Why Europe needs an amendment to the Interchange Fee Regulation

SEPTEMBER 2020

The Interchange Fee Regulation (IFR) has NOT achieved its objectives

The Commission's objective was to address the *"hidden fees imposed on retailers for accepting payment cards [in particular, fees known as payment card interchange fees, which…] retailers in turn pass on to consumers in higher prices […and which] neither retailers nor consumers can influence".* This was intended to meet the European Parliament's aim of "lower prices for everyone", namely of lower retail prices for goods and services throughout Europe through making cards less expensive to accept.

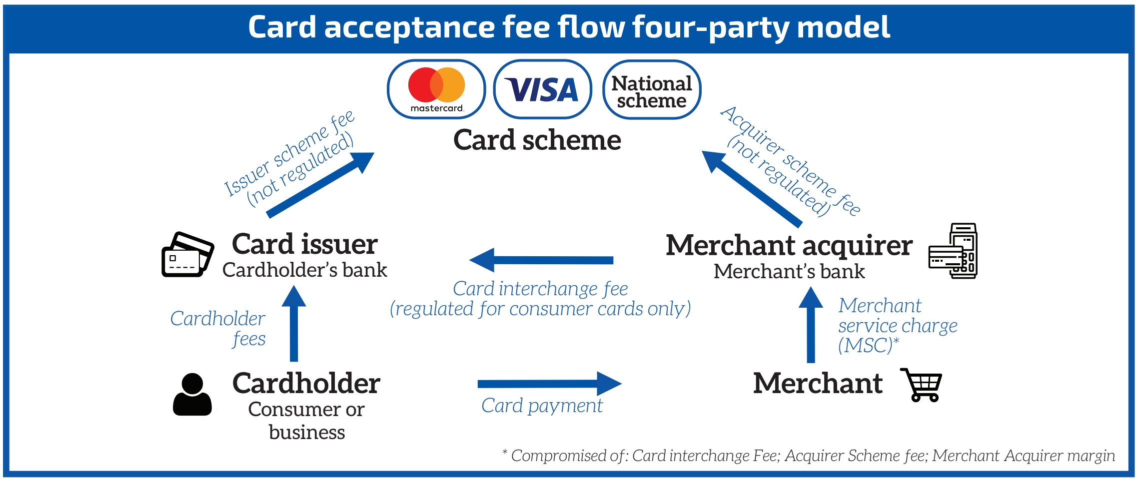
The Commission's subsequent antitrust investigations – stated *"the Commission and EU Courts have consistently found that rules providing for default multilateral interchange fees in 4-party payment card schemes harm competition".*

The adoption of the Regulation in June 2015 was welcomed by European retailers, and in turn, consumers who stood to benefit from lower prices.

However, the Regulation has not addressed:

All elements of card fees imposed on Merchant acquirers; all card transaction types; commercial cards; 3-party schemes; international cards; or ATM withdrawals and left merchants exposed to continued increases in other non regulated fees leading to a substantial erosion of the savings achieved so far.

What is the "four-party" card payment scheme model ?



The graphic shows the flow of fees between the respective participants:

- Cardholders may pay a cardholder fee to the card issuer;
- Merchants pay a fee (merchant service charge, MSCs) to their bank (merchant acquirer) to accept card payments;
- The merchants' banks (merchant acquirers) pay card interchange fees to card issuers (known as multilateral interchange fees MIFs);
- Merchant acquirers also pay acquirer scheme fees to the payment card schemes; and
- Card issuers may also pay issuer scheme fees to payment card schemes.

The merchant service charges (MSCs) that merchants pay to their card acquirer comprise 3 key elements:

- The card interchange fee (paid to the card issuer);
- The acquirer scheme fee (paid to the payment card scheme); and
- The merchant acquirer margin (to cover the merchant acquirer's costs).

Importantly, the merchant only has the ability to negotiate and agree what the merchant acquirer margin will be. All other fees are set and imposed by the card schemes on the merchant acquirer and passed on either directly or indirectly to the merchant and ultimately the consumer.

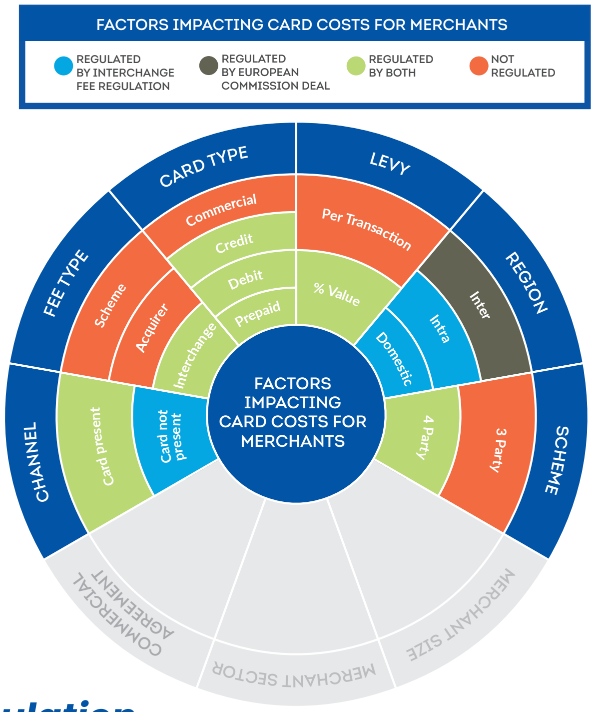
What is the "three-party" card payment scheme model ?

The three-party model, such as American Express, is exactly the same as the four-party model except that the card issuer, merchant acquirer and the payment card scheme are one and the same.

What did the Regulation do ?

In simple terms, the Regulation capped the card interchange fees paid to card issuers at 0.2% for domestic consumer debit cards[1] and 0.3% for domestic consumer credit transactions. However, certain other card types, most notably commercial cards and other fees, such as card scheme fees, were either **excluded** from the Regulation or left to the card schemes to offer commitments on for a limited time period.

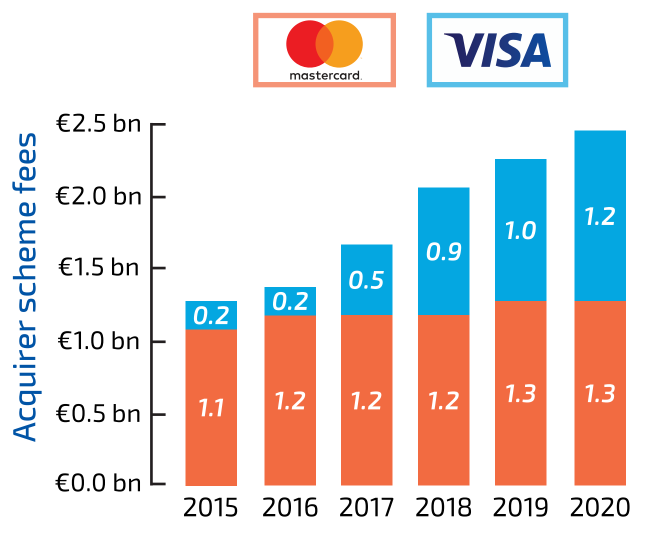
In addition, three-party schemes such as American Express, who have some of the highest fees, were left unregulated as these weren't considered "must take" cards. But for some sectors, particularly travel and entertainment, they are exactly that. The Commission argued that a reduction in the interchange fees for consumer cards would result in a corresponding reduction in three-party scheme fees (and commercial card fees): **this hasn't materialised**.



Unintended consequences of the Regulation

The IFR has successfully regulated **consumer** interchange fees. But this has not been enough to meet its stated objective at the launch of the regulation, in sustainably addressing the *"hidden fees imposed on retailers for accepting payment cards"* – in particular **card scheme fees** charged to acquirers, which have been increasing dramatically. The sheer volume, complexity, lack of transparency (no information is published by the card schemes) of these makes it impossible for any merchant to know with any certainty that their invoices are accurate or correct, or the justification for such fees.

Acquirer scheme fees now close to total interchange fee reductions



Data for EU & UK based on average scheme fees across all card types and cardholder present and not present.
Source : CMSPI

The Commission's recently completed IFR evaluation study[2] estimates that the Regulation has reduced EU interchange fees by €2.7bn (per year) since 2015. In contrast, we estimate that such interchange fee reductions have been substantially offset by increases in annual card scheme fees charged to acquirers (and in turn charged to retailers), by €1.1bn since 2015 to date, with the largest increases coming post the Commission consultants EY review period.

Since the Commission consultants EY stopped gathering data in 2017, non-regulated fees imposed by Visa and Mastercard have risen by an average of 47% - and in one scheme, by 150% - creating additional costs for merchants up to May 2020 of 800 million euro since January 2018[3].

Moreover, the card schemes, particularly Visa, have strongly signalled their intention to go on raising scheme fees.

[1] Member States were also able to set a lower cap for debit cards and/or impose a fixed maximum fee amount as a limit, for example 0.2% but capped at €0.07c as applied in Spain or €0.056 in Belgium
[2] "Study on the application of the Interchange Fee Regulation: Final report for the European Commission, March 2020.
[3] Source CMSPi

We estimate that should Visa raise its scheme fees to the same levels as Mastercard's current levels in the EU (as Visa has indicated[4]), this would result in further additional costs to merchants of c.€0.9bn per annum.

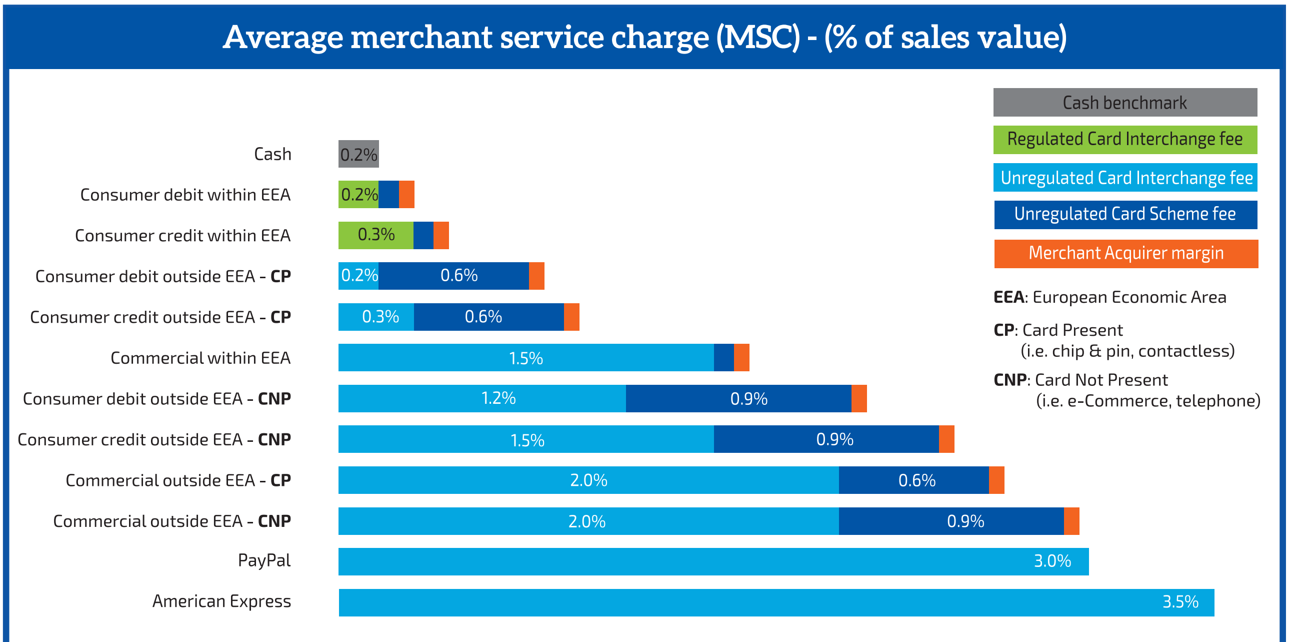
EuroCommerce is aware that the card schemes and major banks have been lobbying strongly for "no change" to the Regulation, arguing that "concerns about excessive fees have been mitigated by the interchange fee caps". However, this is in contrast with EuroCommerce members' experience of recent and significant fee rises – and appears at odds with the card schemes' repeated boasts to their shareholders of successive fee rises and of further large intended rises to come.

EuroCommerce considers this narrative and the increases in card scheme fees experienced to date as a 'clear and present threat' to the intention, integrity and application of the Interchange Fee Regulation.

Additionally, the Commission may prefer the option of competition rather than regulation to address this imbalance. There have already been four successive attempts in recent years to build a competing European card scheme, all of which have failed[5]. However even with consideration being given to the current European Payment Initiative (EPI) to using SCT Instant payments at Point Of Interaction (POI), realistically any solution capable of providing real competition to the existing card schemes is at least 3-5 years away and only addresses one part of the problem, namely debit transactions. Furthermore, there is a concern that continued non-regulation of scheme and other fees could lead to Visa and MC consolidating their position further and leaving no room for any alternative payments system to flourish.

Apart from acquirer scheme fees, are there other concerns ?

Yes. The cost of accepting other, currently unregulated cards, such as commercial cards and inter-regional cards (for which only Commitments have been offered by the card schemes and which will time expire), is still disproportionately high compared to consumer cards. This demonstrates further that these card types also need to be included in any revision of the Regulation. When accepting a card, the majority of merchants are unable to distinguish or treat these cards any differently to regulated consumer cards, as merchants are largely unaware of the type of card presented at Point of Sale (PoS) until they receive their invoice from their card acquirer. The graph below highlights also the high cost of acceptance of the most popular three-party schemes, together with commercial cards and inter-regional cards, which have not, despite the assurances of the Commission[6], reduced in any substantial way since the IFR came into force.

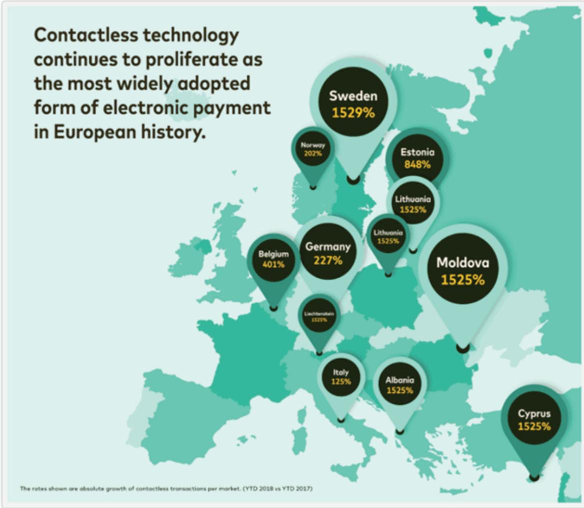


Source : CMSPi; EuroCommerce; Zephyre

[4] See para 96, Section 4 of the Zephyre/EuroCommerce submission to the EU
[5] Euro Alliance of Payment Schemes (EAPS), PayFair, EUFISERV and Monnet project. Source: ECB 2019 report on Card payments in Europe.
[6] The Commission said in the 2013 Proposal for the IFR and 2013 IFR Impact Assessment that the IFR prohibition of the honour all cards rules (Article 10) and prohibition of anti-steering rules (Article 11) would result in cost of non-regulated cards (i.e. commercial cards, three-party schemes, and inter-regional cards) being set at a competitive level.

What impact did Covid-19 have on merchant costs ?

The biggest direct impact on the cost of payments to merchants arising from Covid-19 has been the consumer migration from cash to cards due to concerns about cross-infection and the ensuing migration in spending from in-store to on-line - where interchange and scheme fees are on average 21% higher. For a lot of merchants, cash remains the cheapest form of payment. The switch from cash to contactless, which we believe grew by over 50%, together with the increased growth of shopping on-line has substantially increased the cost of payments for those merchants. We estimate the additional cost of contactless and online growth to be in the region of €70m which will inevitably be passed on to all consumers over time as retailer margins are already at an all-time low.



Quelle: Mastercard

EuroCommerce had already highlighted to the Commission their concern that the decline in cash is compounded by the activities of the card schemes in controlling the interchange fees for ATM withdrawals, which has created an incentive for ATM closures. The increased use of contactless cards and decline of cash further strengthens card schemes' position and joint domination of the payments market.

What is EuroCommerce asking for ?

EuroCommerce is calling for the Commission to propose measures to regulate all multilateral interchange fees in payment card schemes and for regulation of all fees that have an equivalent object or effect as interchange fees, such as scheme fees, in particular through:

1. Regulation of the total wholesale fees charged to payment card acquirers (including but not limited to interchange fees);
2. Removal of all substantive exemptions or exclusions from the Regulation (including commercial cards, three-party card schemes, cash withdrawals at automated teller machines (ATMs), inter-regional cards, and virtual card transactions);
3. Providing for independent acquiring of three-party card schemes (in order to regulate three-party and four-party schemes equally);
4. Providing for mandatory minimum interchange fees for cash withdrawals and deposits at ATMs (in order to protect consumer choice and access to cash); and
5. Strong and dissuasive penalties for non-compliance with the regulation.

A copy of our detailed report and submission to DG COMP and written by Zephyre a specialist antitrust and economics advisory company can be found using the URL: https://bit.ly/35559hD

Contacts:
Neil McMillan, +32 479 40 22 41, mcmillan@eurocommerce.eu
Peter Robinson, +44 7885 060 856, liberticonsulting@gmail.com