Publication of Final Report regarding the data collection on merchants' costs of processing cash and card payments

Questions and Answers

Why did DG Competition carry out the data collection and analysis?

The data collection took place in the context of the Commission's current and possible future competition proceedings in the area of payments.

In the framework of 4-party payment card schemes banks typically charge each other collectively agreed interbank fees (also called Multilateral Interchange Fees or "MIFs") which are paid by retailers, who in their turn pass them on to consumers in the form of higher prices. Over the past decades these MIFs have come under antitrust scrutiny by the European Commission and several national competition authorities. In its judgment of 11 September 2014 in the MasterCard case the Court of Justice of the European Union irrevocably rejected MasterCard's appeal contesting the Commission's assessment of MIFs as a forbidden restriction of competition.[1]

Against the background of the appeal and in the framework of this and other competition proceedings MasterCard, Visa Europe and *Groupement des Cartes Bancaires* voluntarily engaged to reduce certain MIFs. The MIFs that these card schemes proposed to apply were determined on the basis of a methodology developed in economic literature named the 'tourist test' or 'merchant indifference test'[2]. This test is based on a MIF level which ensures that merchants are on average indifferent whether customers use payment cards or cash to pay for their purchases.

The reduced fees offered in settlements by the payment card schemes also served as benchmarks for the caps on interchange fees imposed by the Interchange Fee Regulation proposed by the Commission in July 2013 and voted by the European Parliament on 10 March 2015.

To be able to apply the Merchant Indifference Test on the basis of complete and precise information and to determine a benchmark for assessing efficiency justifications brought forward by payment card schemes under the competition rules, DG Competition launched a data collection exercise to measure merchants' costs of processing payments by cash and by card.

What is the structure of the report?

Although after a series of publications in economic literature the principles of the Merchant Indifference Test are relatively clear, its concrete application through the collection and analysis of a specific data set implies a series of methodological considerations and choices, all influencing the various outcomes of the analysis in a certain way. Thus, the study explains the methodological choices applied to the data collection carried out on request of DG Competition. It also discusses several approaches with respect to the analysis of the data based on a different coverage of the

1 Judgment of the Court (Third Chamber) of 11 September 2014, MasterCard Inc. and Others v. European Commission, Case C-382/12 P, nyr.

2 Jean-Charles Rochet and Jean Tirole, "Must-Take Cards and the Tourist Test", DNB Working Paper, No. 127, 2007. See also Joseph Farrell, "Efficiency and Competition between Payment Instruments", Review of Network Economics, Vol. 5, Issue 1, 2006.

merchant population, the way heterogeneity between merchants is dealt with, the time horizon chosen for the identification of fixed costs and the reliance on merchants' judgments as regards the allocation of costs between payment means and the split between fixed and variable costs.

From an academic point of view, it is not always possible to distinguish an unequivocally preferable option among these outcomes. The study may therefore also serve as a basis for debate and further research.

What is the outcome of the data collection and analysis?

The outcome of the data collection and analysis is in line with the benchmark figures applied in the 2009 undertakings and the 2010 and 2014 settlements by payment card schemes, which are also the caps imposed by the Interchange Fee Regulation that was recently agreed by the European legislator[3].

For the population of large merchants - accounting for at least half of the card transactions in the EU 28 - the analysis found that in the medium-term the merchant indifference thresholds stay well below the benchmarks applied in the settlements and the Interchange Fee Regulation and range between 0.06% and 0.16% for debit and between -0.04% and 0.13% for credit cards. In the short-term the indifference benchmarks for debit and credit cards are slightly lower, while in a long-term perspective, they are slightly higher. The data collected did not permit drawing conclusions on benchmarks for the whole merchant population.

In previous competition cases, DG Competition took account of several parameters, in particular the evolutions in the payment sector (changes in payment habits, intensity of card use, technological developments, development of innovative payment solutions), and as a result took a forward looking time horizon of 4-5 years as a basis for its actions, which is in line with a medium-term approach. Obviously, if and to the extent that parties disagree with this and other methodological choices discussed in the report, or wish to argue that certain elements are not relevant to their specific case, they would have to bring forward arguments and/or further evidence.

Will the Commission publish results at country level?

The dataset could be used to derive some figures at country level. However, the payment markets is currently integrating at European level, and the past and on-going competition enforcement cases before the Commission concern the European market as a whole. The same is likely to apply to possible future competition cases, therefore the definition of European benchmarks for the merchant indifference thresholds appeared to be the most appropriate. Consequently, the results focus on benchmark figures at the EU level.

Do the results cover online transactions?

The data collection focused only on face-to-face transactions; 'at-distance' (such as online) transactions have not been analysed. The main reason for this is that in the at-distance environment, different payment instruments are available as alternatives to cards than in the case of face-to-face transactions. The existence of a different set of payment alternatives, and of different competitive dynamics between them, also implies that the efficiency of cards in the at-

3 http://europa.eu/rapid/press-release_IP-15-4585_en.htm

distance environment remains to be demonstrated. Also, the need to incentivize consumers to use their card for those specific transactions and the adequacy of a MIF mechanism (and the relevance of the Merchant Indifference Test) needs to be assessed and demonstrated separately for at-distance payments. In any event, the choice of a comparator to cards in that context would require an in-depth examination of the alternative payment means available. Finally, the measurement of their transactional costs would require a specific study and a different sampling of merchants. For this reason, given the still limited (although growing) shares of online and other remote payments, the Commission has prioritized the estimation of transactional benefits of cards for face-to-face transactions.

The Commission claims that without further research no meaningful conclusions can be drawn for the whole merchant population. Why?

In order to collect precise and detailed cost data, the Commission decided to survey a sample of large merchants. Deriving from those cost data cost functions or merchant indifference thresholds that would describe the whole merchant population requires strong assumptions about the relationship between costs and merchant size. However even if a specific modelling of this relationship appears relevant for large merchants, there is no certainty that it is valid for all merchant sizes.

In addition, the Commission faced difficulties when measuring the acquiring margin (i.e. the part of the MSC on top of the interchange). It used a benchmark of 0.06% for the large merchants' results which is relatively low. However the Commission had no benchmark acquiring margin for the whole merchant population. The 0.06% figure appears very likely to be an underestimated value when it comes to the whole merchant population.

Will the Commission provide public access to the source data?

No. The merchants who agreed to participate in the survey provided sensitive commercial information that falls under the definitions of business secrets and other confidential information as described in Regulation 1/2003 on the implementation of the competition rules[4], Regulation 773/2004 relating to the conduct of proceedings pursuant to Articles 81 and 82 of the EC Treaty[5] and Regulation 1049/2001 on access to documents[6]. In particular, the information provided related to value of sales, to costs of labour and costs of equipment (e.g. payment processing devices and software) and services (e.g. cash transport and deposit, provision of change, card acquiring, account crediting) supplied by external providers, as well as to the merchants' internal business processes (e.g. information regarding the organisation of back-office tasks and the frequency of cash deposits). Such information represents business secrets, and its disclosure to other parties could seriously harm the undertakings concerned. For this reason many participating merchants have required the contractor to enter into non-disclosure agreements before agreeing to participate in the survey. The Commission will therefore not provide public access to the data collected other than through the publication of aggregated data in the report.

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4 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003R0001:EN:NOT

5 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004R0773:EN:NOT

6 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32001R1049&rid=2