

ECB – MNB conference: Cost and efficiency of retail payments, Budapest, 15 – 16 November 2012

Thank you for your invitation to take part in this very informative and timely discussion.

The title of today's conference is '*Cost and efficiency of retail payments: evidence, policy actions and role of central banks*'. The marked developments in the retail payments area in recent years makes this a very relevant and timely gathering.

Globally, non-cash payment volumes continue to grow, with cards (debit and credit) still the biggest driver in this area. According to the World Payments Report 2012, cards accounted for more than 55% of all non-cash payments in 2010 with debit cards alone accounting for more than one in three of all payments.

In parallel, electronic and mobile payments are also growing rapidly. Industry estimates show the number of online payments is forecast to reach 31.4 billion in 2013, after growing by a sustained 20% a year in recent years. Analysts believe the number of payments using mobile devices could grow even faster.

In this rapidly changing environment, it is very important that public institutions such as the European Commission and central banks base their policy actions on facts and evidence. In this context, I have been asked to speak about '*The role and instruments of regulatory authorities: current and future initiatives by DG Competition*' and am happy to take this opportunity to update you on DG Competition's actions and reflections in this area.

The current state of play is very much defined by the General Court's judgment in the MasterCard case of 24 May 2012. This was the first judgment of the European Court on the issue of collectively agreed interchange fees in payment card schemes. One could say that the Court, by rejecting all MasterCard's grounds of appeal, in fact supported more than 20 years' of analysis of collective fee arrangements in payment card systems by the EU competition authorities.

The MasterCard judgment confirmed that such jointly agreed interchange fees restrict competition and rejected MasterCard's justifications of the arrangements at issue. The judgment also gave a general framework in which collective interchange fees should be assessed.

Therefore, one could argue that the judgment takes away the need to take regulatory action on MIFs and leaves this issue for further competition enforcement. Indeed, after the judgment it should be clear to payment card schemes that apply fees established in the same way as MasterCard's cross border fees – probably all multilateral interchange fees applicable in Europe - that such fees are forbidden unless the schemes and their members can demonstrate they are justified on the basis of efficiencies under Article 103 TFEU. However, we see that the schemes are not proactively adjusting or justifying their fees on the basis of the judgment, yet. Looking at competition law enforcement, we need to establish that the EU proceedings against MasterCard and Visa Europe currently only cover cross-border transactions in case of

MasterCard and cross-border and national transactions in 10 Member States¹ in case of Visa Europe. While many national competition authorities are and have been active in addressing MIFs and the MasterCard judgement should help them in this work, ensuring compliance with the competition rules of the majority of multilateral interchange fees applied in the EU will be a long and fragmented process, with no upfront guarantees to ensure full and timely consistency across the EU.

At the same time, the very high variety in fee levels across member states maintains a fragmented European payments market that is an obstacle to the internal market in goods and services.

This fragmentation is exacerbated by the fact that retailers are 'locked into their domestic fees' by scheme rules preventing them from benefiting from lower fees offered by acquiring banks in other EU Member States.

The wide divergence of fees expected by banks for their payment authorization services also prevents new payment schemes from entering into the European market with EU wide business models, as banks would expect the new entrants to provide them with at least the same level of MIFs as the one they currently enjoy in the respective national markets.

It furthermore forms an inefficient infrastructure for the many innovative payment services ready to emerge on the market in the mobile and internet world, which for their 'payment channelling' intend to build on four party payment card schemes.

These factors speak in favour of addressing the issues I mentioned today through regulation. Regulating could help the players in this market move, in a controlled and comprehensive way, to a system that would also be acceptable under a competition law analysis as carried out by the General Court in the MasterCard case.

At the beginning of the year the European Commission published the Green Paper on card, internet and mobile payments, with the purpose of identifying hurdles to the integration and efficient functioning of the European electronic payments market. We have identified the lack of common standards, the quite restrictive scheme rules, the limited transparency and the lack of interoperability between service providers as important barriers. But obviously MIFs and other pricing-related practices feature among the key issues examined in the Green Paper.

The Single Market Act II issued by the Commission last month lists the improvement of electronic payment services as a key action to achieve a truly functioning internal market. It specifically expressed the Commission's intention to regulate MIFs for cards with proposals to be published by April 2013.

Of course this 'declaration of intent' raises many questions such as 'How to regulate in order to facilitate an efficient choice of payment instruments and ensure the right incentives are set in place?' 'What benchmark should be used?' How to enhance transparency, promote

¹ Belgium, Hungary, Iceland, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands and Sweden.

competition and facilitate market access? 'Which categories of cards and schemes should be regulated?'

These are all questions which cannot be answered, yet, today; a so called Impact Assessment - on which work has now commenced – must first provide facts and material that make it possible to formulate a proposal which effectively addresses the problem.

Naturally, the work carried out in the competition cases and the remedies designed in that context, will be examined in this process in order to determine to what extent we can learn from experience.

Against this background and taking into account the title of today's conference referring to **'policy actions and evidence concerning cost and efficiency of retail payments'** it would seem worthwhile devoting some reflections to the so-called Merchant Indifference Test. In assessing the commitments offered by MasterCard and Visa, we relied on this test developed in economic doctrine as a benchmark for an acceptable MIF level. Under the MIT, the MIF must be at or below the level of transactional benefits that card use delivers for merchants. Such transactional benefits are derived when card payments reduce merchants' costs relative to cash payments. The implementation of the MIT ensures that the merchant is indifferent as to whether a payment is made in cash or by card. To the extent that this MIF is passed on by the issuer to the cardholder, it also ensures that cardholders make more efficient choices with respect to payment instruments.

The evaluation of the MIT-compliant MIF level requires merchants' costs of processing cash and card payments to be measured. As everyone here today surely knows, comprehensive and precise information on merchants' costs of payments, as required to implement the MIT, is scarce. At the time of MasterCard's Undertakings, we relied on data on costs of cash and cards from four studies published by the Central Banks of Belgium, the Netherlands and Sweden. This delivered the 0.2% and 0.3% levels for debit and credit card MIFs, respectively, currently applied by MasterCard for cross-border transactions and by Visa Europe for debit cards for cross-border transactions and in the Member States² where VISA Europe sets the level of the MIF.

However, as these studies had been carried out in different contexts and had a different objective and it was likely that the MIT would continue to be discussed as (one of the) benchmark(s) for fees that could stand the test of Article 101 (3) TFEU – the article that exempts restrictive agreements of prohibition in case objective economic benefits outweigh the negative effects of the restriction - , we considered that it was important to engage in collecting detailed and accurate empirical data for implementing the MIT. We have therefore launched a study to identify and measure the costs relevant in the context of the MIT, namely the costs borne by merchants for accepting payments by cash and by card. As surely experienced by the ECB and the national Central Banks carrying out the studies on the social and private costs of retail payments, surveying merchants on their costs is not an easy task.

² The above 10 Member States minus Italy, where domestic banks in the meantime started setting their debit MIFs.

Ours is particularly challenging as it involves a measurement of all relevant costs (both internal and external), the identification of their fixed or variable nature, and a high level of detail and precision of the data collected. After a relatively complex process of defining the survey methodology, we are now at the stage of launching the data gathering exercise.

When completed, in addition to providing a solid basis for the assessment of claims based on the MIT in our antitrust cases concerning MIFs, we hope our study will also be able to shed further light on some of the aspects examined by the ECB in its own study discussed at this conference.

The MIT is quite a robust tool for remedying some of the concerns we identified in our cases, as it aims to eliminate the so-called 'negative externality' imposed on merchants, and improve price signals. With 'negative externality' we mean a situation in which a customer's decision to use a certain payment instrument for a given transaction that is relatively more expensive than others imposes a loss on the merchant. This is the case when the costs of accepting cards exceed those of accepting cash payments.

Also in the context of the application of competition rules, which, as I mentioned before, is mostly focused on the effects on the card accepting side, there are certain limits to the application of the MIT. MIFs are generally justified as a means to promote efficient payment instruments by making consumers internalise the benefits that accrue from card usage for merchants. The need to subsidize card issuing disappears when the market is mature and a payment instrument has what could be called 'universal usage'. Currently we see that payment cards are already very widespread and their use is expected to continue growing in the longer run. In the EU there are in fact already around one and a half payment cards issued per citizen – that is including children. The number of card transactions per citizen is continuously increasing, too, in 2011 with 8.4% compared to 2010 - to 74 transactions per year on average.

Similarly, the need for a MIF is less obvious when there are other means available to merchants to steer consumers towards certain payment means through rebates, surcharges and other steering practices, including the refusal to accept a payment mean below a certain amount. Essentially, this is about retailers providing cardholders with a signal about the costs they 'inflict' on retailers and other consumers – as these costs are not visible to cardholders. Failing this, consumers will use the payment instrument providing the most 'miles' or 'bonuses' for themselves, but which is likely to be the most expensive to merchants and to society as a whole. By providing direct signals to consumers merchants also incentivise them to use the payment instrument they prefer and there is no need any more for banks or schemes to create a separate incentive in the form of a MIF. Currently merchants do not make massive use of such steering mechanisms, not least as a consequence of the historical ban on surcharging imposed by card schemes and, in some countries, by national legislation or because other steering possibilities than surcharging or rebating are forbidden under scheme rules. The fact that merchants are made to accept cards within the same brand under the Honour All Cards Rule (HACR) also prevents retailers from effectively influencing consumers' behaviour, especially as steering mechanism are seldom used. However, this is also an area where progress could be brought about through regulation.

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Finally, another key issue to look at is whether the barriers to cross-border acquiring, in particular the obligation imposed on acquirers to apply the MIF of the country of transaction, are justified and in line with EU internal market rules.

The Commission is currently reflecting on measures that can promote a more efficient use of payment instruments, and increased integration of the retail payments market – which in turn would be a strong driver for better functioning internal market for services and goods. We are assessing different policy options on the basis of the empirical evidence available. The publication of the ECB study is therefore very timely in this sense, as it provides a broad overview of the costs of European retail payments, from the social welfare perspective. We shall carefully take this and other empirical data into account in our reflections.

Thank you.