



NON-PAPER

Interchange fee regulation and domestic debit card schemes

The regulation of interchange fees as proposed by the Commission may help the payments framework to better serve the needs of an effective European payments market, fully contributing to a payments environment which nurtures competition and innovation. However, the regulation may also have unintended and possibly harmful consequences for domestic debit card schemes, that are in general cheaper than international card schemes¹ and often subject to regulation on national basis.

Thus, it is important to ensure that the interchange fee regulation does not impose regulation that may hinder a sound and cost efficient development of the national card schemes. Following the assessments below the interchange fee regulation as a whole should therefore not apply to domestic debit card schemes when the interchange fee in general is lower than the proposed caps on interchange fees of 0,20 % when using debit cards.

The national card scheme in Denmark

The Danish card scheme, the Dankort, was launched in 1983 and is by far the most used payment instrument in Denmark. Since 1988 it has been possible to co-brand the Dankort with Visa meaning in practice that the Dankort applies on all domestic transactions and the Visa card applies on all foreign transactions.

Denmark is one of the countries with highest usage of payment cards per capita. The number of transactions made solely with the Dankort per capita exceeds the total number of card transactions per capita in UK, Netherlands, France and Belgium,² and around two thirds of all payments at the point of sale (POS) is made with the Dankort and almost all Danish merchants accept the Dankort.

For the Danish economy overall the Dankort is by far the cheapest solution for card payments. This is primarily due to the large number of transactions processed by the same card scheme and system in Denmark and that the Dankort is a basic payment scheme without incentivising practices such as free insurance, bonuses and rebates. The social cost per payment with a Dankort amounted in 2009 to 0,40 € while the social costs of international debit and credit cards amounted to 1,6 € and 2,8 € respectively.³

¹ IF-regulation, page 15.

² ECB Blue Book and Nationalbanken.dk

³ "Costs of Payments in Denmark", The Danish Central Bank, 2012:

<https://www.nationalbanken.dk/en/publications/Pages/2012/04/Costs-of-payments-in-Denmark.aspx>

The Dankort is owned by Nets A/S and is primarily financed through banks and through fees paid by merchants. Nets is both the scheme owner and the sole acquirer of the Dankort. Furthermore Nets also runs all processing associated with the Dankort. All banks in Denmark have licence to issue Dankort meaning that the Dankort scheme is a four-party scheme according to the proposed regulation.

In general the Dankort enjoys strong support among merchants as well as consumers.

The financing has been regulated since the launch in 1983. Regarding ecommerce merchants pay a fixed fee per transaction around 0,16 €. This is subject to regulation in the Danish Payment Service Act implying that the merchant service charge (MSC) may not be higher than the associated costs including a reasonable profit. A part of the MSC is passed on to the issuers. This is also a fixed fee per transaction and is an interchange fee. The interchange fee is also regulated by the Danish Payment Service Act.

At POS the merchants pay an annual subscription fee to Nets for accepting the Dankort which is subject to regulation. The subscription fee is divided into eight levels depending on the number of transactions and the levels are regulated in a ministerial executive order. Until 2012 the sum of the subscription fees was not to account for more than 50 % of the total costs of the Dankort scheme regarding POS transactions. However, this regulation was changed in 2013 and the share of 50 % will be raised gradually each year and reach 100 % in 2018 implying that the merchants annual subscription fee will cover the total costs of the Dankort scheme. The calculation of the costs is supervised by the Danish Competition and Consumer Authority. The change in the regulation was made in order to ensure a continuous sound and well-functioning domestic debit card scheme. The subscription fee paid in 2012 amounted to around 0,05 € per transaction.

A part of the subscription fee is passed on to the issuers as a fixed fee per transaction and is an interchange fee. Thus, an interchange fee applies when using the Dankort. Due to the national regulation the interchange fee (IF) connected with the Dankort is in general lower than the proposed cap on interchange fees on 0,20 % of the amount when using debit cards.

Assessment of the consequences to the Dankort due to the interchange fee regulation

The regulation may have possibly harmful consequences for domestic debit card schemes, that are in general cheaper than international card schemes and often subject to regulation on national basis. This is due to the fact that the regulation may impose higher costs and possibly lower usage of domestic debit cards.

Following the specific assessments below the interchange fee regulation as a whole should therefore not apply to domestic debit card schemes, such as

the Dankort, when the interchange fee in general is lower than the proposed caps on interchange fees of 0,20 % when using debit cards.

Article 4

Since the interchange fee with respect to the Dankort has a flat fee structure it may exceed the levels capped by the proposal in article 4 when the payer uses the Dankort for small amounts. If the interchange fee is say 0,07 € per transaction, payments for amounts smaller than 35 € will imply a breach of the price cap. Thus, the current proposal lacks an appropriate flexibility regarding smaller amounts. This issue may be solved either by not letting the cap on the interchange fee apply to domestic payments cards or by introducing a cap on debit cards that is not a percentage of the amount but a flat fee.

A flat fee may also be more in line with the actual costs held by issuers. A study carried out by the Danish Central Bank shows that the Danish banks have no costs that vary with the value of the transaction when using a debit card, but indeed have costs that vary with the number of transactions.⁴ When using credit cards the banks have both costs that vary with the number of transactions and the value of transaction. Hence, it may be more appropriate with a low flat fee cap on the interchange fee when using debit cards on say 7 eurocent as proposed by the European Parliament Committee on Economic and Monetary Affairs in its first reading.⁵ Such cap will also ensure appropriate low interchange fees to transactions with larger amounts.

Article 6 and 7

The articles 6 and 7 regarding licensing and separation of card scheme and processing entities will also have an impact on the Danish card scheme. Since the payment card infrastructure primarily is based on the Dankort card scheme the possibility that authorisation and clearing messages of single card transactions be separated and processed by different processing entities may imply a greater incentive for other players than Nets to enter the Danish market. However, it is unlikely in the shorter run that these benefits can compensate for the likely increase in costs of handling the Dankort.

This is due to the fact that the economics of scale by processing all Dankort transactions will be diminished leading to a possible increase in the costs of the scheme. A domestic debit card scheme being cheaper than international card schemes is often due to the large number of transactions,

⁴ The study shows that the banks transaction-variable costs are 0,37 DKK (0,05 €) per transaction with Dankort and 0,88 DKK (0,12 €) per transaction with an international debit card. The amount-variable costs are zero for both cases. Regarding international credit cards the banks transaction-variable costs are 1,86 DKK (0,25 €) per transaction and the amount-variable costs are 0,12 %. "Faste og variable omkostninger ved betalinger i Danmark, Nationalbanken, 14. juni 2014", page 13.
http://www.nationalbanken.dk/da/publikationer/Documents/2012/06/WP_79_2012.pdf

⁵ <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2014-0279&language=EN>

the centralized handling and processing of all transactions and the lack of incentivizing practices such as free insurance, bonuses and discounts. Thus, an exemption from article 6 and 7 will secure a sound and cost efficient development of the national card schemes.

Article 8

The extended possibility regarding co-badging and choice of application in article 8 may have substantial impact on the number of transactions for domestic debit cards that are often co-badged with an international scheme as is the case with the Danish Visa/Dankort. As mentioned, the Visa/Dankort is always a Dankort when using it domestically, while the Visa card applies when used abroad.

Following the proposal banks may co-badge the Dankort with international credit cards with more benefits to the payer such as rebates and free insurances. Since surcharging will be prohibited for all cards subject to the interchange regulation payers may have less incentive to actively choose the Dankort when co-badged with other cards even though the Dankort is in fact a cheaper payment instrument. This may lead to a lesser usage of efficient payment cards and give rise to transparency issues, since the payer when making his choice of application will not be able to see which costs are associated with the payment card. Possible discounts or rebates provided by the merchants may also lead to reduced transparency since it may be more difficult for consumers to compare prices between merchants.

This may reduce the number of transactions with the Dankort and thus lead to higher costs per transactions and a possible increase in consumer prices. Thus an exemption from article 8 regarding domestic debit card schemes may ensure that the usage of cost effective cards is not reduced.

Proposed changes in the interchange fee regulation

Following the assessments above the interchange fee regulation should provide an option for member states to let domestic debit card schemes that operate with an average interchange fee or net compensation model which is verifiably below the threshold value in Articles 3 and 4 be exempted from the regulation as a whole.

The articles that may in particular impose regulation that may hinder a sound and cost efficient development of the national card schemes are the following:

- Article 4
 - The current cap on interchange fee on debit cards lacks an appropriate flexibility regarding smaller amounts when interchange fee is a low flat fee.
- Article 6 and 7
 - The articles may diminish economics of scale by acquiring and processing all domestic debit card transactions leading to a possible increase in the costs of the scheme.

- Article 8
 - The regulation of co-badging may reduce the number of transactions with the Dankort and thus lead to higher costs per transactions and a possible increase in consumer prices.