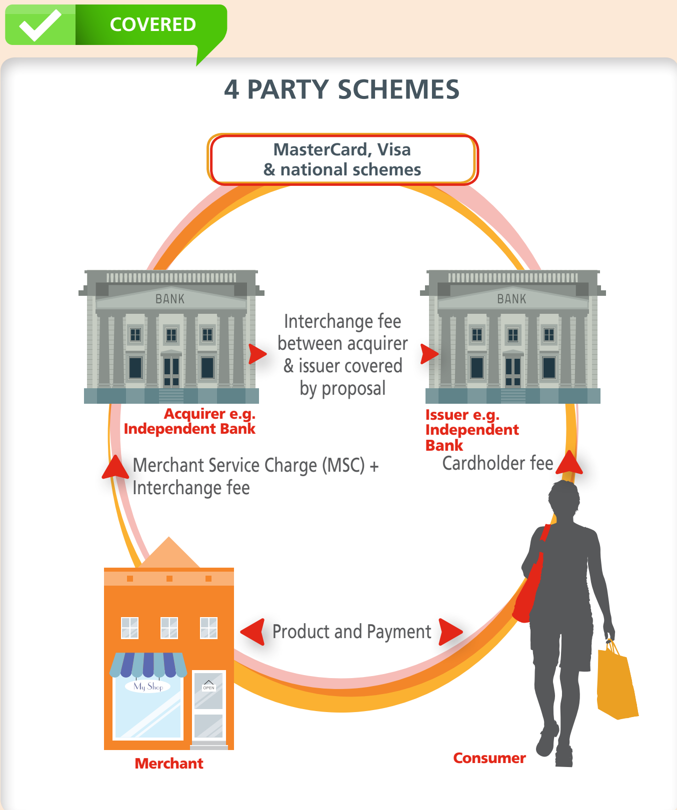
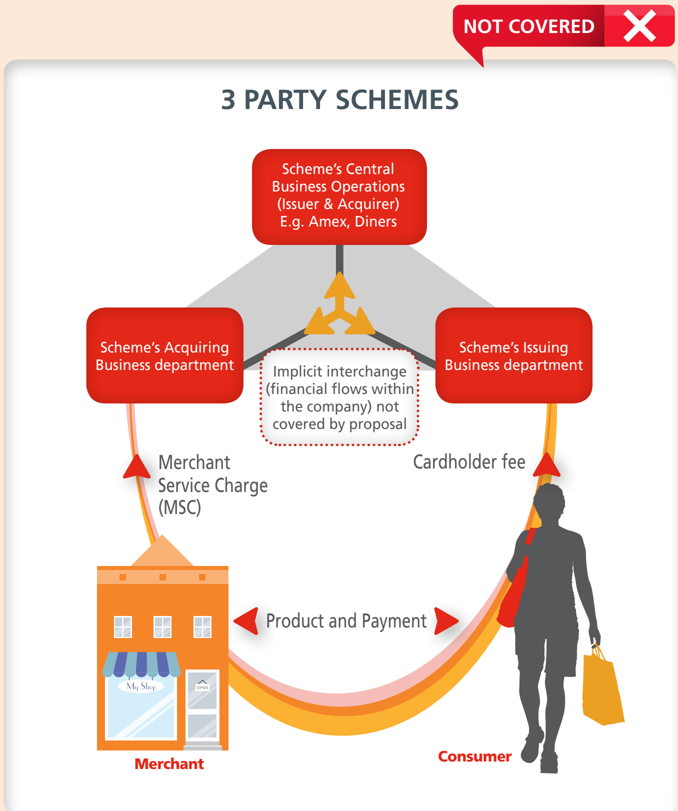
NEW PAYMENTS REGULATION: HOW TO ENSURE EQUAL TREATMENT AMONG CARD PAYMENT SCHEMES

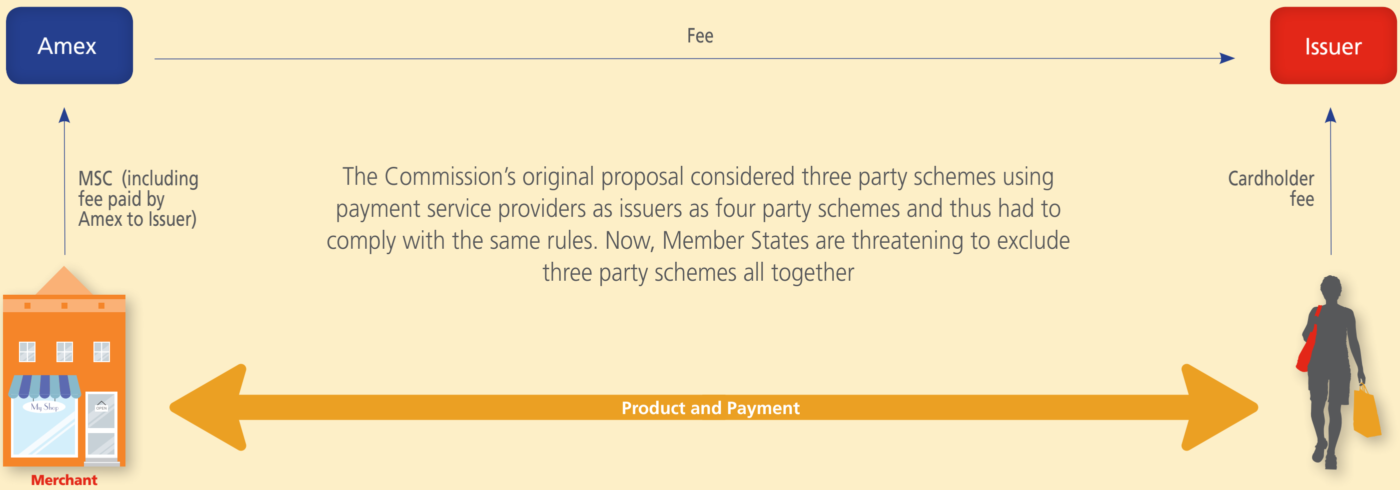
European decision makers are discussing the new rules for electronic payments. The European Commission's proposal for MIFs Regulation does not treat all payment schemes equally and does not fully cover three party schemes. There are a number of loopholes that would allow three party schemes to circumvent the interchange caps despite their cooperation with partners and them acting in a similar way to four party schemes.

HOW DIFFERENT SCHEMES WORK AND WHAT IS COVERED UNDER THE CURRENT PROPOSAL





THREE PARTY SCHEMES ACTING LIKE FOUR PARTY SCHEMES



The Commission's original proposal considered three party schemes using payment service providers as issuers as four party schemes and thus had to comply with the same rules. Now, Member States are threatening to exclude three party schemes all together

HOW CAN THREE PARTY SCHEMES CIRCUMVENT INTERCHANGE?

THE "AGENT" MODEL

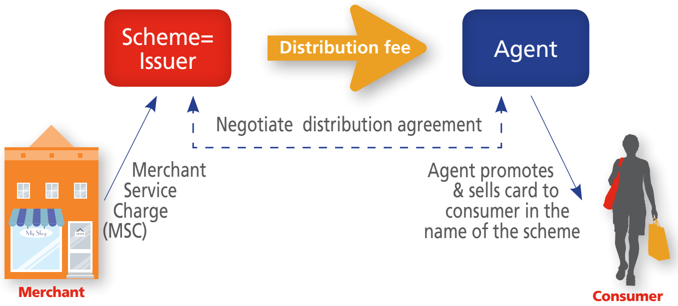
The 3-party scheme remains the issuer

1 It uses a **bank to distribute and promote the card** among potential cardholders

2 The bank acts as a service provider/agent to the card scheme and is paid by the scheme to do it

3 Contrary to the scenario caught by the original proposal, the bank is not the issuer of the card, merely a distributor.

While there is no interchange in this model, a **service fee flows from the scheme to the agent.** Its purpose is similar to interchange as this fee is funded by the contribution of the retailer (MSC). The original EU proposal does not foresee a cap for this in the same way as it does for interchange.



THE "REFERRAL" MODEL

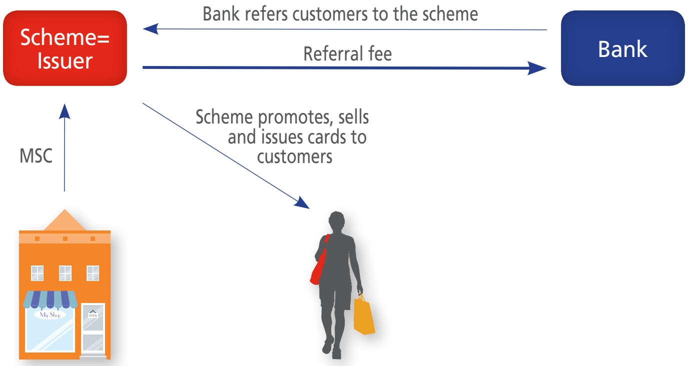
In this scenario, the 3-party scheme is the issuer

1 The scheme has a **direct relationship with the cardholder** and distributes it.

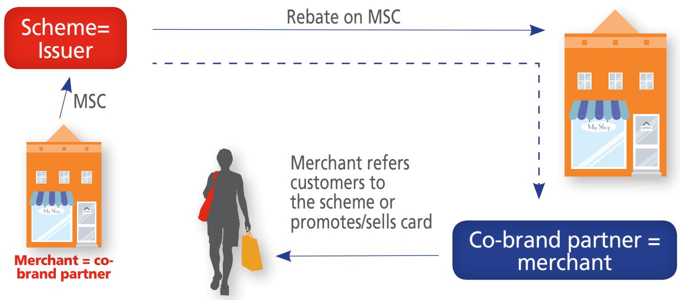
2 The scheme does not use a bank or other third party to undertake any of those activities. However, the **bank retains a role in that it provides customer data to the scheme.**

3 It **"shares" its customer base with the scheme against the payment of a certain fee.**

This significantly **broadens the scheme's reach among cardholders, similarly to the reach 4-party scheme** have. Again, this model is financed by the merchants' contribution.



THE "CO-BRAND" MODEL



The 3-party scheme is the issuer.

1 It has a **direct relationship with the cardholder**. However, it also **places the merchant's logo on the card** and **uses the merchant as a distributor** (similar to the "agent" model with a bank).

2 Alternatively, the **merchant sometimes provides its customer data** to the scheme, similar to the "referral" model.

3 In exchange for the merchant's "help" to gain a greater cardholder base, the scheme reduces the merchant service charge for accepting cards.

The issuing side of the **3-party scheme is enhanced through a financial contribution** (in the form of lower merchant service charge) **from the acquiring side of the business.** It fulfills the same purpose as official interchange and should therefore be caught by the legislation.

We would support amendments to the proposed Regulation **that**:

1 Maintain the European Commission's original proposal to **consider three party schemes using payment service providers as issuers or acquirers as four party payment schemes and follow the same rules**

2 Review the definition of interchange to **include implicit interchange fees** existing within 3-party schemes as well as **potential discounts to merchants so that when a three party payment card scheme issues or distributes payment cards with a co-brand partner or through an agent or any intermediary, it is considered as a four party payment card scheme**

3 Make transparent implicit interchange fees within 3 party schemes by **imposing accounting separation**

4 Require that the business units of **3 party schemes establish transparent contracts with partners** involved in the distribution/ promotion of the schemes' cards

5 **Avoid discounts on merchant service charges which are linked to the existence/performance of co-brand portfolios**

6 **Consider any net compensation** received by issuing activities as **implicit interchange**

7 Ensure the scheme's internal transfer prices are **transparent** and there is a **clear identification of costs and revenues**

Failure to address these loopholes would represent a breach of fair competition and would ultimately lead to higher costs for **consumers and merchants**. The number of three party scheme cards **issued using four-party models (which typically have the most expensive fees for consumers and merchants)** is likely to increase **significantly**. Banks / co-brand partners will **issue more of these cards** due to the higher incentives they would gain **in comparison to regulated cards and most merchants will feel compelled to accept them**