LEVELLING THE LAND: **REGULATORS BOOST COMPETITION**

Non-traditional players are now entering the payments space

REGULATION New technology and the entry of non-traditional players promise a more innovative payments industry. But regulators must ensure that the interests of consumers and businesses are properly safeguarded in this period of profound change, says **Geoff Nairn**

In the past, the payments sector was largely self-regulated and dominated by financial institutions that favoured stability over innovation. Consumers grumbled about the high cost of credit cards or the time required for a bank transfer, but there were few alternatives.

In the last five years, however, the industry has been shaken out of its complacency. In 2006, the Office of Fair Trading (OFT) ruled that the standard charges paid by cardholders to credit card companies were "significantly higher than is legally fair".

A year later, the OFT criticised the lack of competition in the card payment protection insurance market, which had to that point been a lucrative sideline for card companies.

The processing fees that UK businesses pay for accepting credit cards have also been investigated by both the OFT and the European Commission. This has been rumbling on for over a decade; so far without a definitive ruling.

The regulators argue the fees merchants pay are excessive, infringe competition and ultimately lead to higher prices. The level of these "interchange fees" varies widely but averages around 1.75 per cent.

In the US, a similar controversy over cards sparked tough new legislation. The Durbin Amendment, which recently came into effect, caps the fees on debit card transactions and lets merchants choose which processing network they use.

Experts argue the biggest beneficiaries of the Durbin Amendment are likely to be the retailers rather than the consumers, which was the intended aim. The card issuers, while disappointed, are also relieved as they had feared more drastic measures. "The financial industry is still worse off and will have to adapt," says Zilvinas Bareisis, senior analyst at market research firm Celent.

Nevertheless, he is surprised at the negative reaction of many retailers to the new legislation, designed to cut their card-processing costs. "They should be declaring victory," he says.

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Smaller retailers are not in a strong position to renegotiate lower fees. But large retail chains have greater bargaining power and can call the shots. So when the furore over Durbin has dissipated, they could quietly negotiate lower fees and pocket the savings themselves, experts predict.

The debate over card fees comes at a critical time for the payments industry. It is eagerly promoting new technologies such as contactless cards or mobile payments and needs the support of retailers if these initiatives are to succeed.

But these technologies are also being promoted by new players such as Apple, Google and PayPal. "PayPal is looking at how it can leverage its brand in the "customer present" payments market," says Ian Rutland, managing director of Commidea, which processes most of the contactless payments in the UK.

Not surprisingly, the banks are getting anxious as upstart pretenders invade their turf. For example, US start-up Square has found a niche in processing card payments for small businesses, which often complain they get a raw deal from the card companies.

"A conventional merchant account can take six months to set up if you are a small business," says Keith Brown, managing director of Paythru, a UK-based mobile payments provider. Using Square, the retailer can accept cards from day one and Square even throws in its iPhone-based card reader for free.

Once, the idea that Google, Square or PayPal could pose a threat to the mainstream payments industry would have seemed far-fetched. But much current legislation and regulatory efforts are designed specifically to remove barriers and encourage competition in payments. For example, the EU's Payment Services Directive, which became UK law in 2009, removed legal obstacles to non-bank institutions offering payment services.

The new E-Money Directive, implemented in the UK through this year's E-Money Regulations, could also have wide ranging impact on the payments market, suggests Brown, by allowing non-traditional players such as mobile phone operators to offer electronic money services.