European Interchange:

Who Wins? Who Loses?

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EUROPEAN MERCHANTS and acquiring banks are about to pay a lot less for processing credit and debit card transactions.

The European Commission announced in July of 2013 that it had agreed on standard interchange fees across the 28-member European Union – 0.2 percent for debit card transactions and 0.3 percent for credit card transactions – beginning early 2014 in a series of stages.

It predictably drew proponents and critics as well as many who are attempting to predict the long and short term impacts. One publication aptly called it a Christmas present to merchants, compliments of the European Commission.

Who will benefit most? Experts say merchants and acquiring banks. The issuing banks are said to be the losers, and will be forced to make up for losses.

How Merchants and Acquiring Banks Will Benefit: Reviewing the Payments Chain of Command

The European Commission's ruling to set a standard interchange means European merchants will pay only a fraction of what they previously paid to the credit card issuers per transaction.

In a credit or debit card transaction, the merchant sends the details of the transaction to its bank (the acquiring bank), which relays the same information to the consumer's bank (card issuing bank).

When the card issuing bank approves the payment to the acquiring bank during a transaction, it keeps a small percentage from the total cost. This is called the interchange fee (card issuers use this fee for operational undertakings such as fraud prevention measures, call center operations and innovative projects).

The funds are then transferred from the acquiring bank to the merchant account. Similar to the issuing bank, the acquiring bank deducts a small fee from the merchant – the merchant services fee – which covers things such as payment gateway use or POS technology and/or upgrades. The merchant services fee is settled upon by the merchant and his/her acquiring bank at the agreement of the merchant account.

European Union Interchange By Country in 2014

Country	MC	Visa
Austria	1.0	1.0
Belgium	0.8	0.95
Bulgaria	0.8	0.7
Croatia	1.25+0.4 HRK	1.6
Cyprus	--	1.5
Czech Republic	1.10	1.0
Denmark	0.5	0.75
Estonia	0.6	1.0
Finland	0.75	0.55
France	0.225+0.024 €	0.22+0.015 €
Germany	1.4	1.85
Greece	1.2	0.85
Hungary	0.3	0.3
Ireland	0.8	0.55
Italy	0.8	0.95
Latvia	0.73	0.29+0.015€
Lithuania	1.0	0.90
Luxembourg	0.8	0.95
Malta	0.8	0.95
Netherlands	0.4	0.95
Poland	0.3	0.3
Portugal	1.47	1.6
Romania	1.2	1.5
Slovakia	0.8	0.7
Slovenia	0.95	1.6
Spain	0.3	0.3
Sweden	0.8	0.95
UK	0.7	0.77

Rates by consumer, chip & pin

Acquiring Banks Will Be Tested

In a perfect world, the acquiring banks will pass on the savings from lower interchange (from the issuing banks) to the merchants. The merchant will then pass it on to the consumer.

Realistically, the acquirers will enjoy the savings from the issuers temporarily, but experts believe it will be a matter of time before the merchants will look to renegotiate their rates with their acquirers. This will likely result in merchants shopping around for the best rates they can find.

When the lower interchange rates take effect, Instabill will make certain its network of merchant partners and acquiring banks are communicating with one another.

"I feel it is an important step and a significant measure of good faith that the acquiring banks contact their merchants, who may or may not know about the European Commission ruling, to make certain they are aware," said Jason Field, CEO of Instabill, a global e-commerce payment processor in Portsmouth, N.H. "By doing so, acquiring banks are proactively building a new level of trust with their merchants and improving their image."

What was the impetus behind lower interchange in Europe?

The European Commission voted to regulate interchange fees in 2013 for several reasons:

- **To make transactions more transparent:** Per its March 10 press release, the European Commission felt that interchange fees were hidden from consumers.
- **Spur competition between credit card brands:** Now that interchange fees are transparent – where they were somewhat hidden before – this will give consumers the option of which card type best suits their needs.
- **Antitrust Laws:** The current interchange structure, said the European Court of Justice in 2014, violated European Union antitrust laws.

Interchange fees were vastly different between the 28 countries that make up the European Union. For example, Visa Europe interchange rates in Germany were 1.8 percent for credit card transactions opposed to 0.5 percent in France. For debit transactions, domestic rates were 1.7 percent in Germany opposed to 0.2 percent in eight other countries.

Translated, merchants in Germany will now pay Visa Europe issuing banks a 0.3 percent fee per transaction – about 17 percent of what it used to pay. In France, the change isn't as drastic: Interchange fees by country slip from 0.5 to 0.3 percent for credit card transactions.

According to a fact sheet issued by the European Commission in 2013, the variations of the interchange fees worked

Key Dates in the Reduction of European Interchange Fees

Effective in 2015, merchants and acquirers will be paying 0.2 percent for debit transactions and 0.3 percent for credit. Visa and MasterCard are handling the interchange differently. Below is a list of important dates to be aware of:

Jan. 1, 2015: All Visa cross-border fees became applicable to where the merchant's acquiring bank is located, no longer where the merchant/customer's issuing bank is located.

Jan. 4, 2015: MasterCard began reducing European interchange fees in a series of stages – every 90 days – unique to each country, payment category and card type. For example, consumer chip and pin interchange fees in the UK will drop in five stages beginning with 0.7 percent in early April 2015 to 0.3 percent Q2 in 2016. Other countries will reach the new interchange levels in two stages.

"All of our European merchants for which we are processing credit and debit card transactions will benefit from this new pricing overhaul," said Jason Field, CEO of Instabill, a global e-commerce payment service provider in Portsmouth, N.H.

Mar. 1, 2015: Domestic interchange rates change for Visa card-present debit transactions: from 8 pence/18 pence per transaction to 0.2 percent of the transaction value plus 1p/11p for 3D secure and non-3D secure transactions.

Apr. 1, 2015: Consistent with its series of stages (mentioned above), MasterCard reduced its premium card rates to 0.8 percent, with another reduction effective Sept. 9 followed by two more reductions until April of 2016.

Dec. 9, 2015: All domestic consumer credit card transactions in the European Union are capped at 0.3 percent (credit) and 0.2 percent (debit).

against what the commission was trying to accomplish: As level a playing field as possible.

The Reaction: Skepticism, Resistance

While capping European interchange was predictably lauded by the European Commission, it is a significant setback for Visa Europe and MasterCard, and both resisted before they accepted.

Among the advocates of lower interchange throughout Europe is Jonathon Hill, Commissioner for Financial Stability, Financial Services and Capital Markets Union, who said in the European Commission press release, "I welcome this vote which will bring transparency and legal certainty for the credit card market. It also paves the way for more innovation and competition in the field of online and mobile payments. Crucially, merchants will see the costs of payments fall, which should in turn drive down prices for consumers."

Visa Europe disagreed, claiming that the move would increase costs for consumers rather than the opposite. It argued that issuing banks would adjust their fee structures to buffer any losses.

"It is unlikely that retailers will pass on all, if any, of the savings that they gain," wrote Marc Temmerman, Visa Europe Director of European Affairs, in a column in the Economist's *European Voice*. Mr. Temmerman also noted that because issuing banks will see a reduced rate of revenue from payments, they may restructure their fee models, leading to an increase in consumers' credit card bills.

The effects, short term and long team, remain to be seen, but all eyes are on 2016.

Short term: Higher Interest Rates for Consumers, Stalled Innovation

One of the major issues the European Commission is looking to amend are cleaner, clearer transactions, so that merchants know exactly what they are paying in interchange fees. Capping rates at 0.2 and 0.3 percent throughout the 28-member European Union does just that.

"This newer model is very transparent as to who gets what," said Sebastian Gollwitzer, Vice President for Strategic Projects at Pay.On in Munich. "The issuers don't like it because they will see a huge amount of revenue dwindling away. If I was an issuer, I would be angry. But on the other hand, it only applies to a handful of markets at this point."

Mr. Gollwitzer said that the main beneficiary of lower EU interchange is the merchant. He also agrees with Mr. Temmerman that the card issuers will come up with new fees – likely inflicted upon the consumer – to make up for losses.

Both Mr. Gollwitzer and Mr. Temmerman have a point: As of early June, some issuers' annual percentage rates in Europe have risen higher than 20 percent while many card issuers have frozen their rewards programs.

Card issuers use interchange fees to pay for a number of things, such as fraud prevention studies and endeavors, staffing call centers and research into faster payment schemes. With reduced revenue through lower interchange fees, experts say those areas will be slowed.

This is Just the Beginning

The European Commission, Visa and MasterCard have clashed for a very long time regarding the capping European interchange. Mr. Field feels this is just the latest stage in a long history with plenty more to come.

"I feel requiring Visa and MasterCard to make their prices the same across Europe is long overdue," said Mr. Field. "The next 3-4 years are going to be a very important time for our industry. It will be very interesting to see the impact of the EU ruling and whether other regions will follow suit."

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