Position Paper on the EU Interchange Fee Regulation (Regulation (EU) 2015/751)

24 June 2020

About EDPIA: The European Digital Payments Industry Alliance represents the interests of independent Payment Services Providers headquartered in Europe. Its purpose is to contribute to EU policy debates that define the business environment for electronic payments, and to strengthen the visibility and understanding of the European payments industry amongst policy makers and society as a whole. Its founding and current members are: Ingenico Group, Nets Group, Nexi, and Worldline.

Key messages and introduction

- We believe the **2015 Interchange Fee Regulation**[1] **(IFR) has had an overall positive structural impact on the EU payments market**. The IFR has generally led to a significant lowering of costs for merchants to accept card payments. This has contributed to the further take-up of convenient and innovative digital payments in the EU.
- That said, the continued decline of costs for merchants is being incrementally eroded by **rises in card scheme fees**.
- The European payments market is currently characterized by massive market consolidation, new market entrants, and new technology that enhances innovation, competition and user-experiences. Taking these developments and the overall success of the IFR into account, we believe that **the time is not right for a legislative revision of the IFR in the short term.**
- In the longer term, it is important to ensure that the IFR continues to achieve its policy goals in practice. The effects of the IFR should not be undermined by increases in scheme fees, or new practices associated with new technologies. At this point in time, we support close monitoring of market developments and effective enforcement of applicable rules.

EDPIA welcomes the assessment of the impact of the Interchange Fee Regulation

When assessing the effects of the IFR, it is important to recall its origin and purpose, and particularly that of its price regulation element. The IFR focuses on network effects in the card payments environment and does not intend to regulate the activities of payment service providers in general.

Despite this focus, the IFR has been a key factor structuring the card payments landscape in Europe today. Together with the revised Payment Services Directive, it represents the EU's most significant step to this date towards a competitive, innovative and secure single market for digital payments.

EDPIA welcomes the European institutions' approach to periodically assess the impact that legislation has had on the economy and society as a whole. EDPIA has taken note of the study on the impact of the IFR which the European Commission commissioned EY and Copenhagen Economics to produce[2] (hereafter "the EY/CE Study") published in March 2020 and agrees with its general assessment. That said, the study only assessed the period 2015-2017, which does not provide a complete picture of how the market has evolved since the application of the IFR.

[1] Regulation (EU) 2015/751 of the European Parliament and of the Council on interchange fees for card-based payment transactions
[2] EY and Copenhagen Economics, *Study on the application of the Interchange Fee Regulation* (2020)

This paper is structured as follows:
1. How has the IFR impacted the payments landscape?
2. Beyond IFR: Industry changes shaping the European payments market.
3. Considerations on the EY/CE Study.

1. How has the IFR impacted the payments landscape?

In general, EDPIA considers the IFR to be balanced and proportionate legislation that has increased competitiveness in the EU payments market. We believe that the IFR has largely achieved its goals. In addition to stimulating digital payments by effectively reducing cost of acceptance for merchants, the IFR has also helped to promote an integrated European payments market.

However, while some IFR provisions have applied since June 2015, many of its most impactful provisions were implemented later. This includes the interchange fee caps (*December 2015*), some of the most significant business rules (*June 2016*) and the detailed rules on the functional separation of card schemes and processing entities[3] (*February 2018*). This means that the IFR has only been applied in full force for a little over two years.

1.1. Interchange fee caps: the effect on costs for merchants

Capping interchange fees on consumer debit and credit cards has generally led to price reductions for merchants when they accept card payments, which is positive for the deployment and development of digital payments in the EU. Perhaps even more importantly, the EY/CE Study finds some support for the assumption that these price reductions have been "passed through" to consumers, although we must recognise that establishing a direct and undisputable correlation between consumer prices and the price of accepting payments is and will remain difficult given the complex economics driving consumer prices.

This, combined with the fact that the market for issuing cards remains highly competitive, leads us to the belief that the current caps on interchange fees are appropriately calibrated and do not warrant a fundamental review. We therefore support the recommended approach in the EY/CE Study to keep existing measures in place while closely monitoring if competitive market dynamics continuously drive these positive developments forward.

The EY/CE Study showed that the decrease of interchange fees has resulted in lower merchant service charges (MSC). There are two key mechanisms through which this has happened:

Immediate decreases: a significant number of contracts between merchants and acquirers are designed to automatically pass-through changes in interchange fees or scheme fees to merchants (so called "Interchange++" contracts). This means that reductions in interchange fees automatically led to reductions in the fee merchants pay their acquirer.

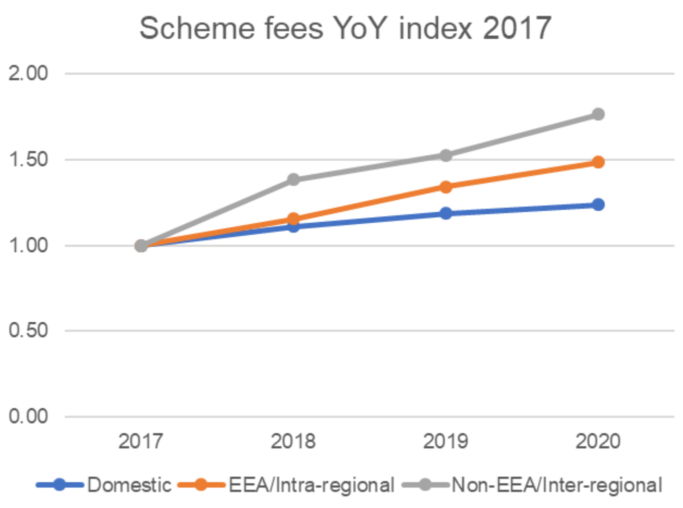
- This pricing model was encouraged by the IFR's provision mandating acquirers to provide merchants with unblended price information. Due to the IFR, Interchange++ contracts between acquirers and merchants have become more widespread throughout Europe, particularly with large merchants. Interchange++ contracts are also offered to smaller merchants, who however often opt for more stable and simple "blended" prices that for instance safeguard them from frequent increases in scheme fees.

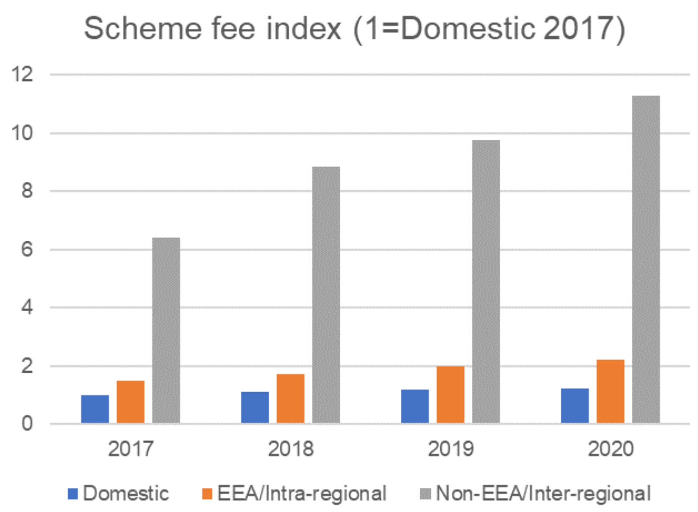
[3] EU Delegated Regulation on interchange fees for card-based payment transactions with regard to regulatory technical standards establishing the requirements to be complied with by payment card schemes and processing entities to ensure the application of independence requirements in terms of accounting, organisation and decision-making processes

Gradual decreases: For "blended" contracts that do not automatically translate changes in interchange fees or scheme fees into lower merchant service charges, the effect of the interchange fee cap has translated into lower prices through a gradual process reflecting renegotiations of expiring contracts, increasing competition between acquirers, and general adaptation to the harmonised business rules enshrined in the IFR.

That said, significant general increases in card scheme fees in recent years have partly eroded the decrease in merchant service charges. Card scheme fees, a critical component of the total Merchant Service Charge, have indeed risen significantly since the application of the IFR. The EY/CE Study[4] confirms this for the period 2015-217, and EDPIA members can confirm that card scheme fees have risen further since. As well as the broader changes to the payments landscape, the IFR coincided with the Visa Inc. acquisition of Visa Europe (closed June 2016) which naturally influenced the commercial landscape and the policies of the largest international card schemes.

Rising scheme fees[5]

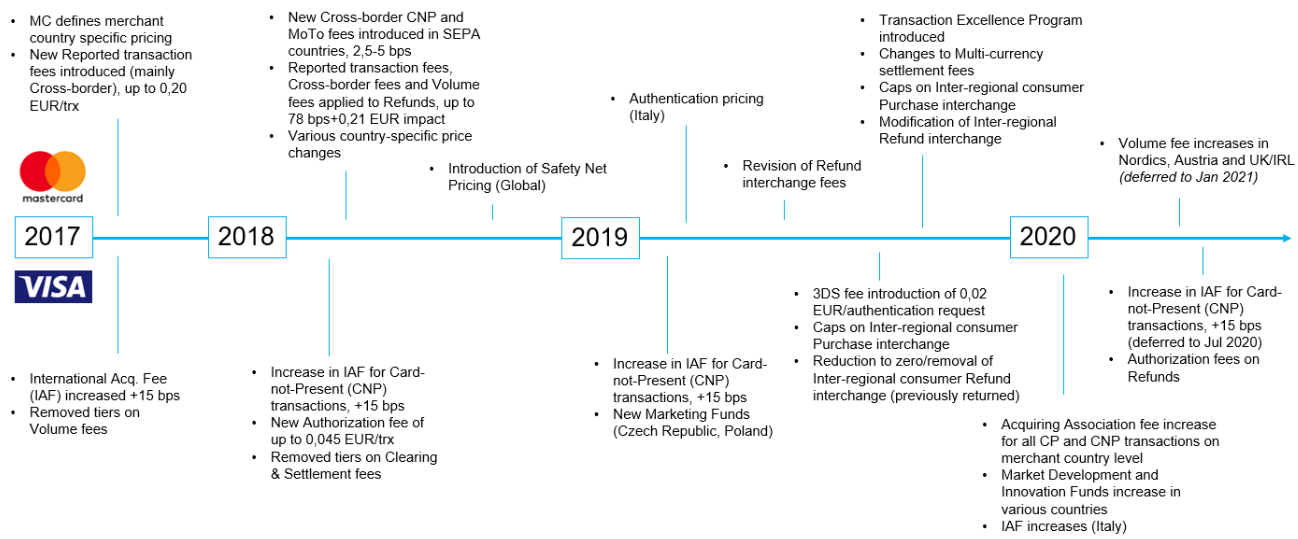




[4] EY/CE study p. 101: "We find that issuer scheme fees paid by issuers to schemes for consumer debit and credit card transactions have increased from 2015 to 2017 in a statistically significant manner. We also find that acquirer scheme fees paid by acquirers to schemes for consumer credit card transactions and to a certain degree also for debit card transactions have increased from 2015 to 2017."

[5] Unique scheme fee data seen in relation to transaction values split by jurisdiction for international schemes for EEA merchant countries has been collected from EDPIA members for the years 2017-2020 (YTD). Domestic refers to merchant- and issuer country being the same, Intra EEA means both countries are within the European Economic Area, while Interregional/non-EEA means the merchant has a legal entity within the EEA but the issuer is from another region. The first graph presented uses 2017 data split by regionality/jurisdiction as base (index 1), showing the cost development in relation to transaction values for subsequent years for each regionality vs their own starting point. The second graph uses Domestic 2017 as base, highlighting the difference by regionality vs Domestic fees 2017 as a starting point.

Timeline of select scheme fee increases



1.2. Effects of the IFR's "business rules"

We believe the IFR's business rules have also made a predominantly positive mark on the payments market, although market structure and competition dynamics are to a stronger degree shaped by other factors than the legislative framework alone.

In particular we would raise:

Unblending of merchant service charge fees

The IFR requires acquirers to offer merchants unblended fees and detailed invoicing information, which is meant to allow merchants to see the different components of the total merchant service charge and stimulate demand for contracts that pass-through fee changes directly. We believe this system works well and has significantly increased price transparency in the market, but we would nevertheless urge that merchants can continue to choose a blended fee if they prefer. Restricting that choice would be disproportionate and counterproductive in our view.

Choice is important. Blended contracts should remain possible because transparent pricing works two ways: while merchants that have opted for an unblended contract immediately benefit from a decrease of interchange fees (as described in 1.1.) or a decrease in card scheme fees, they also suffer immediately from an increase in card scheme fees or increase in uncapped interchange fees, given all fee changes are directly passed through. While interchange fees are mostly capped and therefore quite stable, scheme fees have been rising steadily since the introduction of the IFR, of which the direct risk falls on the acquirer, not the merchant, in a blended pricing model. In our membership's experience, this means that in many cases, merchants, particularly in the small/medium segment, prefer blended contracts as they offer price stability. The current IFR allows acquirers to offer merchants a choice.

Brand selection by merchants/consumers at point of sale

The IFR rightly included provisions that would better allow choosing a “brand” when paying, which is relevant when cards are co-badged. We believe this system works well for physical card in a ‘card present’ environment, as almost all terminals are now able to identify different card types. We do note that provisions on co-badging appear better defined for physical than virtual cards. This could lead to competitive distortion, for example concerning how the co-badging choice is displayed to cardholders in a mobile application.

We therefore agree with the EY/CE Study recommendation that focus ought to lie with the merchants and their steering and terminal default setting abilities. After all, merchants no longer have the same surcharging ability as previously and therefore carry the cost. However, we do not see the need for further harmonisation of technical standards for point of sale terminals, which would be disproportionality costly compared to the benefits it could bring.

Cross-border acquiring

The IFR mandated lifting territorial restrictions on acquiring inside the single market, which was meant to stimulate cross-border acquiring. Whilst it is hard to determine the exact contribution of these provisions, cross-border acquiring has taken place for several years now and is continuously gaining significance. Initially, this was led by large merchants exploring merchant service offerings at European scale; it is currently also driven by intra-regional competition and market consolidation that has led acquirers to serve multiple merchants out of one Member State.

EDPIA would however see value in having a mechanism to raise with supervisors any issues on the application of horizontal regulation (e.g. consumer law, contract terms, domestic settlement requirements) that can act as a barrier to cross-border acquiring.

Separation of card schemes and processing

The IFR mandated a functional separation between card schemes and processing entities, which was meant to open up the market for processing of transactions made with large global card scheme brands. We strongly support this provision, which is only in full force since February 2018, but we do see some challenges with this in practice, as it remains difficult for independent processors to break into card processing of mobile card transactions based on the large global card scheme brands.

Whilst we do not believe that harmonisation of standards would help in this context, as it would not prevent schemes from imposing their processing solutions on users, the EU should ensure it is impossible for the choice of processor to be *de facto* the choice of the processing services of the scheme.

This is particularly relevant as new technologies become more prevalent. Payments are more often initiated using a mobile device and mobile payments is a segment in which independent processors find it particularly hard to compete. This is because card-based mobile payments rely on pivotal tokenisation services, and European payment processors find it difficult to be accepted by the international card schemes as trusted tokenisation services integrators, which is a pre-requisite to become a processor of these services for issuing banks.

Given that this element of the legislation entered into force particularly recently we believe that its functioning should be closely monitored and effectively enforced.

2. Beyond IFR: Industry changes shaping the European payments market

Whilst it is clear that the IFR has had significant impact on pricing and business models, we believe it is essential to take a more comprehensive look at developments that have occurred since the application of the IFR before pursuing a legislative review.

This will ensure that the best possible regulatory approach is applied, and that regulatory intervention is carried out where needed, and only if needed. Indeed, the ongoing transformation of the payments space means that now is a difficult moment to revisit this piece of legislation.

Three main forces are shaping the development of the European payments market – new regulation, new technology and new industry players – while changing consumer patterns and the persistent threat of digital fraud require firms to constantly focus on balancing convenience and security.

2.1. Regulatory changes beyond IFR

Whilst this paper focuses on the impact of the Interchange Fee Regulation, it is worth pointing out that the other leg of the “Payments Package”[6], PSD2, has yet to apply in full. Most notably, the key principle of Strong Customer Authentication is only expected to be applied in full as of 31 December 2020.

Further, it is worth underlining that the payments industry is not only impacted by IFR and PSD2, but also by broader legislation such as the different Anti-Money Laundering Directives and GDPR, which present significant compliance related challenges for our industry as well.

When assessing the impact of IFR, it is hence relevant to consider how these various pieces of legislation interplay.

2.2. Technological developments

Our sector has seen enormous technological change since 2015. We are currently seeing numerous game changing technological transformations taking place, ranging from the growth of data-driven business models, the ever more rapid development of e-commerce, the uptake of mobile technology, and the spread of instant payments.

Most importantly, instant payments have been made available in most European countries, and the launch of the Eurosystem’s TARGET Instant Payment Settlement (TIPS) in November 2018 marked a milestone on the European journey towards faster and instant payments. Combined with the PSD2’s account access provisions, instant payments may strengthen payment solutions that compete with card-based payments and could be developed further through existing or new market entrants as well as collective regional bank-led initiatives.

Also, mobile payments were not a significant retail payment alternative to physical cards in Europe when the IFR started to apply in 2015. Today, new mobile-based players and the entry of smartphone manufacturers into the mobile payments ecosystem mean that mobile payments have become a real force to be reckoned with in Europe with annual growth rates of up to 60%[7] across Europe.

[6] COM 2013/547 and COM 2013/550.
[7] OVUM Forecast 2017-2021

2.3. New players and broad sector changes

Aside from smartphone manufacturers, other large technology companies have for some time been establishing themselves within the payments landscape with a strong cross-border consumer reach and a strong interest in consumer data. "Bigtechs" indisputably have strong reach and an enormous client base, which could have significant and sudden impact on the European payments landscape in the years to come.

Following the application of PSD2, hundreds of fintech companies – particularly focused on paytech – have emerged across Europe[8]. An increasing number of them move from being non-regulated technology providers to licensed payment initiation and account information service providers, as encouraged by PSD2. In total, more than 225 "Third Party Providers" have been licensed by national competent authorities which gives them the right to offer their services across the EEA[9]. It is still too early to predict the long-term impact these new players will have on the European card payments landscape, but successful providers operating out of Germany, Sweden and the UK have shown that they can become significant very quickly.

Finally, and probably most importantly, European payment service providers have continued their own transformation, most commonly moving from being domestically focused and bank-owned, to becoming bank-independent regional or pan-European specialised payment service providers. This development is driven by a huge wave of mergers and acquisitions that is consolidating the European payments industry further and which underpins the establishment of a still more deeply integrated single market for payments. As noted by the EY/CE Study this allows the industry to reap economies of scale and ultimately lower merchant costs.[10]

3. Considerations on the EY/CE Study

Generally, EDPIA agrees with most of the findings in the EY report, notably that the IFR has largely been successful in driving down costs for accepting card payments, without causing strong displacement effects. Importantly from our perspective, we concur with the findings that acquirers have significantly passed through the benefits of the interchange fee caps to merchants, that cross-border acquiring has increased, and that greater price transparency has had a positive impact on the market.

In particular, EDPIA agrees with the recommendations to keep interchange fees in place, not to introduce caps for unregulated cards, and to look into the level, structure and transparency of scheme fees.

3.1. Limitations of the EY/CE Study

While the EY/CE Study generally finds that the objectives of the Interchange Fee Regulation have been reached, the authors of the study have left a lot of issues open for debate. This is fully understandable considering the fact that the EY/CE Study only covers the years 2015 to 2017, which by definition means the assessment is only partial.

None of the provisions of the IFR have applied throughout the entire period from 2015 to 2017, which in itself already hinders a conclusive impact assessment (with the authors' showing a clear awareness of this challenge at various points in the study). On top of that, additional analyses must be performed to fully understand how the market has evolved since the end of 2017. The provisions on interchange fee caps, licensing requirements, and information obligations have only applied since December 2015.

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[8] Norfico and Konsentus, *The Tricky Encounter* (2020)
[9] Ibid, p 15
[10] EY/CE Study, p 13

Co-badging and application selection, unblended fees, and the restrictions to the "honour-all-cards"-rule have applied only from June 2016, whereas the European Commission's Delegated Act on independence of schemes and processing entities only applies since February 2018.

Because of the focus on 2015-2017, the continuing drops in merchant service charges after 2017 following full adaptation to the interchange fee caps across merchant categories are not captured, whilst continued service improvements have not been taken into account either.

The focus on 2015-2017 also cannot take into account the consequences of the acquisition of Visa Europe nor the continued rise in scheme fees since 2017, demonstrated above, which EDPIA believes is an important element to consider for any discussion related to interchange fees and card payments in the EU.

Conclusion

In conclusion, EDPIA feels that the time is not right for a revision of the IFR considering the current evolution of the payments landscape and the relatively limited time that the legislation has been fully in force.

In the longer term, the European Commission should pay close attention to the development of the payments market to ensure that the IFR's policy goals are not undermined particularly by incrementally rising scheme fees. This trend was rightfully highlighted by the recent EY/CE Study but has continued to develop adversely since 2017.