Message to Europe: Get Out of the Way

By imposing price controls, treating the payments industry as public utilities, and making key decisions at home in Brussels, the European Commission is effectively getting in the way of an efficient marketplace and slowing benefits to the consumer

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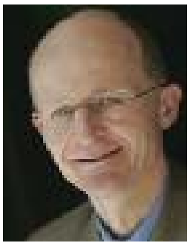

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Festering crises of unsustainable debt, fiscal profligacy and anemic growth threaten to create an economic nuclear winter for Europe. Meanwhile, Brussels is waging war on the payments industry, notwithstanding the fact it's not broken.

European consumers and merchants take the enormous convenience, security and utility of retail payment networks such as MasterCard and Visa for granted. The European Commission believes it should direct the payments industry. It imposed price controls on networks, deciding they are public utilities with key decisions best made by Brussels' mandarins from on high rather than by the dynamic interplay of consumers', merchants' and financial institutions' market choices.

The Commission's actions are best understood through the lens of public-choice theory: government bureaucracies act to maximise their own utility and power. It's an exceptional regulator who decides markets rather than his beneficent insight are the right answer.

The EC's campaign against payment network interchange fees (a pricing system the two-sided payment networks use to balance the participation of spend and acceptance to maximise total value), is illustrative. In 2007, the EC ruled MasterCard's interchange system was illegal. In 2009, it jawboned MasterCard into rescinding a fee increase to merchant acquirers and by diktat decreed that interchange fees capped at 30 basis points for credit and 20 basis points for debit were legal. Price controls stifle bank and nontraditional card-issuer innovation, hurting consumers and merchants, and the European Central Bank's ballyhooed "war on cash."

On May 24 of this year, the European General Court rubber-stamped the EC's interchange ruling, dismissively swatting down MasterCard's appeal.

To make its case, the EC contended the relevant market was card acceptance, that notwithstanding its IPO, MasterCard was still bank-controlled, and interchange fees were not necessary and reduced card-acceptance competition.

In antitrust cases, the more limited the market, the easier it is to find – or manufacture – issues. Payment networks are two-sided markets where products are jointly consumed by those making payments and those receiving payments. Value and competition must be analysed holistically, not at one point in the value chain.

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The EC contended, and the General Court affirmed. That MasterCard was an "association of undertakings." For four decades MasterCard was a bank association, causing legitimate worries about collective price-setting. MasterCard's and Visa's IPOs were intended to eliminate these concerns and to unshackle the global payment networks' commercial potential. However, MasterCard didn't go all the way. To corral European banks in its IPO, MasterCard retained a European bank board. But this unfortunate vestige of MasterCard's bank ownership was remedied by the board's elimination in 2009.

In contrast, Visa's IPO failed to keep Europe in the fold. Visa EU remains a bank association.

Brussels contended MasterCard's IPO was a sham with banks still in control, risibly arguing that, because in serving its public shareholders, it was in MasterCard's interest to serve banks (i.e. its customers), it was therefore an "association of (bank) undertakings" and "an institutionalised form of coordination of the banks' conduct." By this tortured logic, any pan-European business tending to its customers could be put in the EC Competition Directorate's cross-hairs.

The General Court also bought the argument that because MasterCard wouldn't "collapse" without interchange, it wasn't necessary. Judges acknowledged "a reduction in the benefits conferred on cardholders" and that they might well pay more, but they concluded this was "entirely irrelevant." How does that square with the foundational principle that competition law is supposed to enhance consumer welfare?

Providing card acceptance to European merchants is ferociously competitive. Whether or not interchange were zero, 30 or 200 basis points, and whether or not consumers or retailers bore credit, fraud, processing and rewards costs, it would not affect its intensity. It would, however, affect merchants' willingness to accept cards and cardholder fees and benefits. Better for all, except the regulators, market choices rather than central planners determine the right balance.

Evincing continental protectionism, the EC and ECB rooted for putative European retail-payment-network challengers: Monnet, PayFair and the Euro Alliance of Payment Schemes (EAPS). An ad hoc group of 24 Western European banks flirted with launching a payment network Monnet, but ultimately baulked. Why would capital-strapped banks invest billions of euros launching a network, which would be treated as a public utility? Plucky PayFair entrepreneur Dominique Buysschaert faces

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Merchants v Bankcards

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power to enact laws to limit surcharging and interchange fees. The chance that they would depends on the lobbying strength of merchants, banks and consumer groups in each state. The ATM experience tells us that determined advocates can often change the law to their favor. I believe the odds are good that: 1) some states will adopt laws prohibiting surcharging; 2) no states will repeal the surcharging laws on their books; and 3) none of them will tamper with interchange pricing for many years to come.

Final Thoughts

The 100-page settlement comes at the end of seven years of lawyer arguments, motions to the court, exchanges of 50 million pages of documents, and over 400 depositions of witnesses. Much of the case was a terribly inefficient lawyers' game. The judge didn't help matters. He should have dismissed the lawsuit immediately on the ground that the plaintiffs had asked for a remedy that would destroy the banking system and the US economy with it. That it was taken seriously so long is sad testimony about constitutional due process in the US.

Think about it. A lawsuit petitioned a judge and a jury of regular people to decide an earth-shattering commercial dispute of unimaginable cost, complexity and consequence. Under the US Constitution, the decision should have been put solely to Congress.

In fact, the November elections could end up putting many of the issues of the case into the lap of Congress to determine the fate of the various private and government challenges I have listed. On the one hand, a big win for Democrats could embolden the DoJ, Congress and the CFPB to get tough about surcharging and interchange pricing. On the other hand, a big win for Republicans could end federal, and suppress any state, challenges. It could also lead to a repeal of the Durbin Amendment and a termination or neutralization of the CFPB.

A draw, as I see it, will pose more of a problem for the merchants. It could delay the settlement's implementation for an extra year and perhaps cause some changes of modest bearing. ■

A Shifting Market in Latin America

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in both credit card outstandings and rollover rates. This decline is likely to continue as a minimum monthly payment regulation introduced last year by that country's central bank continues to take effect in 2012 and 2013. This minimum payment requirement is calculated as a percentage of the total debt or line of credit, whichever is higher. Credit cards are the pillar of the traditional bank strategy for offering consumer finance and, as a result, credit cards are the largest non-mortgage consumer finance channel in Mexico, representing over one-quarter of total consumer debt.

In Brazil, while card borrowing competes with a range of successful alternative consumer credit products – not least of which is the growing payroll loans market – growth in total credit card outstandings has more than quadrupled between 2005 and 2010, underlining the wider opportunities and attractiveness of the Brazilian market. However, despite unprecedented economic growth in Brazil, high APRs and generous instalment schemes have discouraged consumers from revolving credit. As a result, Brazilian consumers see credit cards as a payment instrument rather than a credit vehicle. ■

The Vision Ahead

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needs such as remittances under the overall ambit of financial inclusion.

1.9 In this endeavour, the role of the Government would be very crucial and significant. The intention of the Government to effect subsidy payments electronically, rather than through cash transfers, is a major step in this direction. As indicated above, the continued year-on-year growth in electronic transactions is likely to encounter a huge exponential rise in volume when electronic benefit transfers and direct transfers of subsidies from the government to the beneficiaries take place in an electronic mode. The systems have to be geared up and the reach expanded to serve the growing payment needs which would arise from this concerted move towards electronic payments.

1.10 Given the above, the Vision Document 2012-15 focuses on the ways and means to achieve the above goals of increasing the share of electronic payment transactions and taking measures towards moving to a less cash society and customer convenience. [...] ■

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an enormous challenge finding a path to network critical mass. EAPS is an under-capitalised, underbranded and underintegrated coalition of legacy bank-owned national networks, and absent a course correction, not a formidable contender.

The EC might resist its authoritarian instinct and instead try to increase system-wide network competition, letting markets set prices and encouraging a rollup of legacy national payment networks by private equity or Amex, Discover or PayPal. It might also encouragebanks to take Visa EU public on the London Stock Exchange or to sell it to Visa Inc.

Through its actions, it is also putting a damper on the nascent mobile-payments market. This comes at a cost to the market. For example, getting Brussels' imprimatur is UK mobile-payments venture Oscar's first priority rather than iterating value propositions for consumers and merchants.

Consumers would be better served if Brussels played the role of night watchman in payments, rather than paternalistic central planner. ■

The Burgeoning E-Commerce Space...

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operators, retail bankers and payment providers across the region.

And with the significant rise in Smartphone penetration, other innovations are also leading the way. Paypal, for example, recently introduced a mobile-optimized landing page in the Singapore market, helping drive a six-fold increase in the mobile commerce market. Mobile commerce now comprises 23 percent of the $258 million market in online purchases recorded last year.

This upward trail within the APAC countries brings immense possibility for growth. However, adapting to customer-specific needs and wants and optimizing their approach is the key for online portals to survive in a highly competitive marketplace. ■