DECISION ON DETERMINING THE INTERCHANGE FEE IN VISA AND MASTERCARD SYSTEMS

The proceedings initiated upon a complaint of the Polish Organisation of Commerce and Distribution, were conducted under Polish and EC law against 24 entities: 20 banks, Visa Europe, Visa International, MasterCard Europe and the Polish Bank Association. Banks were accused of restricting competition in the market for acquiring services by means of the joint setting of interchange fee rates, separately in Visa and MasterCard systems. Together with Visa Europe, Visa International, MasterCard Europe and the Polish Bank Association they were also charged with coordinating activities in order to restrict access to the relevant market.

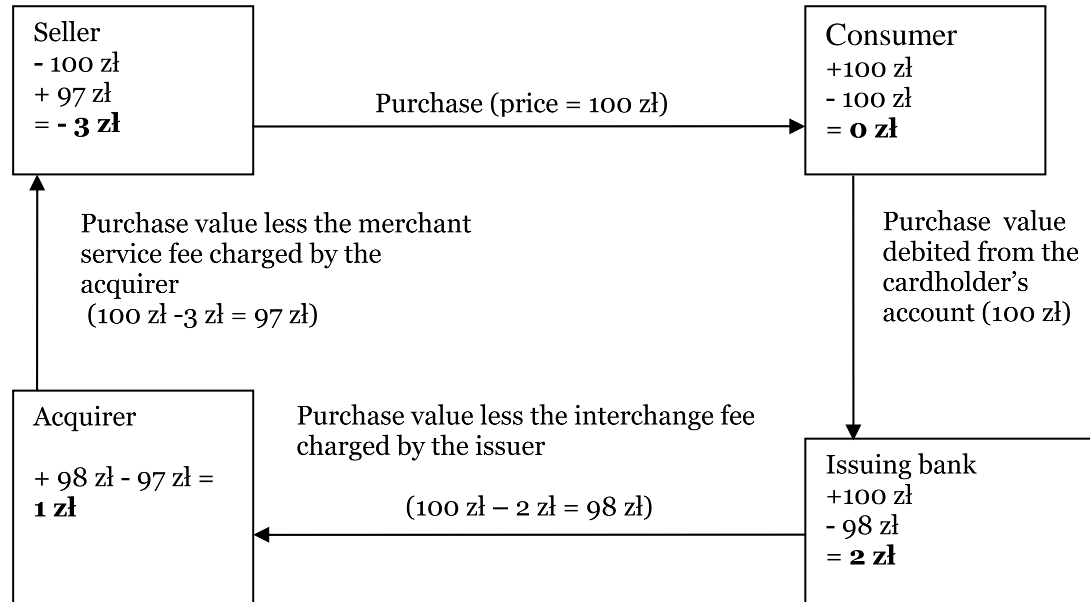
The President of the Office found that banks participating in the proceedings did restrict competition by means of the joint setting of the interchange fee rates. A charge of coordinating activities in order to restrict market access has not been confirmed by collected evidence.

Agreements on the multilateral setting of the interchange fee (IF) in Visa and MasterCard systems

The President of the Office found that 20 banks participating in the agreements on the multilateral setting of the interchange fee, separately in Visa and MasterCard systems, violated the prohibition of agreements restricting competition provided for in the Polish legislation (article 5 section 1 of the law on competition and consumer protection) and in the EC legislation (article 81(1) of the EC Treaty).

The banks - parties to the proceedings – participate in Visa and/or MasterCard payment card systems (most of them issue cards in both systems). Meeting in the fora grouping Polish members of Visa and MasterCard, the banks jointly set, separately for Visa and MasterCard systems, rates of the domestic interchange fee. The interchange fee is charged by the card-issuing bank on every transaction paid with its card. It is indirectly paid by the retailer accepting the card (merchant).

The scheme below presents an example of a card transaction under simplifying assumption that the interchange fee rate amounts to 2 per cent of the transaction value, while the fee paid by the merchant to the acquirer (i.e. an entity that processes card transactions) is 3 per cent (actual levels are different):



The interchange fee jointly set by the banks constitutes the major part (sometimes over 90 per cent) of merchant service charge (MSC), which is a fee paid by merchants to acquirers. Since acquirers cannot offer MSC lower than the IF rate, the latter fixes a *de facto* floor for the former. Acquirers are thus unable to provide merchants with fees based on their real costs of transaction processing, since every card transaction is „taxed" by card-issuing banks.

It leads to an artificial growth of merchants' costs, which translates into higher prices in shops. Since due to the rules applicable in one of the systems and practical reasons, prices in shops are the same for customers paying with cards and those making their purchases with cash, higher costs related to card acceptance are shifted to all consumers, even those who pay with cash. Thus in fact the latter subsidise customers who pay with cards.

A potential consequence of the agreement on the interchange fee rates is also a hampered development of new payment systems, which require participation of banks (e.g. as issuers) for their correct functioning. The banks may not be willing to participate in a system that will not bring them profits comparable with the profit made on the collection of the interchange fee on every transaction made with a card they issue. Consequently, even a more effective, lower cost payment system may be hampered in its development, with detriment to innovation and consumers.

The parties to the proceedings claimed that even if the agreements on the joint setting of the interchange fee rates restrict competition, they are necessary for the functioning of the four-party payment card system and they fulfil the conditions provided for both in Polish (article 7 section 1 of the

law on competition and consumer protection) and the EC legislation (article 81(3) of the EC Treaty) which allow for a restrictive agreement to be exempted from the prohibition, due to its beneficial impact on the economy. The above-mentioned conditions are as follows:

- an agreement contributes to improving the production or distribution of goods, or to promoting technical or economic progress,
- while allowing consumers a fair share of the resulting benefit,

without:

- imposing on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives,
- affording such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

In order for an agreement to be exempted from the prohibition, it must fulfil all the above conditions.

The President of the Office found that the arguments of the parties mentioned above are not supported by evidence. Even though it might be necessary to define some default rules regulating money transfers among the participants of the system, it is not indispensable to define them in such a way that merchants pay issuers for each card transaction. The interchange fee is not charged in several four party payment card systems operating in countries such as: Denmark (Dankort), Norway (Bank Axept) or the Netherlands (PIN), yet they develop quickly, contrary to parties' claims that lack of interchange fee would inevitably lead to a collapse of a four-party system. Therefore, the President of the Office decided that the claim of „indispensability" of the interchange fee setting cannot be accepted.

Arguments on the fulfilment of the above-mentioned exemption conditions by the agreements on joint setting of the interchange fee rates were examined as well. Under both Polish and EC provisions, the burden of proving that a specific agreement fulfils such conditions rests on the parties to the agreement.

While analysing whether the agreements on joint setting of the interchange fee contribute in fact to improving the production or distribution of goods or to promoting technical or economic progress, the President of the Office pointed out to the fact that the presented arguments were of a highly theoretical nature and benefits resulting from the agreements in question were assumed rather than proven on the basis of convincing evidence. The parties claimed that the interchange fee is an instrument of the optimal distribution of costs among the participants of the four-party payment card system, which leads to maximisation of the system's size. In their opinion, the interchange fee is an indispensable income source for the banks issuing cards, allowing them to cover their costs related to card operations

and to avoid charging the cardholders. However, the necessity of such an income source has been assumed, not proven, by the banks and the way it was determined does not indicate that it was established, as claimed by the parties, to the benefit of all the system's participants. By 2006 the interchange fee rates, both in Visa and MasterCard systems, were not determined on the basis of any objective criterion, while the cost analyses that have constituted such a basis since the beginning of 2006, are based on flawed or incomplete assumptions. Therefore it cannot be accepted that the agreements on the joint setting of interchange fee rates fulfil the first condition of the exemption, i.e. they contribute to improving the production or distribution of goods or to promoting technical or economic progress.

Even though a failure to fulfil any of the four conditions of the exemption makes an agreement incompatible with the competition law, the President of the Office additionally examined the possibility that the agreements on joint setting of the interchange fee rates fulfil the second condition of the exemption, i.e. they allow consumers of Visa and MasterCard systems (cardholders on one side and merchants on the other) a fair share of the benefits resulting from the agreement. The parties claimed that the cost analyses they had presented prove that the agreements fulfil this condition, since they establish a relationship between the amount of the fee and costs incurred by the banks in relation to activities and services provided to the benefit of merchants. The President of the Office took also into account that the European Commission, in its decision concerning Visa cross-border interchange fee rates, examined the first and the second condition jointly, paying close attention to the assumptions of cost analyses, which Visa offered to undertake.

The President of the Office took notice of the fact that the claim of benefits to consumers and merchants from the joint determination of the interchange fee rates is based on the theory of the interchange fee as „a mechanism balancing costs and revenues within the system” and assumes that merchants are charged with the fee in order for the consumers not to be charged with it. This claim is not confirmed by the scarce empirical data that are available. Extensive research of the payment cards' market, conducted by the European Commission[1] shows, that in the EU countries growth of the interchange fee is not related to a reduction of charges paid by card users, and the business of payment card issuing is highly profitable, which indicates that the interchange fee performs a role of an additional income source, not a subsidy allowing for a reduction of charges paid by card users.

Having examined the presented cost analyses, the President of the Office found that they do not prove that the rates of interchange fee determined on their basis would allow merchants a fair share of the benefits resulting from a joint setting of the interchange fee by the banks. Cost base, on which the fee is based, includes numerous costs, the transfer of which to the merchants is not justified and in many cases may result in charging the latter with detrimental consequences of banks' own business

[1] European Commission, Sector Enquiry Retail Banking, Interim Report I: Card Payments, available at http://ec.europa.eu/comm/competition/antitrust/others/sector_inquiries/financial_services/interim_report_1.pdf

decisions. Some costs, that according to the presented analyses should be borne by merchants, refer to services provided by banks to card users (such as interest-free period in case of credit cards or some activities related to the maintenance of a bank account in case of debit cards). In view of the President of the Office there are no compelling reasons to shift such costs onto merchants by means of an agreement restricting competition.

Taking the above into consideration, the President of the Office found that basing jointly determined rates of the interchange fee on the presented cost analyses does not guarantee that the interchange fee in the future will not exceed the costs of services rendered by the issuers wholly or in part to the benefit of merchants (i.e. one of the two groups of consumers in the payment card system), which lead him to a conclusion that the agreements on the joint setting of the interchange fee rates cannot be said to fulfil the second condition of the exemption.

Immediate enforceability

Prohibition of the agreements setting the rates of the interchange fee in Visa and MasterCard systems respectively, has been declared immediately enforceable. Since the volume of card transactions is sharply rising, the consequent losses to entrepreneurs and consumers, resulting from jointly set interchange fee being charged on every such transaction, grow constantly. Estimated bank revenues from interchange fee in 2005 exceeded PLN 400 million, and due to the fast development of the card payments market it is likely to exceed PLN 0.5 billion soon. The immediate enforceability order will result in practices entailing substantial losses to entrepreneurs and consumers being discontinued.

Coordination of activities by banks, Visa International, Visa Europe, MasterCard Europe and the Polish Bank Association in order to restrict access to the market

In the course of the proceeding the Applicant's charge, that banks, card organisations and the Polish Bank Association coordinated their activities in order to restrict access to the relevant market, was also examined. Although, as it was stated above, the agreement on joint setting of the interchange fee, which may be regarded as coordination of activities, may restrict development of competitive payment systems, it was impossible to state on the basis of collected evidence that attainment of such a result was the objective of the parties. Therefore, the President of the Office found, that the Applicant's charge in this respect is not justified.

Financial fines

Taking into consideration the long duration of the infringement of the competition law (the agreements in Visa MasterCard systems have been in force since 1993, and 1994 respectively), as well as benefits which banks derived from the agreements, the President of the Office imposed financial fines on the banks - parties to the proceedings. The amounts were varied depending on the period of participation in both agreements and the number of issued cards. The highest fines, amounting to PLN

16,597,140 were imposed on Pekao SA and PKO BP, while HSBC Bank Polska that has discontinued practices it was accused of, has to pay PLN 192,220.