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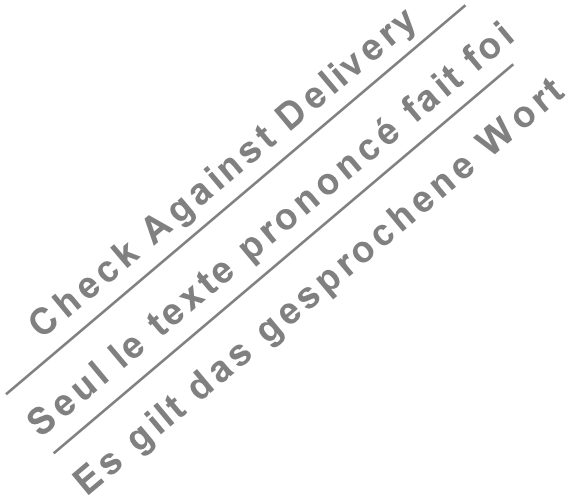
SEPA and competition



European Payment Council, Coordination Committee offsite meeting
Château-de-Limelette, Belgium , 3 September 2008

Ladies and gentlemen,
Thank you for inviting me here today.

The great work you are realising to make SEPA a reality is a major revolution in the European payments market. It has been said many times: SEPA has huge potential benefits for European banks, consumers and companies in terms of efficiencies and enhanced competition. In this remarkable exercise, such advantages are primarily created by the industry itself with the European legislator in a rather facilitating role.

What happened since last meeting?

Some of you may remember that I also spoke at the EPC off-site last year. As you probably recall, I then shared with you a number of potential competition concerns related to SEPA, which had been identified by the national competition authorities together with DG Competition.

As I explained then, even though SEPA is a commendable initiative, it is based on a co-operation between –potential- competitors, which effectively shapes the future European market for payment services. It is only natural that such an initiative is followed with close interest by competition authorities who have a keen eye for its effects on consumers, other service users and new entrants.

I remember that not all attendants of last year were pleased with this special attention. Perhaps it was felt that it unduly disregarded the huge efforts made by banks and the uncertainty whether they would be able to recoup their investments. However, I assure you that DG Competition and the other competition authorities are well aware of the magnitude of the banks' voluntary assignment.

One year later, I am happy to tell you that we made a lot of progress concerning the identified competition issues.

As you know, the EPC and the Commission have had an informal dialogue on these issues. I consider this was a valuable exercise and a unique chance for the industry to have an *ex-ante* competition assessment.

The dialogue can be already called a success: On a number of issues, the EPC was able to provide a satisfactory clarification - which we have passed on to the NCAs in order to meet their competition concerns. Also, I am confident that as a result of the meetings the EPC now understands that the competition concerns were not purely speculative and that it is also in the industry's own interest to improve transparency and to engage in communication with competition authorities.

On the individual topics the picture is now as follows:

Migration for cards

The - at the time- most urgent issue 'migration' for cards concerned the interpretation of the notion of 'SCF compliance' on the basis of the SEPA Cards Framework (SCF).

At the heart of this issue was our concern that SEPA would be used as a pretext to replace well functioning low cost national card schemes by more expensive payment card schemes. There was uncertainty what "SEPA compliance" really meant. Market participants appeared to interpret the SEPA Cards framework in a way that a card scheme would only be SEPA compliant if it *covered all 31 states of the SEPA territory*. However, in the dialogue the EPC clarified that SEPA compliance should not be interpreted in this way. Banks should be able to decide for themselves whether joining one or another card scheme represents a good business case to them. In other words: market forces alone shall decide which SEPA states and how many of the SEPA states should *actually* be covered by a particular payment scheme. This means that new schemes are guaranteed a real chance to enter the market.

You know that the result of these discussions was the publication by the EPC of easy-to-read Questions and Answers which clarify key aspects of compliance with the SCF for payment card schemes and banks as well as the conditions for geographical coverage. This should facilitate the transition from the existing fragmented and monopolistic national payments markets towards a competitive, SEPA-wide payment cards market.

Governance in general

On a number of other issues, the EPC was also able to provide satisfactory clarifications. For instance, any entity which becomes a payment institution will in principle be treated on an equal footing with banks under the SEPA credit and direct debit schemes.

In the context of governance we discussed the need to optimise the EPC's working methods and practices in order to give stakeholders a genuine possibility to provide input and influence the decision making process. We feel that in that respect, the ongoing consultation process in the framework of standardisation for cards is a very positive development in the right direction.

Governance for cards

In the area of governance of the SEPA Cards Framework, certain concerns remain, due to the fact that the SCF is entirely built on the principle of *'self-assessment'*: It is for the schemes, infrastructure providers and other players to determine themselves whether they think they are 'SCF compliant' and to publicly announce this 'compliance'. No monitoring, supervision, dispute resolution and/or enforcement powers are foreseen. In this respect, the SEPA Cards Framework relies completely on the principle of 'peer group pressure' to convince market participants that they have to adjust their business model or characteristics if others make it clear they do not agree with their claim of compliance.

Competition policy is very much about 'making markets work effectively' or in other words: putting in place the conditions for companies to deliver better services to consumers. This is only possible if there is a level playing field and market entry is determined on the basis of objective and transparent criteria, which

are applied in an objective and non-discriminatory way. Only then will new entrants have sufficient confidence in profitable market entry to invest in it.

We therefore think that especially for the longer term there remains a need for further reflection on structural solutions for compliance assessment, monitoring and dispute resolution.

Standards

With respect to standards for cards it is important to distinguish between,

- on the one hand, the well known 'EMV' standards, which are a proprietary standard issued and managed by EMV Co
- and, on the other hand, the interoperability standards being developed by the EPC.

As to the EMV standard we have received quite some comments by stakeholders on the fact that the European banking industry has not developed a truly open standard for something so important as the European payment cards market. Indeed, on a general note Commissioner Kroes recently mentioned in a speech on standardisation that she fails to see the interest of customers in including proprietary technology in standards when there are clear and demonstrable benefits over non-proprietary alternatives: When a market develops in such a way that a particular proprietary technology becomes a *de facto* standard, then the owner of that technology may have such power over the market that it can lock-in its customers and exclude its competitors. EPC has explained to us that in the field of payment cards, there were many good reasons pleading in favour of the further use of the proprietary EMV standard, which at the time of beginning of the EPC's standardisation work was already widely accepted and implemented in Europe. However, the EMV standard is indeed a proprietary standard: EMV Co, the owner and manager of the standard, is in its turn owned by the three international card schemes Visa, MasterCard and JCB. We understood that EPC is conscious of the risk of having chosen a proprietary standard and is looking for ways to limit the possible negative consequences of the market power this conveys on the owners of the standard. For the time being the EMV standard is used free of charge '*courtesy* of EMV Co'. However, in principle this could change in the future. Similar considerations apply with respect to PCI. This is an issue on which we would like to continue fact finding in order to better assess the possible negative effects on competition and if so, possible solutions.

The other issue regarding standardisation concerns the availability of the interoperability standards which are so important for a true '**S**ingle **E**uro **P**ayments **A**rea'. You will recall how we emphasized, in the context of migration, that 'SEPA' compliant should not mean *'covering 31 SEPA states'*. However, as we agree with the EPC, it should mean '*complying with the interoperability standards that are being developed under the auspices of the EPC*'. SEPA will only allow effective competition and market access by new players if it will abolish the technical and regulatory barriers which currently prevent the occurrence of a European payment cards market. It is therefore of key importance that these standards are available and

implemented at the moment the industry decides to "impose" SEPA compliance on all market players. In other words, the standards should be in place and effective once a decision is made that all banks should only issue SEPA compliant cards. Indeed, if no interoperability standards will be available and applicable then, there is a risk that there will be a collective migration only towards existing international card schemes. Such a migration – justified only by the given end date, but not by the consideration to move to a more efficient system – would have no added value to consumers *vis-à-vis* the schemes that are abolished. This would risk restricting competition without generating efficiencies as referred to in Article 81 (3) EC.

In our dialogue, the EPC was therefore made clearly aware of the need for standards to be available and implemented at the moment the industry decides to move over to SCF compliant schemes.

MBP direct debit

I would now like to concentrate my intervention on a hot issue for industry and competition authorities: the direct debit multilateral interchange fee, or multilateral balancing payment – MBP as you wish to call this.

As a general point, the debate on interchange fees brings in complex and fascinating legal and economic analyses. This is partly due to the huge economic impact of such fees for the banking industry and for end users (even if the latter ones hardly knew about these fees, until recently).

In December 2007, the Commission adopted a long-awaited decision with respect to MIFs for cards. Although it is very clear to us that the specificities of direct debit are different in a number of respects, the principles established for the analysis of MIFs in the MasterCard decision have to be taken into account.

In this decision, the Commission established that the MasterCard intraregional MIFs were caught by Article 81 (1) EC, because they restrict competition between the acquiring banks by inflating the base on which acquiring banks set charges to merchants and by creating an important cost element common to acquirers. At the same time MasterCard failed to demonstrate that the conditions set out in Article 81 (3) EC for an exemption from the prohibition of Article 81 (1) EC were fulfilled.

We believe that multilateral balancing payments between banks with respect to SEPA direct debit transactions may have similar effects as MIFs with respect to cards. We have therefore asked EPC to provide a justification of the envisaged system, explaining the underlying model, the methodology and the efficiencies to be generated with the MBP.

From a competition viewpoint we have not seen a proper justification for a permanent MBP on all transactions, yet - let alone for the specific amount proposed by the EPC.

There is wide consensus that the new SEPA direct debit will benefit European consumers and companies in terms of new and enhanced product characteristics, such as EU wide reachability and potentially increased competition. However, the facts are also that in 75% of the market, direct debit schemes are working without multilaterally agreed interchange fees on each transaction.

If the real objective of a MBP is to incentivise the use of the direct debit and to balance costs and revenues on both sides of the market, we believe that there are other mechanisms which are less harmful to competition such as specific fees for defective payments. Also, we think that there are better - more direct - incentives to use direct debit payments, e.g. rebates of the utility companies, etc. Such practices would reduce the price for the final consumer in a transparent and efficient way; and they are actually in place in a number of Member States.

We therefore conclude that currently, there seems to be no justification for a general per transaction multilateral inter change fee for cross border and national SEPA direct debits in the long run.

However, we fully understand the need for this important new facility for European industry and consumers to successfully take off. This applies in particular to the cross border services, which until now were simply not available to European customers.

Therefore, it could make sense, also from a competition view point, to allow for a temporary interbank fee for cross border SEPA direct debit transactions for a transitional period. However, as always, such an inter bank fee must be based on a proper economic justification. We invite the EPC to come forward, as a matter of urgency, with concrete facts and figures which would underpin the need and level of a possible fee for the start up phase of cross-border SDD transactions.

The question whether SEPA Direct Debit will successfully take off at a domestic level clearly is dependent on the question whether the right incentives are in place:

On the one hand, an important consideration for certain banking communities to insist on a MBP for SEPA direct debit is the fact that in their home country a MIF for existing (national) direct debit transactions applies. If no such fee would be available in the SEPA system, they have no incentive to join.

On the other hand, in those countries where such fees are not applicable, creditors (utility companies) are afraid that the introduction of a European fee will bring a considerable price increase. In that case these customers have no incentive to join the system.

This raises the very difficult question of: What is the most effective 'mix' of incentives for migration?

Considering all circumstances, we think that migration is probably best served if banks are allowed to continue applying their current system also for national SEPA Direct Debit transactions during the transitional period. This will mean that effectively, no player will be 'worse off' as a consequence of having moved to SEPA.

In practice, this would mean that during the transition period, as far as national direct debit transactions are concerned, national banking communities could apply a MIF for national SEPA direct debit. This MIF could, however, *not be higher than the existing MIF for national legacy direct debit.* In countries where no 'legacy' MIF applies, none would apply to SEPA direct transactions, either.

At the end of the transition period, there would no longer be any 'per transaction' MIF for any SEPA direct debit transaction – national or cross-border, unless there is proper justification for it. This would of course be without prejudice to the possibility of other compensation, for instance for defective payments. Such arrangements, and any other acceptable multilateral financing arrangement, will have to be based on a proper economic justification, to be provided by the respective players.

Let me conclude by saying that we are very firm on the fact that a MIF could be acceptable only for a temporary period – with a clear sunset clause. At the same time, as you hear, we are also willing to provide the industry with concrete guidelines to create the necessary conditions for the start off of the scheme.

We know time is of the essence.

Conclusion

To conclude: it seems we and you have lots of work in front of us, but I am confident our continued dialogue is reinforcing and strengthening the goals of SEPA which ultimately is to bring more competition into the market and will help to achieve better services for a better price for consumers.