

Brussels, 19th December 2007

Antitrust: Commission prohibits MasterCard's intra-EEA Multilateral Interchange Fees – frequently asked questions

(see also [IP/07/1959](#))

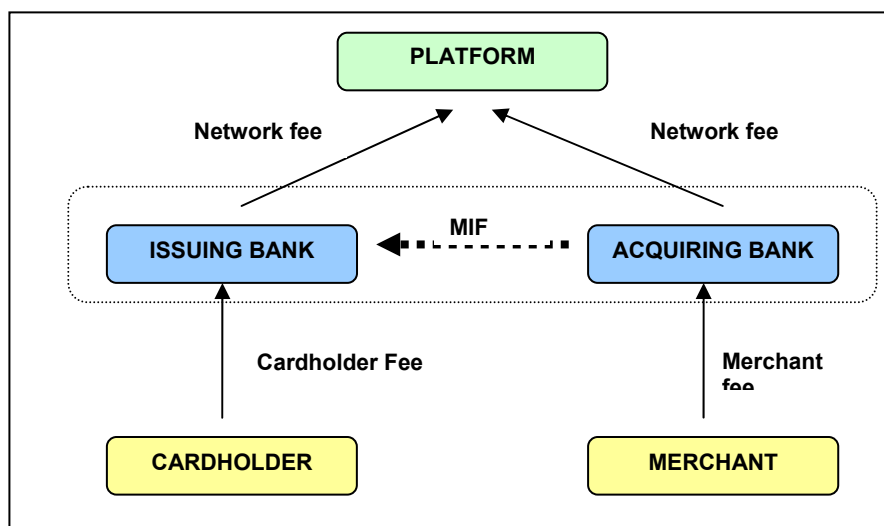
General

What are interchange fees?

Interchange fees are charged by a cardholder's bank (the issuing bank) to a merchant's bank (the acquiring bank) for each sales transaction at a merchant outlet with a payment card.

Interchange fees are either agreed bilaterally, between issuing and acquiring banks, or multilaterally, by means of a decision binding all banks participating in a payment card scheme. Industry refers to these multilateral interchange fees as "**MIF**". A MIF can be a percentage, a flat fee or a combined fee (percentage and flat fee).

When a cardholder uses a payment card to buy from a merchant, the merchant receives from the acquiring bank the retail price less a merchant service charge, a large part of which is determined by the interchange fee. This merchant service charge is the price a merchant must pay to his bank for accepting cards as means of payment. The issuing bank, in turn, pays the acquiring bank the retail price minus the MIF. The retail price is deducted from the bank account of its customer.



Interchange fees are one of the sources of revenue for issuing banks from payment cards (others include annual fees, interests for the use of a credit facility, late payment fees, currency exchange fees, etc.).

Which interchange fees are subject to the Commission's decision?

The Commission's decision addresses one specific multilateral interchange fee (MIF) within the MasterCard payment card organisation. This MIF, called "intra-EEA fallback interchange fee", applies to virtually all cross-border card payments with MasterCard and Maestro branded payment cards and to domestic payments in several European Economic Area (EEA) Member States. The decision prohibits this MIF as far as it regards consumer credit and debit cards but not as far as it regards commercial (e.g. corporate) cards.

This MIF applies as "fallback", that is, when no other interchange fee has been agreed bilaterally between issuing and acquiring bank. In practice, virtually all cross-border payments with MasterCard or Maestro branded payment cards *between* Member States of the European Economic Area are subject to MasterCard's intra-EEA fallback interchange fees. Moreover, the fees also apply to domestic credit card transactions *within* eight Member States of the European Economic Area (Belgium, Ireland, Italy, the Czech Republic, Latvia, Luxembourg, Malta and Greece) and to domestic debit card payments within Greece and the Czech Republic. The economic importance of MasterCard's intra-EEA fallback interchange fees is therefore considerable.

Why does MasterCard's MIF restrict competition under EC Treaty rules on restrictive business practices (Article 81 (1))?

MasterCard's MIF is a mechanism that restricts price competition between acquiring banks by artificially inflating the basis on which these banks set their charges to merchants. A MIF effectively determines a floor under the merchant service charge and merchants are unable to negotiate a price below it. This can considerably inflate the costs of payment card usage at merchant outlets to the detriment of merchants and their customers. For instance, the Commission estimates that MasterCard's MIF accounted for more than 70% of the merchant service charges for credit cards in Belgium (2002) and for approximately 60% of these charges in Italy (2003).

If MasterCard operated without a MIF, merchants would pay lower prices for accepting cards and, as a consequence, their customers should also incur lower costs for shopping at a merchant's.

Why does MasterCard's MIF not fulfil the exemption provided by Article 81 (3) of the EC Treaty?

There is no single decisive criterion for assessing whether a MIF is designed in a way as to promote progress and pass on a substantial share of the benefits achieved to consumers. Rather, the existence of objective appreciable efficiencies is appreciated with respect to the arguments and the evidence brought forward by the parties. In MasterCard's case, the Commission in particular verified whether the model underlying MasterCard's MIF was founded on realistic assumptions, whether the methodology used to implement that model could be considered objective and reasonable and whether the MIF had indeed led to the positive effects that MasterCard claims.

In principle, the Commission does not dispute that payment systems can be characterised by indirect network externalities and, in theory, interchange fees could help optimising the utility of a card network to all of its users. However, the concrete model underlying MasterCard's MIF operates with unrealistic assumptions and MasterCard failed to submit empirical evidence to demonstrate any positive effects of its MIF on the market.

MasterCard's MIF is a subsidy to its member banks and burdens the acquiring party with costs, thereby rendering payment card acceptance artificially more expensive. Due to the lack of empirical evidence submitted by MasterCard, the Commission was not in a position to balance these negative effects of the MIF with possible objective efficiencies. The Commission therefore concluded that MasterCard's MIF does not fulfil the first condition of Article 81 (3) of the EC Treaty.

As to the second condition of Article 81 (3) of the EC Treaty, consumers must get a fair share of the benefits resulting from a MIF.

There is no reason to simply *assume* from the outset that a MIF would increase the utility of the payment card system to *both* cardholders and merchants alike. The Commission attributes particular importance to the question whether in setting a MIF a scheme uses a *methodology* that guarantees from the outset that both cardholders and merchants obtain a fair share of the benefits. MasterCard in practice sets the level of its MIF using cost benchmarks. These benchmarks are, however, largely arbitrary and inflated. Hence, without further evidence - which MasterCard failed to submit - it cannot safely be assumed that by pursuing its member banks' aim of maximising sales volumes MasterCard's MIF has created efficiencies that benefit *all* customers, including merchants. The Commission therefore found that MasterCard's MIF does not fulfil the second condition of Article 81 (3) of the EC Treaty.

Finally, MasterCard did not provide any empirical evidence on the actual effect of this MIF in the market although ECB statistics indicate that card schemes without a MIF display the highest card usage per capita in the EU.

MasterCard has therefore not proven to the requisite standard that its MIF is indispensable to achieve a maximised system output or any claimed related efficiencies.

What was the duration of the infringement?

The infringement lasted over 15 years, from 22 May 1992, when Europay International S.A. (now: MasterCard Europe S.p.r.l) submitted its first notification of the scheme to the Commission until the adoption of the Commission's decision, on 19 December 2007.

Why is MasterCard's MIF only prohibited now?

Since 1992 the Commission has been investigating not only MasterCard's MIF but also various other network rules and arrangements within the organisation which were addressed one after the other and which also raised competition concerns.

MasterCard started notifying its network rules on 22 May 1992 and submitted its last notification on 23 May 1997. The Commission formally opened proceedings with respect to these network rules in 1999. MasterCard subsequently modified some of these network rules to allow for more cross-border competition between its member banks. In 2002 the Commission opened an '*ex officio*' investigation into MasterCard's MIF for commercial cards and on 24 September 2003 it sent MasterCard a second Statement of Objections, addressing the MIF. On 21 June 2006 the Commission sent MasterCard a second Statement of Objections (see [MEMO/06/260](#)).

In parallel, the Commission also investigated Visa's network rules and in particular Visa's MIF and adopted a formal decision on 24 July 2002 (see also below questions on the Visa decision). During 2005 and 2006 the Commission moreover screened the entire payment cards industry in the framework of its competition sector inquiry into retail banking.

Has the IPO of MasterCard Inc. influenced the Commission's assessment under Article 81(1) of the EC Treaty?

No. MasterCard Incorporated, along with MasterCard International Inc. and MasterCard Europe S.p.r.l., is one of the three legal entities representing the payment organisation of banks participating in the MasterCard payment card scheme. The Initial Public Offering (IPO) of MasterCard Incorporated on the New York Stock Exchange on 25 May 2006 did not affect the decisive elements to qualify MasterCard's payment organisation as an association of undertakings and its decisions setting the level of MIF as decisions of such association within the meaning of Article 81(1) of the EC Treaty.

Does the Commission impose fines? What is the remedy?

No, the Commission decision does not impose fines on MasterCard, because MasterCard notified the MIF arrangements to the Commission between 1992 and 1997 and therefore benefits from immunity.

Today's decision orders MasterCard to cease applying its current intra-EEA fallback interchange fees for consumer credit and debit cards and to refrain from adopting measures having a similar effect. This also implies that MasterCard cannot apply its recently adopted SEPA/intra-Eurozone fallback interchange fees to payment transactions within the Eurozone.

MasterCard was, however, granted a *transition period of 6 months* from the date of notification of the decision, to comply with this order. This is an exceptional measure. However, the Commission considered it adequate in view of MasterCard's obligation to review its network rules to be able to comply with the order. Moreover, MasterCard must inform clearing houses, settlement banks and its member banks in Europe of the rule changes.

If, after the transition period, MasterCard does not fully comply with the remedy, MasterCard will be ordered to pay a penalty payment per day until it fully complies with the decision. The periodic penalty payment is 3.5% of MasterCard's Inc. daily turnover of the preceding business year for each day of non compliance.

Why did the Commission not yet decide about MasterCard's MIF in the commercial cards segment?

The Commission did not yet take a final conclusion with respect to MasterCard's commercial cards' MIF, as it has not yet finished its investigation in this segment.

The MasterCard decision and SEPA

What does the MasterCard decision mean for SEPA?

The decision will support the creation of a Single Euro Payments Area (SEPA) in the Eurozone by removing the danger of price increases due to the MasterCard's MIF that could result from the ongoing migrations of domestic debit cards to MasterCard's Maestro debit products. In most Benelux and Nordic countries banks issue and acquire domestic debit cards at low cost, because domestic card schemes operate without a MIF. Maestro, to the contrary, carries a MIF.

The SEPA project must not lead to an artificial increase of merchant fees across the Eurozone due to illegal pricing mechanisms such as MasterCard's MIF, a MIF of which MasterCard did not prove that it creates efficiencies or benefits to the consumers.

Some banks claim that they need a MIF to make appropriate investments in SEPA – is this true?

Generally speaking, new investments are normally not financed through the collective exercise of market power of competing undertakings. The payment cards industry is no exception in this respect.

For instance, domestic schemes without a MIF introduced chip & PIN technology very early on, more than ten years ago. MasterCard credit cards, to the contrary, are only now being equipped with this chip technology, although they carry the highest interchange fees. Domestic schemes without a MIF have found ways to price cards in a competitive manner rather than hiding their cost through a MIF that ultimately becomes part of the retail price. Cost transparency has spurred efficiency and today the highest card usage per capita exists precisely in those EEA Member States where card schemes operated without a MIF for decades (Norway, Finland and Denmark).

Moreover, MasterCard and Visa are not the only options available to banks to achieve SEPA compliance for their card portfolios. As the EPC pointed out, SEPA can be achieved by several means under the SEPA Cards Framework (for more information on SEPA Card Framework see <http://www.europeanpaymentscouncil.eu>). *Inter alia*, existing schemes may join an alliance of domestic schemes. They can also co-brand their cards with an international scheme rather than replacing a domestic payment card entirely. The Commission, like the ECB, would welcome the emergence of new pan-European schemes that would compete with international schemes such as MasterCard and Visa. This will require a level playing field between the potential newcomers and the incumbent schemes.

To the extent that proceeds from a MIF are dedicated to cover one-off expenses for upgrading existing payment card schemes to SEPA standards this may possibly be considered in evaluating the existence of objective efficiencies of a MIF under Article 81 (3) EC.

The interchange fee has been a card industry standard, globally, for many years. How can the industry survive without it?

Whether it is correct or not that interchange fees have been industry standard for years, this has no bearing on the application of Article 81 of the EC Treaty. A MIF does not become legal because it has been applied for many years.

Moreover, this statement is factually wrong. Open card schemes such as MasterCard's can operate without a MIF:

- the Commission's Sector Inquiry into retail banking of 2005/2006 (see [IP/07/114](#)) showed that in 22 of 25 EU Member States credit card issuing remains profitable without interchange fees.
- five domestic payment card systems in Europe (in The Netherlands, Denmark, Norway, Finland and Luxembourg) have successfully operated without a MIF for decades.

Can Europe win the "War on Cash" without MIF?

Yes. Domestic card schemes in Europe have been very successfully replacing cash and cheques as payment means even though they operate without a MIF. Card usage per capita in Europe is the highest in countries such as Norway, Finland, Denmark or the Netherlands, where MasterCard is hardly present and where domestic systems operate without a MIF or a MIF-like subsidy mechanism to the benefit of card issuing banks. These countries have also been the first to eliminate the use of cheques, a quite expensive payment instrument.

Is the possibility of a MIF excluded by the decision?

As explained below in relation also to the Visa 2002 decision, the Commission does not from the outset exclude in the MasterCard decision the possibility that a MIF may be indispensable to creating efficiencies that may outweigh the restriction of competition.

Interchange fees after the MasterCard decision

Is there any "acceptable" MIF under Article 81 EC?

The Commission's decision addresses solely MasterCard's multilateral intra-EEA fallback interchange fees for MasterCard and Maestro branded payment cards. This decision does not cover interchange fees in general and it does not prohibit interchange fees as such.

The Commission considers that MIF's must be examined under Articles 81(1) and 81(3) of the EC Treaty on a case by case basis. However, like any other agreement that restricts competition, interchange fee agreements must fulfil the four cumulative conditions of Article 81 (3) of the EC Treaty. This also holds for an entirely new (that means materially different) MIF in the MasterCard scheme should MasterCard choose to continue operating with this mechanism. Otherwise, the MIF is illegal. If the criteria of Article 81(3) of the EC Treaty are not met, the Commission would adopt a cease and desist order and, if appropriate, impose fines. However, the Commission could not set a different level of interchange fee. The Commission does not apply competition rules to regulate the level of interchange fees.

Is a MIF the only possible "balancing mechanism" in an open payment card scheme?

A revenue transfer between acquiring and issuing banks can take other forms than a multilaterally pre-determined fee per card transaction that inevitably sets a floor under the merchant fee. Economic literature has so far concentrated its research on improving models on how to set an "optimal" MIF. There is hardly any research so far on balancing mechanisms that do not effectively pre-determine the price on either side of the scheme. This should change.

New pan-European card systems are needed. It would, however, be disastrous if competition authorities took different approaches with respect to MIFs. What does the Commission decision mean for the pending cases on domestic interchange fees in various Member States?

The MasterCard decision brings much awaited clarity and guidance. However, this does not mean that during the last years competition authorities have applied Article 81 of the EC Treaty in an inconsistent manner; The Commission has co-ordinated its policy and competition law enforcement with that of other national competition authorities through the mechanisms of the European Competition Network. In several Member States national competition authorities carry out investigations on domestic interchange fees (such as in the UK). The Polish Competition Authority has adopted a prohibition decision on MasterCard's and Visa's domestic MIFs in December 2006. The Commission will continue to co-operate closely with the relevant competition authorities in the Member States in the framework of the European Competition Network.

What MIFs would the Commission accept as in conformity with Article 81 EC?

If a card scheme decides to in effect pre-determine a minimum fee merchants must pay to acquiring banks through a MIF, this will lead to a restriction of competition within the meaning of Article 81(1) unless, very exceptionally, the scheme would not be viable without a MIF.

Where a MIF is restrictive under Article 81(1), the parties to the agreement must demonstrate that despite the restrictive effects **the conditions of Article 81(3) of the EC Treaty** are met, namely:

- i. empirical proof that the MIF creates efficiencies that outweigh the restriction of competition
- ii. consumers get a fair share of those benefits
- iii. there are no less restrictive means of achieving the efficiencies and
- iv. competition is not eliminated altogether.

In this respect, the Commission will generally ascertain that the concrete model underlying a MIF is based on realistic assumptions, that the model is plausibly implemented through an objectively verifiable methodology and that the MIF indeed yields the objective efficiencies on the market which are claimed by the parties. The methodology underlying a MIF should be transparent to the final users of a scheme. However, if a card scheme wishes to pre-determine the fees merchants pay through a MIF, it must be aware that the burden of proof to demonstrate the fulfilment of the four conditions under Article 81 (3) of the EC Treaty lies upon the scheme and its members.

In the MasterCard case the Commission has in particular analysed a **MIF that aims at internalising network externalities** to increase system output. The Commission does not dispute in principle that such interchanges fees may yield efficiencies which rest on the relative importance of network effects on both sides of the markets. However, an imbalance of network externalities must be carefully assessed on the basis of empirical evidence including both cost and revenue data related to providing payment services that fall respectively on issuing and acquiring, the willingness to pay of cardholders and merchants (elasticities) and the competitive conditions on both sides of the scheme. Such a MIF must therefore be based on a detailed, robust and compelling analysis that relies in its assumptions and deductions on empirical data and facts.

It should be noted that a mere increase in a scheme's system output alone without at the same time benefiting the scheme's users (that is cardholders and merchants as well as their customers) cannot be considered as an objective efficiency within the meaning of Article 81(3) of the EC Treaty. Any methodology to set a MIF should therefore from the outset ensure that a fair share of the benefits is granted to the final users of a card scheme.

Finally, there are indications that **a new generation of MIFs** is being developed by some stakeholders in the industry which will be detached from the concept of network externalities and that could more clearly contribute to technical and economic progress. The Commission is open to review these MIFs. Particular regard will be given to the possibility that these new MIFs contribute to promoting more efficient payment means and help win a "war on cash".

In reviewing any new MIFs the Commission would need to **involve all stakeholders**, that is card schemes, banks, merchants and consumers as well as the European Central Bank. National competition authorities in the European Competition Network must be involved in this process to ensure a consistent application of Article 81 (1) of the EC Treaty to MIFs across the EU.

The 2007 MasterCard decision and the 2002 Visa decision

To what extent is the Commission's line different in the MasterCard decision than in the Visa decision of July 2002 and why?

In 2002 the Commission *exempted* Visa's MIF in the European Union for a period of five years, subject to certain conditions. The exemption comes to an end on 31 December 2007. Already in the Visa decision, the Commission considered that a multilateral interchange fee restricts competition. However, the Commission also stated that a MIF can in principle contribute to economic and technical progress within the meaning of Article 81 (3) of the EC Treaty.

The MasterCard decision reflects the Commission's increased market knowledge on the effects of multilateral interchange fees since the Visa decision in 2002.

As in the Visa decision, the Commission does not exclude the possibility that a MIF could create efficiencies that would outweigh the restriction of competition. A MIF may be compatible where it contributes to technical and economic progress and sufficiently benefits consumers. This is a matter of evidence. In the present proceedings, MasterCard was unable to provide this evidence, as explained above.

Why did the Commission prohibit MasterCard's MIF but not Visa's MIF?

The Commission sought to find an agreement with MasterCard on an acceptable MIF. However, the modifications proposed by MasterCard were not appropriate to bring its MIF in line with Article 81 (3) of the EC Treaty. The Commission therefore continued its investigation.

Was Visa discriminated because it had reduced its MIF under the terms of the VISA exemption decision while MasterCard maintained its MIF at the same level during the last five years?

Both, Visa and MasterCard have claimed that they were discriminated because of the Commission's decision on the Visa MIF in 2002. While MasterCard complained that Visa benefited from legal certainty under an exemption decision, Visa argued that MasterCard had been able to benefit from a higher MIF during the whole period during which Visa had accepted to reduce its MIF under the terms of the exemption decision. This situation is about to change as the Visa exemption decision will expire on 31 December 2007.

Once the non-confidential version of the MasterCard decision is available, it will provide guidance to the market. In the end, however, both Visa and MasterCard must be aware that they are in no less privileged situation than all other undertakings operating in Europe which are not addressees of a Commission decision and have to ensure that they comply with EU competition law.