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LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM

Session III: Addressing Competition Challenges in Financial Markets

-- Contribution from Chile --

4-5 April 2017, Managua, Nicaragua

The attached document from Chile (FNE) is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session III at its forthcoming meeting to be held on 4-5 April 2017 in Nicaragua.

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Note by Turkey

The information in this document with reference to “Cyprus” relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the “Cyprus issue”.

Note by all the European Union Member States of the OECD and the European Union

The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM



15th Latin American and Caribbean Competition Forum
4-5 APRIL 2017, Managua, Nicaragua

Session III: Addressing Competition Challenges in Financial Markets

CHALLENGES TO INTRODUCING COMPETITION INTO CREDIT AND DEBIT PAYMENT CARD SYSTEMS

-- CONTRIBUTION FROM CHILE (FNE)* --

1. Introduction

1. Chile's competition rules aim to promote and defend free market competition, and are overseen by the Fiscalía Nacional Económica (FNE, the national agency responsible for safeguarding fair competition), and the Competition Tribunal (TDLC).¹

2. Electronic payment systems, in particular those associated with credit and debit cards, are financial markets that have a profound impact throughout the economy because their inefficiencies extend to all trade in goods and services in which they are used. The continued growth in the use of payment methods other than cash and cheques poses an ongoing challenge for both sectoral regulators and competition agencies in efforts to prevent the absence of competition in these markets from becoming a millstone round the neck of the rest of the economy.

3. Accordingly, these markets have traditionally been a recurring item in the work of the FNE and the TDLC, whether in procedures for imposing penalties, controlling mergers or promoting free competition. As a result, it has been possible to conduct an exhaustive and virtually unbroken study of the card payment system in place in Chile, together with the economic operators involved, from 1991 to date.

* Contribution from the Fiscalía Nacional Económica (FNE), Chile.

¹ Chile's free competition rules are set out in Statutory Decree (Decreto con Fuerza de Ley) No. 1 laying down the consolidated, co-ordinated and standardised text of Decree Law (Decreto Ley) No. 211 of 1973, published in the Official Gazette of 7 March 2005 (hereinafter "DL 211"), and recently amended by Law No. 20,945 of 30 August 2016.

4. The card payment industry is a two-sided market with one or more platforms providing services that allow various types of end-users with different demands to interact², involving network externalities and issues with pricing by multi-product companies, where various prices are set using balances in which the prices do not necessarily reflect each market's costs.

5. The features of this industry have given rise to concern at the comparative level, especially in respect of the exercise of market power over merchants, and have been reviewed in a growing number of countries both in the economic literature and by organs of the State. Over the past decade, significant regulatory changes have been adopted, often originating in cases initiated by competition agencies³, including penalties or corrective measures intended to make the market operate in a more competitive fashion, especially with regard to (i) co-ordination between banks to set interchange fees; (ii) the very high concentration on the acquirer side; and (iii) vertical integration between issuers and acquirers.

6. The structure of the Chilean credit and debit card payment market has a number of special features that make it almost unique in the world⁴. It is based on vertical integration between the issuance, acquisition and processing of transactions and has a single acquirer for universally accepted cards (the result of a joint venture between issuers known as "Transbank"), which operates as a monopoly in relation to merchants under a regulated price structure.

7. Even more unusually, in 1991, this structure was authorised⁵ by the then competition authority on grounds that still protect concerted action by banks in the wake of a series of mergers that occurred during the 1990s. As a result, Transbank became the sole licensed acquirer for international card brands (Visa, MasterCard, American Express and Diners credit cards, Cirrus and Maestro debit cards), the holder of the local debit card brand Redcompra and the authorised representative of all issuers in recruiting merchants to become affiliates of the system.

8. The arguments put forward at the time as to why this merger would not raise issues for free competition included: (i) the relevant market was the payment methods market in general, including bank and non-bank cards, cash, cheques, etc.; (ii) that market was open to the entry of new issuers and operators; (iii) the role of the acquirer provided an opportunity for competition between banks; (iv) the conditions governing marketing and advertising to merchants, in which Transbank would act merely as a tool; and (v) the vertical integration between card issuers and the card operator and administrator – Transbank – would be reflected in greater competition in the role of issuer, resulting in greater benefits to all parties in the system, namely cardholders, merchants and issuers.

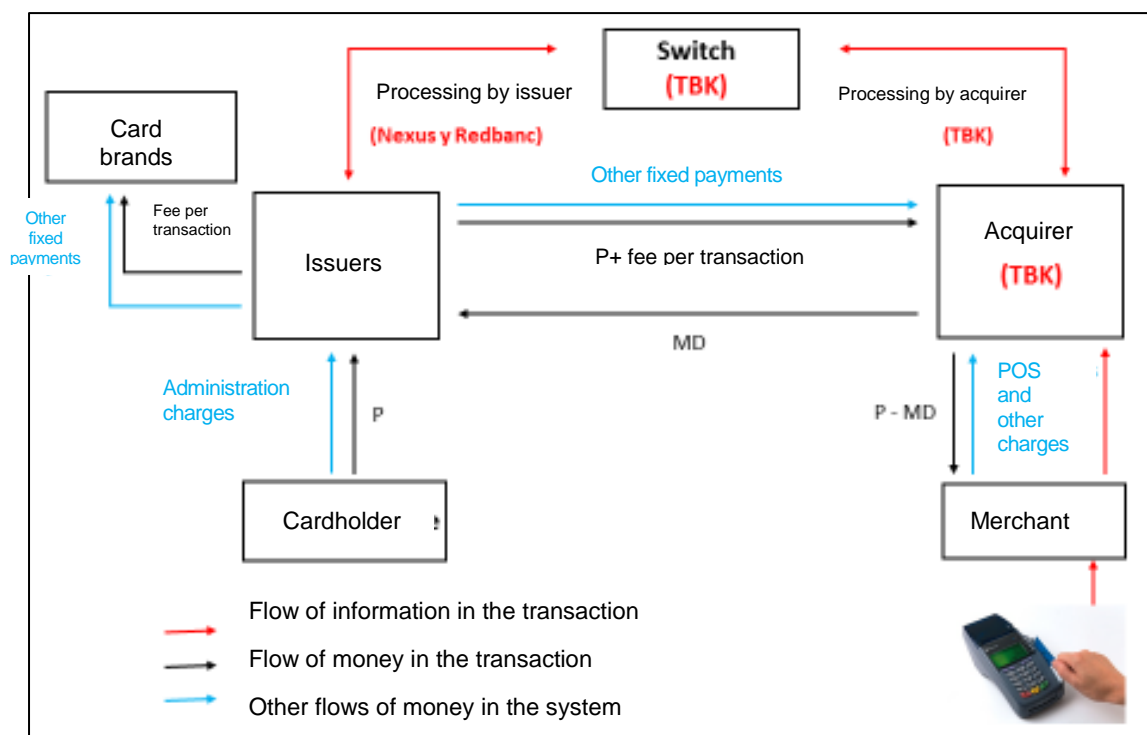
² Buccirossi P. "Competition Policy in Two-Sided Markets, with Special Emphasis on Payment Cards". In: *Handbook of Antitrust Economics*. Chapter 8, MIT Press, 2008.

³ In the USA, the EU, the UK, Colombia, Italy, and South Korea, among others.

⁴ There are other examples in the world of monopolistic or dominant acquirers that are vertically integrated with issuers, for example in Austria, Belgium, Cyprus, the Netherlands and Portugal.

⁵ Dictamen [Decision] of the Central Preventive Commission, No. 752/262 of 18 April 1991.

Figure 1. Chilean card payment system



NB: TBK = Transbank; MD = merchant discount; P = price of the good or service
 Source: Compiled by author.

9. In view of the vertical integration between issuance, operation and acquisition, there is no incentive of any kind for the issuing financial institutions and banks to perform acquisition activities themselves or to entrust their performance to any third party other than Transbank. As a result, in Chile, the acquirer pays no explicit interchange fee to the issuer; instead, Transbank takes the merchant discount that it charges merchants and passes it on in full to the issuers, who pay Transbank a fee per transaction to cover its costs (the profits earned by Transbank are later passed on as dividends to the issuers who own the company). Thus the difference between the merchant discount and the fee paid by issuers to Transbank has been dubbed an “implicit interchange fee”.

10. Based on a settlement arrangement between FNE and Transbank in 2005, and a ruling of the TDLC penalising the latter for abuses of dominant position, Transbank is subject to a TDLC-approved Self-Regulation Plan that lays down the structure of merchant discounts, the maximum levels of those discounts (in itemised fashion), the fees paid to issuers and a profit limit of 18%.

2. Interaction with sectoral regulatory bodies

11. The Chilean Central Bank is authorised to regulate issuers and operators of credit and debit cards⁶, to the extent that they are widely accepted payment methods, and this power has been exercised through the regulations governing the sector⁷. Additionally, the regulatory authority for banks and financial institutions (*Superintendencia de Bancos e Instituciones Financieras* – SBIF) has powers to inspect companies whose line of business is in issuing or operating credit cards or any other similar cards, and to provide guidance to inspected entities. In the exercise of those powers, the SBIF has laid down a number of general standards.⁸

12. In terms of regulations, there are only two kinds of activities involving cards: issuance and operation, and the sectoral regulations of the Central Bank and the SBIF set out the scope of those activities, the terms and conditions governing their performance, solvency, liquidity, and management of operational and technological risk. The issuer was given responsibility both for entering into affiliation contracts with entities to ensure that they would accept cards as a payment instrument, and for operating the cards, although card operation may be entrusted to third parties. Companies that hold international debit card brands are not directly regulated.

13. The Central Bank is of the view that its constitutional independence provides that sectoral rules are subject to special control by the courts, therefore the TDLC does not have the powers to amend or nullify them; rather its interest and remit as an institution is to promote development and innovation in payment methods while safeguarding other public assets such as public confidence and trust. Accordingly, a proper understanding of the scope of the regulation would lead to the conclusion that there are no regulatory barriers to entry.

14. The Central Bank considered two regulatory aspects that could be amended to introduce more competition into the market: (i) an easing of the regulations restricting issuance of prepayment cards and allowing participation by non-banking entities; and, (ii) greater connectivity between credit and debit card systems. It also noted the importance of TDLC access to additional empirical background data on penetration of retail payment methods in Chile, and the relationship between innovation and competition in that sphere given its view that it is necessary to balance the generation of competition with the need to safeguard the normal operation of payment systems.

15. Therefore, any regulatory proposal made by the competition agencies must not disregard the power and independence of the Central Bank to lay down standards that protect the proper functioning of the financial system, particularly with regard to the security of payment systems. Neither must it disregard the powers of inspection conferred upon the regulator under the General Banking Act.

⁶ Article 35(7) of the Central Bank Act; and Article 69 of the General Banking Act.

⁷ Currently set out in Chapters III.J.1 and III.J.2 of the Central Bank Compendium of Financial Standards.

⁸ Chapters 8-3 and 2-15 of the Updated Digest of SBIF Standards.

3. Market studies and recommendations for regulatory changes to introduce competition into card payment systems

16. Following an exhaustive market investigation opened in 2011 by the FNE that considered a request to the TDLC in 2013 to conduct a structural review of joint action by the banks through Transbank and other related companies, the TDLC opened a procedure to draft recommendations for regulatory reforms within the scope of its powers to promote competition; that procedure recently closed with the delivery of Proposal No. 19 of 13 January 2017 addressed to the Executive through the Minister for Finance.

17. It should be noted that the sectoral regulators (Central Bank and SBIF) took an active part in that process, raising the issues of how their public policy objectives, such as confidence in and the stability of payment methods and the financial system, interact with the objectives of promoting competition.

18. In substance, the Proposal embodies the conclusions reached by the FNE during its investigation and highlights the need to adopt a combination of structural and conduct-related measures to resolve the lack of competition in universally accepted credit and debit card systems as well as associated inefficiencies and over-pricing issues.

19. The lack of competition on the acquirer side is also damaging to consumers who are affected by higher end-prices, the low penetration of POS terminals in Chile, and poor levels of innovation in quality and service; this is a burning issue for e-commerce solutions.

20. In particular, the TDLC recommended (i) a paradigm shift in regulations governing the card payment system away from a business based on issuers and towards an industry based on networks along the lines of the Australian model; (ii) the clear and precise identification in the regulations of the actors involved in the industry and their duties, thus making it possible to regulate each link in the system in line with its specific characteristics; (iii) the amendment of the standards governing Auxiliary Financial Services Companies (SAGB) to allow them to provide services to third parties that are not financial services companies, thus reducing barriers to entry; (iv) the prohibition of joint action by issuing banks on acquisition activities – this will immediately generate new acquirers on a scale that makes competition viable; (v) the regulation of joint action by issuers on the processing performed by acquirers in order to increase the opportunities for acquirers who are independent of the issuers to enter the market; (vi) the partial amendment of the regulations laid down by the Central Bank in order to remove acquirers' dependence on issuers; (vii) the removal of the unilateral imposition of the non-discrimination rule for payment methods in order to shed light on their costs to merchants on the grounds that, where the level of interchange fees is set efficiently and the merchant discount is competitive, merchants tend to be indifferent to the payment method used and there would be no competitive justification for price differentials; (viii) the regulation of the conditions governing interconnection between network providers and the providers of acquisition services to prevent barriers to new entrants; (ix) the establishment of fixed interchange fees between acquirers and issuers thus preventing their setting in direct negotiation between the aforementioned actors or by international card brands; and (x) the regulation of the conditions in which the international brands award licences, in order to prevent them creating barriers to independent acquirers and operators.

21. The anticipated effects of introducing competition into the acquisition market are, in general terms, a reduction in the merchant discounts charged to merchants, greater coverage, a boost to innovation and the development of new forms of payment, and facilitation of the entry of new businesses into other links in the system, such as processing or switching. We do not anticipate a significant impact on the issuers' side of the market (such as increased charges to card users), given that the regulations would result in rent dissipation on the acquirers' side and which does not currently exist on the issuers' side.