>> EU Looks at Fees; 'Paradise' Over?

BY DAVID BALTO

Regulatory action in numerous other countries from Australia to the United Kingdom is focusing on the impact of interchange fees and other apparently restrictive practices of card associations. The result of these actions establishes new precedent and offers guidance to regulators and courts in other countries.

One of the most significant contributions is a recent report issued by the European Commission. It is a comprehensive analysis of the competitive landscape for payment cards across the EU's 25 member countries.

Though the study addresses a wide range of payment systems, it focuses primarily on credit cards and, in particular, on interchange fees.

Through this multinational review, the EC was able to test the rationale for and economic effect of interchange fee structures. The preliminary observations in the report raise several concerns about interchange.

The report is clearly skeptical about whether interchange fees are necessary to maintain profitability in card issuing. The report observes that even without interchange fees card issuing would be profitable in 20 of the 25 EU countries.

Moreover, card issuing has been far more profitable than acquiring. The report notes "the difference and relative profitability is striking. A range of explanations is possible, including the observation that card issuers may have market power relative to acquirers."

One of the arguments made by the card association economists is that high interchange fees do not harm consumers because they result in lower bank fees or greater benefits such as cardholder rewards programs.

The EC's study contradicts that notion. "The empirical evidence shows that if interchange fees increase by one euro, only 25 cents are passed on to consumers in lower fees," the report notes.

Thus, increasing interchange fees are not a "wash" that is neutral to consumers.

The report's authors understand that the economic argument for interchange is based on the perceived need to balance the interests of issuers and acquirers. However, the fact that many countries have payment systems without interchange undermines the theory.

Similarly, the report casts doubt on the claim that there is a cost justification for those fees. The report notes that this argument was "largely refuted by our results" since in many cases interchange fees were significantly above costs. It also found that the evidence did support the argument that the interchange fee is merely a transfer fee that seeks to redress the imbalance between issuers and acquirers.

One of the report's most insightful aspects concerns remedies. One important check on both high cardholder fees and high merchant fees, according to the report, would be to make information on price differentials more transparent.

This transparency would lead cardholders to use the lowest cost and most efficient payment mechanisms.

An educated consumer with options is the best solution to the competitive ills of the market. Transparency will strengthen the ability of consumers to shop around for the lowest price and most efficient product.

The EC is inviting public comment on the report until June 21. A final report is expected by the end of this year.

When the report was issued, EC Competition Commissioner Nellie Kroes said, "Let me be clear: European-competition law provides a series of powerful tools to bring about more competition." She also warned that the "paradise days" are over for some high-fee-charging participants in the market. **CP**

David Balto is an antitrust partner at Robins Kaplan Miller & Ciresi, which is representing merchants in litigation over MasterCard and Visa interchange fees. Balto can be reached at dbalto@rkmc.com.