



Credit Card Interchange Fees Background Information for the Media

Which companies operate in the Swiss credit card business?

In Switzerland, Cornèr Banca SA, Credit Suisse, UBS AG and Visa Card Services SA currently act as issuers under the Visa and MasterCard four-party systems (see diagram). At present so-called "dual branding" predominates, i.e. the issuers are members both of Visa and of MasterCard and market products for both credit card systems.

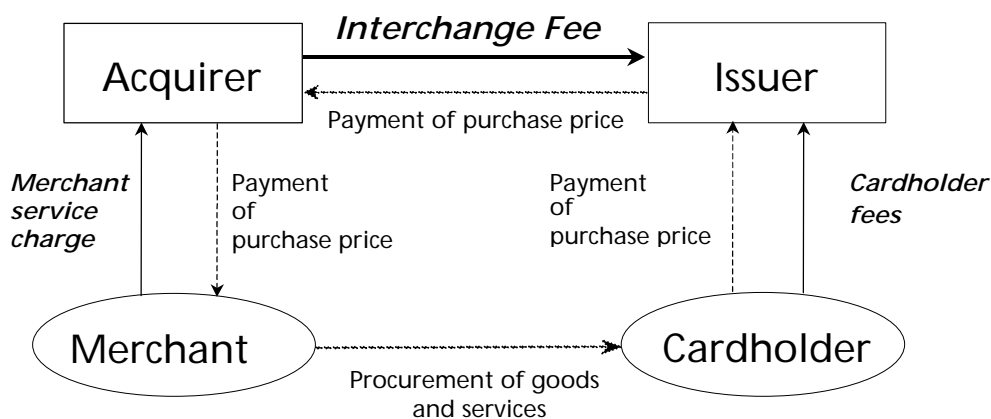


Diagram: Four-party system

On the acquiring side, Telekurs Multipay AG and more recently Aduno SA (a subsidiary of Visa Card Services SA) operate within the Visa and MasterCard four-party systems. Aduno SA took over the Cornèr Banca SA acquiring business in July 2005. Foreign acquirers such as B&S Card Service GmbH and ConCardis GmbH also offer acquiring services in Switzerland. In the acquiring business "dual branding" also predominates.

In addition, there are the three-party systems operated by American Express, Diners Club and JCB. In the case of American Express, issuing and acquiring in Switzerland is carried out by Swisscard AECS AG, a joint venture between Credit Suisse and American Express. Issuing and acquiring for the Diners Club credit card is carried out by Diners Club Switzerland Ltd. JCB credit cards are used mainly by Asiatic tourists and are not issued in Switzerland.

What is the function of the Domestic Multilateral Interchange Fee (DMIF) and what effect does it have?

In each domestic credit card transaction (transaction using a credit card issued in Switzerland at a point of sale in Switzerland) the acquirer, with whom the merchant in question has entered into a contract, pays the issuer the DMIF in the form of a percentage of the price paid in the transaction. For the acquirer, the DMIF accordingly represents an element of the costs that have to be covered by the merchant service charge. The level of the DMIF thus has an effect on the level of the merchant service charge (MSC) that must be paid by the merchants.

On the other hand, the DMIF is part of the revenues received by the issuers. The level of the interchange fee therefore also influences the portion of the issuing costs that must be covered by the card holder fees. The higher the DMIF is, the lower the share of the issuing costs that have to be covered by the card holder fees.

Is the DMIF a price-fixing agreement?

In Switzerland the DMIF for the MasterCard and Visa credit card systems are negotiated multilaterally in national card committees in which the issuers and the acquirers are represented.

The DMIF is the most important cost component for the acquirers, as it is an essential element of the MSC. The level of the DMIF thus has a direct effect on the latitude available to the acquirers in setting prices. In practical terms, it sets a minimum price in the acquiring business.

As already mentioned, the DMIF also influences the latitude available in setting prices on the issuing side, albeit in the opposite direction. It has an influence on the portion of the costs that has to be covered directly by the card holder fees. The revenues from the DMIF amount to a fifth of the issuers' overall revenues.

The DMIF must therefore be regarded as a price-fixing agreement as defined by the Cartel Act (ACart).

What measures are contained in the amicable settlement?

The amicable settlement provides for far-reaching measures intended to revive competition in the credit card sector.

a) Limitation of the DMIF to network costs

The amicable settlement puts the *average* DMIF applied by the issuers on an objective footing. Issuers no longer have the opportunity to take account of costs other than those that are purely network-related when setting the level of the DMIF.

In accordance with the decision made, the effective network costs incurred by the issuers therefore constitute an upper limit for the DMIF. The costs of services from which only the card holders benefit (such as costs of the interest-free period until the card holder is billed, interest costs of credits in the case of part payment, etc.) must not be taken into account in the calculation of the average DMIF. The ascertainment of the network costs is based on a precise definition of the cost elements that are allowed to be taken into account and is verified by a firm of auditors.

The issuers have undertaken to make an initial reduction of the DMIF of around 15% directly after the decision comes into force.

b) Abolition of the “non-discrimination rule” (NDR)

The amicable settlement abolishes the so-called “non-discrimination rule” (NDR). The NDR prohibits merchants who accept credit cards from imposing a surcharge on customers who pay by credit card or allowing a discount in return for payment in cash. By abolishing the NDR, competition between the various methods of payment is increased.

The NDR was already the subject matter of proceedings before the Competition Commission. In November 2002, it ruled that the NDR infringed the law on cartels. Following an appeal by the acquirers against the decision of the Competition Commission, the Competition Appeals Commission referred the case back to the Competition Commission for re-examination in June 2005. The grounds for doing this were related mainly to the change in market conditions in the acquiring business that had taken place in the intervening period. These proceedings are currently pending before the Swiss Federal Supreme Court.

c) Creation of transparency

The acquirers undertake in the amicable settlement to disclose to merchants on request the (sector) relevant interchange fee rate.

What effect does the amicable settlement have?

The amicable settlement will lead to a substantial, step-by-step reduction in the average DMIF, from a current [1.65 – 1.7%] to [1.3 – 1.35%]. The reduction in the DMIF should also have an effect on the merchant service charge, which in turn should have an effect on the end price paid by consumers.

With the abolition of the non-discrimination rule and the transparency regulations, competition between the various methods of payment and the bargaining power of merchants in dealings with credit card companies is increased. These additional measures should ensure a revival of competition in the credit card business.

Is the Swiss DMIF excessive in comparison to other countries?

There are various difficulties in trying to compare the DMIF in Switzerland with that in other countries. In some cases there are varying DMIFs for different sectors and forms of transaction. In addition, the demarcation of sectors can vary from country to country.

If a comparison is made using the so-called standard DMIF, which is applied in all sectors for which no specific DMIF has been defined, then Switzerland is currently to be found in mid-table among European countries.

Various foreign competition authorities and regulators have already tackled the problem of interchange fees in credit card systems. In 2002, the EU Commission exempted the interchange fee for cross-border Visa transactions (the intraregional interchange fee) on condition that it was objectively related to costs and that transparency vis-à-vis merchants was ensured. This exemption has been limited to a period of five years.

In a number of countries, including the UK and Spain, the DMIF is also the subject matter of ongoing proceedings. The amicable settlement that the Competition Commission has reached with Swiss issuers and acquirers is restrictive by international comparison in relation to the costs that may be taken into account in determining the interchange fee.

Why has the Competition Commission reached an amicable settlement with the banks and not simply issued a decision?

The subject matter of an amicable settlement of a dispute is the measures that eliminate a probable restraint of competition under art. 5 or art. 7 of the Cartel Act. In reaching such a settlement, it is not only necessary to state what an undertaking must not do as far as competition law is concerned, but also what is still possible such that competition is not seriously harmed or justified on the grounds of economic efficiency under art. 5 para. 2 of the Cartel Act.

The Cartel Act regards an amicable settlement as the equivalent of a sovereign decision. This also corresponds to the new rules in the EU, according to which the Commission may by decision make commitments that undertakings offer in order to meet the requirements of the Commission binding.

In the present case, the Commission could have prohibited the multilateral agreement of the DMIF. However, this would inevitably have resulted in bilateral negotiations. As the relationship between issuers and acquirers under the four-party systems is not in keeping with the customary relationship between business partners in a market, there were indications that bilateral negotiations would have obstructed market entry for foreign companies and would possibly have led to an increase in the DMIF.

For these reasons, it was appropriate in the present case to declare the positive commitments made by the parties to be binding.

Does the amicable settlement apply for an unlimited period?

The approval of the amicable settlement has been limited by the Competition Commission to a period of four years. This allows the Competition Commission to re-examine the expected effects of the measures taken on competition in the credit card business at a later date on the basis of the new market conditions and to take account of developments abroad.

Why is the case not subject to direct sanctions under the new Cartel Act?

As the parties signed the amicable settlement before the expiry of the transition period for the revised Cartel Act and had expressed their intention to implement it immediately, there was no requirement to impose sanctions in terms of the revised ACart.

Was it possible to determine the existence of an agreement between issuers in relation to the annual fees?

The Competition Commission in the first instance concentrated on the agreement in relation to the DMIF. The measures taken as part of the amicable settlement should also have effects on the issuing market, in that competition between the issuers is revived. If the expected effects are not achieved, the Competition Commission reserves the right to instigate proceedings in relation to the issuing market.

Statistical details on the credit card market

In Switzerland, over 3.4 million credit cards are in circulation (Visa, MasterCard, American Express and Diners). There are over 360'000 businesses that accept cards.¹ In 2004 turnover in Switzerland from 82 million transactions amounted to around CHF 15 billion.² The total revenues of Swiss issuers in 2003 according to a survey by the Competition Commission amounted to CHF 840 million. This includes revenues from the DMIF of just under CHF 160 million.

Glossary

<i>Acquirer</i>	Merchants and service providers that accept payment by credit card enter into an agreement with an acquirer. The acquirer passes all credit card transactions from his contractual party on to the issuer of the credit card (the issuer) and pays the merchant the purchase price for the product or service purchased using the credit card. Currently there are primarily two acquirers in Switzerland, Telekurs Multipay AG and Aduno SA (a subsidiary of Visa Card Services SA) that act for the two credit card systems, Visa and MasterCard. Since 2002, several foreign acquirers have also entered the acquiring business, but their market share is small.
<i>Issuer</i>	The issuers issue credit cards to end consumers and charge credit card transactions to the accounts of the card holders. Currently in the Swiss market there are four issuers of Visa and MasterCard credit cards, namely UBS AG, Credit Suisse, Cornèr Banca SA and Visa Card Services SA (a company jointly owned by the cantonal, Raiffeisen, regional and other banks). In addition there are issuers of credit cards that operate according to the

¹ The figures relate to May 2005 (Source: Swiss National Bank).

² Transactions and turnover with Swiss and foreign cards in Switzerland (Source: Swiss National Bank).

	three-party systems (Swisscard AECS and Diners Club).
<i>Three-party system</i>	In a three-party system, the acquiring and the issuing are carried out by the same company. American Express, Diners Club and JCB are examples of three-party systems.
<i>Four-party system</i>	Four-party systems are characterised by the acquiring and the issuing being carried out by separate companies (see diagram). Visa and MasterCard are examples of four-party systems.
<i>Merchant service charge</i>	For each credit card transaction, merchants pay a certain percentage of the purchase price to the acquirer in the form of a merchant service charge (MSC). The merchant service charge is deducted from the purchase price paid to the merchant by the acquirer. A portion of the merchant service charge is passed on by the acquirer to the issuer of the card used in the transaction in the form of the interchange fee.
<i>Card holder fee</i>	The card holders pay card holder fees for the use of various services (annual fee, fee for additional cards, credit interest, foreign exchange commission, etc.) to the issuer involved.
<i>Interchange fee</i>	The interchange fee is a fee paid under the four-party system by the acquirer to the issuer. It is levied in each credit card transaction as a percentage of the transaction price. A different interchange rate applies depending on whether it is a domestic, European or non-European transaction. There are also varying interchange rates for different sectors and forms of transaction (manual, electronic, PIN code, telephone, internet, etc.).
<i>Domestic interchange fee</i>	The domestic interchange fee applies to all domestic transactions (payment using a credit card issued in Switzerland at a point of sale in Switzerland). It is the subject matter of the investigation by the Competition Commission. As the domestic interchange fee is fixed jointly by the Swiss acquirers and issuers, it is also known as the "domestic multilateral interchange fee" (DMIF). In Switzerland, there is a generally valid rate for each of the Visa and MasterCard credit card systems (the so-called Standard DMIF) as well as various sectoral rates.
<i>Intra- and interregional interchange fee</i>	The intra- and interregional interchange fees apply to cross-border credit card transactions. They are set by the credit card organisations Visa and MasterCard and do not form the subject matter of the Competition Commission proceedings.
<i>Ban on price discrimination</i>	The credit card acceptance agreement of the acquirer includes a ban on price discrimination ("Non Discrimination Rule", NDR). It prohibits the merchant from charging different prices depending on the method of

	payment. The merchant is thus prevented from passing on the MSC to the credit card holder or granting a discount to customers who use a different method of payment.
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