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**COMMISSION STAFF WORKING DOCUMENT**

**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}

# Contents

# 1 INTRODUCTION

Secure, efficient, competitive and innovative electronic payments are crucial if consumers, merchants and companies are to enjoy the full benefits of the Single Market, and increasingly so as the world moves beyond bricks-and-mortar trade towards e-commerce. Many European consumers and payment users have become used to travelling outside of their country of origin and to buying goods and services abroad. More importantly still, today the internet enables consumers to make purchases abroad without even having to leave their home. In both cases, electronic payments that work smoothly across borders are of utmost importance.

Despite the significant progress achieved in the development of a regulation framework for the payments market, card payments and new means of payments, such as internet and mobile payments, remain fragmented along national borders, making it often difficult for consumers to use these payment methods at pan-European level (with the possible exception of credit cards). Recent developments in these markets have also highlighted certain gaps and inconsistencies in the current payments regulation framework.

An initiative to drive market integration for card, internet and mobile payments has benefits along several axes:

– A more competitive market leading to downward convergence of costs and prices for payment users;

– More choice and transparency of payment services for payment users;

– More innovation based on improved scale effects and easier market access for payment service providers; and

– More security and trust regarding payment services.

In view of the importance of payments systems for the real economy and in line with the Commission's better regulation approach, policy orientations need to be carefully considered and their impact thoroughly assessed. Accordingly, this report identifies problems in EU payment markets, in particular those owing to the identified market failures and regulatory and supervisory gaps, and analyses the rationale and potential implications of intervention at EU level.

It is important to note that robust data for the payment methods analysed in this paper is not always available. For core payment instruments such as credit transfers, direct debits and, to some extent, payment cards, transaction data is regularly published by the European Central Bank (ECB). While business related data for card schemes has been gathered by the Commission it cannot be used and published in the present report due to on-going proceedings in competition cases. Reliable data for internet and mobile payments is even more difficult to collect and identify as the environment is fragmented and transaction data cannot easily be separated from the overall data for core payment instruments.

# 2 PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

## *1.1 Procedural issues*

This initiative was led by the Directorate-General Internal Market and Services. It was foreseen in the Commission Work Programme for 2013[1] and subject to a dedicated Roadmap[2].

Work on the Impact Assessment started in September 2012 with the first meeting of the steering group taking place on 19 October 2012, followed by two further meetings, the last one taking place on 30 January 2013. The following Directorates General (DGs) and Commission Services participated in the steering group: Communications Networks, Content and Technology; Competition; Enterprise and Industry; Health and Consumers; Justice; Legal Services and the Secretariat General.

The report was sent to the Impact Assessment Board on 20 February 2013. The Board discussed the report on its hearing on 20 March 2013. Following the hearing, several changes were made to the document, in accordance with the Board recommendations. The most important include:

– substantiating the urgency for the revision of the Payment Services Directive (PSD);
– providing supplementary information on the card market, its functioning and on the EU case law about interchange fees,
– clarifying the difficulties relating to SEPA governance,
– streamlining the presentation of impacts by focussing on the impacts of the most important options in the main text and moving less significant issues to annexes,
– substantiating the reasons for regulating MIF through legislation,
– better explaining the interdependencies between different options and packages,
– providing the stakeholders' view on individual issues and summarising their positions in annexes.

## *1.2 External expertise and consultation of interested parties*

The Commission has reviewed the impact of the PSD and the Regulation on cross-border payments on the Internal Market. The review process was based on two dedicated external studies, providing the Commission with a comprehensive picture of the economic and legal consequences arising from the PSD. The first study provided a legal conformity assessment regarding the transposition of the PSD in the 27 Member States.[3] The second study analysed

1 See Annex to the Commission Work Programme 2013, item 25. http://ec.europa.eu/atwork/pdf/cwp2013_annex_en.pdf

2 http://ec.europa.eu/governance/impact/planned_ia/docs/2013_markt_005_secim_en.pdf

3 Report on the transposition of Directive 2007/64/EC by Member States (general report and 27 national reports) done by tipik communication agency, 2011

the economic impact of the PSD in comparison to its original objectives.[4] For the same purpose, input by Member States and the relevant market actors was gathered via the Commission's advisory committees for the retail payments policy, i.e. the Payments Committee (representing Member States) and the Payment Systems Market Expert Group (representing non-governmental stakeholders from the demand and supply side of the payments market).

Additionally, the Commission published a Green Paper "Towards an integrated European market for card, internet and mobile payments"[5] in January 2012 which was followed by a public consultation. The comprehensive feedback by stakeholders[6] provided relevant information on some recent new developments and on possible requirements for changes to the existing payments framework. A public hearing in the same context took place on 4 May 2012 and was attended by some 350 interested stakeholders.

The extensive consultation process has allowed the identification of some key messages. First, stakeholders from all categories consistently agreed that there was a need to provide legal clarity on multi-lateral interchange fees (MIFs)[7] between banks. This was seen as particularly relevant due to the number of on-going competition cases launched at European and national level. Second, especially merchants but also stakeholders from other categories pointed to obstacles for cross border acquiring[8], compromising a genuine Single Market for payment services. Third, the importance of a regulatory framework on payment initiation services[9] was highlighted by both payment service providers (PSPs) and users. Fourth, many stakeholders across all categories stressed the negative effects of surcharges[10]. Finally, there was broad stakeholder consensus regarding the benefits of technical standards and inter-operability and the fact that a sufficient level of standardisation and inter-operability has not been reached yet. Annex 3 provides more details on stakeholder feedback, in the context of both the public consultation on the Green Paper and the Commission's advisory committees.

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4 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).

5 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0941:FIN:EN:PDF

6 http://ec.europa.eu/internal_market/payments/docs/cim/gp_feedback_statement_en.pdf

7 These are collectively agreed payment service provider (PSP) fees between the acquiring leg (i.e. the PSP of the merchant) and the issuing leg (i.e. the PSP of the cardholder) of a payment transaction.

8 Cross-border acquiring refers to a situation in which a merchant uses the services of an acquiring PSP established in another country. Under this arrangement, not only do all merchants benefit from more competition on Merchant Service Charges (MCSs) but companies can also appoint a single acquirer for their transactions, resulting in administrative efficiencies and cross-border competition.

9 Internet-based payment initiation services allow consumers to immediately pay for purchases of goods and services using their payment account instead of other instruments, such as cards. Once a consumer chooses the online banking payment option, a credit transfer from the consumer's to the merchant's account is executed automatically. The consumer authorises the purchase by entering his or her online banking credentials.

10 This is a term commonly used in reference to the charge applied by a merchant on top of the requested price for goods and services when a certain payment instrument (usually a card) is used by the consumer, in order to cover the costs borne by the merchant for such a use.

The European Parliament adopted an own-initiative report on the Green Paper in November 2012[11]. The report acknowledges the objectives and integration hurdles identified in the Green Paper and calls for legislative action in a number of areas concerning card payments while it suggests a more cautious approach regarding internet and mobile payments due to the lesser maturity of those markets.

Overall, the consultation results call for important regulatory adjustments to the existing framework. This should reinforce the effectiveness of the European payments market and contribute to a payment environment which nurtures competition, innovation and security.

# 3 POLICY CONTEXT, PROBLEM DEFINITION AND SUBSIDIARITY

## *1.3 Background and context*

### *3.1.1 The EU retail payments market*

The European Union's retail payments market is one of the largest in the world and involves millions of companies and hundreds of millions of citizens. According to the latest European Central Bank (ECB) payments statistics, 8,829 institutions offered retail payments services in the EU27 in 2011 and €90.6 billion transactions were undertaken for a total value of €240.24 trillion.

The economic benefits of integrating this market are substantial and were driving the establishment of the Single Euro Payments Area (SEPA). A study conducted for the European Commission[12] suggests that full migration to SEPA for credit transfers, direct debits and payment cards could yield direct and indirect benefits of more than EUR 360 billion over a six-year period.[13]

Payment cards, followed by credit transfers and direct debits, are the most popular non-cash payment instruments in the EU (see Figure 1). Together, these three methods of payment account for over 90% of all cashless transactions.

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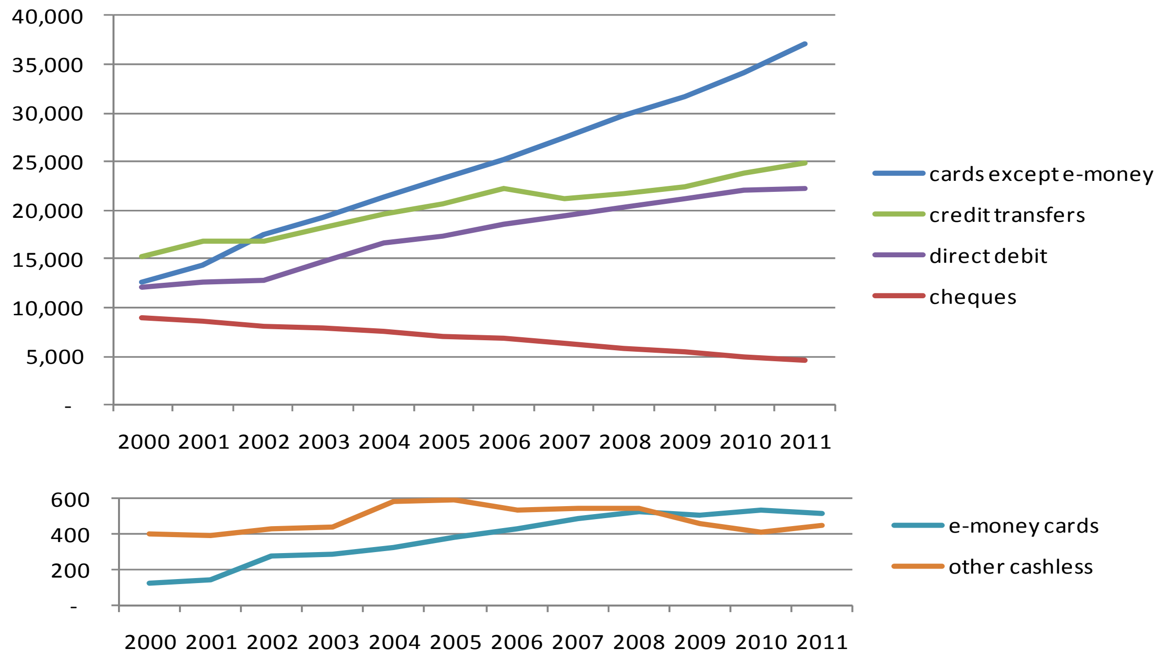
[11] http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0304&language=EN

[12] Source: *SEPA: potential benefits at stake,* CapGemini, 2007, http://ec.europa.eu/internal_market/payments/docs/sepa/sepa-capgemini_study-final_report_en.pdf

[13] Starting from the point in time when pan-European payment instruments have reached a critical mass

**Figure 1 - Number of transactions by type of payment instrument (millions) – EU-27**

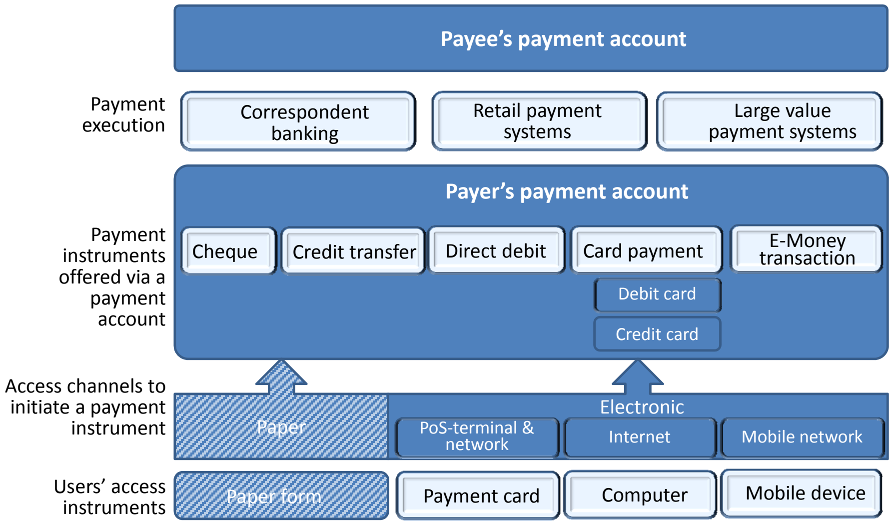



Source: European Central Bank, Payment Statistics, Data as of September 2012[14]

The current degree of payment integration at European level varies markedly between the various payment methods. While pan-European credit transfers and direct debits schemes have already been established, an integrated market for payment cards or for internet payments (e-payments) and mobile payments (m-payments) yet has to be achieved. The graph below illustrates the different possibilities for retail payment transactions (cash excluded).

**Figure 2 – Illustrations of the different possibilities for retail payment transactions**

[14] 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) p19




Annex 4 provides a general description of the payment market and payment methods.

### *3.1.2 Payment cards – basic functioning, market size and integration*

Basic functioning

A distinction can be made between debit cards and credit cards as well as between consumer cards and corporate 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. Debit card payments imply an "immediate" or "near-time" deduction of the funds for the individual transaction from the cardholder's account. Transactions with credit cards and 'deferred debit' cards are aggregated for some period of time and settled on the cardholder account at regular intervals, for example monthly. Credit cards offer a credit facility that the cardholder may use each time he receives the (monthly) bill, instead of paying back the entire due sum at once. If the user does not take advantage of the credit facility, the card is used the same way as a differed debit card. 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 – although in practise the difference might not always be so clear-cut.

Card payments are made possible through the existence of card schemes at national and international (cross-border) level. Purely domestic debit card schemes exist in several Member States. However, domestic debit cards, when not co-badged[15] with an international scheme, are not accepted outside the Member State of origin, which makes any cross-border use impossible. International card schemes, such as Visa and MasterCard, are available across the EU and are usually accepted outside the country where they were issued.

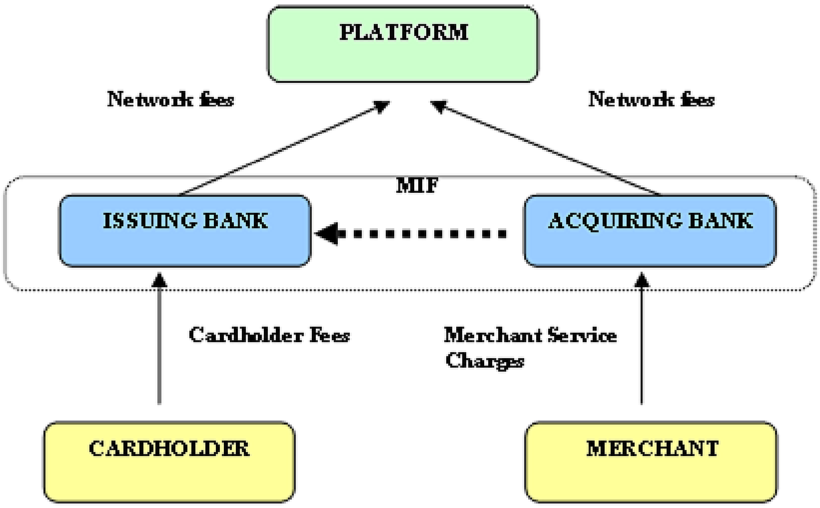
In most cases, payment cards are provided to the consumer by the issuing bank. On the acceptance side, merchants usually have one or several acquiring bank(s).

15 Co-badging allows different payment brands for instance domestic and international to co-exist on the same card or device

The most common type of card scheme is the so-called 'four party' scheme (for example MasterCard and Visa), under which usually a collectively agreed 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.

The bank of the cardholder (issuing PSP) pays to the bank of the merchant (acquiring PSP) the amount of the transaction after the deduction of MIF. The MIF along with other fees - a card scheme fee (network fee) and a fee paid by merchant for the services of the acquiring PSP - is passed on by the acquiring PSP (bank of the merchant) 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. MIFs thus act as a minimum price floor and determine to a large extent (in general 50 % or more) the price charged by PSPs to merchants for card acceptance.

**Figure 3 - Illustration of the operation of a four-party scheme, including the transfer of the IF**

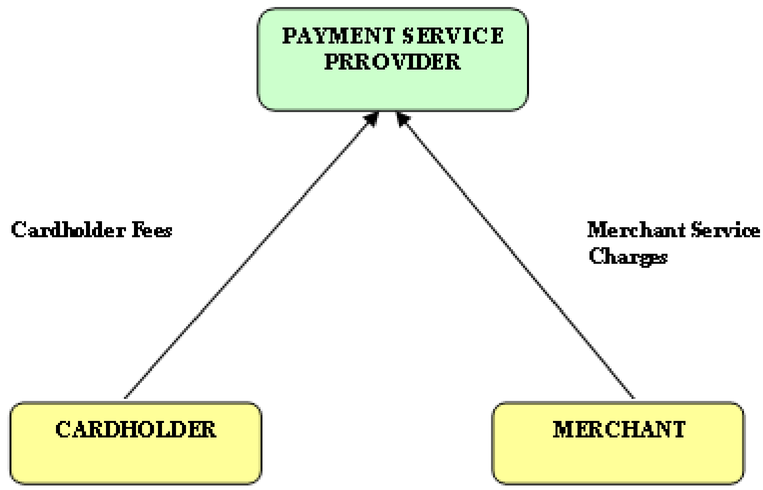



A second type of card scheme model is the so-called 'three party' scheme (e.g. American Express, Diners Club). In the case of a three-party scheme, only one PSP is involved, being at the same time the issuer and the acquirer.16 Three-party schemes do not have a MIF explicitly agreed between PSPs. There 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’ of the transaction or the other (i.e. the merchant or the cardholder), resulting in an implicit MIF.

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.

[16] 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.

**Figure 4 - 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 interchange 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. Hence, on the cardholder side, typically the direct cost of using the payment instrument is often not apparent unless merchants convey the information about the costs to consumers or turn down costly payment instruments, both of which they are reluctant to do for fear of losing business.

Usually, MIFs are justified by card schemes and card issuers either as a means to make a merchant cover the costs to the issuing banks or as a means to encourage consumers to use a payment card. In accordance with this theory, MIF enables low cardholder fees and allows card issuers to encourage the frequent use of the card by offering bonuses to consumers (e.g. air miles). More recently the ‘balancing mechanism’ argument has been used. Under this argument the MIF allows issuers to promote greater card use, which creates efficiencies for the society as card use is presumed to be more efficient and less costly than the use of cash.

These justifications have been much discussed and contested in economic literature, including as regards (imperfect) competition in the issuing and acquiring markets, the issue of internalisation of costs, the limits of steering and interchange fees acting as a means of transferring rent from acquiring to issuing banks which cannot be competed away by merchants as well as in competition enforcement cases. Regulatory intervention has gained prominence as a possible tool to deal with the competition and welfare issues raised by collectively set interchange fees. More details on this subject and card market are provided in Annex 5 and in the problem description below.

<u>Payment cards: Market size and integration</u>

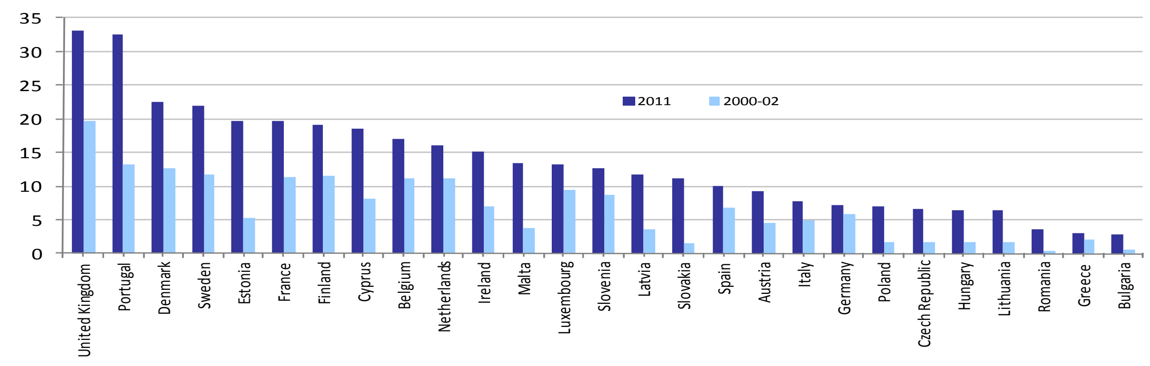
Payment cards are the most common and frequently used electronic payment instrument for retail payments.

In terms of volume (number of transactions), card payments represented 41% of all non-cash retail payments in 2011. There were some 727 million payment cards in use in the EU, representing 1.44 cards per capita. 63% of all cards issued in the EU were debit cards. On average, EU consumers spent on a yearly basis EUR 2 596 per card in 50 point-of-sale card transactions (in 2011[17]).

However, the potential economies of scale associated with this volume and its significant growth over the last two decades, have either not been realised so far or they have not been translated into substantially lower fee levels for consumers or merchants. The reasons for such situation are explained in this impact assessment.

The usage of payment cards across the EU Member States varies strongly, as shown by the table below.

**Figure 5 - Card payments (other than e-money) in value as a percentage of GDP**




Source: European Central Bank, Payment Statistics, Data as of September 2012[18]

Internet payments: Market size and integration

With the emergence of e-commerce, i.e. the buying and selling of products and services over the internet, payments over internet play an increasingly important role. They can take on different forms. For example, they can be based on card payments, credit transfers, direct debits, or through pre-funded accounts with dedicated internet payment providers.

According to Forrester Research the number of online shoppers in Europe is expected to increase from 157 million in 2010 to 205 million by 2015[19]. Annual growth rates of the e-commerce market size over the next five years are projected at around 10%. Average

17 Source: ECB Payment Statistics (http://www.ecb.int/press/pr/date/2012/html/pr120910.en.html), see Annex 5 with basic payment statistics for more details

18 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) p23

19 http://www.forrester.com/European+Online+Retail+Forecast+2010+To+2015/fulltext/-/E-RES58597

spending per capita at EU level is forecast to rise from EUR 483 in 2009 to EUR 601 in 2014. Despite its significant growth potential, e-commerce currently only represents 3.4% of all retail trade in the 27 Member States[20]. The internet economy has generated 21 % of the GDP growth of the last 5 years and could represent as much as 20% of GDP growth in the period up to 2015 in the Netherlands and the UK[21].

According to a public consultation on the future of e-commerce[22], payments have been identified as a significant barrier[23] to the future growth of e-commerce. The related key issues that were identified include the diversity of payment methods across Member States, the cost of payments for consumers and merchants and payment security. Regarding online banking based payments the lack of a coherent and comprehensive (self-) regulatory framework for payment initiation services[24] currently leads to a European internet payments environment that is largely fragmented along national borders with a limited number of domestic internet payment schemes[25] and a few proprietary solutions[26] for online-banking based payment initiation services. Furthermore, (potential) market participants seem reluctant to invest as long as the legal situation regarding scope for applying collective fee arrangements[27], such as for payment cards, has not been settled and common standards have not been identified.

<u>Mobile payments: Market size and integration</u>

Like internet payments, mobile payments can be based on card payments, credit transfers and direct debits, in each case using the underlying infrastructure of bank accounts, or performed through pre-paid cards or dedicated payment accounts which are not linked to bank accounts (e-money). Finally, mobile payments can also be settled through the Mobile Network Operator's (MNO) billing to the consumer.

Several studies indicate that the volume of payments made by using mobile phones is the fastest growing of all payment methods at the global level. The rapid proliferation of smart phones is fuelling this growth in developed markets. Gartner estimates the world-wide value of m-payments in 2012 at USD 171.5 billion, growing to USD 617 billion in 2016.[28] IE Market Research estimates the world-wide value of m-payments in 2012 at slightly above

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20 See Commission Staff Working Document Online services, including e-commerce, in the Single Market available at http://ec.europa.eu/internal_market/e-commerce/docs/communication2012/SEC2011_ 1641 _en.pdf

21 McKinsey Global Institute, Internet matters: The net's sweeping impact on growth, jobs, and prosperity, May 2011, on the G8 countries, South Korea, Sweden, Brazil, China and India. Available at: http://ww1.mckinsey.com/mgi/publications/internet_matters/pdfs/MGI_internet_matters_full_report.pdf

22 http://ec.europa.eu/internal_market/consultations/2010/e-commerce_en.htm

23 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

24 Third party providers that facilitate the use of the consumer’s online banking platform to make immediate guaranteed internet payments on the basis of credit transfers

25 iDEAL, Giropay and EPS

26 E.g. Sofortbanking, Trustly, or Safetypay.

27 Whether or not fees can be charged for internet payments will have an effect on the cost for potential market participants. Legal uncertainty in this regard slows down the growth of e-commerce

28 http://www.gartner.com/it/page.jsp?id=2028315

USD 100 billion and in 2015 at USD 945 billion.[29] This reflects annual growth rates of more than 37% and more than 100%, respectively.

However, market penetration of m-payments in the EU still lags behind, in comparison to other regions. According to Gartner, there were 26.7 million mobile payment users in Europe in 2012, compared to 85 million users in Asia/Pacific, 57.8 million users in Africa and 32.8 million users in North America.[30] A recent study suggests that the 'latent', i.e. untapped, demand for mobile payments in the EU amounts to more than EUR 50 billion in 2012.[31]

Several national initiatives started to emerge in Europe, for example the so-called 'Weve' joint-venture between three MNOs (Vodafone, O2, and Everything Everywhere) in the UK which is foreseen for commercial launch in 2013. Overall however, the market for mobile payments at European level is still fragmented. The lack of a concrete European framework addressing main concerns, such as technical standards, security and inter-operability, risks perpetuating market fragmentation for the m-payments market in Europe.

### *3.1.3 Overview of legislative framework*

Regulation (EC) No 2560/2001 on cross-border payments in euro was the first building block of the legislative framework on retail payments in the EU. The Regulation was later repealed by Regulation (EC) No 924/2009 on cross-border payments, primarily to include direct debits in the scope of the Regulation. The Regulation eliminated the differences in payment charges for payment service users (PSUs) between cross-border and national payments in euro within the Union. The Regulation applies to all electronically processed payments, including credit transfers, direct debits, cash withdrawals at ATMs, payments by means of debit and credit cards and money remittance.

The Payment Services Directive (PSD), adopted in 2007, aimed at establishing a harmonised legal framework necessary for the creation of an integrated payments market so that payments could be made more quickly and easily throughout the whole EU. By removing the legal and technical obstacles blocking the creation of a single payments market as well as by promoting market entry by a new class of financial institutions, namely payment institutions, the Directive aimed at introducing more competition in payment systems and facilitating economies of scale. At the same time the PSD facilitated the operational implementation of the Single Euro Payments Area (SEPA). The PSD also provides a set of rules with regard to information requirements and reinforces the rights and obligations linked to payment services.

More background on the PSD, including its objectives and impact, is provided in Annex 6.

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29 http://www.iemarketresearch.com/documents/3Q2011GlobalMobilePaymentMarketForecastOverview-September6-2011.pdf

30 http://www.simonwhatley.co.uk/mobile-payment-users-on-the-rise-says-gartner

31 The 2011-2016 Outlook for Mobile Payment (mobile Money) Services in Africa, Europe & the Middle East by Icon Group International, Inc. USD data was converted at 1.3 USD/EUR.

While the PSD did bring significant improvements in many areas a number of specific regulatory failures and gaps remain. These will be described in more details in the next section.

Other relevant legislation for the retail payments sector includes *inter alia*:

- The SEPA migration Regulation (EC) No 260/2012 which sets migration deadlines for pan-European credit transfers and pan-European direct debits, replacing national schemes for national and cross border euro payments within the European Union as of 1 February 2014. Regulation 260/2012 also addressed interchange fees for direct debit transactions;
- The E-Money Directive 2009/110/EC which provides for the legal framework to issue and redeem e-money (pre-paid payment instruments) and which brings the prudential regime for electronic money institutions in line with the requirements for payment institutions in the PSD; and
- Regulation (EC) No 1781/2006 which lays down rules for payment service providers to send information on the payer throughout the payment chain for the purposes of prevention, investigation and detection of money laundering and terrorist financing.

The regulatory framework is complemented by a number of investigations and cases in the context of EU competition law which were launched by the Commission over the past years in the field of retail payments.

## *1.4 Problem definition*

The following section provides a short overview of the main problem drivers. The specific problems created by these drivers are described in more detail under section 3.2.2. The negative effects caused by the specific problems are described under 3.2.3.

### *3.2.1 Drivers for integration gaps*

The Payment Services Directive has already allowed for significant progress regarding the overall integration of the retail payments market. However, there are a number of specific and well-defined problems in the field of card, internet and mobile payments. The drivers behind these problems broadly fall into two categories. First, in a number of areas, the market is not functioning optimally. Second, there are a number of gaps and shortcomings that revolve around the existing provisions in the legal framework.

#### 3.2.1.1 Market failures

The retail payments market is a two-sided market. This means that there are two distinct groups of users to which providers need to align their services: The consumers who are serviced by the issuer of payment instruments and the merchants who are serviced by acquirers of payment instruments. In the field of card, internet and mobile payments, transactions between these user groups are based on the intermediaries - "schemes" or "platforms" that connect the two user groups through a network.

Even if the corporate form may vary, banks often exercise control over key elements of schemes, especially in the case of card schemes, and have a commonality of interests in deriving revenues from it. While such schemes create societal value by enabling payment transactions, in certain cases schemes and/or scheme participants can use their market position to impose restrictive rules and business practices on other market actors. This is for example the case for so-called multi-lateral interchange fees (MIFs) which are fees set multilaterally and paid by the PSP of the merchant (acquirer) to the PSP of the card holder (issuer). Furthermore, certain rules, such as the so-called Honour All Cards Rule (see 3.2.2.2. below) limit the choice of payment instruments for merchants and consumers.

Restricted access to crucial components of the payments infrastructure is a possible source of market distortion. In many cases, these restrictions are applied by incumbent payment service providers (mostly banks) based on their market position in comparison to new entrants, such as new card schemes or new service providers of internet and mobile payments.

Finally, the lack of standards and inter-operability between different market actors, for example in the case of mobile payments, is possibly delaying the broad scale adoption of innovative payment methods.

#### 3.2.1.2 Regulatory and supervisory gaps in the PSD

The PSD has been adopted in December 2007 on the basis of a Commission proposal from December 2005. It constitutes the first, comprehensive legislation on payments in the EU and a good basis for the development of EU-wide payments. This legal framework generally proved valid and robust. However, an unprecedented development of the payments market, in particular the rapid emergence of e- and m-payments, gave rise to important challenges from a regulatory perspective. Many innovative payment products or services do not fall, entirely or in large parts, under the current scope of the PSD. This leads to legal uncertainty (no supervision, no regulation), potential security risks in the payment chain and to a lack of consumer protection. This is for example the case for online-banking based payment initiation services (PIS) provided by third party providers (TPPs)[32].

Furthermore, the current scope definition of the PSD and in particular the existing ‘negative scope’, which exempts certain payment-related activities from the general rules, proved in a few cases too ambiguous and too general, in particular taking into account market developments. As a result, the justification for some exemptions (like in the context of mobile payments and within so called limited networks) has changed. Some of the exempted and therefore unregulated service providers are now competing with the regulated players, enjoying unjustified competitive advantages (e.g. in terms of initial capital, own funds required, safeguarding of funds or liabilities and responsibilities vs. consumer) which results in an un-level playing field and creates consumer protection gaps.

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[32] 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 initiation services are usually provided by third party providers (TPPs) i.e. PSPs different than the bank that holds the account of the consumer.

Finally, some few of the 23 options set out in the PSD have been implemented and are enforced by Member States in very different ways. This has led to considerable regulatory arbitrage (e.g. as regards so called waived Payment Institutions), legal uncertainty, cases of poor consumer protection (e.g. in cases of consumer liability) and competitive distortions in a number of areas. This is e.g. the case of national options regarding so called small (waived) PIs, safeguarding rules, consumer liability thresholds and surcharging.

### *3.2.2 Specific Problems stemming from the problem drivers*

Five specific problems were identified and descriptions of these problems are presented in the following sections. Annex 7 provides more details and illustrations of the specific problems.

#### 3.2.2.1 Market fragmentation

Technical standardisation and interoperability are crucial in the network-based payments business to maximise the reach between users (consumers and merchants). Under a payment scheme, payment relevant information is transmitted on the basis of technical and commercial rules. In order to maximise the reach between payers, payees and their payment services providers, either a common set of technical requirements (such as those established for credit transfers and direct debits under Regulation 260/2012) or inter-operability between different schemes is required. In this context, card, internet and mobile payments all suffer, in varying aspects and to different degrees, from a lack of standardisation and inter-operability between different solutions, especially at cross-border level.

In the case of card payments, there is a lack of inter-operability between national debit card systems, resulting in diverging standards and messaging protocols, for example between the card terminal at the merchants' Point-of-Sale (POS) and the PSP acquiring the card payment. Similarly, card terminals are subject to different national certification procedures in order to comply with obligatory security criteria. While several European market initiatives are attempting to overcome these problems by setting common standards, the adoption and implementation of these standards across the market represents a major challenge and national protocols and approaches therefore still prevail.

Regarding internet payments, online-banking based payments are an attractive and often cheaper alternative to card payments. They could also open the world of e-commerce to many EU citizens, as less than half of the EU citizens own a credit card while more than 80% of EU citizens have a bank account.[33] However, inter-operability between online-banking based payment solutions is very limited, meaning that individual solutions only cover small clusters of banks and are limited to the national level.

Mobile payments, due to the nascent state of the market, show by far the strongest degree of fragmentation. The current landscape for proximity m-payments is characterised by applications for niche users and by a myriad of pilot projects, mostly at domestic or even local level. A lack of standards and inter-operability is identified as one of the key obstacles for the broad-scale adoption of mobile payments by numerous studies.

33 2011 Eurobarometer on Retail Financial Services, p. 9

The problems described above are overarched by insufficient governance arrangements for the European retail payments market. Until very recently, the European banking industry under the umbrella of the European Payments Council (EPC) has been the main driving force of the SEPA project by defining and developing business rules and standards for retail euro payments, in particular credit transfers and direct debits, as well as high level principles and rules for card payments.

The EPC is nonetheless perceived by large parts of the market, notably by users of payment services (consumers, retailers, corporates including SMEs), non-licensed market players offering payment-related services (such as TPPs) and new players in the field of e- and m payments as not balancing or adequately representing the interest of all actors in the market in its standardisation work. Even more, lack of adequate involvement of users (corporates, SMEs, retailers, consumers) and of the supply side players other than banks in the consultation and decision making process raises serious concerns about the capacity of this body to coordinate the development of the SEPA project from the governance perspective. Furthermore, the EPC does not possess the powers to ensure the implementation of the already defined standards.

In order to improve stakeholder involvement in the governance and to balance the interests of all market participants in the SEPA project, including in the process of the development of standards, an informal body, the SEPA Council was established in March 2010. It is composed of high-level representatives from the demand side (corporates, SMEs, retailers, consumers and public administrations) and the supply side (banks and payment institutions) of the market as well as the representatives of National Central Banks. The European Commission and the ECB, which strongly supported the creation of the Council, are co-chairing the meetings and providing the secretariat support. The SEPA Council started playing an important role in the SEPA project and providing useful input and support to the work of the Commission in the field of retail payments (notably in the run up to the migration to SEPA credit transfer and SEPA direct debit).

However, due to uncertainties surrounding the informal mandate of the SEPA Council (no clear responsibilities are defined, no follow-up to the recommendations, guidance and statements is ensured by the market) and its composition (specific groups on the supply side, e.g. some categories of payment service providers, market players falling outside the scope of current payments regulation, as well as some important participants on the demand side, e.g. internet retailers are still not represented), there is a need to reform the current arrangements. With the quick development of e- and m-payments the balancing of interests of all stakeholders and the need to meaningfully steer the SEPA process, including in the area of standardisation, is more pronounced than ever. Otherwise, there is a high risk of fragmentation of the market along national borders and proprietary standards for e- and m-payments. This is already the case for cards and the lack of standardisation in this area has deeply impacted the EU market.

The European Parliament and Council highlighted these problems and, in the context of the adoption of the SEPA Regulation[34], called for a review of SEPA governance and if necessary for a revised governance model.

3.2.2.2 Ineffective competition in certain areas of card and internet payments

In the area of cards there are several restrictive business rules and practices that lead to a situation of ineffective competition. This results in sub-optimal market outcomes and relatively high prices for card payments that are at the end of the day reflected in the prices of goods and services.

In this context, the ECB estimates the total social cost of payments at €156 billion per year in the EU or 1,2%% of GDP[35]. According to the same ECB report, the social costs of debit cards are about 1.4% of the transaction value, of cash about 2.3% and of credit cards about 3.4%[36].

*Interchange fees*

Multilateral Interchange Fees (MIFs) and Bilateral Interchange Fees (BIFs) for card based payments and the way they are defined and applied cause several problems.

**First, IFs are subject to reverse competition** meaning that competition between card schemes to attract card issuers (banks) leads to ever higher interchange fees (and consequently, MSCs). IFs are basically revenues offered to banks by card schemes in exchange for issuing their cards rather than the cards of the competitors. Therefore, an increase in MIFs offered by one card scheme leads banks to issue the cards of this particular scheme.

The UK debit cards market is an excellent example of how competition between Visa and MasterCard triggered an increase in interchanges fees. In 2005, MasterCard increased its MIFs to 6.93p per debit card transaction. In reaction Visa increased its interchange fee to 8.00p in 2007. MasterCard did not react at that time. The result was immediate: a number of banks decided to move to Visa. For example in 2009, HSBC switched 10 million customers from Maestro to Visa debit. Maestro had 27 million cards in 2008 but only 2.8 million in 2011, losing 90% of its market share in the process.

A similar situation was observed in Hungary, where in the result of the competition proceedings Visa consumer debit card MIFs were lowered to a level of 0.20%. This led to the massive migration of debit card issuers from Visa to MasterCard, with Visa losing 45% of its market share (more than a million cards) in the first semester of 2012 compared to 2009[37].

**Table 1**

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[34] See Recital 5 of Regulation EU 260/2012 of the European Parliament and the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation EC 924/2009.

[35] This includes social costs for households.

[36] ECB report on the cost of retail payments systems of September 2012. http://www.ecb.int/pub/pdf/scpops/ecbocp137.pdf. See in particular table 9. See also Annex 8 of this IA on the effects of ineffective competition.

[37] Cf. Table 50 under 9.2.1.1 (option 12 – no policy change)

| UK debit cards market[38] | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Mastercard | MIF per transaction (pences) | 5.97 | 6.93 | 6.93 | 6.93 | 6.93 | 6.93 | 6.93 |
| | Number of cards (million) | 24.6 | 24.9 | 25.8 | 27 | 20.8 | 8 | 2.8 |
| Visa | MIF per transaction (pences) | 6.50 | 6.50 | 8.00 | 8.00 | 8.00 | 8.00 | 8.00 |
| | Number of cards (million) | 42.4 | 43.7 | 45.8 | 49.3 | 58.5 | 76.6 | 83.5 |

As a result, a large and still growing part of the merchant service charge, paid by the retailers to acquirers for payment card acceptance, is determined by the interchange fee. MSCs in the EU add up to an amount of app. 14 billion EUR annually[39]. Close to 75 % 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)[40]. MIFs made up 60% of MSCs in Czech Republic in 2003, 60% in Italy in 2003 and 73% in Belgium in 2002[41].

Another aspect of the same problem is that banks issuing cards, getting ever higher MIF revenues can encourage consumers to use these cards through additional incentives (such as air miles, insurances, etc.), as the cost for these benefits is not directly apparent to the cardholder as they are borne in the first place by the merchant accepting the card. Merchants are normally reluctant to turn down payment instruments which are costly to them (and ultimately to their subsequent purchasers) for fear of losing business. For the same reason, most merchants prefer not to use surcharging (see also the section below, diverse charging practices – surcharging). As a result, merchants pass on to all their customers the increasing costs of accepting card payments through the general prices of their goods and services.

Furthermore reverse competition on MIFs also means that market entry for new pan-European players remains difficult. Such new schemes would have to offer issuing banks interchange

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38 Commission estimates based on figures from Worldpay 21 May 2012 and Payment Cards and Mobile, Nov.-Dec. 2012 p. 16-17e

39 Commission estimates

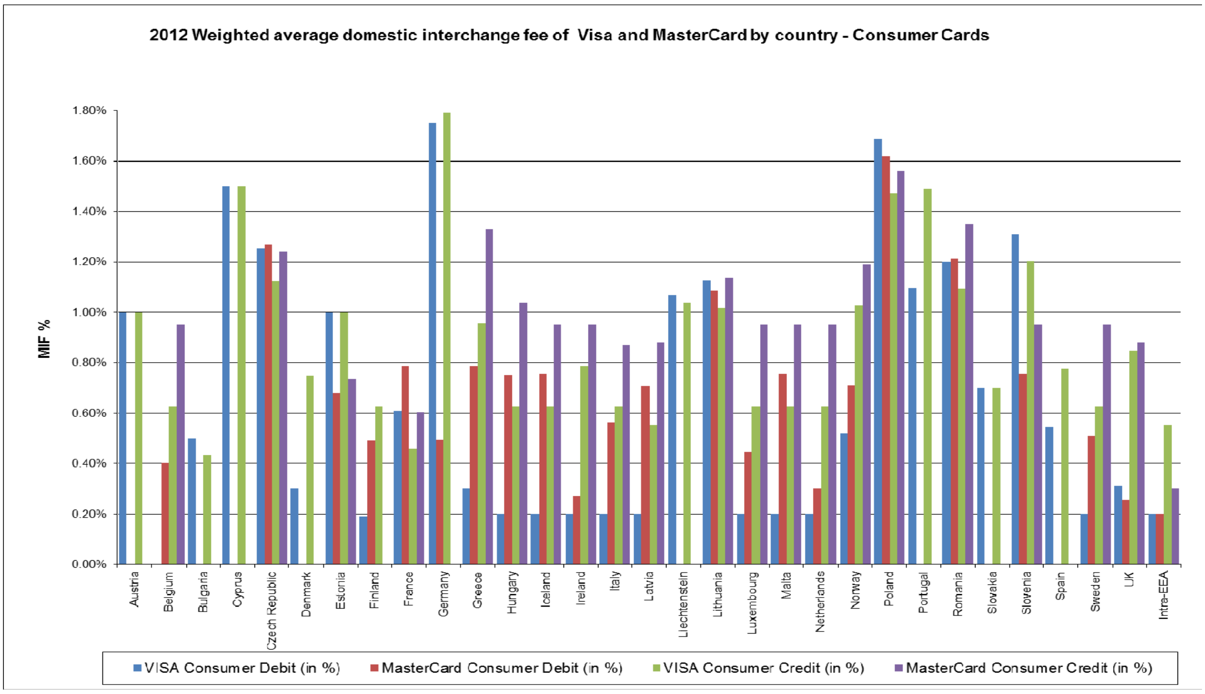
40 These estimated figures include the amounts corresponding to interregional fees, whose average weighted levels are considerably higher than for intraregional EU transactions, i.e. when the retailer and the cardholder are from the EU. In spite of a very limited share of inter-regional transactions in the total volume of card payments in the EU, the annual MIF amounts involved could be estimated at around 0.5 Bio €.

41 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).

fees that are at least comparable to those prevailing in the market they want to enter. This also explains why in a number of Member States, national ('cheaper') card schemes continue to dissapear and beeing replaced by MasterCard and Visa. This happened, for example, in the UK, Ireland, the Netherlands, and Finland. On top of maintaining the status quo in favour of incumbent card schemes, high MIFs also form barriers to entry for cheaper and more efficient payment solutions, e.g. in online payments area (offered e.g. by TPPs). This results in limited market entry and less payment innovation.

**Secondly, the widely diverging levels of MIFs** between Member States constitute a real obstacle for market integration.

**Figure 6 - Average domestic MIF levels in the Member States, 2012[42]**




The above graph illustrates that MIF levels show significant variation between 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.

This is especially the case when the widely diverging levels of MIFs between Member States are seen in combination with scheme rules which force acquiring banks to apply the MIFs applicable in the country where the payment transaction takes place even if the acquirer is based in a different country with a potentially lower domestic MIF level. This effectively eliminates the benefits of cross-border and centralised acquiring for merchants and limits their

[42] Commission estimates

ability to avoid paying high MSCs resulting from high MIFs through using acquirers in other Member States.

Another problem in the MIF area is **the perceived limited legal certainty**.

The General Court's MasterCard ruling of 24 May 2012[43] has confirmed the Commission's analysis that Multilateral Interchange Fees restrict competition, are forbidden under the competition rules and 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[44].

However, 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 in the case of Visa. In spite of the many past and current competition proceedings against MIFs at national and European level, domestic IFs are still there and vary widely in most Member States at a high level. The remaining domestic MIFs remain to be addressed by National Competition Authorities (NCAs), in close cooperation with the Commission, by the Commission itself or through private damages action. While arguably these domestic fees are not different from the MasterCard ones that were deemed unlawful and not justifiable under competition rules, competition enforcement for each MIF would be a long and fragmented process, which is unlikely result in a coherent, consistent and timely outcome across the EU. Arguably, only an 'across the board' lowering of fees by all market players for instance on the basis of regulation could assure EU wide alignment of the market based on the Court judgment.

In addition, since competition between payment card schemes is based on offering higher IFs to convince issuing banks to issue their cards, it is difficult for individual schemes to reduce their fees, as it will only result in giving the market to the other banks/schemes– as happened in Hungary. There is a 'last-mover-advantage' in complying as late as possible with Court cases and decisions from (European) competition authorities.

Competition proceedings on MIF

The Commission's Decision of 19 December 2007[45] prohibits MasterCard's multilateral intra-EEA interchange fee for cross-border payment card transactions made with MasterCard and Maestro 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

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

[44] Cf. The analysis for option 15 under 9.2.1.4 below

[45] 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

merchants and effectively determining a floor under the merchant service charge below which merchants are unable to negotiate a price.

The main argument of MasterCard was based on the efficiencies created by encouraging the issuing and use of 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. The Commission held that 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 (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 Commission stated that, in light of the Undertakings, it did not intend to open proceedings against MasterCard for non-compliance with the Decision[46.]

Following the expiry of the Visa II exemption decision in December 2007, the Commission opened an antitrust investigation against Visa. 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, based on the MasterCard Undertakings, but the MIF reduction only covered debit transactions (reduced to 0.2%). These commitments were made binding in December 2010[47.]

In May 2012, the General Court rejected MasterCard's appeal against the Decision of 2007. The General Court confirmed in particular that MIFs are not objectively necessary for the operation of a four party payment scheme. According to the Court banks can operate within a payment system without a MIF, save costs from card issuing (the use of debit cards reduces the need for cash handling by banks) and receive additional revenue from card issuing (interest on credit card balances). 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[48].

In July 2012 the Commission issued Visa a supplementary SO covering its MIFs for credit card transactions. In the supplementary SO sent to Visa in 2012, the Commission also expressed the concern that Visa's rules on the conditions of cross border acquiring were an infringement in their own right of the competition rules[49].

46 http://europa.eu/rapid/press-release_MEMO-09-143_en.htm?locale=en
47 Case COMP/39.398, *Visa MIF*, Commission Decision of 8 December 2010
48 OJ C 319 from 20.10.2012, p.4.
49 http://europa.eu/rapid/press-release_IP-12-871_en.htm?locale=en

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[50].

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[51], including in the UK, Germany and Italy.

*Other issues*

The ability of merchants to resist high IFs is also hindered by a number of business rules that for instance 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).

The Honour All Cards Rule (HACR) requires merchants to accept all products issued under the same brand, even if the fees for these cards can vary by a factor of 3-4 within the same card category (i.e. credit / debit cards in Belgium) or by a factor of up to 25 between card categories, such as premium credit card and low-cost debit cards in the UK. These costs, initially borne by the merchant are usually passed to the consumer through the price of the goods and services. Some of the business rules of card schemes, in addition to MIFs, have been addressed through the MasterCard Undertakings and the Visa Commitments, the applicability of which is however by nature limited in time.

Another problem caused by market restrictions is the lack of access to information on the availability of funds on a payment account by third parties. For example, for new card schemes, this implies that they depend on the willingness of the account servicer (often a bank) to provide this information in order for a payment to be initiated and guaranteed. This puts new players possibly at a disadvantage versus incumbents.

Finally, small Payment Institutions (PIs) often have difficulties to directly participate in designated payment systems. This creates competitive disadvantages versus banks. Indirect participation is possible for PIs in some cases, but again this creates competitive advantages for the bank through which indirect participation for the PI is enabled. In any case, there is an unlevel playing field between these PIs and incumbent banks.

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

51 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

#### 3.2.2.3 Diverse charging practices between Member States

A surcharge is a charge from merchants to consumers that is added on top of the requested price for goods and services when a certain payment method (usually a card) is used by the consumer. One of the reasons for surcharging is to direct consumers to cheaper (from the merchant's perspective) or more efficient payment instruments. The PSD provides an option for Member States to allow or prohibit surcharging in their territory. This has led to a situation where around half of the Member States allow surcharging while it is forbidden in the other half.

The problem of surcharging lies both in its original design and implementation. Because of the divergent national practices, it is often unclear for consumers whether merchants can surcharge them and under which conditions. Especially in the e-commerce sphere this can be confusing as merchants located in a country where surcharging is allowed can offer products and services in countries where it is not and in this case surcharge the consumer. Therefore the lack of harmonisation in this regard is a rapidly growing problem in itself.

Furthermore, surcharging was intended to allow merchants to steer consumers to the most cost-efficient payment method. However this 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 Honour All Cards Rule. As merchants are obliged to accept all cards within a brand and the fees for the use of these cards are usually not separated, merchants do not know which cards are most expensive and how much a single transaction costs them.

Moreover, in those countries where surcharging is allowed, surcharges are sometimes exploited by retailers who applied excessive surcharges to increase their revenues. Even though the Consumer Rights Directive 2011/83/EU prohibits excessive surcharges[52], consumer representatives from several Member States, in the public consultation on the Green Paper on payments, called for a ban on surcharging.

As the cost of a card payment for merchants is to a large extent determined by the MIF, any regulation of MIF should logically be accompanied by a revision of surcharging rules.

#### 3.2.2.4 Legal vacuum for third party providers (TPPs) for payment initiation services, account information services and other equivalent services

Since the adoption of the PSD in 2007, new services have emerged especially in the area of internet payments. In particular, third party providers, which do not maintain payment accounts for payers, offer so-called payment initiation services (PIS) to merchants. These services facilitate the use of the consumer's online banking platform to initiate immediate (typically guaranteed) internet payments on the basis of credit transfers. For this purpose, most PIS require that consumers introduce their online banking credentials (e.g. username, password and transaction authorisation codes) on the PIS provider's website for the initiation of a payment transaction. Some other PIS (often based on a scheme) are forwarding the

52 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:304:0064:0088:EN:PDF Article 19

consumer to the online banking website and are receiving the confirmation of the successful payment initiation from the account servicing PSP.

However, access to consumer online banking credentials by third parties raises a series of issues, ranging from consumer protection, security, liability to competition and data protection. As PIS providers are not licensed, they are not supervised by any competent authority and do not follow the PSD requirements. There is clearly an issue with the scope of the Payment Services Directive as it did not foresee such market developments.

TPP providers are present in the majority in the EU Member States, with an established position in the German, Dutch, French and Scandinavian market, as well as an increasing presence in Spain and Poland, among other countries. As the number of transactions initiated by the market leaders is counted in millions each month and rapidly increasing, and as the established providers enter new EU markets, there is an urgent need to address the concerns listed above.

#### 3.2.2.5 Scope gaps and inconsistent application of the PSD

Certain exemptions in the PSD lead to very divergent interpretation and application across Member States. In some cases the exemption criteria appear too general or outdated in respect of market developments, raising doubts about the appropriateness of the current scope of the Directive. In other cases the same exemptions are being interpreted by Member States in very different ways, thus indicating implementation difficulties. Finally, in many cases "would-be PSPs" often decide on their own that they should be subject to specific exemptions and do not consult or even inform the authorities about their exempted payment activities, indicating a serious enforcement problem. These identified problems are particularly applicable for the PSD exemptions regarding commercial agents (acting on behalf of the payer or payee), limited networks (in which payment activities take place), payment transactions initiated by a telecom device and independent ATM providers.

A second issue related to the scope of the PSD are the so-called one-leg transactions, i.e. when one of the PSPs involved in a payment transaction is located outside the EEA (e.g. in Switzerland or USA). In those cases the rights and obligations related to the transaction as well as transparency and information requirements of the PSD do not necessarily apply, since it is left to the discretion of the Member State or PSP. This creates confusion and detriment for PSUs, for example regarding information on applicable charges or liability rules for incorrectly executed transactions. Furthermore, payments in non-EU currencies fall outside the current scope of the PSD which creates similar problems as for one-leg transactions.

Finally, there are some issues around licensed Payment Institutions (PIs), a category of service providers which was introduced by the PSD. First and foremost, the possibility offered in the PSD for Member States to waive some requirements for small PIs seems to have led to an un-level playing field, giving competitive advantages for "waived" PIs. Some larger PSPs seem to have circumvented the law by setting up multiple legal entities which on an individual level stay below the waiver threshold.

The significance of these problems is often difficult to assess, given the lack of any reliable market data “by design”. Clearly, as the exempted providers are bound neither by a requirement to seek authorisation nor by any specific conduct of business rules, current exclusions encourage “would-be PSPs” to design or redesign their products so as to meet the exemptions criteria and, thus, to fall outside the PSD scope. It is unofficially observed by some market experts and representatives of the Member States that the size of the exempted market in terms of volumes and values may be much larger than the size of the regulated market. Certainly, in some Member States non-regulated providers have developed into powerful competitors to authorised providers in their respective niche markets (e.g. pre-paid cards, independent ATM deployers, bill payment providers, currency exchange bureaus). Given even these anecdotal data, there is an urgent need for revisiting the scope of the PSD.

The scope of the regulatory divergences and possible effects of arbitrage may also be roughly assessed by the distribution of PI licenses and national waivers for small PIs, though of course many other factors influence these figures. 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) are 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 only eight Member States, with the huge majority located again in the UK and Poland. Many of the PIs using extensively passporting are located just in two/three Member States.

#### 3.2.2.6 Conclusions

<u>PSD</u>

The case for a selective revision of the PSD some six years after its adoption and only four years after it has been transposed is strong and supported by the results of external studies[53], opinions of Member State authorities[54] and stakeholders[55]. The need for urgent action has been also highlighted by the European Parliament resolution of 20 November 2012[56]. Four main issues requiring the regulatory intervention are:

– Addressing the issue of legal vacuum for TPPs,
– Limiting risks of circumvention of the PSD in reviewing its negative scope,
– Changing these Member State options that lead to regulatory arbitrage (including surcharging) and
– Ensuring appropriate governance arrangements for SEPA.

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53 See the executive summary and conclusions section of “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)” by London Economics and iff in association with PaySys

54 Payments Committee meetings of 21 March, 9 July and 17 October 2012, accompanied by written consultations.

55 Payment Systems Market Expert Group meetings of 27 March and 6 November 2012, accompanied by written consultations

56 http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2012-0304&language=EN

These main changes could be accompanied by some fine-tuning measures (see chapter 5.6).

Interchange fees

IFs lead to much higher costs to merchants and ultimately their customers. Any efficiencies they generate do not appear to justify these costs, at least at the current IF levels. IFs also constitute an obstacle to market integration. These negative IF effects are reinforced by a number of business rules, which reduce transparency, limit the ability of retailers to steer their customers towards more efficient means of payment and the ability of retailers to choose an acquirer in another Member State. The lack of a level playing field persists, in spite of the many national and European competition proceedings. Fragmented competition law enforcement may even lead to further legal uncertainties and distortions. A reduction of IFs by all market players, would be the most appropriate way to ensure a competitive market.

### *3.2.3 Effects of the identified problems – a baseline scenario*

The problems identified in the sections above result in significant consequences for all stakeholders. The effects described below should be understood as a description of the situation in the payments market both today and in the foreseeable future, if no intervention is taken at the EU level. They can therefore be considered as a baseline scenario for the policy options described in Chapter 5 of this impact assessment. A short presentation of the main effects is provided in the following sections. Annex 8 provides a more detailed overview.

#### 3.2.3.1 Unlevel playing field between service providers / payment institutions

Barriers to market entry for new and innovative PSPs an: 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 the context of online and mobile payments. Even already existing and successful payment solutions face serious difficulties when they try to diversify their service offering into new areas or expand geographically.

While standardisation and interoperability work in the domain of card payments is advanced in most areas and is likely to progress further, the rate of this progress would continue to be slow. Market participants are unlikely to either universally agree on the choice and use of already existing standards or implement them, even in the medium term perspective (5-10 years), without a major regulatory push[57].

Providers operating with no authorisation and supervision by Member States: The gaps in the scope of the PSD lead to a situation where some market players are subject to authorisation and supervision by the Member States while others, operating on the same market and providing similar payment services, are not. This leads to very different costs and market access possibilities for regulated versus non-regulated players.

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[57] For example, the market driven adoption of the EMV card standard took some 15 years. The rates of migration to pan-European SEPA credit transfer and direct debit were also very disappointing and prompted an EU regulatory intervention in 2012.

Within the category of regulated PIs the competitive playing field is far from being equal or harmonised across the Member States. There are very different authorisation and prudential requirements for PIs, including different national rules for registration of small, waived PIs.

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 PI agents. Thus, some Member States grant numerous passports and allow for active provision of services by PI agents abroad, while other Member States are much more reluctant in this respect. Voluntary passporting guidelines, although existing, are not applied by those Member States that are against the cross-border provision of services without an establishment (either via an office or through an agent).

<u>Market dominance of (expensive) card schemes:</u> Market incumbents – in particular banks issuing cards and card schemes - are eager to protect and if possible increase the revenues from card payments, above all from MIFs. In some Member States national schemes – with lower fees – are being abolished and replaced by international schemes 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. The market share of two biggest international schemes in issuing cards in 2008 was 41.6% (Visa) and 48.9% (MasterCard) respectively[58].

Consequently, service providers offering payment solutions that could challenge the payment model based on MIFs (for example online-banking based payments) encounter serious difficulties in entering the market and in introducing their product onto the market. As explained above, this market dominance is unlikely to be comprehensively and consistently addressed through the enforcement of competition rules and precedents by the national competition authorities alone.

<u>No direct access to payment systems for PIs:</u> As PIs depend on banks for the settlement of their payments, this could in many cases impact negatively on the services they offer, including prices and execution times.

**Table 2 - 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) |
| Providers operating with no authorisation and supervision by MS | X | X | X | X (waived providers, other |

[58] 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.

| | | | | |
|---|---|---|---|---|
| | | | | businesses)) |
| Market dominance of (expensive) card schemes | X (main impact) | X | X | X (businesses) |
| No direct access to payment systems by PIs | X (main impact) | X | X | X (businesses) |

#### 3.2.3.2 High costs, limited choice and protection for Payment Service Users (consumers, merchants)

<u>High merchant service charges for the acceptance of card payments:</u> High MIFs lead to high Merchant Service Charges (MSCs) from acquiring PSPs to merchants. This is a challenge especially for small merchants as to whether they can afford to accept card payments due to their high cost.

On-going competition cases at the EU and national level as well as the General Court MasterCard case may address some of the MIF-related issues on a national and cross-border basis. This would however be a very long and fragmented process, with no guarantees to ensure any consistency across the EU[59]. Any competition and national procedure would also leave the question of the appropriate level of MIFs open. MIF could be also lowered in some Member States on the basis of regulation. However, in such case, the change would apply in a single Member State, lead to a similar fragmentation as the competition enforcement and be potentially easily circumvented by banks and card schemes due to a national-only scope reach of the law.

<u>Socialisation of costs for expensive payments instruments:</u> As card-issuing PSPs wish to obtain high revenues through the MIF income, they provide consumers with incentives to use high MIF cards, such as premium cards. Due to restrictive business rules of the card schemes merchants may not refuse to accept or charge the consumer for the use of such expensive cards. As a result, all consumer prices are inflated as the costs of even most expensive payment instrument are included in the prices for goods and services offered by the merchant

<u>Limited choice of payment instruments:</u> In those cases where merchants decide not to accept certain payment instruments based on their high cost, consumers are often limited in their choice of payment instrument and in many cases restricted to cash payments.

<u>Excessive surcharges in some cases:</u> Even if surcharging is often not allowed due to a prohibition at Member State level or restrictions based on the business rules of card schemes, in those cases where surcharges can be lawfully applied, they are sometimes used to generate incremental revenues for merchants.

The Consumer Rights Directive aims at addressing this problem. Its provisions should be enforced in the Member States as of 13 June 2014. However, actual enforcement might be complex in practice, taking into account the existing blending practices and HACR. At the

59 For example, it took five years between the MasterCard Decision (2007) and the General Court judgement. The judgement is now being appealed by MasterCard.

same time, limitation to costs may also result, in different treatment of cardholders from different Member States[60].

Overly strict liability rules: Due to Member States' inconsistent application of the PSD rules on liability, payment service users are often exposed to overly strict liability regimes. This concerns in particular the liability for an unauthorised transaction and responsibility for the use of lost, stolen or misappropriated payment instrument or credentials.

Limited or non-existent protection for some categories of payment transactions: As a result of the scope of the PSD, payment service users suffer from a lack of consumer protection, for example in the case of one-leg transactions, payments in limited networks or payments initiated by mobile devices.

**Table 3 - Effects of the identified problems (High costs, limited choice and protection for Payment Service Users)**

| Effect | PSPs | Consumers | Merchants | Other stakeholders |
|---|---|---|---|---|
| High merchant service charges for card payments | - | X | X | - |
| Socialisation of costs of expensive payment instruments through prices for goods and services | - | X | - | - |
| Limited choice of payment instruments | - | X | X | X (businesses, administration) |
| Excessive surcharges | - | X | - | - |
| 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 |

#### 3.2.3.3 Low cross-border activity (market integration)

No genuine cross-border acquiring: A genuine Single Market for acquiring services has not yet materialised. There is no incentive for even large European retail companies to use the services of acquirers located in another Member State since domestic rules apply. This leads to missed opportunities for economies of scale and the streamlining of operations.

Limited choice of payment service providers: Similar barriers make it difficult for providers to expand their operations beyond their country of origin. For merchants, this usually limits the choice of payment or acquiring service providers to the domestic incumbents.

60 In view of huge differences in MIF and MSC on national and cross-border basis, different surcharges could apply to payments with cards issued nationally and cards issued in other Member States, leading to indirect discrimination based on nationality.

Limited choice of payment instruments for cross-border online purchases: Due to a lack of inter-operability, in particular for debit cards or online-banking based payments, consumers are mostly restricted to credit cards and wallet solutions (such as Paypal) when buying online in a different country. These payment methods are expensive for merchants and discourage many of them from taking-up cross-border trade.

Slower take-up of cross-border e-commerce: As a consequence, there is a growing gap between the popularity of domestic and cross-border e-commerce. In 2011, 34% of consumers in the EU ordered goods or services over the internet domestically, but only 10% of them ordered products on a cross-border basis.

**Table 4 - 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 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) |

#### 3.2.3.4 Dispersed and hampered innovation

Limited economies of scale for providers: Due to technical differences between national payment formats and infrastructures, new market entrants or existing payment providers who would like to start offering innovative services see their business case restricted to the national market. This limits the potential for scale economies, both in terms of cost reductions and potential revenues and therefore discourages start-up investments.

Competitive disadvantage of EU versus other regions: A fragmented environment along national borders might lead to lagging innovation in Europe in comparison to other regions. Whereas leading players in internet payments mostly originate in the US (PayPal, Amazon), the most promising developments in mobile payment can currently be observed in Asia Pacific.

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

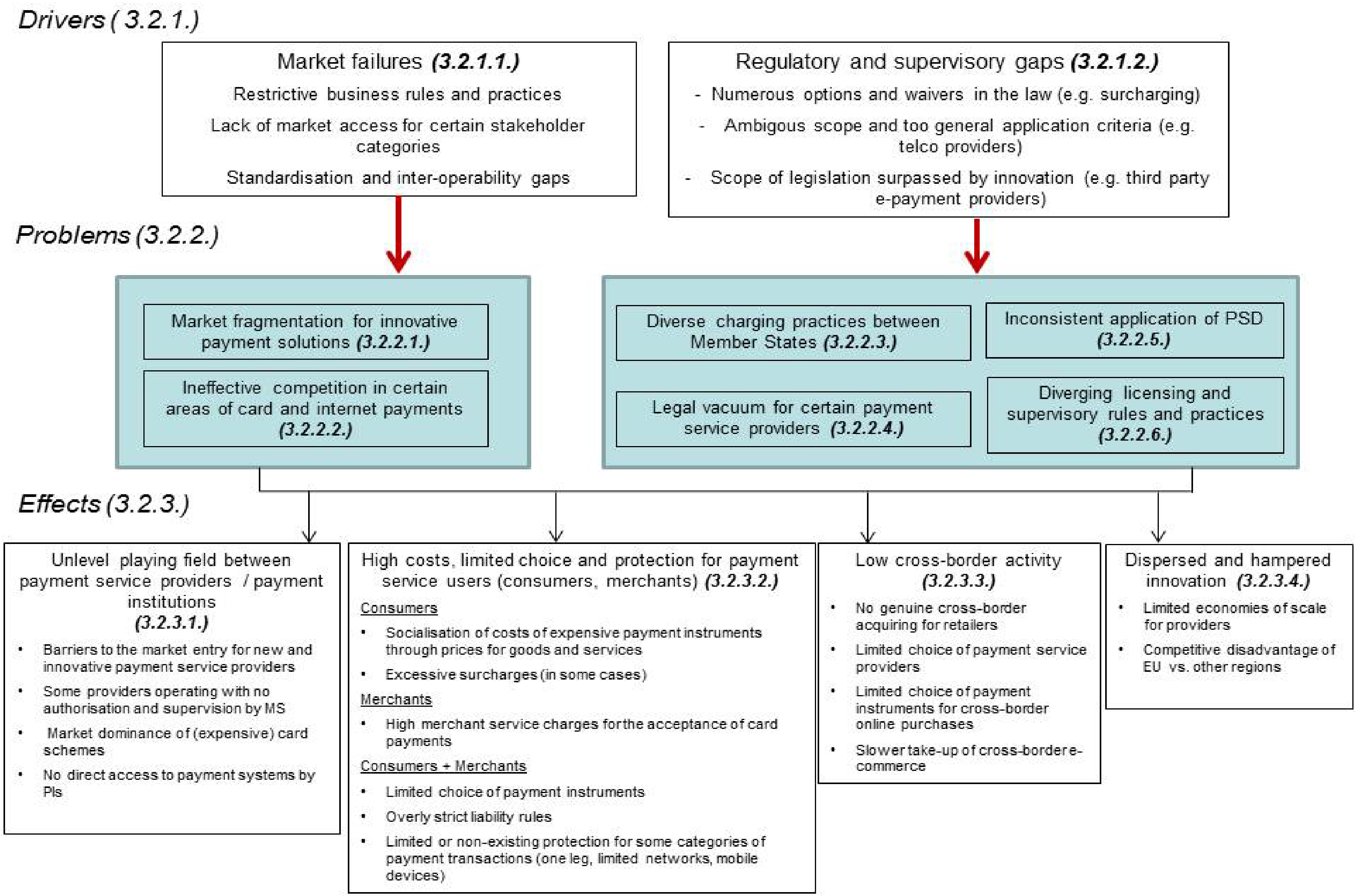
| Effect | PSPs | Consumers | Merchants | Other stakeholders |
|---|---|---|---|---|
| Limited economies of scale for providers | X | - | - | - |

| | | | | |
|---|---|---|---|---|
| Competitive disadvantage of EU vs. other regions | X | - | - | X (businesses) |

### *3.2.4 The problem tree*

The figure below provides an overview of the various problems, their drivers and their consequences.

**Figure 7 - Problem tree:**


Drivers (3.2.1.)
Market failures (3.2.1.1.)
Restrictive business rules and practices
Lack of market access for certain stakeholder categories
Standardisation and inter-operability gaps
Regulatory and supervisory gaps (3.2.1.2.)
- Numerous options and waivers in the law (e.g. surcharging)
- Ambigous scope and too general application criteria (e.g. telco providers)
- Scope of legislation surpassed by innovation (e.g. third party e-payment providers)
Problems (3.2.2.)
Market fragmentation for innovative payment solutions (3.2.2.1.)
Ineffective competition in certain areas of card and internet payments (3.2.2.2.)
Diverse charging practices between Member States (3.2.2.3.)
Inconsistent application of PSD (3.2.2.5.)
Legal vacuum for certain payment service providers (3.2.2.4.)
Diverging licensing and supervisory rules and practices (3.2.2.6.)
Effects (3.2.3.)
Unlevel playing field between payment service providers / payment institutions (3.2.3.1.)
• Barriers to the market entry for new and innovative payment service providers
• Some providers operating with no authorisation and supervision by MS
• Market dominance of (expensive) card schemes
• No direct access to payment systems by PIs
High costs, limited choice and protection for payment service users (consumers, merchants) (3.2.3.2.)
Consumers
• Socialisation of costs of expensive payment instruments through prices for goods and services
• Excessive surcharges (in some cases)
Merchants
• High merchant service charges for the acceptance of card payments
Consumers + Merchants
• Limited choice of payment instruments
• Overly strict liability rules
• Limited or non-existing protection for some categories of payment transactions (one leg, limited networks, mobile devices)
Low cross-border activity (3.2.3.3.)
• No genuine cross-border acquiring for retailers
• Limited choice of payment service providers
• Limited choice of payment instruments for cross-border online purchases
• Slower take-up of cross-border e-commerce
Dispersed and hampered innovation (3.2.3.4.)
• Limited economies of scale for providers
• Competitive disadvantage of EU vs. other regions

### 1.5 *The EU's right to act and justification*

An integrated EU market for electronic retail payments market contributes to the aim of Article 3 of the Treaty on the European Union stipulating an internal market. Market integration is necessary to fully unlock a number of benefits for European citizens. These benefits include more competition between payment service providers and more choice, innovation and security for payment service users, especially consumers. An integrated payments market ultimately facilitates the cross-border provision of goods and services and thereby contributes to a genuine Single Market. The depth of revision of the Payment Services directive is proportionate to the issues arisen to date. PSD remains globally fit for purpose; at the same time, this EU legal framework needs to evolve to take due account of the latest technological and business developments in the area of retail payments.

According to the subsidiarity principle, EU action should only be taken if the envisaged aims cannot be achieved by Member States alone.

By its nature an integrated payments market, based on networks that reach beyond national borders, requires a Union-wide approach as the applicable principles, rules, processes and standards have to be consistent across all Member States in order to achieve legal certainty and a level playing field for all market participants. The alternative to a Union-wide approach would be a system of multilateral or bilateral agreements the complexity and costs of which would be prohibitive as compared to legislation at European level.

Member States, in many cases, have refrained from acting at national level, pending the adoption of possible measures at the level of the Union.

A possible intervention at EU level therefore complies with the subsidiarity principle.

The approach supports the Single Euro Payments Area (SEPA) and is consistent with the Digital Agenda, in particular the creation of a Digital Single Market. It promotes technological innovation and contributes to growth and jobs, in particular in the areas of e- and m-commerce.

## 4 OBJECTIVES

According to Article 26 of the Treaty on the Functioning of the EU, the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties. In the context of the Union policy and in accordance with the problems identified in Chapter 3, the following policy objectives are identified:

*General:*

– To ensure a level playing field between incumbent and new providers of card, internet and mobile payments

– To increase the efficiency, transparency and choice of payment instruments for payment service users (consumers and merchants)

– To facilitate the provision of card, internet and mobile payment services across borders within the EU by ensuring a Single Market for payments

– To create an environment which helps innovative payment services to reach a broader market

– To ensure a high level protection for PSUs across all Member States of the EU

*Specific:*

– To address standardisation and interoperability gaps for card, internet and mobile payments

– To eliminate hurdles for competition, in particular for card and internet payments

– To better align charging and steering practices for payment services across the EU

– To ensure that emerging payment service providers are covered by the regulatory framework governing retail payments in the EU

– To improve the consistent application of the legislative framework (PSD) across Member States and to better align licensing and supervisory rules for payment services across Member States

– To protect the consumer interest in view of regulatory changes in the card business and to extend the regulatory protection to new channels and innovative payment services

*Operational:*

– To reinforce the governance of the SEPA project and to empower all stakeholders to take a more active role in the conception and realisation of the retail payments policy (governance)

– To facilitate standardisation through adequate governance framework and through the better involvement of the European Standardisation Organisations (standardisation)

– To ensure legal certainty in the field of interchange fees for card-based payments and provide clarity on an acceptable business model for current and future payment initiatives based on cards (interchange fees)

– To abolish restrictive business rules for card payments which lead to market distortions (interchange fees flanking measures)

– To harmonise the Member States policies on surcharging in line with the regulatory decisions on interchange fees (interchange fees flanking measures)

– To define conditions of access to the information on the availability of funds for third party providers, including payment initiation services (scope of the PSD)

– To adjust the scope and improve the consistency of the legislative framework (scope of the PSD),

– To improve the implementation of the existing PSD rules (PSD fine-tuning measures)

– To reinforce the rights of PSUs in the PSD and safeguard the consumer rights in view of the regulatory changes (scope of the PSD, interchange fee flanking measures)

# 5 POLICY OPTIONS

## *1.6 Market fragmentation*

### *5.1.1 Weak governance arrangements*

#### 5.1.1.1 No policy change

No legislative or non-legislative action from the Commission is envisaged. The SEPA Council would remain an informal body based on its current mandate.

#### 5.1.1.2 A self-regulatory body set up by market participants

A new self-regulatory body could be set in place at the initiative of market participants. The existing EPC which currently only consists of banks and one payment institution could be invited by the Commission to open its membership to all stakeholders in the field of retail payments. The current EPC could become a balanced forum of the supply and the demand side. The existing SEPA Council would remain as it is today in its composition and functioning.

#### 5.1.1.3 Formal body based on legal act of the co-legislators

An alternative option would be to transform the informal SEPA Council into a European Retail Payments Council and set it up as a formal body based on a legal act of the co-legislators with a clarified mandate. This could be achieved through the revision of the PSD or in an autonomous new Regulation. The draft legislation would be accompanied by a Commission Communication on the review of retail payments governance arrangements.

### *5.1.2 Standardisation and interoperability gaps (for card and mobile payments)*

#### 5.1.2.1 No policy change

No legislative or non-legislative action from the Commission is envisaged.

#### 5.1.2.2 Drive standardisation through the governance framework for retail payments

In order to ensure the involvement of all relevant stakeholders, standardisation for card or mobile payments could be addressed through a formally set up governance body (see previous section) in the future. Possible technical working groups in this context would be entirely open to all interested stakeholders.

#### 5.1.2.3 Mandate to European Standardisation Organisation

Three independent European Standardisation Organisations (ESOs) are officially recognized by the European Institutions as competent in the area of technical standardisation[61]. The two relevant ESOs in the context of card and mobile payments are the Committee for European Standardisation (CEN) and the European Telecommunications Standards Institute (ETSI). These organisations provide a framework to prepare voluntary standards with the participation of all relevant stakeholders. The Commission may issue standardisation mandates to the ESOs to develop standards that are needed in support of policy or legislation, or that meet a set of pre-determined requirements. Applying standards would nevertheless remain voluntary.

#### 5.1.2.4 Establish mandatory technical requirements through legislation

In the context of credit transfers and direct debits, Regulation (EU) No 260/2012 established a number of technical and business requirements for credit transfers and direct debits. The requirements become mandatory upon the entry into force of the Regulation after a transition period. A similar approach could be envisaged for card and/or mobile payments.

## *1.7 Ineffective competition in certain areas of card and internet payments*

To address the restrictive business rules and practices that lead to a situation of ineffective competition, several options can be envisaged.

### *5.2.1 Interchange Fees (IFs) for card payments*

It is proposed that the options following below cover debit and credit card transactions, as well as the e- and m-payments that are based on card transactions.

#### 5.2.1.1 No policy change

No legislative or non-legislative action from the Commission is envisaged. This would imply that those practices would only be addressed by possible competition proceedings.

#### 5.2.1.2 Regulate cross-border acquiring and the level of interchange fees for cross-border transactions only

Caps for the IF for cross-border transactions could be set – e.g. at 0.2% of the transaction value for debit cards and 0.3% of the transaction value for credit cards. Allowing cross border acquiring would mean the IF paid would be either the IF for cross-border transactions (capped), or the IF applicable in the acquirer’s Member State.

#### 5.2.1.3 Mandate Member States to set domestic IFs on the basis of a common methodology

Legislation would define the methodology for setting domestic interchange fees, and it would be up to each Member State to implement it. The disparity between national measures could

[61] Regulation (EU) No 1025/2012 of the European Parliament and of the Council of 25 October 2012 on European standardisation

in theory be reduced by supplementary use of caps or cap ranges, on top of the national solutions.

#### 5.2.1.4 Regulate a common, EU-wide maximum level for interchange fees.

A maximum, EU-wide interchange fee level for consumer debit cards and consumer credit cards would be set. There are four sub-options possible, depending on (1) whether the maximum IF cap covers both debit and credit cards or just debit cards and (2) whether the IFs for debit card transactions are to be forbidden altogether or just reduced to a low level.

**Table 6 – Sub-options (Regulate a common, EU-wide maximum level for interchange fees)**

| Suboption | Debit cards IFs (domestic) | Credit cards IFs (domestic) |
|---|---|---|
| 1 | maximum 0.2% of the transaction value | Not covered by the legal act |
| 2 | Prohibition | Not covered by the legal act |
| 3 | maximum 0.2% of the transaction value | maximum 0.3% of the transaction value |
| 4 | Prohibition | maximum 0.3% of the transaction value |

This option could be considered in combination with the option of regulating cross border acquiring above. The caps identified above (0.2%; 0,3%) are set on the basis of existing proceedings, cases at European level and recently negotiated agreements between French competition authorities and *Groupement des Cartes Bancaires.*

#### 5.2.1.5 Exemption of commercial cards and cards issued by three party schemes

Commercial cards and three party schemes – to the extent that they do not make use of licensed banks – would be exempted from the options previously discussed as these schemes have limited market shares in the EU and different fee structures.

#### 5.2.1.6 Regulate Merchant Service Charges.

This would imply regulating the fees paid by the retailer to its acquiring bank (Merchant Service Charges (MSCs)). These fees cover not only interchange fees but also the other fees merchants have to face i.e. scheme fees and fees for the acquiring Payment Service Provider.

### *5.2.2 Restrictive business rules*

#### 5.2.2.1 No policy change

No legislative or non-legislative action from the Commission is envisaged.

#### 5.2.2.2 Voluntary removal of Honour All Cards Rule by card schemes

Under this option, the Honour All Cards Rule would be voluntarily removed by card schemes by self-regulation, thereby allowing merchants to differentiate between the payments cards they wish to accept.

5.2.2.3 Regulating a Prohibition of (part of) the Honour All Cards Rule

This option would give merchants the freedom to choose the payment cards that they wish to accept within each card brand. Nevertheless, merchants would have to accept these cards regardless of where they were issued. (Honour All Issuer Rule).

## *1.8 Diverse charging practices between Member States*

### *5.3.1 Steering practices - surcharging*

5.3.1.1 No policy change

No legislative or non-legislative action from the Commission is envisaged.

5.3.1.2 Prohibit surcharging for all payment transactions in all Member States

In order to harmonise current practices regarding surcharging, an option would be to prohibit it in all Member States.

5.3.1.3 Allow surcharging in all Member States

In order to harmonise current practices regarding surcharging, an option would be to allow merchants to use surcharging in all Member States.

5.3.1.4 Oblige merchants to always offer at least one "widely used payment means" (non-cash) without any surcharge

This option would ensure that merchants always offer the consumer the possibility to pay with one payment means available on a pan-European basis without being surcharged.

5.3.1.5 Ban surcharging for IF-regulated payment instruments and allow for non-regulated

Under this option merchants would not be able to surcharge for those payment instruments that were subject to IF regulation, but would be allowed to surcharge those that are based on these and entail additional costs and those instruments that are expensive for them.

## *1.9 Legal vacuum for certain payment service providers*

### *5.4.1 Access to information*

Access to information on the availability of funds for new card schemes and other third party providers (TPPs), including payment initiation services, account information services and other equivalent services

5.4.1.1 No policy change

No legislative or non-legislative action from the Commission is envisaged.

5.4.1.2 Define the conditions of access to the information on the availability of funds, define rights and obligations of the TPPs, clarify the liability repartition

Under this option, the conditions of access to the information on funds would be set in the PSD. Whereas card issuers, new or existing, are considered and licensed as payment institutions (or credit institutions), TPPs would be required to become licensed under the scope of the PSD before they offer their services within the EU. The issues of rights, obligations and liabilities between TPPs, banks servicing the accounts and consumers would be also set. TPPs would be obliged to explicitly inform consumers about the information they access. Security and data protection requirements applying to TPPs and banks would be specified in order to foster trust in these services and to ensure an equivalent level of protection for the users as the ones already provided in the PSD.

5.4.1.3 Allow TPPs access to the information on the availability of funds under a contractual agreement with the account servicing bank

The possibility for a TPP to access payment accounts on behalf of consumers would be subject to a mandatory collective or individual contract between the TPP and the account issuing PSP.

### *1.10 Scope gaps and inconsistent application of the PSD*

In order to address the specific problems related to inconsistent application of the PSD, several possible options for each of the identified problems are proposed:

#### *5.5.1 Negative Scope of the PSD*

Each of the options discussed below could be chosen separately for each of the discussed exemptions

5.5.1.1 No policy change

Under this baseline option the scope of exemptions in the PSD would remain unchanged.

5.5.1.2 Update and clarify the scope of exclusions

Following this option the scope of the commercial agent, limited network, telecom and ATM exemptions would become more clearly defined through an update of the definitions in the PSD.

5.5.1.3 Delete the exclusions

Under this option, 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.

5.5.1.4 Require payment service providers that make use of the exclusions under the PSD to inform the competent authorities and ask for their clearance.

Any payment service provider that intends to benefit from the exemptions under the PSD would be obliged to inform the competent authorities on the scope of these exemptions or to receive their approval before starting any payment activities, if appropriate.

### *5.5.2 "One-leg" transactions and payments in non-EU currencies*

5.5.2.1 No policy change

The application of the PSD to one-leg transactions and to transactions in non-EU currencies would not be harmonised across the Member States.

5.5.2.2 Full extension to all one-leg transactions and all currencies

The PSD would become fully applicable to one-leg payment transactions and payments in non-EU currencies.

5.5.2.3 Selective extension of certain PSD rules to one-leg transactions and to all currencies

Only certain specific provisions of the PSD, for example on the information requirements or liability, would become applicable to one-leg payment transactions and payments in non-EU currencies.

## ***1.11 Other measures***

The previous sections described the main policy options addressing the identified problems. Beyond this, there are a number of other possible measures which either address problems of a lower priority or ensure that the main policy options are fully effective without having a significant impact per se (ancillary measures).

### *5.6.1 Ancillary measures addressing competition issues*

The first set of measures includes additional requirements to make the policy options addressing interchange fees and interchange fees flanking measures more effective. This includes:

- The requirement for card schemes and issuing banks to enable merchants to technically distinguish between different card types, in particular consumer versus commercial cards.
- The requirement for card schemes and acquiring banks not to blend fees for different types of payment cards unless it is requested by the merchant, so that merchants are enabled to make a choice of the charging method and distinguish the fees of individual payment instruments, if required.
- The requirement for card schemes and acquiring banks to issue invoices when charging merchants.
- The requirement for card schemes and acquiring banks to allow merchants to provide information on the cost of different payment instruments to consumers.
- The requirement for terminals at the Point-of-Sale to enable the consumer to make a choice of the preferred payment instrument in case several payment instruments are available on the same device.
- The requirement for card schemes to allow acquirers to operate on a cross-border basis once they are licensed under the scheme and not to limit the acquiring services to one country.

- The requirement for certain card schemes not to prevent merchants from applying surcharges for the use of a specific means of payment, implying the abolishment of the so-called Non-Discrimination Rule imposed by some card schemes.
- Addressing the possible circumvention of MIF regulation, in particular possible fee increases to compensate the revenue losses of card schemes and banks.

The cumulative impact of these measures is low in comparison to the main measures proposed in the previous sections. Nevertheless, a more detailed description of these measures is provided in Annex 10.

### *5.6.2 PSD 'fine-tuning' measures*

The second set of measures represents a 'fine-tuning' of provisions which already exist in the current PSD. This includes:

- Strengthening the implementation of information requirements from PSPs to payment service users, in particular regarding the timeliness and transparency of the provided information.
- Streamlining and harmonising the safeguarding requirements for Payment Institutions (PIs) licensed under the PSD, in particular reducing current possibilities for Member States to limit or extent safeguarding requirements and reducing the number of possible safeguarding methods.
- Clarifying the rules for the passporting regime of PIs operating in several Member States by providing notification guidelines (for example issued by a European Supervisory Authority) and criteria to distinguish between the free provision of services and the right of establishment.
- Clarifying the rules on passporting for PIs operating in several Member States, via guidelines or regulatory technical standards, specifying cooperation between competent authorities in home and host Member States in the context of notification and supervision of the PI, their agent and branches (for example through a mandate to the a European Supervisory Authorities).
- Fine-tuning the provisions on access to payment systems by PIs, by providing the PIs with a possibility to access the designated payment systems indirectly, in a way comparable to the access enjoyed by smaller banks.
- Clarifying the refund right for direct debit transactions,
- Lowering and harmonising across the Member States the consumer liability threshold in case of theft or loss of a payment instrument and adding precision to the gross negligence concept,
- Decreasing the waiver threshold for small payment institutions.
- A more detailed impact analysis of these measures is provided in Annex 11.

## 6 ANALYSIS OF IMPACTS

This section summarises the policy options and their impacts on stakeholders. The policy options are not necessarily mutually exclusive and should not therefore automatically be viewed as alternatives. They may be combined to achieve a more effective and efficient outcome. The preferred policy options are indicated in bold. When comparing the options, the tables illustrate how each of the policy options contributes to meeting the objectives and their efficiency (cost-effectiveness) in doing so when compared to the 'Do nothing' hypothesis. The following schema is used: +++ (strong positive contribution), ++ (moderate positive contribution), + (weak positive contribution), --- (strong negative contribution), -- (moderate negative contribution), - (weak negative contribution) and 0 (neutral contribution). The impact on stakeholders follows a similar approach.

**The following sections combine key conclusions on the impact of each option and on the comparison between available options. A more detailed impact analysis, mirroring the structure of this chapter, is provided in Annex 9.**

## *1.12 Market fragmentation*

### *6.1.1 Weak governance arrangements (operational objective 1)*

#### 6.1.1.1 Option 1 (No policy change)

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 role and it might decide to decrease its 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.

#### 6.1.1.2 Option 2 (A self-regulatory body set up by market participants)

This market-driven approach would not satisfy all stakeholders, especially consumer representatives, who clearly call for a strong driving 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 in the end call for increased corrective measures by the Commission.

#### 6.1.1.3 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. The body would 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 call from most market participants 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 a better clarified role vis-à-vis the Commission and the ECB who would keep their freedom to act at any time, in accordance with their competences as laid down in the Treaty.

Option 3 would contribute to defining the steering 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, set up as a formal body and based on a legal act adopted by the co-legislators (e.g. through the revised PSD) 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. The preferred option 3 enjoys the support of most stakeholders, except banks, who have a preference for self-regulation.

**Table 7 -Summary of the impact for governance (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 8 - 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** | **(+)** | **(+)** | **(+)** |

### *6.1.2 Standardisation of card payments (operational objective 2)*

#### 6.1.2.1 Option 4 (No policy change)

Based on a study on the benefits of SEPA and assumptions on the share of payment cards in these potential benefits, savings of up to EUR 25 billion over six years could be generated from full integration of the cards market. These benefits would mostly apply to merchants and consumers. However, this assumes a standardised card market.

European market initiatives for card standardisation exist and a 'do nothing' approach on card standardisation could eventually lead to market uptake for these initiatives but only over a relatively long time span (20 years or more based on a comparison with the EMV standardisation initiative) and possibly only by a limited group of market actors. This would delay or even partially eliminate the possible economic benefits mentioned above.

#### 6.1.2.2 Option 5 (Standardisation through governance framework for retail payments)

This option could create benefits versus the baseline option, in particular an accelerated and more comprehensive adoption and implementation of existing standards for card payments by market actors. The option could therefore facilitate the realisation of the possible economic benefits mentioned under the baseline option. This option would also take a proper account of the need to involve online and mobile payment service providers given their possible link to card payment.

Technical frameworks for card payments are already in place and do not have to be developed from scratch. Since the focus is therefore more on the implementation of the existing frameworks into practice, the European Retail Payments Council would be a more appropriate forum than European Standardisation Organisations for that purpose. The composition of the European Retail Payments Council with participants of the supply and demand side of the market would ensure that there is a proper balance of interests.

On the functioning, the European Retail Payments Council would be mandated to set up a new multi-stakeholder group being responsible for the implementation of the general strategy into practice. This new group would be set-up for a limited period of time to perform technical work, such as developing common standard implementation guidelines and technical standards, if need be. Stakeholder representatives at expert level would be present due to the executive nature of this work. The European Retail Payments Council would strive for a proper, efficient, timely and transparent function for the multi-stakeholder group and closely monitor its work. The multi-stakeholder group could set up as hoc technical working group(s) or exceptionally entrust the technical work to the market. At the very end, the European Retail Payments Council would assess the work delivered by the complementary level and in case of a positive assessment adopt it. The assessment would be accompanied by possible recommendations to the ECB and Commission, to ensure the proper implementation of the standards.

6.1.2.3 Option 6 (Mandate to European Standardisation Organisation)

The main benefit of this option versus option 5 is the possibility for stronger steering role of the Commission from the very beginning, ensuring truly balanced participation of all stakeholders in the conception of open standards, fulfilling all criteria of various market participants, in particular users. However, this advantage is more than offset by the fact that stakeholder participation in ESO work is always voluntary and at this stage, with many market-driven initiatives already on-going and well advanced, participation by the supply side of the market could be very limited. Moreover, starting card standardisation from the beginning would risk undermining the momentum achieved on card standards over last years. Implementation of the standards might be put at risk. This assessment is further reinforced by stakeholder comments provided in the context of the public consultation on the Green Paper on payments.

This option would therefore be far less effective –under the current market situation – in accelerating the materialisation of benefits from standardisation in comparison with option 5. The possible involvement of ESOs could be revisited in the medium term if sufficient progress through option 5 is not achieved.

6.1.2.4 Option 7 (Establish mandatory technical requirements through legislation)

While this option creates certainty regarding the timeframe and the comprehensiveness of take-up by all market actors, 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.

Conclusion

Card standardisation is a pre-requisite for a fully integrated cards market and for the resulting benefits which could be as high as EUR 25 billion. Option 5 is the recommended option to achieve best progress on standardisation at this stage. It enjoys the support of most stakeholders, in particular consumers, merchants and public authorities. However, many banks and card schemes have preference for industry – driven standardisation as it is today (option 4). The tables illustrate the efficiency and effectiveness of each option to reach these benefits and how they would impact stakeholders.

**Table 9 - 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 10 - 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 | (+) | (+) | (--) |

### *6.1.3 Standardisation of mobile payments (operational objective 2)*

#### 6.1.3.1 Option 8 (No policy change)

As an example for the impact of standardisation on proximity m-payments, one 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.[62] Consumers, merchants and PSPs would all benefit from the benefits of market growth.

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. On the basis of the assumptions above, this means that almost 40% of the market potential could remain untapped in a 'do nothing' or baseline scenario. Conversely, a standardised market could be almost 70% larger than a non-standardised one.

#### 6.1.3.2 Option 9 (Standardisation through governance framework for retail payments)

This 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, different than for card payments the required changes in the composition and tasks of the SEPA Council are substantial due to a number of stakeholder categories that are only relevant for mobile payments but not necessarily for

[62] 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

other forms of payments (e.g. MNOs, handset manufacturers, operating system providers). Other costs related to this option are marginal.

#### 6.1.3.3 Option 10 (Mandate to European Standardisation Organisation)

This option could create benefits versus the baseline option. The main benefit of this option versus option 9 (SEPA governance framework) lies in the considerable specific expertise of European Standardisation Organisations (ESOs) in the field of telecommunications and in running standardisation initiatives for mobile commerce. These organisations could be mandated by the Commission to work on specific standardisation issues. The Commission would acknowledge the standardisation work in the area of mobile payments which has been conducted in various private standardisation fora so far. 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.

#### 6.1.3.4 Option 11 (Establish mandatory technical requirements through legislation)

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.

Conclusion

A standardised European proximity m-payments market could be almost 70% larger in terms of transaction volume by 2016 than a non-standardised market. Option 10 is the recommended option to achieve progress on standardisation for m-payments. It is supported by merchants and non-bank PSPs, including mobile payment providers and technical providers. Most banks and card schemes expressed a preference for no changes (option 8). The tables illustrate the efficiency and effectiveness of each option to reach these benefits and how they would impact stakeholders.

**Table 11 - Summary of the impact for the standardisation of mobile payments (options 8 to 11)**

| 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 12 - 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) | (-) | (-) |

## *1.13 Ineffective competition in certain areas of card and internet payments*

### *6.2.1 Interchange Fees (IFs) for card payments (Operational objective 3)*

#### 6.2.1.1 Option 12 (No policy change)

Currently, the card market in the EU is characterised by significant variation of MIF levels among Member States. After a gradual replacement of a number of national payment card schemes by the two major, international four-party payment card schemes - Visa and MasterCard - the European payment card landscape is dominated by these two market players. At the same time, the current diversity of interchange fees paid to issuing banks on a national basis under the two international card schemes prevents market entry by new payment card schemes. As explained in the problem definition, new schemes would have to offer to the issuing banks at least a comparable level of interchange fee to that applied in the market they want to enter. This not only has a negative impact on the viability of their business model but also prevents the economies of scale and scope that would be possible on a European payments market with low MIFs/MSCs. European retail merchants foot a bill of approximately €14 billion annually for card acceptance, which is eventually passed on to consumers including those paying with low of no fee payment means.

A 'no policy change' option would continue to leave these issues to competition enforcement actions, in particular on the basis of the MasterCard judgement. This is however unlikely to be efficient and effective. Legal uncertainty persists as the judgement has been appealed. Long-term, comprehensive commitments from both Visa and MasterCard, in particular on fees charged for domestic transactions, are unlikely as neither of the schemes has the incentive to be a 'first mover' introducing lower fees. Competition proceedings by National Competition Authorities, in close cooperation with the Commission, are likely to lead to a long and fragmented process with uncertain results. This will not ensure a level-playing field, and may lead to further legal uncertainties and distortions on the card payments market.

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

This option foresees the removal of legal and scheme-imposed obstacles to cross border acquiring and the introduction of maximum caps on the IF of 0.2% and 0.3% of the transaction value for debit and credit cards, respectively (in line with the undertakings of MasterCard). It could create benefits versus the baseline option as it would allow cross border acquiring i.e. the ability of merchants to benefit from lower interchange fees when choosing an acquirer outside their own Member State, in line with the principles of a true Internal Market. It will therefore address partly the issue of retailers fees mentioned under the baseline option, and could put a downward pressure on national IFs, through the threat of merchants' changing acquirer to one located abroad. Similarly to the approach followed under the SEPA end-dates Regulation, allowing cross border acquiring and regulating the level of cross border interchange fees would provide legal clarity and be conducive to market integration.

Nevertheless, addressing only cross border interchange fees would have a limited impact, as it would mean covering 5% to 10% of the EU market in terms of current transaction values. Only MasterCard and Visa are present in more than one country and have different fees in different countries. Since national schemes have only fees for domestic transactions, measures on cross-border MIFs have no effect on those fees. In addition, regulating only cross border fees would take away the incentive for banks to invest in EU wide standards; by maintaining different standards they could try to benefit as long as possible from a segmented market with limited competition and possibly higher domestic fees.

Benefits are likely to be limited because of the existing technical obstacles to cross-border acquiring (currently, due to technical differences, cross-border acquiring would be possible in only 10 Member States). Besides, only big retailers would have the necessary negotiating power with acquirers and the financial resources to pursue this solution. Small merchants would not benefit. Therefore, this limited policy intervention is unlikely to bring a significant, immediate or medium term change in many domestic markets and to the level and variability of domestic MIFs. It could however be pursued as a transitory solution, before more wide ranging options are fully implemented, as a means of promoting market integration.

#### 6.2.1.3 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. It would be up to each Member State to implement it. This would allow for national differences in card usage, acceptance and in cash usage to be reflected in the domestic Interchange Fees levels. National solutions could then be maintained or developed.

The effects of this option as compared to the baseline scenario are however likely to be more limited than option 13, in particular in terms of reducing interchange fees variability and facilitating market integration.

Whilst it would appear to make sense to align MIF levels to the different maturity of card and payment markets, in practice this is not simple and straightforward. The relative use and costs of cards and cash vary significantly also within Member States, between their regions (e.g. across Germany), but also between urban and rural areas. More importantly, countries with high MIFs have very low card acquiring and acceptance rates and countries with low MIFs have high issuing and acquiring rates. In the current market situation in Europe, no obvious identifiable link can be established between the level of MIFs and a possible need to subsidize the issuing of cards (main argument for MIF existence). For instance, Poland is the country with the highest level of average MIFs in Europe, but only about 20% of all establishments accept payment cards. Even some big retail chains (including the biggest discount supermarket chain in Poland with over 2000 stores) do not accept cards. In such a situation the logic of a MIF as a 'balancing fee' would arguably lead to a fee going into the opposite direction, stimulating card acquiring (thus increasing card acceptance) instead of issuing. The reality shows the opposite, however.

As a result 'new' pan European players are unlikely to emerge, and the national IF levels are likely to be higher than under option 15 below. Consequently, retailers' savings and consumers’ welfare gains are likely to be limited. In addition, heavy administrative resources would have to be invested in defining a concrete methodology for national regulators, implementation and monitoring. This raises serious concerns in terms of the efficiency of this option.

Legislative action on MIF is currently considered in several Member States. In Poland, the lower chamber of Parliament (*Sejm*) presently considers five drafts of legislation regulating interchange fees[63]. In Hungary, a legislative proposal is under discussion that would cap domestic credit and debit interchange fees at their respective cross border level, with the Hungarian Central Bank in charge of calculating and publishing these fees. In Italy[64], a draft Decree by the Ministry of Economy and Finance has been published for consultation in December 2012. It focuses on transparency measures in the field of payment cards (limits to blending, comparability of interchange fees and merchant service charges, merchant service charges should take into account the volume of transactions and should be lower for low value payments). These provisions are related to the obligation for retailers to accept payments by debit cards from 01.01.2014 onwards (decreto legge 18 ottobre 2012).

#### 6.2.1.4 Option 15 (Set a common, EU-wide maximum level for interchange fees)

Under this option, a single common cap on the MIF on all card transactions (domestic and cross-border) would be defined. This would result in the highest level of legal certainty on

[63] One of the drafts was submitted by the Polish Senate and is supported by the government. This draft act aims at regulating card payments in a more comprehensive manner proposing to cap MIFs, with caps progressively falling to 0,5% by the start of 2016, abolish the HACR and some aspects of NDR, as well as allowing surcharging (for credit cards only), while providing for a 3-year exemption for genuinely new card organizations. A special subcommittee was created to discuss the draft acts and introduce amendments.

[64] In the framework of Decree n. 201/2011 (converted into Law n. 214/2011)

business models for existing card schemes and new entrants, promote market integration for consumers and merchants and favour pan-European market entry. It would also address the threat of 'exporting' the IF model to new, innovative payment services. Within this option there are four sub-options possible, depending on (1) whether the maximum IF cap covers both debit and credit cards or just debit cards and (2) whether the IFs for debit card transactions are to be forbidden altogether or just reduced to a low level.

| Suboption | Debit cards IFs (domestic) | Credit cards IFs (domestic) |
|---|---|---|
| 1 | maximum 0.2% of the transaction value | Not covered by the legal act |
| 2 | Prohibition | Not covered by the legal act |
| 3 | maximum 0.2% of the transaction value | maximum 0.3% of the transaction value |
| 4 | Prohibition | maximum 0.3% of the transaction value |

The text below discusses, due to length and complexity considerations, main arguments of the suboptions 15.3 and 15.4. All suboptions are extensively discussed in the Annex 9 of this impact assessment (as indicated at the beginning of this chapter).

Banning or setting low interchange fees for debit cards would contribute significantly to the development of the single market in card payments in the EU. Examples show that low or no interchange fees are linked with higher card issuing and usage.  This fact contradicts the traditional arguments of the international card schemes that sufficiently high MIFs are needed to stimulate card issuing and therefore card usage. For instance in Norway, the absence of IFs for debit cards is accompanied by very high level of card acceptance by merchants and usage. Denmark also has one of the highest card usage rates in the EU at 216 transactions per capita with a zero-MIF debit scheme. This is also true of international schemes: in Switzerland Maestro has no MIF and is the main debit card system. It is also worth noting that all European card schemes were originally created without MIFs. MIFs have been introduced by banks and card schemes only later.

A prohibition or a low MIF for debit cards would therefore go a long way to ensure a high card acceptance, in particular by small retailers and SMEs. Besides, if markets are mature and cards are used everywhere there is no need to incentivise their issuing. Currently, every adult in the EU has at least one debit card on average[65] and it is very rare to find a payment account which does not include a card. Moreover, there is also an important aspect of wider EU policies. An EU initiative adopted earlier this year –basic bank account proposal - sees a debit card as an integral part of the basic account package, accessible for every EU citizen, including socially vulnerable groups with no access to bank accounts today. A further

[65] ECB data, 2012

increase in issuance and usage of debit cards may be therefore expected, while no MIF for debit cards would result in much higher acceptance of these cards by small, local shops.

Banning entirely debit card MIF would allay fears that card market integration would result in higher IFs and costs structures for domestic debit schemes without a MIF or with a MIF lower than 0.2% (Belgium, the Netherlands, Denmark, Finland, Ireland, Luxembourg, Sweden and the UK). Conversely, fixing a cap instead of banning IF for debit cards could result in a situation where current domestic schemes that expand cross border or new entrants increase their fees to the level of the cap, as it happened with the Australian domestic scheme EFTPOS.

However, the maturity of EU markets as regards debit cards issuance and usage would need to be carefully investigated if the proposal to entirely abolish interchange fees for debit cards is to be made. The Commission intends to address this issue in the future, assessing in particular the appropriateness of the level of interchange fee, taking into account the use and cost of the various means of payments and the level of entry of new players and new technology on the market.

If credit cards interchange fees are also covered by a cap, in addition to the debit cards cap, the impact on the current variability and level of interchange fees would be profound and direct, leading to a true Single Market for card-based payments. It should be noted that the Commission's sector inquiry of 2007 assessed that in 20 out of the 25 Member States at that time, positive profits in credit card issuing could be obtained even without interchange fees[66].

The reference caps of 0.2% and 0.3% for debit and credit cards respectively are figures accepted by card schemes (MasterCard, Visa, Groupement Cartes Bancaires). These levels were also proposed by card schemes in competition enforcement proceedings and accepted by the competition authorities as not raising competition concerns. They would therefore appear to be reasonable benchmarks for the card schemes and banks and would provide legal certainty, demanded by the sector.

Sub-option 15.3 – a cap of 0.2% for consumer debit cards and of 0.3% on interchange fees for consumer credit cards (see Annex 9.2.1.4 for details) is the preferred option. Transparency and steering measures would remain key to prevent promotion of (expensive) credit cards by PSPs once this option is followed. Anti-circumvention measures would also have to be considered. In addition, the possible impact of this option on pricing of payment services to consumers – especially if credit cards are covered - would need to be carefully monitored.

**Possible impact of capping interchange fees on cardholder fees, overall consumers' welfare and bank revenues**

[66] Cf. figure 45 p.132 of the Report of the retail banking sector inquiry of 31 January 2007

There appears to be no convincing evidence of a direct link between capped interchange fees and increased cardholder fees in the countries where IFs have been the subject of regulatory intervention or other measures from public authorities.

In the US banks tried to increase cardholder fees after IF regulation but had to back down due to consumers' revolt. In Switzerland there was a decrease in cardholder fees in parallel with the decrease in IFs. In Australia, cardholder fees were increasing fast before caps on interchange fees were introduced. After IFs become regulated, the cardholder fees were interestingly growing at a slower pace than before. In Spain, the lack of competition in the banking sector seems to have played a major role in the increase in cardholder fees as banks turned to extract extra profit from cardholders, more than compensating for decreased IF revenues. From 2005 to 2010, revenue for card issuers and card acquirers in Spain increased by 0.6 Bio EUR and 1 Bio EUR respectively, with an average increase of 5 EUR per year per card issued.

Isolating visible retail price decreases resulting from a cap on interchange fees is however likely to be difficult, as many other factors might play a role in the evolution of prices (e.g. inflation, personnel costs, including any minimum salary regulation, costs of basic, raw materials, general economic situation, changes in taxation etc). Besides, the level of competition in the specific retail market segment considered will impact the degree of pass through of retail cost savings to consumers. However, the direct benefits to consumers through pricing are much more likely to materialise than the potential increase of card fees for consumers, as competition in the retail sector is fiercer than between banks, retailers are less concentrated, pricing to consumers is more transparent, and there is no bundling. There is anecdotal evidence of price decreases happening in the USA, one year after the MIF regulation was introduced. In addition, from evidence in Australia, it seems that retailers would benefit integrally (100%) from lower IFs – as acquiring markets tend to be more competitive than issuing markets, whilst the potential increase in cardholder fees is limited to 30-40% of the amount of the IF decrease.

Even if cardholder fees increase – which is not a given as the impact of capping interchange fees on banking revenues is likely to be mixed - consumers are still likely to benefit from lower interchange fees through lower retail prices, even if retailers do not pass through 100% of the savings, and from new entry in the payment market. It has also to be considered that consumers are very likely to benefit from the services offered by new market entrants. A real-life example of this is the Netherlands, where the cheap online payment solution (Ideal) was developed largely because the low interchange fees (below 0.2% of the transaction value) prevailing there encouraged bank to innovate. In consequence, Dutch consumers do not have to pay high credit card subscription fees in order to shop online.

At the same time, the impact of capping interchange fees on bank revenues seems to be mixed. Decreases in IFs lead to increases in the volume of card transactions (higher acceptance and usage of cards allows acquiring banks and card schemes to collect higher revenues at the point of sale, even as income per transaction is lower). In a related effect, there is a decrease in the use of cash and a decrease in the ATM withdrawals (thus issuing banks save on the IF amounts normally paid to ATM acquiring banks). Therefore, the volume effect and the savings on cash could at least partly compensate the losses due to the cap on interchange fees. In Norway for instance, the absence of IFs for debit cards is accompanied by very high level of usage and acceptance, with the domestic debit scheme BankAxept more than doubling its number of transactions between 2001 and 2011. In Switzerland there was also an increase in acceptance on the retailer side: the reduction in MIFs encouraged the two biggest retailers to start accepting credit cards.

In terms of viability, a debit card scheme without any IF seems to be perfectly viable from a commercial perspective without raising the costs of current accounts for consumers. Denmark for example has a zero-IF on its domestic debit scheme while an average account holder pays current account fees well below the EU average. Similarly, in Switzerland the main debit card network is Maestro (part of MasterCard) which has no MIF.

#### 6.2.1.5 Option 16 (Exemption of commercial cards and cards issued by three party schemes)

Under this option, it is considered to exempt commercial cards (from all schemes) and (all cards from) three party schemes from the IF regulation as described in previous options. It could be argued that to create a level playing field for all (card) payment providers, all types of cards and of card schemes should be covered. However, commercial cards and three party schemes have very limited market shares in the EU and are not expected to expand significantly as a result of possible IF regulation. They could not substitute consumer credit or debit cards as they cater for a specific market segments and their needs, not for the average consumer. Nevertheless, to avoid circumvention of the law, it is proposed to cover three party schemes by the IF regulation when they use banks to issue their cards to customers (thus using de-facto a four-party scheme model). In addition, transparency measures, including card identification (consumer/commercial or third party) need to apply in full for options 15 and 16 to be effective.

#### 6.2.1.6 Option 17 (Regulate Merchant Service Charges)

Regulating just interchange fees does not directly address the issue of Merchant Service Charges (MSCs), although interchange fees make up the largest share of these fees. Regulating MSC would bring an even bigger impact on the market than option 15 and allow for three party schemes, based on MSC fees, to be fully regulated, thus creating a level playing field 'across the board'.

However, as discussed above, there does not seem to be a compelling reason to fully regulate three party schemes. Equally importantly, regulating MSCs raises serious subsidiarity, proportionality and efficiency issues. Capping IFs, as proposed above in option 15, cannot be equated with retail price regulation. Interchange fees make the most of the Merchant Service Charges bearing on merchants, whilst IFs are not final prices to retailers and even less to consumers. Capping MSCs, as proposed in this option, would however mean controlling de facto prices for merchants. It would make it impossible for (big) merchants to negotiate with their acquirers, 'freezing' the MSC market instead and regulating also this part of the card market that functions relatively well. Finding the appropriate MSC level, implementing and monitoring this solution would also require heavy public administration resources.

Nonetheless, possible circumvention of the law through MSCs increases needs to be addressed.

Conclusions

The level and variability of interchange fees for debit cards and credit cards have to be tackled to promote market integration for retailers and consumers, foster efficient electronic payments in Europe and to facilitate pan European market entry for new players. A combination of option 13 (allowing cross-border acquiring and regulating the level of cross-border interchange fees), sub-option 15.3 (capping interchange fees for debit and credit cards) and option 16 (exempting commercial cards and three party schemes) are the recommended options to achieve a true Single Market for card-based payments. Whilst option 13 would be of application as of the entry into force of the new law (Phase 1), sub-option 15.3 and option 16 would become operational after a transition period (Phase 2), set in the law. Option 15.4 i.e. banning interchange fees for debit cards, which would generate potentially higher benefits to merchants and consumers, would deserves further examination in the future. A transitory approach (cross-border MIF first, domestic MIF second) is recommended in order to give to the card schemes, banks and other participants in the payment chain time necessary to adapt their business model and commercial strategy to the radically new situation and avoid a potentially de-stabilising effect for the EU financial system[67].

Transparency measures are key for all these measures to become effective.

Regulation of IFs is generally opposed by banks and card schemes. However many non-banks PSPs, including mobile and internet providers, support the harmonisation of IFs. The regulation is supported by merchants and most consumers, with both groups calling for basic card payments without any IF. Competition authorities, are supportive of the IF regulation, in particular as regards four-party schemes. Other public authorities are divided regarding an IF regulation, with some favouring a ban or a decrease of IFs to increase competition, and others favouring competition enforcement only.

**Table 13 - 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) | (--) |

[67] MIF revenues on domestic transactions constitute the majority of EU banks income from card transactions.

| | | | |
|---|---|---|---|
| **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 cards issued by three party schemes** | **(0/+)** | **(+)** |
| Option 17 | Regulate Merchant Service Charges | (-) | (--) |

**Table 14 - 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**<br><br>**(-/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 cards issued by three party schemes** | **(0/+)** | **(0/+)** | **(0)** | **(0/+)** |
| Option 17 | Regulate Merchant Service Charges | (-/0) | (-) | (-) | (-) |

### *6.2.2 Restrictive business rules (Operational objective 4)*

#### 6.2.2.1 Option 18 (No policy change)

The existence of restrictive business rules currently leads to costs for merchants that are higher than in a situation without these rules. Under option 18, no policy change is envisaged and this will most likely result in a continuation of the status quo. Therefore both the Honour All Cards Rule and the Non-Discrimination Rule will probably stay in place and prevent merchants from refusing certain payment cards or steering consumers towards the more cost efficient payment cards.

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

Under this option, merchants would be able to differentiate between the payments cards they wish to accept. This will create a more competitive environment as merchants will have more negotiating power. Issuers, acquirers and card schemes will incur costs as they stand to lose some of their revenue. The lower costs will however benefit the merchants as well as consumers, at least in price sensitive markets. The total potential gain for merchants (and partly consumers) can be between €370 million and €1.5 billion, depending on the actual shift of credit card use to debit cards.

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

This option would have the same final effect as option 19, but the main advantage is that it ensures the certainty and comprehensiveness of the measure as well as its timely execution. 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.

Conclusion

Restrictive business rules are an obstacle for effective competition in the cards market. To address this, option 20 is the recommended option. It is supported by public authorities, merchants and most non-bank PSPs. Consumers support it too, but are afraid that the choice of payment methods may diminish if no other flanking measures are taken. Most banks and card schemes are opposed to any changes.

**Table 15 - Summary of the impact for operational objective 1 for card payments (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 16 - 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** | **(+/0)** | **(++)** | **(-)** | **(-)** |

### *1.14 Diverse charging practices between Member States*

*6.3.1 Steering practices (Operational objectives 4, 5 and 9)*

6.3.1.1 Option 28 (No policy change)

The current PSD allows for divergent charging practices in the Member States, explicitly allowing surcharging, rebating and other steering practices (e.g. acceptance of cards above certain level only) in place. Surcharging, which is most controversial, is allowed in roughly half of the Member States and prohibited in the other half. However, the effects of surcharging can be easily felt by consumers in any Member State, in the e-commerce and cross-border context.

Current national practices lead to many controversies and negative effects on consumers, in particular in some sectors (travel, hospitality industry). Moreover, surcharging has been sometimes used as a source of extra revenue for merchants rather than as a steering mechanism to recover true costs. This concern has in principle been addressed with the adoption of the Consumer Rights Directive, which forbids retailers to surcharge above their costs. There may however be issues about the definition of costs and the possibility for merchants to identify, roughly, the true cost of a single payment transaction, as long as blending practices persist and HACR is applied.

If no policy change is envisaged, the current, complicated situation of national solutions will persist. The results from the study undertaken by London Economics and iff in 9 Member States[68] suggest a total cost of surcharging – borne by consumers - of at least € 731 million annually and growing.

6.3.1.2 Option 29 (Prohibit surcharging in all Member States)

Prohibition of surcharging in all Member States and for all payment instruments would harmonise the current diverging practices. It would eliminate the possibilities for excessive surcharging by definition. It could however have the effect of incentivising merchants to promote the use of cash, not to accept certain (expensive) payment methods they could otherwise accept or to increase prices. Besides, it would negatively affect merchants' – including those not surcharging- bargaining power *vis-à-vis* acquirers.

6.3.1.3 Option 30 (Allow surcharging in all Member States)

Allowing surcharging in all Member States would resolve the current divergence, but might not lead to efficient steering, as merchants are subject to the HACR and often do not know the costs of individual payment transactions (as a result of blending practices). This prevents them from efficiently steering consumers. In addition, surcharging can be an incentive for consumers to use cash and some merchants might continue to use surcharging as a way to obtain extra revenue (in spite of the Consumer Rights Directive provisions).

[68] 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

Under this option, merchants will be able to recover their costs related to fees for card use by passing them along to consumers. If they were not surcharging before it is likely that their payment costs were integrated in their retail prices.  Steering consumers to more efficient payment means and using the increased negotiating power implied in the threat of surcharging *vis-à-vis* acquirers costs could drive down costs for these merchants but the extent to which consumers would benefit from these cost reductions would depend from competitive pressure in retail markets.

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

In case option 28 is followed or 30 is implemented, not allowing surcharging for a widely used payment means will decrease the incentive for consumers to use cash. If there are limited fees related to this payment instrument, both merchants and consumers will gain. Allowing surcharging for all other (more expensive) means of payment would make it possible for merchants 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. This would result in overall gains as compared to the baseline scenario. The key difficulty of this option is that a widely available pan-European payment means is currently not available, which would lead to situations where consumers purchasing goods and services on a cross-border basis have no option but to pay a surcharge (pay for the right to pay).

6.3.1.5 Option 32 (Ban surcharging for IF-regulated payment instruments and allow for non-regulated)

This option would ensure that the payment instruments for which interchange fees have been regulated (i.e. consumer debit and credit cards of four party schemes, including Visa and MasterCard, see options 13 and 15.4) are not surcharged, as they can be accepted by merchants without the latter incurring high fees. Therefore, a logical link between the fees paid by merchant for accepting card payments and the corresponding fees paid by consumers at the cash desk for using the card (real or virtual) would be maintained (no IF or low IF for merchant – no surcharge for consumer).

For payment instruments that continue to generate high costs for merchants, including commercial cards and cards issued by three party schemes (e.g. American Express, Diners), exempted from interchange regulation under option 16, merchants would be able to surcharge.

A prohibition to surcharge would apply when the relevant provisions regulating the interchange fees are implemented in full. Rebates or other steering would still be possible for all payment instruments, independently of interchange regulation. This would enable merchants to steer consumers to efficient and cheap payment instruments, such as e.g. credit transfers or debit cards for internet purchases.

Conclusion

Addressing the divergence in charging practices between Member States and the costs consumers incur because of surcharging could lead to substantial gains for both consumers and merchants. It is estimated that a large part of the currently estimated amount of EUR 731 million of annual surcharges could be gained indirectly by consumers following measures to ban surcharging on payment instruments with regulated interchange fees. Additionally, consumer and merchant gains could be expected when rebating and other steering is encouraged. Option 32 is recommended to achieve the desired results, if combined with options addressing the interchange fees (13 and 15.4).

The prohibition of surcharging is supported by consumers, banks, and most other payment service providers. Merchants and public authorities are divided on the issue, some supporting the prohibition, others favouring surcharging or taking a neutral position.

**Table 17 - 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 IF regulated payment instruments, allow for non-regulated** | **(++)** | **(++)** |

**Table 18 - 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 |
| Option 29 | Prohibit surcharging | (+) | (-) | (+) |
| Option 30 | Allow surcharging | (-) | (+) | (-) |
| Option 31 | Widely used payment means without surcharge | (0/+) | (+) | (-) |
| **Option 32** | **Ban surcharging for IF regulated payment instruments, allow for non-regulated** | **(+)** | **(-)** | **0** |

### *1.15 Legal vacuum for certain payment service providers*

#### *6.4.1 Access to information*

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

##### 6.4.1.1 Option 33 (No policy change)

The legal status of third parties who wish to provide payment-related services, such as new card schemes, payment initiation services (PIS), account information services and equivalent services is currently not defined. Consequently, these providers face serious difficulties in accessing the information on the availability of funds on payment accounts. This information is however needed for card authorisation, payment initiation purposes and for payment guarantees (if applicable). Access to this information by third parties would create a downward pressure on current interchange fees because of increased competition from new players, leading to benefits for merchants and consumers and contributing to the reduction of overall payment costs to society.

Under option 33, account servicing PSPs would continue to be able to restrict access to the necessary information, hampering the emergence of new schemes for card and internet payments and the provision of PIS. Therefore, this option does not address the current barriers for market access for card and internet payments in any way. Moreover, no other uncertainties surrounding the provision of payment services by TPPs would be addressed. This includes security requirements, rights and obligations of the TPPs and of the PSUs/consumers as well as liability allocation.

##### 6.4.1.2 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 allocation)

This option would ensure that third parties are allowed to obtain the necessary information on the availability of funds in order to provide their services and that TPPs are incorporated into the legal framework of the PSD. It would at the same time guarantee that all necessary data protection and security requirements are fulfilled by both TPPs and the PSPs servicing the account. This option would insure that a consumer is properly informed before giving a TPP an explicit consent to access his or her accounts and that rights and obligations are appropriately shared in a balanced way between TPPs, banks and consumers.  In addition, defining a balanced liability repartition between PSPs servicing the account and the TPPs would oblige both parties to take responsibility for the respective parts of the transaction that are under their control and clearly point to the responsible party in case of incidents.

This option creates clear benefits in comparison to the baseline scenario, in particular by eliminating the main barrier for market access and the development on the market of new card schemes and by addressing the concerns surrounding TPP operations. It also has the great potential to increase the competition in the market, by providing an additional payment solution to the consumers and merchants. The merchants, even the SMEs, which have far less negotiation power than big corporations versus the card schemes, would benefit from a less expensive and more tailor-made online payment facility. Costs for account servicing PSPs are minimal and necessary investments by third parties will be recovered by the increase in their revenues. Merchants however stand to gain the most as their transaction costs would decrease in comparison with the fees they face for card payments (depending on the current level of these costs). Some of this cost reduction will be passed on to the consumers.

#### 6.4.1.3 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. In this context, 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.

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.

However, this option leaves the ultimate decision on the access to the information on the availability of funds to the account servicing PSPs, rather than to the account owner. It would therefore still constitute a potential barrier to the market access, as it would give account servicing PSPs the possibility to refuse cooperation with a TPP or to impose specific requirements in the contracts. For example, a significant charge for the access, e.g. of the value comparable to MIF for card transactions, could be demanded, thus partially recreating the market entry barriers for PIS services and new card schemes.

This option could therefore undermine some potential benefits of option 34, such as the equitable conditions of entry on the market of new service providers, additional choice of payment solutions for consumers and significantly limit or even negate the potential price benefits for the merchants of accepting TPP services. In this way, account servicing PSPs could therefore protect their card businesses from competition and prevent new payment services from developing on the market.

<u>Conclusion</u>

Lack of access to the information on funds and lack of legal status within the PSD hinder the market entry of third parties such as new card schemes, PIS services and others. Defining secure access conditions, granting legal status and consequent rights and obligations for TPPs will provide legal certainty to TPPs and banks and benefit the consumers. Possibly 20 new service providers operating in 8 Member States will be licensed and the savings for merchants could range at a rough estimation from minimum 863 million EUR to maximum 3

520 million EUR (detailed estimation of the savings in Annex 9). Option 34 is the recommended option to eliminate barriers for market access and adjust the scope of the PSD to encompass new relevant categories of market actors.

The recommended option is supported by merchants, consumers, public authorities and non-bank PSPs. Most banks and card schemes are opposed to granting access to TPPs and new card schemes under the recommended option, though many of them would change their view if a financial compensation for the access was provided.

**Table 19 - 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 20 - 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) | (--) | (-/--) | (++) |

## *1.16 Scope gaps and inconsistent application of the PSD*

### *6.5.1 Negative Scope of the PSD (Operational objectives 7 and 9)*

#### 6.5.1.1 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, 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. Possibly even much greater part of PSP services will be offered outside the scope of the directive. Technical and business innovations would be undermining any efforts of homogenous application of negative scope exemptions, leading to further regulatory arbitrage.

#### 6.5.1.2 Option 37 (Update/clarify scope of exclusions)

Under this scenario, the four exemptions would be subject (separately from each other) to a comprehensive update, including clarification or introduction of necessary definitions and explanations in recitals.

Thus, for **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. The foreseen change would impact those commercial agent activities that clearly concentrate on management of financial flows between buyers (consumers) and sellers on a professional basis and should not have been exempted from the PSD. The main benefit would be to limit the risks and increase the rights and protection of consumers.

As regards the **limited network** exemption, an improved definition would comprise a limitation to the specific volume of transactions or a maximum transaction value and specify that a network should be strictly focused on a very limited range of goods and services. The benefit of this scenario consists in extending PSD protection to a range of payment instruments and methods that go clearly beyond strictly defined payment service in a limited network and suffer from reduced consumer protection. 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.

**The 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). The main impact of such definition would be on mobile network operators who do not strictly offer mobile-related payment services. This would be in favour of PSUs[69], 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 limit the non-regulated part of the market and protect the consumer, in particular as regards the fees for withdrawal.

[69] For example, cases of abusive premium SMS services, reported in some Member States, would no longer be possible.

#### 6.5.1.3 Option 38 (Delete the exclusions)

Following this scenario, 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.

A 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 the new definition option.

As regards the deletion of the **telecom exemption**, there appears to be indeed no rationale for maintaining this provision, even in a more limited form. Thanks to advances in the technology, mobile payments are now a fully-fledged payment channel thanks to the arrival of a smartphone. Accordingly, access to payments by mobile phone should no longer be subject to a special exception. Issues specific to payments for mobile network services could be addressed more simply through the improved limited network exemption.

Finally, the deletion of the **independent ATM provider** exemption would appear justified. Independent ATM providers need to enter into agreements with a card scheme or with the PSPs holding accounts of the users in order to offer ATM services. 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 matter of remuneration for withdrawal should be negotiated between PSP and ATM deployer and not dumped on consumers, leading to high or double charges.

#### 6.5.1.4 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 scenario is independent from the actions proposed in options 37 and 38. A PSP 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 the payment activities. In order to avoid excessive administrative burden, the necessity of clearance would apply to larger providers (full PIs or their exempted equivalent), while small providers (equivalent to waived PIs) would only inform authorities about their activities.

Such a measure would benefit the competent authorities, who currently have little, if any, formal knowledge on the size of the exempted market. It would also put the authorised and exempted PIs on equal footing as regards the application of the exemption criteria, thus reinforcing the level playing field on the market. The necessity of scrutiny would also, indirectly, contribute to the better and more coherent protection of consumer rights in the Member State.

For potentially exempted operators, the burden of scrutiny would be marginal in comparison with the potential costs of getting and maintaining a full PI license (below 1% of costs) and fully justified in view of the potential abuses and PSU detriments that could otherwise occur.

Conclusion

The clarification of the scope is recommended for the "commercial agent" and "limited network" exemptions. The deletion of the exemption is recommended for the "telecom" and "ATM" exemption. Independently, negative clearance requirement is also the preferred option. The clarification of the scope is supported by most payment services providers and public authorities; consumers are divided on limited network exclusion, calling for its deletion or narrowing of scope. The deletion of the telecom exception is supported by all payment service providers except the telecoms and by the consumers; public authorities expressed the need for a change of the current provision, but their opinions vary between deletion and narrowing of the scope. The ATM exemption deletion did not raise many comments, but was supported by the ATM sector itself and the consumers.

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 21 - Summary of the impact for operational objective 5 (options 36 to 39)**

| Policy option | Description | Effectiveness | Efficiency |
|---|---|---|---|
| Option 36 | Baseline scenario | 0 | 0 |
| Option 37 | New definition/clarification of scope | | |
| **commercial agents** | | (+++) | (++) |
| **limited network** | | (+) | (++) |
| Telecom | | (++) | (++) |
| ATM | | (+) | (++) |

| | | | |
|---|---|---|---|
| Option 38 | Deletion | | |
| commercial agents | | (--) | (+++) |
| limited network | | (---) | (+++) |
| **Telecom** | | (+++) | (+++) |
| **ATM** | | (+++) | (+++) |
| **Option 39** | **Negative clearance** | **(++)** | **(++)** |

**Table 22 - Summary of the impact for main stakeholder categories (options 36 to 39)**

| Policy option | Description | Consumers | Merchants | PSPs<br>(exempted/ authorised) |
|---|---|---|---|---|
| Option 36 | Baseline scenario | 0 | 0 | 0 |
| Option 37 | New definition/clarification of scope | | | |
| **commercial agents** | | (+++) | (+) | (-/0) |
| **limited network** | | (+++) | (+) | (--/0) |
| Telecom | | (++) | (+) | (-/0) |
| ATM | | (++) | (0) | (-/0) |
| Option 38 | Deletion | | | |
| commercial agents | | (+) | (--) | (-/0) |
| limited network | | (+) | (+) | (---/0) |
| **Telecom** | | (+++) | (++) | (-/0) |
| **ATM** | | (+++) | (0) | (-/0) |
| **Option 39** | **Negative clearance** | **(+)** | **(+++)<br>for authorities** | **(-)** |

### *6.5.2 "One-leg" transactions and payments in non-EU currencies*

(Operational objective 7 and 9)

#### 6.5.2.1 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. Differences in geographical scope of application, in currencies covered and in the extent to which the PSUs are protected by the PSD provisions in particular Member States will remain. This will have detrimental effects for PSUs and contribute to unlevel playing field across Member States.

#### 6.5.2.2 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. 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 (some 32 billion EUR annually for 27 EU Member States). Another group of better protected consumers would be those involved in cross-border online shopping outside the EU. 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.

#### 6.5.2.3 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 could easily be applied. As regards rights and obligations a selective approach could be followed, keeping the high protection of consumer rights in place. Those obligations that could be fulfilled by the PSP should be applicable. Obligations out of control of EU-based PSPs or not realistic from the technical perspective in case of discussed transactions would not apply. The benefits of such approach would be, in terms of PSU protection, almost the same as of the previous option. 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.

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. The extension is opposed by most banks, but supported by consumers, some non-bank PSPs and most public authorities (though there is no agreement on the exact scope of the extension).

**Table 23 - 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 24 - 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)** |

## 7 CHOICE OF THE MOST APPROPRIATE POLICY INSTRUMENT

The choice of the policy instrument is partly predetermined and facilitated by the specific area of action – Single Market in payments – a "by definition" complex and sensitive area of financial services, which calls for strong common EU rules and harmonised approach. Furthermore, the choice is also based on the existing legislation in the area of payments. A large part of this impact assessment adresses the issues of regulatory deficiencies in the existing Directive – PSD – identifing several regulatory failures and legal gaps and proposing to amend them. A natural choice for amending these deficiencies is to do it through the revision of this Directive, which is also reflected in the considered options.

A substantial part of this impact assessment discusses issues that were, until now, not covered by legislation at the EU level, in particular when the card payments structures and their business, technical and organisational set-up are concerned. However, these very issues were subject to numerous competition policy procedures and court rulings, both at the EU and the national level, over the last 15-20 years. As a result of such procedures, several self-regulation commitments were reached, including two at the EU-level. As this impact assessment amply demonstrates, these commitments did not influence significantly the way the card schemes operate. In the wake of such disappointing outcome, several Member States have engaged independently into attempts of regulating card business, both through more vigorous competition policy and through legislation[70]. These attempts remain however uncoordinated and concentrate only on the purely national dimension of the card business, while most aspects of the card payment business are pan-European or global in their nature. Therefore, a rationale for a binding legislation on these issues is very strong.

[70] It is also the global regulatory trend, where the MIFs were subject to Regulation e.g. in Australia and USA.

In terms of the legislative instruments for the card area, the preferred options call for the use of Regulation for the core provisions, including MIF. This would take into account the specific, technical character of card provisions, distinctly different from the more general articles of the PSD. Furthermore, it would ensure a possible maximum harmonisation of rules in an inherently pan-European card business, with a limited number of stakeholders competing on EU wide basis. These stakeholders would be subject to one, consistent set of rules and supervisory practices and would not attempt to play on national law differences, likely to appear in case of the transposition of a Directive. However, some of the flanking measures accompanying the MIF Regulation, for example those that impact on PSU rights and obligations, as surcharging, could well be included in the revised PSD.

It should be also noted that some of the options, in particular in the standardisation of card and mobile payments area, call for a soft law approach (improved governance arrangements, involvement of the standardisation bodies) as described under 6.1.

In conclusion, a combination of a Directive (PSD review) and a new IF Regulation would therefore offer the best way forward for addressing the problems identified in this impact assessment.

# 8 CUMULATIVE IMPACTS, IMPACTS ON STAKEHOLDERS AND CHOICE OF POLICY INSTRUMENTS

## *1.17 Cumulative impact of the recommended policy options*

For the purposes of a final, summary analysis the discussed policy options can be divided into four main packages:

1. governance and standardisation (including SEPA governance and standardisation in the domain of card and mobile payments, options 1-11),
2. interchange fees (including the core of the interchange regulation, options 12 and 14-17),
3. flanking measures for interchange fees (including cross-border acquiring, restrictive business practices and surcharging, options 13 and 18-25),
4. scope of the PSD (including access to the information on funds by TPPs, PSD exemptions and rules related to one-leg transactions and all currencies, options 26-35).

Various ancillary and fine-tuning measures, discussed in the Annexes 10 and 11, can be attributed to these packages.

These policy packages could in principle be discussed and adopted in three different combinations, if strictly necessary. However, it is important to note that there are strong interdependencies between the packages as well as the recommended options. Therefore, discarding one of the packages or recommended options would in many cases have negative implications across all potential benefits identified in this impact assessment and may in some cases turn to be counter-productive.

| Possible legislative packages | Main impacts |
| --- | --- |
| 1+4 | + addresses most identified weaknesses in the PSD (except surcharging); guarantees the involvement of all stakeholder categories in the development and governance of EU retail payments market; gives additional impetus to the market-driven standardisation in the field of card and mobile payments<br><br>- does not solve or touch upon the existing problems of lack of transparency and ineffective competition in the card area, with repercussions on the development of e- and m- payments; negative effects for PSUs will mostly persist; in case of the main regulatory change – inclusion of TPPs - the impact on competition is much diminished without IF regulation and other measures in packages 3 and 4<br><br>Estimated benefits for main quantifiable element of the package (access to information on the availability of funds for TPP): up to 3.5 billion EUR per annum in savings for merchants; a part of this amount could be passed through to consumers; additional 4 billion EUR per annum in benefits (mainly for businesses and consumers) if card standardisation is pursued. |
| 1+3+4 | + in addition to package (1+4) adds market transparency measures (HACR, steering/surcharging) and market-based mechanisms promoting competition (cross-border acquiring, ancillary measures –as e.g. blending and co-branding) to alleviate the market fragmentation and competition problems; remedies some negative effects for the PSUs (but not all the underlying problems)<br><br>- addresses only some important, but secondary problems related to market failures; does not address the main competitive and market entry problem identified in this impact assessment – interchange fees; the impact of most transparency and competition-promoting measures in this package is much diminished without direct IF regulation measures<br><br>Estimated benefits for main quantifiable elements of the package (access to information on the availability of funds for TPP, cross-border acquiring, restrictive business practices, surcharging): up to 4 billion EUR per annum in savings for merchants; a part of this amount could be passed through to consumers; additional 4 billion EUR per annum in benefits (mainly for businesses and consumers) if card standardisation is pursued. |
| 1+2+3+4 | + in addition to package (1+3+4) addresses comprehensively IFs, greatly reinforces the effectiveness of transparency and competition promoting measures in package 3; directly addresses all problems identified in this IA; brings positive effects for PSUs<br><br>- requires a direct regulatory intervention in the business model of the (international) card schemes as well as card issuing and acquiring PSPs; implies a careful monitoring of application by competent national authorities (both for merchant and consumer fees)<br><br>Estimated benefits for main quantifiable elements of the package (access to information on the availability of funds for TPP, cross-border acquiring, restrictive business practices, surcharging, regulation of cross-border and national MIF): up |

| | |
|---|---|
| | to 13 billion EUR per annum in savings for merchants; a part of this amount could be passed through to consumers; up to 730 million EUR per annum for consumers; additional 4 billion EUR per annum in benefits (mainly for businesses and consumers) if card standardisation is pursued. |

A more detailed rationale for a comprehensive package (1+2+3+4), including IF regulation measures, is presented in the box below.

<u>Rationale for all-inclusive package including interchange fees</u>

It should be considered whether reviewing the PSD and adopting IF flanking measures, without however attempting direct MIF regulation, could be effective. Such an approach would follow a traditional, classic economic theory, where improved transparency measures (e.g. abolishing HACR, addressing the steering/surcharging) and other market mechanisms promoting competition (discussed as the ancillary measures e.g. free choice of brand in case of co-branding) could lead to the desired economic outcome and to market balance.

However the functioning of the card market does not resemble the traditional market model from the classic economics textbooks. The card market, as mentioned before, has certain characteristics of a two-sided market (a market having two distinct groups of users and intermediaries necessary for the market to function), with intermediaries (card schemes and banks) able to increase the transaction costs imposed on one or both groups without facing diminishing returns typical for a traditional market. Thus, any regulatory intervention addressing only a part of this market will have limited effects.

When the realities of payment markets are considered, introducing more transparency and creating more effective market mechanisms could help create a positive dynamics towards more efficient pricing and a more competitive environment, but is far from sufficient.

The current differences in fees across the Internal Market are such that it would seem difficult to ‘bridge’ them just by steering consumers to lower cost payment instruments. For instance, the difference in interchange fees between certain credit cards in Belgium can amount to 250% whilst in the UK certain credit cards are 24 times as expensive as certain debit cards[71].

Furthermore, steering mechanisms in practice might not in isolation make much of a difference. Retailers tend to make limited use of them since they have limited incentives to do so. There is a risk that consumers do not react favourably to steering and in particular to 'negative' price signals, as surcharging, retailers would often refrain from steering. This would require 'Educating' consumers about the relative costs of payment instruments and the logic of making them pay for high fee instruments that inflict costs on others. However this may take a long time and bring limited results. Retailers may also not want to be the first-movers in this respect as they fear that consumers would go to their competitors not using surcharges (business-stealing effect). In the end, merchants can always pass on the costs of all payment means, including the most expensive ones, to all consumers (including the ones using 'cheap' payment means) through increased retail prices.

[71] Cf. annex 7, problem 3.2.2. Ineffective competition

Transparency and market measures would therefore only suffice for payment instruments that merchants can reasonably refuse (e.g. commercial cards, three party systems), as they are not too widespread. For instruments that are ‘must take’s’ (consumer debit and credit cards), in order to create the required level playing field, all interchange fees – cross border and domestic – should be regulated. Conversely, to avoid a shift to expensive three party systems, the regulation of interchange would have to be accompanied by effective steering measures.

Regulating cross-border interchange fees only would mean covering a small part of the transactions (5-10%), with limited if at all impact on domestic fees, which would remain highly divergent, fuelling an un-level playing field and preventing market integration. Cross border acquiring would go some way in addressing the current market failures, but it would mostly benefit large retailers - able to make the investment in applying one system (‘protocol’) to make cross border acquiring possible and only work in Member States where common protocols exist (in at most only 10 MS and on the Internet). Market entry for new pan-European players would remain difficult, as they would have to offer issuing banks the highest level of interchange fee prevailing in the market they want to enter – which impacts the viability of their business model.

In summary, the recommended policy options, assembled in the “full” package 1+2+3+4, imply that i) market fragmentation is decreased, ii) obstacles for competition in the area of card payments are addressed, in particular by regulating MIFs, eliminating restrictive business rules and improving market access, iii) possibilities for surcharging by merchants are limited the instruments left outside the scope of MIF regulation, iv) the access to the information on funds by TPPs becomes regulated, v) the regulatory gaps and inconsistences in the PSD are greatly reduced.

In combination, these measures will substantially improve the further integration of the EU payments market, yielding the following key benefits:

– A level playing field across service providers, merchants and consumers and more competition between service providers;
– A broader range of payment services for consumers and merchants;
– The provision of new and innovative payment services at European level; and
– More transparent and secure payment services.

The economic impact of the recommended options varies between the different areas under which measures are proposed.

Standardisation measures: General benefits of market integration, in particular through standardisation, would apply to the market as a whole. Based on a previous study and some simplified assumptions, such integration benefits could amount up to more than EUR 4 billion per annum for the card market. The benefits for mobile payment standardisation are more difficult to estimate as the proximity m-payment market is nascent but a study suggests that a standardised market could be up to 70% larger than a non-standardised one by 2016.

Measures increasing competition: Savings from these measures would mostly apply to merchants through reduced payment fees. Conversely, revenues of payment service providers and card schemes would be reduced by the according amounts. Merchant savings from a direct reduction of MIFs could amount to EUR 9 billion. Merchant savings from better alternatives for cheaper payment means are estimated at EUR 1.5 – 6 billion. Some of the overall savings for merchants could be passed through to consumers.

Limitation of surcharging: Direct savings for consumers are estimated at a portion of EUR 731 million annually. Merchants would also benefit from lower costs especially if seen in combination with the MIFs options and transparency measures, although revenues from opportunistic surcharging are expected to decrease.

More consistent application of PSD: This could lead to higher costs of EUR 128 – 193 million (one-off) for those PSPs to be moved into the revised scope of the PSD. Changes in liability rules (PSD fine-tuning measures) could lead to a reduced exposure for consumers of up to EUR 295 million annually.

**Table 25 - economic impact of the recommended options.**

| Identified issue | Recommended Option | Economic Impact at EU level |
|---|---|---|
| Governance and standardisation | | |
| Governance arrangements | Through formal body (European Retail Payments Council) | Better involvement of stakeholders. Costs marginal. |
| Standardisation card payments | Through payments governance framework (under European Retail Payments Framework) | Contributes to fully integrated card market. Benefits estimated at 4 billion per annum mainly for businesses and consumers |
| Standardisation mobile payments | Through European Standardisation Organisation | Drives volume of m-payment transactions. Estimate: 68% more transactions if standardised |
| Interchange fees (for card-based payments) | | |
| IFs regulation (Phase 1) | Cap cross-border IFs (debit and credit) and allow choice of IF for cross-border transactions (through cross-border acquiring, see below) | Operational savings for large merchants. Estimated at EUR 3 billion annually. |
| IFs regulation (Phase 2) | Cap MIFs for debit and credit cards at EU level at 0.2% and 0.3% respectively (cross-border and domestic) | Operational savings for all card accepting merchants. Estimated at EUR 6 billion annually. Part of these could be passed through to consumers. |
| Interchange fees – main flanking measures | | |
| Cross-border acquiring | Remove obstacles imposed by | Operational savings for large |

| | | |
|---|---|---|
| | card schemes and laws to cross-border acquiring | merchants up to EUR 3 billion annually (if supported by cross-border IF regulation), a small part of this amount if a stand-alone measure |
| Restrictive business rules | Prohibit Honour All Cards and Non-Discrimination Rules | Operational savings for all card accepting merchants. Estimated at most at EUR 0.4 – 1.5 billion annually. Under caps of 0.2% and 0.3% for debit and credit cards, savings estimated at EUR 0.095 – 0.4 billion annually. Part of these savings could be passed through to consumers. |
| Diverging charging practices between MS | Ban surcharging for payment instruments with regulated MIF (see MIF options above) | Savings for consumers: part of EUR 731 million annually |
| Scope gap and inconsistent application of the PSD | | |
| Access to the information on the availability of funds by TPPs | Define the conditions of access to the information on the availability of funds, define rights and obligations of the TPPs, clarify the liability repartition | Better market access for Third Parties including new card schemes and other innovation. Savings for merchants if PIS substitute credit cards in online transactions estimated at EUR 0.9 – 3.5 billion annually. These savings are at least maintained if IFs regulated as above. New online payment solution for consumers, including those not possessing credit cards. |
| Negative scope (exemptions) | Re-definition of scope for commercial agents and limited networks;<br>Include IT / mobile initiated transactions and independent ATMs in scope;<br>Require clearance for exempted services by competent authorities | Cost for relevant PSPs estimated at EUR 128 – 193 million (one-off). Benefits not quantifiable but include improved consumer protection, increased payments security and a level playing field for competition. |
| Positive scope (one-leg and non-EU currency transactions) | Selective extension (Title III and IV) of PSD scope to one-leg and non-EU currency | Costs marginal. PSD benefits extended to payment transactions with an estimated total value of EUR 60 billion annually for some 32 million PSUs. |

### *1.18 Impact on different stakeholders*

Generally, payment service users (merchants and consumers) benefit most from the package of proposed measures. On the supply side, there are significant benefits for new entrants and payment institutions. Incumbent providers benefit least from the recommended options.

Consumers: Beyond the direct economic benefits through a limitation of surcharges and possible pass-through effects of merchant savings through their pricing of goods and services, consumers mostly benefit through:

- increased choice of payment means, in particular online-banking based and mobile payments and
- strengthened consumer protection rules through the inclusion of additional payment services and transactions under the PSD regime, stronger information requirements for PSPs and a revised liability regime
- stronger involvement in retail payments governance

On the negative side, there is a risk that consumers face increased card issuing and maintenance fees by PSPs that compensate for reduced revenues from MIFs.

Merchants: The vast majority of direct economic benefits applies to merchants through a significant reduction of fees as applied by banks and card schemes and more freedom in terms of not having to accept expensive payment means. Merchants also benefit from more standardisation (for example in the area of card payments) and the possibility for cross-border / central acquiring.

New entrants on the supply side: The recommended measures address a number of market access hurdles, in particular for payment initiation services, new card schemes and payment institutions. New entrants will also benefit from the elimination or significant reduction of reverse competition on MIFs for cards. Overall, the key benefits for new market entrants therefore stem from a more level playing field versus incumbents.

Existing PSPs and card schemes: Incumbent banks and card schemes will be affected by a revenue reduction through the limitation of anti-competitive fee models and restrictive business rules. They will also face stronger competition from new entrants as obstacles for market entry and market access will be addressed through the proposed measures. They may however see benefits in the long run through more standardisation, i.e. a reduction of operational cost and possibilities for new value-adding services, for example in the area of mobile payments.

**Table 26 - Impact of the recommended options for different stakeholder categories (based on the terminology introduced in chapter 6).**

| Identified issue | Recommended Option | Economic Impact at EU level |
|---|---|---|
| Governance and standardisation | | |
| Governance arrangements | Through formal body | Consumers: (+) |

| | | |
|---|---|---|
| | (European Retail Payments Council) | Merchants: (+)<br>PSPs: (+) |
| Standardisation card payments | Through payments governance framework (under European Retail Payments Framework) | Consumers: (+)<br>Merchants: (++)<br>PSPs: (0) |
| Standardisation mobile payments | Through European Standardisation Organisation | Consumers: (++)<br>Merchants: (++)<br>PSPs incl. MNOs: (+) |
| Interchange fees (for card-based payments) | | |
| IFs regulation (Phase 1) | Cap cross-border IFs (debit and credit) and allow choice of IF for cross-border transactions (through cross-border acquiring, see below) | Consumers: (0/+)<br>Merchants: (+)<br>PSPs: (-/0)<br>New entrants: (+) |
| IFs regulation (Phase 2) | Cap MIFs for debit and credit cards at EU level at 0.2% and 0.3% respectively (cross-border and domestic) | Consumers: (0/++)<br>Merchants: (++)<br>PSPs: (-/0)<br>New entrants: (++) |
| Interchange fees – main flanking measures | | |
| Cross-border acquiring | Remove obstacles imposed by card schemes and laws to cross-border acquiring | Consumers: (0)<br>Merchants (big retailers): (+)<br>Merchants (SMEs): (0)<br>PSPs: (0)<br>Card schemes: (-) |
| Restrictive business rules | Prohibit Honour All Cards and Non-Discrimination Rules | Consumers: (+/0)<br>Merchants: (++)<br>PSPs: (-)<br>Card schemes: (-) |
| Diverging charging practices between MS | Ban surcharging for payment instruments with regulated MIF (see MIF options above) | Consumers: (+)<br>Merchants: (-)<br>PSPs: (0)<br>Card schemes: (0) |
| Scope gap and inconsistent application of the PSD | | |
| Access to the information on the availability of funds by TPPs | Define the conditions of access to the information on the availability of funds, define rights and obligations of the TPPs, clarify the liability repartition | Consumers: (++)<br>Merchants: (++)<br>TPPs (++)<br>Banks: (0) |
| Negative scope (exemptions) | Re-definition of scope for commercial agents and limited networks;<br>Include IT / mobile initiated transactions and independent ATMs in scope; | Consumers: (+++)<br>Merchants: (+)<br>PSPs (exempted): (-)<br>PSPs (authorised): (0) |

| | | |
|---|---|---|
| | Require clearance for exempted services by competent authorities | |
| Positive scope (one-leg and non-EU currency transactions) | Selective extension (Title III and IV) of PSD scope to one-leg and non-EU currency | Consumers: (++)<br>Businesses: (+)<br>PSPs: (-/0) |

### *1.19 Other impacts*

Impact on Member States: The impact of the proposed options on the Member States should be limited. Member States would incur the costs of legislating and transposing of the revised PSD. Once this is done, the Member States would need to cover some one-off costs, related to the implementation of the preferred options, as well as recurring costs of supervising and monitoring the new law rules. These costs are, whenever possible, calculated and indicated in the impact assessment under the respective options. However, the total costs indicated are not necessarily cumulative as heavier supervision and monitoring in some areas, implying higher administrative costs for Member States, would be at least partially compensated by lower expenses in other areas of the public administration. For example, thanks to the card regulation, significantly lower administrative burden and expenses could be expected for national competition authorities and courts, currently involved in investigating card market practices and MIFs.

In the longer perspective, Member States (and society as a whole) would benefit from the possibly lower costs of payments and more varied payment means that could be used for public payments. For example, if electronic payments are used more frequently, Member States could realise important tax gains on those transactions that currently go unregistered in the "black" or "grey" economy.

Administrative burden for businesses: As estimated under various options of this impact assessment, the administrative burden for stakeholders related to the introduction of new legal rules is marginal. As much as possible the preferred options took into account the minimisation of impact into account e.g. by applying a light-touch information regime for exempted, low-value PIs. Administrative obligations arise basically only in three cases, i.e. for prudential, security and PSU protection reasons. Furthermore, it is important not to associate some capital-intensive prudential requirements (own funds, licensing) that are introduced on some categories of PIs with purely administrative burdens.

Social impact: The recommended measures do not imply a direct social impact. Economic downsides for incumbents are compensated by benefits for new entrants, resulting in a neutral impact on employment at worst. To the extent that the proposed policy options contribute to the further development of e-commerce (and m-commerce), jobs are more likely to be created than to be reduced. As highlighted in the Commission Communication on e-commerce72, in

72 See Communication "A coherent framework for building trust in the Digital Single Market for e-commerce and online services", COM(2011) 942 final; p.1

the G8 countries, the internet economy has brought about 21% of the growth in GDP in the last five years. It also generated 2.6 jobs for every job cut.

Environmental impact: The preferred policy options will not have any direct impacts on the environment. In terms of an indirect impact, many of the proposed options would facilitate and promote the development and more extensive use of the electronic means of payment, including card, mobile and online payments. This should contribute to the reduction of the level of cash in circulation and lead to environmental benefits.

Impact on third countries: If the preferred options were extended to the three European Economic Area countries which are not members of the EU, the same impacts as described above would affect the relevant stakeholders in Iceland, Liechtenstein and Norway. With regard to the impact on third countries, the regulation of MIF as well as the revision and extension of PSD rules will not lead to discrimination or competitive advantages for PSPs, businesses and other stakeholders offering or making payments in Europe, as they would be subject to exactly the same legal rules.

Impact on Union resources: No mesurable impact on Union resources is expected. In the medium time perspective (5-10 years), thanks to the regulation of the card business some of the human resources currently involved on the card issues could be redeployed in other areas of the EU institutions activities.

Impact on other EU legislation: Many provisions of the PSD are applicable, mutatis mutandis, to Directive 2009/110/EC (E-money Directive, EMD). Therefore, changes to the current PSD text would also affect the EMD, insofar the provisions of PSD are applied to the EMD.

## 9 EVALUATION AND MONITORING

Both the revised Payment Services Directive and the legally binding instrument would include a provision stating that a review of its appropriateness and effectiveness in meeting the objectives should be carried out. This review should take place a few years after the implementation and could focus on evaluating the impact of the revised provisions on:

– the reduction of the divergences between Member States in the implementation of the PSD

– the reduction of barriers to effective competition and related effects, such as the emergence of new innovative means of payment, better access of newcomers to the market and increased standardisation

– the level of Merchant Service Changes for card payments and possible side-effects on banking revenues and consumer prices

The review may include a public consultation and/or survey stakeholders to review the effect of the revised PSD and legally binding instrument on the different categories of stakeholders. Regard would also be given to monitoring quantitative indicators, such as the number of new players in the market (PIs, card schemes, etc.) and the use of the different payment methods (cash, debit cards and credit cards), the level of MSCs, cardholder and current account fees prior to and after full implementation.