

Green Paper

Towards an integrated market for card, internet and mobile payments

Answers given by the Magyar Nemzeti Bank (the central bank of Hungary)

and the Hungarian Financial Supervisory Authority (PSZÁF)

10 April, 2012

MULTILATERAL INTER-CHANGE FEES (MIFS)

Under the same card scheme, MIFs can differ from one country to another, and for cross-border payments. Can this create problems in an integrated market? Do you think that differing terms and conditions in the card markets in different Member States reflect objective structural differences in these markets? Do you think that the application of different fees for domestic and cross-border payments could be based on objective reasons?

- Our general opinion is that competition shouldn't be hindered unduly, because competition can guarantee advances in efficiency in the long run. We are convinced that MIFs should be the same for domestic and cross-border transactions within a card scheme inside the EU (as in the case of SDD), in order to enjoy the benefits of a single market.
- We think that it is hard to find objective structural differences in international card schemes. The only issue may be the maturity of the market, as payment card schemes are still in their infancy in some Member States where MIFs may have a positive effect on building the market. Nevertheless, our opinion is that in mature markets where MIFs have a restrictive effect, mature schemes shouldn't be backed, and thus MIFs should be abolished.
- We are convinced that within a given scheme, geographic differentiations of MIFs do not fit with the SEPA concept, and hence they should be abolished.
- Furthermore, we hold the opinion that theoretically the market may be segmented in terms of objective conditions (e.g. consumer groups), which could help determine an adequate MIF level.

Is there a need to increase legal clarity on interchange fees? If so, how and through which instrument do you think this could be achieved?

- In our view, increasing the legal clarity on MIFs has significant importance. We believe that today's public authority interventions on MIFs are mostly developed by the decisions of competition authorities, which have a serious impact on the payments card market and thus on MIFs. (In Hungary, for example, these decisions contributed to strengthening the market leader card company.) From our point of view, competition authorities (e.g. DG Competition) have a serious role to play in ensuring equal and fair competition, but they shouldn't replace regulatory decisions. To our mind, it is the regulatory bodies who should assume responsibility by creating the framework of regulation at the European level.

- We agree with the ECB's 7th progress report on SEPA: "In addition to the commitments made by MasterCard and Visa Europe on MIFs, further guidance from the European Commission on the MIF is considered necessary, with guidance in the form of a regulation as the ultima ratio."

If you think that action on interchange fees is necessary, which issues should be covered and in which form? For example, lowering MIF levels, providing fee transparency and facilitating market access? Should three-party schemes be covered? Should a distinction be drawn between consumer and commercial cards?

- The European Commission should have definite rights in the field of regulation on MIFs. This is necessary to achieve a transparent MIFs rule in the EU. It should enhance competition, and thus consumers would enjoy the benefits of a Single Market.
- We expect that the EC's regulation prohibit differentiation among Member States and enhance transparency.
- We believe that a tangible lowering of MIFs – or, even better, abolishing them – would be reasonable in the long run. Because in most cases MIFs are calculated as a given percentage, we can see no reason why they shouldn't be lowered, as long as card payments turnover thrives.

CROSS-BORDER ACQUIRING

Are there currently any obstacles to cross-border or central acquiring? If so, what are the reasons? Would substantial benefits arise from facilitating cross-border or central acquiring?

- In our view, cross-border transactions are of great importance. Therefore, barriers to them should be abolished in the European Union (in the euro area as well as in the non-euro area).
- We think that new regulations may be advanced further to enhance efficiency. From our point of view, the definition of domestic/cross-border acquiring should be refined (e.g. whether a transaction should be considered domestic only if the merchant is domestic, even if the bank is not domestic).

How could cross-border acquiring be facilitated? If you think that action is necessary, which form should it take and what aspects should it cover? For instance, is mandatory prior authorisation by the payment card scheme for cross-border acquiring justifiable? Should MIFs be calculated on the basis of the retailer's country (at point of sale)? Or, should a cross-border MIF be applicable to cross-border acquiring?

- According to our general view, the European Union is a single market, and thus there is no place for cross-border differentiation within the EU.
- The Payment System Directive regulates payments in the European Union by aiming at a common market. Hence we cannot see the reason why card schemes make a differentiation by Member States. In our opinion, EU-wide licensing should be created in order to enforce competition and thus efficiency.

CO-BADGING

What are the potential benefits and/or drawbacks of co-badging? Are there any potential restrictions to co-badging that are particularly problematic? If you can, please quantify the magnitude of the problem. Should restrictions on co-badging by schemes be addressed and, if so, in which form?

- We see co-badging as beneficial, as it could further enhance competition in the payment cards market. A lack of transparency seriously hinders the spread of co-badged cards, however, and thus the benefit of competition has not been exploited. Hence we are convinced that transparency should be backed by regulators.
- On the other hand, we would like to emphasise that security requirements must increasingly be applied in order to minimise fraud in the domain of co-badging cards.

SEPARATING CARD SCHEMES AND CARD PAYMENT PROCESSING

Do you think that bundling scheme and processing entities is problematic, and if so why? What is the magnitude of the problem?

- We hold the opinion that separation between scheme management and processing must be further improved, because it would increase competition between card schemes and between processors. The separation of scheme and infrastructure at SCT serves as a good example.
- From our point of view, bundling schemes and processing entities may carry the risk of exclusion of potential competitors or innovation. One should avoid giving processors an unreasonable competitive advantage.
- Furthermore, we have the opinion that scheme owners may prescribe minimal security elements for the operators.

Should any action be taken on this? Are you in favour of legal separation (i.e. operational separation, although ownership would remain with the same holding company) or 'full ownership unbundling'?

- We hold the opinion that one should adhere to the SEPA Cards Framework, which lays down specific arrangements on separation. We suggest that further actions should be taken for full separation at the corporate level, including operational, information, financial, accounting, commercial and legal separation.

ACCESS TO SETTLEMENT SYSTEMS

Is non-direct access to clearing and settlement systems problematic for payment institutions and e-money institutions and if so what is the magnitude of the problem?

Should a common cards-processing framework laying down the rules for SEPA card processing (i.e. authorisation, clearing and settlement) be set up? Should it lay out terms and fees for access to card processing infrastructures under transparent and non-discriminatory criteria? Should it tackle the participation of Payment Institutions and E-money Institutions in designated settlement systems? Should the SFD and/or the PSD be amended accordingly?

- We are convinced that payment institutions (PIs) and e-money institutions (ELMIs) should have the right to choose freely between different types of access (including even direct and indirect participation, according to the Settlement Finality Directive (SFD)) to clearing and settlement systems (including even clearing and settlement systems 'designated' in accord with the SFD). We agree that the text of the SFD is not clear about whether PIs and ELMIs can become indirect or direct participants even in designated clearing and settlement systems. (Of course, PIs and ELMIs are free to choose to remain as 'clients' of direct or indirect participants and, consequently to stay at lower levels of the 'tiering'.) That is why we strongly support improvement of the drafting of the SFD, in order to make it more explicit on this issue.

We have three main arguments to underpin our point of view:

- I. Firstly, we believe that by this move the payments markets' safety cannot be endangered. On the contrary, it could only be improved. Legal protection of payments cleared and settled in the designated clearing and settlement systems is highly important. This protection can be relevant to every actor in the payments market. In our opinion, PIs and ELMIs can be such actors in the single European market. For example, if there is a PI which executes a considerable amount of payments and cannot have access as a direct or indirect participant to the designated clearing and settlement systems, this 'tiering' may endanger the safety of the payments market. However, we are aware that, depending on the monetary framework (counterparty regime in monetary policy operations), PIs usually do not have access to standing facilities (i.e. o/n collateralised loans) of the central bank. Consequently, they cannot be provided with intraday credit in liquidity consuming clearing and settlement systems. Owing to this fact, the liquidity risk of PIs as direct participants in such systems should be managed properly.
- II. Secondly, PIs and ELMIs are supervised by different competent authorities (national central banks, financial supervisory authorities, etc.); furthermore, they are subject to licensing and prudential requirements as well:
 - a. they can provide payment services or issue e-money only in possession of the authorisation of the competent authorities,
 - b. they are under the tight control of the competent authorities on the basis of their regular data supply or by other methods (e.g. on-site inspections), and these authorities can be responsible for the notification procedure laid down in the SFD,
 - c. they are subject to own funds requirements,
 - d. defence of clients' funds is ensured ('ring-fencing' requirements) even in the event of insolvency of these institutions (clients' funds are insulated against the claims of other creditors).

Consequently, we cannot see how these institutions could endanger the safety of the designated systems. If there are safeguards at the regulatory and supervisory level, these institutions should not be able to threaten the operation of the designated systems.

- III. And last but not least, we would like to highlight the importance of competition. If a PI's or an ELMI's access to any (including designated) clearing and settlement systems is limited, competition can be impeded. If PIs and ELMIs are allowed to use 'tiered arrangements' only to access (designated) systems, their service prices may be higher. Due to the longer payment timeframe in clearing and the settlement chain, PIs and ELMIs may face operational challenges in terms of providing quick services and following the legal requirements of execution times.
- Based on the reasoning explained above, we would more than welcome a solution at the European level that modifies the SFD. In our opinion, PIs and ELMIs could be listed in the definition of the 'institution'. The definition of 'participant' and indirect participant could be redrafted as well.
 - If such an explicit compromise cannot be reached at the European level, each Member State should be given the opportunity to make its own decision whether it gives PIs and ELMIs the right to choose freely between types of access to designated clearing and settlement systems. Similar to the topic of 'indirect participation', this question could be a national option.

COMPLIANCE WITH THE SEPA CARDS FRAMEWORK (SCF)

What is your opinion on the content and market impact (products, prices, terms and conditions) of the SCF? Is the SCF sufficient to drive market integration at EU level? Are there any areas that should be reviewed? Should non-compliant schemes disappear after full SCF implementation, or is there a case for their survival?

- We are convinced that the SEPA process is crucial to making retail payments in the single market more efficient. Although the SEPA Cards Framework was not fully implemented as earlier scheduled, the SCF process must be further enhanced. We are of the view that it has achieved many important accomplishments, such as defining technical and business rules for cards to be SEPA compliant (e.g. 'chip & PIN' method).
- Unfortunately the SEPA framework for cards doesn't function as accepted, and hence many of the main elements of SCF are not applied in practice by card schemes. This seriously weakens the whole SEPA process and may undermine the recent achievements of the initiative, as card payments represent a significant part of cashless transactions in the EU.
- Therefore, we believe that the SEPA Cards Framework must prevail and non-compliant schemes should disappear after full implementation of the common framework, similar to the migration process in the field of credit transfers and direct debits. This is also a way to reap the benefits of the single market in the cards domain.

INFORMATION ON THE AVAILABILITY OF FUNDS

Is there a need to give non-banks access to information on the availability of funds in bank accounts, with the agreement of the customer, and if so what limits would need to be placed on such information? Should action by public authorities be considered, and if so, what aspects should it cover and what form should it take?

- In our view, policy actions in this field should be balanced between two interests. Firstly, the safety of bank accounts must be safeguarded and the regulatory environment should support banks to maintain the level of security. On the other hand, fostering innovation is very important in retail payments, and policy or regulatory actions should create an environment that supports market innovation.
- It is important to note that banks have invested in their advanced account management systems and in a fair market economy the ones who invest should be the primary candidates to harvest the proceeds and benefits of their investments. In our view, this means that an agreement is necessary between banks and those seeking to have information on the availability of funds in bank accounts. From our viewpoint, regulators should not intervene in this process at this point in time. Rather, they should facilitate dialogue between stakeholders.

CONSUMER – MERCHANT RELATIONSHIP: TRANSPARENCY

Should merchants inform consumers about the fees they pay for the use of various payment instruments? Should payment service providers be obliged to inform consumers of the Merchant Service Charge (MSC) charged / the MIF income received from customer transactions? Is this information relevant for consumers and does it influence their payment choices?

- Most importantly, consumers must be clearly informed about the fees that they must pay for a payment transaction. In our view, consumer behaviour is influenced primarily by the costs imposed on them, rather than the costs borne by the merchants. Thus, we would not expect substantial market effects from a regulation that would require merchants to make their fees transparent to consumers. However, this kind of practice shouldn't be prohibited.

CONSUMER – MERCHANT RELATIONSHIP: REBATES, SURCHARGING AND OTHER STEERING PRACTICES

Is there a need to further harmonise rebates, surcharges and other steering practices across the European Union for card, internet and m-payments? If so, in what direction should such harmonisation go? Should, for instance:

- certain methods (rebates, surcharging, etc.) be encouraged, and if so how?
 - surcharging be generally authorised, provided that it is limited to the real cost of the payment instrument borne by the merchant?
 - merchants be asked to accept one, widely used, cost-effective electronic payment instrument without surcharge?
 - specific rules apply to micro-payments and, if applicable, to alternative digital currencies?
- In our view, it is highly important to increase transparency in pricing in the retail sector and to ensure equal framework for each payment method. Regulators must stimulate the use of the most efficient payment instruments.
 - Theoretically, we can imagine a situation where costs of the different payment methods would be transparently indicated for consumers. This would facilitate the market actors in using more cost-efficient payment methods. A level playing field should be secured for the different payment methods.
 - Otherwise cash should be surcharged, as done with other payment instruments. We cannot see any reason why cash should not be allowed to surcharge, if it is permitted for any other payment instruments.
 - Alternatively, if surcharging cash is not permitted, surcharging any other inefficient payment instruments may be justified.

MERCHANT – PAYMENT SERVICE PROVIDER RELATIONSHIP

Could changes in the card scheme and acquirer rules improve the transparency and facilitate cost-effective pricing of payment services? Would such measures be effective on their own or would they require additional flanking measures? Would such changes require additional checks and balances or new measures in the merchant-consumer relations, so that consumer rights are not affected? Should three-party schemes be covered? Should a distinction be drawn between consumer and commercial cards? Are there specific requirements and implications for micro-payments?

- In our view, the rule to honour all cards shouldn't be enforced on merchants. We are convinced that regulators should back competition and freedom of choice as well.
- In our view, blending is not favourable because it hampers merchants' freedom of choice, as they cannot refuse more expensive schemes or instruments.

STANDARDISATION

Do you agree that the use of common standards for card payments would be beneficial? What are the main gaps, if any? Are there other specific aspects of card payments, other than the three mentioned above (A2I, T2A, certification), which would benefit from more standardisation?

- In our view, the use of common standards for retail payments is generally beneficial. They should be backed, as they are important cornerstones in the field of interoperability and security. We are convinced that the SEPA process is of significant importance, creating common European standards to make payments in the retail sector more efficient.
- We also agree that standardisation without proper governance may carry the risk of shutting out potential competitors and impeding innovation, and thus standardisation initiatives must be closely monitored. Regulators must be careful to escape the trap of technology (namely, a situation where a newly standardised technology serves as a market entry barrier).

Are the current governance arrangements sufficient to coordinate, drive and ensure the adoption and implementation of common standards for card payments within a reasonable timeframe? Are all stakeholder groups properly represented? Are there specific ways by which conflict resolution could be improved and consensus finding accelerated?

- We think that the lack of full adherence to the SEPA Card Framework process demonstrates the need for stronger coordination in the cards domain as well. In the long run, if no significant improvement is achieved, we would welcome regulatory actions similar to the SEPA end date regulation.

Should European standardisation bodies, such as the European Committee for Standardisation (Comité européen de normalisation, CEN) or the European Telecommunications Standards Institute (ETSI), play a more active role in standardising card payments? In which area do you see the greatest potential for their involvement and what are the potential deliverables? Are there other new or existing bodies that could facilitate standardisation for card payments?

- We acknowledge the efforts made by different committees in the field of standardisation. Their work has key importance in Europe as they can involve stakeholders outside the financial sector.
- However, we hold the opinion that if self-regulation is not efficient enough, regulatory decisions should be made as in the case of SEPA end date regulation.

On e- and m-payments, do you see specific areas in which more standardisation would be crucial to support fundamental principles, such as open innovation, portability of applications and interoperability? If so, which?

- To achieve a truly single market, it is of utmost importance that European or broader standards are developed and implemented already at the start-up phase of innovative e-payments products, so that innovation becomes truly European and not only national. The European authorities and central banks have a responsibility to create an environment that ensures this.

Should European standardisation bodies, such as CEN or ETSI, play a more active role in standardising e- or m-payments? In which area do you see the greatest potential for their involvement and what are the potential deliverables?

- We acknowledge the efforts of the different committees in the field of standardisation. Their job has key importance in Europe as they can involve stakeholders outside the financial sector.
- On the other hand, we hold the opinion that standardisation in an immature market such as e- or m-payments may hinder innovation, so regulators should be careful about early standardisation. If standardisation is inevitable, rules must be clear in order to provide clear guidance to the market.

INTEROPERABILITY BETWEEN SERVICE PROVIDERS

How could the current stalemate on interoperability for m-payments and the slow progress on e-payments be resolved? Are the current governance arrangements sufficient to coordinate, drive and ensure interoperability within a reasonable timeframe? Are all stakeholder groups properly represented? Are there specific ways by which conflict resolution could be improved and consensus finding accelerated?

- From our point of view, interoperability between market infrastructures is a key element of competition, and so it shouldn't be hindered. Hence, regulators should create an environment that fosters interoperability and, accordingly, competition. We believe that these regulations must be transparent in order to provide a clear orientation for market actors, since clear competition rules support clear guidance to the market.
- We are convinced that by creating common European standards, the SEPA process is essential to making payments in the retail sector more efficient. In our view, on the basis of the SEPA process, national schemes should be replaced by European ones.

PAYMENTS SECURITY

Do you think that physical transactions, including those with EMV-compliant cards and proximity m-payments, are sufficiently secure? If not, what are the security gaps and how could they be addressed?

- Upon introduction of the 'chip & pin' method of the newly issued EMV-compliant cards, physical payment card transactions became significantly more secure. Despite this favourable trend, regulators should further monitor EMV-compliant cards and take steps to fight against fraud, if necessary.
- On the other hand, in the case of m-payment, there is not sufficient experience with physical transactions to judge trends.

Are additional security requirements (e.g. two-factor authentication or the use of secure payment protocols) required for remote payments (with cards, e-payments or m-payments)? If so, what specific approaches/technologies are most effective?

- In our opinion, service providers must elaborate on and apply their own defence instructions and must study possible technology-related attacks and vulnerabilities. Regulatory oversight and supervision are necessary to study these instructions.
- We are convinced that sufficient customer service and education are necessary to enhance remote payments security.
- As far as two-factor authentication is concerned, it can seriously enhance security. It is especially useful if the second element is dynamic (e.g. token device or SMS-based authentication messages). A posterior notification can increase security as well. We suggest that payment service providers shouldn't charge extra fees on SMS notification of authorisation and accomplishment of transactions.

Should payment security be underpinned by a regulatory framework, potentially in connection with other digital authentication initiatives? Which categories of market actors should be subject to such a framework?

- We think that regulators should closely monitor the trends of fraud (especially in CNP transactions). Regulations should foster innovation in the field of security as well.

GOVERNANCE OF SEPA

How do you assess the current SEPA governance arrangements at EU level? Can you identify any weaknesses, and if so, do you have any suggestions for improving SEPA governance? What overall balance would you consider appropriate between a regulatory and a self-regulatory approach? Do you agree that European regulators and supervisors should play a more active role in driving the SEPA project forward?

- We agree that European regulators and supervisors should play a more active role in driving the SEPA project forward.
- We have no doubt that, given conflicts of interest of individual banks and the importance of avoiding a stalemate in progress, authorities may need to use their regulatory power. It means from time to time that SEPA self-regulation must be adjusted by regulators (e.g. in the aspect of the SEPA end date). In other words, regulators should assume the role of 'watchdog of progress'.
- In our opinion, self-governance must be backed if the actors of the process advance on previously laid principles. It is also important to note that long-term interests shouldn't be overruled by short-term ones.
- Our viewpoint is that self-governance shouldn't lead to a situation where its entities decide about other market actors' investments. Therefore, all important stakeholders (both the supply side and demand side) should be involved in such a dialogue.

GOVERNANCE IN THE FIELD OF CARDS, M-PAYMENTS AND E-PAYMENTS

How should current governance aspects of standardisation and interoperability be addressed? Is there a need to increase involvement of stakeholders other than banks and if so, how (e.g. public consultation, memorandum of understanding by stakeholders, giving the SEPA Council a role to issue guidance on certain technical standards, etc.)? Should it be left to market participants to drive market integration EU-wide and, in particular, decide whether and under which conditions payment schemes in non-euro currencies should align themselves with existing payment schemes in euro? If not, how could this be addressed?

- We strongly believe that all of the stakeholders who bear the consequences of a decision must be involved. One should avoid a situation where a market actor must bear expenses in which they couldn't have a say. This means the non-financial sector must be involved, too.
- In our opinion, national self-governance is not efficient as long as entities serve non-European, but national interests. Regulators in the EU should closely monitor this development and, if necessary, shouldn't hesitate to make rules to foster integration and alignment with existing payment schemes.

Should there be a role for public authorities, and if so what? For instance, could a memorandum of understanding between the European public authorities and the EPC identifying a time-schedule/work plan with specific deliverables ('milestones') and specific target dates be considered?

- Yes, this could be a solution. It is important to enhance dialogue between stakeholders.
- It is important that in the case of self governance, long-term interests shouldn't be overruled by short-term ones.