

## Payment Services

### EC weighs in on interchange fee battle

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*Legal battles over MasterCard and Visa's interchange fees have raged for years in various markets around the world, but now the European Commission is pushing ahead with legislation that will cap the level of the fees, which will have major repercussions for card-issuing banks and the payments market.*

#### What are interchange fees?

Multilateral interchange fees are inter-bank charges that are paid when payment cards are used. The fees apply to the four-party system, which comprises the cardholder, the cardholder's bank (issuing bank or issuer), a retailer (merchant) and the retailer's bank (acquiring bank or merchant acquirer). The interchange fee is paid by the retailer's bank to the cardholder's bank, and the acquiring bank then bills the merchant for the charges.

The four parties are connected by payment networks such as MasterCard and Visa, which started out as bank associations that built the inter-bank infrastructure for cards. The networks set the multilateral interchange fees (but do not earn revenue from them) so that banks do not have to arrange a series of bilateral agreements among themselves.

#### What's the fuss about?

Retailers have rallied against interchange fees for years, arguing they are anti-competitive and, because of MasterCard's and Visa's market power, the fees have been unreasonably high and the cost of accepting cards has gone up.

Merchants have accused acquirers in the past of not being transparent in the billing of fees and blending interchange with other charges. Issuers earn more for cards with rewards programmes, which the merchants would have to pay more to accept, but the merchants have not been able to refuse the more expensive cards because of the networks' rules. Without the ability to surcharge, or refuse certain cards, retailers were unable to steer their customers to cheaper payment options such as cash or debit cards. The end-user – the consumer – was not paying directly for the fees and is not in a position to choose a payment method based on cost.

These issues have been the source of lawsuits and competition proceedings in many markets around the world.

## **What has the European Commission (EC) been doing about it?**

The EC has previously taken anti-trust action against Visa and MasterCard and is now seeking to cap interchange fees with formal regulation that needs to be adopted by the European Parliament and Council of Ministers.

The EC believes that the cards market in Europe is fragmented and the interchange fees vary widely, particularly for cross-border transactions, which is against the vision of creating a single market where there is no difference between domestic and cross-border transactions. The EC also aims to create a level playing field where new entrants can compete in the payments market against the likes of MasterCard and Visa.

In July 2013, the EC proposed to cap interchange fees and the regulation was announced as part of a package with the revision to the Payment Services Directive (PSD2), which was initially hoped to be agreed upon by April 2014. The cap has been set at 0.2% of the transaction value for debit cards and 0.3% for credit cards. There will be a transition period of 22 months when the caps will apply to cross-border transactions and the caps will then be applied to domestic transactions.

The EC's vice-president, Joaquín Almunia, said at the time of the announcement: "The interchange fees paid by retailers end up on consumers' bills. Not only are consumers generally unaware of this, they are even encouraged through reward systems to use the cards that provide their banks with the highest revenues. Complementing the enforcement of anti-trust rules, the regulation capping interchange fees will prevent excessive levels of these fees across the board. A level playing field will be created for payment services providers, new players will be able to enter the market and offer innovative services, retailers will make big savings by paying lower fees to their banks, and consumers will benefit through lower retail prices."

The proposals are progressing through the European legislative process. In February 2014, the members on the European Parliament's Economic and Monetary Affairs Committee approved the proposals.

## **What does the industry say?**

When the EC issued its proposals, Visa and MasterCard both continued to defend the need for interchange. Peter Ayliffe, president and CEO of Visa Europe, said: "Payment cards provide huge benefits to consumers, retailers and the economy as a whole and we are concerned that these proposals will be detrimental to the innovation that will support European economic growth. There is little evidence to support the claims that these proposals will be beneficial to consumers."

Meanwhile Javier Perez, president of MasterCard Europe, said that the caps on interchange fees, and rules that will allow merchants to refuse certain cards, will actually harm and inconvenience consumers and small merchants, as well as hinder competition and innovation.

Francesco Burelli, a partner at consultancy Value Partners, says that one of the effects of the regulation is that it will force banks to look for revenue elsewhere. "It will likely result in an increase of cardholder fees," he says, adding that any savings from the cap in fees are not likely to be passed on to consumers in the form of lower prices and "are likely to be largely absorbed by retailers".

"The ongoing decrease of interchange fees is impacting the European card-issuing industry quite significantly, and it is ultimately taking the business to an unsustainable economic level for all cards portfolios that are not revolving or conduits to consumer credit solutions," he says.