

Interchange Fee Regulation

Phase 3 – Effective Thursday 9th June, 2016

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Contact: Peter Robinson, liberticonsulting@gmail.com

REGULATION ON INTERCHANGE FEES FOR CARD-BASED PAYMENT TRANSACTIONS

On 9th June, the last set of rules under the Interchange Fee Regulation will enter into force, which will reinforce the position of merchants with regard to card payments. In a nutshell, merchants will have the following main rights and obligations:

- Acquiring banks have to specify to merchants *for each category and brand of payment card* the level of the merchant service charge, the interchange fee and the scheme fee—unless merchants explicitly request otherwise. Merchants can use this information:
 - i. to negotiate the best deal with different banks; and,
 - ii. make more informed choices about the payment card brands they accept and encourage consumers to pay with;
- Merchants can no longer be forced to accept all cards from a given brand if they accept one card from this brand, except if these cards are subject to the same interchange fee cap. They can for example be able to accept only debit cards and not credit cards;
- In exchange, merchants will have to display which cards they accept in a clear and unequivocal manner at the entrance to the store and at the till. (For distance sales - on the website or other applicable electronic or mobile medium).
- Consumers and merchants, and no longer banks and schemes, choose the payment card brand or application used at the point of sale. Merchants can install a default choice of application, also for contactless payments. Consumers can 'override' this with their own preferred brand (within the brands and applications accepted by the merchant) – unless this is not technically feasible e.g. when there is no keyboard or screen.

- **Merchants must inform consumers in a clear and unequivocal manner about their preference and how consumers can override the selection – in practice, before the transaction has been initiated.**

The main rules of the 3rd phase of the Regulation are set out below. For full details, reference should be made to the final text.

On Thursday 9th June, 2016 the 3rd phase of the Interchange Fee Regulation (2015/751) comes into force.

You will recall that the 2nd Phase which came into effect on 9th December, 2015 resulted in the following key deliverables:

- Article 4 – Consumer credit cards reduced to a maximum of 0.3%
- Article 3 - Consumer debit cards set at a maximum of 0.2% (with an option for Member States to set a lower limit and/or offer a weighted average until 2020)
- Commercial cards were deemed out of scope
- Pure 3 party schemes, which don't use a bank as an Issuer or Acquirer, such as American Express, were deemed out of scope, and
- Three party schemes with licensees (or co-brand partners/agents) were to be included within the regulation

On 9th June 2016, the remaining Articles 7, 8, 9 & 10 will come into force.

By way of explanation as to what the changes are and their impact on retail:

ARTICLE 7 – SEPARATION OF PAYMENT CARD SCHEME AND PROCESSING ENTITIES

This requires the payment card schemes and processing entities to be totally independent of one another in terms of accounting, organisation and decision making processes.

Over the years, the card schemes have been on an acquisition trail purchasing payment services providers (PSP's) and processors. Merchants were concerned that following any reduction in interchange fees, the fees being charged by these card scheme owned processors would result in fee increases to process merchant transactions.

This article ensures that where a scheme owns a processor, prices are not cross-subsidised or bundled in any way and that all processing entities within the EU are required to ensure that their systems are technically interoperable with other systems of processing entities through the use of common standards.

ARTICLE 8 – CO-BADGING AND CHOICE OF PAYMENT BRAND OR PAYMENT APPLICATION

This allows card issuers to co-badge their cards and offer two or more payment brands or payment applications on a card-based payment instrument. As an example, a local domestic debit card may also carry the Maestro international functionality. It is now prohibited for issuers to insert in the chip of the card an automatic mechanism the effect of which would be that only the local domestic scheme is used for local transactions and the international for

transactions abroad. This article also prohibits card schemes from blocking or hindering a card issuer if it wishes to issue co-badged cards or devices.

There is one other key clause (6), which allows merchants to determine what their preferred payment option is in these circumstances and can 'direct' the customer down their preferred route via a priority selection mechanism. Taking the example of Domestic debit vs. Maestro above, the merchant may prefer to accept the local debit card in preference to Maestro and therefore configure their PoS to put the local debit as the first choice on their terminal and Maestro second.

However, the regulation also states that the customer must always have the final choice and be able to override the merchants preference if need be.

The challenge is how to ensure that merchants obtain the benefit of the regulation while ensuring that the customer experience is consistent for both Contact and Contactless transactions. Some of the more technically aware members of EuroCommerce are active participants in groups representing the retail sector in discussions with the card schemes, banks, processors and terminal providers to try and agree how this can be achieved.

ARTICLE 9 – UNBLENDING

There is some evidence to suggest that not all acquirers are passing on the full benefits of the regulation to those merchants on a 'blended rate'. A blended rate is where a single Merchant Service Charge (the amount paid by the merchant to their acquirer), which incorporates the different interchange fees, is applied and the card acquirer is calculating an average or 'blended rate' for all transactions. This results in a lack of transparency of pricing and could result in merchants paying more than they need to.

Article 9 has two key provisions within it to address this.

- (1) Merchants should receive a contract detailing the 3 key components that make up the MSC by providing an individual breakdown of the components that make up the MSC. The 3 key components are the :
 1. Card interchange fee
 2. Card Scheme fee
 3. Merchant Service charge (from which the card acquirer fee can be calculated)

Its purpose is to cut through any lack of transparency and ensure merchants are aware of exactly how their card charges are arrived at.

- (2) The Article goes even further and specifically states that in addition to providing this information for each different category and brand of payment cards which carry different interchange fee levels, this shall be the default option *"unless the payee (merchant) subsequently makes a different request in writing"*.

Furthermore, Article 12 of the regulation also details what information should be provided to the payee (merchant), which as a minimum is:

1. the reference enabling the payee to identify the card-based payment transaction,
2. the amount of the transaction in the currency in which the payee's payment account is credited, and
3. the amount of any charges for the card-based payment transaction, indicating separately the MSC and the amount of the interchange fee.
4. But can also include (if requested by the merchant) the information above to be aggregated by brand, application, payment instrument categories and interchange fees applicable to the transaction
5. Information in this way must be provided periodically, at least once a month, and in an agreed format which allows merchants to store and reproduce the information unchanged.

The outcome the European Commission expects from this is that merchants should know for each transaction the amount of the MSC and the interchange fee and are therefore able to check if the benefit of the regulation has been passed to them.

ARTICLE 10 – 'HONOUR ALL CARDS' RULE

The rule requiring all merchants to accept all cards of the same brand irrespective of cost will no longer apply and merchants can, if they choose, decline to accept certain cards within the same brand. An example, merchants can :

1. Choose to accept Visa debit but not Visa credit (even though they both carry the Visa badge), or
2. Choose to accept Consumer cards, but can refuse to accept Commercial cards

However, merchants cannot decline cards issued by any individual card issuer, for example they cannot decline cards issued by Bank A or Bank C if they accept the same card from Bank B.

Issuers and merchants are also required to do certain things to facilitate the working of this Article.

Issuers must ensure that their cards (or payment instruments) are electronically identifiable and if a newly issued card, it must be visibly identifiable too so as to ensure that both the customer and merchant can *"unequivocally identify which brands and categories of prepaid cards, debit cards, credit cards or commercial cards are chosen by the payer"*.

Merchants, if they choose not to accept all cards must inform consumers of this in a clear and unequivocal manner, at the same time as they inform consumers of which cards they do accept. The regulation goes on to say that *"Such information shall be displayed prominently at the entrance of the shop and at the till"*.

What this in effect means is that if a merchant decides not to accept (for example) Commercial cards, it must be made clear at the entrance to the store and at the payment desk that 'Commercial cards are not accepted'.

COMMERCIAL CARDS

Given its impact on some merchants, it would be remiss of me not to make reference to Commercial cards.

While not directly affected by any new regulation coming into effect, Commercial cards are still an issue for most merchants. As previously stated, Commercial cards were excluded from the regulation. The reason given was that it was felt that competition with 3 party schemes could be materially impacted if they were included.

As a result of the political compromise reached in discussions between Council and Parliament the definition of Commercial cards has been strongly tightened – transactions are only classified as ('commercial card' transactions if they concern business expenses charged directly to the account of the employer, public sector entity or self-employed person.

Currently merchants have the choice of:

1. Continuing to accept cards as now
2. Declining to accept, or
3. If permitted in your Member State, passing through the cost of accepting commercial cards by surcharging.

UPCOMING

Article 17 of the regulation contains a review clause which states that *“by 9 June 2019, the Commission shall submit a report on the application of this Regulation to the European Parliament and to the Council. The Commission's report shall look in particular at the appropriateness of the levels of interchange fees and at steering mechanisms such as charges, taking into account the use and cost of the various means of payments and the level of entry of new players, new technology and innovative business models on the market.”*

The review will cover a wide range of subjects from the development of the market, fees, pass-through, competition, effect of excluding commercial cards, cross-border acquiring, surcharging etc.

As a result of this forthcoming review, the Commission are seeking to collect data at, what they refer to, as 'time zero' or the 'zero study report' which is effectively a snapshot in time before and after the interchange fee regulation came into effect.

Its primary purpose is to obtain an understanding of how much it was costing merchants to accept cards before the regulation came into effect on 9th December, 2015 and whether overall costs (preferably by card type) have gone up, down or broadly stayed the same. Their measures won't be limited to interchange only, but the overall Merchant service Charge (MSC), which includes card scheme and acquirer fees.

Their expectation (hope?) is that costs have come down following regulation and if so, they will be looking for evidence that some of the savings (if applicable) made by merchants have been passed down to consumers either through lower pricing, removal of surcharges, etc. in order to offset criticism levied against them and merchants, by the card schemes, that following regulation “merchants will simply pocket the savings”.

Questionnaires have already been sent by the Commission to the Schemes and the Banks in March 2016 and an ‘eQuestionnaire’ for merchants is currently under preparation.

PAYMENT SERVICES DIRECTIVE II (PSD2)

Unless implemented by individual Member States beforehand, the PSD2 comes into effect on 13th January, 2018. As far as cards go, the biggest impact will be on merchants ability to surcharge.

From this date, no surcharging will be allowed on regulated (consumer) cards. Until then the current situation remains.

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