EU Regulation

REGULATING THE CARD-BASED TRANSACTION MARKET

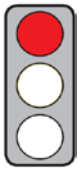
cep**PolicyBrief** No. 2014-13

Centrum für Europäische Politik

KEY ISSUES

Objective of the Regulation: The Commission wants to restrict the level of interchange fees and eliminate anti-competitive business rules and practices by the players on the card-based transaction market.

Affected parties: Card schemes, card issuers, card users, merchants' banks, merchants, processors.



Pro: –

Contra: (1) Only in the case of unassailable market domination is any regulation justified. In this case, however, rather than mandatory statutory upper limits on interchange fees the competition authorities should take action.

(2) Only in the case of unassailable market domination is it justified to impose a ban on the "honouring all cards" rule or to require processors to be independent of card schemes. Such decisions should be made by the competition authorities and not the legislator.

(3) Card schemes should be able to decide whether licences for issuing cards or for acquiring are valid nationally or EU-wide and whether to permit "co-badging".

(4) A mandatory organisational separation between the card scheme and processors breaches the card schemes' freedom to conduct a business.

CONTENT

Title

Proposal COM(2013) 550 of 24 July 2013 for a **Regulation** of the European Parliament and of the Council on **interchange fees for card-based payment transactions**

Brief Summary

- **The market for card-based transactions**
  - When payments are made using debit or credit cards, the merchant's bank collects the payment amount from the account which the card user holds with his own bank ("card issuer") ("four-party card scheme": card user - card issuer - merchant's bank - merchant).
  - Debit and credit card transactions can be processed
    - directly between the merchant's bank and the card issuer ("acquiring") or
    - indirectly via an intermediate payment processing service provider ("processor").
  - The merchant's bank and the card issuer are members of a "card scheme" - e.g. MasterCard, VISA - which determines the framework for processing payments.
  - The card schemes operate different "card categories" - e.g. credit cards, debit cards - and "card brands" - e.g. Maestro from MasterCard or Electronic Cash from Visa).
  - Various different charges and fees pass between the four parties and the card scheme:
    - The merchant's bank pays an "interchange fee" to the card issuer ("multilateral interchange fee, MIF") which is set by the card scheme or agreed between the merchant's bank and the card issuer.
    - The merchant pays a "merchant fee" to the merchant's bank which is based on the interchange fee.
    - The card user generally pays a "card fee" to the card issuer.
    - The card issuer and merchant's bank pay "scheme fees" to the card scheme.
  - In addition to the four-party card scheme, there are also three-party schemes - e.g. American Express, Diners Club - in which the card scheme acts both as card issuer and as the merchant's bank.
- **Context**
  - In the last few years numerous national and European competition authorities have investigated competition on the card-based transaction market. Many of them found the interchange fees and some of the "restrictive business rules and practices" to be anti-competitive. (Page 2 and 4)
  - The Commission therefore wants to
    - set upper limits on interchange fees,
    - prohibit "restrictive" business rules and practices, and
    - promote competition among processors.
- **Scope**
  - The Regulation applies to all card-based transactions in the EU where both the card issuer and the merchant's bank are located in the EU (Art. 1 (1)).

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– The Regulation applies irrespective of whether the transaction takes place directly by using the card or by way of a payment device - e.g. mobile phone, tablet PC - or software (Art. 2 (7)).
– The Regulation does not apply to transactions based on payment instruments – mainly certain cards – and used for the acquisition of "a limited range" of products from the issuer of the payment instrument or in a "limited network" of merchants with whom the issuer has an agreement. This covers petrol cards and store cards. (Art. 1 (2))

► **Upper limits on interchange fees**
– Interchange fees are limited in the case (Art. 3 and 4):
  - of debit cards, to 0.2% of the payment amount,
  - of credit cards, to 0.3% of the payment amount.
– These upper limits apply in the case of (Art. 3 and 4)
  - cross-border card-based transactions, as from two months after the Regulation comes into force,
  - domestic card-based transactions, as from two years after the Regulation comes into force,
– The upper limits do not apply to (Art. 1 (3), Art. 2, No. 15)
  - cash withdrawals at cash machines,
  - transactions with cards issued to undertakings, public sector entities or self-employed persons for business purposes ("commercial cards") and
  - transactions under three-party schemes.

► **Ban on "restrictive" business rules and practices**
– **Partial abolition of the obligation to accept all cards ("honour all cards" rule)**
  - Card schemes may not force merchants, who accept certain card categories or card brands belonging to their respective scheme, to accept other card categories or brands in their scheme. This relates only to cards for which the same upper limits on interchange fees apply (Art. 10 (1)).
  - Card schemes may prohibit merchants from discriminating against card issuers who are members of their respective scheme. In this case, merchants who accept a certain card category or card brand from the respective card scheme, have to accept this card category or brand irrespective of the identity of the card issuer. (Art. 10 (2))
  - Merchants must inform consumers in a "clear and unequivocal" manner, at the entrance to the shop, at the till, or on their website or other applicable electronic medium, which cards from a card scheme they accept (Art. 10 (3)).
– **Incentives to use certain payment instruments**
  - Card schemes, card issuers and merchants' banks cannot prevent merchants (Art. 11 (1) - (2))
    - from encouraging consumers to use certain payment instruments - e.g. debit cards,
    - treating the payment devices of a card scheme more or less favourably than others and informing payers about interchange fees and merchant service charges.
– **Rules on merchant service charges**
  - Merchants' banks must offer and charge merchants individual service charges for each card category or brand ("unblending") unless a merchant has requested "blended merchant service charges" (Art. 9 (1)).
  - After every payment transaction, the merchant's bank must transmit to the merchant the payment amount and the merchant service charge including the interchange fee. The merchant's bank may, at the merchant's request, combine this information according to brand, application, card brand or valid interchange fee. (Art. 12 (1))
– **Rules on cross-border cards and cross-border "acquiring"**
  - Card schemes cannot restrict their licences to certain Member States (Art. 6 (2)). This applies, for example, to (Art. 6 (1))
    - licences to card issuers to issue payment cards, and
    - licences to merchants' banks to collect card payments.
  - This means:
    - Card issuers may issue cards to card users from other Member States ("cross-border authorisation").
    - Merchants may collect card payments from merchants' banks in other Member States ("cross-border acquiring").
– **Allowing several brands to be displayed on one payment card ("co-badging")**
  - Card schemes may not prevent card issuers from allowing a card or payment device to carry different card brands even if they are from another card scheme ("co-badging") (Art. 8 (1)).
  - Card schemes may attach various conditions to co-badging by card issuers insofar as this is "objectively justified and non-discriminatory" (Art. 8 (2)).
  - Card schemes cannot impose reporting requirements or payment obligations on card issuers or merchants' banks in respect of payment transactions using cards which display the card scheme's brand but where payment was processed by way of another card scheme (Art. 8 (3)).
  - When making a purchase, the card user must be able to determine the card brand to be used where this option is offered by the payment device (Art. 8 (5)).
  - Card schemes, card issuers, merchants' banks and processors cannot equip the payment infrastructure used at the point of sale in such a way as to restrict the card user's choice of card brand (Art. 8 (6)).

- **Competition among processors**
  - In terms of legal form, organisation and decision making, processors must be independent of the card schemes (Art. 7 (1)).
  - Card schemes cannot oblige card issuers or merchants' banks to use the services of the processor (Art. 7 (1)).
  - Card schemes must permit the activities of third-party processors (Art. 7 (2)).
  - Card schemes cannot provide for any territorial restrictions in their processing rules (Art. 7 (3)).
  - All processors must ensure the "technical interoperability" of their systems with the systems of other processors by applying European or international standards (Art. 7 (4)).
  - The rules do not apply to three-party schemes (Art. 1 (4)).

Statement on Subsidiarity by the Commission

According to the Commission, national measures on interchange fees would disrupt the smooth functioning of the payment market and would not result in a level playing field. In addition, the payment market is by its nature a cross-border market and therefore requires an EU-wide approach.

Policy Context

In 2009, MasterCard undertook to cap the interchange fees for all cross-border debit and credit cards at 0.2% and 0.3% of the transaction value. Visa capped the fees at 0.2% in 2010 (for all debit card payments) and in 2013 (for all cross-border credit-card payments).
Interchange fees may, as "decisions by associations of undertakings" or "agreements between undertakings", fall under the ban on cartels (Art. 101 TFEU). On 24 May 2012, the General Court of the EU upheld the decision of the Commission to classify MasterCard's interchange fees as anticompetitive (Case T-111/08, MasterCard and others v. Commission). MasterCard appealed against this judgement (Case C-382/12 P, MasterCard and others v. Commission). On 30 January 2014, Advocate General Mengozzi advised the ECJ to reject the appeal. In 2012, the Commission referred to numerous sections of this Regulation in the Green Paper on card, internet and mobile payments [COM (2011) 941, see cep**PolicyBrief**]. The Regulation is accompanied by the Payment Services Directive 2 [COM (2013) 547, see cep**PolicyBrief**].

Options for Influencing the Political Process

Leading Directorate General:	DG Internal Market
Leading Committee of the EP:	Economic and Monetary Affairs; Rapporteur Pablo Bidegain (EVP Group, ES)
Leading Federal Ministry:	Ministry of Finance
Leading Committee of the BT:	Finance
Decision-making mode in the Council:	Qualified majority (Adoption by a majority of the Member States and with 260 of 352 votes; Germany: 29 votes)

Formalities

Legislative competence:	Art. 114 TFEU
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Legislative procedure:	Art. 294 TFEU (Ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

Statutory upper limits on fees for credit and debit card payments - and particularly on interchange fees - constitute major interference with pricing. The limits cannot be justified on an ordoliberal basis without the existence of unassailable market domination. This would be the case if there were no "potential competition" - such as from new suppliers entering the market or the development of alternative products. Although significant economies of scale and network effects are apparent on the card-based transaction market, which make market-entry difficult for new card schemes, at the same time, alternatives to card-based payment - such as mobile and internet-based payment methods - are gaining popularity. These alternatives significantly weaken the market position of card schemes. As long as there is no evidence of unassailable market dominance, setting upper limits on interchange fees should be avoided.
The sweeping nature of **statutory upper limits on interchange fees** means that they affect existing and developing card schemes in equal measure, although the latter certainly cannot be accredited with an unassailable market position. They **may** even **obstruct market entry for new card schemes because new players will not be able to offer the banks more attractive conditions.**
Instead, in order to prevent the abuse of market power, competition law should be applied. **Only where there is unassailable market dominance should the competition authorities be able to discipline a card scheme.** One possibility is an official price control or an obligation to grant competitors access to the card scheme in return for payment ("access regulation").

In addition, an EU-standard arrangement for upper limits is problematic in two ways. Firstly, standard upper limits severely restrict the market players' scope for responding to the preferences of card users - which vary from one Member State to another -, the structure of the card-based transaction market and the intensity of competition. Secondly, differences between national and cross-border interchange fees are virtually unsustainable, even though there are thoroughly plausible reasons for them.

Banning the "honour all cards" rule, whereby card schemes oblige merchants to accept all card categories and brands of the respective card scheme, **is only justifiable where there is unassailable market dominance** because only then would the rule constitute product tying which gives rise to problems under competition law. Otherwise, merchants are not obliged to agree to such a rule. The decision whether to ban an "honour all cards" rule should be made on a case-by-case basis by the competition authorities.

The same argument **likewise** applies to **the requirement that processors be completely independent of the card schemes**. Although close ties between the card scheme and the processor can restrict competition on the downstream market for payment processing services and stifle investment in innovation, banning ties **is again only justifiable where the card scheme has an unassailable market position.**

It should be left up to the card scheme to decide whether licences for issuing cards or for acquiring apply nationally or EU wide. Although the EU-wide licences proposed by the Commission strengthen competition and efficiency, particularly because merchants can have acquiring carried out in all Member States by a single merchant's bank, it is unclear why the legislator should impose this unless there is unassailable market dominance.

Card schemes should be able to ban "co-badging" by the card issuer. Even where there is unassailable market dominance, the planned obligation to tolerate co-badging would not bring about competition because the unassailability of market dominance depends on other factors - such as the ability to set up IT infrastructure - and not on the ability to display a brand on a card.

Legal Assessment

Legislative Competency

The internal market competence (Art. 114 TFEU) is the relevant legal basis. The requirement is that the internal market is constrained by existing or pending national provisions. Until now, according to the Commission, there has been no direct statutory regulation of interchange fees. Some Member States are, however, currently adopting such legislation.

Subsidiarity and Proportionality

Unproblematic.

Compatibility with EU Law in other Respects

Setting price caps is in breach of the card schemes' freedom to conduct a business [Art. 16 EU Charter of Fundamental Rights]. Intervention in the scope of protection is not justified because setting price caps is disproportionate. This is because it is not a suitable measure for promoting competition on the card-based transaction market since it prevents new card schemes from using higher interchange fees to make their cards more attractive to card issuers than those of established providers. It thus constitutes a barrier to market entry.

A mandatory organisational separation between card schemes and processors also breaches the card schemes' freedom to conduct a business (Art. 16 CFREU). Intervention in the scope of protection is not justified because such separation is disproportionate. This is because - irrespective of the economic concerns - a less draconian measure is available to facilitate the processors' market entry, namely no longer permitting card schemes to require that their own subsidiaries be commissioned for payment processing by the participating parties.

Impact on German Law

Depending on the arrangement, interchange fees may breach the ban on cartels [Section 1 Unfair Competition Act (GWB)]. Section 32 (2) GWB does not expressly provide for structural remedies such as the separation of card schemes and processors but, according to the preamble, its "broad formulation does not exclude the possibility of [… such] intervention in the corporate structure" (Bundestag Parliamentary Record 15/3640, p. 33).

Conclusion

Statutory upper limits on fees for credit constitute major interference with pricing and may, in addition, obstruct market entry to new card schemes because new players will not be able to offer the banks more attractive conditions. They are only justifiable where there is unassailable market dominance. In this case, any action should be left up to the competition authorities rather than the legislator. Bans on the "honour all cards" rule and the requirement that processors be completely independent of the card schemes are only justifiable in the case of unassailable market dominance. The card schemes should be able to decide whether licences for issuing cards and for acquiring are valid nationally or EU-wide and whether to ban "co-badging". A mandatory organisational separation between the card scheme and processors breaches the card schemes' freedom to conduct a business.