

The European Commission's Decision on Visa's Interchange Fees

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The European Commission—acting as a European competition authority—cleared Visa's European cross-border interchange fees on July 24, 2002, accepting undertakings given by Visa.

Let me begin by making two preliminary remarks. In making a ruling based on competition law, the Commission did not “regulate” Visa's interchange fees. Its role as an antitrust agency was to investigate alleged competition problems. Having done so, the Commission accepted undertakings devised and offered by Visa because it considered those undertakings sufficient to remove the competition concern. The initiative to find a remedy remained with the market.

This also means that the solution found in the Visa case was not the only possible outcome. As a number of competition authorities within the European Union (EU) are currently investigating interchange fees and related issues, there is a need to ensure that the methodologies applied are coherent. But the facts and their assessment may differ from case to case and from market to market, and future decisions will have to take into account evolving market conditions and remain open to new arguments.

I will limit myself to three points in summarizing the Commission's findings:

- The competition concern identified.
- The possible efficiency justifications for interchange fees.
- The remedy proposed by Visa and accepted by the Commission.

The Commission's case was based on a two-fold concern. On the one hand, the Commission qualified Visa's European cross-border interchange fees¹ as a collective and confidential agreement between competitors (Visa's member banks) that restricted the freedom of individual banks to decide their own pricing policies. The agreement therefore distorted competition in the markets for card issuing and merchant acquiring. In particular, inter-

change fees were found to set a de facto floor for the fees charged by banks to merchants. Because Visa's interchange fees were a business secret, those who paid the interchange fee in the end—the merchants—could not know its level and therefore could not effectively negotiate the merchant fee.

On the other hand, the Commission found that there were upward pressures on the level of the interchange fee, in particular, the fact that most banks were members of both the Visa and the competing MasterCard systems and therefore were likely to issue whichever of the two brands of card had the higher interchange level and brought them the most revenue. The possibility of merchants ceasing to accept Visa if the interchange fee was too high was not sufficiently strong enough to constrain this upward pressure, as long as the interchange fee did not reach exceedingly high levels. This was due to a "lock-in" effect. Once a merchant accepts Visa cards and is then faced with an increase in the interchange fees, the merchant's recovery from this cost increase through a small price increase for all goods sold will normally lead to a smaller fall in turnover than ceasing to accept Visa cards. There was thus a possibility that the interchange fee was set at a revenue-maximizing, output-limiting level, rather than at the level maximizing the output of the Visa system.

At the same time, the Commission did accept possible efficiency justifications for interchange fees. This did not mean that the Commission considered interchange fees to be inherent in card payment systems or indispensable for their operation—indeed there have been for many years successful debit card systems in Europe that have achieved a high degree of market penetration without interchange fees or using different mechanisms. But the Commission accepted that if a network opted to adopt interchange fees, it could, in principle (provided it met certain conditions as detailed below), quote certain efficiencies to justify this choice under competition law.

Two possible efficiencies should be mentioned. The Commission accepted that a collective, multilateral agreement between banks to set interchange fees may lead to efficiency gains, compared to multiple bilateral agreements, for instance, due to lower negotiation and transaction costs. And the Commission recognized that in a payment card system characterized by network externalities, interchange fees can help optimize the utility of the network to its users (merchants and cardholders). Given the difficulties of measuring the average marginal utility of a Visa card payment to each category of user, some acceptable proxy for this had to be found.

European competition law (article 81 of the EU Treaty) provides for a two-step analysis. Once a competition authority has established that an

agreement appreciably restricts competition, grounds for a possible exemption based on efficiencies and consumer benefits are examined at a second stage. The law allows balancing the efficiencies and consumer benefits that an agreement between banks may generate against the restrictions to competition that such an agreement may cause. If the former outweigh the latter, then the agreement may be cleared. That exemption clause of article 81 requires that a “fair share of the benefit” (the efficiency gain) be passed on to consumers (the customers in the relevant market). When examining such a justification for a restrictive agreement under the terms of the exemption clause, the burden of proof shifts to the companies involved. The Commission’s investigation had shown that it was difficult to see how market forces alone could remove the competition concerns identified, so a remedy was needed. Visa proposed a remedy which the Commission accepted for a period of time ending in 2007.

Visa’s undertaking introduced an objective benchmark for its interchange fee. The benchmark was to be set at the level of the cost of supplying Visa payment services and would not exceed the cost of the services which issuing banks provide wholly or partly to the benefit of merchants. The benchmark includes three cost categories: (1) the cost of processing transactions, (2) the cost of providing the payment guarantee, and (3) the cost of the free-funding period. Visa also committed to cap its interchange fees at an absolute amount for a limited period of time.² The cap does not entirely prevent Visa from setting differentiated interchange rates for different types of card payment (for example, paper-based or electronic) to provide an incentive for certain ways of using a card, as long as the weighted average cost does not exceed the benchmark. Finally, Visa committed to giving merchants more information about its interchange fees.

WHAT IS THE OUTCOME OF THAT DECISION TODAY?

The Commission’s decision has influenced other competition authorities within the European Union. Other authorities have adopted the cost-based approach. But different outcomes remain possible. Different market conditions, with interchange fees set separately in domestic markets, mean that the analysis of facts and the conclusions on possible solutions need not necessarily lead to identical results.

The Commission has not become involved in determining the cost benchmark for Visa’s interchange fees; it limits itself to monitoring whether Visa’s cost calculations are acceptable. Even so, it can be queried whether that level of ongoing monitoring does not go beyond what an antitrust agency can provide.

It has also become clear that addressing interchange fees may not be the only way—and may not be sufficient—to ensure competition in card payment markets. Merchant acquiring in Europe is still largely restricted to domestic markets, and some of these markets may not be sufficiently competitive. Other network rules may dampen competition. Visa and MasterCard have recently relaxed some of these rules.³

ENDNOTES

¹The set of fees covered by the Commission's decision was Visa's EU intraregional interchange reimbursement fee scheme for consumer cards, applicable to cross-border Visa consumer card transactions at merchant outlets in the then-15 EU member states, Iceland, Liechtenstein, and Norway.

²The weighted average interchange fee for cross-border debit card payments will not exceed 0.28 until 2007; the weighted average interchange fee for credit and deferred debit card payments will be reduced to 0.7 percent by 2007.

³Visa and MasterCard recently withdrew issuing-before-acquiring requirements for their members.