From Brussels to Beijing, Regulators Block Open Payment Networks

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By Eric Grover

Several billion consumers and 35 million merchants worldwide take the enormous convenience and security of branded payment cards for granted.

Open general-purpose bankcard networks such as MasterCard and Visa were the greatest retail banking innovation in the 20th century. But there was no reason retail payment networks had to continue as they began, as bank-owned nonprofit cooperatives. Collective bank ownership put a damper on electronic payments innovation and made it difficult for the networks to cultivate potent nonbanks channels.

Since their debut there has been a sea change. Today the dominant global and U.S. retail payment networks are commercial enterprises independent of their bank licensees, heralding increased competition, innovation and use, with nonbanks such as mobile-phone operators delivering payment products.

However, across the globe governments are increasingly regulating payment networks as public utilities.

Taking a cue from Senator Durbin, Beijing is the latest to jump on the bandwagon. The Commerce Ministry proposes capping interchange fees for China Union Pay at .3% up to $15 and network switch fees at .05% up to 79 cents.

Though China Union Pay attempts to expand abroad, the network enjoys a protected monopoly at home. In 2001 China made a commitment to the World Trade Organization to open up its domestic credit and debit card market by 2006, yet it continues to prevent Visa, MasterCard, Amex, Discover and JCB from competing in its immense domestic market. In April 2010, after years of forbearance, the U.S. initiated a WTO complaint against China for flouting its obligations.

The European Union patchwork is the world's second largest card-payments market. Despite rhetoric to the contrary the E.C. and European Central Bank view the retail-payment-network industry as a utility for which enlightened regulators rather than markets should determine products and pricing. In 2007 the E.C. ruled Europe's leading commercial network MasterCard's interchange fees were illegal.

In 2009 it jawboned MasterCard into rescinding a network price hike and forced it to accept .3% credit and .2% debit interchange price caps.

Like in China, protectionist sentiment runs strong in Brussels. E.U. regulators pine for more "European" payment networks than MasterCard and Visa E.U. competing in Europe — this in spite of the Polish and E.U. laws requiring payment networks in Warsaw deliver value to Poles.

Regulators cheer three putative "European" payments schemes: Monnet, EAPS and PayFair.

Monnet is a political rather than economic network that an ad hoc group of 24 primarily continental Western European banks plan to launch. But why would undercapitalized European banks battered by the financial and sovereign debt crises invest billions of euros building a new network the E.C. will in the event regulate like a water utility, restricting it from maximizing shareholder value, particularly when they have a surfeit of profitable products from established networks?

EAPS is pushing interoperability among a coalition of national payment schemes, but so far has been unwilling to invest in its brand or consolidate national systems. Its strategy is lame, but EAPS's assets provide potential for a competitive Western European network.

If Brussels wants to foster payment network competition and innovation it should take a different tack, encouraging banks to demutualize EAPS and Visa EU, and America domiciled networks Amex, Discover and PayPal to expand.

Elsewhere, as far back as 2003, the Reserve Bank of Australia mandated price controls on MasterCard, Visa and the EFTPOS debit network. Merchant fees fell causing an increase in fees on the cardholder side of the network. Nevertheless the RBA contends merchants' savings are a net societal gain.

In the emerging markets of India, Brazil and Russia regulators too are meddling, attempting to spur creation of national network champions, though thus far none have commercial legs.

Regulators agitate for intervention to the detriment of consumers. Would anybody applaud Brussels or Washington intervening to make search engines (Google, Yahoo), consumer electronics (Apple, Dell, Ericson, Nokia) or entertainment (Hollywood) more efficient? When the state tries to manage the economy to improve efficiency, it destroys value and innovation.

Policymakers should take note, retail payments are not a natural monopoly. Other than government few products and services are. Consumers and merchants are best served by vigorous payments competition. If payment systems are regulated as public utilities and national or regional champions protected, value and innovation will be suppressed.

Eric Grover is a partner at Intrepid Ventures in Minden, Nevada.