European Commission's

Sector Inquiry into the Payment Cards Industry under Article 17 Regulation 1/2003 on Retail Banking

Response from:

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Specific Comments

Financial analysis of the industry

1. Are high merchant fees a competitive issue for the EU economy?

Yes. The level of merchant fees is a competitive issue, especially as merchants will in the main pass the cost on to consumers as a general business cost either indirectly within the price or as a surcharge, where permitted.

Our Members advise us that the merchant service fees vary considerably across the EU. But, as clearly identified in the EC's '*Interim Report 1 - Payment Cards'*, the car rental sector has been identified as a sector paying one of the highest Merchant Service Charge (MSC). We note with great interest that car rental, amongst others identified, fall within the Travel & Entertainment (T&E) sector where travellers would be expected to pay with payment cards. In contrast, lower MSC are levied where the margins of the merchant are low. This policy must justify closer examination.

There is one further issue which we believe warrants closer examination. A card acquirer normally provides the merchant with the option of being charged the MSC either by using a rate by card type or using a blended rate.

Card types normally are categorised in the following way:

- Consumer cards
- Corporate cards
- Business cards
- Purchase cards

The rate charged for Corporate, Business and Purchase cards are 40-70% higher than the rate for consumer cards. When our Members request justification for these differences the acquiring banks have indicated that as the card issuer, they have to provide the end user (normally businesses) with enhanced billing information/reports and there is therefore additional cost to recover thus the higher rates.

We would therefore suggest that the additional information is supplied by the merchant and penalising the merchant for doing so should be deemed as unjustifiable. Our Members have noticed that the volumes of corporate and purchase cards being used have been increasing significantly and where this is the case our Members have noticed adverse commercial impact.

The biggest issue in all these instances is the reluctance to make the interchange rates clear and transparent to the merchant. The merchant would benefit if the basis of calculation of the MSC Rate for all card types are made available. However, one advantage of using separate rates is that as the MSC is billed by volumes processed, our Members are able to identify the costs separately for future negotiations. The application of rate by card type, as understood by our Members, is available only for transactions paid by Visa and MasterCard.

A blended percentage fee is charged for most transactions based on the country in which the vehicle rental transaction takes place. The make-up of the blended rate is not provided or is transparent. With the intelligence available to our Members, it is generally felt that vehicle rental companies appear to pay a higher merchant service fee in contrast to other business sectors. This view is now being re-enforced by the findings in the EC's report.

For clarity, a blended rate is where a single rate is applied irrespective of card type. Our Members have stated that there does seem to be no or little explanation which would help to explain how this rate has been calculated and therefore makes it extremely difficult for our Members to identify how and when cost savings can be made. Indeed, in order to ascertain whether this is a viable option, the merchant would require an appropriate explanation supported by workings of such rate. Again, the report has confirmed quite rightly that this not an advisable option.

MSC Rate - Transactions paid by non-UK issued cards (International Cards)

The rate charged for these transactions (cards issued outside the UK) again are considerably higher than what is charged for UK card transactions. There is no justifying reason why this should be so. Once again if there is transparency these rates maybe understood better.

MSC Rate - Cross Border Acquiring

In the UK the rate charged for transactions paid by domestic issued cards, is lower than that charged for International cards. However, for example in Germany and Switzerland, the domestic cards are charged the same rate as for International cards. This is another area where it is believed that the merchant is being exploited. This again has been recognised by the report and it is anticipated that there will be redress for the merchant.

Dynamic Currency Conversion

There is no specific reference in the report to DCC and the effect of interchange fees on a MSC rate for such transactions. Acquirers are charging separate rates for these type of transactions. The rates charged for DCC has no relation to the other rates charged. With the increase in volumes in our business sector it is apparent that these transactions must be recognised and a consistent and acceptable MSC rate applied.

2. Are there compelling justifications for the comparatively high level of merchant fees observed in some parts of the EU25?

Our Members are not aware of any. The merchant fees vary considerably across the EU. However, as all transactions are submitted to one acquirer in the UK, our Members feel there this is little justification for such variation.

3. Are the high profits observed due to innovation or do they arise from some kind of market power in a two-sided industry?

With the exception possibly of Chip and PIN, from a merchant perspective innovation is not obvious or evident. However, the benefit of Chip and PIN to the car rental industry is limited given the other inherent controls required to be in place, for example, a driving licence is required and possibly a passport. The lack of innovation is evidenced when the renter disputes the charge, some of our Members merchant acquirers have only very recently been able to send Retrieval Requests electronically and cannot send Chargeback Letters electronically they have to be faxed.

As Visa and MasterCard have a dominant market position and thus representing the majority of the card issuers and acquirers, our Members feel that vehicle rental companies are not getting the support from their acquirers to change the Visa and MasterCard Operating Regulations because the acquirer has competing interests. Neither the interest of the cardholder nor the interest of the merchant are therefore adequately represented. That said, the BVRLA has taken the initiative to address this imbalance, by entering into direct discussion with both Visa and MasterCard. Unfortunately, it is becoming patently clear to us that the solutions are only likely to be delivered over the longer term, when clearly more urgent and direct action is required. There would appear to be a limited number of acquirers that are able to process cross border transactions thus stifling the existence of a competitive market.

4. What pricing practices, rules and legal provisions distort price signals to consumers and the choice of the most efficient payment instrument?

It remains unclear to our Members whether cardholders are fully aware that a merchant is required to pay differing fees depending on the payment card present i.e. the fee paid by a merchant for the acceptance of a Visa Corporate card differs from the fee paid for accepting a Visa Credit card. It is only in very limited instances that a merchant can charge a cardholder a fee for accepting the debit or credit card.

From a merchant perspective there is not a choice, if a merchant wishes to accept a Visa card or a MasterCard card it has to accept all cards issued by the two Card Schemes even if the card is not appropriate for the merchant. Furthermore, MasterCard issue a prepaid card, in accordance with the MasterCard Operating Regulations which car rental companies would be expected by MasterCard to accept.

There seems to have been little or no consideration given to the fact to the constraints such an operating model would have upon the vehicle rental transactions, such as fuel recharge or accident damage costs, especially as there may be insufficient funds on the prepaid card.

A merchant does not pay one fee for accepting a Visa issued or MasterCard issued card, the fee varies by card type and again according to the Visa and MasterCard Operating Regulations all card types have to be accepted. Needless to say there is limited scope for negotiation.

As you will see, there is, from our Members perspective, very little or no choice and furthermore, Visa and MasterCard's Operating Regulations are very restrictive to merchants examples are:-

Vehicle Damage

A rental customer would normally be asked to agree and sign a rental agreement which would contractually hold the customer responsible for any damage caused to the rental vehicle. In addition, the customer would be asked specifically to sign a mandate for the payment card presented to be used to deduct the cost of the damage. In such instances, the rental company is required to submit the rental charge and the damage charge separately. In addition, both card schemes have different, but specific requirements as to what the renter should sign.

Failure to charge the accident damage separately means that car rental companies get charged back for the damage and then have to accept it or bill the renter directly. As stated earlier banks are both card issuers and acquirers, the support available to merchants to get the rules changes is ineffectual.

Furthermore, both card schemes fail to recognise the commercial and operational requirements, thus the operating rules fail to accommodate the practical realities as there seems to be a very strict interpretation on the documentary evidence required to help substantiate the charge. For example, the car rental company is asked to provide the following:

a) An estimate of the costs of the damages from an organisation that can legally provide repairs. *As some rental companies do not actually repair every single item of damage noted, they would estimate the cost of the repair themselves and carry out a full repair when they sell the vehicle.*

b) Rental agreement makes it clear that the customer is responsible for any end of rental damage;

c) The rental company has obtained separate written statement, signed by the customer confirming that the vehicle was damaged when returned; and *(this has created problems when the vehicle is returned out of office hours or where there us an unattended collection)*

d) The rental company, with the customers approval may use the payment card to pay for the charge by preparing a specific sales slip with proof of card presence; *(this creates immense problems as the customer may not be present)*

e) Incident report

f) Other pertinent documentation indicating the Cardholder's consent to pay for damages with his payment card.

No show fee

In Europe, apart from American Express, the major payment card providers do not currently permit car rental companies to charge a no show or cancellation fee where the customer has requested a vehicle to be booked, but fails to honour this commitment without any prior notification.

The car rental sector has noticed an escalation in the number of customers taking advantage of Internet to make comparisons and book with several firms at the same time, only taking the cheapest option. This trend has increased, as consumers are fully aware that they would not be charged for failing to honour the commitment they made to the rental company. This practice is seen as a direct increase in operational costs as vehicles are being reserved and not being utilised, especially as rental companies are unable to rent the vehicle.

Given the commercial and market impact this creates for car rental companies, we fail to understand why the major payment card rules prevent the merchant being allowed to make such charges and is seen by our Members as discriminatory and prohibits the sectors commercial freedom. We understand that other similar industry sectors such as the hotel and airline are able to levy such reasonable charges on their customers. Furthermore, it would seem that in the rules relating to no show fee are permitted in the United States of America, and we therefore fail to understand the logic of why the European market should be treated any differently.

Dynamic Currency Conversion (DCC)

Merchants are permitted to convert the currency of the transaction to the cardholder's currency provided they adhere to Visa's Operating Regulations which are in practice proving to be onerous. One such requirement is to include a statement that the cardholder's decision of billing currency is final. However if the cardholder complained to their card issuer the merchant is likely to receive a charge back, in accordance with the Operating Regulations, for the total rental value thereby proving that the decision was not final.

Finally, given that Visa and MasterCard both issue payment instruments to a similar group of individuals it would be beneficial to merchants if there was only one set of key Operating Regulations that had to be followed.

The Operating Regulations, as they currently stand, appear to be very restrictive and similar however each may require a merchant to do something slightly differently. Thus as the Operating Regulations do not appear to offer one card scheme a competitive advantage, our recommendation would be for there to be one set of broad guidelines, which fairly reflected commercial practices and legal requirements that merchants are subject to.

Moreover, as cardholder's of a Visa card or a MasterCard are similar, there should only be one requirement in terms of the data that has to be provided by a merchant to an acquirer. Currently Visa and MasterCard have differing requirements and MasterCard is seeking for more information to be provided.

5. Would cost based pricing promote the use of efficient payment instruments and how could such pricing be implemented?

It appears that for customers renting in the UK there is a different fee for each Visa and MasterCard card type, a different fee is paid depending on whether the card is a Visa Business Credit, Visa Business Debit, Visa Delta, Visa Corporate, Visa Credit, Visa Purchasing, UK Electron, MasterCard Business, MasterCard Corporate, MasterCard Credit, MasterCard Purchasing one.

Given that a merchant has to accept all cards issued by Visa and/or all cards issued by MasterCard cost based pricing does not currently promote the use of efficient payment instruments. If a merchant was permitted to choose which Visa or MasterCard they would accept it could possibly be argued that merchants could then choose to accept those cards that were more financially advantageous. However significant system changes would be necessary to ensure that only selected cards were accepted if it was at all possible (a BIN range may cover several card types).

6. Do currently existing pricing practices have a substantial negative effect on cross border card usage by consumers?

As we do not have sufficient information, we cannot comment on the pricing practices and whether they have a negative impact.

A card issuer generally converts the value of the transaction from the currency of the country in which the transaction took place to the cardholder's statement currency generally using a marked up exchange rate. Merchants are permitted to convert the transaction currency to the cardholder's currency subject to complying with very onerous rules.

Market structures, governance and behaviour

7. What market structures work well in payment cards?

As merchants, our pan-European Members have advised us that they centrally submit the majority of European transactions to one acquirer, central acquisition would be required in the future. The return to a transaction having to be submitted to an organisation in the country of the transaction would not be considered as a viable and efficient option.

8. What payment structures do not appear to work well/deliver efficient outcomes?

See above.

9. What governance arrangements can facilitate competition within and between card payment systems?

The separation of card issuance and card acquiring, hence an organisation can only be either a card issuer or a card acquirer.

10. What governance arrangements can incentivise card payment schemes to respond to the needs and demands of users (consumers and merchants)?

A new body that was totally independent of the card payment schemes, the card issuers and the acquirers would be required to review issues raised by merchants. If this body supported the merchant then there would need to be a penalty mechanism to incentivise the card payment scheme to amend their Operating Regulations.

11. What governance arrangements can allow minority participant or minority members to receive appropriate information and participate appropriately in decision making?

No comment

12. What access fees are indispensable?

No comment

13. To what extent is separation between scheme, infrastructure and financial activities desirable to facilitate competition and efficiency?

Very desirable as currently acquirers appear not to work in the best interest of the merchants, their customers as they are tied by their membership of Visa/MasterCard and are not therefore independent.

Future market developments

14. Are significant structural changes to be anticipated in the payment cards industry?

No, given the lack of independence.

15. What are the anticipated impacts on the industry of innovation and technological change?

None and in any case is very limited.

16. Potential solutions to market barriers

Please see our comments under Question 10.

17. How can structural barriers to competition, which may arise for instance from the integration of different functions within a payment system or from join acquiring ventures, be tackled?

We are unaware on how structural barriers could be effectively tackled.

18. Are there compelling justifications for the identified behavioural barriers to competition?

Not from our Members / Merchant's perspective.

19. How much need and scope is there for harmonising technical standards in the payment cards industry? How large are the potential benefits and costs of harmonisation?

No comment.

20. What lessons (best practice) for the design of SEPA schemes can be learnt from existing national and international payment systems?

No comment.

21. How could competition between schemes in SEPA be strengthened?

No comment.

22. Which structural and behavioural barriers to effective competition between banks and payment service providers should be removed to achieve SEPA?

No comment.

23. What governance requirements should SEPA schemes meet?

No comment.

24. By what means can interoperable communication protocols, security and other technical standards be achieved and certification procedures be limited to the minimum necessary?

No comment.

25. Do the removal of barriers to competition, the observance of pro-competitive governance and the creation if interoperable standards require (further) regulation?

No comment.

Response to EC – Payment Card Inquiry

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Bona-fides **BVRLA, the Industry and its Members**

- The BVRLA is the representative trade body for the companies engaged in the operating leasing of cars and commercial vehicles. Its Members provide short-term self-drive rental, contract hire and fleet management services to corporate users and consumers. BVRLA Members operate a combined fleet of 2.3 million cars, vans and trucks of widely differing sizes from 3,300 locations throughout the UK.

- BVRLA Members provide a vital service to UK industry and commerce, facilitating the movement of goods and people for essential business purposes. Members buy around 1 million new vehicles every year, at a cost of nearly £14 billion, representing the biggest volume of purchases by any fleet sector. In making these purchases, Members are a major support to the UK automotive industry. In addition, by way of ancillary services, our Members spend an additional £2 billion.

- Together the Rental, Leasing and Commercial Vehicle Membership provide the significant voice of an industry which purchases almost half the personal and company transportation in the United Kingdom. This is combined with the diversity of BVRLA Members to create a unique organisation where one Association represents three combined sectors allowing Members to share representation on committees and in the activities of the BVRLA

- BVRLA Members subscribe to a Code of Conduct which sets out stringent standards in terms of the operation and quality of vehicles and the commercial propriety of Members. The BVRLA adopts a strict process of vetting applications for Membership.