European Payment Institutions Federation aisbl

JANUARY 2016

CALL FOR EVIDENCE: EU REGULATORY FRAMEWORK FOR FINANCIAL SERVICES

ABOUT EPIF (EUROPEAN PAYMENT INSTITUTIONS FEDERATION)

Founded in 2011, the European Payment Institutions Federation (EPIF) comprises more than 250 authorized payment institutions and other non-bank payment services providers across Europe. Thus, EPIF represents more than one third of all authorized Payment Institutions in Europe [1]. Our diverse membership includes a broad range of business models:

- Three-party Card Network Schemes;
- Acquirers;
- Money Transfer Operators;
- FX Payment Providers;
- Mobile Payments;
- Payment Processing Service Providers;
- Card Issuers;
- Third Party Providers; and
- Digital wallets.

EPIF seeks to be the voice of the European PI industry and the non-bank payment sector with EU institutions, policy-makers and stakeholders. We aim to play a constructive role in shaping and developing market conditions for payments in a modern and constantly evolving environment. We also seek to promote a single EU payments market through consistent regulation.
We strive to be a provider of efficient payments in that single market and it is our aim to increase payment product diversification and innovation tailored to the needs of consumers and merchants (e.g. via mobile and e-Commerce). EPIF seeks to represent the voice of this industry with EU institutions, policymakers and stakeholders. It aims to play a constructive role in shaping and developing market conditions for payments in a modern and constantly evolving environment.

For this call for evidence EPIF gladly provides examples concerning the Payment Services Directive (PSD II), the Interchange Fee Regulation and the Consumer Credit Directive (CDD). These examples touch upon different issues in all four thematic areas:

- Rules affecting the ability of the economy to finance itself and growth;
- Unnecessary regulatory burdens;
- Interactions, inconsistencies and gaps;
- Rules giving rise to unintended consequences

[1] According to the European Commission, there were 568 authorized Payment Institutions in Europe as per end 2012.

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THEME: RULES AFFECTING THE ABILITY IF THE ECONOMY TO FINANCE ITSELF AND GROW

Issue: Proportionality / preserving diversity in the EU financial sector

Example: 1 (of 3)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:

While the price cap-related sections of the IFR have only recently come into force, these will clearly have a detrimental effect on the payments sector by limiting the ability of firms to differentiate product offerings. This will drive out competition and dramatically weaken the economic viability of the smaller networks to act as a counterweight to the dominant schemes.

Price controls suggest that card services, whether to consumers or merchants, are commodities subject only to cost considerations. This has a disproportionately detrimental effect on smaller payment networks and new entrants, who wish to compete on providing added value and not solely on price. We have already seen in the U.K. and elsewhere that some four-party scheme issuers have announced that they will withdraw from reward products or dramatically reduce their benefits as a result of the implementation of the IFR. This will ultimately negatively impact on the consumer, for example, in the form of lower rewards on card products, higher card fees or the introduction of other fees.

In particular, extending price caps to smaller networks working with licensing partners is also disproportionate and eliminates an important point of differentiation that smaller, non-bank schemes can offer their partners. These licensing partners may now take the view that their relationship with such non-bank schemes is unviable and terminate their relationship. To a large extent, issuers' responses will also depend on the breadth of their business. "Mono-line" issuers will therefore face tougher challenges in adapting to the change than retail banks. Such issuers have a limited ability to cross sell cards as they do not offer traditional current accounts, savings, loans or mortgages.

Differentiation and innovation often go hand in hand. The interchange fee caps retard innovation by limiting the ability of firms to differentiate themselves from each other and by reducing the funds available to card companies to invest in cutting-edge products or systems.

Ensuring effective competition, rather than introducing price controls is the best way card networks can ensure this added value can be delivered. There is considerable scope for regulatory error when attempting to determine the appropriate level of price regulation, which can distort the marketplace. As a result of the IFR we expect to see a reduction in choice and competition in a sector already dominated by a duopoly, which today accounts for more than 95% of the sector.

Suggestion:

Card pricing regulation should only have been introduced where the market is shown to have clearly failed with resultant detrimental effects on consumers. The competition-based approach previously pursued by E.U. bodies had already had a significant impact on lowering interchange fees, without the disproportionate and anti-competitive effects of price regulation.

Example: 2 (of 3)

Refers to Directive or Regulation: Payment Services Directive 2 (PSD2)

Summary:
The extension of "open access" requirements, as set out in the revised PSD, to smaller, proprietary networks with licensees amounts to a form of compulsory licensing of network brands and other intellectual property. E.U. law is clear in recognising that intellectual property owners should only be forced to license their brands, know-how and other property in exceptional circumstances, for example, in the case of utilities infrastructure that constitutes an "essential facility" for market access.

The only way for smaller three-party schemes to compete with the dominant four-party schemes is by offering distinctive products and services, either directly or via partners selectively chosen to carry the network brand. The consequence of forcing open access on smaller three-party schemes is to impose a Visa/MasterCard-type business model (including potentially interchange) while removing the ability of such networks to distinguish products and services meaningfully and pro-competitively.

Merchants and cardholders are however not interested in another "utility-style" network; they already have two ubiquitous schemes to choose from. "Open access" requirements will therefore only serve to reduce competition, for the benefit of the dominant duopoly and to the detriment of merchants and consumers.

"Open Access" requirements may alternatively force three-party schemes to stop working with partners altogether, thus dramatically diminishing their ability to maintain geographic coverage and market relevance across Europe, which will also ultimately reduce competition and customer choice.

Example: 3 (of 3)

Refers to Directive or Regulation: Payment Services Directive 2 (PSD2)

Summary:
Consumer spending is the cornerstone of the European economy. Yet the practice of surcharging – an additional charge levied on consumers who make purchases using credit or debit cards – is unfair and deceptive, and only serves to discourage this key economic activity.

While the revised PSD bans surcharging for more than 95% of all card payments in the E.U., a minority will still be subject to surcharging. In particular, perversely, consumers who use cards issued by smaller, three-party networks will be penalised, as only these cards will be subject to surcharges, in member States which permit the practice.

As well as leading to greater confusion for consumers and merchants, this will also lead to a particularly counter-productive outcome: it will handicap three-party networks from acting as effective counterweights to the dominant, four-party networks – the net result being more business for Visa and MasterCard; an outcome clearly contrary to the overall intention of the legislation.

THEME: UNNECESARY REGULATORY BURDENS

Issue: Excessive compliance costs and complexity

Example: 1 (of 2)

Refers to Directive or Regulation: Payment Services Directive 2 (PSD2)

Summary:
There remain a number of tensions and unresolved issues within the Passporting regime set out in the PSD, particularly that the rules around the provision of credit by Passporting Payment Institutions (PIs) are fragmented and unduly burdensome.

Article 16(3) PSD permits PIs to grant credit subject to a number of restrictions (e.g. the credit must be repayable in 12 months or less) when the PI is operating under a passport. Certain Member States impose additional credit license requirements (e.g. UK consumer credit regime) on top of the PSD regime, which imposes excessive compliance costs.

The current lack of harmonization between Member State credit license requirements, including those within the Consumer Credit Directive (CCD), inhibits competition by placing additional constraints and costs on PIs who want to operate across the E.U.

Some further examples include:

- The Netherlands has a consumer credit licensing regime which applies in addition to any payments authorisation requirements. There are also specific conduct of business laws applying to credit (e.g. advertising) which go beyond the CCD requirements.
- In Spain, for the issuing of revolve (credit) cards, there is a requirement to observe the rules applicable to PIs, but also the provision of the Consumer Credit Act.
- In Italy, there is a requirement for a separate licence in respect of the credit beyond 12 months.
- Finland, Sweden, Norway and Denmark all have their own local requirements which go beyond CCD, in relation to marketing, affordability etc and there is also a requirement to register with local data protection authorities in each country as a data controller.

Example: 2 (of 2)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:

Proposals in the original draft of the IFR for a 22-month gap between the introduction of domestic and cross-border interchange fees would have placed a huge burden on – and threat to - merchant acquirers, potentially placing the commercial viability of merchant portfolios at risk. It could have resulted in discrimination against smaller merchant acquirers who would not have been able to adapt - like their larger counterparts - by transferring their business to markets with more favourable interchange rates. This could have led to smaller acquirers being forced out of the market during the differentiated time period for the introduction of domestic and cross-border interchange fees, ultimately leading to increased prices for consumers.

While this outcome was avoided in the final version of the IFR, it is important to note that the terms of Visa's Europe's Commitments to the European Commission in February 2014 created similar problems for acquirers participating in Visa's Cross-Border Domestic Interchange Programme (CBDIP), forcing some of them to relocate to take advantage of more favourable interchange rates. Based on the examples above, we would recommend harmonised timeframes for the introduction of future industry reforms to avoid potential market distortions.

Issue: Reporting and disclosure obligations

Example: 1 (of 1)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:

The monitoring of interchange caps is likely to be very complicated, especially for 'total compensation', because it will be difficult to clearly identify the beneficiaries of fee-generating activities. An example of this is the launch of development funds by card schemes in some EU countries which are increasingly paid for by merchant acquirers. An example of this is the "E-commerce Development Fund" launched by one of the payment schemes in Germany to increase the use of e-commerce in the country. Fees for this programme were originally paid by both issuers and acquirers and are now paid by acquirers only.

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THEME: RULESINTERACTIONS OF INDIVIDUAL RULES, INCONSISTENCES AND GAPS

Issue: Definitions

Example: 1 (of 1)

Refers to Directive or Regulation: Other; Consumer Credit Directive (CCD)

Summary:

With the Consumer Credit Directive (CCD) a SECCI, including a standardized APR calculation, was introduced for all credit products. Although the intension of a European standard for pre-contractual processes to facilitate a baseline comparison of credit products for customers is clear, in practice this worked out differently.

Firstly the "standard" APR calculation differs between some of the Member States, due to diverging views on interpretation of the calculation. At a later stage more guidance was provided in this area.

Secondly the standardized method for calculation an APR can differ significantly from how specific credit products are used by consumers in practice. This can result in a situation where the standardised APR differs from the actual APR based on typical usage of a certain credit product by consumers.

Issue: Gaps

Example: 1 (of 1)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:

Under the first Payment Services Directive (PSD I) Member States could decide to allow or prohibit surcharging, and to which extent. Different national practices have led to extreme heterogeneity of the Union's payments market and have become a source of confusion for consumers, in particular in the e-commerce and cross-border context. There are also many examples of merchants surcharging consumers at levels much higher than the cost borne by the merchant for the use of a specific payment instrument.

With the introduction of the IFR it was agreed that any justification for surcharging would disappear due to the capping of the interchange and that surcharging should be prohibited. This ban on surcharging is part of PSDII and will be effective with the implementation of PSDII. This means a delay of about 2 years during which EU consumers can still be faced with this unfriendly consumer practice.

Suggestion:
In those cases where a clear interdependency is pertinent it would be preferable, for reasons of transparency and market homogeneity, that implementation timelines are better aligned. For example by introducing the ban on surcharging in the IFR instead of PSDII.

THEME: RULES GIVING RISE TO POSSIBLE OTHER UNINTENDED CONSEQUENCES

Issue: Risk

Example: 1 (of 5)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:
The reduction in the interchange rates charged by the international card schemes - and the resultant reduction in the pricing gap between international and domestic schemes - may lead to international schemes taking more market share from domestic schemes (or putting them out of business altogether), thereby potentially increasing retailer costs in those markets

Example: 2 (of 5)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:
There are early signs that schemes are structuring their rules, services and fees to benefit issuers and are passing more costs to acquirers. As far as we are aware, the United Kingdom is the only country that is consulting with interested stakeholders on how the IFR should be interpreted and implemented. We would encourage this practice in other EU countries also.

Example: 3 (of 5)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:
Time will tell to what extent consumer rewards on payment (especially credit) cards will be reduced or withdrawn and to what extent card fees will be introduced to compensate issuers for lost interchange revenues. Issuers in the UK have already started to reduce or withdraw reward programmes on some credit card products and this may also occur in other EU countries.

Example: 4 (of 5)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:
A reduction in industry revenues does not usually result in more investment in innovation. In this scenario any innovation is likely to be in activities that reduce costs, although this may still provide some benefit to consumers

Example: 5 (of 5)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:
It is not beyond the realms of possibility that reduced issuer and acquirer revenues could lead to an erosion of consumer protection i.e. where the global card scheme protects consumers in the event that purchased goods are not as described or not delivered at all.

Issue: Procyclicality

Example: 1 (of 3)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:
The IFR has focused on the activities of the leading global card schemes but the setting of EU-wide interchange fee caps has crystallised existing bank/scheme partnerships (leading to potentially reduced competition) as up to now interchange has been the main competitive market variable

Example: 2 (of 3)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:
European regulators have tried in recent years to encourage new payment schemes to enter the market. However, by reducing the revenue potential there is less incentive for new players to enter the market.

Example: 3 (of 3)

Refers to Directive or Regulation: Interchange Fee Regulation (IFR)

Summary:
IFR sets out requirements for the payment process that possibly conflict with the customer experience of contactless payments thereby hindering the ability of the contactless economy to grow.

The combination of merchants' preferences and the possibility for consumers to choose to override the choice of card used for a payment can lead to a "two tap" experience and thereby negatively impact the customer experience of contactless payments.