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**LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM - Session III: Competition
and Payment Card Interchange Fees**

– Contribution from Mexico –

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The attached document from Mexico (COFECE) is circulated to the Latin American and Caribbean Competition Forum FOR DISCUSSION under Session III at its forthcoming meeting to be held on 20-22 September 2021, via a virtual Zoom meeting.

Ms. Lynn Robertson, Competition Expert, OECD Competition Division - Lynn.Robertson@oecd.org.

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Session III: Competition and Payment Card Interchange Fees

- Contribution from Mexico -*

1. Introduction

1. In Mexico, there are important areas of opportunity for introducing competition in the card payments system in the national territory. To achieve more competitive pressure and solve the competition problems in this market, the Federal Economic Competition Commission (COFECE or Commission) has carried out several actions of which two are highlighted in the present contribution.

2. The first one is the “*Research and recommendations on competition conditions in the financial sector and its markets*” (Research),¹ presented on July 9, 2014, and which identified several competition problems in the card payments system and for which recommendations were issued (these are addressed in section 2 of the document).

3. The second one is the “Preliminary opinion of file IEBC-005-2018 of the investigation to determine barriers to competition or essential inputs” (Preliminary Opinion),² which was published in the Federal Official Gazette on September 16, 2020. In this, the Investigative Authority of the Commission establishes the possible existence of four barriers to competition in the market of the card payments system in the national territory (which are addressed on section 3 of this contribution). Currently, this case is in a stage similar to the one of the trial-like procedure of anticompetitive practices and will subsequently be resolved by the Board of Commissioners.

4. Lastly, and derived from the non-binding nature of the recommendations of the Commission made to improve the competition conditions in the card payments system in Mexico, the last section of this document takes up again the importance of the suggestions of the peer review conducted by the OECD regarding competition policy in Mexico (Peer Review) which if adopted, would strengthen the recommendations of COFECE.

2. Research: card payments system

2.1. Background and structure of the research

5. Among the objectives of the financial constitutional reform of 2014 was to increase competition in the sector. Consequently, the fifth transitory article of the Law to Regulate Financial Groups (derived from the reform) ordered COFECE to conduct a study to analyze competition in the sector and its markets.

* Contribution from the Mexican Federal Economic Competition Commission (COFECE).

¹ Published in 2014 by COFECE, available at <https://www.cofece.mx/executive-summary-research-and-recommendations-on-competition-conditions-in-the-financial-sector-and-its-markets/>

² Preliminary Opinion of file IEBC-005-2018 available in Spanish at <https://www.cofece.mx/wp-content/uploads/2020/12/DOF-16diciembre2020-01.pdf>

6. Based on the powers provided in section XXIII of article 12 of the Federal Economic Competition Law (LFCE), which mandate COFECE to conduct studies or research in matters of competition, and addressing the aforementioned mandate, the Commission initiated the study on January 16, 2014, having a legal timeframe of one hundred and eighty calendar days to conduct it. The Research was published on July 9, 2014.³

7. To carry out the investigation on the competition conditions in the financial system and its markets, and in order to be able to formulate recommendations to financial authorities to improve competition, the Commission focused on the conduction of a study about different segments of the financial sector. In this, it analyzed several financial products and services (such as credits, savings, securities financing, insurance, as well as several relevant cross-cutting aspects of the sector). Among the relevant cross-cutting aspects the low-value payment systems were analyzed. In the low-value payment systems the following instruments are used:⁴ cheques, electronic funds transfer, direct debiting, credit or debit cards, and most recently, mobile phones. Hereinafter, the credit or debit card payments systems are described.

2.2. Card payments system in Mexico

8. These systems accept both credit and debit cards. In the first ones, the client has a credit line with the issuing bank (issuing entity), while in the latter the account of the client is generally a current account of a bank.

9. The card payments system in Mexico is a network in which several entities participate with different roles: a) *the issuing bank* is the bank that issues the card related to a credit contract or a current account, and this bank will pay the amount of the purchase to the business where the card was used; b) *the acquiring bank* is the bank that provided the business with an account where the amounts of the card purchases will be deposited, and is in charge of managing the point of sale (POS) installed in the business to process the purchases; c) *clearinghouses (or switches)* are (processing) companies that provide communication services between issuing and acquiring banks; and d) *card brands*, who establish the operative and financial standards that issuing banks must comply to bear the brand in the card (in Mexico the heads of brand are MasterCard, Visa, American Express or Carnet).

10. The card payments system is a two-sided *platform* that faces interdependent demands from two groups (issuers and acquirers). In this case, there are network externalities between both sides: the cardholder will value more its payment cards (credit or debit) the greater the number of businesses that accept them; on the other side, the retailer will value its affiliation contract as long as cardholders are willing to use more their card.

11. *Exchange fees* are a fundamental element of these systems. These fees are tariffs charged by banks among themselves and other financial institutions for payment services operations through the platform. Specifically, the exchange fee is the fee that generates for each transaction made in a POS where the issuing bank is different to the acquiring one. In this case, the issuing bank may charge the acquiring bank a percentage over the total amount of the payment being done (that is, an *ad valorem* charge) or a fixed fee. The

³ The Research was made public on July 9, 2014. See Press Release COFECE-013-2014, available in Spanish at: https://www.cofece.mx/images/comunicados/COFECE_013_2014.pdf

⁴ In the low-value payment systems, the average of payments is low, and the clearing and settlement are on the same day or a day after.

acquiring bank charges the retailer that is accepting payments with bank cards a fee known as discount rate. This discount rate in most of the cases is charged as a percentage of the transaction and cover the exchange fee and other operation costs of the acquiring bank.⁵

12. Lastly, regarding the performance of the market at the moment of the realization of the Research it was reported that the card payments system positioned as the second in importance in Mexico, after cash. As for issued (and used) cards, both credit and debit, the study establishes that their number has increased in a sustained way in Mexico.⁶ In turn, the statistics available at the moment showed a growing trend in the number of POS.⁷

2.3. Problems of the card payments system in Mexico

13. The problems identified in the Research related with the card payments system are summarized as follows:

- The issuing side has more participants than the acquiring one; and all the banks that participate in the acquiring side participate in the issuing side. Overall, the biggest banks of the system have important participations both in the acquisition and in the issuance of cards. It was concluded that a low developed acquiring side could be hindering the growth of card payments.
- The E-Global and Prosa clearinghouses are the only ones in Mexico and are co-owned by the eight main issuers and acquirers. Also, the operation conditions for the processing of cards were established in the Acceptance Contract of Bank Cards (CATB per its acronym in Spanish), and it was concluded that the private nature of this contact constitute an entry barrier for the participation in this market.
- Exchange fees in Mexico are a sui generis mechanism, as they are fixed by common agreement between the banks and, in this, the Mexican Banks Association (ABM for its acronym in Spanish) has played an important role for their determination.
- Also, the exchange fees were not balancing efficiently the incentives between cardholders and businesses. It was observed that in big-surface business (for example, self-service stores, commercial chains, big warehouses, etc.) 17% of the total credit and debit operations was concentrated and the exchange fee in this business is a fixed charge per operation of 1.15 Mexican pesos, where the average invoice was of 527 Mexican pesos. In contrast, in debit card payments there were

⁵ Banxico, available in Spanish at: <https://www.banxico.org.mx/sistemas-de-pago/cuotas-intercambio-comisiones.html>

⁶ The information of the Bank of Mexico, online in the Economic Information System, for low-value payment Systems, available in Spanish at: <https://www.banxico.org.mx/SieInternet/consultarDirectorioInternetAction.do?sector=5&accion=consultarCuadro&idCuadro=CF256&locale=es>, indicates that valid credit cards in the last quarter of 2013 were 25,887,321, while in the last quarter of 2020 they were 27,679,900; likewise used credit cards in the last quarter of 2013 were 18,978,118, while in the last quarter of 2020 the registered as used were 20,988,324. Regarding debit cards, the valid ones in the last quarter of 2013 were 126,006,604, while in the last quarter of 2020 they were 157,782,610; likewise, the used credit cards in the last quarter of 2013 were 51,559,394, while in the last quarter of 2020 they were 73,683,116.

⁷ The information of the Bank of Mexico, online in the Economic Information System, for low-value payment systems, available in Spanish at: <https://www.banxico.org.mx/SieInternet/consultarDirectorioInternetAction.do?sector=5&accion=consultarCuadro&idCuadro=CF256&locale=es>, indicated that the number of POS in the Mexican Republic has increased from 129,971 in the last quarter of 2002 to 1,494,370 in the last quarter of 2020. Likewise, operations in POS in the last quarter of 2014 were of 16,778,326 while in the last quarter of 2020 30,761,249 were registered.

businesses with equivalent average invoices that were facing a five-time greater exchange fee and in specific transactions, the exchange fee could be up to 12 times greater than the one paid by the big-surface businesses (payments subject to a cap of 13.50 Mexican pesos). By considering the average invoice as an approximate measure of the disposition to use cards by cardholders and from businesses to accept them, the mentioned differences in exchange fees did not seem to be related to the sensitiveness of the demand of payments acceptance from businesses or from use by cardholders.

2.4. Recommendations to improve the system

14. The main recommendation issued by the Research in relation to the card payments system in Mexico is centered in regulating the exchange fee for their balancing (in credit and debit cards), with the objective of optimizing the use of this payment method and its coverage, taking into account the sensibilities of final users to price changes.

15. Specifically, it was proposed the determination of an exchange fee closer to the efficiency that could increase that users who already have a card use it more frequently. Also, it suggested the reduction of the exchange fee since users who already have a card could not be using it in an efficient level given that tariffs tend to be established on the basis of marginal consumers.

16. Lastly, during the elaboration of the Research, the Commission issued an opinion regarding the draft “*Rules for the organization, functioning and operation of clearinghouses for card payments*” of the Bank of Mexico (Banxico),⁸ whose fundamental elements were included in the Research. Hereinafter, the identified problem and the recommendations issued in the opinion are described:

- The authorization of third-party subcontracting by clearinghouses for the provision of clearance and settlement services is regulated, which could imply an entry barrier for the provision of these services. In this regard, COFECE considered that this authorization is not necessary since clearinghouses can be made responsible of subcontracting non-regulated companies. However, if maintained it was recommended that the conditions established by Banxico to be very general.
- The creation of a single protocol or group of exchange rules (presumably CATB) between clearinghouses is established, which could have the effect of limiting the innovation or flexibility needed for the supply of specialized or differentiated services. COFECE recommended the possibility of establishing an initial general regulation and that in the future other protocols or new rules, differentiated from the existing one, that promote dynamic innovation and efficiency can be accepted. This recommendation was adopted by Banxico.
- Rules for the non-discriminatory dealing between shareholders of the clearinghouses, as well as for the authorization of differentiated charges and fees are established. However, these rules could encourage the collection over the costs when shareholders could recover this surplus through profit sharing. In this sense, it was suggested that the regulation of charges to be established cautiously.

⁸ PRES-CFCE-2014-029, Opinion related to the draft “Rules for the organization, functioning and operation of clearinghouses for card payment systems”. Available in Spanish at <https://www.cofece.mx/conocenos/pleno/resoluciones-y-opiniones/>

17. With respect to the rest of the problems identified in the Research, these were analyzed after in the market investigation for barriers to competition that is described in the following section.

3. Market investigation for barriers to competition in the card payments system

3.1. Legal framework of the market investigations for barriers to competition

18. The constitutional reform of 2013 in matters of economic competition bestowed the Commission with powers to order measures to eliminate barriers to competition, regulate the access to essential inputs and order the divestiture of assets, rights, social parts or stocks of economic agents.

19. Accordingly, the 2014 LFCE, in its article 2 established as one of its objectives to “*prevent, investigate, fight, prosecute effectively, punish severely and eliminate [...], the barriers to free market access [...]*”, and in section IV of article 3, it defined these barriers as “*Any structural characteristic of the market, event or act of the Economic Agents that has as an object or effect to impede access to competitors or limit their capacity to compete in the markets; that impede or distort the process of competition and free market access, as well as the legal provisions issued by any order of government that unduly impede or distort the process of competition and free market access*”.

20. This law, in section II of article 12, empowers the Commission to eliminate said barriers and article 57 establishes that the Commission will conduct the appropriate to prevent them, eliminate them, as well as their anticompetitive effects, through the procedures established in it. In this sense, article 94, establishes said procedures, for the Commission, through its Investigative Authority, initiates and conducts market investigations for barriers to competition and, through the Board of Commissioners, resolve on them.

3.2. Investigation of the card payments system market

21. In October 2018, the Investigative Authority of COFECE announced that it found elements that suppose the lack of effective competition conditions in the card payments system whose processing involve a clearinghouse for card payments, due to the possible existence of barriers to competition and/or essential facilities and, therefore, opened an investigation procedure (IEBC-005-2018). In December 2020, the Investigative Authority of the Commission issued the Preliminary Opinion about this investigation which establishes that there are no effective competition conditions in the card payments system in Mexico. Hereinafter the most relevant findings of the Preliminary opinion are presented.

3.2.1. Definition of the relevant market

22. In the investigation it was defined that the investigated market corresponds to the one described in section 2.2. of this document, establishing two relevant markets (one for credit and one for debit), considered open card payment systems⁹, characterized for being

⁹ The investigated market has several similarities with open systems, the most important are: (i) issuers and acquirers that compete to serve final users participate in them; (ii) the transactions of payments initiates in a payee which, through the services of an acquirer, communicated the information to a clearinghouse; (iii) the brand holders license the use of brands of cards to issuers and acquirers; (iv) the acquirer negotiates the discount rates in a bilateral way with each payee.

transactional two-sided markets in which services for domestic transactions for the purchase and sale of goods and services to cardholders and businesses are provided.

23. Notwithstanding the above, it was identified that in Mexico there are differences with respect to open international systems, mainly due to the applicable regulatory framework and to the structural organization of the market. Examples of these differences are that in Mexico the brand holders do not act as managers of the network,¹⁰ and that in the market there are operation rules and standards that regulate payment transactions applying the same conditions to all cards regardless of their brand.

24. Likewise, the regulatory framework establishes the following obligations: (i) authorization from Banxico to be organized and operate as clearinghouse; currently Prosa, E-Global, MasterCard Mexico and Visa Mexico are authorized (however, to the date of the issuance of the Preliminary Opinion the last two ones had not had initiated operations); (ii) that clearinghouses that process transactions in a card payments network link their systems; and (iii) the establishment of an agreed mechanism between participants of the market for the determination of the exchange fees that are applied to the card payment transactions (mentioned in point 2.3 of this document).

25. Regarding the market structure, the Preliminary Opinion highlights that the rights and obligations concerning the operation and exchange of card payment transaction with a national issuer and acquirer have been established through instruments agreed between the participants, as for example the Domestic Exchange Contract (CID per its acronym in Spanish) which substitutes the CATB,¹¹ and that include the agreed exchange fees, and the conditions for the exchange between clearinghouses authorized by Banxico. In this sense, given that all authorized transactions that operate through clearinghouses do it under the aforementioned rules, a sole card payments network, named domestic network, was identified.

3.2.2. Competition Analysis

26. Regarding the level of competition among market participants (issuers, acquirers, clearinghouses) it was identified that their operations have remained stable and without big changes in their market position from 2009 to this date. Derived from this, in the market it is observed:

- Lack of mobility of market participants, which is aggravated due that issuers, acquirers, and clearinghouses have carried out behaviors that translate in delays in innovation, security problems, commercial schemes, alliances and exclusivities that imply high entry costs for new participants.
- Limited competition between financial institutions with greater positioning in both sides of the market (issuance and acquisition) as they have: (i) information provided by their own clearinghouse to have knowledge of the market and their competitors, (ii) economic incentives to establish actions that strengthen their position in the markets in which they participate (issuance and acquisition), and (iii) powers to

¹⁰ “A closed system is that in which a sole economic agent acts as manager of the network, as issuer, acquirer and at the same time is the one in charge of the processing of the transaction and is who establishes the rules of the system and owns the brand” Extracto del Dictamen Preliminar del expediente IEBC-005-2018, disponible en: https://www.dof.gob.mx/nota_detalle.php?codigo=5607752&fecha=16/12/2020

¹¹ Before 2014, the operation was subject to the Bank Cards Acceptance Contracts (CATB) between banks, Prosa and E-Global. However, from 2014, CATBs were substituted by Domestic Exchange Contracts (CID) of multilateral nature, in which the agreed exchange fees are included, as well as the Conditions for the Exchange between Clearinghouses authorized by the Bank of Mexico.

analyze, design and execute actions through Prosa and E-Global for the strengthening of the estate of their shareholders.

- Only Prosa and E-Global have capacity to restrict the supply of the service for domestic transactions. This capacity is observed from the constant intermittencies and interruptions of the processing service causes by their systems. Also, it was identified that the possibility of differentiation of the services between both clearinghouses is limited because the processing is made in accordance with the aforementioned regulatory framework.
- Market failures related to the behavior of final users. (cardholders and payees) by registering very low mobility even though there are attractive offers for them. Which translates into a poor competitive response between issuers and acquirers. Specifically, it was identified that:
 - Cardholders are prone to single-homing,¹² since they predominantly use a single card, which is characterized by a reduced mobility, exclusive use, high permanence, and persistence.
 - Payment recipients present the same single-homing characteristic. Also, there are important operative scale advantages for Prosa and other banking institutions generated from commercial schemes that anticompetitively impact in the mobility of payees.

3.2.3. Possible barriers to competition

27. Under the foregoing market conditions, four barriers to competition were identified in the Preliminary Opinion which are described as follows:

- *Existence of a sole card payments network*, called domestic network, resulting from the rules of the system, which makes the coexistence of other payment networks with lower fees, better services, and more transaction security impossible. This is because any other network that would like to operate and expand in the market will have the need to interconnect with the domestic network to operate payment transactions and attract participants to its network.
- *Existence of anticompetitive requirements that increase the entry costs of new participants in the existing payments network or into a new one.* It is observed that the domestic network operates the 100% of the domestic transactions of debit cards and 88.65% of the domestic transactions with credit cards, therefore the entrance to a new payments network requires necessarily, to interoperate transactions with the domestic network and, consequently, it is necessary for the clearinghouses of a new network to link or interconnect with the clearinghouses of the domestic network. However, these new networks must assume the high costs of entry of this link derived from the extensive periods of authorization and from the link requirements with the domestic network that in some cases are uncertain, must be certified by the existing clearinghouses, and must adjust to the ISO 8583 messaging standard.

¹² “If a client decides to use only a platform for a specific service, generally it is considered as single-homing. Failing this, when using multiple platforms is said to be a multi-homing client” in page 10 of OECD Digital Platforms and Competition in Mexico, available in Spanish at <https://www.oecd.org/daf/competition/esp-plataformas-digitales-y-competencia-en-mexico.pdf>

- *Eight banks, co-owners of the clearinghouses, are in charge of processing the operations of the payments network, allowing them to: (i) have detailed information that other banks do not have; and (ii) design, facilitate, implement and monitor commercial schemes and internal policies that advantageously favor their operation in the issuer and acquirer side.*
- *The obligation to guarantee daily liquidity of the transactions falls on the brand holders and not on clearinghouses (network managers in Mexico)¹³ which are the ones that process the payments and know the risks of each operation: for one side, discourages the entry of other card brands, and on the other, by not having this obligation, clearinghouses stop investing and monitoring the system to detect threats, which generates risks to the security of the payments network.*

3.3. Stage similar to the trial-like procedure and resolution of the case

28. Currently, the Preliminary Opinion is under a stage similar to the trial-like procedure, foreseen for anticompetitive practices. This stage foresees that those economic agents that prove to have a legal standing can manifest what is in their best interest and offer the evidence that they deemed pertinent. Also in this stage, the involved economic agents can propose, on one occasion, ideal and economically viable measures to eliminate the identified competition problems. Once processed the evidence and arguments they will be integrated into the file, so that the Board of Commissioners issue a final resolution of the case, in no more than sixty days.

29. To eliminate barriers to competition the Board of Commissioners may resolve to: (i) order behavioral remedies that oblige economic agents to act in a specific way or stop making acts that distort the competitive process; (ii) order structural remedies, that allow to modify the structure of the market, including the possibility of the divestiture of assets, rights or social parts, with the objective of generation or restoring competition conditions; and (iii) provide recommendations to the authorities of any level of government to eliminate those regulatory barriers identified.

30. In this sense, the Preliminary Opinion makes four proposals to eliminate the aforementioned barriers, and that the Board of Commissioners can consider in its final determination, these are:

- Banxico and the National Banking and Securities Commission (CNBV per its acronym in Spanish) are recommended to issue the necessary regulation that allows the participation of other payment networks and for each network to formulate their own exchange fees. Likewise, that both regulators analyze the suitability of clearinghouses to operate with their own rules, protocols and exchange fees, and the elaboration of a study about the suitability of the exchange fees levels was recommended to Banxico.
- Banxico is recommended to issue regulation for establishing the requirements for the link with processing systems between clearinghouses, specifically the elimination of the certification of the link by the incumbent clearinghouses, that establishes maximum times for these houses to make links, and to issue guidelines for the link requirements.

¹³ In many countries, payment networks include the figure of a "network administrator" who can usually be the brand owner (Visa or MasterCard). The advantage of this mechanism is that the "network administrator" does not have a stake in either side of the platform. Consequently, the "network administrator" seeks to balance the network. In Mexico it is not clear that this is happening.

- Banxico and the CNBV are recommended to eliminate obligations of the brand holders to guarantee daily liquidity of operations and, to issue regulation so that each clearinghouse guarantees transactions that operate under their own rules of operation.
- Order the divestment of 51% of the shares of the clearinghouses (E-Global and Prosa), owned today by some of the banks.

4. Nature of COFECE's recommendations

31. Finally, the recommendations of COFECE's Research and the market investigation directed to public authorities are of non-binding nature. In this sense, these could have a slow adoption by regulators and public authorities. Therefore, the OECD's Peer Review of 2021, which analyzed the powers and work of COFECE in the last years, made suggestions related with said recommendations of COFECE. Specifically, the OECD suggested:

- for market studies, Mexican government agencies commit to publicly answer every recommendation made to them in a timeframe defined from the date in which these are issued; and
- market investigations, for the scope and legal effects of the resolutions approved in accordance with Article 94 of the LFCE and directed to public authorities to be clearly stated. If these are still non-binding, it is recommended that public authorities inform COFECE the objective reasons for not abiding their resolution within an established timeframe. Also, it is recommended that COFECE, could have the possibility to directly challenge these laws and provisions before tribunals, for constitutional reasons.

32. If the suggestions of the OECD were implemented the adoption of COFECE's recommendations would increase, given that (i) there would be more transparency regarding the intention of public authorities to implement (or not) COFECE's recommendations, (ii) the reasons why, if it is the case, these consider that they could not be adopted would be known; (iii) in case of having intention of adoption, the estimated timeframe for that would be known and, (iv) in the case of market investigations, the possibility of a direct challenge from COFECE before the Supreme Court of Justice of the Nation for constitutional reasons would make this procedure more expedite.