

Romania: The Romanian Competition Council released the report in relation to the payment cards market

June 2013

Introduction

In 2011, the Romanian Competition Council (the “**RCC**”) launched a sector inquiry in relation to the market focused on:

- (i) how the interchange fees on the payment cards market are established;
- (ii) how the level of interchange fees and the taxes paid by the merchants to the acquiring bank (which owns the POS) for the services provided in card transactions is established;
- (iii) the profitability of the payment cards sector;
- (iv) the degree of concentration on the market of payment cards.

For the aforementioned sector inquiry, information were requested from 28 Visa / MasterCard member banks, from 22 economic agents with activity in various fields (hypermarkets, supermarkets, travel agencies, restaurants) and from Visa Europe and MasterCard organizations.

The RCC issued the report in relation to the market of payment cards in Romania on 30 May 2013 (the “**Report**”).

Main conclusions and proposals of the RCC in relation to the payment cards market

The RCC observed that for the national transactions (transactions performed on the Romanian territory with cards issued by a Romanian bank) specific interchange fees may be established, through bilateral agreements between the two parties directly involved (issuing and acquiring banks), or through multilateral interchange agreements between the banks members of a payment card system.

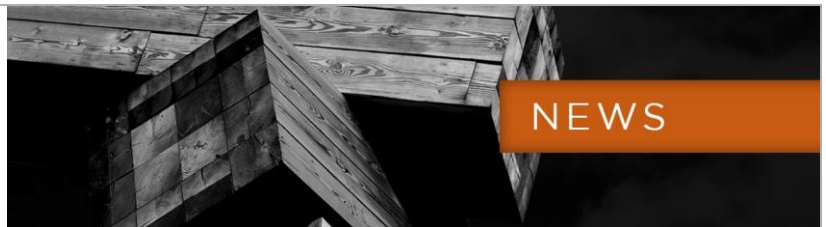
Bilateral negotiations may generate significant transactional costs, costs that are likely to increase exponentially with the numbers of players on the market. The obligation to contract with each issuer could preclude new entries on the market.

From this point of view, the interchange fees agreed at a multilateral level facilitate the entry on the market, as a new entrant, may adopt the interchange fee in force at that time, without long negotiations with each issuer.

However, the RCC stated that the fact that a multilateral agreement on the interchange fee has potential efficiency advantages, compared to a bilateral system, does not automatically mean that such an agreement leads to an optimal level of the fee from a economic standpoint.

The competition between the cards schemes could influence the level of the interchange fees within each system. However, in practice, the intra-brand competition seems to be hampered by the fact that most of the banks issue both Visa and MasterCard branded cards, and the acquiring banks, in their turn, accept both brands.

In the case of Romania, in accordance with the rules of the two card schemes, the RCC found the level of the interchange fee applicable on the national cards payment market is the result of a multilateral agreement between the banks which held approximately 98% of the internal cards market, and has the following values: 0.5% + LEI 2.50 (EUR 0.58) for ATM transactions, where the fee is paid by the issuing bank to the acquiring



bank (the ATM's owner), and 1.00% (standard), 1,50% (e-commerce) and 0.7%(oil) for POS transactions, where the fee is paid by the acquiring bank to the issuing bank).

The RCC observed that the level of interchange fees remained unchanged for a long period of time (1996-31.12.2011), irrespective of the market conditions which have changed. These levels of the interchange fees are common to both card system, i.e. Visa and MasterCard, as well as to both of the card types, though credit cards are more expensive than debit cards.

The banks' practice to establish, uniformly, the interchange fees level for both card systems (Visa and MasterCard), may lead to a potential competition distortion both between the two card systems, as well as between the acquiring banks, the interchange fee being an important element of the services fees applied to merchants. This finding takes into account the fact that, starting with the year 2012, immediately after MasterCard's increase in the level of the interchange fees applicable to domestic transactions, the banks transferred this increase into the commissions charged to merchants.

As a result, the establishing of the interchange fees represents an agreement between undertakings or a decision by associations of undertakings, which has as object the potential restriction of competition on the cards issuing market and on the cards acquiring market, mainly through the common treatment by the banks of the two cards systems. Besides, the rules of the two card systems have allowed banks to establish uniform interchange fees.

According to the international payment cards organizations, Visa and MasterCard, the establishment of an interchange fee is necessary in order to achieve full utilization of the four party payment card scheme. The interchange fees represent payments performed between the acquiring and issuing banks regarding transactions involving the use of the card system where the issuing bank and the acquiring bank are not the same member bank (transactions between banks).

If there is no interchange fee, the absence of an agreement between the issuing bank and the acquiring bank regarding the payment fees would have negative effects on the evolution and improvement of the payment system. The combinations between the fees related to card holding and the ones paid by the merchants generates different services system utilization volumes. A certain level of the cardholder fees, combined with a certain level of the fees paid by the merchants, will increase the system utilization.

The lack of these interchange fees is regarded by the card systems as a direct loss for the consumers who will bear themselves the equivalent amounts of these fees. Each issuing bank should fully recover the costs incurred as issuing bank form the profits obtained from the cardholders. By comparison, in the event of the existence of an interchange fee, the later should accordingly adjust its issuing activities, in order to create a balance between costs and profits.

In other words, the RCC stated that the payment cards issuing banks need these revenues in order to maintain profitability of the issuing activity, thus attracting more cardholders' clients.

The RCC findings on the profitability rates recorded in the issuing activity could confirm the hypothesis that, in the absence of interchange fees, the issuers would not be able to recover the costs incurred with the cards issuing activity to the holders, or, may lead to the conclusion that the level of interchange fees is too high, which may have implications on the products' and services' final prices.

Although the available data is limited, the RCC's finding on the profitability rates indicates the fact that the card issuing activity is much more profitable than the acquiring activity, and that the card issuing activity will remain profitable, for a significant number of issuers, even in the absence of the interchange fee. The interchange fees appear thus, to increase the profits from the issuing activity.

In addition, the RCC analysis within the Report revealed that an increase of the interchange fee has not been tied to a decrease of the fees charged to cardholders, which supports the conclusion that, for the issuing activity, the interchange fees represent an additional source of revenue.

The fact that the interchange fee is passed on to merchants, together with the lack of a correlation between the level of fees charged to cardholders and the level of the interchange fees, appears to be a potential extraction of revenues and the transfer of these revenues from the acquirer to the issuer. This process may be explained also by the fact that the majority of the issuing banks are also acquirers.

In case the interchange fees would represent a simple mechanism for the redistribution of costs in order to allow a sustainable issuing activity, these should insure a marginal positive profit for the issuer.

However, from the profitability analysis, it results that the average profitability rate recorded for the issuing activity, between 2009 and 2011, was between 62,1% and 101,1%, while in the acquiring activity this was between -37,5% and -32,1%.

Moreover, the transfer mechanism of costs would be necessary when the issuing activity would not generate sufficient revenues as to recover the costs. However, the results of the profitability analysis indicates that, in the hypothetical situation where there were no revenues obtained from interchange fees, the issuing activity registers positive profitability rates, which suggests that these interchange fees charged by the issuing banks are not that essential for the functioning of the card payment systems.

Conclusion

The RCC concluded that the interchange fees applied in Romania to transactions with VISA and MasterCard branded cards are among the highest in Europe. Moreover, the RCC stated that the interchange fees charged by the issuing banks are not that essential for the functioning of the card payment systems.

The RCC took the commitment to pay a special attention to this matter in the future, also in compliance with the European Commission's actions in respect the cards payment systems. The RCC Report is opened to public debate 30 days after its publication.

Text of the case:

http://www.consiliulconcurentei.ro/uploads/docs/items/id8327/raport_privind_piata_serviciilor_de_plati_prin_card_uri-neconfidential.pdf

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