Credit Cards – Interchange Fee

Summary of the Decision by the Competition Commission dated 5 December 2005

In modern banking business, institutions offer their customers the option of using a credit card to make certain payments. In Switzerland the two major banks, UBS AG and Credit Suisse AG, together with Cornèr Banca SA and the cantonal and regional banks offer this service. For this service they charge an annual fee as well as a commission. UBS AG, Credit Suisse AG and Cornèr Banca SA issue credit cards directly, while the cantonal and regional banks entrust this task to Viseca Card Services SA.

The institutions that issue credit cards are known as issuers. They are – inter alia – licensees of Visa and MasterCard. In the Visa and MasterCard credit card system, the issuers are involved only in providing credit cards to their customers, and not however in the transactions carried out by the customers.

Special institutions, known as acquirers, are responsible for contractual relations with merchants. They engage in acquiring the largest possible number of merchants that are prepared to enter into contracts with them in terms of which they agree to accept payments for goods and services by credit card. The merchants pay a fee in the form of a certain percentage of the sale price. This fee is known as the Merchant Service Charge and is negotiated individually between the acquirers and the merchants. In Switzerland at present Telekurs Multipay AG and Aduno SA are active in the acquiring business for Visa and MasterCard.

Payment by credit card is thus based on a complex multiparty relationship. In this relationship, in addition to the card issuers and the acquirers, there are card holders on the one hand and the (contractual) merchants on the other. In the case of the Visa and MasterCard credit card systems, one therefore uses the term "four-party system".

In addition to the four-party system, there are also three-party systems. In this case the tasks of issuing and acquiring the card are undertaken by the same institution. In Switzerland Diners Club and American Express operate according to the three-party system.

The Visa and MasterCard credit card systems command a share of the entire Swiss credit card market of almost [85-95%]. The corresponding market share held by Diners Club and American Express is around [0-10%].

The present investigation relates to competitive relations in the credit card market.

In the case of the Visa and MasterCard credit card systems under the four-party system, a fee is charged by the card issuers to the acquirers, which the acquirer has to pay to the issuers for certain issuing services. This fee is known as the multilateral interchange fee (MIF). A distinction is also made between national, interregional and international interchange fees.

In Switzerland a variety of interchange fee rates apply. They relate to the various sectors and forms of transaction and can vary considerably.

The domestic multilateral interchange fees (DMIF) in Switzerland are fixed by two bodies, the Issuer/Acquirer Forum Visa (IAFV) and the Card Committee MasterCard (CC). As in Switzerland all institutions market both Visa and MasterCard (so called "dual branding"), the same parties are represented in both bodies. The DMIF fixed by these bodies accordingly cover the Swiss credit card market that is based on the four-party system, i.e. around [85-95%] of the entire credit card market.

Basically, the Competition Commission assesses the fixing of the DMIF by these bodies as a price-fixing agreement. Under the Cartel Act (ACart), a price-fixing agreement is presumed to be unlawful. The presumption of illegality can only be rebutted by providing evidence of special circumstances.

The DMIF in the four-party system is not an end price. It is however a component in the price. It amounts on average to around 70% of the merchant service charge that merchants have to pay to the acquirers. Among the card issuers, around a fifth of revenues come from the DMIF and consequently they have a considerable influence on the level of card charges. There is therefore a certain latitude for competition that the parties could theoretically exploit. At present, though, there is little incentive to do this. This is in part due to the fact that merchants are prohibited under the current agreements from charging customers a lower price if they do not pay by credit card (non-discrimination rule).

The Competition Commission has established that for some time foreign acquirers have been active in the Swiss market. Their market shares are small, but their presence has led to the development of a certain competitive pressure at acquirer level.

Overall, the result is therefore that competition has not been entirely eliminated, but it has been considerably impaired. The detrimental effect is due to the fact that the DMIF is negotiated in the bodies by means of a multilateral procedure, i.e. jointly, by the issuers and the acquirers.

In the case of complex systems such as the four-party system, this type of multilateral procedure can have advantages of efficiency. In particular, it simplifies market entry for foreign acquirers, which would otherwise have to enter into a separate agreement with each individual Swiss issuer. In addition, the multilateral procedure results in a saving in transaction costs, which increase exponentially in a bilateral system, based on the number of market participants.

In the opinion of the Competition Commission, however, the advantages of the multilateral procedure outweigh the disadvantages only if the fixing of the DMIF is objectively limited to the cost elements that are necessarily linked to the functioning of the network. This requirement is not fulfilled in the current system:

The DMIF is at present negotiated according to criteria that result in a “fee” that goes significantly beyond these network costs.

In view of these circumstances, the parties have stated that they are prepared to base the fixing of the DMIF only on objective network cost elements. To this end they have agreed an objectified cost scale, which contains only cost elements that are inherent to the network. Excluded are in particular the costs in respect of the interest-free period as well as the costs of credit losses in terms of the payment guarantee. The same applies to the costs of the Merchant Marketing and Spend Incentives programmes. In addition, the parties have undertaken to disclose the DMIF calculated in this way both to the Competition Authority and on request to individual merchants.

Finally the parties have undertaken with immediate effect not to impose a non-discrimination clause on merchants.

The Competition Commission regards these undertakings as sufficient to remedy their concerns on competition law issues. They allow the advantages of the multilateral system in terms of efficiency to be exploited without competition being harmed by coordinated conduct by the parties.

The transparency created by the disclosure of the DMIF also increases the bargaining power of the merchants in negotiations with acquirers.

Lastly, the abolition of the non-discrimination rule exposes the credit card system to increased competitive pressure from other payment systems. In future, individual merchants will be free to allow customers to choose between the advantages of using a credit card, possibly tied to a higher price, and using another method of payment, at a lower price. In this way, the market and ultimately the consumer decides how much paying by credit card costs at the end of the day.

For all these reasons, the Competition Commission has accepted the undertakings made by the parties and approved them as an amicable settlement in terms of Art. 30 para. 1 ACart.

Despite this settlement, the developments in the credit card market cannot be evaluated in detail at present. In order to prevent a future improper increase in the DMIF, the Competition Commission is thus limiting the DMIF to the amount that would currently result from the agreed settlement and accordingly fixes a maximum DMIF of [1.3-1.35%]. In comparison with other European countries, this amount lies in the medium to lower third.

The Competition Commission will continue to monitor the market. To reserve its option to act after the introductory phase of the amicable settlement the approval is limited to a period of four years.

The letter of undertaking was signed by the parties on 30 March 2005, and its terms were accepted unreservedly and unconditionally. Accordingly, it was received before the end of the transition period in terms of the revised ACart of

20 June 2003, which expired on 31 March 2005. There is therefore no latitude for the imposition of penalties in these proceedings.