Paris, February 14th 2011

French Banking Federation position paper on the proposal for a regulation "establishing technical requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009"

INTRODUCTION

The French Banking Federation (FBF) has analysed with great care the proposal for a regulation "establishing technical requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009" - the so-called "end-date regulation" - published by the European Commission on 16 December 2010.

While welcoming the Commission's efforts to respond to the need to set end dates for migrating credit transfers and direct debits to SEPA, FBF legal experts have serious reservations on the procedure adopted by the Commission to:

- Impose technical standards and exercise extended delegated powers;
- Prohibit multilateral bilateral and unilateral interchange fees ("MIFs") for direct debits and the legitimacy of this prohibition.

The proposed regulation has, in addition, several flaws in its technical aspects which, if adopted, could substantially hinder the proper development of SEPA

1) The procedure followed by the Commission in establishing technical standards and the exercise of delegated powers

The Commission is using this regulation as an opportunity to amend the essential requirements of SEPA credit transfers and direct debit. It has amended the provisions developed by the European Payments Council (EPC) and proposed by banks to their customers at a time when credit transfer migration and direct debit migration have been underway for respectively three years and 15 months. The Commission is indeed imposing new developments and new investments on all operators (companies and banks), despite the fact that these operators agree on the need for stable rules and standards and consumers are asking for time to get accustomed to new products.

Moreover, many amendments do not reflect general market demand. It amounts to making all users shoulder the cost of new developments imposed by the Commission. For example, imposing the usage of a common standard (ISO 20022) and a specific syntax (XML) on all companies and payment services providers (PSP) constitutes an interference by the Commission in the competitive domain of the relationship between a PSP and its client and will dramatically inflate the costs of implementing the SEPA direct debit product in the market.

This does not comply with the requirements of article 290 of the Treaty on the Functioning of the European Union (TFEU) which only allows delegation of such powers for “non-essential elements” because:

- Some of the provisions proposed in the annex are not limited to “non-essential elements”, as they impose obligations on payment services providers and whose violation is subject to criminal sanctions.
- The regulation confers a delegation of power for an undetermined period to the Commission.

In a fast moving industry such as the payment industry, the evolution of a payment system cannot depend on decisions by a regulatory body. The proposed Regulation should therefore be limited to high level requirements only to ensure a proper migration to SEPA.

The general approach and, more specifically Articles 3, 4 and 6 and the annexes should therefore be amended to make the proposed Regulation a useful support of SEPA.

2) The procedure followed by the Commission to prohibit interbank fees for direct debit

In 2006, Clifford Chance commissioned a report by independent economists at CRA International to analyse and evaluate interbank costs and an economic model for SEPA direct debits. CRA collected the responses to a very detailed questionnaire sent to a large panel of banks (49 large, medium-sized and small banking institutions in the eurozone covering the three sectors of the banking industry and currently accounting for more than 50% of credit transfers and direct debits). The conclusions of this report, which were submitted to the European Commission, show that a default fee of 9.3 euro cents per transaction would have to be paid by the creditor’s bank to the debitor’s bank to maintain a multilateral equilibrium within the SEPA direct debit system. Without this equilibrium, there is no hope of successfully introducing SEPA direct debits on the market.

This report and its conclusions demonstrate that the execution of a direct debit has a unit cost that is borne by debitor banks. For the system to function, this cost must be met by the bank whose customer benefits from the service, i.e. the creditor bank.

On the basis of this analysis and the specific features of SEPA direct debit, the conclusion was also reached that a default multilateral interchange fee would:

- Improve market’s transparency compared to bilateral charging agreements and reduce the global cost of SEPA introduction by eliminating the expense of bilateral negotiations between more than 4,000 member banks;
- Facilitate the management of the interchange fee by the authorities responsible for market regulation;
- Create a level playing field between large banks and small banks, which otherwise could be disadvantaged by bilateral agreements;
- Facilitate access to the market for new entrants.

Regulation 924/2009 recognised the need for an interchange fee for direct debits and introduced an interbank fee of € 0.088 (very close to the € 0.093 fee recommended in the CRA report).

The Commission proposal is premature and not consistent with the provisions and general scheme of regulation No 924/2009 of the European Parliament and of the Council of 16 September, 2009, in particular its eleventh recital and its article 15: before submitting a proposal for a regulation on the subject, the Commission must indeed present towards the end of the transition period (*"By 31 October 2012 »*) to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank a report on market developments, particularly in relation to the application of articles 6 and 7 on interchange fees for cross-border and national direct debits.

In addition, the European Commission wrongly bases its proposal on article 114 of the (TFEU). Indeed, at the time of adoption of both regulation No. 924/2009 and PSD directive 2007/64/CE, six member states (Belgium, Spain, France, Italy, Portugal and Sweden) already applied multilateral interchange fees (MIF).
The Commission was fully informed of this, notably by the survey conducted by the Director General for Competition into competitive conditions in retail banking. None of the conditions have changed since then. Accordingly, while acknowledging that the proposal for a regulation is intended to improve the conditions for the establishment and functioning of the internal market, the Commission has not provided justification, as is its obligation under this directive, that sufficient changes of circumstances have occurred since the adoption of regulation No. 924/2009 and directive 2007/64 (the so-called "Payment Services Directive") to require amendments to these texts. The conditions that would justify the application of article 114 of the TFEU have therefore not been met.

➔ Consequently, the prohibition of interbank fees applicable to SEPA direct debits does not comply with either the general principles of European law or of European Community competition law.

2.1 In the light of the general principles of European law

a) The proposal for a regulation not only infringes the principle of free trade and its corollary, the principle of free industry, but also the principle of proportionality. In effect, by prohibiting MIF for direct debits, along with any agreed remuneration with an equivalent object or effect, article 6 prohibits debtors banks to receive a compensation for the services they are obliged to deliver to creditors banks. As a matter of fact, article 3 of the proposal obliges debtors banks to execute all direct debit orders received from creditor banks.

Moreover, the Commission does not respect the principle of proportionality, since it has failed to examine or to demonstrate in a serious manner that the objectives pursued by the prohibition of MIFs for direct debits justify the negative economic consequences of this measure on some of the operators concerned (debtors banks), notably by conducting economic studies in a transparent and contradictory manner. Suppressing MIFs on direct debits is a very drastic measure that is not necessary to achieve a successful migration to SEPA as it might have exactly the effect to the opposite.

b) By proposing to prohibit MIFs for SEPA direct debits, the Commission is infringing the community principle of legitimate confidence. Contrary to all expectations, this proposal constitutes a U-turn in the analytical technique and policy of the Commission by imposing a new economic model on the banks concerned, which have been able to base their forecasts until now on the application of cost-based multilateral interchange fees. The Commission just issued a working document for consultation in December 2009, without publishing any feedback statement. FBF comments are annexed for more details on the content of the working document.

c) The prohibition of the principle of MIF for direct debits infringes the principle of an open market economy expressly stated in article 3 of the Treaty of the European Union and article 119 of the TFEU, which must benefit all economic operators. However, this is not the case here as the Commission proposal discriminates against debtors banks.

2.2 With regard to European competition law

a) The statement in recital 14 that *"Per transaction MIF for direct debit restrict competition between payees banks and inflate the charges such banks impose on payees and thus lead to hidden price increases to payers",* which the Commission uses as a basis to *"prohibit per transaction MIF",* has never been demonstrated, neither in the different cases examined by the Director General for competition concerning various means of payment, nor in the summary of the impact assessment presented in the summary of the grounds for the proposal. Consequently, the Commission is clearly making an error of judgment on the allegedly restrictive nature of these fees or "*other agreed remuneration with an equivalent object or effect*" (article 6).

b) In the European Union MIFs have been subject to numerous analysis and procedures since 1984 and, most recently in the context of regulation 1/2003 of 16th December 2002. Such procedures have never led to a condemnation of the principle of MIFs.

Article 6 should therefore be deleted.

3) Some provisions of the proposed regulation are incompatible with regulation applicable to payment systems

The present proposal for a regulation reveals numerous difficulties both on its scope and some contradictions with the payment services directive (PSD) and other essential provisions of banking regulation. The notion of "direct debit" is not consistent with that of the PSD; the proposal for handling "R-transactions" (art. 6-2) contradicts the provisions of article 65 §1, 3rd paragraph of the PSD; the list of data to be provided to the payee or beneficiary (annex – points 2.b and 3.g) does not comply with article 48 of the PSD on the information to be provided to the beneficiary of a payment transaction; and it imposes additional controls on payment services providers compared with those foreseen in the PSD.

The same incompatibility relates to "R-transactions" that should be handled in the same manner regardless of whether they are rejected (total non-execution) or rectified (partial non-execution), although this is completely different; they lay down a principle of payment accessibility that would amount to obliging the payer that agrees to pay with a "national" credit transfer not to refuse making cross-border transfers, which would infringe individual freedoms and impose a payment method. Moreover, it asks for the communication to the beneficiary or the payer of data covered by banking secrecy (points 2.b.*i* and 3.g.*iii* of the annex on technical requirements), which would be problematic not only with regard to banking secrecy, but also with regard to the protection of personal data.

Lastly, Article 3 seems to impose "reachability" on debtors banks for all schemes that are in line with the "technical requirements". For payment service providers, this would amount to oblige banks to run multiple SEPA compliant schemes and to impose them on their clients.

4) The FBF disagrees with many technical aspects of the regulation

The proposed regulation raises many technical issues likely to disrupt the implementation and success of SEPA.
To avoid an unnecessarily lengthy explanation at this stage of our position, we have summarised below two fundamental aspects of this technical analysis:

a. The inclusion of large-value payment systems in the scope of the regulation is not justified

The inclusion in the scope of the regulation of transactions executed via large-value payment platforms (article 1b), such as Target and Euro 1, has never been part of the scope of the SEPA project. The success of the SEPA project does not justify such an inclusion in the scope of the regulation and infringes the principle of proportionality.

b. Whereas interoperability of clearing systems is justified, interoperability of payment schemes makes no sense

While the interconnection of compensation systems is an important part of the success of the SEPA project, interoperability (as envisaged in article 4) can only be imposed when PSPs have adhered to the same scheme, i.e. when they are committed to respecting the same body of rules within that payment scheme. Imposing schemes interoperability would force competitors to align their rules and procedures to a point where the integrity of the payment transaction would be jeopardized (a transaction with payment scheme A would be compensated through A but paid through B) hence making competition impossible (i.e there would be no difference left between the schemes to differentiate themselves).

We will shortly be sending amendments to the Commission proposal to improve the proposed Regulation so as to make it a truly positive contribution to the success of SEPA, for both Direct Debits and Payment transfers.