

Interchange fees for card-based payment transactions

SUMMARY

Card-based payments have a growing share of retail payments, as do non-cash payments in both e-commerce and traditional commerce. There are different types of cards, according to their characteristics (debit and credit) and their holders (consumer and commercial). Card schemes are set up as four-party or three-party schemes providing a framework for schemes' fees and rules. Using cards for payments generates costs, which are distributed in the form of fees among the participants in the scheme. Interchange fees are designed to cover a portion of these costs and they are paid by the merchant's bank to the cardholder's bank, per transaction.

In the European Union (EU), the payment services framework is currently under review to take account of developments in the payments area. The current review specifically addresses interchange fees for card-based payments in a separate legislative instrument.

The interchange fees associated with four-party schemes raise concerns, for reasons which include their varying levels across the EU, their influence on prices and their impact on new entrants on the card market. So far, antitrust authorities have assessed whether specific agreements were anticompetitive or not, and whether they could be accepted or whether commitments to adapt the schemes would be sufficient to make them compatible.

The proposal for a regulation addresses interchange fees at EU level through regulatory means, providing for capping of the interchange fees for cross-border and domestic transactions (after a transitional period) and laying down schemes' business rules. Parliament and Council reached agreement on the proposal in December.



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Glossary

Card acceptance: refers to the process whereby a particular brand of card is accepted by a terminal, merchant or other entity.

Card acquirer: in point-of-sale (POS) transactions, the entity (usually a credit institution) to which the acceptor (usually a merchant) transmits the information necessary in order to process the card payment. In automated teller machine (ATM) transactions, the entity makes banknotes available to the cardholder.

Cardholder: a person to whom a payment card is issued and who is authorised to use that card.

Card issuer: a financial institution that makes payment cards available to cardholders, authorises transactions and guarantees payments to the acquirer for transactions that are in conformity with the rules of the relevant scheme.

Card scheme: a technical and commercial arrangement set up to serve one or more card brands, which provides the organisational, legal and operational framework necessary for the functioning of the services marketed by those brands. It enables a cardholder to effect a payment and/or cash withdrawal transaction with a third party other than the card issuer.

Co-branding: an arrangement whereby a product or service is associated with more than one brand. Co-branded schemes indicate that cards are equipped with both a domestic and an international scheme.

Interchange fee: a transaction fee payable between the merchant's bank and that of the cardholder involved in a transaction (e.g. card or direct debit). When agreed by members of a scheme multilaterally they are 'multilateral interchange fees'. They can also be agreed bilaterally.

Card payments

Payments made outside the financial markets between individuals – private persons, companies, NGOs, government agencies – of relatively low value and typically not of a time-critical nature are [retail payments](#). They include, for instance, payments made by consumers to retailers. Salary or tax payments made by businesses are also retail payments.

Retail payments are made by cash, cheque, card, direct debit and credit transfers. At physical points of sale (POS), [card](#) payments come second after payments in cash and are the most commonly used non-cash instrument.¹ In general, non-cash payments are replacing cash payments in the EU, although some Member States diverge from this trend.

Electronic payments cover the use of cards, direct debit and credit transfers, as well as e-money. Here, card payments have a predominant and growing share spurred by the growth of e-commerce (through the internet) and m-commerce (through mobile devices). Every transaction bears a cost, cash payments having the lowest unit cost.²

Card typology

Cards can be consumer or commercial cards, which in turn can be debit or credit cards. Furthermore, they can be issued by different card schemes which involve different types of fees.

Credit cards enable cardholders to make purchases and/or withdraw cash up to a prearranged credit limit. The credit granted may be either settled in full by the end of a

specified period, or settled in part, with the balance taken as extended credit (on which interest is usually charged). **Debit cards** enable their holders to make purchases and/or withdraw cash and have these transactions directly and immediately charged to their accounts, whether these are held with the card issuer or not. Another type of card is used in some Member States: a **card with delayed debit function**, which enables the holder to have purchases charged to an account with the card issuer up to an authorised limit and the balance settled in full at the end of the specified period.³

Consumer cards are issued to private individuals. **Commercial** cards are specifically issued to companies and their employees⁴ and apply specific conditions and incentives to the cardholders, different from those defined and applied for consumers. Typically, they entail higher fees than consumer cards.

Card schemes

In such arrangements, merchants and consumers are the two customer groups using a means of payment and interacting on one or several common platforms (the underlying systems that enable the card scheme to function). Card schemes are administered by a governance organisation which can be a non-profit-making body or a commercial company. The card payment market can be considered as a two-sided market.⁵

Card schemes cover credit and debit cards and define rules and fees; fees are currently set up on a country basis for national or cross-border transactions. Card schemes (whether domestic or multinational) and their cards are frequently co-branded for use in the country and abroad.⁶ In addition, card schemes are disjointed from card-payment-processing entities. This is considered to be a core element for increasing competition and efficiency in card payments.⁷

Four-party schemes

Some 95% of card payments in the EU are made with four-party scheme cards, including both the Visa and MasterCard networks. Four-party scheme involves a merchant (card acceptor), a consumer buying with a card (card holder), a card issuer and a card acquirer (both of which are banks), all of whom transact on the platform run by the payment brand which set up the card scheme.

These schemes charge different fees, meant to cover costs and generate benefits for the scheme. Fees are paid by cardholders to their banks for the entitlement to use the card, merchants pay fees to their banks for access to the card payment system ('merchant service charge'), while the banks pay fees to the governance authority

Card, internet and mobile payments

Card payments generally cover all payments made with a debit or credit card, either at the POS or remotely, e.g. through the internet or on the phone by voice communication.

Internet payments (e-payments) include online payments made with payment cards, online banking facilities or e-payment service providers with which the consumer has an individual account.

Mobile (contactless) payments cover all payments made with a mobile device (smartphone or tablet) and can take different forms (by means of a card or via direct debit). These relate to remote payments, e.g. online payments, or payments at the POS. This is the case for *digital wallets*, referring to applications offering payment methods to consumers, either linked to banks or not, which can link existing cards through mobile devices to make transactions in shops using specific technologies.

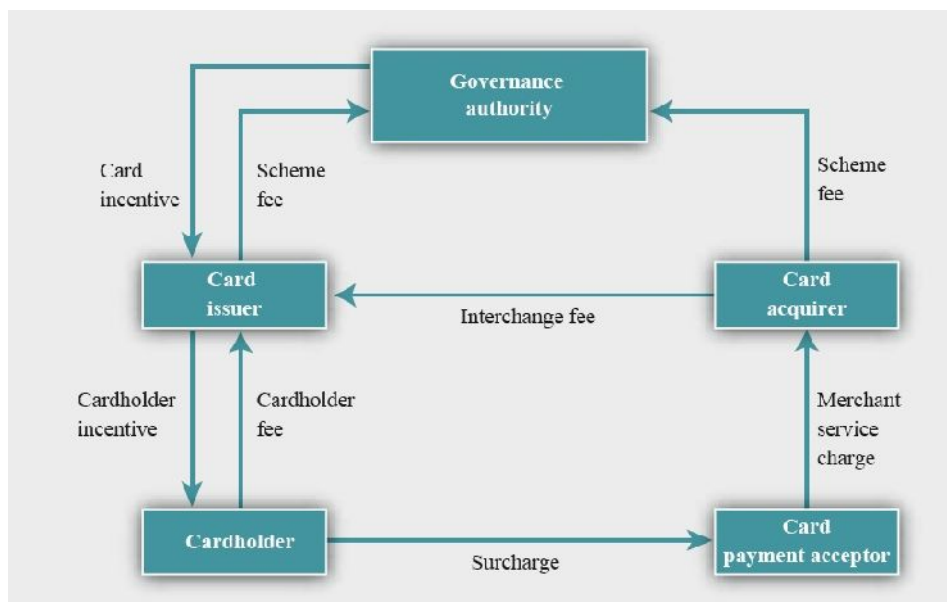
They raise security and interoperability concerns; 'danger moving from thieves to hackers'.

One payment can include all three aspects, for instance when an internet purchase is paid by a card from a mobile device.

('scheme fees') for their membership of the scheme. There are also interchange fees, which are designed to share the costs of processing payment-card transactions.

In the case of a card-based payment, the amount for the payment flows from the cardholder (via the card issuer) to the card acceptor (via the card acquirer). The interchange fee flows in the opposite direction to the payment for each transaction, that is, from the acquirer to the issuer. Interchange fees are commonly the main element of the merchant service charge. When legally possible, merchants can request cardholders to pay a surcharge as compensation for the extra cost for card payments, in comparison to other means of payment. Figure 1 shows the types of relations and the corresponding fees.

Figure 1: Four-party-scheme and typical fees



Source: As presented in ECB's [Card payments in Europe a renewed focus on SEPA for cards](#).

Three-party schemes

Three-party card schemes have been referred to in the course of the legislative discussion, although not covered by the proposal. Examples of such schemes are American Express and Diners' Club. The governance authority (which acts here as issuer and acquirer) receives two sets of information: one on the amount of the transaction and one on the consumer's card; the money goes directly to the merchant's account as soon as the transaction is authorised. Fees are paid by the cardholder (mainly annual fees and fees per transaction) and by the merchant. Three-party schemes do not apply interchange fees as such. However, an 'implicit' interchange fee exists when fees subsidise either merchant or consumer side.

Payment services legislation

Harmonisation of payment systems in the EU is part of the integration process of the European financial market. The objectives of the Payment Services Directive (PSD) are to increase competition and strengthen the efficiency of the supply of payment services and reduce the fragmentation of the internal market, which is detrimental to competitiveness.

Current legal framework

The **Payment Services Directive** (PSD, [Directive 2007/64](#), transposed by 1 November 2009) provides a harmonised legal framework for payments made within the EU in euro, and in all EU currencies, for national and cross-border transactions. It opened the supply of certain payment services to non-banking providers⁸ authorised under national law which can obtain permits to provide services cross-border. Payment services include the execution of bank transfers, direct debits and money remittance and acquiring of payment instruments.

The PSD also provides for transparency and information requirements on the payment providers as well as rights and obligations of both users and providers of payment services. It rendered payments easier and quicker across the EU, by setting time limits for processing.⁹ The PSD includes [options](#) for Member States with regard to its implementation (25 options are included in total). This means that differences remain between national payment systems, some of them relating to card payment (e.g. surcharging, see below).

Apart from the PSD, other relevant provisions are contained in [Regulation No 924/09](#) on cross-border payments, which provides for the same charges for cross-border and national payments in euros (including by card), and [Regulation No 260/2012](#) on migration to SEPA. For payments by consumers, [Directive 2011/83](#) on consumer rights 'prohibit(s) traders from charging consumers, in respect of the use of a given means of payment, fees that exceed the cost borne by the trader for the use of such means'.¹⁰

Update of the PSD

Article 87 of the PSD required the European Commission to present a report on the implementation and impact of the Directive, together with proposals for its revision, in November 2012. On 24 July 2013, the European Commission published a '**payments legislative package**' which includes the [report](#), a [proposal for a revision of the Payment Services Directive](#) (PSD2) and a separate [proposal for a regulation](#) on interchange fees for card-based payment transactions.

Since the adoption of the 2007 PSD, e-commerce (where card payment is crucial) as well as online and mobile payments has 'exploded'. PSD2 covers regulatory and security issues linked with cards and new mobile payment services. It also aims at promoting a truly open single European payments area and rendering the card market more competitive. The proposal aims to create downward convergence of costs and prices for payment services users. It is being [discussed](#) by the Parliament and Council.

Single Euro Payments Area (SEPA)

[SEPA](#) started as a private initiative in 2002, with the banking industry creating the European Payments Council.

It now covers [34 countries](#) (the 28 Member States and Iceland, Liechtenstein, Monaco, Norway, San Marino and Switzerland). It is aimed at making non-cash payments in euro, in Europe fast, safe and efficient. Consumers can rely on one bank, one account and one card to make euro payments across Europe.

SEPA focuses on the three most commonly used electronic retail-payment instruments: credit transfer, direct debit and payment cards. [Eurosystem](#) and European institutions have supported and provided legal basis for European payments market. In particular, SEPA migration Regulation No 260/2012 defines the end-date for the migration to SEPA credit transfers and direct debits in the euro area (extended for six month until [1 August 2014](#)).

SEPA for cards ('any card at any terminal') is at a less advanced stage.

Common technical [standards](#) allow processing of SEPA payments across Europe. The International Bank Account Number (IBAN) and the [EMV](#) chip, replacing magnetic stripes on payment cards, are examples of such standards.

Addressing interchange fees for card-based payments

Interchange fees in four-party schemes

Interchange fees in the four-party system are payments made for transactions. They are designed to share the cost of processing payment card transactions between the buyer and seller.

There are wide differences in how fees are charged across the EU. Differences exist between the fees applied in Member States for domestic transactions and for cross-border transactions, resulting in a fragmented situation. The interchange fees in each country typically include the operating costs (processing, clearing settlement and accounting), the costs of the payment guarantee for merchants, and security costs (as well as credit funding costs for credit cards).

From a merchant's point of view, interchange fees are part of the 'merchant service charge' (MSC) for card acceptance, which includes a 'charge for the acquiring service' and interchange fees paid by the merchant's acquiring bank. The interchange fees determine to a large extent the charges merchants pay to their banks for accepting cards, in other words, the cost. This cost is not transparent, and can be passed into retail prices, i.e. onto consumers. From a consumer's point of view, the actual cost of using their cards (i.e. all fees and not only those they pay for holding the card) is unknown. Merchants can pass on the cost to the consumer by requesting higher prices when paying by card, whenever this is legally possible (a process known as 'surcharging'), or by increasing prices generally, irrespective of the means of payment used by the consumer. Some consider that, in this way, all consumers effectively pay on behalf of card-holders who do not pay for the costs of the card and consequently have no incentive to use less expensive means of payment.

Under the provisions of the PSD,¹¹ allowing the imposition of an extra charge on consumers using cards is an option left to the Member States. Currently, 12 Member States have not prohibited surcharging in general in their national provisions. Surcharging is common practice in some areas such as the airline industry, ticket sales for events, and online purchases. It is worth noting that consumers established in a Member State not permitting surcharging may still be charged when they are purchasing online from a company established in a Member State allowing it.

Interchange-fees for card payments under EU competition scrutiny

Interchange fees are collectively agreed by the members of the scheme. A high level of interchange fees is attractive for the issuing and acquiring banks (most banks serve both functions). Being part of pricing schemes, interchange fees have focused antitrust concerns. They can be viewed as horizontal agreements (prohibited by competition law) and they can also amount to setting of a minimum price, if it is difficult to agree bilaterally on a lower fee (a *de facto* fee floor that affects price competition in the card-issuing and merchant-acquiring markets). Interchange fees have been under the scrutiny of competition authorities since 1984 at national and European level. This is not limited to Europe since competition authorities around the world have also intervened in the field of card payment systems. In particular in the USA and Australia, competition authorities intervened too and regulatory action followed, capping the fees and limiting network exclusivity.

Interchange fees may be necessary for the creation of efficiencies, the benefits of which may offset the restriction of competition, but they can be accepted with regard to EU

competition rules (i.e. being granted an exemption) only when certain mitigating conditions are met, according to the [Commission](#). Such conditions relate to low levels of interchange fees, transparent fee-setting methods and publication of interchange fees as well as allowing merchants to accept competing schemes.

Sensitive card-scheme rules

Among the rules of card schemes, some attract particular competition scrutiny:

- 'bundling' with other services, for instance insurance, which are perceived to be worth more than the cost of the card;
- the 'Honour all cards'¹² rule, according to which merchants are obliged to accept all cards issued by a single card scheme. Here, acceptance of the scheme implies acceptance of all of its products, irrespective of the merchant fees (does not apply when a scheme involves only one payment);
- the 'no steering' rules prohibiting merchants from encouraging the use of certain types of payments over others; and
- the 'blending' rule, imposing a single price for card-based payments.

Major competition decisions on four-party-schemes

VISA: while the international payment scheme was granted a 'negative clearance' in 2001 (VISA I), the cross-border multilateral interchange fees for consumer cards were temporarily (until the end of 2007) exempted under certain conditions in 2002 (VISA II), in particular reduction of interchange fees, capping and more transparency. In 2010 commitments by Visa Europe to lower the fees that banks charge for national and cross-border transactions was accepted for four years. On 26 February 2014, Visa Europe's commitment to cut its multilateral interchange fees for card payments as of 1 January 2015, to 0.30% of the value of the transaction for credit cards and to 0.20% for debit transactions, was made legally binding for four years by the European Commission.

MasterCard's Commission decision [19 December 2007](#) found that interchange fees were contrary to Article 101(1) TFEU and could not benefit from an exemption. MasterCard provisionally reduced its cross-border interchange fees to 0.30% of the transaction value for consumer credit cards and to 0.20% of the transaction value for consumer debit cards, pending the [Court's](#) settlement of its complaint lodged against the Commission decision. The Court upheld the Commission's decision on appeal on 11 September 2014, concluding that interchange fees for cross-border payment transactions in the European Economic Area restrict competition between associations of undertakings (banks) with regard to interchange fees.

See *European Commission, Competition DG, ['Competition enforcement in the payment card market'](#)*.

New entrants into the EU card market

Merchants cannot opt not to use a widespread card scheme since it could result in potential clients not buying from them. Widespread card schemes are thus necessary for merchants since they are widely used by their clients; therefore these schemes enjoy the possibility of setting higher interchange fees. They can then be used to offer ['negative prices'](#) to cardholders, for example a cash reimbursement or reward programme, reducing the effective price for the cardholder. Negative prices in turn serve to attract new cardholders. A competing card scheme wishing to enter the market would have to offer attractive conditions too (e.g. lower prices) in order to attract cardholders. To be able to do so, it would need to finance itself by imposing a price on merchants that provides sufficient revenues. This is only possible when the scheme's acceptance is widespread enough to make merchants accept such price levels via an adequate level of interchange fees.

Interchange fees function as a financial threshold which deters market entry. In the EU, interchange fee varieties makes it all the more difficult since new entrants need to offer

fees at least comparable to those established in each market they want to enter. There are not many examples of entry into the EU card market.¹³ Four European initiatives have been trying to establish new card schemes (the Euro Alliance of Payment Schemes (EAPS), the PayFair initiative, the EUFISERV and the Monnet initiative, which was discontinued at the end of 2012).

Regulating interchange fees for card-based payments

Commitments made by card brands in competition investigations have resulted in a reduction of interchange fee levels for a limited time. The proposed regulation is closely linked to competition concerns. Currently in the EU most Member States have no specific legislation regulating interbank fees (except Denmark).

Draft regulation on interchange fees

The Commission's [proposal for a regulation](#) on interchange fees for card-based payment transactions is part of the 'payments legislative package'. The proposal introduces a cap on interchange fees for cards widely used by consumers and sets out permitted business rules that will become applicable after a transitional period for all categories of cards in both cross-border and national transactions. The Commission assessed the possible related savings at up to €6 billion in annual savings for retailers. The idea that the reduction of interchange fees would lead to savings being passed on to consumers is put forward as one of the objectives.

Scope: the proposal covers four-party schemes for consumer cards. Commercial cards, three-party schemes and cash withdrawals (at ATMs) are not covered.

Capping: The proposal would establish a fixed interchange fee cap of 0.20% for debit card, and 0.30% for credit card transactions respectively. These caps¹⁴ are based on the 'merchant indifference test' (MIT), a market test which aims at defining indifferent fee levels (when merchants do not pay higher charges than the advantage that card use generates for them). They correspond to the caps accepted by the Commission in antitrust proceedings concerning four-party schemes. The capping would be introduced in two phases, cross-border transactions being capped two months after the regulation enters into force and domestic transactions two years after. There is also a review clause (two years after entry into force) on the level of capping.

The PSD2 proposal, also part of the package, would prohibit surcharging for card-based payments covered by the regulation.¹⁵

Stakeholders take [different positions](#), with some (like EuroCommerce, the association representing the retail, wholesale and international trade sectors in Europe) calling for much lower interchange fees and others (card providers) voicing concerns that the proposed regulation would hurt consumers, and potentially also SMEs and small retailers, while not ensuring that possible savings by retailers would translate into reduced prices for consumers, since retailers could decide to use them to increase their margins and profitability.

Business rules: the proposal provides for business rules applicable to card-based transactions. The scope of the 'honour all cards rule' and the 'no steering rule' will be limited; there will be transparency regarding the fees merchants pay (by way of monthly statements and a detailed indication of the fees per category and individual brand, or 'unblending'). Customers will also benefit from increased transparency, because merchants will no longer be prohibited from disclosing to them the fees they charge. Some [stakeholders](#) have stressed that some of the rules or practices which cause

competition concerns do not automatically generate anti-competitive results in a context different from the four-party schemes investigated by competition authorities.

State of play

A [report](#) prepared by the Committee on Economic and Monetary Affairs (ECON) (rapporteur Pablo Zalba Bidegain, EPP, Spain) was approved on 3 April 2014 by the outgoing Parliament, but the legislative resolution was not adopted and the proposal returned to the ECON Committee. Trilogue discussions with the Council were concluded in [December 2014](#), and ECON Members endorsed the resultant compromise text in a vote on [27 January 2015](#). The proposal is expected to be presented for a vote in plenary in March, before being formally approved by the Council at first reading.

Main references

- **Cards and interchange fees**
- ECB glossaries on '[Payment, clearing and settlement systems](#)' and '[Payments and markets](#)'.
- [Commission website on the PSD](#).
- ECB glossaries on '[Payment, clearing and settlement systems](#)' and '[Payments and markets](#)'.
- '[Multilateral Interchange Fees: Competition and regulation in light of recent legislative developments](#)', a report by Maria Chiara Malaguti, Alessandra Guerrieri, ECRI Research Reports, 31 January 2014.
- [Card payments in Europe – a renewed focus on SEPA for cards](#), ECB Eurosystem, April 2014.
- [Information paper on competition enforcement in the payments sector](#), European Competition Network, March 2012.
- [Interchange fees in card payments](#), ECB Eurosystem, Occasional paper series, no 131 / September 2011.
- **Related aspects: retail payments**
- [Study on the impact of Directive 2007/64/EC on payment services in the internal market and on the application of Regulation \(EC\) no 924/2009 on cross-border payments in the Community](#), 2013.
- [The single euro payments area \(SEPA\) – an integrated retail payment market](#), ECB Eurosystem, 2013.

Endnotes

- ¹ Some 40 billion card payments were made in 2012.
- ² The costs related to different means of payment are estimated as follows: 'Calculated per transaction, cash payments recorded, on average, the lowest unit costs (€0.42), followed by debit card payments (€0.70); cheques recorded the highest unit costs (€3.55)' ([Card payments in Europe a renewed focus on SEPA for cards](#), ECB, April 2014, p. 26)
- ³ This is particularly common in some Member States, for instance France's '*carte bleue*'.
- ⁴ It includes business cards typically issued to small businesses, corporate cards issued to medium and large consumers, and purchasing cards (see Green Paper 'Towards an integrated market for card, internet and mobile payments', [COM\(2011\)941 final](#), p. 8).
- ⁵ A 'two-sided market' refers to a situation where supply and demand on one side determines supply and demand on the other, resulting in both sides determining the pricing.
- ⁶ 'Six multinational governance authorities are issued and/or acquired in most EU countries, with a median value of four multinational card schemes offered per Member State. MasterCard (governance authority: MasterCard Inc.) and Visa (governance authority within the EU: Visa Europe) are the leading card schemes in Europe and are offered in all Member States, followed by American Express and Diners'. JCB and UnionPay are only issued and/or acquired in a few Member States.', [Card payments in Europe – a renewed focus on SEPA for cards](#), p. 31.
- ⁷ For a detailed presentation see [Card payments in Europe – a renewed focus on SEPA for cards](#), Part 6 'Card schemes and processing', p. 40 sqq.
- ⁹ Execution time 'D+1', D being a business day.

- ¹⁰ Article 19; however, calculating this cost might prove difficult for trader themselves.
- ¹¹ Article 52(3) of the Payment Services Directive; countries allowing surcharging for all (debit and credit cards) are Belgium, Estonia, Finland, Germany, Ireland, Malta, the Netherlands, Poland, Slovakia, Slovenia, Spain and the UK; and Denmark for credit cards only.
- ¹² It 'requires merchants to accept all products issued under the same brand, even if the merchant fees for these cards can vary by a factor of 3-4 within the same card category (i.e. credit / debit) or by a factor of up to 25 between card categories, such as premium credit card and low-cost debit cards'. (Explanatory memorandum to the Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions, p. 3.)
- ¹³ For more information, refer for instance to [Card payments in Europe – a renewed focus on SEPA for cards](#), p. 32 sqq.
- ¹⁴ MasterCard requested access to the documents used by the Commission. The Commission denied the access. Court decision rendered 9 September 2014, in [case T-516/11](#), annulled the Commission's refusal decision.
- ¹⁵ Article 55 of the [PSD2 proposal](#) envisages that charging is possible for cards not covered by the Regulation on interchange fees for card-based transactions.

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eprs@ep.europa.eu

<http://www.eprs.ep.parl.union.eu> (intranet)

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