This note is submitted by the delegation of the European Union to the Competition Committee FOR DISCUSSION under Item VI at its forthcoming meeting to be held on 24-25 October 2012.
EU APPROACH TO COMPETITION AND REGULATION IN THE PAYMENTS SECTOR
-- Note by the European Union --

Introduction

1. The aim of this short paper is to provide an overview of the activities of the EU in the area of payments, both through competition enforcement and regulation, and the current review of the card, mobile and e-payments sector launched in January 2012. The paper is also intended to explain the underlying reasons behind the action taken and in particular to explain the competition analysis in the different types of cases that have been examined.

2. Payments are important and justify detailed scrutiny by competition authorities for three reasons. First, payments are estimated by the ECB to represent a total cost to society of about 1% of GDP or €130 billion per year. The ECB also estimates that revenue from payments represents about 25% of total bank revenue in the EU, so any action on the banking sector must take into consideration payments. Secondly, an effective payments market is essential for the development of the internal market in the EU. In particular, barriers to cross-border payments, which appear to limit the willingness of people to buy cross-border even over the internet, have a major impact on the whole internal market. Finally, payments are a network industry as it must be possible to make payments from one bank to any other. It is therefore essential that payment service providers ("PSPs") work together to develop and adopt necessary standards for inter-operability. However, this sort of co-operation between potential competitors can give rise to competition concerns if elements are discussed that are not strictly necessary for inter-operability.

1. Action Taken

3. Since payments were last discussed in the OECD in 2006, the European Commission ("Commission") has been particularly active in this sector. In January 2007 the Commission published its final report on the Sector Inquiry into retail banking, where payments were one of the two main issues examined. In 2007, the Commission adopted three competition decisions. The Cartes Bancaires Decision found that the pricing system organised by Cartes Bancaires, the main card scheme in France, restricted

---

2 Gertrude Tumpel-Gugerell, Member of the Executive Board of the ECB, at the conference “The future of retail payments: opportunities and challenges” Vienna, 12 May 2011.
competition by hindering the entry to the market of new card issuers. The Visa / Morgan Stanley Decision⁶ found that Visa restricted competition by refusing to allow Morgan Stanley to acquire Visa card payments. And the MasterCard Decision⁷ found that MasterCard's Multilateral Interchange Fees ("MIFs") for cross-border consumer card transactions restricted competition by raising the level of merchant service charges ("MSCs") to banks for the acceptance of card payments. All three decisions were appealed. The General Court upheld the Visa / Morgan Stanley Decision in 2011 and the MasterCard Decision in 2012. We are still awaiting the judgment in the Cartes Bancaires case. Visa did not appeal the Morgan Stanley judgment, but MasterCard has appealed the judgment to the ECJ.

4. In 2009, MasterCard offered Undertakings to reduce its cross-border consumer MIFs to 0.2% for debit cards and 0.3% for credit cards; it introduced a number of changes to its scheme rules to facilitate competition in the card payments markets; and it repealed the increases in its scheme fees to acquirers which could have had a similar effect on the market to MIFs. The Commissioner for competition at the time stated that in light of the Undertakings, she did not intend to open proceedings against MasterCard for non-compliance with the Decision. In 2009 the Commission also issued a Statement of Objections ("SO") to Visa for all the MIFs it sets in the EEA (cross-border MIFs and the MIFs for domestic transactions in eight Member States). In 2010 Visa Europe offered commitments, very much based on the MasterCard Undertakings, but the MIF reduction only covered debit transactions (reduced to 0.2%) and not credit. These commitments were made binding in December 2010⁸. In July 2012 the Commission issued Visa a supplementary SO covering its MIFs for credit card transactions, which also included the possibility that the Visa scheme rules obliging acquirers in other Member States to apply the MIF of the country of the merchant ("cross-border acquiring") to be a possible restriction of competition. In September 2011 the Commission opened proceedings against the European Payments Council ("EPC") for its work on e-payments as the Commission was concerned that it may hinder the entry of new players and new technology in the e-payments market.

5. In parallel, the European regulation of payments has changed significantly the scope for competition in these markets. The Payment Services Directive⁹ introduced the notion of Payment Institutions, which are non-banks who are regulated and able to provide payment services throughout the EEA. It also provided that merchants are allowed to offer customers rebates for different payment means if they so choose, and that they can charge surcharges for different payment means, unless the Member State decides that surcharging should be prohibited. This therefore removes the issue of surcharging from the payment scheme and makes it a public policy issue. In 2009, Regulation 924/09¹⁰ strengthened the rules on cross-border payments and covered for the first time direct debit payments. The SEPA Regulation¹¹ in 2012 provided for the removal of the national credit transfer and direct debit schemes and the transfer to the EU-wide SEPA schemes from 2014. It also prohibits per transaction MIFs for direct debit and provides strict criteria for MIFs for transactions that cannot be properly executed or have been reclaimed by a payment service provider (so-called "R- transactions").

---

⁸ Case COMP/39.398, Visa MIF, Commission Decision of 8 December 2010
6. In January 2012, the Commission published a Green Paper on card, internet and mobile payments. This is an important sector for the future in its own right as already mentioned in the introduction. It also has significant impacts on other sectors, as payments by card, internet and mobile are needed to promote the development of e-commerce and the internal market more generally. The aim of the consultation launched by the Green Paper was to see if there was a need to change the balance between regulation, self-regulation and competition enforcement in this sector. In October 2012 the Commission announced that it would bring forward proposals to regulate MIFs and review the PSD by April 2013.

2. Competition Enforcement

7. In competition enforcement in the payments sector, the Commission has given priority to action against MIFs, but it has also addressed business rules which limit competition between incumbents and exclusionary behaviour hindering market entry. This section looks at these three types of case.

2.1 MIF cases

8. In 2001 in the Visa I Decision, the Commission found that a number of the Visa scheme rules (excluding the MIF rules) did not appear to restrict competition under Article 101(1) at that time. In 2002 in the Visa II Decision, the Commission found that the Visa cross-border MIFs were a restriction of competition by effect but exempted the MIFs provided they were reduced to 0.70% for credit transactions and €0.28 per debit transaction until the end of 2007. In 2007 as noted above the Commission found that the MasterCard MIFs restricted competition and that MasterCard had not demonstrated that they were covered by the exception in Article 101(3). The 2009 Visa SO and the 2012 Visa supplementary SO express the preliminary concern that Visa's MIFs restrict competition by object and by effect and Visa has not demonstrated that they fall within Article 101(3).

9. The General Court judgment in the MasterCard case broadly supported the framework of assessment under the competition rules used by the Commission in its MIF cases. The judgment addressed in particular the issues of: association of undertakings, MIFs as not objectively necessary, restriction of competition by effect, and Article 101(3). The Commission's analysis of MIFs under competition rules can be briefly summarised along the lines below.

- MIFs constitute a decision of an association of undertakings (in this case the banks that use the MasterCard system) under EU competition law, even if the corporate form has changed: in 2006 MasterCard became a publicly listed company. When qualifying MasterCard as an association of undertakings after its incorporation as a separate company, the Commission took into account that: (a) the banks continued to exercise control over key elements of the scheme (although not the level of the cross-border MIF itself), (b) the banks and MasterCard continued to have a commonality of interests in having a MIF and (c) competition rules cannot be evaded simply on account of form.

- The relevant market identified by the Commission is the acquiring market.

- MIFs are not objectively necessary for the operation of a four party payment scheme. There are examples of four party payment schemes operating without a MIF. It is also perfectly conceivable that banks operate within a payment system with at par settlement, if necessary, with a less restrictive default, such as the prohibition of ex post pricing. In Australia a significant reduction in MIF levels had not led to a decrease in card use. And in general banks save costs from card issuing (eg the use of debit cards reduces the need for cash handling by banks) and receive additional revenue from card issuing (eg interest on credit card balances). It is therefore unlikely that they would stop issuing cards if MIFs did not exist.
• The competition analysis therefore focuses on MIFs alone and not on the card scheme as a whole. Any other alleged benefits of MIFs are not examined under Article 101(1), which determines whether the MIFs are a restriction of competition, but under Article 101(3) which provides an exception for restrictions provided they meet the criteria.

• MIFs are a restriction of competition by object and/or effect. MIFs restrict competition by object as they reduce the level of uncertainty on the market for acquiring banks and they have an impact on MSCs. They also restrict competition by effect between acquiring banks by artificially inflating the basis on which these banks set their charges to merchants and effectively determine a floor for the merchant service charge below which merchants are unable to negotiate a price. The restrictive effect in the acquiring markets is further reinforced by the effect of the MIFs on the network and issuing markets as well as by other network rules and practices, namely the Honour All Cards Rule (the 'HACR'), the No Discrimination Rule (the 'NDR'), blending, and application of different MIFs to cross-border as opposed to domestic acquirers.

• In principle it is not excluded that MIFs may be justified under Article 101(3) but the burden of proof is on schemes. The main argument\(^\text{12}\) that the schemes have brought forward, for example in the MasterCard case, has been based on the efficiencies created by encouraging the issuing and use of cards to match greater demand from merchants to receive card payments. This argument is based on the presumption that merchants are unable (for legal or practical reasons) to steer customers to favoured payment means. The alleged efficiencies and the indispensability of MIFs to achieve these efficiencies continue to be challenged by the Commission. But in any case under Article 101(3) the MIFs must be set at a level that allows merchants overall to receive some of the benefits of these alleged efficiencies.

10. After the 2007 Decision concerning MasterCard's MIFs and following discussions with the Commission, the Merchant Indifference Test ("MIT") formed the basis for the MasterCard Undertakings of 2009 and the Visa Commitment Decision of 2010. Under the MIT, the cost incurred by the merchant when a customer uses its card should not exceed the cost for receiving a cash payment. This requires detailed estimates for the costs to merchants of handling cash and card payments, of the average size of these payments and the fees charged to merchants for both cash and card handling by third parties (principally banks but also others such as cash handling companies). Finally, it is also necessary to estimate the average level of the acquirer margin and scheme fees to estimate the maximum level of the MIF\(^\text{13}\).

11. Economists have argued that under certain conditions the MIT gives rise to an efficient outcome. However, the key point under a competition analysis is that the MIT is a way to measure the benefits to merchants of card acceptance compared to cash acceptance and this allows the calculation of a MIF level that cannot be exceeded under Article 101(3). This is not to say that any MIF that meets the MIT is necessarily justified under Article 101(3). It is also necessary to confirm that the other conditions of Article 101(3) are met. The Commission has therefore identified a number of limits of the MIT:

• If merchants can steer customers then there is no justification for a MIF which in effect leads to steering via the banks. This is because the efficiencies that are allegedly created by the MIF can be generated in a less restrictive manner by the direct surcharging of merchants. For example, when receiving payments by direct debits merchants are normally in long-term relations with customers and so can steer them directly (eg €10 discount if you sign a mandate for direct debit).

\(^{12}\) Other arguments that have been put forward include: the efficient allocation of costs (see the discussion on reject direct debit transactions in paragraph 16; and services of general interest such as "the war on cash".

\(^{13}\) These calculations are explained in more detail in the Commission Decision of 8 December 2010 on Visa Europe's commitments, paragraphs 57-68.
2.2. Business Rules and Competition

12. In addition to addressing the level of MIFs and exclusionary behaviour, the Commission has examined the business rules of card schemes. In the MasterCard Decision of 2007 the Commission found that some of MasterCard's business rules reinforced the effect of the MIFs on competition. In response, MasterCard included a number of changes to its business rules in its Undertakings of 2009. Similarly, Visa's commitments of 2010 modified its business rules. In the supplementary SO sent to Visa in 2012, the Commission expressed the preliminary concern that Visa's cross-border acquiring rules were an infringement in their own right of the competition rules. The cross-border acquiring rules require all acquirers, even if based in other countries, to apply the domestic MIF of the country of the merchant. The concern is that these rules have the object and effect of restricting competition by hindering cross-border acquiring leading to market sharing. Under the MasterCard Undertakings and Visa Commitments, the card schemes modified their business rules to promote competition and transparency:

- Honour All Cards Rule (HACR) and unbundling. The card schemes would only apply the HACR within a brand and not across brands. For example, a merchant could accept Maestro cards but not MasterCard cards. Merchants could also have separate acquirers for different brands of card if they wanted.

- Non-discrimination. Merchants would not be prohibited from steering their customers to different payment means. This issue was addressed under the Payment Services Directive for surcharging and rebating (see below) and so there was no justification for the schemes to impose their own rules.

- Unblending and publication. The acquiring banks would offer unblended prices (e.g. MIF+ pricing) by default to merchants, so merchants would benefit from the use of cheaper cards by their customers. The card schemes would publish all their MIF rates.

- Commercial cards: The schemes would ensure that commercial cards issued in the EEA are visibly and electronically identifiable at POS terminals if the terminal has the necessary capability.

2.3 Exclusionary cases

13. The third category of behaviour that has been subject of investigation under the EU competition rules has been exclusionary behaviour by the banks. Examples include the Visa / Morgan Stanley Decision of 2007, the Cartes Bancaires Decision of 2007 and the proceedings against the EPC opened in 2011.\(^\text{14}\)

- In Visa / Morgan Stanley, the Commission found that Visa excluded Morgan Stanley from the acquiring market as it refused to let it join the Visa scheme because Morgan Stanley operated the Discovery card in the US. This decision was upheld by the General Court in 2011 and Visa did not appeal.

\(^\text{14}\) For Visa / Morgan Stanley and Cartes Bancaires see Supra notes 4 and 5. For the EPC see: [http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39876](http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39876)
In Cartes Bancaires, concerning the domestic French card scheme, the Commission found that changes to its pricing system hindered card issuing by new issuers. This decision was also appealed to the General Court and we are awaiting the judgment.

In the EPC e-payments case, the Commission opened proceedings in September 2011. At the time, the Commission announced that the investigation focused on the standardisation process for payments over the internet ('e-payments') due to concerns about the alleged exclusion of new entrants and payment providers who are not controlled by a bank. Joaquín Almunia, Commissioner, Vice President in charge of Competition Policy, said: "Use of the internet is increasing rapidly making the need for secure and efficient online payment solutions in the whole Single Euro Payments Area all the more pressing. I therefore welcome the work of the European Payments Council to develop standards in this area. In principle, standards promote interoperability and competition, but we need to ensure that the standardisation process does not unnecessarily restrict opportunities for non-participants." This investigation is continuing, but the EPC has announced that it has decided to abandon the development of the e-payment framework and any standardisation initiatives that would have the same object or effect.

14. In the two cases where the Commission has adopted a decision, the basic structure of the concerns is similar.

- The banks act together through an association of undertakings (as in the MIF cases).
- The alleged restriction is not ancillary to the main operation because it is not objectively necessary for the main payment system.
- Therefore it is necessary to carry out the competition analysis on the exclusionary behaviour alone and not on the whole payment scheme. As the alleged restriction does not seem to be ancillary, any justifications for the exclusionary behaviour (eg security) must be examined under Article 101(3).
- In principle this behaviour may be justifiable under Article 101(3), but the burden of proof is on the parties. In practice Visa did not argue for an exemption in the Morgan Stanley case; and in the Cartes Bancaires case the Commission found that the argument put forward of limiting free riding was not justified.

3. SEPA and the Regulation of Payments

15. In parallel with the competition enforcement outlined above, the regulation of payments has continued at EU level. When the euro was introduced the EU adopted a Regulation on cross-border payments in euros according to which the fee charged by banks to their customers for cross-border payments cannot exceed the fee for the equivalent domestic transaction. One of the principal aims of this provision was to ensure that the banks would not benefit from continued segmentation of the payments market and so remove potential barriers to the creation of new EU-wide payments infrastructure. In 2002 the European banks, working through the EPC, launched a self-regulatory initiative called the Single Euro Payment Area ("SEPA"). The aim is to ensure that cross-border payments with euros throughout the EU are as easy and efficient as national payments. It is intended to cover all the main means of payment: credit transfer, direct debit, and payment cards. SEPA can be seen as the natural complement to the introduction of the euro. The EPC has created EU-wide credit transfer and direct debit schemes that will replace the old

---

national systems. For card payments, the EPC does not intend to create a new scheme but has published the SEPA Cards Framework which sets out criteria for card schemes to be considered compatible with SEPA.

16. In addition to the work by the EPC, it was necessary to harmonise national payments legislation.

- In 2007 the EU adopted the Payment Services Directive ("PSD")\(^\text{16}\) which harmonises the key elements of the payments systems in the EU. From the competition point of view the key provisions were on payment institutions and steering rules. The PSD introduced the concept of payment institutions, which are not banks as they cannot hold funds except for transaction purposes, but which are active in payments. As a result a number of new companies including telecoms companies have entered the payments markets in the EU. This provision therefore clarifies and enlarges the scope for non-banks to operate in the payments market. On rebating the PSD provides that all merchants shall be allowed to rebate different payment means if they so choose. Merchants are also able to surcharge unless the Member State decides not to allow surcharging. About half the Member States decided to allow merchants to surcharge and about half decided not to allow them to. This provision in principle therefore means that it is the public authorities which decide whether surcharging can take place and no longer the payment schemes.

- In 2009, a revised Regulation on cross-border payments was adopted. The main change from a competition point of view compared to the 2002 Regulation was that the MIFs for direct debit were regulated. MIFs for domestic direct debit transactions could continue at or below their existing level until November 2012 in the six Member States which had MIFs. For cross-border direct debit transactions a default MIF of 8.8 cents was applicable until 2012.

- In 2012, the SEPA Regulation\(^\text{17}\) was adopted. This will oblige all the old national systems for credit transfer and direct debit to be phased out by 2014 and the transactions moved to the new EU-wide schemes created under SEPA. The Regulation also clarifies that there should be no per transaction MIFs (that is MIFs that are charged for each transaction) for direct debit transactions. For cross-border transactions this applies from November 2012 and for domestic transactions in the six Member States with MIFs from 2017. This is intended to provide clarity to the market in line with the competition rules\(^\text{18}\). However, MIFs are allowed under clear conditions for direct debit transactions which cannot be properly executed or have been reclaimed by a payment service provider (called R-transactions). Normally the costs of direct debits are very low, but if they are not properly executed costs can be significant as the parties and the banks need to be informed and to examine the reasons for the failure. An appropriate collection of MIFs for R-transactions can help to ensure that the costs for the failure of the transaction are imposed on the party that is responsible. This should therefore encourage all parties to prevent failures and so create efficiencies. It should be noted that this justification for a MIF in line with Article 101(3) is one of the few that has been viewed positively by competition authorities which does not rely on the balancing argument\(^\text{19}\).

---

\(^{16}\) PSD, *Supra*, note 8.

\(^{17}\) SEPA Regulation, *Supra*, note 10.

\(^{18}\) See paragraph 9 which explains that MIFs for direct debits do not appear to be justified under Article 101(3) as merchants and payers tend to be in long-term contractual relationships and so merchants can incentivise directly the use of direct debit if they choose (for example by offering customers an annual discount if they sign a direct debit mandate).

\(^{19}\) See paragraph 9.
4. The Green Paper and Next Steps

17. The Commission published the Green Paper because it identified efficient and competitive payments as a key driver for the development of the internal market in the EU and because of the rapid advances in technology, particularly online and mobile payments, which is likely to change the functioning of the market. The Green Paper assesses the current landscape of card, internet and mobile payments in Europe. It also identifies the gaps between the current situation and the vision of a fully integrated payments market and the barriers which have created these gaps. The objective of the Green Paper was to launch a broad-scale consultation process with stakeholders on this analysis and to help identify the right way to improve market integration. About 300 replies were received and published with a summary in June.

18. In the Green Paper the Commission sets out its vision and objectives for the payments market. This is that:

"there should be no distinction between cross-border and domestic payments. On the basis of the standards and rulebooks provided by SEPA, this distinction should also become obsolete for non-euro payments within the EU. This would result in a true digital Single Market at EU level. Full integration would mean:

- Consumers use a single bank account for all payment transactions, even if they live outside their country of origin or travel frequently throughout the EU. By accelerating innovation, payments become more convenient and adjusted to the specific circumstances of the purchasing transaction (online v offline, micro-v large-value payments, etc.).

- Businesses and public administrations are able to simplify and streamline their payment processes and centralise financial operations across the EU. This has significant potential to generate savings. Furthermore, common open standards and faster settlement of payment transactions improve cash-flow.

- Merchants are also able to benefit from cheap, efficient and secure electronic payment solutions. Increased competition makes alternatives to handling cash more attractive. In turn, this also makes moving into e-commerce more compelling and leads to improved customer experiences when making payments.

- Payment service providers (PSPs), i.e. banks and non-bank PSPs, are able to benefit from economies of scale through standardising payment instruments, thereby achieving cost savings after the initial investment. It opens access to new markets, both for increasing the revenue base for existing payment instruments and for launching innovations on a broader scale.

- Technology providers, such as software vendors, processors and IT consultants, can base their development work and solutions on pan-European instruments, facilitating innovation across the EU Member States.

For this vision to become reality for card, e- and m-payments, a number of additional issues need to be addressed, such as security, freedom of choice, unhindered technical and business innovation, standardisation of the various components and interoperability."

19. The Green Paper then looks at six different issues to achieve this objective. The two most controversial issues, which are particularly important from a competition point of view, are regulation of

---

20 Commission Green Paper, Supra, note 2
21 Available at: [http://ec.europa.eu/internal_market/payments/cim/index_en.htm](http://ec.europa.eu/internal_market/payments/cim/index_en.htm)
MIFs and related measures and access to information on the availability of funds on bank accounts. As regards MIFs, the issue is whether the wide variation in MIFs across the EU can be justified or whether there is a need to regulate them. A related question is whether the barriers to cross-border acquiring, and in particular the obligation to apply the MIF of the country of the transaction, are in line with EU internal market and competition rules. Transparency and business rules can be seen as flanking measures to the issue of MIFs. Key issues here are the possibility for merchants, if they choose, to offer rebates or ask for surcharges to their customers depending on the means of payment they use.

20. Standards is a highly technical area but essential if a fully functioning internal market in payments is to develop. The EPC in particular, but other bodies as well, are devoting considerable time to developing and rolling out such standards. But the rate of progress is very slow in some areas. Related to standards is the question of the conditions under which third parties should have access to information on the availability of funds in bank accounts. This is very closely linked to the Commission's competition case against the EPC opened in September 2011. Ideally, clear standards and conditions (particularly concerning security) should be established by the authorities or the market, and all payment means that meet these conditions should be allowed on the market. This aim was clearly stated by Mr Barnier, Commissioner responsible for the internal market, at the Hearing on the Green Paper.

21. The European Parliament is preparing an Opinion on the Green Paper which should be adopted in November 2012. The draft Opinion, which has been adopted in Committee but not by the Parliament as a whole, shows a consensus calling for an impact assessment on the possibility to regulate MIFs and on the need for further harmonisation of the rules on surcharging. In October 2012 the Commission announced that it would bring forward proposals to modify the PSD and to regulate MIFs by April 2013. Work is now beginning on impact assessments but it is too soon to say what the conclusions will be or what form the legislative proposals will take.

5. Conclusion

22. This short paper makes it clear that payments will continue to be a priority for the Commission in the coming years. Harmonisation of regulation should help to break down the barriers to cross-border payments and improve the scope for competition and develop opportunities for both payment providers and consumers. The Commission has announced that this will include a proposal on MIFs which will be controversial. But it is hard to see how else the segmentation of the national payments markets can be addressed, given the reluctance of the major payment schemes to adapt their business models (and in particular the MIFs they apply) in a pro-active manner to the competition rules. Competition enforcement appears likely to remain necessary to address the behaviour of market players that is not fully regulated. Self-regulation, particularly in the area of standards is going to be essential as well, and a key question will be how to ensure that the incentives of all involved will encourage rapid development and roll-out of these standards. An appropriate mix of these instruments should result in payments markets that are better equipped to meet the demands of their users and create integrated markets on the basis of current and future technology.

---

22  See paragraphs 13 and 14.

23  Speech by M. Barnier at the Hearing on 4 May 2012: "D'une manière générale, il ne devrait y avoir aucun obstacle injustifié à l'accès au marché de nouveaux prestataires, dès lors que la sécurité des paiements est garantie." ("In general, there should be no unjustified obstacles to access to the markets by new entrants, provided that the security of the payments is guaranteed").

24  The draft Opinion also calls for a ban on MIFs altogether, but it is unclear to what extent this will be supported by the Parliament as a whole.