



# Regulating Interchange Fees for Card Payments

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# Agenda

- European payment cards market
- Interchange fees
- EU Regulation Interchange Fees (IFR) for Card-Based Payments
- Impact interchange fee regulation inside and outside the EU
- Expected impact of IFR on EU cards market
- Concluding remarks



# The European payment cards market

- SEPA: 1 August 2014 removal technical + legal barriers wrt X-border payments.

- SEPA credit transfer and direct debit

*No difference between making payments within and towards other EU countries*

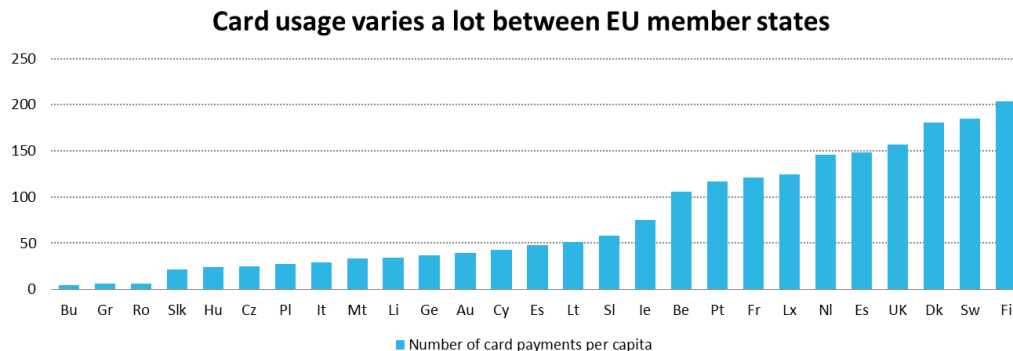
- But no EU 'SEPA for Cards' yet:

ECB (2014): *Card payments “have not reached the same level of harmonisation and integration as credit transfers and direct debits”*

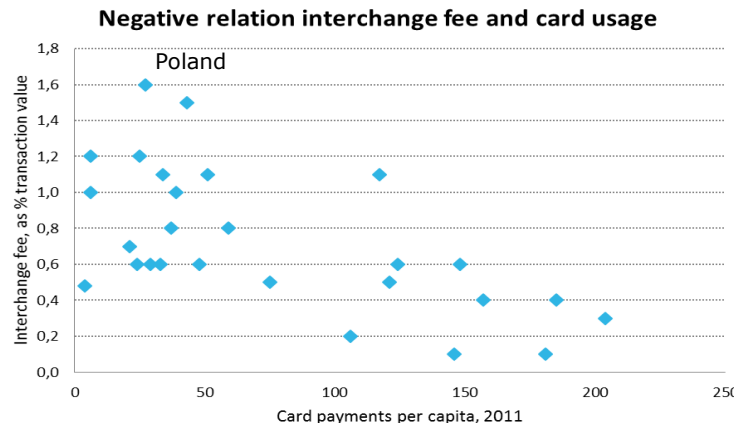
*“substantial efforts are still required in order to achieve a single card payment area”*

# Negative relation interchange fee and card usage

- Card usage varies a lot between EU Member States .....



- .... and variation in interchange fee (IF) may have contributed to these differences
- High interchange fees seem to correlate with low card usage
- IF per trx: 0.5% trx value (0.4% debit, 0.8% credit)



# Interchange fee: What is it?

Interchange fee: fee paid by the merchant's bank to the consumer's bank if a buyer uses his payment card

Costs consumer's bank > Costs for merchant's bank.

Consumers more price sensitive than merchants.

=> Interchange fee divides costs of the consumer's bank

Interchange fee:

- ✓ Lowers the consumers' transaction fee
  - ✓ Increases the merchants' transaction fee
- } Stimulates card usage (in theory)

# Interchange fee: who sets the fee level?

Multilateral interchange fees (MIF)

1. Level MIF is determined by card scheme (global MIF) or.....
2. ... by a banking association (domestic MIF)

1 & 2: collective price agreement => antitrust implication

3. Or limited by a regulator

# EU-Interchange Fee Regulation (EU-IFR) (June 2015)

Goal: Addressing widely varying and excessive hidden interchange fees which are an obstacle to the Internal Market and a barrier to innovation

Key elements EU – IFR:

## 1. Capping interchange fees (Dec. 2015)

- Debit card: IF X-border 0.2% of trx. size
- Debit card: IF domestic 0.2% of trx. size or fixed amount < € 0.05
- Credit card: IF 0.3% of trx. size

# EU-Interchange Fee Regulation (June 2015)

Key elements EU – IFR (continued):

2. More freedom of choice for consumers and retailers (June 2016)

- E.g. co-badging, priority default scheme selection

3. More transparency on card transaction fees (Dec 2015/June 2016)

- E.g. no single blended fee, clarity on retailer fees in contracts

4. More (x-border) competition in payments market (Dec 2015/June 2016)

- E.g. no territorial restrictions in licensing, separation scheme and processing entities



# Impact MIF regulation in Spain

- Low card usage, low card acceptance
- Strong role government in interchange fee regulation
- Ministry of Industry, Tourism and Trade & Tribunal de Defensa de la Competencia
- May '99:
  - Cap MIFs debit+credit card: 2.75% (July '02) (MIFs avg. 3.25%)
- Dec '05:
  - Reduction cap MIF credit card from 1.4% in '06 to 0.35% in '09, cap MIF debit card: € 0.35

Impact (see Carbó Valverde et al. 2010) using bank level data

- Higher debit and credit card acceptance by retailers
- Higher debit and credit card usage by consumers
- Bank revenues stable: revenues issuing side went up and acquiring side stabilised

# Impact MIF regulation in Australia

- Market power credit card systems led to a less efficient/competitive cards market
- Reserve Bank of Australia and Australian Competition and Consumer Commission
- '03-'04: credit card market
  - Standard on IF-setting, removal no surcharge rule, lowering entry barrier
- '06 -'13: promotion low cost domestic debit card scheme
  - Strong reduction IFs intl. schemes from 44 to 12 dollar cents
  - Alignment IF domestic scheme with VISA/Maestro schemes, removal honour all cards rule

Impact (see Board, '07-'08, '15)

- Lower entry barriers, more price transparency, merchants surcharge creditcard payments
- Change interchange fees passed on to merchants and consumers
- Growth debit card usage exceeds growth credit card usage since reform

# Impact IF regulation in the US

- Durbin amendment giving Board of Governors mandate to regulate IF debit card trx
- Aim: promote efficiency and competition card payment market
- '11: Debit card market
  - Cap IF 21 cents + 0.05% trx value for debit card payments
  - Exemption financial institutions < USD 10 billion on assets
  - Merchants cannot be forbidden to give debit card discounts, ..  
.. may set lower bound trx value for credit card acceptance and..  
.. can choose between at least two card networks

Impact (see Hayashi '12, Kay et al. '14)

- Profit of banks fell by 4% core non-interest income
- Lower IFs passed on to merchants (lower trx fees) and consumers (higher bank fees)
- No evidence that growth in number of bank accounts/debit card trx has been affected

# Possible impact of IFR on EU cards market

International evidence suggests that in EU-Member States with high interchange fees the IFR may lead to

- lower merchant transaction fees for card payments
- higher card acceptance by merchants
- higher (domestic card) usage by consumers
- rising consumer bank fees and less generous reward programs
- debit card usage rising faster than creditcard usage => higher cost efficiency

X-country differences in card usage may narrow down => less fragmentation

# Possible impact of IFR on EU cards market

Impact IFR on X-border card usage may be limited

- Card acceptance of international debit card schemes not perfect yet

Impact IFR on X-border competition uncertain

- Lower entry barriers newcomers (e.g. harmonisation business rules)
- X-border card acquiring still limited by scheme rules?? (EC 9 July 2015 Statement of Objections to MC)

Further legislation PSD2 may also help newcomers

- New players (account information service providers and payment initiation service providers) less dependent on cooperation with incumbents to enter the market
- However, national implementation of PSD2 may lead to (unintended) fragmentation

# Concluding remarks

- EU-IFR contributes to a less fragmented EU payment card market but..
- .. for a true 'SEPA for Cards' additional steps still seem to be needed
- IFR may increase competition in payment services from newcomers and contribute to innovation
- Point of attention: national implementation EU-wide regulation

# Thank you for your attention

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