



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

**DAF/COMP/WP2/WD(2006)42  
For Official Use**

**Working Party No. 2 on Competition and Regulation**

**ROUNDTABLE ON COMPETITION AND EFFICIENT USAGE OF PAYMENT CARDS**

**-- Germany --**

**6 June 2006**

*This attached document is submitted by Germany to the Working party No. 2 of the Competition Committee FOR DISCUSSION under Item III of the agenda at its forthcoming meeting on 6 June 2006.*

**JT03209883**

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## 1. Overview of different payment methods used in Germany

1. Apart from cash payment and payment by transfer, there are different electronic payment systems in Germany.

2. The most common system is ELV (elektronisches Lastschriftverfahren). This is an electronic debit card system set up by retailers which is mostly operated offline and by signature. By the signature the customer authorises the retailer to withdraw a specific amount from his account. The payment card is only needed to extract the data on the bank account and the corresponding bank identification code. Since the system works offline, there is no check of the current total of the account or a possible account block. It is the cheapest but also most insecure means of payment for the retailer.

3. Quite similar to this is POZ (POS without payment guaranteed set up by the banks), which is to expire by the end of 2006, and OLV (Online-Lastschriftverfahren). In both cases there is an online check-up whether the card is invalid or stolen.

4. "Electronic cash" is the domestic debit card system in Germany for debit cards that are used with a PIN for authorisation at special POS-terminals. Meanwhile in Germany there are more than 400,000 such terminals and more than 90 Mio. "electronic cash" cards are used by bank customers. The increasing use of electronic cash and payment via debit cards is due to the fact that this means of payment is faster than cash payment and less expensive for the merchant than other card payments. A new version including a chip on the debit card also permits offline payments and payments abroad.

5. Credit cards in Germany usually exist as charge cards (mostly charged within a month's period), often including further services like insurances, lounges etc. As you can see from the chart below credit cards are used for a relatively small percentage of the overall payment volume in Germany. This is due to the fact that in Germany a regular bank account is provided with a (personal) drawing credit, so that there is no urgent need for the short term credit facilities that are connected with the credit card. The maximum amount the customer can overdraw his account usually relates to the monthly incoming payments or depends on an explicit agreement between the bank and customer. Furthermore banking cards allow the use of ATM and payment via ELV, POZ and EC cash.

6. The Kundenkarte ("Customer Card") – with or without payment function - is issued by retailers, such as the PaybackCard and the HappyDigitsCard. By offering discounts and other advantages the customer card is used as a marketing instrument, in order to bind the customer.

7. Finally there is the Geldkarte ("electronic purse"). This prepaid card is set by banks and allows the loading and transferring of funds in order to replace cash payments. This means of payment is not very successful at the moment. It is mainly used for low payment amounts, especially to avoid the necessity to have coins always available for automatic vending (e.g. parking fee or subway tickets).

Means of Payment	Payment volume share in 2004 (Germany)
Cash	64,9 %
Transfers	3,0 %
Electronic debit card (ELV/POZ)	16,9 %
Electronic cash (incl. EC Chip)	8,6 %
Credit card	5,0 %
Customer Card (Kundenkarte)	1,1 %
Electronic purse (Geldkarte)	0,0 %
Others	0,5 %

8. ATM cannot be considered as a payment system. They are more or less belonging to cash payments. Nevertheless, this sector has also generated competition issues similar to those of the genuine payment systems (see below).

## 2. Access conditions

9. The principal actors in the field of payment systems are the issuers, acquirers, and network operators/processors.

- Card issuers are required to have a full banking licence. The permission to operate banking business is given by the Federal Financial Supervisory Authority (BaFin) after an examination under the rules of the Financial Services Act (KWG) that is based on standardized and non-discriminatory criteria and deals mainly with liquidity and safety aspects.
- Acquiring companies – unless being a bank themselves - must be owned at least 51% by a bank with a full banking licence. This might be a significant market entry hindrance, but is generally accepted as non-discriminatory. Concerning credit cards, acquirers have to be licensed by a credit card organisation (e.g. Mastercard, Visa, Amex).
- Network operators - at the moment 24 in Germany - have to apply for approval by the Zentraler Kreditausschuss (ZKA), an association of five central associations of German banks, covering almost all German banks. The ZKA demands the fulfilment of mostly technical and safety conditions. This procedure takes a certain time and may be seen as costly, but is commonly also regarded as non-discriminatory.
- The specific – mostly technical and operational – requirements for "electronic cash" cards, the respective terminals and the network operation are defined by the ZKA. The POS-terminals are operated by 24 independent network operators, among them GZS, Intercard, Esso and Postbank.

10. Credit cards are available from all well-known providers like Mastercard, Visa, Amex etc. Each bank focused on retail banking usually issues credit cards of at least one of those credit card organizations. As regards credit card payment systems in Germany there are eight acquirers, among them Citibank, Deutsche Bank and Postbank.

## 3. Role of regulatory institutions

11. The regulatory institutions (Bundesbank, BaFin) set the overall frameworks for the finance systems, especially those concerning liquidity, liability and safety, and thus more or less the access conditions for the actors on the finance markets as a whole. The access conditions for the payments systems are set in a more detailed (and more technical) manner by the ZKA, which is no "classical" regulatory institution, but takes the form of "self regulation" by the market participants themselves. The ZKA consists of the five major German banks' associations, namely Bundesverband der Deutschen Volksbanken und Raiffeisenbanken e. V., Bundesverband deutscher Banken e. V., Bundesverband Öffentlicher Banken Deutschlands e. V., Deutscher Sparkassen- und Giroverband e. V. und Verband deutscher Pfandbriefbanken e. V., representing almost all of the 2.200 German credit institutions.

12. As in most European countries the German Central Bank, the Bundesbank, monitors payment instruments and payment and securities settlement systems. This oversight is one part of the statutory tasks assigned to the European System of Central Banks (ESCB). Article 105 (2) of the EC-Treaty defines as a

basic task of the ESCB the promotion of the smooth operation of payment systems. This provision is reiterated in Article 3.1 of the Statue of the ESCB.

13. On an international level, central banks participate in the Committee on Payment and Settlement Systems (CPSS). As a forum for G 10 central banks to discuss issues relating to payment, settlement, clearing and securities system, the CPSS also sets standards for designing and overseeing payment systems (notably the Core Principles for Systemically Important Payment Systems) and securities settlement systems (especially the CPSS/IOSCO Recommendations for Securities Settlement Systems). In addition, the CPSS provides a means for central banks to coordinate oversight.

14. In this international context, the Bank of International Settlement (BIS) developed "Core Principles for Systemically Important Payment Systems (Core Principles)", which have been adopted by the Governing Council of the ECB and have been transformed into the "Oversight standards for Euro Retail Payment Systems" of the European Central Bank. Standard IX of these oversight standards requires that "the system should have objective and publicly disclosed criteria for participation, which assure fair and open access". However, these standards' main intention is to avoid systemic risks for payment systems. The non-discriminatory access to payment systems is promoted for the sake of the system's efficiency. Competition issues are subordinate. Furthermore, the central bank does not have any intervening powers. The oversight of the central bank is based on "soft law".

15. The Federal Financial Supervisory Authority (BaFin) has an indirect influence on access to payment systems, because it issues the banking-licence, which is the central access criterion in the rules of the payment systems. According to the EUDirectives on Banking-Coordination, the status of a bank or credit institution in the Member States is regulated by law. The national laws on the legal status and supervision of credit institutions aim to protect the savings of the public and to safeguard the smooth functioning of the credit system by laying down rules for the establishment and the operation of the credit institutions as well as for the supervision of the latter. In this process of issuing the banking licence no competitive aspects are considered.

16. The review of the terms and condition of payment systems in the light of competition concerns is solely task of the German Bundeskartellamt. Rules of the payment systems formerly had to be notified to and approved by the Bundeskartellamt with respect to their compatibility with applicable German competition law (former §§ 1, 29 Act against Restraints of Competition). Since the Council Regulation 1/2003 EG and the new Act against Restraints of Competition came into force in May 2004 and July 2005 respectively, there is no more obligation to notify new rules to the Bundeskartellamt, since the former specific rule for credit institutions in § 29 Act against Restraints of Competition has been abolished. The approval of existing rules remains in force for a transitional period of time (until the end of 2007). Now, under the system of legal exception, the market participants themselves have to assess the eligibility of their agreements for an exemption. Any agreement between undertakings, decisions by associations of undertakings and concerted practices can be examined ex officio whether they are compatible with § 1 ff of German and Art. 81 of European competition law.

#### **4. Fees**

##### **4.1 General Remark**

17. Since the rules of the payment systems do not have to be notified to and approved by the Bundeskartellamt any more due to the coming into force of Regulation 1/2003 EG and the new Act against Restraints of Competition (see above), there is no more automatic examination of rules concerning fees with respect to their compatibility with applicable German competition law (§§ 1, 29 Act against Restraints of Competition). In general, there is no approval of fees by any part of the government nor is there an

overall system for setting fees based on consultation with government. A review of pricing is only possible according to the measures of Art. 82 EC Treaty or Section 19 and 20 of the German Act against Restraints of Competition. Furthermore price setting behaviour can be discussed with relation to the cost in the context of Art. 81 (3) EC Treaty.

#### **4.2 Interchange Fee**

18. The Bundeskartellamt has not yet conducted any particular investigations on the level of interchange fees that the issuing banks charge to the acquiring institutions in Germany. The level of the interchange fee is not publicly known. The Bundeskartellamt has punctual knowledge of MIF from various cases and studies by EU-Commission. Companies partly claim that they are business secrets.

19. The Bundeskartellamt recently received a formal complaint from the German retailers' association concerning interchange fees in the credit card sector. Detailed investigations (price investigations including calculation of costs and benchmarking) on fees will be necessary to assess this complaint.

20. According to the interim results of the sector inquiry (p. 70) the Commission published this year in 20 of 25 countries of the EU the profit ratio of the issuing institutions remains positive even in the extreme situation of a "zero" interchange fee. Therefore a high number of issuing institutions would remain profitable in the situation of a complete elimination of interchange fees.

21. In March 2001 the ZKA applied for an exemption from § 1 German Act against Restraints of Competition for a collective agreement between German Banks on the introduction of interchange fees in the German debit card system (EC cash). The economic background of the intended common interchange fee was the desire of the banking sector to receive remuneration from retailers when using ELV (see above 1.) as a means of payment. By charging a common interchange fee the credit institutions wanted the retailers to participate in the costs for providing the infrastructure and the credit assessment that is undertaken before a debit or credit card is issued to each bank customer. It was therefore intended to redistribute the costs within the system and between its participants and to balance the costs between the issuing bank and merchant's bank.

22. In its assessment in the statement of objections the Bundeskartellamt considered in particular that such interchange fees are typically passed on to merchants and therefore increase costs to consumers. If German issuing banks would indeed issue ec cash cards without earning profits, it would be up to the banks to recoup these costs from cardholders subject to competitive forces. The Bundeskartellamt was furthermore of the opinion that the agreement was not necessary for the finance industry to be able to provide the POS System Service. Only the agreement on technical and operational matters and standards was considered to be indispensable to ensure the functioning of the system and the interaction of the credit institutions in particular. Since the intended agreement on interchange fees aimed at redistributing the costs among issuer and acquirer (respectively merchant), the Bundeskartellamt could not see any rationalisation, i.e. the improvement of the relation between revenue and expenses. The intended agreement was therefore classified as a simple cartel to regulate pricing. The application for exemption was withdrawn by the ZKA.

23. According to the Interim Report of the Commission based on the Sector Inquiry on Payment Cards (p. 123) a no surcharge rule is contained in the rules of the electronic cash system. This prohibition against surcharging stems from the framework agreement between issuers and merchants governing access to the electronic cash card system. Under the rules of the international mastercard network, which are applicable to the German merchant participants, the merchants must not add any surcharges to a transaction, unless a law expressly permits merchants to impose such surcharges. There is no such provision in Germany.

#### **4.3 Merchant Fee**

24. The level of the merchant fee for participants in the electronic cash system is publicly available: 0.3 percent of the transaction volume and 0.08 Euro per transaction for transactions up to 25.56 Euro. The Bundeskartellamt does not have any information about the development of the merchant fee level over time and in relation to the expansion of card usage.

#### **5. Findings from merger cases**

25. The Bundeskartellamt has to decide on a merger case affecting the market for network operator services and processing services. In this context the theory of two-sided markets was brought forward by the notifying parties as an argument to define the relevant market as consisting of issuing and acquiring processing services. In its preliminary assessment the Bundeskartellamt had some doubts whether the theory is a concept for market definition and whether the conditions for the phenomenon of the two sided markets are– or at the most in a very indirect manner – fulfilled in this context, since there is no common platform with respect to processing services. The processing services as well as the network operator service are services that support the other participants in the payment systems and allow a more efficient handling for them.

#### **6. Competition Concerns**

26. The sector inquiry that the commission conducted in the field of payment cards across EU 25 has revealed indications that markets are not yet competitive (e.g. large price differentials within the single market, generally high profitability over time, higher fees for SME than for large enterprises for the use of a payment card without justification by transaction volume). The inquiry has also found evidence for a number of potential structural, technical and behavioural barriers to competition (e.g. vertical integration, joint ventures between local banks to acquire merchants, divergent technical standards, agreement on preferential interchange fees between local banks, bilateral clearing arrangements between local banks) that inhibit the growth of a Single Market in payments.

27. More competitive payment card industries with payment systems that are compatible with one another, e.g. in the frame of a Single European Payments Area (SEPA-initiative), could create significant efficiencies for businesses, increase competitiveness and innovation. It is therefore important to take the necessary actions to remove the identified obstacles.