**MASTERCARD’S COMMENTS**

**EBA CONSULTATION PAPER ON DRAFT REGULATORY TECHNICAL STANDARDS (RTS) ON SEPARATION OF PAYMENT CARD SCHEMES AND PROCESSING ENTITIES**

**DEADLINE FOR COMMENTS: MARCH 8, 2016**

1. MasterCard would like to thank the EBA for the opportunity to comment on the draft Regulatory Technical Standards (RTS) on separation of payment card schemes and processing entities under Article 7(6) of Regulation (EU) 2015/751 (“IFR”). Below MasterCard provides its views on the EBA consultation paper (CP) of December 8, 2015.
2. Should the EBA wish to discuss any of the below, please reach out to Christoph Baert, Europe Region Senior Regulatory Counsel, based in Waterloo, Belgium (+32-2-352-5993 or christoph\_baert@mastercard.com).

**Background and rationale**

***The IFR definition of ‘processing’ is clear and includes authorization, clearing and settlement***

1. We are surprised that there are different interpretations of the definition of ‘processing’ and that there is even a debate about this definition. The definition of ‘processing’ is very clearly explained in the IFR (Article 2(27)):

“*‘processing’ means the performance of payment transaction processing services in terms of the actions required for the handling of a payment instruction between the acquirer and the issuer;*”

In other words, the IFR definition of ‘processing’ includes only the following services:

* Authorisation: routing of transactions between acquirers and issuers
* Clearing: accounting statement between acquirers and issuers
* Settlement: informing banks about settlement position

1. This is because only authorization, clearing and settlement are (1) actions that occur between the acquirer and the issuer, and (2) are at the same time necessary for the handling of a payment instruction between them.
2. Thus, the IFR definition of ‘processing’ covers one of the three domains identified in the SEPA Cards Processing Framework Book 7: the Inter-PSP domain (also called inter-bank domain), which covers the services allowing Acquirer Processors to interact with Issuing Processors for the execution of the transactions. The other two domains identified in the SEPA Cards Processing Framework Book 7 are instead excluded: (a) the Acquiring domain (services provided to Acquirers and their merchant customers for acceptance of transactions) and (b) the Issuing domain (services provided to Issuers and their cardholder customers for issuance of card payment products).
3. EBA’s mandate under Article 7(6) of the IFR is not to re-write the definition of ‘processing’ contained in the IFR. There is no need to clarify this definition because it is already clear. EBA should expressly endorse the IFR definition and refrain from stating that other interpretations are possible. No other interpretation is lawful under Article 2(27) of the IFR. Thus, points 24, 25, 26 (page 9) of the CP should be deleted.

***One-stop-shop for compliance is needed to achieve a Single Market for electronic payments***

1. There is no clarity in the RTS on whether schemes will be able to limit their interactions in terms of compliance with Article 7 to a single national competent authority (NCA). International card schemes offer their services across Europe but have a primary establishment in one single Member State. The NCA of that single State should be the only authority empowered to assess compliance with Article 7.
2. This would be consistent with Article 7(2) of the IFR, according to which it is only the NCA of the home Member State that may request a report confirming compliance with the separation requirements. Article 7(2) of the IFR reads:

“*The competent authority of the Member State where the registered office of the scheme is located may require a payment card scheme to provide an independent report confirming its compliance with paragraph 1.*”

1. Indeed, it is a general principle for payment systems and banks to be overseen by their home NCA. The PSD and PSD2 allow companies to deal primarily with a single NCA, which authorizes them to operate across the entire EU through passporting. For example, the home NCA is competent for a number of compliance issues, even when cross-border aspects are involved:

* authorisation and prudential supervision;[[1]](#footnote-2)
* taking measures for non-compliance;[[2]](#footnote-3)
* receiving notifications of major operational or security incidents;[[3]](#footnote-4)

1. The new regulation on Data Privacy has also endorsed the concept of one regulator[[4]](#footnote-5) and so has the NIS Directive.[[5]](#footnote-6)
2. The reason why these regulations allow companies to deal primarily with a single national regulator is to guarantee the proper functioning and completion of an integrated Single Market. The PSD, the IFR and the PSD2 clearly state in their recitals that they have been adopted to create a Single Market for electronic payments.
3. If schemes had to liaise with 31 NCAs across Europe for the purpose of demonstrating compliance with Article 7, there would be a very high risk of inconsistent implementation of RTS across the EU Member States, and this would jeopardize the objective of creating a Single Market for electronic payments.
4. The requirement to liaise with 31 NCAs across Europe would also be very complex, costly and inefficient. EBA is conscious that compliance with Article 7 will increase the level of costs for schemes and this could result in increased scheme access costs for all scheme participants (point 3.2.20 CP). EBA itself has stated to have “*carefully considered the potential impacts on costs when developing the proposed draft RTS*” (point 3.2.21 CP). EBA should apply the same approach on this aspect too and expressly recognize that it is impractical for a scheme to liaise with 31 NCAs across Europe.
5. We propose therefore to add a new article in Section 5:

*Article 18  
Competent authorities*

*The tasks of ensuring compliance with this Regulation shall be the responsibility of the competent authority of the Member State where the registered office of the scheme is located.*

1. We also recommend amending Article 6 as follows:

*Article 6  
Frequency and availability of the financial information*

*The financial information produced in accordance with Articles 3 and 4 shall be prepared at least annually.*

*The financial information, as well as the review by the independent auditor in accordance with article 5 shall be made fully available to the competent authority~~ies~~ ~~designated according to Article 13 of Regulation (EU) 2015/751~~ of the Member State where the registered office of the scheme is located upon ~~their~~ request.*

***Three-party schemes acting as a four-party scheme must also be subject to separation for their entire operations***

1. We welcome the acknowledgment in the CP that “*three-party payment card scheme operating under a four party scheme model will have to comply with the RTS as proposed in this Consultation Paper, unless they decide to migrate the limited number and amount of transactions processed under a four party scheme model to a three party scheme model as defined by the IFR.*” (point 3.2.23 CP).
2. This provision confirms our understanding that a three-party scheme acting as a four-party scheme is subject to the separation requirement for its entire operations across the EEA, including its proprietary business.
3. This is in line with the PSD2 rules on access to payment systems. According to the PSD2, a three-party schemes acting as a four-party scheme is subject to the access requirement for its entire operations across the EEA.[[6]](#footnote-7)
4. We strongly recommend confirming this point expressly by adding the following new article:

*Article 1  
Scope*

*This Regulation shall apply to payment card schemes and processing entities, including three party payment card schemes that license other payment service providers for the issuance of card-based payment instruments or the acquiring of card-based payment transactions, or both, or issue card-based payment instruments with a co-branding partner or through an agent.*

***Reference to hypothetical price discrimination through inter-regional interchange or processing fees should be deleted***

1. We note that EBA makes reference, in relation to accounting separation, to aspects of interchange fees and pricing, which have nothing to do with separation (point 3.2.17 CP). We strongly recommend that this reference be removed.

**Section 2 – Accounting**

***Separate balance sheet requirement is disproportionate (Article 3)***

1. The risk of cross-subsidization for which the IFR regulation was developed would not be mitigated with a separated balance sheet. We do not utilize balance sheet reporting in Europe to manage our business, rather only Profit & Loss (P&L) reporting is used. The balance sheet is managed at a corporate level by the parent company for the global business, which is managed as one operating segment. Therefore, a separated balance sheet would have no influence on how decisions are taken and how the business is managed within the EU Region.
2. Furthermore, the cost and effort to MasterCard related to the balance sheet allocation will be particularly onerous as we do not currently tag our assets and liabilities to divisions or cost centres within the legal entity MC Europe S.A (MCE). We question the value of allocating the balance sheet accounts to scheme vs. processing when there really is not a direct allocation for the majority of our balance sheet accounts. The regulation does not require us to have separate legal entities, therefore it would seem logical that a balance sheet allocation would not be required.
3. There does not appear to be much value in going through an exercise to allocate our balance sheet accounts to scheme vs. processing as the majority will be common accounts to both businesses. The primary difference between the scheme and processing business in terms of assets will be the IT infrastructure; however MCE does not own these assets, rather they are owned by the parent company. MCE receives an intercompany IT charge for the use of these assets in our business, so the relevant allocation is only on the P&L side. This IT P&L charge, which includes the amortization expense related to the IT assets as well as other costs incurred to operate the IT infrastructure, would be allocated as part of the P&L separation exercise.
4. Below we provide our proposed amended version of Article 3:

*Article 3  
Financial information*

1*. Payment card schemes and processing entities shall have accounting processes in place that enable them to produce, as a minimum, financial information related to separated ~~balance sheets,~~ profit and loss accounts and explanatory notes to this financial information for the payment card scheme and the processing entity respectively.*

*2. The accounting processes referred under paragraph 1 shall enable payment card schemes and processing entities to allocate all relevant expenses and~~,~~ revenues~~, assets~~ ~~and liabilities~~ in accordance with the provisions of Article 4.*

*3. The resulting financial information referred to in paragraph 1 shall be consistent with the payment card schemes and processing entities applicable accounting framework for preparing financial statements.*

1. Accordingly, Recitals 5 and 6 should be amended as follows:

*(5) This Regulation specifies that for accounting independence, payment card schemes and processing entities shall have accounting processes in place that enable them to produce, as a minimum, financial information related to separated ~~balance sheets,~~ profit and loss accounts and explanatory notes to this financial information. These requirements are not meant to replace or amend accounting principles and standards or the annual financial statements that apply to payment card schemes and processing entities.*

*(6) To that purpose, this regulation specifies how expenses and revenues~~, as well as assets and liabilities,~~ shall be allocated under these accounting processes. It requires that payment card schemes and processing entities produce this financial information at least annually and that the financial information is reviewed by an independent auditor. Such financial information as well as the review by the independent auditor shall be made available to the competent authority of the Member State where the registered office of the scheme is located when requested.*

1. For the same reasons, we propose to delete Article 4(4) entirely and the words “*assets and liabilities*” in the title of Article 4.

***The requirements imposed in terms Activity Based Costing are disproportionate and less heavy/costly alternatives exist (Article 4)***

1. The requirements imposed in terms Activity Based Costing are disproportionate for the type of functional separation imposed and less heavy/costly alternatives exist.
2. MasterCard is of the opinion that activity-based costing (ABC) should not be listed as the preferred method of cost allocation in the RTS as this might create too much focus on the method rather than on the goal that needs to be achieved: a stand-alone P&L for the processing division separate from a stand-alone P&L for the payment scheme division. In MasterCard’s view all methods to allocate costs that cannot be directly allocated should be treated equally, without any preference over traditional methods, activity based costing, transfer pricing methods accepted by tax authorities, or time driven activity based costing.
3. It is widely accepted that activity based costing is difficult, costly to implement and sometimes subjective. We should avoid driving costs into the value chain where these costs do not lead to a regulatory reporting providing significantly higher assurance of compliance with the IFR. Focusing too much on the method might also have the adverse effect of applying activity based costing as a method in circumstances where another method might be more appropriate. Therefore, activity based costing should not be presented as a safe haven.
4. The problem is compounded by the fact that international card schemes are often globally integrated companies. This means that some costs are considered on a global level rather than on an EEA level.
5. We recommend therefore deleting article 4(2)(c) and amending article 4(2)(d) as follows:

*(d) where expenses are not directly attributable ~~and cannot be allocated on an activity-based costing (ABC)~~, they shall be allocated according to a methodology documented in a supporting note. The supporting note shall indicate for each allocated costs under that methodology:*

*i. the basis for allocation; and*

*ii. the rationale for that basis.*

***The title of Article 5 on review of financial information should be amended (Article 5)***

1. Despite the title of Article 5 reads “*Audit of Financial Information*”, the texts of Article 5 and Recital 6 require instead a “*review*” of the financial information, as opposed to an “*audit*”.
2. A review is substantially different from an audit. An audit requires the independent auditor to (1) issue an opinion that the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework; (2) obtain an understanding of the entity’s internal control and assess fraud risk; and (3) corroborate the amounts and disclosures included in the financial statements by obtaining audit evidence through inquiry, physical inspection, observation, third-party confirmations, examination, analytical and other procedures.
3. A review instead requires the independent auditor to perform procedures (primarily analytical procedures and inquiries) that will provide a reasonable basis for obtaining assurance that there are no material modifications that should be made to the financial statements for them to be in conformity with the applicable financial reporting framework. A review includes primarily applying analytical procedures to management’s financial data and making inquiries of management.
4. Since the texts of Article 5 and Recital 6 require a review and not an audit, the title of Article 5 should be amended as follows:

*Article 5*  
*~~Audit~~ Review of financial information*

**Section 3 – Organization**

***The provision on remuneration should be amended (Article 11)***

* We propose that the remuneration may be linked to at least a portion of the company (including Scheme + Processing) overall performance. This is important to motivate staff and make them feel that they belong to the same company (even if they work in separate units).
* For this reason, we recommend amending Article 11 as follows:

*Article 11  
Remuneration*

1*. Remuneration of the staff of processing entities shall reflect ~~solely~~ the objectives of the processing entity and shall not be directly ~~or indirectly~~ linked to the performance of the payment card scheme to which the processing entity provides services.*

*2. Remuneration of the staff of payment card schemes shall reflect ~~solely~~ the objectives of the payment card schemes and shall not be directly ~~or indirectly~~ linked to the performance of a processing entity.*

* Accordingly, Recitals 9 should be amended as follows:

*(9) The regulation also requires that remuneration frameworks for staff of the payment card scheme and staff of the processing entity are not set directly on the economic performance of respectively a processing entity or a payment card scheme to avoid any incentives for staff of the payment card scheme or processing entity to provide each other with preferential treatment or privileged information not available to their competitors.*

***The provisions on shared services appear balanced (Article 10(2)(a) and 10(4)(a) and Article 12)***

* We agree with the provisions on shared services and with Recital 11.

\* \* \*

1. Article 22(4) of PSD2 and Article 49(1)) of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV package). [↑](#footnote-ref-2)
2. Article 30 of PSD2. [↑](#footnote-ref-3)
3. Article 96(1) of PSD2. [↑](#footnote-ref-4)
4. Article 51a(1) of the Proposal for a General Data Protection Regulation – Political Agreement of Jan 28, 2016. [↑](#footnote-ref-5)
5. Article 15 of the Proposal for a Directive concerning measures to ensure a high common level of network and information security across the Union – Political Agreement of Feb 10, 2016. [↑](#footnote-ref-6)
6. Article 35.2(b) of the PSD2. [↑](#footnote-ref-7)