

EXCESSIVE PRICES-VISA-MULTILATERAL INTERCHANGE FEES

€-KONOMICA'S NEWSLETTER #3

The proposition that a competition authority would get involved into a discussion of whether a price is “excessive” appears initially as a lost case. Actual cases on predatory prices are also infrequent/rare¹, because there is a feeling that it is particularly difficult for a competition authority to determine the right level of a price and the actual cost of a good or service.

With regard to excessive prices, difficulties are compounded by the perceived pre-requisite of defining an “adequate” rate of return on investment or an “adequate” cost mark-up or profit margin.

This requisite, however, can be avoided in certain situations, and a case on excessive pricing can successfully be made without any reference to a “proper” or “decent” rate of return. The question is primarily one of finding a proper benchmark and to provide evidence that against that benchmark, the practices at stake result in abusive or excessive prices.

1. The context of the case.

E-konomica has provided assistance to a complainant to assess the level of the commissions charged by banks when consumers pay with VISA credit cards.

The level of the commission paid by the

¹ Although by no means inexistent, see recent Commission decision in Case COMP/35.141 — Deutsche Post AG.

retailer to the (acquiring) bank processing the transaction is determined to a large extent by the commission the bank in turn has to pay to the (issuing) bank, i.e. the bank that issued the credit card to the consumer. These inter-bank rates (multilateral inter-change fees or MIF) are normally fixed collectively for those banks affiliated to a particular payment system (for instance VISA or MasterCard). The MIF determines a floor on the level of the commission the retailer will have to pay to its (acquiring) bank.

There has been a government-sponsored agreement in Spain to reduce progressively the maximum commission retailers pay to their banks for processing card payments, which involves a reduction of the fixed MIF. Yet, retailers consider they still pay excessive commission rates.

Representatives of Eurocommerce and their Spanish affiliate, Confederación Española de Comercio, have publicly stated they consider that still over half of establishments in Spain pay over 3% of the value of the transaction when the consumer pays with a card. The Spanish hotel's professional association consider that bank charges for the use of payment cards impose an over-cost of €600 million per year on their members.

The reference to excessive charges, over-costs or abusive rates take as reference the maximum rate of 0.7% that VISA has undertaken to apply in international transactions in the context of an

investigation by the Commission.

The economic stakes of the debate around payment card fees are exceptionally high. The professional associations that have complaint to the Spanish competition authorities against bank commissions on payment cards represent nearly a million undertakings, three million workers and 30% of the Spanish GNP.²

Also, payment cards affect almost any consumer and almost any retail establishment in Europe. The number of credit and debit VISA cards in 2002 amounted to over 200 million worldwide; the worldwide number of Maestro, MasterCard and Cirrus cards amounted to 1.7 billion in the same year.

The total expense with VISA cards represented around €720 billion in Europe in 2002. Assuming a weighted average commission of, say, 2%, bank charges represent 14.4 billion euros a year, and a change in the commission paid by retailers by just 0.1 percentage points implies annual revenues of €720 million.

The economic importance of payment cards can only increase with time: the volume of transactions with payment cards is growing at around 15% on an annual basis, way above the current levels of growth of our economies.

2. How to approach the issue of excessive fees?

² Source: Spanish press, Expansión 02/04/2003

Firstly, we need to consider that the initial objective is not to calculate a “fair” market price, but just to show that the current arrangements for payment systems substantially eliminate competition and lead to unconstrained and excessive levels for commissions and fees.

With regard to the first aspect, it is somehow surprising that the collective fixing of a multilateral interchange fee has been accepted as permissible by certain competition authorities. It amounts to price fixing cartel for a bank service and thereby eliminates all price competition for that service.

Partly, the collective fixing of the MIF has been accepted on grounds of efficiency, in so far as it avoids the transactional costs of negotiating a multitude of bilateral fees. But there are many other bank services where two banks need to interact to accomplish the provision of a service involving crediting an account and debiting another account (for instance, bank transfers, cashing of checks). These other services can perfectly function without the need to collectively fix the commission or price paid for that service³.

With regard to the level of an unconstrained MIF, a first benchmark to establish whether the MIF is excessive can be provided by the prices of those other banking services that substantially involve the same activity: the processing of (usually) electronic information

³ There is a (questionable) argument based on the externalities present in four party payment systems that would make the difference, but the argument was of relevance primarily when credit cards were a nascent market.

between two banks. The assets used to provide all these services are to a large extent the same: the bank's informatics platforms.

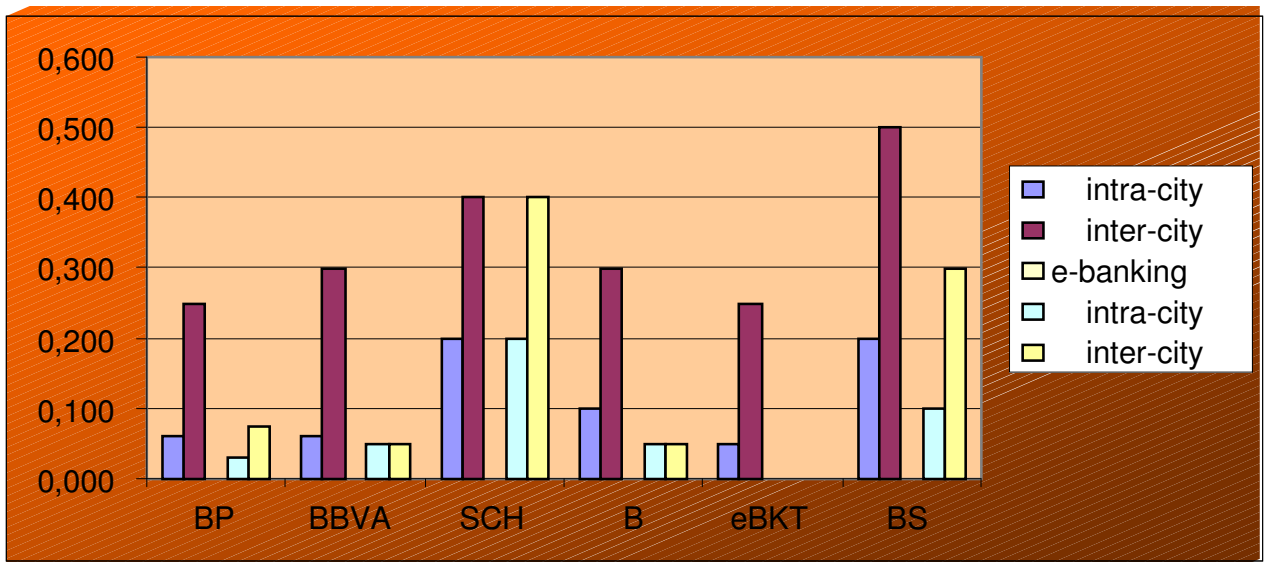
The graph in the following page shows the maximum commission charged by the leading Spanish banks on bank transfers and on electronic bank transfers through e-banking. The rates of the service usually distinguish between intra-city transfers and inter-city transfers.

The rates of maximum commissions for manual transfers are plotted in %. The

the same banks to retailers when processing a card payment. Lets recall that a large number of retailers in Spain pay rates between 2.5%-3%, which represent between 500% and 750% the price charged for a bank transfer. This type of comparison was carried out for a basket of bank services, with similar results.

Excessive prices for payment cards processing? At a cost of €720 million per 0.1 change in the discount applied by the bank to the retailer over the price of the

Figure 1. Commissions in % for bank transfers.



highest rate for an inter city manual transaction, one can confidently advance the idea that the current commissions

Source: €-konomica

transfer is 0.5%, the lowest 0.25%. An intra-city bank transfer is never charged more than 0.2%. The commissions are usually a fraction of these rates when the customer initiates the transfer by electronic means.

The peaks of these maximum commissions (0.5%, 0.4%) represent just a fraction of the average price charged by

paid by retailers on payment cards in Spain are excessive by reference to roughly comparable services.

Since as a rule one cannot rely on just one piece of evidence, we also considered a second issue: for each banking service under scrutiny, we calculated the price ratios between domestic transactions and

the equivalent international transaction.

This second comparison is not unproblematic, because the reference taken for international card payments is the weighted average of 0.7% MIF agreed by VISA with the Commission.

One could argue that it is somehow a regulated price, but one that nevertheless was considered appropriate by VISA itself as the level reflecting the true cost of providing the service in international operations (i.e., a consumer using his VISA credit card outside the country where the card was issued).

This rate for international transactions was compared to the Spanish rates. It appeared that with practically no exception, Spanish acquiring banks would be charging for a domestic card payment a much higher price than for the equivalent international transaction.

However, a domestic transaction is

systematically cheaper than the same transaction at an international level for any other bank service in the basket of reference and for any bank included in the sample. In other words, payment cards constitute a unique exception in the pricing structure of domestic versus international bank services. Prices for the use of a payment card by retailers seem therefore not only excessive but also exceptional.

The analysis has to be completed to take into account issues of fraud and free credit granted to cardholders. But with interest rates at historic lows and rates of fraud with credit cards surprisingly close to zero in most retail sectors of the Spanish economy, these two issues are not of a nature as to jeopardise the impression that the costs payment cards are imposing on retailers are excessive.

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