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3. **Swiss ATM Interchange**

1. Final Report of the Sector Inquiry¹

On January 31st, the EU commission finally published the results from the sector inquiry into retail banking and card payments. Given the fairly critical results of the interim reports, tough measures had to be expected. However, for the moment the industry seems to have gotten away with a stiff warning. Since not everybody may have had the time to read the relevant documents it seems best to start with a brief summary of the final report (focussing on the parts that are relevant for card payments).

The report starts off with a number of observations on anti-competitive practices in card markets:

Variation in card fees:

The “substantial discrepancy in merchant, cardholder and inter-bank fees” is seen as evidence of “the presence of competition barriers”. The level of multilateral interchange fees in some countries is criticised. But the Commission does not condemn interchange fees altogether.

Structural barriers in payment card networks

Interbank joint ventures that act as monopoly acquirers in some countries are seen as severe barriers to competition.

Access and governance arrangements

Scheme membership rules and access rules to infrastructure are seen as barriers to competition. The Commission points out that there may be a case for restricting membership to financial institutions. But it warns that the costs in terms of reduced competition have to be

¹ COMMUNICATION FROM THE COMMISSION. Sector Inquiry under Art 17 of Regulation 1/2003 on retail banking (Final Report). Brussels, 31 January 2007, COM(2007) 33 final. http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/financial_services/com_2007_033_en.pdf

taken into account and hints to the possibility that the passing of the PSD (introduction of the new legal entity “payment institution”) may widen access.

The Commission is also critical of a number of other practices including blending, prohibition of co-branding with competing networks, no-surcharge rules and high joining fees.

Preferential bilateral fee agreements

Preferential bilateral fee-arrangements (‘on-us’ fees) and bilateral clearing mechanisms are seen as potentially severe restrictions on competition.

Beyond cards:

Membership rules for Clearing & Settlement systems (the need to be a bank) are seen as restricting competition (but again the Commission acknowledges that some kind of restriction must apply). The same applies for the restricted access to credit registers. In banking, the Commission also criticises in-transparent pricing and tying of banking products.

Possible next steps:

Based on these findings the Commission envisions a number of potential measures:

- Competition law enforcement:

access barriers, discriminatory rules, fee structures and governance arrangements in some payment card networks and clearing and settlement systems, high interchange fees, access to credit registers

- Regulation or self-regulation:

The Commission is confident that SEPA and the PSD will improve competition:

The proposal for a Directive on Consumer Credit requires Member States to ensure cross-border access to credit registers

“The European Commission will not hesitate to exercise its powers of enforcement under Articles 81, 82 and 86 EC, to ensure that the competition rules are respected in retail banking; and with respect to the various payment markets and the SEPA project in particular.”

Our comment:

One of the most important elements of the final report is the fact that interchange is not condemned outright. Unlike the Polish competition authority which made multilateral interchange fees illegal (subject to appeal – see January newsletter), the Commission sticks to its strategy of bringing interchange fees down without outlawing them. In the words of

Commissioner Neelie Kroes.² **“Let me make clear our view of these interchange fees. We are not arguing for their abolition. But it is clear that the present level of interchange fees in many of the schemes we have examined does not seem justified.”**

Thus, the current trend of falling interchange fees is likely to continue. At least from the point of view of DG Competition, a unified European interchange does not seem to be a “must”.

2. EAPS Interscheme Fee

At the ZKA conference held on 8. Feb. 07 in Berlin, Oliver Hommel (Association of German Co-operative Banks) has presented the recent progress of EAPS³. In particular, Oliver Hommel presented a concept for the fee structure within EAPS. It is planned to implement an „Inter**scheme** Fee“, to be negotiated between participating schemes (cf. page 10 of the presentation: „Für POS und GA Transaktionen wird zwischen den beiden Zahlungssystemen ein Entgelt verrechnet, das bilateral festgelegt wird aber gemeinsamen Leitlinien folgt“). Also mentioned in the presentation is that fee structures of participating payment schemes may remain unchanged. (cf. page 14: „Entgeltstrukturen innerhalb der beteiligten Zahlungssysteme müssen nicht angetastet werden.“) Accordingly, if we understand page 13 of the presentation correctly, an acquirer in EAPS will pay the interchange fee set by **his** (the acquirers) home system regardless of the origin of the presented card. On the other side, the issuer of a card receives the amount of interchange as set in **his** (the issuers) home scheme regardless of the location of the terminal where the transaction was originated.

Obviously, in this way, there will be no change for „on scheme“-transactions, i.e. transactions where issuer and acquirer are belonging to the same scheme (for now, basically domestic transactions).

If an issuer and an acquirer are belonging to different schemes, the acquirer pays the amount of interchange as set by his home scheme (as for “on-scheme” transactions). But in

² Neelie Kroes, European Commissioner for Competition Policy: Introductory Remarks on Final Report of Retail Banking Sector Inquiry, Press Conference, Brussels, 31st, January 2007 (Speech 07/50) <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/50&format=HTML&aged=0&language=EN>

³ His presentation can be downloaded from ZKA’s website at: http://www.zentraler-kreditausschuss.de/upload/1171969070.Vortrag_Hommel_BVR.pdf.

this case, the interchange fee is paid to the scheme – not to the issuer. Thus, in a way, the scheme represents all the foreign issuers. The issuer (coming from a different scheme, receives the amount of interchange as set by his home scheme and he receives it from his home scheme (which can be understood as representing all the foreign acquirers). Finally, there is a (bilaterally agreed) interscheme fee paid from the acquirer scheme to the issuer scheme.

Our comment:

Obviously, with the rules mentioned above, the entire system is financially balanced only when certain conditions are met. The most simple case would be, if all schemes have the same interchange, which actually is not (yet) the case. The next obvious case is met when issuing and acquiring volumes between each pair of participating schemes is balanced. In this case, the interscheme fee can be agreed in a way that the entire system is balanced. But the whole set-up raises two interesting questions:

- 1) Based on current volumes of intra-EAPS-transactions, is there a rough balance between the participating schemes or are there credit and debit positions within the entire group of participants?*
- 2) Is the system stable?*

Due to lack of reliable data we are not able to answer the first question. With regard to the second question, we believe that the system allows for arbitrage against the schemes: acquirers of low interchange schemes and issuers of high interchange schemes will expand. This implies that the schemes will increasingly receive low interchange fees and pay out high interchange fees, which results in a debit position for the schemes.⁴ As consequence, we believe that all EAPS-schemes will have to converge to a common interchange fee. This is not contrary to the objectives of EAPS but it proves that the ECBs fears are justified that SEPA ultimately will have the effect of higher merchant fees in some countries: At least there will be schemes with increasing merchant fees, if we assume that the common EAPS interchange will not converge to the lowest of the actual fees, but will ultimately settle close

⁴ It is easily understood that an acquirer has an incentive to move to a scheme with low interchange and issuers have an incentive to move to schemes with high interchange. In our understanding it would clearly not be SEPA-compliant to prevent issuers and acquirers from moving in this direction.

to the current average (0,27 EUR per trx.). In our view, with this first impression of the commercial design of EAPS, EAPS has lost a bit of its charm, as it seems to preserve the technical efficiency of the recent systems at the expense of a loss in diversity in commercial propositions.

3. Swiss ATM Interchange

In issue 2006/3 of "Politik und Recht des Wettbewerbs"⁵, a periodical issued by the Swiss Wettbewerbskommission (competition authority, WEKO in the following), the secretary of the WeKo reports about an investigation regarding fees for cash advance at ATMs. The WEKO investigated whether a reduction of the disloyalty fee down to 2 CHF (following a collective agreed reduction of the acquirer fee in the Swiss ATM scheme) of most Swiss banks was an infringement of competition law. We only want to pay attention to one particular point in the comprehensive report: The WEKO argues that the danger of misuse of market power is smaller if fees are set multi-laterally rather than bi-laterally. ("Diese Gefahr des Missbrauchs ist bei der multilateralen Verhandlung jedoch geringer als bei bilateralen ATM Service-Fees, bei welchen Banken mit einem grossen Bancomaten-Netz ihre Marktposition ausspielen können."⁶) However, the WEKO also makes the point that ATM-fees are not strictly comparable to interchange fees in credit and debit card systems. ("Die ATM Service-Fee ist bezüglich Funktionsweise und Wirkung nicht direkt mit der Interchange Fee in Kredit- und Debitkartensystemen vergleichbar, auch wenn es sich in beiden Fällen um eine multilateral vereinbarte Gebühr handelt.")⁷

Our comment:

To support its view, the WEKO also looked across the border to Germany, where the ATM scheme is lacking a multi-laterally ATM fee, which results in extremely high disloyalty fees.

⁵ <http://www.weko.admin.ch/publikationen/00212/2006-3.pdf?lang=de>

⁶ "The risk of misuse is lower with multilaterally negotiated ATM-fees compared with bilaterally negotiated ATM-fees, where in the later case banks with largen networks can make use of their market power"

⁷ The ATM-fee is with regard to function and effect different from interchange fee in creditdard and debitcard scheme, even if the fee in both case is multilaterally agreed.

We find WEKO's statement remarkable, as it addresses the case of execution of market power between members of a scheme, a point which is sometimes neglected in the discussion about interchange.

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