however sees evidence (from surveys) that consumers respond to surcharges by avoiding the use of (more) expensive cards where possible.

Besides, from a market analysis perspective, three party schemes and commercial cards cannot be regarded as substitutes for credit cards or debit cards. In fact, they mostly issue credit cards both for corporate clients and for well off consumers. They therefore cater for a specific clientele and their needs, not the average consumer.

As these cards are much used in some segments of the retail market, notably travel and leisure which attract a large number of corporate clients, transparency measures need to apply in their full force to them

Therefore, three party schemes and commercial cards would not be subject to regulated fees. It would also take out the need to resort to a complex methodology heavy in public administration resources, which would also be necessary to verify implementation. However, the main way that Amex could increase significantly its market share would be to have its cards issued by banks to their customers. This happens to a certain extent already. It is proposed that if three party schemes use issuing banks, they would fall under the scope of the Regulation, to avoid possible circumvention.

<u>General conclusions for option 16</u>

Commercial cards and three party schemes have very limited market shares. Based on the experience in other countries such schemes would not be in a position to take over the market of 'normal' debit and credit cards by offering more advantages to the average consumer. It is therefore proposed to exempt them from the scope of the Regulation, except for cards issued to customers by three-party schemes through banks. In any case, transparency measures and card identification in particular should apply.

2.7 Option 17 (Regulate Merchant Service Charges)

Regulating interchange fees does not directly address the Merchant Service Charges (MSCs) merchants are facing, although interchange fees make up the largest share of these fees (60% in Czech Republic in 2003, 60% in Italy in 2003 and 73% in Belgium in 2002)[188]. Regulating MSCs would also allow three party schemes to be regulated – beyond transparency measures.

A Merchant Service Charges (MSC) has three main components: the MIF, the scheme (and processing) fee and the acquirer margin.

The acquiring market is a market on which in most country there is competition at least on the acquirer margin. As shown by the MasterCard decision, acquirers are unable to negotiate

187 *Ibid.*

188 See: Case COMP/34.579 MasterCard, COMP/36.518 EuroCommerce and COMP/38.580 Commercial Cards, section 7.3.2.1.3. (paras 426-439.

on the MIF part of the MSC. It is therefore is more logical to neutralize the interchange fees which are restriction of competition than to freeze competition on the acquirer margin.

Regulating MSCs would appear to give merchants full certainty about the costs they have to face for accepting payments. As it would also allow schemes based on implicit interchange fees, the three party schemes, to be covered it would allow for a level playing field 'across the board'.

However, capping MSCs would make it difficult for (big) merchants to negotiate with their acquirers on the acquiring margin for instance. In the UK the acquirer offers are usually divided in three bits: MIF+Scheme fee+ margin. This presentation is known as a MIF++ (MIF plus plus) offer. It could imply the same MSC level for merchants from all walks of life, and effectively 'freeze' the market at this level. This raises also the issue of the level at which the MSC should be fixed, under which methodology and how this would be monitored, at EU and national level. This is likely to require heavy resources in terms of public administration. Measures should however be considered to avoid circumvention of the Interchange Fee Regulation, similarly to what has been done in the US (cf below).

In essence, regulating MSCs would appear very interventionist. There are nagging question marks about the subsidiarity and proportionality of such measures, especially as competition in payment services takes place on a Member State level. If a specific issue arises, Member States could appear best placed to intervene.

In October 2011 the ministry of Finance of Norway and the FSA created a project group to assess possible measures to be imposed on the international card schemes (Visa/MC). There were plans on the table to regulate MSCs, however they decided not to. According to the group, regulating MSCs would have adverse effects on competition on the acquiring side, including possible deterrence of innovation.[189]

Also, if the ECJ decision in the case brought by Vodafone[190] against roaming regulation is taken as precedent, regulating MSCs would amount to regulate 'retail prices' which could only be accepted by the Court because of the cross border dimension of roaming. By contrast, regulating interchange fees, only amounts to regulating 'wholesale prices'. There are obviously a number of differences between the roaming regulation and the envisaged regulation of interchange fees, and most notably the fact that in contrast with the roaming regulation, the envisaged regulation of interchange fees will cover domestic ones.

Furthermore, fixing MSCs means fixing prices and is a major step beyond limiting MIFs which have been established to be restrictions of competition.

189 Norges Bank (2012) 2011 Annual report on Payment systems, box on p.11.

190 Judgment of the Court of 8 June 2010 In Case C-58/08 (Regulation (EC) No 717/2007 – Roaming on public mobile telephone networks within the Community – Validity – Legal basis – Article 95 EC – Principles of proportionality and subsidiarity)

It is also difficult to entrust the implementation of this to card schemes and it is likely to have spill over effects to other payment instruments Paypal for instance

Finally, regulating MSCs could also be seen as not proportional to the goal of creating a level playing field. An IF regulation would probably result in a higher acceptance of cards by merchants. In the longer run these gains could become even more substantial. Measures such as application of MIF regulation to online and mobile payments and rules on access to information on bank accounts by third parties would probably lead to a wider choice of payment instruments and contribute to lower prices of goods and services in the economy.

General conclusions for option 17
Option 17 would be the most intrusive of most options. Although attractive *prima facie*, it would raise many issues in terms of subsidiarity, proportionality and practicability. We would suggest that the Commission commits itself to monitoring the situation regarding MSCs.

Table 57 - Summary of the impact for regulating interchange fees (options 12 to 17)

Policy option	Description	Effectiveness	Efficiency
Option 12	Baseline scenario	(0)	(0)
Option 13	**Allow cross-border acquiring and regulate the level of cross-border interchange fees**	**(0/+)**	**(+)**
Option 14	Mandate Member States to set domestic IFs on the basis of a common methodology	(-/0)	(--)
Option 15	**Set a common, EU-wide IF level, based on a maximum cap**	**From (+) to (++)**	**From (0) to (+)**
Sub-option 15.3	**Capping IFs for debit and credit cards at maximum 0.2% and 0.3% of the transaction value respectively**	**(++)**	**(+)**
Option 16	**Exemption of commercial cards and three party schemes**	**(0/+)**	**(+)**
Option 17	Regulate Merchant Service Charges	(-)	(--)

Table 58 - Summary of the impact for main stakeholder categories (options 12 to 17)

Policy option	Description	Consumers	Merchants	PSPs	New entrants
Option 12	Baseline scenario	0	0	0	0
Option 13	**Allow cross-border acquiring and regulate the level of cross-border interchange fees**	**(0)**	**(+) big retail** **(-/0) small retail**	**0**	**0**
Option 14	Mandate Member States to set domestic IFs on the basis of a common methodology	(0/-)	(0/-)	(+)	(-)
Option 15	**Set a common, EU-wide IF level, based on a maximum cap**	**(0/+)**	**(+)**	**(-/0)**	**(+)**
Sub-option 15.3	**Capping IFs for debit and credit cards at maximum 0.2% and 0.3% of the transaction value respectively**	**(0/++)**	**(++)**	**(-/0)**	**(++)**
Option 16	**Exemption of commercial cards and three party schemes**	**(0/+)**	**(0/+)**	**(0)**	**(0/+)**
Option 17	Regulate Merchant Service Charges	(-/0)	(-)	(-)	(-)

Table 59 – Impact on Stakeholders, effectiveness and Efficiency

	Impact on stakeholders	Effectiveness	Efficiency
Option 12: Do nothing	(0) on consumers, merchants and potential new entrants : card schemes relying on high IFs maintain/expand their	(0) legal certainty unlikely: MasterCard appeal, long and fragmented process of NCAs proceedings	(0) No Legal certainty (0) even if NCAs launch proceedings, would do so at different speeds

	market shares/market power, likely closure of further (cheap) domestic card schemes, 'cheaper' operators not issued (0) card schemes and banks: continued segmentation of markets, high level IFs revenues largely preserved, market distortions	(0) level playing field: no guarantee full consistency proceedings, appropriate MIF level not defined by the Court (0) Market entry: (high) level and diversity of IFs persist, no pan-European player likely to emerge	(0) long and fragmented process
Option 13: allowing cross border acquiring and regulating the level of cross border interchange fees	**(+) Promotes market integration** **(+) Benefits limited to big retailers, (0/-) for small retailers, (0) for consumers** **(0) Limited impact on interchange fee levels except (+) if merchants massively changing acquirers ;** **(0) Limited effects on card acceptance in (small) shops** **(0) for card schemes and banks except if changed incentives**	**(0) Does not address technical obstacles and national processing rules limiting cross border acquiring** **(0) No level playing field: patchwork of national MIFs** **(0) no impact on legal certainty of IF level** **(0) no impact on market entry except (+) if banks and card schemes decrease domestic IF to the cap as a reaction**	**(+) No heavy monitoring: merchants and acquirers involved,** **(+) possible limited circumvention attempts** **(+) Need transparency measures to increase efficiency**
Option 14: Mandate Member States to set domestic MIFs on the basis of a common methodology	(+/-) uncertain impact on merchants card acceptance and welfare (0) limited impact on consumers (0) banks and incumbent card schemes likely to benefit from continued segmentation of markets	(0) much more limited impact on interchange fee levels than option 3.4, (-/+) could bring down some domestic IF levels, possible increases of others (0) no level playing field: patchwork of national MIFs and national payment markets (0) Limited market entry especially for Pan European players	(-) Legal certainty (--) Heavy monitoring, implementation and coordination resources: practicability?
Option 15 (Set a common, EU-wide IF level, based on a maximum cap)	(+) Substantial Impact on Merchants fees, increases significantly acceptance (0/+) Consumers may not 'see' visible retail	(+) Substantial impact on IFs (+) Creates a Single Market: Level playing field (+) Legal certainty for	(0/+) Legal certainty depending on the sub-option chosen (0) Need strong steering, transparency and structural measures

	price decreases, may suffer from increase cardholder or current account fees but new services (-/+) Uncertain impact on banks and card schemes (dependent on impact on revenues/possible increase cardholder or current account fees) (+) Market entry of new players – reinforced if options access to information on bank accounts	cards schemes and new entrants (+) Good for innovation and market entry	to increase efficiency
15.1: caps on Ifs for debit cards, credit cards not covered	(0/+) limited Impact on Merchants fees and in acceptance (0) Consumers may suffer from increase cardholder/current account fees, limited new services (0) limited market entry (-) 'cheap' domestic card schemes called into question (0) bank and card scheme revenues largely untouched	(0) Limited impact on IFs (+) Creates a Single Market: Level playing field for debit cards (0) Level playing field for credit cards doubtful, depends on transparency measures (-) No legal certainty for credit cards	(-/0) limited legal certainty (credit cards) (-) Need very strong steering, transparency and structural measures to increase efficiency (-) risk of consumers pushed to use credit cards
15.2: ban on Ifs for debit cards, credit cards not covered	(+) Impact on Merchants fees and in acceptance for debit cards but (0/+) limited for credit cards (0/+) Consumers may suffer from increase cardholder/current account fees, some new services (+) SEPA optimum: 'cheap' domestic card	(0/+) Some impact on IFs (+) Creates a Single Market: Level playing field for debit cards (0) Level playing field for credit cards doubtful, depends on transparency measures (-) No legal certainty for credit cards	(-/0) Limited legal certainty (credit cards) (-) Need very strong steering, transparency and structural measures to increase efficiency (-) risk of consumers pushed to use credit cards (+) Implementation of a ban on IFs for debit cards easier

	schemes not called into question (0/+) some market entry (0/-) limited impact on bank and card scheme revenues		
15.3: caps on Ifs for debit cards and credit cards	**(0/++) Strong Impact on Merchants fees and in acceptance of credit cards, (+) acceptance for debit cards** **(0/+) some market entry** **(-) 'cheap' domestic card schemes called into question** **(0/++) Consumers may suffer from increase cardholder or current account fees, some new services** **(0/-) some impact on bank and card scheme revenues**	**(0/+) Some impact on IFs** **(+) Level playing field** **(+) legal certainty**	**(+) Legal certainty** **(0/-) Methodology and level of IFs for credit and debit cards** **(0) Need strong steering, transparency and structural measures to increase efficiency**
15.4: ban on Ifs for debit cards, caps on Ifs for credit cards	(+ +) Strong Impact on Merchants fees and acceptance (0/++) Consumers may suffer from increase in cardholder /current account fees, but new services (0/++) Consumers may not 'see' visible retail price decreases (+) SEPA optimum: 'cheap' domestic debit card schemes not called into question (+ +) Market entry of new players – reinforced if options	(+ +) Impact on IFs (+) Level playing field (+ +) Legal certainty	Legal certainty (+ +) (+) Implementation of a ban on IFs for debit cards easier (-/0) Methodology and level of IFs for credit cards (0) Need strong steering, transparency and structural measures to increase efficiency

	access to information on bank accounts (+/-) impact on bank and card scheme revenues uncertain: increase in acceptance, decrease cash costs		
Option 16: Exemption of commercial cards and three party schemes	**(0) if transparency measures, no higher costs on retailers (0/+) if transparency measures, no adverse retail price impact on consumers (+) banks/card scheme revenues untouched (+) possible new entry**	**(+) Level playing field (0/+) impact on IFs if transparency measures (+ +) Legal certainty if anti-circumvention measures**	**(+) No need for complex methodology, implementation and monitoring caps**
Option 17: Setting caps on Merchant Service Charges	(+) Certainty to merchants about their costs in accepting payments but (- -) (big) retailers cannot negotiate (-) banks, card schemes including three party	(+) Level playing field but freezes markets (- -) disproportionately regulates competitive conditions	(- -) Complex methodology, implementation and monitoring (- -) Question marks regarding proportionality, subsidiarity, practicality

<u>Preferred option</u>

As marked in the table above, a sequential combination of option 13 (regulating the level of cross border interchange fees and allowing cross border acquiring) and sub-option 15.3 (setting a common, EU-wide IF level, based on a maximum cap) together with option 16 seems the most promising. Sub-option 15.3 and option 16 would become operational after a transition period, which would already be enshrined in the Regulation, i.e. without any conditional review clause, whilst option 13 would be of application as of the entry into force of the Regulation.

Only setting a common, EU-wide IF level, based on a maximum cap as proposed in option 15, would deliver full harmonisation of the IF in the EU, thus creating conditions for the establishment of a Single Market for card payments. Option 15 would also create legal certainty and a level playing field for competition in issuing and acquiring of cards. It would further much facilitate the market entry for any new card schemes and new technology or other innovation. Finally, it would also address the threat of 'exporting' the IF model to new, innovative payment services that are being rolled-out on the market or could be launched in the future. This includes in particular any mobile payment applications and online payments (Internet) applications.

<u>Quantitative assessment for options 13 and 15</u>

<u>Modelling of the impact</u>

On the basis of the public figures for the value of card transactions, and the value of debit and credit card transactions respectively, together with the public figures for average debit and credit MIFs, the Commission has estimated the current MIF revenues at EU level, for credit and debit cards. It has however to be noted that public figures for domestic debit schemes were often not available. Since they are typically lower than the IFs of Visa and MasterCard, the value of debit IFs might be overestimated for some countries. Due to the limited reliability of the public figures available, inter-regional and intra-regional interchange fees were not included in the framework of this quantitative assessment. The resulting savings for merchants could be estimated at around 0.4 billion € and 0.16 billion € respectively, and positive welfare gains to EU consumers could be reasonably expected.

The reductions in MIF amounts for debit and credit cards if caps of 0.2 and 0.3 respectively were to apply can then be calculated. Assuming ceteris paribus constant acquirers' margin prior to and after regulatory intervention – which in the light of precedents seems to be an adequate assumption as discussed below, these reductions in MIFs would correspond to the reduction in MSCs – or savings to merchants and potential savings to consumers through price retail depending on the level of pass through – and to potential revenue losses to banks which might impact cardholder fees – although as already discussed the impact on bank revenues is likely to be ambiguous.

MIF estimates in the EEA

Country	Value of card transactions (EUR)	Value debit calculated (EUR)	Share of debit value	Value credit/delayed debit calculated (EUR)	Share of credit value	Avg debit MIF rate	Avg credit MIF rate	Total debit MIF (EUR)	Total credit MIF (EUR)	Total MIF (EUR)	Reduction no debit MIF (EUR)	Reduction debit MIF 0.20% (EUR)	Reduction credit MIF 0.30% (EUR)
Year	**2011**	**2011**	**2011**	**2011**	**2011**	**2013**	**2013**	**2011**	**2011**	**2011**	**2011**	**2011**	**2011**
Source	*ECB*	*ECB*	*ECB*	*ECB*	*ECB*	*Published rates*	*Published rates*	*Estimate*	*Estimate*	*Estimate*	*Estimate*	*Estimate*	*Estimate*
Austria	27,948,000,000	16,503,000,000	59%	11,445,000,000	41%	1.00%	1.00%	165,030,000	114,450,000	**279,480,000**	165,030,000	132,024,000	80,115,000
Belgium	63,299,040,000	50,375,550,000	80%	12,923,490,000	20%	0.12%	0.76%	60,459,297	97,695,430	**158,154,727**	60,459,297	-	58,924,960
Bulgaria	1,121,965,000	713,233,000	64%	408,732,000	36%	0.48%	0.48%	3,423,518	1,961,914	**5,385,432**	3,423,518	1,997,052	735,718
Cyprus	3,300,673,000	1,595,029,000	48%	1,705,644,000	52%	1.50%	1.50%	23,925,435	25,584,660	**49,510,095**	23,925,435	20,735,377	20,467,728
Czech Republic	10,128,199,000	8,880,350,000	88%	1,247,849,000	12%	1.17%	1.19%	103,821,576	14,793,766	**118,615,341**	103,821,576	86,060,876	11,050,219
Denmark	53,921,075,000	47,675,362,000	88%	6,245,713,000	12%	0.01%	0.75%	3,742,122	46,842,848	**50,584,969**	3,742,122	-	28,105,709
Estonia	3,152,570,000	2,643,290,000	84%	509,280,000	16%	0.97%	0.85%	25,729,937	4,319,307	**30,049,244**	25,729,937	20,443,357	2,791,467
Finland	36,099,400,000	30,482,620,000	84%	5,616,781,000	16%	0.19%	0.65%	58,727,966	36,509,077	**95,237,042**	58,727,966	-	19,658,734
France	393,594,370,000	121,812,763,685	31%	271,781,606,315	69%	0.54%	0.52%	653,748,864	1,399,870,855	**2,053,619,719**	653,748,864	410,123,336	584,526,036
Germany	187,631,000,000	139,142,000,000	74%	48,489,000,000	26%	0.49%	1.80%	685,835,333	870,862,440	**1,556,697,773**	685,835,333	407,551,333	725,395,440
Greece	6,542,424,000	1,100,888,000	17%	5,441,536,000	83%	0.66%	1.10%	7,264,422	59,840,084	**67,104,506**	7,264,422	5,062,646	43,515,476
Hungary	6,413,599,000	5,454,246,000	85%	959,353,000	15%	0.53%	0.87%	28,948,077	8,315,193	**37,263,271**	28,948,077	18,039,585	5,437,134
Iceland	n.d.	n.d.	n.d.	n.d.	n.d.	0.45%	0.78%	n.d.	n.d.	**n.d.**	n.d.	n.d.	n.d.
Ireland	23,572,000,000	12,900,000,000	55%	10,672,000,000	45%	0.22%	0.87%	28,813,275	92,901,320	**121,714,595**	28,813,275	3,013,275	60,885,320
Italy	122,605,610,000	67,005,779,000	55%	55,599,831,000	45%	0.51%	0.70%	341,953,058	391,305,421	**733,258,479**	341,953,058	207,941,500	224,505,928
Latvia	2,338,106,000	1,583,345,000	68%	754,761,000	32%	0.31%	0.67%	4,957,713	5,070,377	**10,028,089**	4,957,713	1,791,023	2,806,094
Liechtenstein	n.d.	n.d.	n.d.	n.d.	n.d.	1.05%	1.05%	n.d.	n.d.	**n.d.**	n.d.	n.d.	n.d.
Lithuania	1,958,341,000	1,475,316,000	75%	483,025,000	25%	1.05%	1.08%	15,453,134	5,205,508	**20,658,641**	15,453,134	12,502,502	3,756,433
Luxembourg	5,666,766,000	2,394,000,000	42%	3,272,766,000	58%	0.28%	0.78%	6,718,828	25,527,575	**32,246,403**	6,718,828	1,930,828	15,709,277
Malta	864,068,000	445,675,000	52%	418,393,000	48%	0.45%	0.78%	2,008,447	3,263,465	**5,271,912**	2,008,447	1,117,097	2,008,286
Netherlands	96,243,303,000	85,112,576,000	88%	11,130,727,000	12%	0.06%	0.81%	51,257,197	89,631,726	**140,888,923**	51,257,197	-	56,239,545
Norway	n.d.	n.d.	n.d.	n.d.	n.d.	0.44%	1.13%	n.d.	n.d.	**n.d.**	n.d.	n.d.	n.d.
Poland	25,593,309,000	18,973,315,000	74%	6,619,994,000	26%	1.64%	1.50%	310,905,397	99,094,728	**410,000,125**	310,905,397	272,958,767	79,234,746
Portugal	55,732,646,000	46,116,828,000	83%	9,615,818,000	17%	1.02%	1.50%	472,236,319	143,852,637	**616,088,956**	472,236,319	380,002,663	115,005,183
Romania	4,819,151,000	3,972,165,000	82%	846,986,000	18%	1.13%	1.28%	44,945,336	10,817,864	**55,763,200**	44,945,336	37,001,006	8,276,906
Slovakia	7,716,990,000	7,095,310,000	92%	621,680,000	8%	0.70%	0.70%	49,667,170	4,351,760	**54,018,930**	49,667,170	35,476,550	2,486,720
Slovenia	4,536,722,000	2,815,395,000	62%	1,721,327,000	38%	0.73%	0.97%	20,414,949	16,726,523	**37,141,472**	20,414,949	14,784,159	11,562,542
Spain	107,294,512,000	45,198,092,000	42%	62,096,420,000	58%	0.59%	0.66%	267,441,351	409,836,372	**677,277,723**	267,441,351	177,045,167	223,547,112
Sweden	84,819,841,000	63,631,880,000	75%	21,187,962,000	25%	0.27%	0.86%	172,433,000	183,037,219	**355,470,219**	172,433,000	45,169,240	119,473,333
UK	578,331,606,000	401,738,971,000	69%	176,592,635,000	31%	0.25%	0.87%	997,824,225	1,530,220,992	**2,528,045,217**	997,824,225	194,346,283	1,000,443,087
Total EEA	**1,915,245,288,000**	**1,186,836,978,685**	**62%**	**728,408,309,315**	**38%**			**4,607,685,944**	**5,691,889,060**	**10,299,575,004**	**4,607,685,944**	**2,487,117,621**	**3,506,664,132**

Table 60 – MIF estimates in the EEA

Under option 13 i.e. allowing cross border acquiring and regulating the level of cross border interchange fees, it is expected that most of the benefits of cross-border acquiring are limited to big retailers, due to the costs inherent with cross border acquiring, at least in the short to medium run, in the absence of common standards and/or their implementation - and to the more limited negotiating power of small retailers.

Accordingly, only the retailers with a turnover above 50 Million Euros are considered as big retailers in the assessment. Turnovers for big retailers in the total retailers' turnover per Member State are used as proxy for estimating their share in the value of transactions. This may however underestimate their share as their level of card acceptance tends to be higher than the one of small retailers. Other factors would have to be considered under a more differentiated approach such as the specific retail sector considered – for instance the level of acceptance in the entertainment sector tends to be higher than in other sectors including for small merchants and the same applies for e-commerce as compared to brick-and-mortar trade. However, for the purpose of the analysis, the share of big retailers in total retail turnover is taken as an adequate proxy.

It can then be estimated that the savings for big retailers would correspond for each Member State to the share of big retailers in turnover multiplied by the reductions in MIF amounts for debit and credit cards respectively.

Estimated effect of MIF reduction for the cross-border acquiring option (EUR)			
Country	**Share of large retailers in retail trade**	**Reduction total (debit MIF 0.20%; credit MF 0.30%)**	**Reduction cross-border acquiring**
Year	**2010**	**2011**	**2011**
Source	*Eurostat*	*Commission estimate*	*Commission estimate*
Austria	50%	212,139,000	**106,069,500**
Belgium	41%	58,924,960	**24,159,234**
Bulgaria	22%	2,732,770	**601,209**
Cyprus	40%	41,203,105	**16,481,242**
Czech Republic	46%	97,111,094	**44,671,103**
Denmark	50%	28,105,709	**14,052,854**
Estonia	50%	23,234,824	**11,617,412**
Finland	53%	19,658,734	**10,419,129**
France	47%	994,649,372	**467,485,205**
Germany	52%	1,132,946,773	**589,132,322**
Greece	40%	48,578,122	**19,431,249**
Hungary	43%	23,476,720	**10,094,990**
Iceland	n.d.	n.d.	n.d.
Ireland	39%	63,898,595	**24,920,452**
Italy	33%	432,447,428	**142,707,651**
Latvia	50%	4,597,116	**2,298,558**
Liechtenstein	n.d.	n.d.	n.d.
Lithuania	51%	16,258,934	**8,292,056**
Luxembourg	n.d.	17,640,105	n.d.
Malta	n.d.	3,125,383	n.d.
Netherlands	45%	56,239,545	**25,307,795**
Norway	n.d.	n.d.	n.d.
Poland	38%	352,193,513	**133,833,535**
Portugal	36%	495,007,846	**178,202,825**
Romania	45%	45,277,912	**20,375,060**
Slovakia	45%	37,963,270	**17,083,472**
Slovenia	68%	26,346,701	**17,915,757**
Spain	42%	400,592,279	**168,248,757**
Sweden	49%	164,642,573	**80,674,861**
UK	73%	1,194,789,370	**872,196,240**
Total EEA		**5,993,781,753**	**3,006,272,468**

Table 61 – Estimated effect of MIF reduction for the cross-border acquiring option (EUR)

Source: Eurostat, Distributive trades by size class of turnover (Last update 24.10.12, Extracted on 14.01.13), Retail trade, except of motor vehicles and motorcycles, Turnover or gross premiums written. 2009 figures were used for Ireland, Italy, Lithuania and the Netherlands; the share of large retailers has been estimated for Cyprus, Estonia, Greece, Latvia and Slovakia.

Savings for big merchants across Europe would therefore amount to 3 billion Euros.

Under option 15 i.e. setting a common, EU-wide IF level, based on a maximum cap, several sub-options are considered, depending on whether caps for debit or credit cards are set respectively.

On that account, the reductions in MIFs – savings to merchants and potential savings to consumers - would correspond to respectively the total amount of IFs for debit transactions in case of a ban of interchange fees, or to the reductions in MIFs for debit and/or credit cards as already estimated above.

Estimated effect of MIF reduction for various options (EUR)							
Country	Reduction no debit MIF (EUR)	Reduction debit MIF 0.20% (EUR)	Reduction credit MIF 0.30% (EUR)	Option 3.4.1	Option 3.4.2	Option 3.4.3	Option 3.4.4
Year	2011	2011	2011	2011	2011	2011	2011
Elements	A	B	C	B	A	B+C	A+C
Austria	165,030,000	132,024,000	80,115,000	132,024,000	165,030,000	212,139,000	245,145,000
Belgium	60,459,297	-	58,924,960	-	60,459,297	58,924,960	119,384,257
Bulgaria	3,423,518	1,997,052	735,718	1,997,052	3,423,518	2,732,770	4,159,236
Cyprus	23,925,435	20,735,377	20,467,728	20,735,377	23,925,435	41,203,105	44,393,163
Czech Republic	103,821,576	86,060,876	11,050,219	86,060,876	103,821,576	97,111,094	114,871,794
Denmark	3,742,122	-	28,105,709	-	3,742,122	28,105,709	31,847,830
Estonia	25,729,937	20,443,357	2,791,467	20,443,357	25,729,937	23,234,824	28,521,404
Finland	58,727,966	-	19,658,734	-	58,727,966	19,658,734	78,386,699
France	653,748,864	410,123,336	584,526,036	410,123,336	653,748,864	994,649,372	1,238,274,900
Germany	685,835,333	407,551,333	725,395,440	407,551,333	685,835,333	1,132,946,773	1,411,230,773
Greece	7,264,422	5,062,646	43,515,476	5,062,646	7,264,422	48,578,122	50,779,898
Hungary	28,948,077	18,039,585	5,437,134	18,039,585	28,948,077	23,476,720	34,385,212
Iceland	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.
Ireland	28,813,275	3,013,275	60,885,320	3,013,275	28,813,275	63,898,595	89,698,595
Italy	341,953,058	207,941,500	224,505,928	207,941,500	341,953,058	432,447,428	566,458,986
Latvia	4,957,713	1,791,023	2,806,094	1,791,023	4,957,713	4,597,116	7,763,806
Liechtenstein	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.
Lithuania	15,453,134	12,502,502	3,756,433	12,502,502	15,453,134	16,258,934	19,209,566
Luxembourg	6,718,828	1,930,828	15,709,277	1,930,828	6,718,828	17,640,105	22,428,105
Malta	2,008,447	1,117,097	2,008,286	1,117,097	2,008,447	3,125,383	4,016,733
Netherlands	51,257,197	-	56,239,545	-	51,257,197	56,239,545	107,496,742
Norway	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.
Poland	310,905,397	272,958,767	79,234,746	272,958,767	310,905,397	352,193,513	390,140,143
Portugal	472,236,319	380,002,663	115,005,183	380,002,663	472,236,319	495,007,846	587,241,502
Romania	44,945,336	37,001,006	8,276,906	37,001,006	44,945,336	45,277,912	53,222,242
Slovakia	49,667,170	35,476,550	2,486,720	35,476,550	49,667,170	37,963,270	52,153,890
Slovenia	20,414,949	14,784,159	11,562,542	14,784,159	20,414,949	26,346,701	31,977,491
Spain	267,441,351	177,045,167	223,547,112	177,045,167	267,441,351	400,592,279	490,988,463
Sweden	172,433,000	45,169,240	119,473,333	45,169,240	172,433,000	164,642,573	291,906,333
UK	997,824,225	194,346,283	1,000,443,087	194,346,283	997,824,225	1,194,789,370	1,998,267,312
Total EEA	**4,607,685,944**	**2,487,117,621**	**3,506,664,132**	**2,487,117,621**	**4,607,685,944**	**5,993,781,753**	**8,114,350,076**

Table 62 – Estimated effect of MIF reduction for various options (EUR)

As indicated in the assessment of the options above, the likely impact of regulating IFs is further explored in the light of precedents. The following impacts are considered:

- Impact on merchants in terms of card acceptance and MSCs
- Impact on incumbents and market entry
- Impact on consumers

Impact on merchants

In countries such as **Hungary** where interchange fees are high, merchant acceptance is lagging far behind card issuance. The interchange fees (varying between 0.2-1%) are considered as a major hurdle for merchants as this greatly increases the cost of facilitating/accepting card payments at POS.[191] According to a joint study between the MNB (central bank) and the NCA, growth in acceptance was lagging far behind the growth in card issuing. According to ECB data[192], the number of POS terminals per one thousand inhabitants is 17.58 in the EU, while in Hungary this figure is less

[191] OECD Roundtable on Competition in Payment Systems (2012). Note by the delegation of Hungary.

[192] ECB Statistical Data Warehouse (2012) at: http://sdw.ecb.europa.eu/

than half at 8.5. According to the national bank, the expansion of card acceptance is of high importance as it is currently only possible to make payments using cards in 30% of retail outlets. This indicates the need to stimulate the *merchant side* as opposed to the current IF practice of subsidizing issuers.

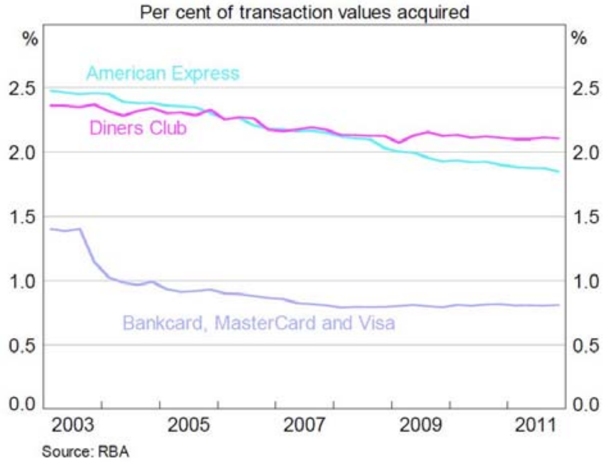
In **Spain,** merchant acceptance increased following a reduction in MIFs. For debit cards a reduction in the average MSC resulted in a statistically significant increase in merchant acceptance.[193] For credit cards a similar trend is observed, where a 1% decrease of the average MSC results in 0.15% increased acceptance. The impact of each intervention differed, but the measures taken in Spain in 2002, 2003 and 2005 all led to increased merchant acceptance with further reductions in MIFs.[194] According to data from the ECB[195], the number of POS terminals has grown from 802.698 in the year 2000 to 1.36 million in 2011. The empirical analysis carried out by Valverde et. al, suggests that especially in markets where acceptance is lagging behind that reductions in IFs are beneficial to merchant acceptance (putting downward pressure on MSCs) and increasing card usage.[196] It seems to be the case that in Spain, in the period 2001 to 2008, both card payment volumes and the volumes of cash withdrawals at ATMs grew continuously, and there is little evidence of higher cash use and cash withdrawals at ATMs as the result of the interventions[197]. The reduction in the average transaction value (ATV) for card payments from €52.1 to 44.3 from 2005 to 2010 can also be seen as an indicator of increased card use[198]. According to another study[199], over the period 2006-2010, there was a 57.3% average reduction in Interchange and a 51.3% reduction of merchant service charges (MSCs).

In **Australia** when examining the longer term, the combined average MSC on Visa and MasterCard

Graph 2

Merchant Service Fees

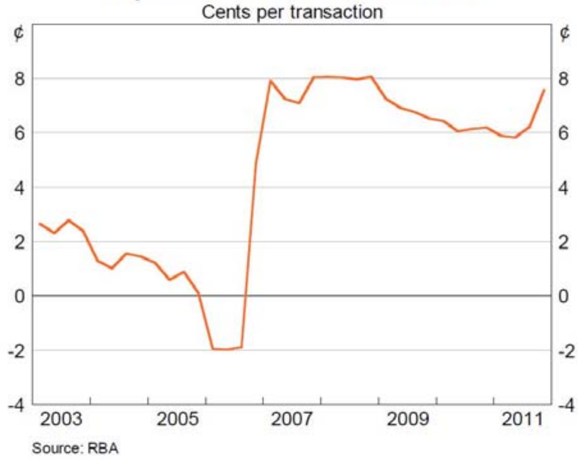
Per cent of transaction values acquired



Graph 3

eftpos Merchant Service Fees

Cents per transaction



a 0.043% increase in acceptance. See: Santiago Carbó Valverde, Sujit Chakravorti and Francisco Rodriguez Fernandez, *Regulating Two-Sided Markets: An Empirical Investigation*, Federal Reserve Bank of Chicago Working Paper No. 2009-11, revised April 2010, Table 5.

194 *Ibid.*

195 ECB Statistical Data Warehouse (2012) at: http://sdw.ecb.europa.eu/

196 Santiago Carbó Valverde, Sujit Chakravorti and Francisco Rodriguez Fernandez*, Regulating Two-Sided Markets: An Empirical Investigation*, Federal Reserve Bank of Chicago Working Paper No. 2009-11, revised April 2010, p. 8.

197 EPSM Market Research Newsletter December 2012 p. 6

198 Ibid

199 Juan Iranzo, Pascual Fernández, Gustavo Matías and Manuel Delgado: The effects of the mandatory decrease of interchange fees in Spain, 2012 (Study June 2012)

has fallen by 59 basis points since September 2003 (just before the reforms) to an average of 0.8% of transaction value in 2012. This is even larger than the reduction in average IFs during that same period (45 basis points) indicating *increased competition in the*

Figure 13 – Merchant Service Fees and eftpos Merchant service fees

acquiring market. The margin between the average MSC and average IF has narrowed from around 45 basis points in 2003 to around 30 basis points in 2012. The average MSC for American Express also declined substantially by 62 basis points following the reforms.[200]

Just as the domestic debit scheme without a MIF in **Norway** has seen an increase in its *usage*, *acceptance* has also been growing at a steady rate (from around 16 terminals per 1000 inhabitants in 2001 to over 27 in 2011).[201] The value of goods purchased/value of transactions? at POS terminals with BankAxept has also seen a healthy increase, almost tripling over the same time period (from 140bn NOK to 387bn NOK).[202]

The NCA decisions in **Switzerland,** reducing credit cards MIFs since 2005, led to a considerable increase in merchants' acceptance.[203] Reductions of the MIFs were fully passed on by the acquirers to merchants, resulting in savings for merchants between 70 and 90mn CHF. In addition this led to acceptance of credit cards by the two largest retailers for the first time.[204] The Maestro debit scheme has also seen a steady increase of acceptance in the absence of a MIF .[205]

Impact on incumbents and market entry

In Australia, regulatory caps were introduced for the domestic scheme eftpos' bilaterally negotiated reversed IF, and the international scheme (Visa/MC) MIF.
Eftpos, the Australian debit card scheme traditionally operated through a (bilateral) low cost *reversed-IF model* (paid to the acquirer). Prior to the interchange fee reform for eftpos in 2006, this fee was set at AUD 0.20 (0.12€[206]). Since then this fee has been capped at AUD 0.05 (0.03€ in 2006/ 0.04€ in 2011) per transaction based on: "the cost to the acquirer of authorisation and processing of the transactions".[207] The RBA also capped MIF on Visa debit, however at a rate (AUD 0.12), more than double that of eftpos. For completing a transaction, a cardholder would see no difference between the cheaper eftpos and international debit transactions. However from an issuer's perspective, the differential offered by international schemes might provide an incentive to migrate.

200 RBA Annual Report of the Payment System Board (2012) at: http://www.rba.gov.au/publications/annual-reports/psb/2012/html/dev-ret-pay-sys.html
201 See: Norges Bank (2012) Annual report on Payment systems 2011, chart 1.3, p. 7.
202 *Ibid*, table 14b.
203 OECD Roundtable on Competition in Payment Systems (2012). Note by the delegation of Switzerland, para 14
204 *Ibid*.
205 RBR Payment Cards Western Europe 2012.
206 ECB AUD-EUR exchange rate October 2006: http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-aud.en.html
207 http://www.rba.gov.au/publications/consultations/201206-rev-reg-frmwrk-eftpos-sys/pdf/201206-rev-reg-frmwrk-eftpos-sys-doc.pdf

In 2008 the international scheme debit cards accounted for 16% of the market based on number of transactions (vs 84% for eftpos). At the end of 2012 this figure increased to 26% of total number of transactions in favour of the international schemes. The increase in transactions over this period was 146% for international scheme debit transactions, and 90% increase for eftpos.[208]

Capping MIFs may still cause negative externalities for 'cheaper' or zero-MIF schemes. The domestic scheme was forced to change its business model by reversing and introducing a higher MIF to compete in the issuing business. The domestic scheme eftpos however has not yet raised their MIF to the same level as the international schemes in Australia. This may be due to the fact that they are driving merchant acceptance also in the smaller merchant segments.

However, Visa has been able to capture new cardholders through providing higher revenues to issuing banks, thus incentivising the issuing of Visa debit to cardholders. In general when a payment card is widely available, merchants may feel the need to accept these cards in order not to lose business. As the MIF (and subsequently the MSCs) is still relatively low in Australia, (large) merchants may not be bothered by the slightly higher cost of acceptance for Visa as compared to eftpos. Eventually though, it seems inevitable that the eftpos system will have to raise its MIFs to the same capped level as the international schemes.

This impact of regulating Ifs **on schemes highlights the need to consider the dynamics of markets when fixing caps. In essence, not banning Ifs for debit cards in Europe but fixing a cap would result, as shown by the Australian example, in current domestic schemes or potential new entrants with lower IFs to increase these to the level of the cap, resulting in a detrimental impact on retailers and consumers.**

Impact on consumers
The argument that cardholder and account fees will increase to the detriment of consumers following a reduction or elimination of IFs, needs to be evaluated in light of precedents.

In **Australia** it is clear that cardholder and account fees increased. However, according to recent empirical studies, there is no evidence to suggest that this is a direct consequence of the intervention. Shampine (2012) indicates that although popular perception seems to be that RBA's intervention caused a rise in fees, this is not clear from the data. Prior to the intervention fees were already increasing steadily, and continued to do so afterwards until reaching a plateau.[209] In any case the intervention seems to have led to a 38 basis point reduction in the 'two-sided price' (combined savings for consumers *and* merchants) as a percentage of purchase value.[210] This is confirmed in a report by TransAction (2011), where data shows that the growth rate of cardholder fees for credit cards *prior* to the reforms was higher than after (between 1997 and 2002: +218% and between 2003 and 2008: +122%).[211] Regarding reward programs, a reduction in the level of rewards on regular credit cards took place after the reforms, and credit card schemes have introduced a large range of premium cards

208 See: http://www.rba.gov.au/payments-system/resources/statistics/index.html
209 Available at: http://www.bankofcanada.ca/wp-content/uploads/2012/09/allan-shampine-paper.pdf
210 *Ibid.*
211 TransAction Resources, *Review of the impact of Australian Payment Reform*, Federal Reserve System Docket Number R-1404, p. 19.

with very high MIFs. This way they still stay under the weighted average cap overall but can retain MIF revenue by segmenting the market.[212]

In the **US**, following Regulation II, regulated banks have tried to raise cardholder fees (by introducing new monthly fees). This strategy to recoup lost IF revenue failed mainly due to the heavy uproar by consumers and politicians.[213] Other strategies by regulated banks included reducing the magnitude of their reward programs, or tightening the requirements for free checking accounts (this may not be a direct consequence of the MIF cap, as also an overdraft fee regulation was introduced).[214] A previous study by F.Hayashi from the Federal Reserve Bank of Kansas City concludes that payment card reward programs are inefficient. Social welfare is lower with the current reward programs than without them. This supports the idea that even if banks decide to offset revenue losses from IFs by reducing rewards, this might actually have a positive impact on social welfare.[215] Under another study[216], it has been estimated that merchant fees and reward are socially regressive since credit card spending and rewards are positively correlated with household income. It was estimated that on average, and after accounting for rewards paid to households by banks, the lowest-income household ($20,000 or less annually) pays $21 and the highest-income household ($150,000 or more annually) receives $750 every year. In turn, reducing merchant fees and card rewards would likely increase consumer welfare. It does not seem adequate to consider the alleged benefits of the so-called rewards to consumers for using specific (expensive) credit cards – or premium cards – as enhancing consumers' welfare in this assessment.

In Switzerland the decrease in credit card MIFs did not impact cardholder fees. Between 2005 and 2008, cardholder fees were actually reduced, leading to cumulated savings of around 200-250 million CHF to cardholders.217 This can be seen as evidence that in the Swiss market, the 'balancing function' of the MIF was ineffective and that the price level was still too high. This may also indicate a lack of competition in the Swiss banking sector.

In **Spain** average annual credit and debit card fees have risen after the caps had been introduced. The change in average fee per card per year increased by 6.18€ for debit cards, and 11.45€ for credit cards.[218] However data shows that the growth in adoption has not been affected by an increase in annual fees. Over the same period, the card portfolio increased by 6.5 million cards. As highlighted earlier, the increase in credit card growth was significantly higher than debit growth. This suggests that credit- cardholders are quite price inelastic or are willing to pay more for the ability to use credit

212 RBA Annual Report of the Payment System Board (2012), p.18.

213 Hayashi, F. *The New Debit Card Regulations: Initial Effects on Networks and Banks*. Economic Review, Fourth Quarter 2012, p. 103.

214 *Ibid*

215 Hayashi, F. *Do U.S. Consumers Really Benefit from Payment Card Rewards?* KCF. At: http://www.kc.frb.org/PUBLICAT/ECONREV/PDF/09q1Hayashi.pdf

216 Scott Schuh, Oz Shy, and Joanna Stavins'Who Gains and Who Loses from Credit Card Payments? - Theory and Calibrations', Federal Reserve Bank of Boston, Public Policy Discussion Papers, August 31, 2010

217 OECD Roundtable on Competition in Payment Systems (2012). Note by the delegation of Switzerland.

218 Juan Iranzo, Pascual Fernández, Gustavo Matías and Manuel Delgado: The effects of the mandatory decrease of interchange fees in Spain, 2012 (Study June 2012). See also the EPSM Market Research Newsletter December 2012 for a criticism of this study

cards in exchange for greater acceptance.[219] This may also be an indication of a lack of competition in the banking sector. Overall bank revenues seem to have increased, not remained constant with interventions on interchange fees. In fact, from 2005 to 2010, revenues of card issuers in Spain (interchange fees plus cardholder fees and interests income increased from € 2.9 billion (2005) to € 3.5 billion (2010), and per issued card (+ 5 € per year), whilst at the same time on the acquiring side, revenue increased b around € 1 billion in the same period under consideration.

According to the study by Valverde already quoted, a sector inquiry showed that increases in MIFs by 1 euro would only lead to about 0.25 pass-through of benefits to cardholders. Though the accuracy of this figure may be questioned, it does support the argument that MIFs are not fully passed on to cardholders. Therefore, a reduction in MIFs would not necessarily lead to higher cardholder fees in the same proportion.

In conclusion, it is often the case that pass-through of interchange is not identical on both sides of the market. Therefore MIF reduction pass-through is likely to occur at 100% on the acquiring side (usually a more competitive market), reducing merchant costs. On the issuing side however, as *inter alia* the Australian experience shows, the cost increase in cardholder fees was only between 30-40%. This leads to an overall reduction in the two-sided price (the sum of fees paid by cardholders and merchants).[220]

In other words, even if retail banking fees were to increase because of MIF reductions and decreased banking revenues – whilst as discussed above the overall impact of IF decreases on issuing and acquiring banks revenues is likely to be ambiguous, **they would increase less than the increase in merchants' savings.** Even if the pass through of savings from retailers to consumers is not 100%, **overall positive welfare gains to consumers could be reasonably expected due to the higher competition level on the retail side as compared to the banking side** overall, even if their magnitude may vary depending on the 'basket' of consumer purchases and the related pass through from one retail sector to another. In addition, **consumers would also benefit from new entry in the payments market.**

Effectiveness and transparency measures

The payment market is not competitive due to a series of commercial practises and rules. Also, any price regulation on MIFs can necessarily only cover a limited number of categories of transactions. If regulation is put into force, behaviour that is harmful to consumers and to market efficiency may continue in 'unregulated' areas and there is a risk that the market will shift to such areas. Regulatory action on interchange fees would cover all consumer debit card transactions and consumer credit card transactions, and e-payments and m-payments based on those – but not commercial cards and three party schemes. Transparency measures, including surcharging, shall be allowed on those transactions outside the scope of the regulation (the 'unregulated' area). This would be necessary to avoid that harmful practices persist there and to mitigate the risk that the market will shift to such areas. Surcharging shall not be allowed in the 'regulated area' - but only once the relevant provisions on

219 Santiago Carbó Valverde, Sujit Chakravorti and Francisco Rodriguez Fernandez*, Regulating Two-Sided Markets: An Empirical Investigation*, Federal Reserve Bank of Chicago Working Paper No. 2009-11, revised April 2010

220 See : Joseph Farrell, "Assessing Australian Interchange Regulation: Comment on Chang, Evans and Garcia Swartz", *Review of Network Economics*, Vol. 4, No. 4, 2005, pp. 359-363

interchange fees are implemented in full. Other steering measures including rebating and enabling measures including card identification and un-blending as further detailed in Annex 10 have to apply in their full force to all transactions.

Restrictive business rules (Operational objective 4)

3.1 Option 18 (No policy change)

This option involves no action at EU level, but rather relies on action by the market to achieve effective competition in the area of card payments. Because of the dominant position of card schemes, this option will most likely result in a continuation of the status quo. In this case, the following shortcomings can be identified:

(1) *Honour All Cards Rule.* Merchants will continue to incur higher costs due to the obligation to accept expensive / premium cards. All consumers, including the ones who do not hold payment cards, are therefore likely to continue paying for the cost of expensive / premium cards as merchants fold these costs into higher prices for their goods and services. Figures show that, for example, in Belgium the lowest interchange fee applied by a certain card scheme for a credit card payment is 0.55%, compared to the highest fee of 1.90% for a credit card of the same brand.[221] This results in a fee that is almost 3,5 times higher for the premium card than the one for the basic card. The difference is even bigger when comparing debit and credit card fees. In the United Kingdom we find that the lowest debit card fee of a certain card scheme is a fixed amount of 0.08 GBP whereas the highest fee for a credit card of the same brand is 1.90%. For a payment of £100, this results in a fee that is almost 24 times higher. Under option 18, this difference in fees would remain.

(2) *Non-Discrimination Rule.* The possibilities for merchants to steer consumers away from high cost payment instruments to cheaper electronic payment instruments are limited. In combination with the HACR, the impact of option 18 will be that merchants continue to incur higher costs for premium cards as they are unable to steer consumers towards the less expensive cards. As discussed under (1), this can lead to a fee per transaction of up to 24 times the lowest possible fee.

3.2 Option 19 (Voluntary removal of Honour All Cards Rule by card schemes)

A voluntary removal of the Honour All Cards Rule by card schemes would lead to the possibility for merchants to differentiate between the payment cards they wish to accept based on cost, type of clientele, or other possible criteria. Merchants could for example limit the choice of payment cards they offer to low cost payment cards only. If card schemes would then want to increase the attractiveness of their more expensive range of payment cards for merchants, they would have to do so by reducing the related cost for the merchant, for example by charging the card holder for premium benefits, or by increasing the benefits for the merchants. In either case, this will result in a more competitive environment as

[221] http://www.mastercard.com/us/company/en/whatwedo/interchange/Country.html

merchants will have more negotiating power. Option 19 will thus resolve shortcoming 1, but not shortcoming 2. At the same time, it is unlikely that card schemes would voluntarily decide to remove the Honour All Cards Rule.

The cost of removing the HACR by card schemes lies with the issuers, acquirers and the card schemes themselves. As the removal of the HACR allows merchants to choose which payment cards to accept, it can be assumed that in the majority of cases, merchants will opt for the lower cost variants. Their total costs, in the form of Merchant Service Charges (MSC) will then decrease. As the MSC is divided between the issuer (MIF), acquirer (service fees) and card scheme (scheme costs), all three stand to lose. Possibly this will be compensated by higher fees in other areas, which might directly impact consumers (e.g. higher costs for consumers related to payment accounts). It is uncertain whether lower costs for merchants will be passed on to consumers. This mainly depends on the level of competition in the relevant retail market segment. To determine the potential cost savings for merchants (or costs for issuers, acquirers and card schemes) is quite complex as it depends on the types of cards merchants will wish to accept once the HACR has been removed, and what the related MIF is. It can be assumed that larger retailers are more likely to continue to accept a wide range of payment cards, whereas smaller merchants might only accept the least costly ones. However this also depends on the sector the merchant is working in.

Based on ECB statistics (Cf. Table 54) the total value of card transactions in the EU amounted to around €1,9 trillion, 62% of which is transacted through debit cards (38% credit). On the basis of the Total EU MIF values (Table 54), one could estimate an average EU MIF rate for debit cards at 0.39%, for credit cards at 0.78%.Due to reverse competition, these average MIF rates are however expected to increase over time in the absence of intervention on interchange fees. The savings under such a status quo scenario are therefore to be taken with caution, as they would decrease over time with higher average (and possibly converging) MIF rates, and should be seen as maxima.

In a **conservative scenario**, removal of the HACR could lead to a shift of 5% in the split between debit and credit cards to 67% – 33%. Costs for merchants would then decrease as 5% of all transactions would incur a lower MIF than before (and assuming a perfect pass-through – MSCs would be lowered equally). The cost savings for merchants would amount to 5%*€1.9 trillion *(0.78%-0.39%) = around **€370 million**.. If caps for debit cards and credit cards of respectively 0.2% and 0.3% were to materialize, and under a similar shift of 5% of the split between debit and credit cards, this would result in cost savings of 5%*€1.9 trillion*(0.3%-0.2%)= around €95 million – although this is a static scenario under which it is assumed that the number of transactions remains constant whilst they are expected to increase with the caps in place. This conservative scenario is however more likely under such caps in place since the shift from credit to debit cards could be limited as the MIF differential is small.

In a very **optimistic scenario**, one might assume a shift of 20% in the split between debit and credit cards to 82% – 18%. The potential gain for merchants would than amount to 20%*€1.9 trillion *(0.78%-0.39%) = around **€1.5 billion**. Under caps for debit cards and credit cards of respectively 0.2% and 0.3% and assuming the number of transactions remains constant, the potential gains to merchant would be around €384 million. If a ban on MIFs for debit cards is in place, a gain at least equivalent to between €370 million and €1.5 billion is to be expected (with the latter figure being more likely), as transactions including with debit cards are more likely to increase proportionately than under a cap of 0.2% for debit cards, and a shift of 20% in the split between debit and credit cards is more likely as the MIF differential is substantial.

It must however be ensured that a voluntary removal of the HACR should not affect the Honour All Issuer Rule but only the Honour All Products Rule. Removing the Honour All Issuer Rule would give merchants the possibility to refuse payment cards based on the issuer which could possibly lead to discrimination of cardholders on the basis of the country in which their card was issued.

3.3 Option 20 (Prohibit (part of) the Honour All Cards Rule)

While this option would have the same general effect as option 19, i.e. the possibility for merchants to differentiate between the payment cards they wish to accept, the main advantage of this option is that it ensures the certainty and comprehensiveness of the measure as well as its timely execution. As under option 19, prohibition should be limited to the Honour All Products Rule while the Honour All Issuer Rule should stay in place in order to avoid discrimination on the basis of the cardholder's provenance. Option 20 would solve shortcoming 1 but not shortcoming 2. The costs related to this option are similar to those described under option 19. Both the benefits and costs would materialise quicker and more comprehensively than under option 19.

Table 63 - Summary of the impact for options 18 to 20

Policy option	Description	Effectiveness	Efficiency
Option 18	Baseline scenario	0	0
Option 19	Voluntary removal HACR	(+)	(+)
Option 20	**Prohibition HACR**	**(+)**	**(++)**

Table 64 - Summary of the impact for main stakeholder categories (options 18 to 20)

Policy option	Description	Consumers	Merchants	PSPs	Card Schemes
Option 18	Baseline scenario	0	0	0	0
Option 19	Voluntary removal HACR	(+/-)	(+)	(-)	(-)

Option 20	**Prohibition HACR**	**(+/-)**	**(++)**	**(-)**	**(-)**

Diverse charging practices between Member States

4.1 Steering practices (Operational objectives 4,5 and 9)

4.1.1 Option 28 (No policy change)

No policy change regarding the diverse charging practices between Member States implies that no changes would be made to the PSD in this regards. Consequently, merchants will continue to have the possibility to use surcharging (as well as rebating or other steering measures) for the use of a given payment instrument, but only in those Member States that have not prohibited or limited surcharging at national level. The shortcomings that can be identified following this option are the following:

(1) *Divergence of charging practices will remain.* As the current situation allows for a national approach, this has led to differences in charging practices between Member States. Option 28 will not lead to harmonisation of these practices.

(2) *Steering will not be efficiently used.* Without any policy change, the current practices will remain and consumers will not be efficiently steered to the most cost-efficient payment instruments, as is generally the case today.

(3) *Incentive to use cash.* In case merchants use surcharging, consumers in an offline environment might be incentivised to use cash. Since surcharging may also lead to increased card acceptance from merchants, in particular for transaction amounts below a threshold under which alternative payment instruments (e.g. cash) are less costly, in case merchants are not allowed to use surcharging mechanisms, they themselves will have an incentive to let their customers pay with cash or the most efficient payment method (e.g. debit cards above a certain threshold).

(4) *Possibility for merchants to use surcharging as a way to obtain extra revenue.* If no action is taken, it is difficult to prevent some merchants from charging more than what is needed to cover the costs for using a certain payment instrument. This possibility may be influenced by the degree of competition in the specific sector, and the costs of alternative payment instruments i.e. high costs of cash above a certain threshold.

4.1.2 Option 29 (Prohibit surcharging in all Member States)

Prohibition of surcharging in all Member States would harmonise the current diverging practices. If fees (MIFs) paid by merchants to their acquirers remain the same, this option may create an incentive for merchants to promote the use of cash. Also, as merchants will not have an appropriate steering mechanism, they might choose not to accept certain payment methods they could otherwise accept. In addition, merchants who previously did surcharge might be forced to include the pricing of all payment instruments into their final retail prices. All consumers would then pay more, even if they pay with cash or other more efficient means of payment. A study by London Economics and iff emphasizes that "it is important to note that the surcharge cost does not reflect the savings that consumers may make in the absence of surcharging as the merchants applying surcharges may increase their price to recoup the costs they incur in accepting certain instruments. Obviously, the precise response of merchants in such a situation will depend on the state of competition of the sector in which they operate and whether the surcharge reflected the costs faced by merchants when accepting a card payment or was at least in part a source of profit for merchants"[222]. If surcharging is prohibited, some sectors will be impacted more than others. The sectors that use surcharging the most are the travel, hotel and hospitality industry, the recreation and entertainment and, to a much smaller extent, the catering and restaurant business[223]. It is in these sectors that 'expensive' cards are being used most[224], such as commercial cards, third party credit cards and premium credit cards. These sectors will be impacted most if surcharging is banned. Although option 28 will solve shortcoming 1 and 4, it doesn't solve the other two shortcomings.

Based on a study by London Economics-iff[225], the total value of surcharge for these sectors where surcharging is most used, adds up to over €731 million. This total aggregate value however does not indicate how much relates to 'true' surcharging, when merchants recover the costs of specific payment instruments and pass on these savings to consumers through retail prices, and how much corresponds to extra revenues from retailers surcharging over the costs of payment instruments and/or not passing on the savings generated to consumers through retail prices. A prohibition on surcharging would therefore initially lead to 'costs' of €731 million for those merchants now using surcharging EU wide, although the costs corresponding to 'true' surcharging will then be recouped through relatively higher retail prices *ceteris paribus*, and only the ones corresponding to extra revenues would be 'lost'.

In addition, a prohibition would also impact negatively all merchants' – including those not surcharging - bargaining power vis-à-vis acquirers to get lower MSCs and their ability to steer consumers towards more efficient means of payment. This could result in a more costly overall payment instruments mix, as the use of relatively more expensive payment instruments will not be discouraged through surcharging, and their costs (MSCs) to retailers might increase due to the latter's more limited negotiating power.

Table 65 - Total value of the surcharge (EUR millions), by country and sector

Country	Catering/	Entertainment /	Retail	Travel/Hotel/

222 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p75

223 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p74

224 Information gathered internally by Commission Services in DG Competition.

225 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (November 2012) p75

	Restaurants	Recreation		Hospitality
Belgium				0.24
Denmark	4.44		0.31	0.79
Finland				0.10
France	0.05	2.38	3.44	5.17
Germany	2.46	17.70	5.92	49.45
Ireland	2.19	0.14	1.53	42.69
Netherlands	12.16	3.06	1.63	19.87
Spain	4.16	21.24	9.80	60.07
UK	5.53	11.64	22.70	398.59

Source: Study on the impact of the PSD and Regulation 924/2009 for the European Commission[226]

4.1.3 Option 30 (Allow surcharging in all Member States)

By allowing surcharging in all Member States, option 30 would also address shortcoming 1. All merchants would then be able to use surcharging to steer consumers to the most cost-efficient payment instruments. It should however be noted that the existence of the Honour All Cards Rule and the blending of fees creates difficulties for merchants to efficiently steer consumers. As the rule obliges merchants to accept all cards within a brand and at the same time the fees charged to them for the use of these cards are usually blended, it becomes unclear for merchants what the actual fee for the use of each card is. Therefore it is unsure whether option 30 would actually resolve shortcoming 2, unless the Honour All Cards Rule is partly or completely prohibited and the fees for all cards are priced transparently. In addition, the existence of surcharging might create an incentive for consumers to use more cash in an offline environment– but may also lead to increased card acceptance from merchants in particular for transaction amounts below a threshold, and could also result in certain merchants using surcharging as a way to obtain extra revenue (unless surcharging is capped for instance at the MSC level by legislation). Shortcomings 3 and 4 might therefore remain.

When reflecting on the overall costs and benefits of this option, it appears that if certain merchants were not surcharging before, it is likely that their payment costs were then integrated in their retail prices – on condition that they already accepted card payments. On account of steering consumers to less costly means of payment, and to higher negotiating power towards acquirers, costs will go down for these merchants. The extent of the pass-through of the cost-savings into (lower) retail prices will determine the extent to which consumers will benefit from these cost savings. In addition, consumers might continue to be faced with excessive surcharging by some retailers.

4.1.4 Option 31 (Oblige merchants to always offer at least one "widely used payment means" without any surcharge)

226 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p75 Source: Analysis of surcharge survey

Option 31 should be seen in combination with options 28 or 30. As discussed under both options, allowing surcharging might create an incentive for consumers to use more cash – whilst surcharging might also lead to increased card acceptance from merchants in particular for transaction amounts below a threshold. This option would ensure that merchants offer at least one widely used payment means to consumers, which cannot be surcharged. Consumers will then have an alternative to cash, without being surcharged. This option would therefore solve shortcoming 3 - subject to the conditions below.

The cost for merchants depends on the fees they pay for the payment instrument they cannot surcharge. Ideally there should be a low fee for this payment instrument. If this is the case, this should allow consumers to use certain payment cards without paying any additional charges. Allowing surcharging for all other (more expensive) means of payment would make it possible for merchant to accept other methods of payment without incurring high costs and passing these on to all consumers including those using cheaper payment instruments in the form of higher overall retail prices. In addition, it would steer consumers towards using the 'free' payment method (resulting in cost savings for both consumer and merchant). However, the main drawback of this option is that such a pan-European widely available payment instrument currently does not exist.

4.1.5 Option 32 (Ban surcharging for some payment instruments and allow for others)

Banning surcharging for only some payment instruments would lead to a situation where several payment instruments, besides cash, are accepted by merchants without surcharging. This would take away the incentive for consumers to choose cash in an offline environment, as some payment cards will be good alternatives – but could also result in a more limited acceptance of cards by (some) merchants. Consequently, option 32 would solve shortcoming 3 to some extent. At the same time merchants could surcharge the more expensive payment instruments in order to steer consumers to the most cost-efficient alternatives. In order to avoid the increase of prices by merchants for their goods and/or services to cover the costs of payment instruments they cannot surcharge, this option should be combined with an option that addresses the current level of the fees for these payment instruments. In principle, to minimise market distortions which would impact negatively card acceptance and to ensure a favourable payment instruments mix conducive to lower costs for society, the payment instrument for which surcharging is banned should bear a low interchange fee.[227] Surcharging should therefore only be banned on the payment instrument(s) for which interchange fees are regulated, and only when the relevant provisions are implemented in full. Other steering measures including rebating should apply with their full force.

[227] The Office of Fair Trading in the UK highlights in its response to the Which? super-complaint that *'To address the concerns raised in the super-complaint we are recommending that the Government introduce measures to prohibit retailers from surcharging for debit cards to ensure a meaningful and consistent solution across the economy'*. Cf. http://www.oft.gov.uk/OFTwork/markets-work/super-complaints/which-payment-surcharges,

Merchants would then incur only very low costs for some payment instruments and would be able to cover their costs for the more expensive payment instruments by surcharging them. In addition, merchants would benefit from lower costs associated with a more favourable payment instruments mix, as acceptance and usage of the specific instrument would increase, and cash usage decrease. As this option would address surcharging in all Member States in the same way, it solves shortcoming 1. At the same time it gives merchants the possibility to efficiently steer consumers thus addressing shortcoming 2. As surcharging would continue to be allowed, shortcoming 4 would only partly be addressed.

Costs might be initially incurred because of the need to invest in the identification of payment cards although these costs are expected to be limited. Without this, it would be impossible for merchants to differentiate between cards. However, as merchant costs in general will go down, and regulated payment instruments will not be surcharged, costs for consumers are likely to go down as well. This is only the case if current fees are addressed in combination with this option, and if rebating is encouraged together with the ancillary measures detailed under Annex 10. Option 32 combined with lower fees would imply a cost saving for consumers of at least a portion of the EUR 700 million identified above as there would be no more need for merchant to surcharge or increase prices to recover their costs for the specific instrument(s) on which a surcharge is not allowed. Surcharging will however remain possible for high cost payment cards. The total cost saving for consumers and merchants is much higher as all merchants who currently do not surcharge, will benefit from lower fees and part of this will be passed on to the consumers to some extent (depending on the price competition in the sector). In case current fees are not addressed, option 32 would lead to additional costs for merchants and will call into question this virtuous circle. For option 32 to be operational, it has also to be ensured that the Honour All Cards Rule is partly or completely prohibited and the fees for all cards are priced transparently.

Table 66 - Summary of the impact for operational objectives 1 and 5 (options 28 to 32)

Policy option	Description	Effectiveness	Efficiency
Option 28	Baseline scenario	0	0
Option 29	Prohibit surcharging	(+)	(+)
Option 30	Allow surcharging	(+)	(+)
Option 31	Widely used payment means without surcharge	(-)	(-)
Option 32	**Ban surcharging for some payment instruments**	**(++)**	**(++)**

Table 67 - Summary of the impact for main stakeholder categories (options 28 to 32)

Policy option	Description	Consumers	Merchants	PSPs	Card Schemes
Option 28	Baseline scenario	0	0	0	0
Option 29	Prohibit surcharging	(-)	(-)	0	(+)
Option 30	Allow surcharging	(-)	(+)	(-)	(-)
Option 31	Widely used payment means without surcharge	(+)	(+)	(-)	(-)
Option 32	**Ban surcharging for some payment instruments**	**(+)**	**(-)**	**0**	**0**

Legal vacuum for certain payment service providers

5.1 Access to information on the availability of funds for new card schemes and third party providers (TPPs), including payment initiation services, account information services and other equivalent services (operational objectives 3,4, 6 and 7)

5.1.1 Option 33 (No policy change)

Under option 33, no action at EU level is envisaged.

As regards access to the information on funds, third party providers not servicing payment accounts themselves (such as new card schemes, payment initiation services, account information services and others) need prior information on the availability of funds on the consumer's payment account. They need to receive information on payment accounts held by PSPs, both for the authorisation and for the guarantee of a payment transaction. Option 33 would leave it to the account servicing PSPs to decide whether third parties will receive information on the availability of funds on a payment account, even if the holder of the account would give its consent. As the restriction of this information could seriously obstruct the business model of TPP, option 33 does not seem to eliminate barriers for market access for card and internet payments in any way.

The shortcomings that can be identified are:

(1) PSPs will remain free to refuse access to information on the availability of funds on payment accounts. This will essentially cause the existing barrier for market entry to continue to exists and hamper the emergence and operations of TPPs.

(2) Possible lack of data protection measures in case third parties are allowed to access information on the availability of funds on payment accounts in an unregulated way.

(3) Unclear liability in case third parties are allowed to access information on the availability of funds on payment accounts in an unregulated way. If there is no clear

definition of the liability repartition, there is less incentive for both parties (PSPs and third parties) to provide a sufficient level of security or to solve cases of fraud.

If third parties could access the necessary information, there will be a downward pressure on transaction costs as the result of competition from new players, which would vary depending on the extent of market entry and the relative market share gained by these new entrants. The level of the potential savings would also vary depending on the Member State(s) considered. For instance, if we compare Belgium and France where the current average transaction costs are about 2-3 times higher than in Belgium alternative solutions for French retailers would imply a higher reduction in transaction costs in France than in Belgium, benefiting both consumers and merchants. However, the exact impact is difficult to quantify ex ante and other measures envisaged including the legislation of Interchange Fees would also result in costs savings independently of whether and to which extent market entry by third parties .

As regards the issue of including the TPPs in the scope of PSD, no action at EU level would mean in practice leaving the decision to Member States. For instance, in some Member States, such as Spain and Sweden, competent authorities consider that TPPs provide to a certain extent payment services, although do not fall exactly under the scope of the PSD. Therefore, they granted licenses to some TPPs. However, this approach is not shared by the vast majority of competent authorities in other Member States.

At the same time, new service providers would still exist and try to enter the new markets, as they are able to offer to merchants a less expensive and more integrated payment solution than a card payment. This approach has a number of shortcomings:

(1) *Legal uncertainty for TPPs and entry on the market*. The TPPs would provide their services in a grey zone, regulated and supervised only to some extent in a very limited number of Member States. This could lead to different risks, e.g. as regards the security of transactions and data protection. In some countries, the TPPs' activity could even be considered as illegal.

(2) *High prices for merchants*. The competition on this market would remain lower than if TPPs were registered as PSPs and, as a consequence, the e-merchants would not benefit of decreased prices.

(3) *Insufficient protection for consumers*. The consumers, who are direct or indirect users of the TPPs' services, would not benefit of the protection measures in the PSD.

The only stakeholders that would benefit from this option would be the account servicing banks, which would promote their own payment solutions, in particular payment cards, offering them high IF income.

Hence, a "no policy change" would not be effective in achieving the objective of eliminating barriers for market access for new service providers and regulating the functioning of actors already on the market.

5.1.2 Option 34 (Define the conditions of access to the information on the availability of funds, define rights and obligations of the TPPs, clarify the liability repartition)

Allowing third parties to request and obtain real-time information on the availability of funds on a payment account, assuming the consent of the account holder and given that a defined set of data protection requirements is met, would eliminate a key barrier for third parties' market access. It would ensure that third parties are legally allowed to obtain the necessary information for initiating the transaction or giving a payment guarantee to the merchant, provided that they can ensure a necessary data protection level. The establishment of a set of security recommendations to be applied by TPPs and banks servicing the accounts will contribute to fraud reduction and will give banks and consumers guarantees that their assets and sensitive data are safeguarded. These security rules will notably take into account the security recommendations on internet payments, established by the ECB[228]. As a result, consumer confidence in the payment system in general will increase and the third parties will be able to access the market.

The inclusion of the TPPs under the scope of the PSD would mean that the consumers that use the services of a TPP would benefit from the same high degree of security and protection provided for in the PSD. The obligation for the TPPs to explicitly inform consumers about the information they access would come on top of the consumer protection provisions already existing in the PSD. Furthermore, extending rights and obligations of the PSD to TPPs and defining a balanced liability repartition between them, banks and consumers would provide a legal certainty for all parties. Importantly, PSPs and TPPs would be obliged to take full responsibility for the respective parts of the transaction that are under their control (which is in line with the established PSP principle and the existing, but informal arrangements in the TPP practice).

As a result of this option, it is probable that a large majority of some 20 TPP companies already operating on the market in 8 Member States will ask for a license and commit to comply with the rights obligations under the PSD[229]. At the same time, new players that were waiting for more legal certainty would be able to enter the market. As they will have a clear legal status it will be easier for them to establish business plans and to convince investors of their business potential. A clear benefit of this option would be the entry and the development on the market of quality and responsible players and the increase in the competition in the market.

This option will clearly benefit the consumers, who will gain a new payment solution, which is easy to use, secure and does not require the possession of a credit card to do the online shopping. This will benefit some 60% of the account owners in the EU who do not possess

228 http://www.ecb.int/pub/pdf/other/recommendationssecurityinternetpaymentsoutcomeofpcfinalversionafterpc201301en.pdf

229 The consultations have shown that virtually all TPPs are very keen to be included in the scope of the PSD.

credit cards. All the legal protection of the PSD that applies to other payment solutions would apply and the data protection concerns will be addressed.

The merchants, even the small ones, which have less negotiation power, would clearly benefit from an additional payment solution, less expensive and more tailor-made for their needs. The resulting decrease in their costs should be in part transferred to the customers. As described below, transaction costs for merchants would decrease, although the exact impact is difficult to quantify since it would depend on the extent of market entry and the relative market share gained by new entrants, as well as the current level of transaction costs in the Member State considered. Both merchants and consumers stand to gain from this.

On the costs side, there would be an additional, though not significant, administrative burden for competent authorities which will have to license and supervise new service providers. A learning effort will be also necessary since the functioning of these new service providers would be most of the time new for the authorities.

Some banks would possibly need, depending on their current infrastructures, to invest in additional security measures. However, much of these investments would have been anyway necessary, in order to comply with the recent security recommendations of the ECB on the internet payments. Given that the information accessed by TPPs is in most cases provided by the account servicing PSPs to the existing card schemes (which are essentially third parties, too) it can be assumed that the incremental cost related solely to the TPP access would be limited.

Finally, for the existing and new third party providers, a possible investment to comply with data protection measures, security requirements and increased consumer protection would be needed.

<u>Estimation of the merchant savings generated by using third party providers against traditional credit cards for payments on the internet</u>

Based on the population of Member States and the percentage of the population making purchases on the internet on each Member State, we calculated that in average almost 165 mil. Europeans made purchases on the Internet in 2011 (this figure does not include Czech Republic, as no data were available). Knowing the figures of the average expenditure per internet user in 19 Member States and the average amount of a transaction in a web shop of 110 EUR in the Netherlands, used as an example, we estimated that in average an Internet user makes around 8 purchases on the Internet per year.

EU population making purchases on the Internet = 165 mil. / year

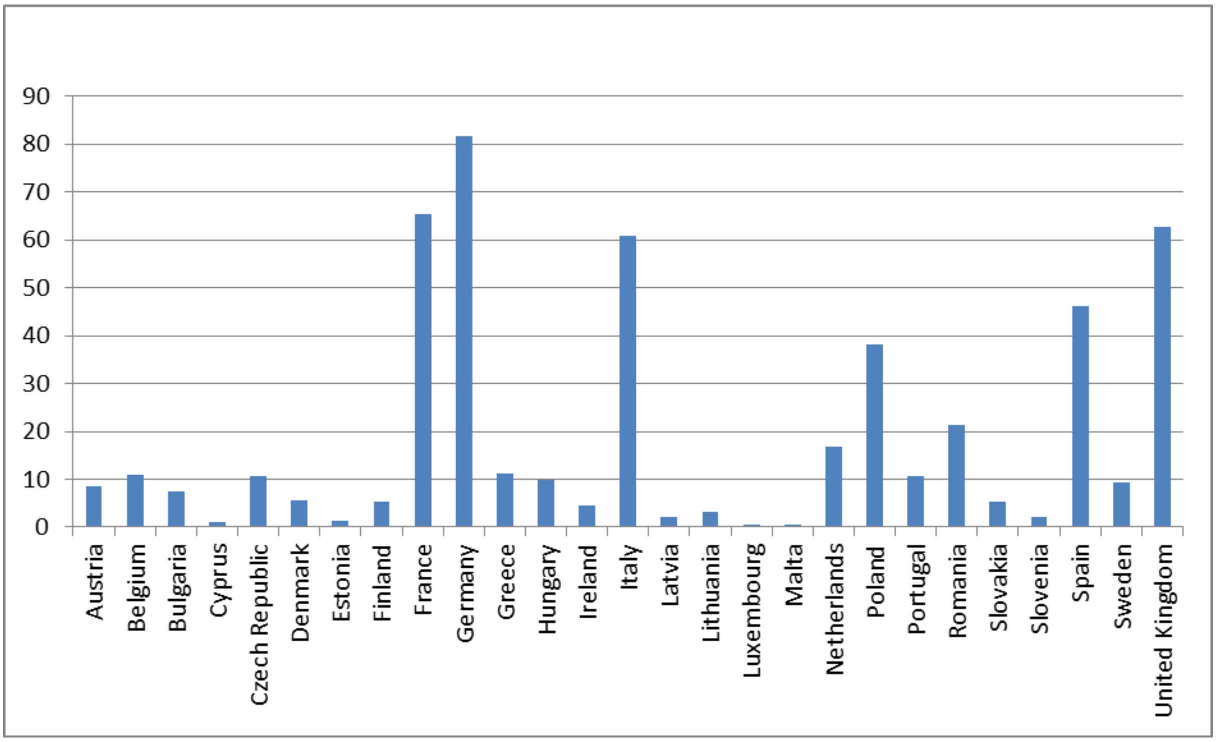
Average number of transactions on the Internet = 8 / year / person

Annual number of transactions on the internet in the EU = 165 mil. * 8 = 1 320 mil. / year.

This estimation is rather conservative as information provided by TPP's in the Netherlands and Germany estimate the market size at around 100 mil / year in the Netherlands and respectively 500 mil. / year in Germany.

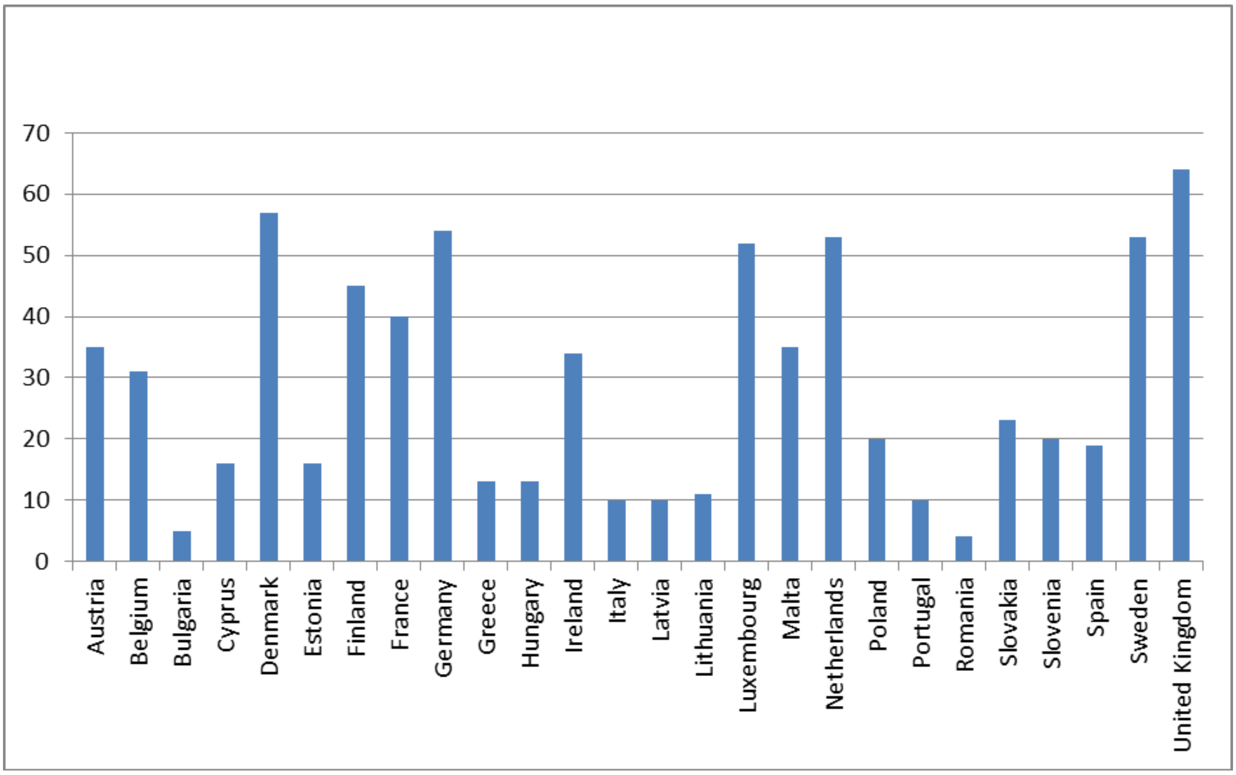
We used the fees applied for a transaction on the internet with a credit card or with a TPP service provider in the Netherlands as a benchmark, as this market is quite competitive for credit cards and the market for payment initiation services is well developed. In the Netherlands, the fees for a transaction on the Internet with a credit card range from 1.65 EUR to 3 EUR and the fees for a transaction on the Internet with the TPP range from 0.35 to 1 EUR. By extrapolating these fees to the number of Internet transactions in Europe (1 320 mil. / year), the savings generated for merchants by the use of payment initiation services instead of credit card would range from a minimum of 863 mil. EUR to a maximum of 3 520 mil. EUR / year. These savings would clearly compensate the additional supervision costs incurred by the competent authorities, generating net societal benefits. The impact of regulating interchange fees to the level of 0.3% for credit cards cannot be accurately assessed, as it would depend inter alia on the current level prevailing in the Member State considered, to the growth potential of internet transactions and of TPPs in the respective national markets. Under such a dynamic assessment, and considering the limited development of TPPs in most Member States, it can be assumed that the savings underlined above are at least sustained once caps on interchange fees for credit cards are in place. For instance incentives for PSPs to 'block' TPPs will decrease when interchange fees for credit cards are capped as more limited revenue streams would be at stake.

Figure 9 – Total population (millions) for 2011



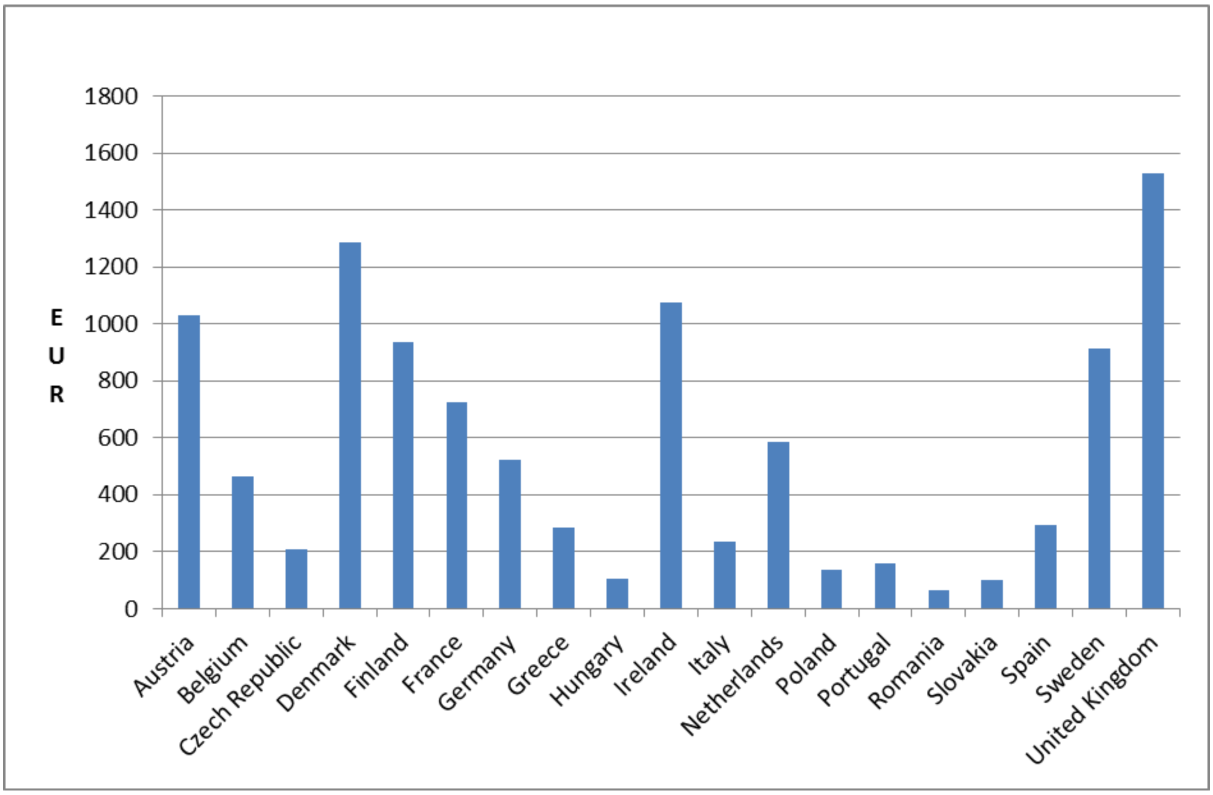
Source: The World Bank

Figure 10 – Internet Purchases by Individuals (% of population) in 2011



Source: Eurostat

Figure 11 – Average Expenditure per Internet User in 2011



Source: IMRG International estimates and analysis

5.1.3 Option 35 (Allow TPPs access to the information on the availability of funds under a contractual agreement with the account servicing bank)

This option should be seen as a possible complement to option 34. Under it, information on the availability of funds on a payment account would become available for TPPs under an additional condition of concluding a mandatory contract (either a framework contract or an individual contract with a specific bank) with the account servicing PSP and with the account holder's consent.

This option, known also as the dual consent approach, is the one supported by many stakeholders from the banking industry. Under it, the TPP should either sign an individual contract with the bank servicing the account of the consumer or accept the terms and conditions of a framework contract proposed by the banks. The consumer would still have to give its explicit consent for the access. The additional benefit of this solution, in comparison with option 34, could possibly be a better technical and operational integration of services provided by TPP with the account, which could provide a better consumer experience and better resolution of any potential payment difficulties, if such arise.

Such approach means that the account servicing PSPs will be able to impose additional requirements on TPPs, leaving it to the PSPs to ultimately decide whether a third party will be able to access the information on availability of funds. Given the commercial interest for PSPs to promote the use of credit cards for internet payments, unless remuneration comparable to MIF revenues is offered by TPPs, this option might not have the intended effect of increasing the competition and therefore lowering costs of the transactions for the users. It would, on the other hand, give account servicing PSPs the possibility to refuse cooperation with a third party based on requirements that they have set themselves.

This option could therefore undermine some potential benefits of option 34.

The costs of applying this option are likely to be in line with the costs already sustained under option 34, as they mainly concern the technical modifications needed (if any) for sharing information on availability of funds. The costs for stakeholders could however be much higher, notably for third parties as well as merchants. These costs would depend on the requirements that PSPs would be able to specify in the obligatory contracts, notably as regards remuneration for the access rights. Accordingly, benefits for merchants (costs, convenience) and consumers (alternative payment solution, no additional payment costs) following this option would be most probably less important than if only option 34 is applied.

Table 68 - Summary of the impacts - Access to information on the availability of funds for new card schemes and third party providers (options 33 to 35)

Policy option	Description	Effectiveness	Efficiency

Option 33	Baseline scenario	0	0
Option 34	**Define conditions of access to payment accounts, rights and obligations of the TPPs and the liabilities**	**(++)**	**(++)**
Option 35	Contractual agreements	(-/--)	(0/+)

Table 69 - Summary of the impact for main stakeholder categories (options 33 to 35)

Policy option	Description	Consumers	Merchants	TPP's	Banks
Option 33	Baseline scenario	0	0	0	0
Option 34	**Define conditions of access to payment accounts, rights and obligations of the TPPs and the liabilities**	**(++)**	**(+++)**	**(++)**	**(0)**
Option 35	Contractual agreements	(0)	(--)	(-/--)	(++)

Scope gaps and inconsistent application of the PSD

6.1 Negative Scope of the PSD (Operational objective 7 and 9)

6.1.1 Option 36 (No policy change)

Under this baseline option, the four discussed exemptions in the PSD (commercial agents, limited network, telecom and independent ATMs) would remain unchanged. In consequence, as discussed in chapter 3.2.3, there will be limited PSU protection in numerous cases (i.e. for consumer funds under commercial agent exception, consumer rights under other exceptions) and a distinctly unlevel playing field among PSPs, with possibly even much greater part of PSP services being offered outside the scope of the directive. Moreover, technical and business innovations (e.g. new forms of distribution based on commercial platforms and limited network concepts, expansion of mobile and online payment wallets, further expansion of ATM networks operating outside the scope of PSD) would be further undermining any efforts of homogenous application of negative scope exemptions based on current wording. This would lead to further regulatory arbitrage and the phenomenon of shopping for least demanding regulatory framework within the EU that could be observed among some categories of PSPs.

While efforts aimed at a more comprehensive, EU wide approach and a common interpretation of exemptions and of the regulatory difficulties could be undertaken by Member States, including under auspices of an ad-hoc working group of the Payments Committee, the possible results would be mitigated at best, due to the wording of these exemptions in the law itself, which is too general, does not address certain issues or is no longer up-to date. Consequently, any recommendations would be not only non-binding, but also limited by the wording used in the law. Moreover, as PSD allows much leeway for market operators, including no need for even a cursory check with the authorities whether the offer falls within the exception, the application of any consistent guidelines would be also seriously hampered.

6.1.2 Option 37 (Update/clarify scope of exclusions)

Under this scenario, the four exemptions would be subject (separately from each other) to the comprehensive update, including clarification or introduction of necessary definitions, explanations in recitals and, if found necessary, through addition of an annex to the PSD with further guidance.

The benefit of this approach is the possibility to define anew the scope of these exemptions, taking into account the knowledge accumulated by the authorities, developments in these fields and the market experience on their functioning. The main rationale for the exclusions is to absolve from the full force of the regulation those limited fragments of the market where the general rules would be too onerous or too rigid, preventing the market from development or forcing the existing niche products, important for some categories of PSUs, to disappear. However, the exemptions are not intended to be used as an excuse to avoid supervision, prudential requirements and ignore PSUs protection rules, leaving whole areas of the payment market to be completely unregulated, subject to possible abuses or unprotected insolvencies. Neither are the exemptions intended to facilitate insufficient fund protection and other PSUs detriments.

Thus, in case of **commercial agents**, the law would clarify that this exemption is intended only for legal persons who use an agent as their representative. It should not be used by agents working on behalf of consumers or to exempt escrow-type services (a third party between a buyer and a seller – e.g. a consumer and a company – who receives the funds from the buyer and keep them until buyer receives the goods or services from the seller) from general PSD framework. The main benefit of such approach would be to limit the risks and increase the rights and protection of PSUs (in this case, consumers) – e.g. in cases when the agent becomes insolvent and the consumer may face not only the loss of funds but still the obligation to pay the seller for the contracted products. Another obvious situation is the prevention of fraudulent activities of agents.

The impact of such refocused scope of this exemption would affect those commercial agent activities that clearly focus on management of financial flows between buyers (consumers) and sellers on a professional basis and should not have been exempted from the PSD. In the great majority of cases, such agents are large commercial platforms, handling millions of transactions every month and of strong financial standings, able without difficulty to obtain a PI licence. However, it is not possible to quantify the impact on them.

As regards **limited network** exemption, an improved definition would comprise a limitation to the specific volume of transactions or a maximum transaction value, specify that a limited network should be strictly focused on a very limited range of goods and services[230] and exclude the possibility of creating virtual wallets that regroup offers of limited network providers, thus creating a general purpose payment instrument and circumventing the law. The benefit of this scenario consists in covering by PSD protection a range of payment instruments and methods that go much beyond strictly defined payment service in a limited network and are also offered to consumers with various limitations on e.g. reimbursement, refund, validity, restricted liability in case of unauthorised transaction and consequently, offer reduced consumer protection. Examples of such products are store cards linked with credit lines, reloadable instruments or instruments linked to a periodical, automatic payment (e.g. to a direct debit). The difficulty would be primarily in defining the border between a limited and a wide network, e.g. whether a store credit card of a retail chain that could be used in hundreds of shops in different countries, should be covered by an exemption.

The main impact of a new, more focused definition would be on these service providers who built extensive payment operations based on very broad interpretation of the exemption or purposefully use it to avoid regulation. As a result they gain competitive advantages over registered PSPs and lower their business costs, also at the expense of consumer protection. As in the case of other discussed exemptions, it is not possible to quantify the impact as authorities lack any transactional details about such operators. However, their assessment is that, in many cases, non-regulated entities managed to gain much larger share of the market than their regulated competitors.

Telecom exception would be reformulated to focus the exemption on the services related purely to telecommunication services (calls, SMS, internet access) or being in a very close relation to telecommunication business (such as e-mailing, virus-protection, purchase of a phone through a package subscription). A purchase of content to which the mobile network operator has acquired service provision rights (i.e. sells them in its own name) and that could be consumed through the use of a mobile phone could be also included. The benefit of such scenario would be to limit the scope of the exclusion to the typical telecom-related payment transactions. As a result, payment transactions when a mobile network operators sells goods and services on behalf of other companies or when the mobile phone is used as a device that only facilitates payment and delivery, but is not needed for the consumption or where the phone is used only as an interface between digital and real world would not be covered by the exemption and subject to PSD.

The main impact of such definition would be on mobile network operators. They would no longer be able to sell gods and services as a simple store or provide payment services linking digital and real world functions without possessing a PI license and being subject to all

230 Limited purpose, e.g. a petrol card, a cinema entrance voucher, a restaurant ticket, but not e.g. a leisure card, regrouping hundreds of different entertainment services or a commercial platform voucher, allowing for purchases of goods and services of many different merchants.

obligations of a PSP. This would be in favour of PSUs[231], protecting their rights and would be also beneficial for the position of third party providers of content.

Finally, for **independent ATM providers**, the law would become much more specific and indicate that the exemption only applies to stand-alone ATMs, not connected in a network and not acting on behalf of other PSPs or providing them any other payment services as a third party. This would allow for distinction between truly stand-alone ATM providers and other providers that operate networks of ATMs or enter into contractual agreements and provide payment services to other PSPs, thus clearly circumventing the PSD rules. This would also significantly limit the non-regulated part of the market and protect the consumer, in particular as regards the fees for withdrawal, where consumers often face charges by both their own PSP and the ATM owner (double charging).

6.1.3 Option 38 (Delete the exclusions)

Following this scenario, the commercial agent, limited network, telecom and ATM exemptions would be deleted from the text of the PSD. As a result, payment transactions through commercial agents, telecom and IT devices, payment activities in the context of a limited network as well as cash withdrawals through stand-alone ATMs would become subject to the PSD rules.

In comparison to the option 37 above, the deletion of the **commercial agent** exemption would bring disproportional impact on businesses that rely on such agents to do their payments. At the same time, it would not change the situation of other stakeholders, in comparison with the clarification of scope scenario. As the reason for the exemption did not disappear and is not put into question, the exemption should therefore exist, with the more focused wording.

Similar reasoning would apply if the **limited network** exemption would be deleted. The rationale for the exemption, in its originally intended, limited scope, remains valid. This exemption is very important for some categories of niche payment providers (such as meal vouchers, petrol cards etc.) and they would be disproportionally affected by its deletion. At the same time, the situation of other stakeholders would not change in comparison to new definition option. Even if it is difficult in practice to make easy criteria for differentiation of limited network and general purpose payment services, the impact of a deletion would be negative, in comparison with current situation and even more so with a more focused and better definition.

As regards the deletion of a **telecom exemption**, there appears indeed no rationale for maintaining this provision - even in a more limited form provided by a new, clearer definition. Thanks to advances in the technology, mobile payments evolved from the original niche of paying for premium SMS, information or music services delivered to the simple

[231] For example, cases of abusive premium SMS services, reported in some Member States, would no longer be possible.

phone. They are now a fully-fledged payment channel enabled through the arrival of a smartphone. Accordingly, access to payments by mobile phone should no longer be subject to a special exception reserved for a nascent and niche market. This is further reinforced by the fact, that the telecom exception as reformulated in the option above is not needed. Issues specific to the provision of payment services by mobile network operators could be addressed more simply through the improved limited network exemption, while normal payment services provided by mobile networks should be subject to general rules. It would further allow for simplification of the Annex to the PSD (list of payment services), as point 7 would lose its purpose.

Finally, the deletion of the **independent ATM provider** exemption would appear justified. Independent ATM providers need to enter into agreements with a card scheme, in order to be able to accept payment cards and to send the information on the transaction/verify card and account status with the PSP of the cardholder. Alternatively, as it is increasingly possible to withdraw cash without a card being present or necessary, such providers need to enter into agreement directly with the PSPs holding accounts of the users. In both cases, there is no direct and independent contractual relationship between the ATM owner and the PSU withdrawing cash. The ATM owner acts only as an agent or proxy of the PSP and provides access to the funds available on the bank account of the PSU, in order to make the cash withdrawal possible. The charge for the withdrawal is not paid directly to the ATM owner at the cash machine, but communicated to the PSP holding the account and subsequently charged to the consumer. There is no good explanation to the question why consumer protection in such case should not apply. Neither is there a reason to exempt one, specific model of provision of ATM services and surrounding payments-related services from the general rules. As ATM owners need to enter into agreements with PSPs holding accounts or card schemes, the matter of remuneration for withdrawal could and should be negotiated between them and not dumped on consumers, leading to the application of extra, often excessive charges for ATM services.

6.1.4 Option 39 (Require payment service providers that make use of the exclusions to inform the competent authorities and ask for their clearance (negative clearance requirement)).

This option is related to the discussion on the exemptions in the PSD scope and could be, if needed, applied to all exemptions listed in Article 3 of the PSD, not only to those discussed in the impact assessment. After its application, any payment service provider that intends to benefit from the exemptions would be obliged to consult the competent authorities on the applicability of these exemptions and to receive their approval before starting any payment activities.

Such a measure would benefit the competent authorities, who currently have little, if any, formal knowledge on the size of the exempted market. On the other hand, the same authorities could easily become overburdened with all the additional information they receive, which would delay the time needed for any administrative decision and clearance and could create an unintended entry barrier for the market. Therefore a more tailored solution would be to limit the necessity of getting clearance from the authorities to larger providers (full PIs or their exempted equivalent), while allow the small providers (equivalent to waived PIs, with the same waiver conditions based on the value of payments) only to inform authorities about their activity.

Such scenario would first of all, give to the authorities a clear picture of the payments market, which is not the case today. Secondly, it would also put the authorised and exempted PIs on equal footing as regards the application of exemption criteria, thus reinforcing the level playing field on the market, at least on a national level. The necessity of scrutiny by competent authorities would also, indirectly, contribute to the better and more coherent protection of consumer rights in the Member State.

On the other side, the necessity of getting the clearance would put an additional administrative burden on the providers that currently enjoy the exemptions or any future providers wishing to obtain such status. This burden would be, however, marginal in comparison with the potential costs of getting and maintaining a full PI license and fully justified in view of the potential abuses and PSU detriments that could otherwise occur. In any case, the intention of the legislator when the PSD was adopted was certainly not to give to the potential payment service providers a completely free hand in deciding, whether they are subject or not the directive.

6.1.5 Calculation of impacts

Commercial agents exemption

For the purpose of cost calculations, it is assumed that the impact of the clarification of scope would be mainly on e-commerce platforms that offer commercial agent payment services to individual consumers. It is further assumed that the number of such large platforms in the Member States varies, but is in between two and five per Member State. In addition, it is assumed that five big cross-border platforms are active in all EU Member States.

This leads to the figure of 54-140 e-commerce platforms that might be impacted by PSD modification (which is most probably overestimated). However, we need to assume that some of them may already possess a PI license. For the calculation purposes we will therefore assume that 50% of them are already licensed or otherwise will change the scope of their payment services so as not to be forced to acquire a PI license.

This leads to the following calculation:

26-70 platforms, each needing a PI license (125.000 EUR) and the necessary own funds (assumption: funds are calculated using method B of the PSD, the average Payment Volume – PV- of the payment services provided in the framework of commercial agent exemption is 120 million EUR, which would put the value of commercial agent payment services to consumers at between 2 to 5% of the total estimated value of the EU B2C e-commerce in

2012). For the administrative costs calculation it is assumed that the preparation of the necessary documents will take one employee 5 business days of 8 hours. 37.30 EUR is the average cost of one hour of work of an employee in the financial services and financial services sector (Eurostat data)[232].

Table 70 – Calculation of impact (commercial agents)

Cost position	Calculation (EUR)	Total Amount (EUR)
PSD License	26-70 x 125.000	3.25 Million – 8.75 Million
PSD Own Funds	26-70 x (200.000 + 125.000)	8.45 Million – 22.75 Million
Administrative Costs (PSD application)	26-70 x 5 days x 8 hours x 37.30 EUR/h	0.04 Million – 0.10 Million
Total	**X**	**11.74 Million – 31.60 Million**

Limited network exemption

For the purpose of cost calculations, it is assumed that the number of entities that are using this exemption is the same as the number of currently licensed PI. Furthermore, it is assumed that 50 to 70% of these entities will be still exempted from the PSD, either as limited network providers in accordance with the new wording of the exemption or as entities too small to require a full PI license (waived providers).

As of September 2012 there were 568 licensed PIs in the EU. Accordingly some 156-284 new entities, for the time being exempted from this obligation, might require a license. The calculation below is based, as previously, on method B for own funds. It is further assumed that 80% of new entities will have relatively small payment volumes (PV), averaging 60 million EUR annually and the remaining 20% would have much higher volumes, averaging 240 million EUR annually. As above, 37.30 EUR is the average cost of one hour of work of an employee in the financial services sector (Eurostat labour cost survey 2007).

Table 71 – Calculation of impact (Limited Network)

Cost position	Calculation (EUR)	Total Amount (EUR)
PSD License	156-284 x 125.000	19.50-33.50 Million
PSD Own Funds	0.8 x 156-284 x 200.000 + 0.2 x 156-284 x (200.000 + 125.000 + 100.000)	38.22-69.58 Million

[232] Eurostat labour cost survey of 2007, labour costs in the financial services sector. Data extracted from Eurobase for NACE section K (lc_n08cost_r2 / lc_n08costot_r2) http://epp.eurostat.ec.europa.eu/portal/page/portal/labour_market/labour_costs/database

Administrative Costs (PSD application)	156-284 x 5 days x 8 hours x 37.30 EUR/h	0.23-0.42 Million
Total	**X**	**57.95-103.50 Million**

Telecom exemption

It is assumed that as a result of the deletion of this exemption most of the Mobile Network Operators (MNOs) would be interested in acquiring a PI license, as mobile payments are bound to be a part of the market strategy of these companies. There are 102 Mobile Network Operators in the EU Member States[233]. For the purpose of this calculation, it is assumed that roughly 60 PI licenses will be issued and used EU-wide.

As previously the calculation of own funds is based on method B. It is assumed that some 30 MNOs, mostly smaller, national only companies, will have relatively small payment operations, with PV averaging 120 million EUR annually (as explained in the IA this does not include payment operations closely linked to the typical telecom payments, which would be still exempted on the basis of limited network exemption). Some 20 MNOs will have somewhat larger operations, PV averaging 360 million EUR annually and the last group of 10 MNOs – leading players in Europe - would have payment volumes averaging 1 billion EUR. As above, 37.30 EUR is the average cost of one hour of work of an employee in the financial services and financial intermediaries sector (Eurostat labour cost survey 2007).

Table 72 – Calculation of impact (Telecom)

Cost position	Calculation (EUR)	Total Amount (EUR)
PSD License	60x 125.000	7.50 Million
PSD Own Funds	30x(200.000 +125.000) + 20x (200.000 + 125.000 + 200.000) + 10x (200.000 + 125.000 + 733.000)	30.83 Million
Administrative Costs (PSD application)	60 x 5 days x 8 hours x 37.30 EUR	0.09 Million
Total	**X**	**38.42 Million**

ATM exemption

The calculations below are based on the estimated number of independent ATM providers, which is some 10-20 in the UK and around 10 in other EU Member States[234]. Furthermore,

233 In addition, some 268 Mobile Virtual Network Operators are registered in the EU, according to the Digital Agenda Scoreboard 2012. However, as these operators, with few exceptions, possess a fraction of the national mobile market share, they are excluded from these calculations.

234 On the basis of information provided by ATM industry association

the value of withdrawals from independent ATMs in the UK is estimated at 3% of all withdrawals in the UK or around 6.6 billion EUR in 2011.[235] It is assumed that the value of withdrawals in other Member States reaches roughly half of the UK value or 3.4 billion EUR. On this basis, an average payment volume for an independent ATM provider is estimated at 333 million EUR, which probably overestimates the amount of own capital needed by ATM deployers, as the main player on the EU-wide is market is Euronet. As above, 37.30 EUR is the average cost of one hour of work of an employee in the financial services and financial intermediaries sector (Eurostat data).

Table 73 – Calculation of impact (ATM)

Cost position	Calculation (EUR)	Total Amount (EUR)
PSD License	30x 125.000	3.75 Million
PSD Own Funds	30x(200.000+125.000+178.000)	15.09 Million
Administrative Costs (PSD application)	30 x 5 days x 8 hours x 37.30 EUR	0.05 Million
Total	**X**	**18.89 Million**

Negative clearance costs and administrative costs for the Member States

The cost of receiving a negative clearance for PSPs using the newly defined exemptions of commercial agents and limited networks as well as subject to the waiver could be calculated under the assumption that the total number of exempted and waived entities subject to scrutiny would be roughly in the range of already waived entities, so in range of 1800-2200 entities (including some 310-484 companies exempted on the basis of previous calculations regarding commercial agents and limited networks).

The cost of submitting the information to the authorities is calculated under the assumption that it would take one employee one day of 8 working hours to prepare the necessary information for the authorities (which contrasts with five 8-hour working days necessary to submit full information necessary to issue the license). As before, 37.30 EUR is the average cost of one hour of work of an employee in the financial services sector (Eurostat labour cost survey 2007).

This leads to the figure of:

1800-2200 x 1 day x 8h x 37,30 EUR = 0.54 Million-0.66 Million

We should further assume that in some cases, on the basis of information provided, the authorities may further demand to provide all additional information, as in the full license application, for clarification purposes. The assumption is that the authorities will do it in

235 According to UK Payments (www.ukpayments.org)

some 20% of cases. Therefore, it would require another 5 days of 8 working hours for one employee to prepare the required documentation:

0.2 x 1800-2200 x 5 days x 8h x 37.30 EUR =0.54 Million -0.66 Million

Thus, the total cost for entities subject to negative clearance would be 1.08-1.32 Million euro (one-off). We could further assume that repeating annual costs of changes in the information on the profile of the exempted/waived entity and related to applications of new entities would reach 25% of this amount, or 0.27 to 0.33 Million annually.

For Member States, there would be the costs of assessing all this information. First, they would need to assess all the new submissions for full licenses under the changes in negative scope: 272-444 applications. Then, they would need to assess the information from 1800-2200 waived and exempted entities and re-examine them in an estimated 20% of less clear cases. The cost of 1 working hour of the public administration employee is estimated at some 20 EUR (as there are no sufficient Eurostat data on the hourly wage costs in the public administration, the sample of existing data cannot be reliably extrapolated). It is further assumed that it would take one employee 2 to 4 hours to assess the information provided by the exempted and waived entities and 3-5 days of 8 working hours to check and assess the PSD licence submission. This calculation also assumes that the additional work will be done by the existing staff or through the internal redeployments rather than by hiring new staff or outsourcing the assessment.

The calculation:

1800 -2200 x 1day x 2-4h x 20 EUR = 72.000 EUR – 176.000 EUR

0.2 x 1800 -2200 x 3-5 days x 8h x 20 EUR= 172.800 EUR – 352.000 EUR

272-444 x 3-5 days x 8h x 20 EUR= 130.560 EUR – 355.200 EUR

In total, one off costs for the competent authorities would reach 0.38 – 0.88 Million euro.

The repeated annual cost could be assumed to reach 25% of this amount or 0.1-0.22 Million Euro.

<u>Conclusion</u>

Clarification of scope is recommended for commercial agent and limited network exemption. The deletion of exemption is recommended for telecom and ATM exemption.

Estimated costs of these legislative changes for all PSPs are between 128 and 193 million euros, related mostly to the necessity of maintaining adequate own funds and to the costs of acquiring the PI licence. Estimated costs for supervisory authorities of all Member States are between 0.38-0.88 million euros. The benefits of changes are non-quantifiable and encompass better consumer protection, increased security of payments and level playing field for competition.

Table 74 - Summary of the impact for options 36 to 39

Policy option	Description	Effectiveness	Efficiency
Option 36	Baseline scenario	0	0
Option 37 **commercial agents** **limited network** Telecom ATM	New definition/clarification of scope	 **(+++)** **(+)** (++) (+)	 **(++)** **(++)** (++) (++)
Option 38 commercial agents limited network **Telecom** **ATM**	Deletion	 (--) (---) **(+++)** **(+++)**	 (+++) (+++) **(+++)** **(+++)**
Option 39	**Negative clearance**	**(++)**	**(++)**

Table 75 - Summary of the impact for main stakeholder categories (options 36 to 39)

Policy option	Description	Consumers	Merchants	PSPs (exempted/ authorised)
Option 36	Baseline scenario	0	0	0
Option 37 **commercial agents** **limited network** Telecom ATM	New definition/clarification of scope	 **(+++)** **(+++)** (++) (++)	 **(+)** **(+)** (+) (0)	 **(-/0)** **(--/0)** (-/0) (-/0)

Option 38 commercial agents limited network **Telecom** **ATM**	Deletion	 (+) (+) **(+++)** **(+++)**	 (--) (+) **(++)** **(0)**	 (-/0) (---/0) **(-/0)** **(-/0)**
Option 39	**Negative clearance**	**(+)**	**(+++) for authorities**	**(-)**

6.2 "One-leg" transactions and payments in non-EU currencies (Operational objectives 7 and 9)

6.2.1 Option 40 (No policy change)

Under this baseline scenario one-leg transactions and payments in non-EU currencies would remain outside the scope of the PSD and non-harmonised across the Member States. Consequently, there would be limited protection of PSUs in many Member States (some 50% of them) that did not introduce the national rules on such transactions. As a result, different national solutions in this area will continue to exist. Notably, differences in geographical scope of application (EU-only, EEA and all other countries), in currencies covered (EU, EEA, all currencies) and in the extent to which the PSUs are protected by the PSD provisions in particular Member States (not at all, partially, widely but with specific exceptions, fully) will remain. This will have detrimental effects for EU consumers and, to a lesser extent, companies, as it would maintain inconsistencies in protection of PSUs (consumers and businesses) and contribute to unlevel playing field across Member States for companies (that engage in one-leg transactions and payments in non-EEA currencies).

Even considering that some Member States (with no rules on one-leg payments and currencies in place) might decide to address these issues in the future, without EU intervention, no individual action of Member States will result in market integration and harmonised approach. Instead, individual actions will contribute to further fragmentation of the market along national borders. For this reason, taking no action would not lead to the desired policy effects at the EU level.

6.2.2 Option 41 (Full extension to all one-leg transactions and all currencies)

Full application of the PSD to one-leg transactions and payments in non-EU currencies would bring the protection of PSUs, in terms of transparency, information requirements and their rights and obligations to the same, high level as for the intra-EU, two-leg transactions. This would also result in full harmonisation of rules across the EU, thus contributing to the level playing field for businesses and to uniform, comprehensive protection of consumers. In practical terms, extension of the geographical scope to one-leg payments and payments in non-EEA currencies would benefit, first of all, consumers sending remittances to non-EEA countries. The Eurostat estimates the outflow of such remittances at some 32 billion EUR annually (2010 data) for 27 EU Member States[236]. Another group of better protected consumers would be those involved in cross-border online shopping (e.g. consumers buying goods in USA). The implications for EU businesses are potentially more important. The EU trade turnover with the rest of the world reached in 2010 over 4 trillion EUR in goods and services. However, large parts of the PSD rules on rights and obligations and all rules on transparency and information are negotiable for businesses and therefore it is difficult to establish the extent of their application in the business world. As a minimum, the extension to one leg transactions and all currencies could benefit microenterprises, which under the PSD may enjoy the same rights as consumers.

A significant drawback of a full application could consist of the fact, that some rules included in the directive may be too complex to implement in practice or simply unreasonable in a one-leg or non-EEA currency context. First, it would be not realistic to expect that PSP located in third countries would implement the rules of PSD on their side of the transaction (however, there would be no good reason to absolve PSP located within the EU/EEA from the PSD rules for the part of the transaction that is under their control and conducted within the EU/EEA). In particular, rules concerning execution times, division of charges and charging requirements and the use of unique identifier appear not practical in one-leg, all-currencies context. The implementation of this option would therefore risk putting a non-proportional burden on PSPs and possibly see them restricting their payment services or rising charges for transactions in question.

6.2.1 Option 42 (Selective extension of certain PSD rules to one-leg transactions and to all currencies)

This would allow for application of only certain rules of the PSD to one-leg payment transactions and payments in non-EU currencies. In particular, rules on information requirements and transparency (Title III of PSD) could be easily extended to the transactions in question. As regards rights and obligations (Title IV of PSD), a selective approach could be followed, keeping the high protection of consumer rights in place, with rules on liability in case of unauthorised and not correctly executed payments and refund rights covered by the extension. As a general rule, those obligations that could be fulfilled by the PSP should be applicable, to the extent that the transaction remains under control of the PSP located in the EU/EEA. At the same time, obligations out of control of EU-based PSPs or not realistic from the technical perspective in case of discussed transactions, i.e. concerning execution times,

[236] See Eurostat – Statistics in focus nr 4/2012 http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-12-004/EN/KS-SF-12-004-EN.PDF

division of charges and charging requirements, or the use of unique identifier would not apply.

The benefits of such approach would be, in terms of PSU protection, almost the same as of the previous option 41 (full application). The difference – in favour of this solution – is that the possible negative impact of the extension on PSPs is neutralised through the exclusion of certain obligations out of control of PSPs or those that could prove too complex technically if applied to non-EU currencies or one-leg transactions. The cost of its implementation would be marginal (as PSPs already have the necessary technical solutions and procedures in place and would be able to use them) and limited mostly to the clear and easy to understand information on consumer rights and consumer protection upon the extension.

6.2.2 Calculation of impacts

In terms of costs, the selective extension of the PSD to one-leg and all currencies would impact only to a very low degree on PSPs. As PSPs would not bear the responsibility for this part of the transaction that remains outside their control, there would be no necessity to change the solutions and procedures that are already in place for such transactions. In effect, the only perceptible change would be in preparing and changing the information for consumers on their new rights and better protection in case of transactions under consideration.

The cost of changing terms and conditions of PSPs could be roughly estimated on the basis that it would require one employee 2 hours to prepare the necessary documents and under the assumption that this would involve all credit institutions and licensed PIs, roughly 9400 PSPs (which is an overestimation). The cost of 1 working hour in the financial sector is, as in the previous calculations 37.30 EUR

2 x 37.30 EUR x 9400 = 0.70 million euro

In addition, the information would need to be delivered to the consumers. It is assumed that the distribution costs would be zero, as the information would normally accompany the account statements sent to PSUs or would be delivered electronically. This leaves the costs of printing the information. It is assumed that the information would require one sheet of A4 paper for each consumer account and that for 30% to 70% of the account owners the information will be delivered on paper.

According to Flash Eurobarometer 182, 93% of consumers in Europe have a bank account, assuming that some of them will own more than one account the rough estimate of the number of consumer accounts in Europe is 500 million. In addition the cost of 1 ream of paper (500 pages) is estimated at 2 to 3 euros, this cost is assumed to cover also the printing costs.

03.-0.7 x 1 sheet x 1 million reams x 2-3 = 0.6-2.1 million EUR

The total cost would therefore reach 1.3-2.8 million euros for all PSPs in the EU.

The benefits of increased consumer rights and protection are not easily calculable. Nonetheless, the value of affected transactions could be roughly estimated at 33 billion EUR for remittances plus roughly a similar amount for consumer transactions in other popular currencies (mainly USD and CHF) and in cross-border online shopping, thus giving the figure of some 60 billion EUR. This represents around 0.5% of the value of all transactions in the EU, but a roughly estimated 5% of all consumer transactions. At least 32 million PSUs (the official number of legal migrants from third countries in the EU) would potentially benefit from the extension.

Conclusion

The preferred option is a selective extension of PSD rules to one-leg and all currencies. The cost of its implementation would be marginal (as PSPs already have the necessary technical solutions and procedures in place and would be able to use them) and limited mostly to the clear and easy to understand information on consumer rights and consumer protection upon the extension. They are estimated at 1.3 to 2.8 million euros for all PSPs in the EU. In terms of benefits, the value of transactions covered by the extension is estimated at some 60 billion EUR or roughly 5% of consumer transactions. Some 32 million PSUs could potentially be positively affected.

Table 76 - Summary of the impact for operational objective 5 (options 40 to 42)

Policy option	Description	Effectiveness	Efficiency
Option 40	Baseline scenario	0	0
Option 41	Full extension	(+++)	(--)
Option 42	**Selective extension**	**(++)**	**(++)**

Table 77 - Summary of the impact for main stakeholder categories (options 40 to 42)

Policy option	Description	Consumers	Businesses	PSPs
Option 40	Baseline scenario	0	0	0
Option 41	Full extension	(+++)	(+)	(--)
Option 42	**Selective extension**	**(++)**	**(+)**	**(0)**

Annex 10: Ancillary measures addressing competition issues

Partial prohibition of the HACR: Need for Card identification

Today it is difficult for a retailer to know which MSC will apply to a given card as often he cannot identify whether it is a debit card, a basic consumer credit card, a commercial card, or a premium card as all of them are presented to him under the same brand. Without this information, the retailer would not benefit from the freedom he would gain through the intended partial prohibition of the HACR.

For the retailer to obtain this information it is necessary to mandate a visual and/or electronic identification of the various cards, and to prescribe that this information is provided to retailers 'in real time'. The details of such provision should be left to standardisation. Nevertheless it is appropriate that the legislation states that this identification is mandatory, also because it is necessary that all retailers' terminals include this capability.

The visual and electronic identification is not something new, as similar provisions have been included in the agreements of the Commission with card schemes (Undertakings for MasterCard[237], Commitments for Visa[238]) as regard commercial cards.

Partial prohibition of the HACR: Need for Unblending

Retailers are often offered a single price for the acquisition of card transactions by their acquirer – this is called a 'blended' price. Many retailers are therefore not aware of the differences in costs for the various payment instruments they accept as acquirers offer the same price for all transactions from the simple debit card to the very expensive business card. Consequently, competition between the various brands is ineffective at the level of the retailer. The lack of transparency also prevents the effectiveness of the intended partial prohibition of the HACR.

As the practice of blending is an important obstacle to effective competition, it was also addressed in the unilateral undertakings and commitments entered into by the international card schemes in the framework of competition enforcement proceedings (MasterCard's Undertakings[239] and Visa Europe's Commitments[240]). However, these engagements only oblige the schemes to impose 'unblending' on the acquiring banks and do not bind the banks directly. In practice, they therefore do not always have the desired effect and many acquirers continue to impose a single price for all cards.

Imposing a single price would also be a way for card schemes to circumvent the effect of the intended partial abolishment of the HACR. Unblending is therefore an indispensable complementary measure to the partial prohibition of the HACR.

[237] http://europa.eu/rapid/press-release_MEMO-09-143_en.htm?locale=en
[238] http://ec.europa.eu/competition/antitrust/cases/dec_docs/39398/39398_6186_3.pdf
[239] http://europa.eu/rapid/press-release_MEMO-09-143_en.htm?locale=en
[240] http://ec.europa.eu/competition/antitrust/cases/dec_docs/39398/39398_6186_3.pdf

Partial prohibition of the HACR: Need for invoices

For the time being most retailers do not receive any invoice regarding the costs applying to them for the various card payments. They only receive bank statements with the number of transactions and the total amount paid, but no information on the individual fees

In the UK large retailers have been able to negotiate with acquirers a merchant service charge called "MIF +", which means that within the MSC a distinction is made between the MIF and the acquiring banks' 'mark up'. In some cases ("MIF + +") there is even a distinction of three tiers: MIF, scheme fees, and acquirer margin.

It is proposed that the a rule would be introduced obliging acquiring banks to indicate separately to retailers, for each category of cards, the amount of the MSC but also the amount of the MIF. This will give retailers the means to check that the rules on the amount of MIF have been correctly applied to transactions.

Another reason why retailers find it difficult to compare and choose/steer between payment instruments are the many different categories of MIFs/MSCs applying. For cross-border transactions alone, MasterCard[241] has 77 categories of MIFs whilst Visa[242] has 34 categories. Transparency about MIF/MSCs to merchants would be to set a limit to the number of MIF categories allowed (in technical terms, the coding of transactions) through legislation.

Steering: Confidentiality rules

Card schemes and acquirers currently prohibit merchants from communicating any information regarding the costs of the various payment instruments to third parties, including consumers. Therefore a retailer cannot inform consumers of the costs he incurs in relation to individual payment instruments nor provide this information to branch associations or display the costs of the various cards in a general way in his (web-) shop.

Preventing card schemes and acquirers from imposing such a prohibitions would allow merchants to inform consumers of the true costs for the various payment instruments and remove the general assumption that the use of the various payment instruments is free of costs or costs are the same for all instruments. This could make steering and rebating more palatable to consumers or at least easier to understand.

Co-badging: Choice of application

In case a payment device includes several payment brands, the choice of the brand used for each transaction should be a decision taken by the payer in agreement with the retailer, once the retailer's device has indicated which brands are available. This would prevent that an automatic selection mechanism has imposed a given brand without the possibility for the consumer to choose. For the time being, in case of co-badged cards issuing banks often insert

241 http://www.mastercard.com/us/company/en/whatwedo/interchange/Intra-EEA.html
242 http://www.visaeurope.com/en/about_us/our_business/fees_and_interchange.aspx

an automatic mechanism in the chip through which the most expensive brand is chosen. This 'automatic' choice on behalf of the consumer will become even more pertinent with mobile wallets containing several payment applications. Freedom of choice should be left, transaction per transaction to the consumer, in agreement with the retailer.

The Commission had discussions with the European Payment Council ('EPC') concerning the provision in the SEPA Card Framework, designed by the EPC that addressed this issue. The Q&A published by the EPC to clarify the SEPA Card Framework[243] indicate:

"*A card with multiple brands must work for the cardholder in the same way as a wallet with several cards. The cardholder chooses which brand or application he/she wants to use at the point of sale, provided of course that the merchant accepts it and their POS equipment allows it*[5]*. The merchant always retains the choice not to accept some brands or to surcharge*".

Unfortunately this provision has been implemented in such a way that it is in fact the issuing bank, in theory in accordance with the consumer, which includes a mechanism in the card that determines an automatic selection. When in the future mobile wallets will contain multiple payment applications, it is essential that the consumer retains the possibility to choose, in agreement with the retailer, which payment instrument he wants to use and no pre-programmed options by issuing banks apply.

Details of this measure (adaptation to certain of payment types like on motorways) could be defined through standardisation but the principle should be laid down in a legislative provision.

<u>Cross-border acquiring: Authorisation</u>

Cross-border acquiring (retailers making use of the services of an acquiring bank established in another Member State against the fees applied by the acquiring bank) faces three categories of obstacles. One category consists of the technical hurdles created by the diversity of standards. A second consists of scheme rules generally applied by the international schemes stipulating that the MIF applicable to a certain transaction is the MIF of the location of the point-of-sale. As a consequence of these rules it is not profitable for merchants to make use of acquiring services of banks established in 'low MIF' countries. The third category of obstacles consists of scheme rules applied by the international schemes determining that the right for the acquirers to act on a cross-border basis is only given on a case by case basis, after a specific authorization process sometimes also involving additional fees.

Once an acquirer has obtained a licence of a given scheme, it should not be prevented from acting on a cross-border basis. The third category of obstacles could therefore simply be removed by prohibiting card scheme from restricting cross-border acquiring through licensing limitations, except for clear security reasons.

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243 http://www.europeanpaymentscouncil.eu/knowledge_bank_detail.cfm?documents_id=132):

Charging practises: Acceptance above a minimum amount

Card schemes and acquirers often impose a so-called Non Discrimination Rule ('NDR') on retailers, preventing retailers from applying any discriminatory treatment regarding their card transactions *vis-à-vis* transactions with cards belong to other card schemes. According to Article 52.3[244] of the PSD (2007/64/EC), card schemes and issuers cannot prevent retailers from offering a rebate or requesting a surcharge, therefore the NDR rule has lost most of its effects.

Nevertheless an important effect of the NDR has remained: the prohibition on behalf of the retailer to set a floor for the acceptance of certain payment cards, if and to the extent that such a floor is not applied with respect to all cards accepted by the retailer. This prohibition is important for countries were the amount of interchange is calculated as a full or partial fixed amount, as a consequence of which the cost for the retailer become proportionally high. In addition, acceptance thresholds allow retailers to only accept a given payment instrument above the amount at which the marginal acceptance costs (e.g. for debit cards) are equal to the ones of alternatives (e.g. cash), resulting in increased acceptance overall, instead of only alternatives being accepted.

It is proposed to indicate that card schemes and acquirers cannot impose a prohibition on a minimum amount being set by the merchant for the acceptance of cards.

Addressing the possible circumvention of MIF regulation

A possible consequence of the regulation of MIFs is that banks would try to raise fees for issuing cards, introduce per transaction fees to consumers or increase the bank account fees. Competition enforcement if there are indications of collusion or concerted practices and/or overall transparency and switching measures would be the best instruments to address this issue. Contrary to MIFs, issuance fees for debit cards or credit cards are known to the consumers and market competition can play a role. The Commission will review the situation regarding cardholder fees once legislation has been in force sufficiently long to observe first effects.

Another possible circumvention could be the increase of fees from card schemes to merchants, i.e. the raising of non-MIF elements of fees, paid by merchants directly to the card schemes. Here, a 'prohibition on net compensation' in line with the Durbin amendment (Regulation II) in the US could be introduced. This prohibition considers all 'net revenues' accrued by issuing banks from the payment card scheme as an interchange fee falling under the Regulation. This would prohibit card schemes from applying higher (scheme) fees or implement other measures to compensate for a reduction or removal of interchange fees.

244 "The payment service provider shall not prevent the payee from requesting from the payer a charge or from offering him a reduction for the use of a given payment instrument. However, Member States may forbid or limit the right to request charges taking into account the need to encourage competition and promote the use of efficient payment instruments."

Annex 11: PSD 'fine-tuning' measures (operational objective 8)

1. Information requirements and consumer rights

Product information on charges and conditions of payment services is a constant and repeated concern for PSUs, in particular consumers. Despite the PSD rules, and notably those on framework contracts, consumers still complain about unsatisfactory access to exhaustive, clear and comprehensible information[245]. Some of these concerns, in particular as regards the availability of information on pricing presented in the transparent way, which is easy to understand and to compare between PSPs, should be addressed through the upcoming bank account package initiative of the Commission.

However, other issues, such as easy to understand and clearly formulated information about the consumer rights, e.g. in case of refunds for both authorised and unauthorised payment transactions or rights in case of non-execution or defective execution of the transactions remain as yet unresolved. While PSD provides for such information obligation, the practice of PSPs is rather different from clear and easy language, requested by the law. With typical terms and conditions of a payment service going easily into tens of pages, written in the formal, legal language consumers are often at loss and unaware of their rights.

Moreover, while PSPs are obliged to provide information on external redress mechanisms and competent authorities, the PSD did not introduce any obligations to address and answer the complaints directly by the PSP and within a reasonable time limit. This may lead to the detriment of consumers and limits their rights in the single payments market.

Case Study : Information requirements in the PSD

General availability of the information on prices

The PSD specifies that information on terms and conditions, including pricing, should be delivered in easily understandable words and in a clear and comprehensible form, on paper or on another durable medium. Accompanying recitals explain in addition, that this comprises both Internet sites of the banks and online content that could be downloaded by the PSU. Consumers should not be charged for the provision of such obligatory information. However, despite precise regulatory provisions on consumer information, consumers continue to struggle to obtain the necessary price information or even when this information is available, to make sense of it.

First, consumers still have, despite the rules established in the Directive, limited access to key information, including pricing. The survey on pricing of most popular payment services (credit transfers, direct debits, card payments) done in the context of the study revealed that out of 243 banks from all Member States covered by the survey, almost 50% did not show sufficient information on pricing of the offered payment services on the internet and close to 20% did not show any prices. This message was repeated through contacts with the consumer association. For example, German

[245] See London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) and complaints and inquiries the Commission received on this subject.

consumer association vzbv reported that a comprehensive study conducted in all banks in the Hessen region in Germany showed that 58% of the banks, in particular savings banks and credit unions did not display prices on their websites. Furthermore, in many cases even if the price list was available, it was hidden under many layers of other, less relevant information.

Furthermore, even the general information provided by PSPs to consumers often does not enable them to shop around for a better deal. For example, the UK consumer association 'Which?' found out that based on the information on bank charges average consumer was not able to make any useful comparisons between PSPs[246]. The information could be all too easily manipulated by the PSP and made available in a way that almost preclude useful analysis.

Besides that, the price lists, if available, are often very lengthy, with hundreds of positions listed, and written in a technical language. Often even the first contact employees in the banks are not able to correctly explain the less common charges.

Persistence of excessive charges for information

In accordance with PSD, additional charges can be levied by the PSP in cases where the information goes beyond the legal requirements or is provided more frequently, on consumer request. When it is the case, the PSD requires that the charge be appropriate and in line with actual cost. However, according to consumer associations those charges are in some cases certainly not in line with actual costs and clearly excessive.

For example, Bulgarian Post Bank was reported to charge 500 BGN (around 250 EUR) for information concerning the debit and payment account of the consumer. German consumer association indicated, that it challenged in the courts Deutsche Bank (charges to consumers for mailing statements of accounts when consumers had not collected them within 30 days from the day they were issued) and Commerzbank (which charges 15 EUR for each reprint of a bank account statement, e.g. for tax purposes). Spanish and Bulgarian consumer associations reported that non-negotiable legal clauses in the framework contracts often contained only vague statements about additional charges for information and that the consumer has no possibility to know them before agreeing to the contract.

Impact of the rules on information concerning framework contracts

Within the study framework, two main issues were raised concerning information in framework contracts. First, the information delivered on framework contracts lacks clarity. It is often complex, very long, written in legal language and with key elements dispersed all over the document, going in tens of pages. Some consumer associations reported contracts of over 60 pages (without annexes with prices) being offered to the consumer. Even more strikingly, not a single consumer association believed that consumers receive indeed clear and easily comprehensible information.

Complexity is an inherent issue in payment services. But, if consumers are to make well-informed decisions and shop around, the application of the existing legislative framework should have facilitated the provision of information that is meaningful to consumers. This appears to be not the

[246] CAQS13 Which? (UK). For further details, see Which?, Bank charges: how clear are they?, Which? Magazine, February 2012, p.15-16.

case in very many instances across most Member States. Part of the issue concerning the lack of clarity and the complexity of the information resides clearly in the ability of the provider to decide how they can present the information in the contract. The PSD had not prescribed any particular way to deliver the information (other than requiring that the information be given in easily, understandable words and in a clear and comprehensible form). It is a very subjective criterion. As a result, the information delivered is often written in both legal and technical terms, not understood by an average consumer. As the Belgian consumer association Test-Achats observes: *"The manner in which the information is provided (presentation, terms, footnotes, etc.) vary from one provider to the other, are too long, seldom clear and sometimes voluntarily confusing. It is very difficult for a consumer to understand the tariffs in his own bank and it is impossible for consumers to compare"*[247].

For example, a common approach of many banks is to announce on its web pages that the prices and conditions may vary depending on branches where an account is held. In other cases terms and conditions mix conditions specific for payment services with other categories of financial information (e.g. information on savings accounts, deposits, securities) and cover a wide range of topics, thus adding to the complexity for the consumer.

Option 50 (No policy change)

Under this baseline scenario, no action would be undertaken. The information requirements in the PSD would remain unchanged and the PSPs will not be obliged to reply to consumer complaints.

As a result, the difficulties encountered by consumers in finding an easy to understand and clear information on refunds for both authorised and unauthorised payment transactions or on their rights in case of non-executed or defectively executed payments would remain. It would be also up to the PSPs to decide if, how and when to respond to consumer complaints. This would lead, in some cases, to the detriment of consumers and limits their rights in the single payments market.

Suboptions 2 and 3 discussed below are independent from each other.

Option 51 (Require PSPs to reply within fixed time limits to consumer complaints)

While many PSPs, in particular credit institutions, appear to have some form of a consumer complaint resolution procedures in place (and the obligation to provide for such mechanism has been even introduced by some few Member States in the past), the practice is not universal and the standards of treatment of such consumer complaints may vary significantly. From the consumer perspective, the most important issue is to receive a reply addressing all points he has raised and to get it in a timely manner. In case of a reply that does not satisfy the consumer, a comprehensive reply of the PSP is a prerequisite before the services of out-of-court complaint bodies could be used or before the complaint could be accepted by competent authorities. Consequently, a timely and, if requested by consumer, written reply to the complaint appears a justified demand.

[247] Test-Achats answer in the study on the impact of the PSD and Regulation 924/2009 for the European Commission

Following this option, payment service providers would be required to answer to all consumer complaints within fixed time limits (e.g. within 15 business days) and in a written form, if it was requested by the consumer. Only once a complaint is answered by the PSP, the consumer may be further directed to the external out-of-court redress or competent authority, if he believes the issue was not solved satisfactorily.

Main impact of this provision would be on these PSPs that did not introduce any procedures on dealing with consumer complaints and that take a long time to treat consumer complaints or do not answer them at all. They would need to appoint persons responsible to deal with such issues or, if necessary, to devote more resources (mainly personnel) to deal with complaints on time. However, there should be no measurable administrative burden for most of PSPs who already possess the necessary resolution mechanisms. The positive difference would be made for consumers and microenterprises (if treated as consumers).

Option 52 (Require PSPs to inform customers about their rights and obligations in a standardised, easy to understand and clear summary form)

If this option is implemented, payment service providers would be required to inform consumers about their rights and obligations in a standardised form, in an easy to understand language. A summary sheet with the relevant information would become available to consumers. The specimen of the information form contents could be attached to the PSD as an Annex or issued at a later stage by the Commission, on a basis of a delegated act.

As the PSPs are already obliged to provide the discussed information to consumers, the provision of standardised summary information sheet in simple, easy to understand language will not increase the administrative burden on them or the amount of information they need to provide. The difference and a positive impact is therefore mainly on consumers and microenterprises (if treated as consumers).

Calculation of impacts

In terms of costs, the impact of introducing a standardised information sheet on consumer rights and obligations could be assumed to have the same financial consequences as in the case of information provided as a result of one-leg, all currencies PSD extension, i.e. 1.3 to 2.8 million euro.

The additional costs incurred by dealing with consumer complaints in a timely manner are assumed to be largely non-existent, as the huge majority of PSPs already possess the internal capabilities and resources to deal with complaints. On occasion, this may require a new division of tasks and internal redeployment, but without generating additional costs. In very limited cases, possibly within the PSPs with very large consumer basis and centralised complaint management, the necessity of dealing with complaints in timely manner may require some additional human resources. Assuming that such necessity may arise in 1% of PSPs the calculation would be based on basis of roughly 9500 PSPs in Europe and 1 to 2 additional employees, working 40 hours a week, 52 weeks a year. The cost of 1 working hour in the financial sector is, as in the previous calculations 37.30 EUR

0.01 x 9500 x 52 x 40 x 37.30 EUR x 1-2 = 7.37 million – 14.74 million

The benefits of this solution are not quantifiable and are related to the better protection of consumer rights.

<u>Conclusion:</u>

Both timely reply to consumer complaints and standardised information sheet on rights and obligations are preferred options. Their impact on PSPs is marginal and estimated at 8.7 to 17.5 million EUR. The benefits of this solution are not quantifiable and are related to the better protection of consumer rights.

Table 78 - Summary of the impact – Information requirements and consumer rights (options 50 – 52)

Policy option	Description	Effectiveness	Efficiency
Option 50	Baseline scenario	0	0
Option 51	**Timely reply to consumer complaints**	**(++)**	**(+++)**
Option 52	**Standardised information sheet**	**(++)**	**(+++)**

Table 79 - Summary of the impact for main stakeholder categories (options 50 – 52)

Policy option	Description	Consumers	Businesses	PSPs
Option 50	Baseline scenario	0	0	0
Option 51	**Timely reply to consumer complaints**	**(++)**	**(+)**	**(-/0)**
Option 52	**Standardised information sheet**	**(++)**	**(+)**	**(0)**

2. Safeguarding requirements

According to the PSD, payment service providers engaged also in other business activities have to safeguard funds which have been received from users for the execution of payments. This is done either by 1) holding such funds in an account separate from the operational account(s) of the payment service provider and insulate such funds from claims of the other creditors in case of bankruptcy or 2) having an insurance policy or a guarantee in place. The most common form of safeguarding used by payment institutions is the first one, known also as “ring fencing”. Firms generally place funds on deposit in a credit institution rather than opting to invest in secure low risk asset. However, it is not clear at what point in time safeguarding should begin and whether or not this creates a window of risk.

According to the study conducted by London Economics and iff, the most popular approach used across Member States is funds segregation[248], as noted by 81% of regulators. 4 out of 5 PI respondents adopted this method of ring-fencing.[249] Reasons given for its popularity include clarity, convenience, cost-effectiveness and conformity with national laws and customs. Moreover, it is considered the most conservative in protecting customer interests. The least used approach is the insurance method: only two authorities claim it is the most commonly applied by payment institutions in their home countries. This is mainly due to unavailability of insurance policy products or better suitability of segregation/insulation of funds[250].

Experience has shown that PI's have problems to fulfil the safeguarding requirements due to the fact that credit institutions and insurance companies are not interested to open accounts or to offer insurance policies. It is argued that AMLTF provisions for such accounts require that the data of all customers have to be revealed to the credit institutions and reviewed by them. As a consequence, this could become a hurdle in obtaining a license.

Option 53 (No policy change)

The option involves no action at EU level but rather relies on action at Member States' or industry level. The Member States have the possibility to implement or not options provided in the Directive. There are three options possible which have been implemented by 23, 22 and respectively 10 Member States. This situation should remain unchained, which would prevent a harmonized application of the safeguarding requirements in the Directive.

Under this option, the payment institutions would continue having the possibility to choose the safeguarding method from three different methods, although only one of the methods is used today by the majority of the service providers.

If this provision remains unchanged in the PSD, the shortcoming of *lack of harmonization of the safeguarding provisions* will still affect the PIs and the competent authorities in charge of their supervision.

Option 54 (Full harmonisation of the safeguarding requirements)

The three options in the article 9 of the PSD would be either generalized or eliminated, which would make possible the harmonization of the safeguarding requirements. This would facilitate the compliance with the safeguarding requirements for payment institutions which provide services in several Member States and increase the market integration. Furthermore it

248 Art 9(1) a of the PSD.

249 The fifth adopts the insurance method.

250 See London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p199

will insure a level playing field for PIs across Europe which will incur comparable safeguarding costs. The benefits of this full harmonization will compensate at an European level the potential costs incurred for PIs in countries which will no longer apply the three options. This policy option will benefit also to competent authorities which will cooperate easier for the supervision of PIs operating in several Member States.

At the same time, it will be clarified the point in time where safeguarding should begin. As explained above, this additional harmonization effort will benefit to both PIs and competent authorities. Furthermore, consumer's funds will be "protected" at the same extent across Europe.

Option 55 (Reduce the number of safeguarding methods)

The three methods for the safeguarding of the funds will be reduced as a general rule to only one, the method known as the "ring fencing". This method is already now and by far the most used by PIs. Exceptionally and based on valid reasons for not applying the first method, the competent authorities could still be accept the second method of safeguarding. The third method which is anyway very marginally used will be deleted. This option will benefit mainly to competent authorities which will be able to asses easier the compliance with the safeguarding provision in the PSD.

Conclusion

This option applied in conjunction with the option 54 will solve the shortcoming identified in relation to the safeguarding provisions.

Table 80 - Summary of the impact – reduction of the number of available options and waivers for safeguarding (options 53 to 55)

Policy option	Description	Effectiveness	Efficiency
Option 53	Baseline scenario	0	0
Option 54	**Full harmonization of safeguarding requirements**	**(++)**	**(++)**
Option 55	**Reduction of the number of safeguarding methods**	**(+)**	**(+)**

Table 81 - Summary of the impact for main stakeholder categories (options 53 to 55)

Policy option	Description	Consumers	Merchants	PSPs	Competent authorities
Option 53	Baseline scenario	0	0	0	0
Option 54	**Full harmonization of safeguarding**	**(+)**	**n.a**	**(+)**	**(++)**

	requirements				
Option 55	**Reduction of the number of safeguarding methods**	**(+)**	**n.a.**	**(++)**	**(++)**

3. Passporting

Under the PSD, a payment institution authorised in one Member State can offer its services throughout the EU, after having informed the competent authorities in his home country (the country where the payment institution was granted its initial authorisation) which then cooperates with those in the host country (the country where a payment institution provides services under the passporting regime) concerned. The payment institution does not need to go through another authorisation process. These passporting rules were established with a view to increase competition and enable providers, following authorisation in one MS, to provide services in other Member States.

Passporting by PIs for activities in other Member States is still a niche in relation to the whole market of payment services. It is dominated by providers from some Member States with a focus on money remittance (for instance Western Union, registered in Ireland and providing services by passporting in all Member States). Stakeholder experiences, both payment institutions and authorities, point to a need for better communication among the competent home and host authorities, both during and after the notification process. Informal guidelines on passporting meant to harmonize especially the notification rules have been issued by Member States since 2011 but they have not been endorsed and applied by all Member States.

The rules on the use of agents, branches and other entities appear difficult to apply in practice, notably the application of the passporting regime to agents providing cross-border services. Furthermore, the definition of an agent appears to be unclear and the PSD is silent in whether the use of agents in another MS is to be qualified as establishment or provision of services. This issue is extremely important as it determines which authority is competent to supervise an agent.

According to the study carried out by London Economics-iff, in the view of PIs the PSD's passporting regime has not reached its full potential both due to concerns about the passporting process and an insufficient level of harmonisation of information, transparency of conditions and conduct of business rules due to non-harmonised AML, consumer protection and data protection rules. The issue most frequently raised relates to an apparent resistance by some host authorities against providing services without a physical presence in a host Member State and prolonging the passporting procedure by conducting robust checks of anti-money laundering and checking compliance with the host country's consumer protection requirements[251].

All these factors result in uncertainty about how long it takes to complete the required passporting procedures. In particular, the process for registering a foreign agent is viewed as slow and resulting in an unlevel playing field between domestic and foreign PIs[252]. This is because a domestic PI wishing to register a domestic agent can do so much more quickly than a foreign agent.

Competent authorities apply very divergent approaches to the general passporting framework. The most important structural issue raised by competent authorities in the study conducted by London Economics and iff is the disagreement between competent authorities whether cross-border provision of payment services takes place (which requires notification) or the customer only makes use of local payment service at distance (i.e. of the home Member State)[253]. This disagreement concerns especially services provided via internet. This problem is not limited to payment institutions but may also arise regarding credit or e-money institutions which can provide also payment services. As a consequence of the conflicting interpretations, some home competent authorities do not notify a service provider, leaving the host authority unaware of its activities. Another key issue is a lack of agreement among competent authorities over the interpretation of what constitutes a payment service.

Evidence about the market situation

The study conducted by London Economics and iff on the impact of the Payment Services Directive shows that passporting is used in the majority of EEA States but to a different degree.

Table 82 - Total number and proportion of passporting payment institutions by Member State

Member State	Number of APIs	Number of passporting APIs	Percentage of passporting APIs in total number of APIs
AT	4	3	75.0%
BE	9	3	33.3%
BG	9	3	33.3%
CY	10	1	10.0%
CZ	13	1	7.7%
DE	37	11	29.7%
DK	6	1	16.7%
EE	8	1	12.5%
EL	11	0	0.0%

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252 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p180

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Table 82 - Total number and proportion of passporting payment institutions by Member State			
Member State	Number of APIs	Number of passporting APIs	Percentage of passporting APIs in total number of APIs
ES	46	2	4.3%
FI	5	1	20.0%
FR	12	4	33.3%
HU	2	0	0.0%
IE	10	1	10.0%
IT	45	0	0.0%
LT	20	0	0.0%
LU	4	1	25.0%
MT	14	2	14.3%
NL	28	10	35.7%
NO	2	1	50.0%
PT	9	0	0.0%
RO	7	1	14.3%
SE	23	4	17.4%
SI	4	0	0.0%
SK	6	1	16.7%
UK	224	123	54.9%
EEA	568	175	30.8%

Source: Registers on the web sites of the competent authorities and complementary information provided by the authorities[254]

Note: Latvia and Poland are not included, since there are no authorised payment institutions in these two countries.

Throughout the EU, a fraction of the PIs have sought passporting rights so far. In Greece, Hungary, Portugal and Slovenia, no passports at all were sought by PIs[255]. On the other hand, seeking passports is a much more spread phenomenon among PIs in other countries such as in Austria where 75% of PIs have sought to obtain passports, Norway (50%) and the UK (55%)[256]. The United Kingdom is the country in which 70% of passporting PIs all over the European Union are actually based[257]. It should also be highlighted that some categories of payment services tend to passport more than others. Money remittances for instance account for 60% of the PIs passporting in Europe[258].

These figures show that passporting is still in its early days but could potentially develop quite substantially in the future. This is especially probable considering the substantial

[254] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p175

[255] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p175

[256] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p175

[257] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p174

[258] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p176

increase from 2010 to 2011 of the number of PIs having obtained a passport to provide payment services[259].

A detailed analysis of the bilateral passporting activities of PIs in various EEA States shows the stronger bilateral activities tend to involve neighbouring countries[260], as for instance the following pairs of countries:

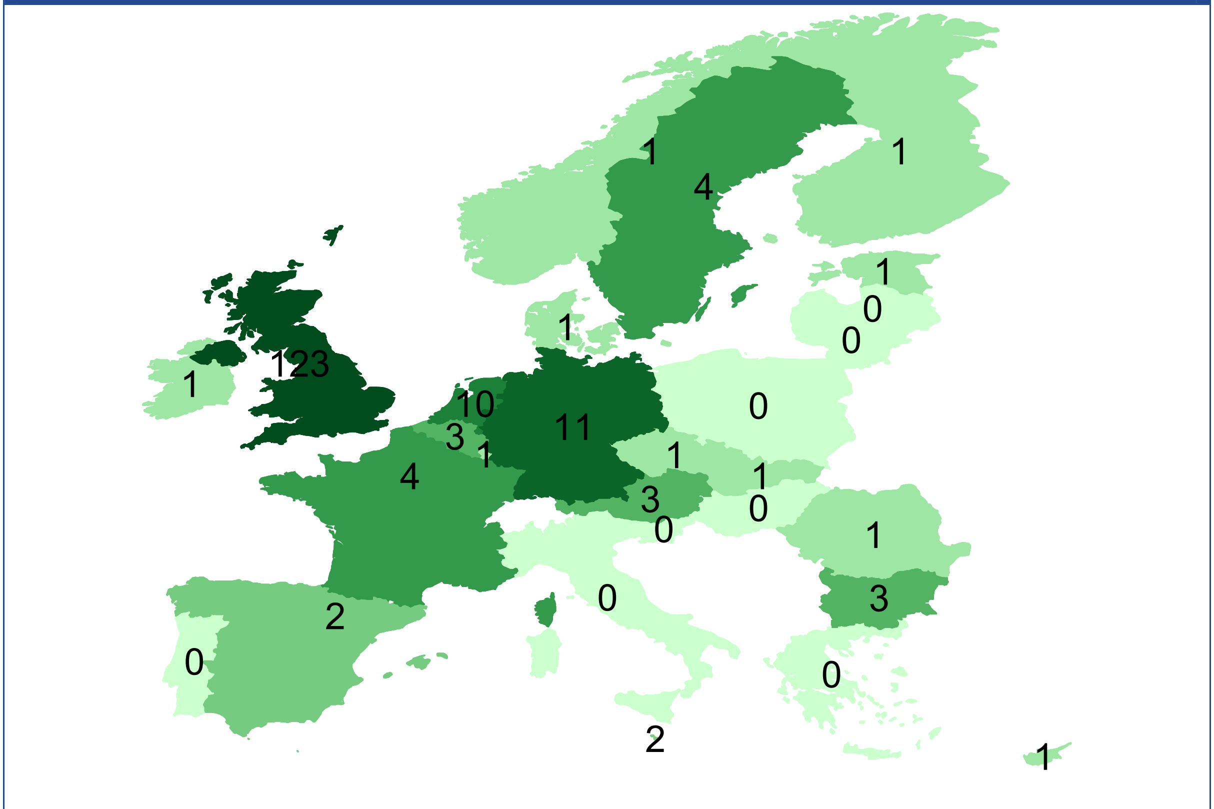
Austria – Germany

Czech Republic – Hungary

Czech Republic – Slovakia

Belgium – Netherlands.

Figure 83 - Geographic repartition of Passporting APIs in the EEA



Source: Registers on the web sites of the competent authorities and complementary information provided by the authorities[261]

259 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p177

260 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p176

261 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p174

As far as the passport regime is concerned, a differentiation should be made between the passports sought by PIs and the number of EEA states in which PIs actually provide payment services. Indeed, it was shown by London Economics and iff that although many PIs sought a large number of passports, it does not necessarily mean that they do actually passport in all these countries262. Indeed, considering that there is no or little difference in cost in applying for one or several passports and that applying for a high number of passports provides more flexibility for PIs to adjust quickly to changing market demands in the different EEA countries, PIs tend to apply for a high number of passports although they may not actually passport their activities in these countries as a result[263].

Option 56 (No policy change)

The option involves no action at EU level but rather relies on action at Member States' level. A competent authority in a home country will notify a passporting request to the competent authority in a host country using its own notification form and communicating information that it deems useful and necessary. Sometimes this notification procedure is negotiated and agreed by competent authorities on a bilateral or multilateral basis but an agreement on a harmonized procedure at European level seems difficult under this policy option. This will prevent the realization of a fully integrated market.

This will continue generating important administrative costs for competent authorities in home countries and payment institutions which will have to provide different information depending on the various queries of competent authorities in host countries. Therefore, the payment institutions benefit only partially of the cost savings generated by the possibility provided in the Directive to use a unique license across Europe.

At the same time host authorities will have to assess notifications received under different formats. Some passporting guidelines issued by an ad-hoc group made up of representative of different Member States are under updating. But their previous version was endorsed and applied only by a limited number of competent authorities. This was mainly because the Member States could not agree on the different notification requirements in case of free provision of services and establishment. A major disagreement between authorities concerns also the provision of services via internet and the need to notify under the passporting regime the provision of services on the internet.

Therefore, the shortcomings of the current situation are:

(1) *Lack of harmonisation* of the passporting procedures

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263 London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p176

(2) *Lack of clarity* on the different passporting situations: free provision of services, establishment and provision of services on the internet.

Option 57 (Ask European Supervisory Authorities (ESA) to issue guidelines on passporting, in particular the notification procedures in case of free provision of services or establishment)

Under this option ESA will be asked to issue and to maintain the passporting guidelines. The existence of guidelines agreed and approved by all Member States will have a positive impact on the timeframe for the passporting, avoiding time-consuming subsequent correspondence from host authorities asking for additional information. Therefore the competent authorities will be able to cope better with the timeframe fixed at one month in the PSD. The guidelines will make a clear distinction between the different notification procedures in cases of free provision of services, establishment and provision of services on the internet.

ESA will be asked to establish and maintain a register with payments institutions and competent institutions in EU as a useful tool for all competent authorities.

On the benefits side, once agreed these guidelines will facilitate the work of the competent authorities, establishing the concrete terms of the cooperation between home and host authorities. The guidelines will be public and will contribute to the transparency of the passporting regime. The payment institutions will be therefore aware of the steps they need to undertake in order to operate in different countries.

Although the establishment of the guidelines and of the European register will mean an additional administrative burden for ESA, this will be clearly compensated by the costs savings for the different competent authorities.

Under this option, both shortcomings identified will be addressed.

Option 58 (Clarify the distinction between free provision of services and right of establishment)

Concrete criteria will be provided to facilitate the distinction between free provision of services, right of establishment and provision of cross-border services on the internet. These criteria will feed in the drafting work to be done by ESA under the policy option 57. Therefore the main benefit of this option would be to serve as input and policy framework for the passporting guidelines to be drafted by ESA.

But this option will have positive spill overs also for all the policy options under the Supervision section as it will clarify what authority is competent and what law is applicable in the case of companies providing cross-border services.

This option will benefit mainly to competent authorities which will have concrete criteria to decide on the legal status of a payment institution. This option would limit also the interpretation possibilities and insure a harmonized application of the passporting provisions in the PSD. The payment institutions will benefit also of increased legal certainty, avoiding situations in which the same activity is considered as free provision of services in a country and establishment in another country.

This option will solve mainly the shortcoming 2. But as the results achieved in this option will serve as input for the policy option 57, it will indirectly contribute to solving also shortcoming 1. Therefore option 57 and 58 should be applied together.

Option 59 (Introduce the possibility to passport a "negative clearance")

Under this option, companies considered by competent authorities in home countries as being outside the scope of the Directive could oppose this assessment to competent authorities in host countries and operate without seeking a licence in host countries. The option will benefit therefore mainly to these companies, which will not be subject anymore to divergent interpretations of the Directive by authorities in different countries. Furthermore, companies will save time and money, as this "negative clearance" will be valid in all Member States. The number of companies which would possibly benefit of this option is very difficult to estimate since under the current PSD, companies which deem themselves as being outside the scope of the PSD do not need to inform the competent authorities. The positive spill-over of this option is that competent authorities would have a better visibility on the number and type of services provided by non-supervised companies.

The drawback of this option is that companies which want to benefit of an exemption would address their request to authorities sought to be more “permissive” and use this decision in other countries. This could lead to unwanted situations where some companies provide services without a licence in host countries where other licensed payments institutions provide the same services while complying with all the obligations in the PSD. So these companies will have a comparative advantage on the licensed payment institutions, which will lead to a disturbing effect on the market.

As a conclusion, this option would solve partially shortcoming 1, but would generate also negative side effects.

Table 84 - Summary of the impact - options 56 to 59

Policy option	Description	Effectiveness	Efficiency
Option 56	Baseline scenario	0	0
Option 57	**Guidelines issued by ESA**	(++)	(++)
Option 58	**Distinction between free provision of services and right of establishment**	(+)	(++)
Option 59	Negative clearance	(-)	(+)

Table 85 - Summary of the impact for main stakeholder categories (options 56 to 59)

Policy option	Description	Consumers	PSPs	Competent authorities
Option 56	Baseline scenario	0	0	0
Option 57	**Guidelines issued by ESA**	**0**	**(++)**	**(++)**
Option 58	**Distinction between free provision of services and right of establishment**	**0**	**(++)**	**(++)**
Option 59	Negative clearance	0	++	-

4. Supervision

PIs exercising passporting rights are subject to supervision. This may take the form of providing relevant information on request or of on-site inspections. Supervision of PIs providing services through passporting in several Member States (thus without the need for additional authorisation in the host Member State) has proven complex, especially in the case of specific services such remittances. This sometimes raises concerns for competent authorities in the home country of the PI regarding the effective supervision of the PI's operations in host countries. In general, competent authorities exercise their supervisory capacity only in relation to PIs established and operating in their territory. The only exception is represented by Slovenian legislation that provides the national authority with competence in other Member States or third countries.

Other issues are more of an operational nature. Notification of intent to provide services in another EU Member State including registration of agent is the stage of passporting that causes least issues. The greatest negative impact on the efficiency of the notification process arises at the level of cooperation between competent authorities of home and host Member State[264].

The key issue raised by competent authorities with regards to the due diligence of payment institutions in the passporting process are: incomplete AML procedures and process and internal control framework that have to be exercised by the agent through whom the payment services are provided. For instance some host authorities would like that a payment institution designate a central contact point for AML compliance purposes in the host Member State. However, this issue will be also addressed in the context of the revision of the Anti-Money Laundering directive foreseen for the beginning of 2013.

Another issue reported by competent authorities as impacting negatively the supervision of payments market is the time frame for passporting, one month being considered as insufficient to properly assess the all the notifications. This timeframe could be sufficient for the review effort required in relation to the exercise in the freedom of services, whether the

[264] London Economics and iff in association with PaySys *Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation (EC) NO 924/2009 on cross-border payments in the Community* (February 2013) p185

effort of a thorough review in relation to the exercise of the right of establishment requires more time.

From a consumers perspective, the main problem reported relates to identifying the competent authority (home versus host authorities) in case of a complaint against a PI licensed in one Member State, but providing services over the internet in another Member State[265]. This appears as a recurrent complaint and query in letters and petitions addressed by payment service users to the Commission services. Another concern reported by consumers' association in the study conducted by London Economic and iff relates to the fact the competent authorities in the host country cannot stop from operating a deficient payment institution authorised in another Member Sate[266].

Option 60 (No policy change)

The option involves no action at EU level but rather relies on action at Member States' level.

The competent authorities will be responsible for the supervision of payment institutions in their respective countries, but the cooperation terms between home and host authorities will remain vague. As a consequence some payment institutions, especially the ones working under the free provision of services or provided cross border services only on the internet would escape supervision. On the contrary, some other payment institutions would be supervised extensively by the home and several host competent authorities. The costs triggered for payment institutions by this extensive supervision would be even higher if all these competent authorities interpret in a different way the Directive and have different requests.

The efficiency of the competent authorities would not be optimal as it would not be clear for them what is the extent of their powers and their concrete tasks in relation to payment institutions operating in several countries. Activities involving the collaboration of authorities in two Member States, such as conducting in-situ inspections in another country would be difficult to organise because of the insufficient definition of tasks repartition. Similarly this could lead to potential conflict situations and reduce the mutual trust between competent authorities. This task repartition is very important also from an AML perspective, but this aspect will be also addressed in the context of the review of the Anti-Money Laundering Directive at the beginning of 2013.

At the same time, consumers will have the impression that some payment institutions are not of all supervised as their complaints are transferred from one competent authority to another. This would clearly deteriorate the consumers' confidence in the benefits of the internal

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market and would discourage them from using cross-border payment services especially on the internet.

Therefore the shortcomings of the current situation are:

(1) *Unclear repartition of powers and tasks* between home and host authorities

(2) *Insufficient or inconsistent supervision* of some payment institutions.

Option 61 (Ask ESA to issue guidelines on passporting with a clear separation of tasks between home and host authorities)

The passporting guidelines foreseen in the policy option 57 would have a second component on the tasks repartition between home and host authorities and the concrete terms of their cooperation. This policy option will clearly benefit to competent authorities which by knowing what payment institutions they have to supervise will be able to plan their time and people resources. An increased cooperation between competent authorities will allow them to better supervise the payment institutions and will insure a harmonized application of the PSD. Based on these guidelines, ESA could act also a mediator in case of divergences between home and host authorities.

Under this option, payment institutions will have a better visibility on the competent authority to which they need to report and the consumers will have a better visibility on the authority to which they can address their complaints.

As stated in the evaluation of the policy option 57, although it will generate additional costs for the ESA, it will be a source of cost savings for the different competent authorities.

This policy option will solve both shortcomings identified above for the existing situation.

Option 62 (Clarify whether the home or the host authority is competent in relation to consumers complaints in case of cross border provision of services)

This policy option will clarify that a consumer's complaint should be received and solved by the competent authority in the consumer's country (host country), if necessary in cooperation with the home authority. This provision will apply also in the case of cross-border services provided only on the internet, to a large part of the consumer's complaint.

A new provision would be included to clarify that as a general rule a consumer's complaint should be dealt with by the competent authority in the consumer's country (host country). These should apply also in case of cross-border services provided only on the internet. The host authorities will need to cooperate closely with home authorities in solving the consumer's complaint.

On the benefits side, the consumers will have as a main interlocutor the competent authority in his/her own country and will be able to file the complaint in his/her own language. This will have a positive impact on the consumer's confidence in the internal market and will increase his appetite for using cross-border services provided only on the internet.

The drawback of this option is that will increase the workload and costs for host authorities, but with the trade-off that will reduce the workload of the home authorities. The main benefiters would be the authorities in United Kingdom, where 70% of the passporting payment institutions are primarily licensed and Luxembourg where some major payment institutions providing services only on the internet are licensed. At the same time, this option will help host authorities to be aware of possible problems with payment institutions operating in the country and therefore to better supervise them.

As a conclusion, this option will solve shortcoming 1 and partially shortcoming 2.

Table 86 - Summary of the impact - options 60 to 62

Policy option	Description	Effectiveness	Efficiency
Option 60	Baseline scenario	0	0
Option 61	**Guidelines issued by ESA**	**(++)**	**(++)**
Option 62	**Competent authorities for consumers' complaints**	**(+)**	**(++)**

Table 87 - Summary of the impact for main stakeholder categories (options 60 to 62)

Policy option	Description	Consumers	PSPs	Competent authorities
Option 60	Baseline scenario	0	0	0
Option 61	**Guidelines issued by ESA**	+	**(++)**	**(++)**
Option 62	**Competent authorities for consumers' complaints**	++	**0**	**(+)**

5. Access to Payment Systems

Option 25 (No policy change)

Due to the exemption of payment systems designated under the Settlement Finality Directive from the general PSD provisions on access to payment systems, PIs are often not allowed under the Settlement Finality Directive to participate ‘directly’ in designated payment systems. They need to rely on direct participants (large banks) to ‘indirectly’ access the payment systems. However, no objective and general rules govern the indirect access by PIs, which results in significant competitive disadvantages for PIs and has an impact on final prices for PSUs (consumers). Option 25 would not address this restriction and they would continue to exist.

Option 26 (Establish objective and transparent rules for PIs to access indirectly designated payment systems)

Establishing objective and transparent rules, including on costs, for PIs to access (indirectly) designated payment systems would lead to easier access for PIs in the same way small banks currently do. This would eliminate the competitive disadvantage PIs can suffer from, by putting them on equal footing with other parties accessing payment systems indirectly. Although there might be costs for PIs (technical investments) and small banks (increased competition), consumers can benefit from option 26 as increased competition will put a downward pressure on the price for service of PIs and small banks.

Option 27 (Allow PIs to participate 'directly' in designated payment systems)

Option 27 would allow payment institutions to participate directly in payment systems. Legal and credit risk would then be transferred to the PIs but it would also increase their competitiveness. It must be noted however that this option possibly leads to higher security risks as PIs do not fulfil all security criteria required from direct participants. PIs might incur much higher costs due to technical investments and a need for increased security measures. They will, on the other hand, become more competitive. Benefits for consumers will be similar as under option 26.

Conclusion

Currently PIs are unable to access payment systems on fair and objectively defined conditions. This creates a competitive disadvantage for them and could lead to higher prices for PSUs. To address this issue, option 26 is recommended.

Table 88 - Summary of the impact for operational objective 2 (options 25 to 27)

Policy option	Description	Effectiveness	Efficiency
Option 25	Baseline scenario	0	0
Option 26	Rules for indirect access by PIs	(++)	(+)
Option 27	Direct access by PIs	(+)	(+)

Table 89 - Summary of the impact for main stakeholder categories (options 25 to 27)

Policy option	Description	Consumers	PIs	TPs	PSPs
Option 25	Baseline scenario	0	0	0	0
Option 26	Rules for indirect access by PIs	(+)	(++)	N/A	(-)
Option 27	Direct access by PIs	(+)	(++)	N/A	(-)

6. Liability for unauthorised transactions

Option 43 (No policy change)

Under this baseline scenario, no action would be undertaken. The liability rules in the PSD would remain unchanged. As a result, differences in treatment of PSUs (mainly consumers) between Member States and very different interpretations (by PSPs and national authorities) of gross negligence and other liabilities imposed on the consumer would persist. This would further result in very different levels of protection of consumers in different Member States and between the PSPs in the same country.

Option 44 (Fix an unique threshold for limited liability in case of a lost, stolen or misappropriated payment instrument)

As a result of this option, one pan-European limit for the liability of PSUs would be introduced. Current Member State option, allowing for the introduction of different national thresholds, up to a maximum of 150 EUR, would be deleted. The liability would no longer be different between Member States and PSPs for cases where the payment instrument (e.g. a card or a mobile phone with stored payment credentials, authentication data for online banking) was stolen or misappropriated by third persons. Accordingly, the liability limit would become fully harmonised across the EU and no longer depend on the location of the payment account or on the classification of the incident on the basis of an arbitrary decision of the PSP or authorities.

The main benefit of this approach is better, more comprehensive and all-around protection of the consumer. Practice has shown that consumers are often unable to prove that a theft, loss or misappropriation of a payment instrument was not caused by their own failure to keep the instrument or its safety features (i.e. PIN codes) safe. In many Member States (where the liability limit was not reduced to zero euro) PSPs automatically assume that consumer acted by definition negligently, as otherwise the incident would not have happened. Vaguely drafted law provisions, national interpretations and contractual provisions are in such cases often used to the consumer detriment and the amount of 150 EUR treated as a penalty, independently of the circumstances and the true amount of a financial loss. In some instances, the law is even interpreted by PSPs to the extent that consumers need to prove that the incident was not a result of gross negligence or fraudulent behaviour, implying full consumer responsibility for potential losses. This is made possible by a too widely drafted reference in Article 61(2) of PSD, obliging consumers to respect the contractual terms and conditions of the issuer PSPs, which allows in turn the PSP to define on its own, what gross negligence and fraudulent behaviour is.

The principal difficulty of a harmonised solution is related to the fact that any fixed amount (unless, that is, the PSU liability is reduced to zero) would be quite arbitrary and have different impact on different consumers, depending first, on the level of average income in the Member States and second, on the individual situation of the consumer. However, the same arguments could be used against the solution in force, as the limit of 150 EUR was originally taken up as an average amount imposed on the payment card users in typical contracts[267]. While there is a rationale in attributing some limited liability for potential losses to the consumer (as it certainly has a preventive effect on consumer behaviour), there is also much true in saying that the simple risk of losing a payment instrument, thus losing a convenient access to own funds, devoting time and effort to get a new instrument and paying for a replacement instrument, acts as a very good deterrent against simple or gross negligence. Moreover, as the main reason for liability imposed on consumer is the fraud prevention and more and more fraud takes place as a result of security breaches at the merchant and even PSP level (when, as a result of e.g. a cyber-attack, card data and personal details are compromised and used in card-not-present transactions) the rationale for hitting hard against consumer is simply not reflecting the todays' reality anymore.

As the liability threshold is closely linked to fraud, mainly the card fraud level, it is interesting to see it also in that context. The current, indicative threshold of 150 EUR in the PSD appears to be far too high in this perspective, in the view of a first, comprehensive data on the card fraud, published by the ECB in July 2012[268] and taking into account the important security progress in recent years, with the implementation of EMV standard and more secure card authentication, 3D Secure. The total value of card fraud in the SEPA countries amounted to 1.26 billion EUR in 2010, which amounts to 1.73 EUR per card issued in the EU and to 12 fraudulent payments for every 1000 card transactions. On a card basis, 1.2% of physically issued cards were affected by fraud.

These figures lead to a very interesting rough estimate – if we assume that each fraudulent use of a card is connected with the application of limited liability of 150 EUR per consumer (so that there are no cases of reduced or no financial liability, but also no cases of gross negligence and proved PSU fraud), the amount of liability penalties paid by PSUs would cover the entire amount lost by PSPs because of card fraud in the EU. This would mean that consumers alone cover all financial consequences of fraud and are de facto made responsible also for security deficiencies in the system. This is even without taking into account merchants fraud contributions, paid in card fees. While this calculation does not take into account the costs of fraud prevention, it is safe to assume that the liability threshold of 150 EUR imposed on users appears disproportionate.

A harmonised threshold of e.g. 50 EUR (which would also be linked to average amount of a card transaction in the EU, at 52 EUR) would appear therefore much more balanced, lowering the risks for consumers, strengthening the trust in payment instruments and incentivising PSUs to prudent behaviour, without punishing them excessively. Such reduced threshold is already in place in a number of Member States. It would be also closer to the payment instrument fraud figures. A much lower, even zero euro liability could be also a solution. This would in turn incentivise PSPs efforts to develop more secure solutions for payment channels of the future, in particular for online and mobile payments.

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267 This was subsequently used in the first Commission Recommendation on the subject of liability of card users, Commission Recommendation 97/489/EC

268 http://www.ecb.int/pub/pdf/other/cardfraudreport201207en.pdf

Option 45 (Fix thresholds for limited liability depending on the degree of security of the payment transaction)

Under this option, the limitation of liability would also become fully harmonised across the EU. In contrast to previous option, instead of one harmonised threshold, different thresholds would apply depending on the payment means used and the degree of security of the payment transaction. First, that could encompass a different treatment of transactions with debit and credit cards. According to the ECB statistics, fraud levels are four times higher for credit and differed debit cards than for simple debit cards (however, this appears to be the result of predominance of credit cards in the e-commerce payments, the difference is not significant for mortar and brick context). Second, different thresholds could instead apply for point-of-sale transactions (when the owner of the card is physically present in the shop and needs to enter PIN into the terminal, in accordance with EMV standards), for ATM withdrawals and for card-non-present payments (where the card is used in a remote transaction, including online and mobile payments).

Such a scenario would have the merit of reflecting the level of fraud in different payment situations, thus linking the risk of fraud and the liability to a concrete payment. However, important considerations question the effectiveness and rationale for such approach. First, the PSU would be de facto made partly responsible for deficiencies in the security of certain payment solutions, covering the costs of fraud for such solutions and providing negative incentives for their improvement. Secondly, another layer of differences in liability would be introduced on top of the existing differences between payment means (credit transfers, direct debits on one side and cards on other side). Third, this approach would have a negative impact on these payment channels that experience the highest growth and have the highest potential for the future – mobile and online payments. It could be even argued that in order to promote the development of secure, pan-European solutions for these channels the legislator should on purpose limit or abolish PSU liability.

Option 46 (Add precision and clarify the concept of gross negligence in the PSD)

If this option is implemented, the gross negligence concept would be clarified in the law and better harmonised across Member States. As a result, there will be less scope for discretionary decisions by the PSPs in case of payment incidents involving liability of the PSUs.

The implementation of this option would in practice go a long way toward rectifing the discussed, current misuses of the existing PSD provisions and clearly limit the number of situations, in which consumers are fully liable in case of so called gross negligence. Up to know, what constitutes a gross negligence is in practice left to the discretion of PSPs, with a consequence that even clearly non-negligent cases, such as theft of a payment card from a coat pocket in a shop or restaurant was sometimes treated as gross negligence. This is made possible by Article 61(2) of PSD, obliging consumers to respect the contractual terms and conditions of the issuer PSPs, which allows in turn the PSP to define on its own, the concepts of gross negligence and fraudulent behaviour.

The main difficulty of this approach is that in practice it is clearly not possible to define a list of cases of gross negligence, taking into account all possible situations that could happen in life. Any such list would need, out of necessity, allow for some flexibility, thus leaving room for arbitrary decisions by PSPs. As a result, the legislator could possibly precise and clarify the circumstances under which gross negligence could be assumed and take the decision on such cases from the hands of PSPs, leaving up to the more precise guidance of the national competent authorities.

Calculation of impacts

The impact of introducing a unique, lower threshold of liability for consumers in case of a lost, stolen or misappropriated payment instrument could be roughly calculated on the basis of the number of fraudulent card transactions in Europe. According to the ECB report on card fraud[269], there were 6,70 million fraudulent transactions involving cards issued in the EU in 2010. If a limited liability of 50 EURO is introduced in the EU, the costs for consumers of such decision would be 335 million euro.

However, in comparison to the present situation, where the liability amounts to 150 EUR, the benefits for consumers would be significant. Assuming that only 50% of fraudulent transactions involves the consumer liability of 150 EUR (as in some cases the liability was reduced by national implementation of the PSD and in other cases the consumer is able to report the theft, loss or misappropriation before the financial losses occur and block the instrument) the EU consumers are estimated to gain some 295 million euro annually in financial terms, in addition to more intangible but psychologically very important guarantee of only limited losses if the situation of the theft or other loss of instrument or its security features occurs..

The same amount of 295 million euro would need to be absorbed by PSPs. However, as discussed earlier in this impact assessment, the fraud costs in the EU appear to be currently financed entirely by consumer and merchants contributions, potentially weakening the incentives for PSPs to develop more secure payment solutions, in particular in online and mobile payments context. Such distribution of fraud costs does not appear justified, as the data show that most of the card fraud exploits weaknesses inherent in the card payment system design and vulnerabilities of the modern communication systems (data theft) and is not related to PSU behaviour or errors.

Conclusion

The preferred option is to introduce a unique, lower threshold for PSU liability and to clarify the gross negligence concept in the PSD. The quantitative impact of this option EU-wide is estimated at some 295 million EUR on a yearly basis. More important are the intangible benefits of consumer confidence and better protection with guarantee of only limited losses in case of theft, loss or misappropriation. The same amount would need to be absorbed by PSPs

269 Report on card fraud, July 2012, ECB

in the EU as a result of non-application of higher responsibility threshold. However, such shared responsibility for card fraud appears fully justified.

Table 90 - Summary of the impact for options 43 to 46

Policy option	Description	Effectiveness	Efficiency
Option 43	Baseline scenario	0	0
Option 44	**Unique, lower threshold for liability**	**(+++)**	**(+++)**
Option 45	Liability thresholds depending on transaction security	(+)	(+++)
Option 46	**Clarify gross negligence**	**(+)**	**(+++)**

Table 91 - Summary of the impact for main stakeholder categories (options 43 to 46)

Policy option	Description	Consumers	Businesses (microenterprises)	PSPs
Option 43	Baseline scenario	0	0	0
Option 44	**Unique, lower threshold for liability**	**(+++)**	**(++)**	**(-/0)**
Option 45	Liability thresholds depending on transaction security	(+)	(+)	(-/0)
Option 46	**Clarify gross negligence**	**(+)**	**(+)**	**(-/0)**

7. Small payment institutions

Option 47 (No policy change)

No legislative or non-legislative action from the Commission is envisaged.

The option involves no action at EU level but rather relies on action at Member States level, as the Member States would decide or not to apply a waiver regime. Under this option, the current situation would remain unchanged, with only one third of the Member State applying a waiver regime, but with the total of the number waived payment institutions (small payment institutions) overpassing more than 3 times the number of authorised payment institutions.

The main benefiters of this situation will be of course the small payment institutions which do not need to comply with the obligations on initial capital, own funds and funds safeguarding. Furthermore, they will still not need to apply for a license and they will have only to be listed in the register of payment institutions. This will give them a comparative advantage over authorised providers, as their costs will be significantly inferior. However this advantage remains limited to their home country.

The consumers would benefit at a certain extent from this situation as small institutions offer mainly niche services. But the trade-off is that consumers' funds are less safeguarded. Therefore the shortcomings of the current situation are:

(1) *Abusive use of the legislation* by some small payment institutions

(2) *Limited safeguarding* of consumers' funds

(3) *Insufficient supervision* of the small payment institutions

Option 48 (Provide for mandatory rules on small payment institutions)

The option for the Member States to waive the application of all or some of the Directive's provision to small payment institutions (called waived payment institutions in the PSD) would be eliminated. Mandatory rules applicable to all small payment institutions and in all Member States would be drafted. The safeguarding requirements would apply also to small payment institutions.

Under this option, mandatory rules would be drafted for small payment institutions, which will mean the cancelation of the existing waiving regime. This way the three shortcomings identified above will be addressed. The comparative advantage of the small payment institutions will cease and consumer's funds will be safeguarded according to the general safeguarding rules provided in the Directive. On the benefits side, it will be also a harmonized treatment of the payment institutions across Member States.

But as a drawback, some payment institutions too small to be able to fulfil all the obligations will either cease their activity or continue operating without an authorisation. Even with the provision of a transition period, we estimate that only a reduced portion of the existing waived institutions will apply for a license as regular payment institutions (a rough estimation would be less than 40% of the existing waived institution – equivalent to less than 900 payment institutions of a total of currently more than 2.000 small institutions. This could be also considered as going against general Commission's approach of supporting SMEs.

On the costs side, it should be also counted the additional administrative burden generated for the competent authorities who will have to supervise more closely these new regular payment institutions.

As a conclusion, this option would solve the three identified shortcomings but would trigger other serious negative side effects.

Option 49 (Decrease the threshold for small payment institutions)

The threshold for small payment institutions would be decreased from an amount of monthly payment transactions of 3.000.000 EUR to 1.000.000 EUR, which would mean stricter conditions for small payment institutions. In addition the threshold could be applied cumulative to the parent company, should one legal entity be the majority stakeholder in more than one waived payment institutions.

Compared to the option 48, the present option would generate roughly the same benefits and drawbacks but with a different intensity. The waiver regime will be applied only for payment institutions managing each month an average amount of 1 000 000 EUR of payment transactions, instead of the current threshold of 3 000 000 EUR. The number of the impacted small payment institutions that will not benefit any longer of the waiver could be estimated at a conservative figure of 50% of the existing small institutions, representing slightly more than 1 000 payment institutions. The comparative advantage will therefore cease for these impacted payment institutions. The waiver regime will be maintained only for the smallest payment institutions which are in the up-taking phase of their activity.

Compared to the option 2, the present option will therefore ensure that a larger proportion of payments institutions will remain in the supervised area, either as regular payment institutions or as small payment institutions. This will decrease the intensity of the drawback identified for option 48. The additional administrative burden for competent authorities would be also limited.

As a conclusion, this option will solve only partially the shortcomings identified, but would be more cost-efficient than the option 1 and would generate less serious drawbacks.

<u>Estimation of the decreased threshold costs for payment institutions and of administrative costs for the Member States</u>

The cost for the payment institutions which will no longer benefit of the waiver could be calculated under the assumption that the total number of waived entities subject to scrutiny would be roughly in the range of half of the already waived entities, so around 1 000 payment institutions.

The cost of submitting the information to the authorities is calculated under the assumption that it would take one employee five 8-hour working days necessary to submit full information necessary to issue the license.

For the administrative costs calculation it is assumed that the preparation of the necessary documents will take one employee 5 business days of 8 hours. 37.30 EUR is the average cost of one hour of work of an employee in the financial intermediaries sector (Eurostat data).

This leads to the figure of:

1 000 x 5 day x 8h x 37,30 EUR = 1 492 000 EUR, with a cost of 1 492 EUR / small payment institution.

We could further assume that repeating annual costs of changes in the information on the profile of the waived entity and related to applications of new entities would reach 25% of this amount, or 373 000 EUR annually.

For Member States, there would be the costs of assessing all the new submissions for full licenses for no longer waived small payment institutions: 1 000 applications. The cost of 1 working hour of the public administration employee is estimated at some 20 EUR (as there are no sufficient Eurostat data on the costs the sample of existing data cannot be reliably extrapolated). It is further assumed that it would take one employee 3-5 days of 8 working hours to check and assess the PSD licence submission. This calculation also assumes that the additional work will be done by the existing staff or through the internal redeployments rather than by hiring new staff or outsourcing the assessment.

The calculation:

1 000 x 3-5 days x 8h x 20 EUR= 480 000 EUR – 800 000 EUR

In total, one off costs for the competent authorities would reach 0.48 – 0.8 Million EUR.

The repeated annual cost could be assumed to reach 25% of this amount or 0.12 - 0.2 Million EUR.

The benefits of the changes are non-quantifiable and encompass better consumer protection and increased security of payments.

Table 92 - Summary of the impact for small payment institutions (options 47 to 49)

Policy option	Description	Effectiveness	Efficiency
Option 47	Baseline scenario	0	0
Option 48	Mandatory rules for small payment institutions	(++)	(+)
Option 49	**Decreased threshold for small payment institutions**	**(++)**	**(++)**

Table 93 - Summary of the impact for main stakeholder categories (options 47 to 49)

Policy option	Description	Consumers	Small payment institutions	Regular PSPs	Competent authorities
Option 47	Baseline scenario	0	0	0	0
Option 48	Mandatory rules for small payment institutions	**(+)**	--	(+)	(+)

Option 49	**Decreased threshold for small payment institutions**	**(+)**	**-**	**(++)**	**(+)**