Clarifying the application of the competition rules to card payment systems: the Commission’s exemption decision on the Multilateral Interchange Fees of Visa International

Stephen RYAN, Directorate-General Competition, unit D-1

On 24 July 2002 the Commission adopted an exemption decision in its case concerning certain ‘multilateral interchange fees’ of Visa International, thus clarifying the analysis, under article 81 of the Treaty, of an important aspect of most common card payment systems, but one which is normally invisible to consumers.

A multilateral interchange fee, or ‘MIF’, is a payment made between the two banks involved in a payment operation with a payment card (the cardholder’s bank, or ‘issuing’ bank, and the retailer’s bank, or ‘acquiring’ bank) which is determined multilaterally by the banks within the payment system.

In the Visa system there is a rule stating that in the absence of a bilateral agreement between two banks on an interchange fee, a default MIF must be paid by the retailer’s bank to the cardholder’s bank at a level laid down in the Visa International payment card rules, which have been notified to the Commission. There are different MIF levels for different types of Visa cards (e.g. consumer cards and corporate cards) and for different types of transactions (e.g. paper based or electronic transactions). Different MIF levels usually also apply, depending on whether the payment is domestic (within a country), ‘intra-regional’ (that is, cross-border but within the same Visa ‘region’ (1)), or ‘inter-regional’ (that is, between two Visa ‘regions’, such as a payment made in Europe by a US Visa cardholder). The levels of these fees are laid down by the relevant Visa board (national, ‘regional’ or worldwide) and effectively constitute agreements between the member banks in the Visa system.

Figure 1 illustrates the functioning of a MIF in a typical card payment operation in a system such as that of Visa, with hypothetical values inserted. For a card payment for a nominal value of € 100, if the MIF is defined as 1% of the value of the operation, then the cardholder’s bank will deduct € 1 from the amount it reimburses to the retailer’s bank, thus in this example only paying € 99 to the retailer’s bank. The retailer’s bank then deducts a further amount to cover its own costs and profit margin; in this hypothetical example, that amount is € 0.50, giving an amount of € 98.50 actually received by the retailer for a purchase with a face value of € 100.

It can thus be seen that a MIF is effectively a device for shifting the burden of the costs of a card payment system between the two different users of the system, namely retailers and cardholders. These two users, both of whom are essential to enable a card payment to take place, have somewhat conflicting interests, in as much as each would prefer the costs of the system to be borne by the other. The MIF in the Visa system, as in the majority of card systems, shifts a significant proportion of the costs of the system onto retailers.

The Commission’s exemption decision of 24 July 2002 only applies to cross-border payment transactions with Visa consumer cards (credit cards, deferred debit cards and debit cards) at retailer outlets within the European Economic Area, which represent about 10% of all Visa card transactions in the EEA. The decision does not apply to MIFs for domestic Visa payments within Member States, nor to MIFs for corporate Visa cards (that is, cards used by employees for business expenditure).

The exemption was only granted following major changes by Visa to the MIFs in question, which were made after the Commission issued a Statement of Objections in September 2000 on the former, unmodified, system. In that system the Visa Board had freedom to set the MIF at any level it wished, and the various MIF levels were treated by Visa as business secrets.

The reforms by Visa to the MIFs in question involve three main elements:

- First, Visa will progressively reduce the level of its MIFs for the different types of consumer cards (that is credit, deferred debit and direct debit cards). As concerns Visa deferred debit card and credit card payments, the MIF will be reduced to a weighted average of 0.7% of transaction value in 2007. For debit card transactions Visa will introduce immediately a flat-rate MIF

(1) The Visa ‘EU Region’ in fact includes 26 countries.
of €0.28 for debit card transactions. The levels of MIFs prior to these reductions cannot be revealed as they are considered business secrets by Visa; however, Visa estimates that the effect of the modifications (debit, deferred debit and credit cards combined) on interchange revenues for issuing banks from cross-border transactions will be a reduction of more than 20% over the five year period 2002-2007.

- Secondly, the MIFs will be capped at the level of costs for three specific services provided by issuing banks, which in the Commission’s view correspond to services provided to those retailers who ultimately pay the cross-border MIF. These services are: transaction processing, payment guarantee (1) and free funding period (2). The costs of these services will be determined by a cost study, to be carried out by Visa and audited by an independent accountant. This cap will apply independently of the reductions in the level of the MIF offered by Visa (that is, if the cost cap is below 0.7%, then the MIF will have to be below 0.7%).

- Furthermore, Visa will allow member banks to reveal information about the MIF levels and the relative percentage of the three cost categories (currently considered business secrets) to retailers at their request. Retailers are to be made aware of this possibility.

These reforms by Visa were described in a notice in the Official Journal in August 2001 (3) and following comments from third parties, they were further amended by Visa on certain details. For example, Visa undertook to introduce a new MIF for transactions by telephone and mail order, where no payment guarantee against fraud is provided. This MIF will reflect the specific costs pertaining to such payments.

Visa has undertaken to implement all of the changes contained in its proposal. However, for technical reasons, it will only be able to introduce the new MIF rate for mail order and telephone payments in April 2003.

A complaint against inter alia the MIFs in the Visa International payment card rules was lodged with the Commission in 1997 by EuroCommerce, a European organisation of retailers. EuroCommerce regards MIFs as a ‘tax on retailers’, considering that there are no services provided by issuing banks to the benefit of retailers, and therefore that the amount of interchange payable by acquiring banks to issuing banks should be zero.

In its decision the Commission rejects those arguments, concluding that, although the amended Visa MIF involves a price agreement between the Visa banks within the meaning of Article 81(1) of the EC Treaty, it meets the conditions for an exemption. In particular, the Commission accepts that some kind of default agreement on the terms of exchange between issuing banks and acquiring banks is necessary in practice in a large-scale international payment system, as without it bilateral negotiations between many thousands of banks would be highly inefficient and increase costs significantly. Nevertheless, a MIF has in practice the effect of dividing the costs of a payment system between the two different users — cardholders and retailers — and for that reason only a MIF set in a manner which is equitable vis-à-vis both of these can qualify for an exemption. The Commission considers the revised MIF of Visa to meet this condition, in particular as it only includes costs which Visa has satisfied the Commission to be to the benefit of those retailers by whom this MIF is ultimately paid — namely those retailers with whom cross-border payments with Visa cards are carried out — in the light of the specific circumstances pertaining to cross-border payments.

The EuroCommerce complaint is directed against all MIFs in all card systems within Europe, both for cross-border and domestic payments. Certain MIFs of other card systems (in particular the cross-border MIFs in the MasterCard system in Europe) have been notified to the Commission. The Commission will carry out a separate assessment of those other MIFs, and also of cross-border MIFs for corporate cards in the Visa system, which are not covered by the present decision. For domestic MIFs, the Commission will first of all have to consider whether it or national competition authorities are competent (that is, whether or not there is

(1) The term ‘payment guarantee’ is used to describe the promise of the issuing bank to honour payments to the acquiring bank, even those which turn out to be inter alia fraudulent or for which the cardholder ultimately defaults, on condition that the retailer undertakes all the security checks necessary to enable the issuing bank to promise payment. This promise is then extended by acquiring banks on to retailers, and effectively constitutes a kind of payment insurance for retailers.

(2) The ‘free funding period’ corresponds to the cost of any time difference between payment by the cardholders’ bank to the acquirer and the time when either payment must be made by the cardholder, or the balance of the credit card bill rolled over into the extended credit facility, to which a rate of interest is applied (that is, it does not include any costs arising from the granting of extended credit to cardholders). This ‘free funding period’ to cardholders is considered by the Commission to benefit retailers in a cross-border context by stimulating sales and increasing turnover.

an appreciable effect on trade between Member States or not).

MIFs are currently the subject of investigation by various competition and regulatory authorities, both inside and outside the European Union. In particular:

- on 27 November 2001 the Bank of Italy adopted a decision exempting the MIF in a domestic Italian debit card payment scheme, PagoBancomat, after the level of the MIF was reduced to reflect relevant costs;

- on 25 September 2001 the UK Office of Fair Trading issued a statement indicating that it provisionally considered that the domestic MIF within the MasterCard system currently does not fulfil the conditions for exemption under the UK Competition Act. No final decision has been adopted in that case;

- on 27 August 2002 the Reserve Bank of Australia adopted reforms to credit card schemes in Australia. As concerns MIFs, the RBA, like the Commission, imposed the use of an objective, transparent and cost-based benchmark for determining interchange fees (1).

However, the Commission’s case is different from the investigation by the US Department of Justice against MasterCard and Visa, which led to a US District Court judgement on 9 October 2001. That investigation did not concern interchange fees in any way, but rather rules of Visa and MasterCard prohibiting member banks from issuing cards of competing brands, and the ‘duality’ issue, meaning the effects on competition of the cross-membership of banks in both systems.

The Commission’s decision of 24 July 2002 confirms previous caselaw and Communications to the effect that MIFs constitute a restriction of competition under article 81 of the Treaty (2). However, it provides much greater detail than previous caselaw on the criteria for evaluating whether MIFs can benefit from an exemption or not, in particular, the principle that in order to be exempted, a MIF must be reasonable and equitable as between the two users of a card system, retailers and cardholders. However, it should be emphasised that the assessment of the exemptability of the reformed Visa MIF was carried out by the Commission in the context of cross-border payments within the Visa payment scheme only. An assessment of MIFs for domestic payments, or in different payment systems than Visa, would have to be made in the light of the different market conditions applicable to such cases. In particular, the question of what constitutes a reasonable and equitable MIF might be answered differently in different circumstances.

**Figure 1**

Illustration of a typical Visa card payment transaction, with a hypothetical MIF of 1% of transaction value, and a hypothetical retailer fee of €1.50 per transaction

---

(1) For more details, see: http://www.rba.gov.au/PaymentsSystem/PaymentsPolicy/CreditCardSchemes/FinalReforms/index.html