



## **2022 Review of the Second Payment Services Directive (PSD2)**

### **- Contribution by the Bundeskartellamt on Surcharging -**

The European Commission has launched a review of the second payment services directive (PSD2). While the review covers a broad range of issues, the present contribution focuses on the right of the payee to request charges for the use of a given payment instrument (so-called 'surcharging').

One of the goals of the PSD was to promote competition among payment schemes through the use of surcharging. This goal was counteracted by an exemption introduced by PSD2 which prohibited surcharges for most card-based payments. The surcharge ban restricts price competition among payment schemes and ultimately harms consumers. Enabling cost-based surcharging would promote lower payment fees and the use of more efficient payment methods throughout Europe, which is why this topic is of high relevance for encouraging competition on the merits in the sector of digital payment systems and - more broadly – strengthening competition policy in financial markets.

#### **1. The PSD2 surcharging framework**

Article 62(3) PSD2 – as previously Article 52(3) PSD – states that the payment service provider shall not prevent the payee from requesting from the payer a charge, offering him a reduction or otherwise steering him towards the use of a given payment instrument. Any surcharge shall not exceed the direct costs borne by the payee for the use of the specific payment instrument. The goal of this provision is to promote competition (cf. recital 42 PSD). However, Member States remain free to decide whether they prohibit or limit surcharging, taking into account the need to encourage competition and promote the use of efficient payment instruments.

Article 62(4) PSD2 introduced a significant exemption to the right of the payee to surcharge. The payee shall not request charges for the use of payment instruments for which interchange fees are regulated under Chapter II of Regulation (EU) 2015/751 (Interchange Fee Regulation - IFR). In essence, this means that merchants are prohibited to surcharge in most cases where consumers pay with a debit or credit card. Other payment schemes such as e.g. PayPal or Klarna are not addressed by this prohibition.<sup>1</sup> Recital 66 PSD2 provides three reasons for introducing the exemption for card payments: According to the text, heterogeneity of national surcharging rules had led to consumer confusion, there had been many examples of surcharging at levels higher than the cost borne by the merchant, and merchant fees mainly consisted of interchange fees which were to be capped by the IFR.

## **2. How a surcharge ban harms competition and ultimately consumers**

Merchants offer a variety of different payment methods to their customers. This is because some customers would rather shop elsewhere if they do not find their preferred payment method at the merchant's store or web shop. This effect is strong enough for merchants to offer at least the most popular payment methods even if the merchant fee for a given payment method is relatively high. The fee that merchants have to pay for accepting a payment (so-called 'merchant service charge') differs significantly across payment methods. The most expensive payment methods may cost merchants up to ten times more than the lowest-cost methods.

When a merchant uses surcharging, customers will take these cost differences into account when choosing which payment instrument to use for a specific transaction. Other aspects relevant to the customers' decision may include e.g. the payment method's convenience, security, privacy and benefits such as guarantees, insurances or rewards. With surcharging, a payment scheme can attract more transactions by offering lower service fees to merchants. This will result in price competition among payment schemes, thus driving prices down, just as in any other 'normal' market.

If, however, surcharging is prohibited – either by law or by contractual requirements of the payment scheme(s) – the incentive for payment schemes to compete on lower merchant fees is largely suppressed. The payment scheme(s) will find it profitable to

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<sup>1</sup> Cf. Federal Court of Justice, decision of 25.3.2021, I ZR 203/19

set higher fees for merchants. Consumers will ignore the fee differences across payment instruments and will opt more often for rather expensive payment methods. A prohibition of surcharging will thus not only lead to higher fees charged by each payment scheme but also to an inefficient payment mix. Merchants will include the (average) payment fees in their product/service prices. The elevated payment costs will ultimately have to be borne by the consumers, and consumers using relatively inexpensive payment methods will end up cross-financing the more expensive methods.

It is important to note that already the mere option for merchants to surcharge will help to keep payment fees down. The option to surcharge places a pricing constraint on payment schemes even if most merchants decide to refrain from surcharging. Capping interchange fees cannot fully substitute for the disciplining effects of optional surcharging. Interchange fee caps only affect some payment schemes, and even those may raise the price of other components of the merchant service charge such as the scheme fees. The possibility for merchants to offer rebates when using a low-cost payment method does not substitute for the surcharge option either. As selecting a payment method is the very last step in the shopping process after the customer has already decided to purchase, this leaves merchants with very little incentive to offer such a 'last-minute' rebate.

### **3. Market developments since 2015**

The market developments that could be observed in the EU and Germany since the adoption of the PSD2 and the IFR are largely consistent with the economic cause-effect relationships described above.

Already pre-PSD2, surcharging was not widely spread in Germany, and it largely disappeared after the PSD2's national transposition came into effect. This also applies to payment methods not covered by Article 62(4) PSD2, such as PayPal, which introduced a contractual surcharge ban. A countervailing proliferation of merchants granting rebates when customers opt for a lower-cost payment method could not be observed – such rebates are still rare exceptions.

While the share of non-cash payments increased throughout Europe to the detriment of cash payments, it seems that relatively expensive payment methods grew stronger than lower-cost payment methods – a trend that could already be observed before

2015.<sup>2</sup> Interchange fees have dropped significantly due to the IFR, but at the same time payment scheme fees have risen. Merchants and their associations have complained that, as a result, the total fee paid by merchants was now roughly back to previous levels as far as Visa and Mastercard are concerned.<sup>3</sup> The European Commission has recently commissioned a study<sup>4</sup> which may shed additional light on these market developments.

#### **4. The Australian experience**

Australia is the most prominent example of a jurisdiction which allowed surcharging and terminated contractual surcharge bans set by payment schemes. In addition, reliable price statistics on merchant service charges for a long time series are available for Australia. For these reasons the Australian experience may serve as an insightful case study.

During 2003, Australia started to implement reforms aimed at strengthening competition between payment systems and increasing efficiency. Interchange fees set by payment schemes were capped and the contractual surcharge bans previously applied by Visa and Mastercard were prohibited. Since 2003, market developments have been monitored stringently and several regulatory reviews were conducted which led to refinement of the regulatory framework. Today, the interchange fee caps are complemented by a prohibition of (net) incentive payments to card issuers in order to avoid circumvention of the interchange fee caps. Surcharge bans set by payment schemes other than Visa and Mastercard were also eliminated either by formal regulation or through less formal arrangements. In order to avoid above-cost surcharges set by merchants, surcharges are capped per payment brand by the fees the merchant pays to third parties for the use of the respective scheme.

The actual practice of surcharging picked up slowly after 2003. It was estimated that by 2010, roughly 30% of all Australian merchants had set a surcharge on at least one of the credit cards they accepted.<sup>5</sup> However, this only translated into low rates of sur-

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<sup>2</sup> Cf. European Central Bank, Card payments in Europe - Current landscape and future prospects: a Eurosystem perspective, April 2019, pp. 9-10.

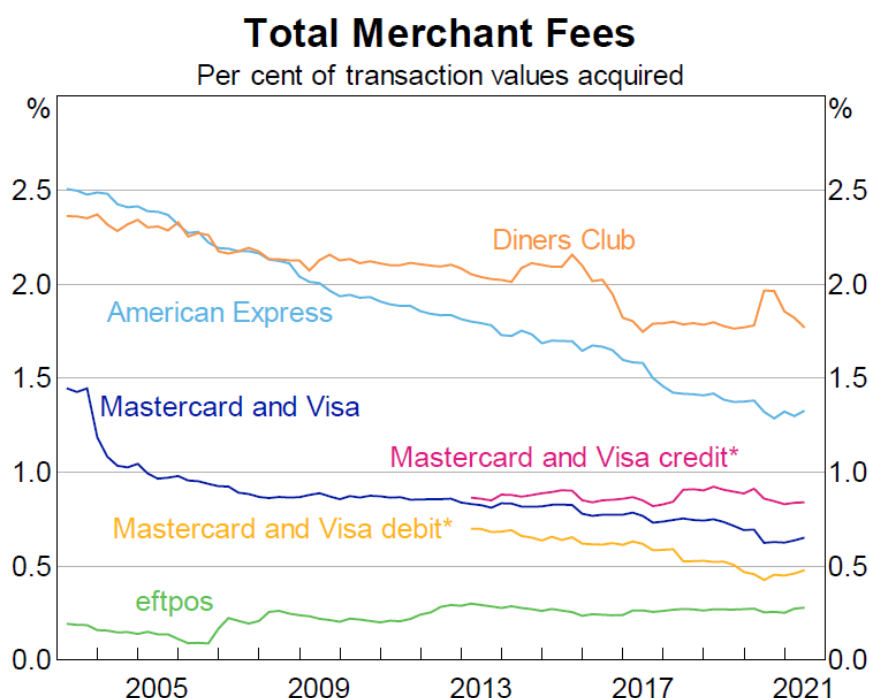
<sup>3</sup> Cf. EuroCommerce submission to the EU Interchange Fee Regulation Review, February 2020.

<sup>4</sup> Call for tenders COMP/2022/OP/0002

<sup>5</sup> Cf. Reserve Bank of Australia, Review of Card Surcharging: A Consultation Document, June 2011, p. 2.

charged transactions as consumers regularly opt for non-surcharged payment methods. In 2019, Australian consumers paid a surcharge on approx. 2% of all payments, which was mainly driven by surcharges on credit cards (5% of all credit card transactions) and internet payments (8% of all online card payments).<sup>6</sup>

The market developments observed since 2003 are consistent with the effects that could be expected as a result of these regulatory reforms. Merchant fees have dropped steadily, also for payment methods that have never applied interchange fees and which were thus not (directly) affected by the interchange fee caps. Moreover, the usage share for lower-cost payment methods (i.e. debit cards) has grown, leaving higher cost payment methods (i.e. credit cards) behind.<sup>7</sup>



Development of merchant service charges in Australia. Note: eftpos is a domestic debit card payment scheme. Source: Reserve Bank of Australia (2021)<sup>8</sup>

<sup>6</sup> Cf. Caddy/Delaney/Fisher, Consumer Payment Behaviour in Australia: Evidence from the 2019 Consumer Payments Survey, September 2020, p. 28.

<sup>7</sup> Cf. Reserve Bank of Australia, Review of Retail Payments Regulation Conclusions Paper, October 2021, p. 23

<sup>8</sup> Cf. Reserve Bank of Australia, Review of Retail Payments Regulation Conclusions Paper, October 2021, p. 12

## **5. Reforming Article 62(4) PSD2**

Due to the surcharge ban of Article 62(4) PSD2, European businesses and consumers pay higher fees than necessary for using payment schemes. The reasons which led the EU legislator to introduce the surcharge ban are no longer convincing from today's perspective. The IFR does not cap the level of merchant service charges, and the fees incurred by merchants today when accepting card-based or internet payments are often several times higher than the interchange caps set by the IFR. Prohibiting surcharges is a bad solution to above-cost surcharges. As the Australian example shows, this issue can rather be solved by implementing a clear surcharge cap standard and corresponding enforcement measures. If heterogeneity across Europe is still perceived as a problem, this should be addressed by removing Article 62(5) PSD2. The principle that the payment service provider shall not prevent the payee from requesting from the payer a charge, offering him a reduction or otherwise steering him towards the use of a given payment instrument (Article 62(3) PSD2), should be enforced without counter-acting exceptions. A reform of the IFR should be considered as a complementary measure, including a review of its rules aimed at preventing circumvention of interchange fee caps.

Such a regulatory reform would be in line with recent EU digital and competition policy legislation involving multi-sided markets. Article 5 Digital Markets Act prohibits digital gatekeepers from using several price and non-price steering/anti-steering measures. In a similar vein, Article 5(1)(d) of the new Vertical Block Exemption Regulation (Regulation 2022/720) excludes any direct or indirect obligation causing a buyer of online intermediation services not to offer, sell or resell goods or services to end users under more favourable conditions via competing online intermediation services. The reasons that motivated these two pieces of EU legislation should inform changes to Article 62(4) PSD2.