
Public Authority Involvement in Payment Card Markets: A Shift from Litigation to Regulation

Fumiko Hayashi and Jesse Leigh Maniff
Federal Reserve Bank of Kansas City

The Evolving Landscape of Payment Systems
Bank of Mexico
October 15, 2014



The views expressed here are those of the authors

Today's presentation

Based on two documents:

- (1) "Public Authority Involvement in Payment Card Markets: Various Countries, August 2014 Update"
- (2) "Interchange Fees and Network Rules: A Shift from Antitrust Litigation to Regulatory Measures," FRB of KC PSR *Briefing*

available at:

<http://www.kansascityfed.org/research/bankingandpayments/>



Outline

- Trends of public authority involvement
- A shift from litigation to regulation
- Reasons for the shift
- Implications
 - For the U.S.
 - For competition and other payment public policy issues
- Summary

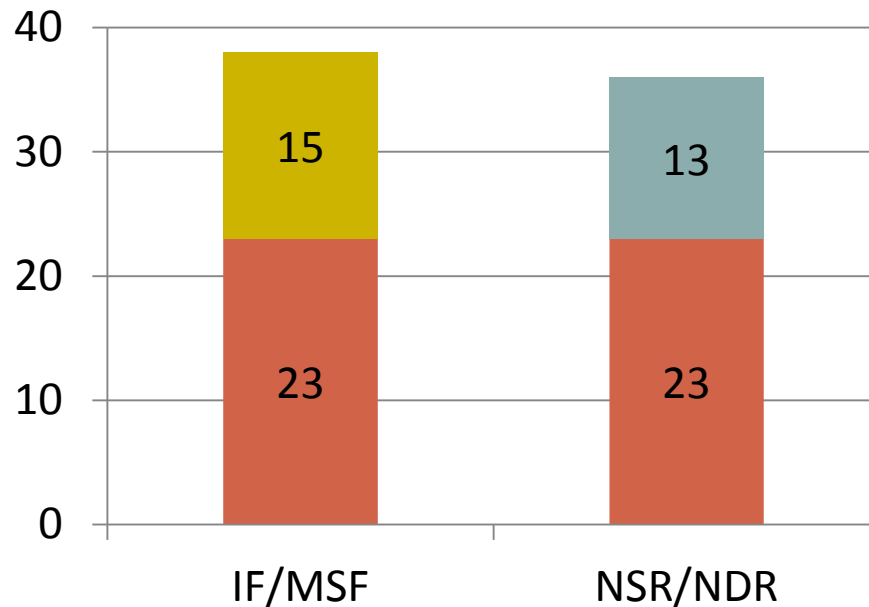


Trends of public authority involvement

- In 51 countries (or areas), public authorities have intervened or initiated investigations in payment card markets:

Interchange/Merchant service fees – 38 countries

No-surcharge/No-discrimination rules – 36 countries



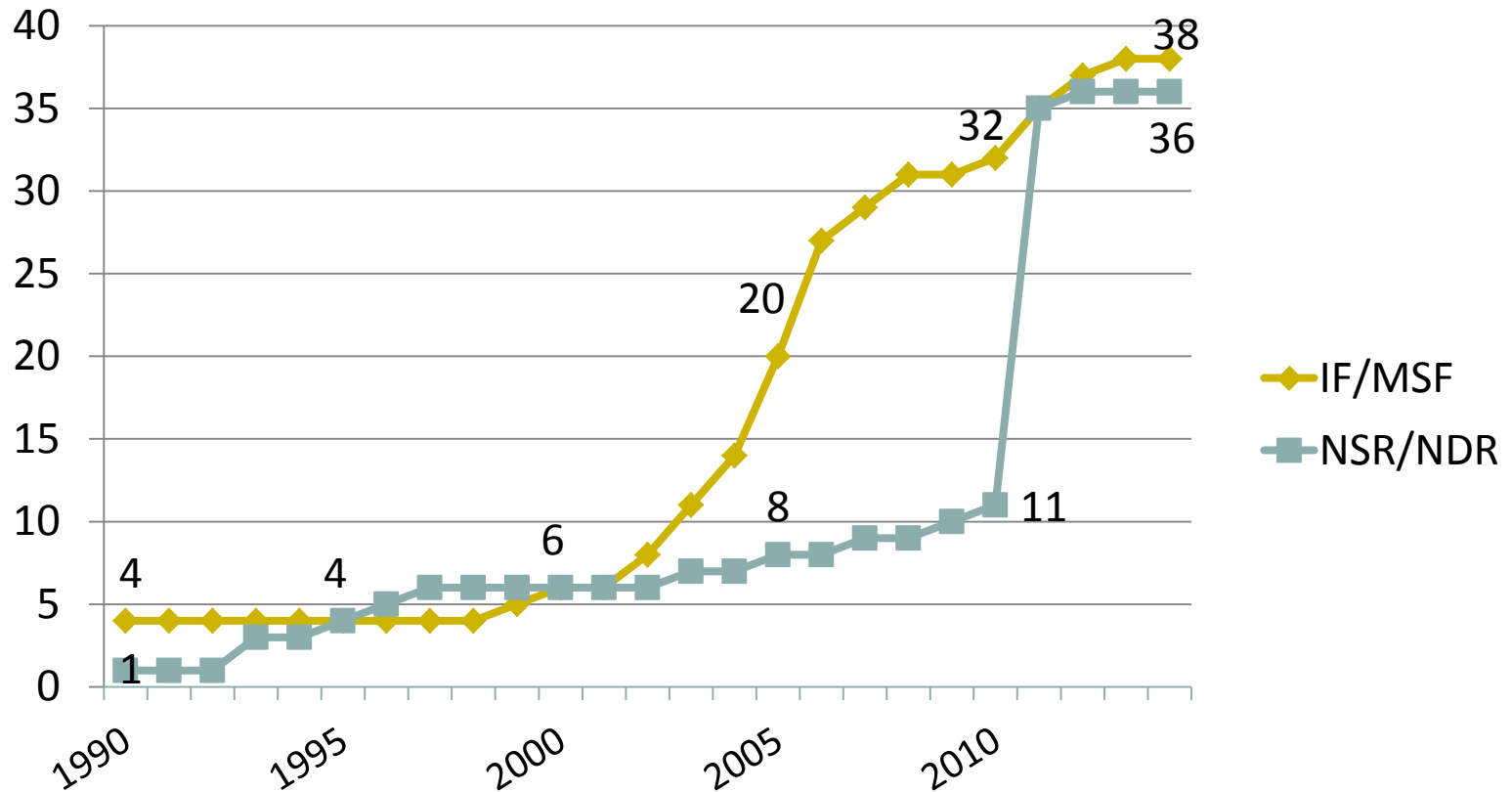
By region	# of countries
Europe	33
Africa	1
North America	4
South America	5
Asia/Oceania	8

Both IF/MSF only NSR/NDR only



Trends of public authority involvement (cont.)

- The number of countries/areas in which public authorities are involved in payment card markets has been growing



A shift from litigation to regulation

- Many early interventions were made by competition authorities/tribunals, primarily on three grounds
 - (1) Collectively-set interchange fees (or MIF) did not meet conditions to receive an exemption from the competition law (e.g., Spanish Competition Tribunal refused to grant exemption sought by three card schemes, 2005)
 - (2) Excessive IFs/MSFs are abuses of the dominant position (e.g., Netherlands Competition Authority fined Interpay for excessive MSFs, 2004)
 - (3) NSRs/NDRs and/or honor-all-cards rules are restrictions on merchant practices and thus are anticompetitive (e.g., Israel Antitrust Authority banned NSRs, 1993)



A shift from litigation to regulation (cont.)

- More recent interventions have increasingly used regulatory and legislative measures
 - Two central banks (Australia, China) have regulated IFs/MSFs since the early 2000s, four central banks (Venezuela, U.S., India, South Africa) joined them in the late 2000s or after
 - IFs/MSFs have been regulated by law in Denmark and Argentina as early as the 1990s; recent additions are Poland and Spain; three possible additions are Hungary, Romania, and the EU, where regulations are currently proposed
 - NSRs/NDRs have been lifted by law in the EU in the late 2000s and by the central bank in Fiji in 2012



A shift from litigation to regulation (cont.)

- In several countries, regulations are issued after judicial interventions, regardless of whether these interventions were successful or unsuccessful
 - After successful interventions (e.g.,)
 - ✓ South Korea
 - ✓ Spain
 - ✓ EU
 - ✓ U.S. (debit card)
 - After unsuccessful interventions (e.g.,)
 - ✓ Canada
 - ✓ Poland



Reasons for the shift

- Canadian Competition Tribunal
 - Explicitly expressed a preference for a regulatory approach, as opposed to judicial relief, in its dismissal decision statement on the case *Commissioner of Competition v. Visa/MasterCard*
 - Dismissed the application due to its inapplicability of the section of the competition law, but extended its analysis and found NSR had an adverse effect on competition
 - Would have declined to grant discretionary relief because the proper solution is a regulatory approach, given experiences in Australia and the UK, where NSRs were lifted but recent regulatory interventions impose some limitations to merchants when surcharging

As a result, the 2014 Budget of the Government of Canada includes provisions to help lower credit card acceptance costs for merchants (card networks' voluntary reduction in IFs is currently being sought)



Reasons for the shift (cont.)

- European Commission (EC)
 - Views its proposed IF regulation as a complement to the EC's investigations and decisions under EU competition law that addresses the shortcomings of the antitrust framework in the EU
 - ✓ Even though the General Court judgment confirms the EC's assessment that IFs set by *one* card network is anticompetitive, such a judgment does not necessarily induce *other* card networks to pro-actively adjust their practices
 - ✓ Although National Competition Authorities work closely with the EC, their different timelines and procedures may lead to an even more fragmented market, preventing the European payments market from achieving desired integration and innovation
 - Proposes to create common rules for IFs in the EU, aiming at providing legal clarity and a level playing field



Reasons for the shift (cont.)

- Researchers elaborate further on the shortcomings of an antitrust approach, compared with a regulatory approach (Malaguti and Guerrieri, 2014)
 - Litigation usually takes too long to resolve the issues
 - Litigation does not necessarily give industry participants legal certainty they need to operate in the market
 - Given the very complex retail payment market structure, a regulator has more flexibility than a competition authority in designing all structural reforms necessary to enhance competition and can evaluate issues such as IFs and NSR in a wider context



Implications for the U.S.

- A shift is evident in the U.S. *debit* card industry
 - Durbin Amendment gave authority to the FR Board to cap *debit* IFs received by large issuers
- *Credit* card IFs are not regulated for now, but...
 - DOJ settlement with Visa/MC, and DOJ v. American Express
 - Merchant class action settlement with Visa/MC (which was appealed and opted out of by many merchants)
 - Limitation of antitrust lawsuits was mentioned by Judge Gleeson in his final approval order of the class action settlement
 - ✓ “A lawsuit is an imperfect vehicle for addressing the wrongs the plaintiffs allege in their complaint”
 - ✓ The court could not grant the sweeping relief such as the regulation of IFs
 - ✓ Several features of the industry landscape, which the court again could not address, may undermine the efficacy of the agreed-upon relief (i.e., elimination of NSR of Visa/MC)



Implications for payment public policy

- Issues surrounding the payment card industry are becoming even more complex
- Competition issues alone were deemed complicated enough to justify a comprehensive regulatory approach instead of depending on a purely antitrust approach in many countries
- Other issues that are becoming increasingly important are card payments security (e.g., fraud and data security) and innovations using payment cards as funding sources (e.g., mobile and digital payments), requiring public authorities to consider the issues in an even broader context and coordinate their efforts to maximize social welfare and minimize adverse effects of public authority interventions



Implications for payment public policy (cont.)

- Is security a fundamental feature of payments or a competitive tool?
 - Proprietary security standards (e.g., EMV) give advantage to owners of the standards (they can earn license fees or other benefits)
 - Even when standards are open (e.g., ISO), if the implementation process is developed in a closed environment (e.g., some tokenization initiatives in the U.S.), some entities may take advantage of their better knowledge, affecting interoperability and efficiency
- Interchange fees can incentivize issuers and merchants to adopt better security methods/technologies
 - Some card networks (and regulators) set lower IFs if only the merchant of a given transaction adopts a better security method (e.g., EMV, PIN, and 3D secure), and higher IFs if only the issuer adopts it



Summary

- More public authorities have been involved in payment card markets in recent years
- In several countries, a shift from antitrust litigation to regulatory and legislative measures has occurred
- In addition to competition, other issues in the payment card industry are becoming increasingly important
- Public authorities should consider the issues in an even broader context and coordinate their efforts



Questions?

Author contact information:

Fumiko Hayashi

Senior Economist

Payments System Research

Federal Reserve Bank of Kansas City

Email: fumiko.hayashi@kc.frb.org

Jesse Leigh Maniff

Payments Analyst

Payments System Research

Federal Reserve Bank of Kansas City

Email: jesse.maniff@kc.frb.org

