

7 Conclusions

7.1. We are required to report whether a monopoly situation exists in relation to the supply of credit card services in the United Kingdom (the reference services). Our terms of reference are given in Appendix 1.1.

Background

The provision of credit card services

7.2. Credit cards are issued by banks and building societies as part of a range of services to clients. Credit cards provide a dual service, a method of paying for goods and services and withdrawing cash, and also access to optional credit, up to a specified limit. Credit is available on a month by month basis, to cover the cost of purchases subject to minimum repayments each month. Initially this credit is free; borrowers can avoid interest charges by repaying the loan in full before the end of the interest-free period. Credit cards are one of a variety of means of payment accepted by traders and are one of a variety of sources of credit available to consumers.

7.3. Because it is impracticable for an individual issuer to arrange directly for his cards to be accepted by banks and traders throughout the credit card-using world, or even, for most issuers, throughout the United Kingdom, issuers normally join one or both of the two international payments organisations MasterCard/Eurocard and Visa International (Visa) which provide the services which enable a credit card, issued by an individual financial institution, to be accepted by banks and traders throughout the world.

7.4. A credit card issued under the MasterCard/Eurocard or Visa trade mark can be used to withdraw cash from any financial institution belonging to the same organisation. In addition, and more importantly in the United Kingdom, a card can be used to pay for purchases from any trader who has agreed to accept cards issued under that trade mark. (Most traders in the United Kingdom who accept credit cards take those issued under both the MasterCard/Eurocard and Visa trade marks.) A trader who agrees to accept payment cards issued under a particular trade mark agrees to accept all cards issued or to be issued under that trade mark, whether or not they are credit cards (the Honour All Cards rule), and to charge the same price for goods paid for with plastic cards as he charges for goods paid for by other means (the No Discrimination rule). A trader who accepts payment by credit card recovers his money from the financial institution (known as the merchant acquirer) with which the trader negotiates an agreement, under which the trader pays the merchant acquirer a commission known as the merchant service charge (MSC). The merchant acquirer in turn recovers his payments to the trader from the relevant card-issuing institution. Where the merchant acquirer is also the issuer of the card used in a transaction he retains all the MSC. Where another issuer's card has been used the merchant acquirer may pay part of the MSC to the card issuer as an interchange fee. Where an overseas card has been used an interchange fee is paid through either Visa or MasterCard/Eurocard (see also paragraph 7.6).

7.5. Until the beginning of March 1989 there was only one Visa merchant acquirer in Great Britain, Barclays Bank PLC (Barclays), which is also the major United Kingdom issuer of Visa cards. In addition, TSB Group plc/TSB Trustcard Ltd (TSB) was a merchant acquirer in Northern Ireland. Barclays and TSB had negotiated individually interchange fees with the other Visa card issuers in the United Kingdom.

7.6. Until the same date there was also only one MasterCard/Eurocard merchant acquirer in the United Kingdom, The Joint Credit Card Company Ltd (JCCC), which is owned by Lloyds Bank Plc (Lloyds), Midland Bank plc (Midland), National Westminster Bank PLC (NatWest) and The Royal Bank of Scotland Group plc (RBS). The JCCC does not pay interchange fees to its members and those others for whom it acts; as a result it has so far paid interchange fees only to foreign issuers of MasterCard/Eurocards. The JCCC shareholders receive a share of the JCCC's surplus, part of which can be regarded as equivalent to an interchange fee.

7.7. Lloyds, although a shareholder in the JCCC, entered the merchant acquisition market in March 1989, offering merchant acquisition services, for the first time in the United Kingdom, covering both the MasterCard/Eurocard and Visa systems.

7.8. Not all United Kingdom members of the two international payments systems are eligible to act as merchant acquirers. To be eligible they must be 'Principal' members (see paragraphs 2.75, 2.76 and 6.481) and have satisfied the organisation concerned of their commitment to its success, usually by having recruited an adequate number of cardholders, but sometimes by producing a plan for cardholder recruitment, followed by some subsequent demonstration of the fulfilment of this plan.

7.9. Any United Kingdom member of MasterCard/Eurocard who becomes eligible to act as a merchant acquirer is therefore free to enter the merchant acquisition market in competition with the JCCC and now Lloyds. All traders for whom a merchant acquirer acts may display the MasterCard and Eurocard signs. Unless the merchant acquirer is a shareholder in the JCCC, or has reached an agreement with the JCCC, the traders for whom the merchant acquirer is acting will not, however, be free to display the Access sign, because it is a JCCC trade mark.

7.10. Until January 1989, when Barclays first issued a credit card under the MasterCard/Eurocard label, the only MasterCard/Eurocard credit cards issued in the United Kingdom were those which also had an Access trade mark. They were those issued by Lloyds, Midland, NatWest and RBS, together with Bank of Ireland (BoI), and National Australia Finance (UK) Ltd (NAF), which now owns the Clydesdale Bank PLC and the Northern Bank Ltd.

7.11. Whereas in many countries a charge is made for credit cards they are normally issued free within the United Kingdom. As a result United Kingdom issuers have only two significant sources of income, the interest payments from those of their cardholders who pay interest, and the payments from traders who accept credit cards (in the form of MSCs, interchange fees, or equivalent payments). In 1988 the six main United Kingdom credit card issuers (Barclays, Lloyds, Midland, NatWest, RBS and TSB) received 67 per cent of their income in the form of interest payments from cardholders and 29 per cent in the form of MSCs or interchange fees or JCCC surplus. The balance was made up of sundries such as insurance commission. In addition there are opportunities to advertise other services. Some 30 per cent of United Kingdom credit card users do not pay interest because they take advantage of the interest-free period on the purchase of goods and services. There is, however, a charge on withdrawals of cash on which interest payments, or an equivalent fee, become due immediately.

The market for credit card services

7.12. Our terms of reference direct us to look at the supply in the United Kingdom of credit card services and exclude from the definition of credit cards certain other types of plastic payment cards. These are store cards, which can only be used for purchases from one supplier or group of suppliers, charge cards on which extended credit is not available, and debit cards which are a means of payment but are not necessarily a source of credit. Trading checks are also excluded. In carrying out our inquiry, however, we have considered credit cards in the wider context of other means of payment

and sources of credit in order to be able to make a judgment about the extent to which credit card services, as defined in our terms of reference, constitute a distinct market.

7.13. In 1988 there were nearly 25 million credit cards in circulation in the United Kingdom compared with around 10 million store cards¹ and about 2 million charge cards. Visa and MasterCard/Eurocard (including Access) credit cards are each accepted in more than 300,000 outlets in the United Kingdom. Store cards are principally issued by large multiple outlet groups although smaller groups and single outlet stores also issue their own cards. Nearly all shops participating in store card schemes also accept Visa and Access. The principal exceptions are Marks and Spencer and the John Lewis Partnership. American Express and Diners Club charge cards are each accepted in over 100,000 outlets. In 1988 credit cards were used to pay for goods and services worth around £16.5 billion, nearly 6 per cent of consumer spending. Store cards¹ and charge cards each accounted for less than 1 per cent of spending. Cash, cheques and credit transfers accounted for the bulk of expenditure.

7.14. At the end of 1988 the amount of credit taken on credit cards stood at £6.2 billion, 14.5 per cent of all consumer credit.

7.15. From our investigations it is clear that while cash and cheques remain the principal means of payment for goods and services, credit cards are an important method of completing transactions and their use is on a significantly different scale from that of store cards and charge cards. Similarly while banks (through loans made otherwise than through credit cards) and finance houses remain the main sources of consumer credit, credit cards provide significant separate access to credit and are more important in this respect than store cards.

7.16. Credit cards offer a mix of facilities in terms of widespread acceptability for payment and the opportunity for extended credit, often for relatively small amounts, that is not matched by alternative products. Store cards provide credit but are restricted to the stores where they are accepted. Cheques and debit cards provide widespread acceptability but no automatic access to credit. Bank overdrafts and term loans require separate negotiation and tend to be for larger amounts. Charge cards are more widely accepted than store cards but are not intended to provide a credit facility and are held by a more restricted group of customers. For certain types of transaction one or other of these forms of payment may be an acceptable alternative to a credit card. In this respect credit cards face limited competition but, taking the whole range of transactions for which credit cards are used and on which credit is available, we consider that credit cards provide a distinct combination of services and can properly be regarded as a separate market for the purpose of our inquiry.

Monopoly findings

Barclays' scale monopoly

7.17. We have shown in paragraphs 3.7, 3.9 and 3.10 that Barclays has at least 25 per cent of the market in the United Kingdom, according to the following measurements:

- (a) 35 per cent of the credit cards in circulation in 1988;
- (b) 39 per cent of credit card transactions with United Kingdom merchants and cash advances in 1988; and
- (c) 36 per cent of credit card debt outstanding in 1988.

We therefore conclude that a monopoly situation exists in favour of Barclays by virtue of section 7(1)(a) of the Fair Trading Act 1973 (the Act).

¹ Figures for store cards are based on data for 1987

7.18. Barclays does not challenge this conclusion, although it questions whether the market for credit card services constitutes a separate market. We have already considered this issue (see paragraphs 7.12 to 7.16) and have decided that plastic payment cards of the type covered by our terms of reference form a separate market distinct from charge cards, store cards and debit cards.

Visa complex monopoly

7.19. We further conclude that a group consisting of Visa International (which, although a Delaware-registered company, comes within our jurisdiction because it has a place of business in Great Britain), together with those United Kingdom banks and building societies which supply Visa credit card services (Banco Bilbao Vizcaya, Bank of Cyprus (London) Ltd, Bank of Scotland (BoS), Barclays, Beneficial Bank PLC (Beneficial), The Chase Manhattan Bank NA (Chase), Co-operative Bank plc (Co-op), Robert Fleming & Co Ltd (Fleming), Girobank plc (Girobank), Halifax Building Society (Halifax), C Hoare & Co, Leeds Permanent Building Society (Leeds Permanent), Lloyds, Midland, National & Provincial Building Society (National & Provincial), Standard Chartered Bank, Town & Country Building Society (Town & Country), TSB Group plc/ TSB Trustcard Ltd (TSB) and Yorkshire Bank PLC (Yorkshire)), constitutes a complex monopoly in accordance with the provisions of section 7(1)(c) and (2) of the Act, because:

- (a) as is demonstrated in paragraphs 3.7, 3.9 and 3.10 this group supplies at least one-quarter of the market for reference services;
- (b) until the beginning of March 1989 only one member of the group, Barclays, provided merchant acquisition services within Great Britain; since then Lloyds has also become a Visa merchant acquirer although Barclays remains the major Visa merchant acquirer;
- (c) all those members of the group which issue Visa credit cards or act as merchant acquirers (ie all members of the group other than Visa) accept Visa's No Discrimination rule;
- (d) they also accept another rule which in our view restricts competition between Visa members that no Visa member is free to become a merchant acquirer in a country in which it does not issue an acceptable number of Visa cards; and
- (e) Visa requires its members to comply with the rules mentioned in the preceding subparagraphs; Visa also provides services (of the types described in paragraphs 2.17 to 2.20) without which its members within the United Kingdom could not offer the reference services.

7.20. Barclays does not agree that there is a Visa complex monopoly. Barclays does not accept that interchange agreements deter other Visa members in the United Kingdom from becoming merchant acquirers, and claims that there is no agreement between Visa members in the United Kingdom on MSCs, or terms offered to cardholders, including interest rates (see paragraph 6.19). These arguments do not, however, in our view go to the basis of our complex monopoly finding, which is more restricted than the grounds on which our provisional complex monopoly finding was made, and to which the arguments in paragraph 7.19 were directed. The basis of the provisional complex monopoly finding is described in Appendix 1.3.

7.21. Visa argued that it did not form part of the complex monopoly because to meet the requirements of section 7 of the Act a common purpose of identity between and among the members of one and the same group had to exist greater than that between Visa and United Kingdom members; and that Visa had a distinct existence from its members and operated in a distinct economic sphere. Visa was an emanation of all its members located throughout the world, not just those members within the United Kingdom. Visa's rules and conduct did not prevent, restrict or distort competition. Visa further argued that it did not supply credit card services and to be a member of the group supply was an essential ingredient. Visa argued that a person could not be a member of the relevant group unless he was a supplier and the purpose of section 7(2) of the Act was to confine or limit those persons who were members of the relevant group to persons who behave anti-competitively in a relevant way. They had to be a supplier and they had to behave relevantly and anti-competitively. It was not possible to behave relevantly anti-competitively if a person were not a supplier. We disagree.

In our provisional complex monopoly findings we stated that Visa itself did not issue credit cards nor did it act as a merchant acquirer. We further provisionally concluded that Visa was so closely connected with the United Kingdom Visa banks, suppliers of such services, as to form part of the group and thereby to restrict or distort competition in the ways described in paragraph 7.19(c), (d) and (e).

7.22. We believe that Visa is properly part of the complex monopoly finding because of its close connection with the United Kingdom Visa banks. Without membership of Visa it would not be possible for the present Visa credit card issuers within the United Kingdom to issue a credit card which was acceptable world-wide, nor would Visa credit cards issued abroad enable their cardholders to use their cards within the United Kingdom in the absence of the services provided by Visa. Further, Visa performs major activities with regard to the credit card business including prescribing operating regulations, authorisation and clearing services. Their computer facilities in London are essential to the operation of the Visa card system in the United Kingdom. For example, through the links between Visa's computers in London and those abroad United Kingdom merchant acquirers recover sums paid to United Kingdom traders for transactions made with Visa cards issued abroad and United Kingdom card issuers reimburse merchant acquirers abroad for payments made in respect of transactions carried out overseas by United Kingdom cardholders.

7.23. Visa argues that the words 'in connection with the supply of services of that description' in section 7(2) are designed to ensure that only anti-competitive conduct of an appropriate kind in relation to the services in question is taken into account. Visa contends that those words exclude from reckoning forms of anti-competitive conduct which have nothing to do with the market in question. In our view a proper approach is to apply a purposive construction to section 7(2) so as to achieve the result that Parliament must have intended, that is to say the control of any restriction of competition in the supply of goods or services.

7.24. We consider, and are advised, that section 7(1)(c) of the Act does not require that the group should consist solely of persons who supply the services. It requires only that those who supply at least a quarter of the total supply of the services shall be members of the group. This leaves the possibility that there may be others who do not themselves supply the services but are in some way closely enough connected to those who do for all of them together to be regarded as a group.¹ On the evidence we conclude, as a matter of fact, that Visa is closely enough connected with the other members of the complex monopoly who supply the credit card services for all of them to be regarded as a group and Visa's conduct is such as to prevent, restrict or distort competition in connection with the supply of the reference services.

7.25. Neither do we accept that Visa's other arguments, including the contention that it has an existence distinct from its members, and operates in a distinct economic sphere, or that members of a group need a common purpose or identity greater than that between Visa and its United Kingdom members, affect this conclusion.

7.26. We do not accept Beneficial's view that it could not form part of the complex monopoly because of the small size of its reference business nor because of the close association between its credit card-issuing and its personal banking business (see paragraph 6.105). A complex monopoly within the meaning of section 7(1)(c) and (2) exists in favour of those persons set out in paragraph 7.19 and who follow the practices referred to in that paragraph, and this does not depend upon the size of the reference business undertaken by a particular person. The close association between the reference business and the personal banking service does not affect this.

¹ See also the Commission's report on Greyhound Racing: Cmnd 9834, paragraph 8.7.

7.27. Similarly, we do not accept Chase's arguments that the complex monopoly does not operate in favour of Chase or that its course of conduct does not operate or might not be expected to operate against the public interest (see paragraph 6.109), because Chase has accepted, and is bound by, Visa's rules which restrict competition such as the No Discrimination rule.

7.28. Fleming accepted that there is a complex monopoly situation although it considered that conclusion to be artificial (see paragraph 6.145). In our view the complex monopoly situation we have identified falls properly within section 7 of the Act.

7.29. We note that Girobank accepts that there is a complex monopoly in Visa merchant acquisition but maintains that the monopoly does not operate against the public interest (see paragraph 6.165). Girobank maintains that it is not a party to any card-issuing monopoly because it competes with Barclays in offering Visa credit cards. We do not accept that no complex monopoly can consequently arise. Although Girobank does compete the conditions of competition are affected by existence of the complex monopoly to which Girobank is a party for the reasons set out in paragraph 7.19.

7.30. We do not accept Lloyds' arguments that its adherence to the No Discrimination rule is not a valid basis for a finding that Lloyds forms part of the Visa complex monopoly. Conformity with this rule is an essential foundation of our finding that there is such a Visa complex monopoly. In addition, Lloyds also complies with Visa's other restrictive rule concerning the eligibility of Visa's members to become merchant acquirers.

7.31. TSB put forward certain detailed arguments (paragraphs 6.229 to 6.233) about the interpretation of section 7(2) of the Act and about the construction of section 49(1) of the Act. In addition TSB argued that Sainsbury's complaint about the Honour All Cards rule was not relevant to a complex monopoly finding on credit cards.

7.32. In our view the use of the verb 'conduct' in section 7(2) of the Act means that the parties concerned necessarily must have a choice of an alternative course of conduct to come within the provisions of the section and we do not accept that the phrase 'voluntarily or not' must be interpreted solely in relation to the absence or presence of contractual or analogous restraints. In our view it is reasonable in the circumstances to give the wording of the section its natural and ordinary meaning. On that basis the course of conduct adopted by TSB brings it within the complex monopoly.

7.33. As to Sainsbury's complaint it is open to us to consider action in a market for non-reference services in this particular instance the market for debit cards as being a step which is being taken for the purpose of exploiting the monopoly situation. Such a view does not conflict with the provisions of section 49(1) of the Act.

7.34. We do not accept Yorkshire's argument (paragraph 6.270) that it is not part of a complex monopoly because there is no collusion or consultation about marketing or trading policies. Section 7(2) of the Act includes conduct which is not the result of an agreement, and Yorkshire falls within the complex monopoly finding for the reasons set out in paragraph 7.19.

Access complex monopoly

7.35. We conclude that a group consisting of the JCCC and those banks operating within the United Kingdom which issue MasterCard/Eurocard credit cards under the Access trade mark (BoI, Lloyds, Midland, NAF, NatWest and RBS) constitutes a complex monopoly in accordance with the provisions of section 7(1)(c) and (2) of the Act, because:

- (a) as is demonstrated in paragraphs 3.7, 3.9 and 3.10 this group supplies at least one-quarter of the market for reference services;
- (b) within the United Kingdom merchant acquisition has been handled until the beginning of March 1989 for all members of the group by a company, the JCCC, which is owned by four members of the group (Lloyds, Midland, NatWest and RBS); Lloyds became a MasterCard/

Eurocard merchant acquirer in March 1989 although the JCCC remains the major source of merchant acquisition services;

- (c) the JCCC also provides a number of other services for all Access credit card issuers (of the types described in paragraphs 2.39, 2.43 to 2.50);
- (d) all members of the group accept MasterCard/Eurocard's rule about No Discrimination; and
- (e) they also accept another rule which restricts competition between MasterCard/Eurocard members that no member of MasterCard/Eurocard is free to become a merchant acquirer in a country in which it does not issue an acceptable number of MasterCard/Eurocard cards.

7.36. Lloyds argued (paragraph 6.365(e)) that a finding of 'inadequate competition' did not fulfil the criterion of 'conduct ... to prevent, restrict or distort competition' set out in section 7(2) of the Act. We disagree with that contention. Even were we to accept that there had been 'inadequate competition', section 7(2) covers conduct which 'in any way' prevents, restricts or distorts competition.

7.37. Midland contended (paragraph 6.369) that it does not form part of a complex monopoly over card issuing as the Access banks did not act together in supplying cardholding services. We disagree, as all the Access banks accept the rules of MasterCard/Eurocard which restrict competition, eg the No Discrimination rule, and are therefore parties to complex monopoly for the reasons set out in paragraph 7.35. Midland accepts that it forms part of a complex monopoly as regards merchant acquisition.

7.38. NatWest maintained (paragraph 6.414(a)) that we should not use the JCCC's past monopoly of MasterCard/Eurocard merchant acquisition as a ground for a complex monopoly finding because the JCCC's actions as a merchant acquirer in enabling Barclays' credit card monopoly to be challenged had been beneficial. That argument is directed to whether any facts found during the course of the investigation operate, or may be expected to operate, against the public interest, rather than whether it is proper to conclude that a complex monopoly exists.

7.39. We do not accept NatWest's argument (see paragraph 6.414(b)) that in considering whether or not there is an Access complex monopoly we should disregard the No Discrimination rule because it is followed by non-Access banks. The rule is relevant to our finding because it has been accepted by all the Access banks. We have of course taken account of the similar rule applying to the Visa members in our complex monopoly finding dealing with the Visa group (see paragraph 7.19(c)).

7.40. As regards the argument put forward by NatWest in paragraph 6.414(d), while the barriers to entry arising from the MasterCard/Eurocard rules have not prevented entry into MasterCard/Eurocard merchant acquisition by Lloyds, Midland, RBS and NatWest itself, these rules have delayed the entry of Barclays.

7.41. NatWest's arguments about terms and conditions (see paragraph 6.414(c)) are relevant to our provisional finding as to the existence of a complex monopoly (see Appendix 1.3) but not to the complex monopoly finding stated in paragraph 7.35.

The public interest

7.42. We have now to consider whether any steps are being taken by the monopolists (the scale monopolist described in paragraph 7.17 and the two groups of complex monopolists in paragraphs

7.19 and 7.35) for the purpose of exploiting or maintaining their monopoly situations, whether any action or omission on their part is attributable to the existence of the monopoly situations, and whether any facts found in our investigation of matters set out in the reference operate or may be expected to operate against the public interest.

Previous monopoly reference

7.43. As background we were able to draw on the report of an earlier inquiry by the Commission which was published in September 1980. This inquiry was limited to credit card services to traders but also covered charge cards. The main recommendation not in the event accepted by the Secretary of State was the abolition of the No Discrimination rule. The report had also concluded that if the credit card profitability of NatWest were to be maintained, and if other credit card issuers were to achieve similar levels of profitability, there would be cause for concern. The Commission were also concerned that MSCs might be too high for some smaller traders. As a result the Commission had suggested that the Director General of Fair Trading (DGFT) should keep the supply of credit card services under review and consider the need for a further monopoly reference. The result was this reference. In announcing it the DGFT said that he had taken into account profitability, the absence of any serious challenge to the established operators, and the level of interest rates charged to credit card borrowers as compared with bank base rates.

Assessment of the public interest

7.44. In making our assessment of the public interest we addressed the following matters:

- (a) the extent of competition at the outset of our inquiry within the credit card market and from non-reference services, particularly store cards and charge cards (see paragraphs 7.45 to 7.49);
- (b) the major changes in the market which emerged during the course of our inquiry, in particular the prospect of greater competition, both in merchant acquisition and credit card issue (see paragraphs 7.50 to 7.59); and
- (c) a number of issues concerning credit card operations, which we list in paragraph 7.60 and which are then considered in paragraphs 7.62 to 7.106.

Competition at the beginning of the inquiry

7.45. When our inquiry began the structure of the credit card market had not changed significantly since the previous inquiry. This immobility was most evident in the supply of merchant acquisition services, where there remained a striking lack of competition, with only one Visa acquirer (Barclays) in Great Britain and one MasterCard/Eurocard acquirer in the United Kingdom (the JCCC). We were struck by the replies to our initial enquiries about the plans of leading credit card issuers to enter the merchant acquisition market which then suggested that no new entrants were likely to emerge in the immediate future.

7.46. Although there was a range of both Visa and MasterCard/Eurocard credit card issuers, many with at least a significant portfolio of cardholders BoS, Co-op, Girobank and TSB all being Visa issuers in addition to Barclays, and with MasterCard/Eurocard Access cards being available from Lloyds, Midland (and also through its then subsidiaries, Clydesdale and Northern), NatWest, RBS and BoI the range of effective choice for cardholders, as regards interest rates, and also terms and conditions of payment, was small. At the beginning of July 1987 the APRs charged by the six main issuers, who accounted for over 95 per cent of credit card lending, were all the same, except for one bank, whose rate was slightly higher.

7.47. At the outset of our inquiry the main prospect of greater competition arose from the possible entry of major building societies into credit card issuing. There was, however, no suggestion that the

existing main issuers were contemplating membership of both international payments organisations as a prelude either to dual card issuing or dual merchant acquisition.

7.48. Although we have already concluded (see paragraph 7.16) that credit cards can properly be regarded as a separate market, we recognise that they did face some limited competition from other forms of plastic payment cards. However, at the inception of our inquiry in May 1987 charge cards had become relatively less important than they had been at the time of the Commission's previous inquiry, although the use of store cards had increased. Debit cards had just been introduced by one United Kingdom issuer (by Barclays in April 1987).

7.49. We therefore began our inquiry at a time when the market remained uncompetitive and there were few signs of greater competition developing among those already in the market. This lack of competition caused us considerable concern.

The changing market

7.50. A conspicuous feature of this inquiry has been a number of major changes in the market which emerged during its course. We have seen the entry into Visa credit card issuing of four building societies, Halifax, Leeds Permanent, National & Provincial and Town & Country, following changes in the law which had previously prohibited building societies from issuing credit cards (see paragraph 3.99). These societies appear to be trying to become mass issuers of credit cards and they are offering a somewhat lower range of interest rates than that available from virtually all the established mass issuers (see paragraph 3.113 and Appendix 3.2). Of these four building societies Town & Country currently offers the lowest monthly rate 1.5 per cent (19.6 per cent APR) only matched by the Allied Irish Banks.

7.51. Two other relative newcomers to the market, Fleming and Chase (both of which have said that they operated a more rigorous selection of applicants than the mass market operators), offered somewhat lower rates of interest than those charged by Halifax and Leeds Permanent.

7.52. The acquisition, or planned acquisition, by many leading banks of membership of both international payments systems has opened up the prospect of a widening choice of credit cards. Building societies are, however, at present free to join only Visa. We welcome the readiness of the Building Societies Commission to remove the prohibition on membership of MasterCard/ Eurocard when a building society asks it to do so.

7.53. New cards already issued following dual membership have offered significant variations in their terms and conditions from those which had hitherto been accepted as the norm, eg the combination of charges for the card with lower rates of interest, rates of interest which decrease as the amount borrowed increases, and an elimination of the interest-free period linked with lower interest rates.

7.54. Another manifestation of increased competition in card issuing in some cases linked to dual membership of the two international payments systems has been the development of affinity cards, under which the card issuer makes payments to named charities (see paragraphs 3.102 and 3.103).

7.55. The dual membership of the two international payments systems was, we were told on all sides, the prelude to a wave of competition in merchant acquisition. As a result Barclays would cease to be the sole Visa merchant acquirer in Great Britain, and the JCCC the sole MasterCard/ Eurocard merchant acquirer in the United Kingdom. Lloyds has already entered the merchant acquisition market and Midland and NatWest have announced that they plan to follow Lloyds.

7.56. A further significant change is that although the ownership of the JCCC remains unchanged it now offers cardholding and merchant acquisition processing services to issuers of Visa and non-Access MasterCard/Eurocard members as well as to issuers of Access cards, and also processing services to other merchant acquirers.

7.57. Another important development is that the leading world issuer of charge cards, American Express, has entered the United Kingdom credit card market by offering a credit card, the Optima

card, for an additional fee, to those who pay for its charge card. The Optima card can be used at businesses which accept American Express charge cards. It is therefore the first internationally-accepted credit card to be issued in the United Kingdom which does not form part of the MasterCard/Eurocard or Visa networks.

7.58. An American Express subsidiary, First Data Resources Ltd, has also entered the credit card processing market.

7.59. During the course of our inquiry we therefore formed a very clear impression that the duopolistic nature of the credit card merchant acquisition market was breaking up. There is also clear evidence of a wider spread of interest rates on offer to the cardholder than was available at the outset of our inquiry. The entry into card issuing by major building societies has resulted in credit cards, which offer lower rates of interest than those offered by the banks, becoming readily available. As most, if not all, those eligible to obtain a credit card from a bank can now obtain a card from a major building society, most cardholders, or prospective cardholders, have ready access to cheaper credit.

The issues

7.60. The issues concerning credit card operations to which we addressed particular attention were:

- (a) whether the profitability of credit card services was higher than could be expected in conditions of normal competition;
- (b) whether the commissions paid by merchants on purchases made with credit cards were higher than could be expected in conditions of normal competition;
- (c) whether the interest rates charged for credit card borrowing were higher than could be expected in conditions of normal competition;
- (d) whether the No Discrimination rule was justified;
- (e) whether users of credit cards were subsidised by non-users;
- (f) whether those credit card users who did not pay interest were subsidised, either by those credit card users who paid interest, or by the traders who accepted credit cards;
- (g) whether any monopolist had exploited his market power in relation to related non-reference services; and
- (h) whether Visa's and MasterCard/Eurocard's rules restricting the activities of their members were justified.

7.61. Before making our assessment of the public interest we put a wider range of issues to the parties provisionally found to be monopolists. These issues are listed in Appendix 1.3. In the event we decided, in the light of the replies from the parties, that not all these issues required further consideration.

Profitability

7.62. We refer in Chapter 4 to our discussions with the banks about methods of measuring the profitability of their supplies of reference services. These discussions were mainly concerned with whether the principal indicator used should be the return on shareholders' funds or the return on capital resources; the basis on which capital resources should be attributed to credit card businesses; and how the deduction for the cost of funds should be calculated. In addition, some of the banks suggested that discounted cash flow (DCF) techniques should be used to show the return on their total investment in credit cards from the time they entered the market.

7.63. We deal first with the question of DCF. We accept that there may be a case for assessing the profitability of a project over a longer period than the five years that we normally use in monopoly inquiries, and for taking into account losses incurred in the earlier years. But we have considerable reservations about whether the historical DCF analyses suggested to us are appropriate for the purpose of this inquiry.

7.64. An essential element in any appraisal of this sort is the valuation which is put on the continuing credit card business. A value for this needs to be included as part of any DCF calculation, but only two banks, Barclays and Midland, included such an element in their analyses.

7.65. Barclays' calculations were based on discounting the after-tax profitability of its credit card business and included residual values for the business based on price earnings ratios in the range 8:12. On the basis of a price earnings ratio of 10, Barclays estimated a post-tax DCF return on its credit card business since 1966 of 17.6 per cent nominal and 7.1 per cent in real terms.

7.66. Midland estimated pre- and post-tax DCF rates of return on its credit card business since 1972. Two alternative valuations of the continuing business were used. The first placed a residual value on the business in 1988 equivalent to the capital invested in it; this showed an internal rate of return of 14.5 per cent pre-tax and 8 per cent post-tax. In the second, the residual value was increased by 25 per cent giving an internal rate of return of 19.2 per cent pre-tax and 10.6 per cent post-tax.

7.67. Lloyds provided an analysis which showed that if its pre-tax profits since 1972 were discounted at 18 per cent the return on its investment to the end of 1988 would have been minimal. No residual value for the business was included. RBS analysed its cumulative profit and loss on its credit card business since 1972 and this showed a pre-tax internal rate of return of 15 per cent compared with an objective of 21.5 per cent. Again no residual value for the business was assessed.

7.68. The variety of methods used, differences in the detailed measurement of cash flows and, in particular, differences in valuations all make it difficult to compare the performance of these four credit card businesses and to assess the returns to date on their investments. We accept that substantial losses were incurred by these businesses in their early years of operation and a DCF assessment is one way of taking an overview of the worth of investments made in the past. Our concern, however, is not just with the past. We have to consider whether the levels of profits which have been earned in recent years, with the credit card as a well-established product, familiar to consumers, can be expected to continue.

7.69. Any DCF assessment of a new investment in credit cards, or of a choice between continuing in the business or withdrawing, will take into account the profits likely to be earned over the life of the investment. For this purpose we would expect the current industry structure and the level of profitability of existing operators in recent years, rather than experience 15 or 20 years ago, to be the principal guide. Where new investment is required that will clearly enter into the assessment, but past investments, and any losses associated with them, have to be regarded as sunk costs. We do not consider that the DCF returns we have been shown, even if they could all be put on a comparable basis, provide a guide to the future returns which might now be expected.

7.70. After extensive discussions with the banks concerned, and after considering a number of different approaches, we therefore decided that the credit card profitability indicator that we should mainly rely on in reaching our conclusions should be the one described for the purposes of this inquiry as the return on capital resources (ROCR). In most of our previous inquiries this has been described as the return on capital employed (see footnote 1 to paragraph 4.2). We also decided to accept the banks' contentions that the capital resources attributed to their credit card businesses should take account of the risks involved in credit card lending and that the cost of funds deductions should be based on, or related to, market rates of interest.

7.71. Credit card profitability figures for the last five years, calculated on these principles by those banks which account for over 90 per cent of the market, are set out in Table 4.5 together with the ROCR that they achieved on their businesses overall. For convenience we reproduce them in Table 7.1.

TABLE 7.1 Comparisons of credit card profitability (ROCR) with the banks' profitability overall

	<i>per cent</i>				
	<i>1984</i>	<i>1985</i>	<i>1986</i>	<i>1987</i>	<i>1988</i>
Lloyds					
Credit cards	37.2	36.2	37.6	35.4	18.9
Overall	19.4	19.5	20.0	(3.3)	24.3
Midland					
Credit cards	30.7	30.5	33.5	26.5	23.3
Overall	7.9	13.5	14.7	(7.8)	18.0
NatWest					
Credit cards	31.4	24.2	25.9	3.0	12.9
Overall	20.4	19.7	19.0	12.3	20.2
RBS*					
Credit cards	16.7	16.7	39.1	34.1	18.5
Overall	16.4	18.1	16.5	15.7	20.0
Barclays					
Credit cards	45.5	42.2	46.7	36.5	35.1
Overall	18.2	20.9	19.3	8.4	21.5
TSB**					
Credit cards	5.1	1.7	10.6	12.4	15.5
Overall	21.3	20.3	19.6	16.4	22.8

Source: MMC study.

*Year ending 30 September.

**Year ending 31 October (1988), period ending 31 October (1987) and year ending 20 November (previous years).

Note: Except in the case of TSB, the 1987 overall profitability figures were affected by exceptional provisions against sovereign debt.

7.72. The banks told us that the return on lending was an indicator that they commonly used to compare the profitability of different parts of their business. For the reasons explained in Chapter 4, we have decided to have regard also to this indicator when considering the profitability of credit card services. The banks' credit card returns on lending, compared with their overall and domestic business returns on lending, are set out in Table 4.6 and we therefore reproduce them in Table 7.2.

TABLE 7.2 Comparisons of the banks' credit card returns on lending with their returns on their overall and domestic business

	<i>per cent</i>				
	<i>1984</i>	<i>1985</i>	<i>1986</i>	<i>1987</i>	<i>1988</i>
Lloyds					
Credit cards	4.8	4.7	4.9	4.6	2.5
Overall	1.1	1.3	1.5	(0.5)	2.0
Domestic business	1.8	2.2	2.5	2.8	2.7
Midland					
Credit cards	3.6	3.7	4.2	3.1	3.1
Overall	0.2	0.6	0.8	(0.9)	1.3
Domestic business	1.5	1.5	1.6	1.8	1.2
NatWest					
Credit cards	3.2	2.5	2.7	0.3	1.4
Overall	1.0	1.1	1.3	0.8	1.5
Domestic business	1.7	1.9	2.1	2.4	2.2
RBS*					
Credit cards	1.7	1.6	3.9	3.4	1.9
Overall	1.1	1.2	1.1	1.1	1.5
Barclays					
Credit cards	4.5	5.0	5.6	4.3	4.2
Overall	1.0	1.3	1.3	0.4	1.5
Domestic business	1.2	1.7	1.6	1.6	1.8
TSB**					
Credit cards	1.1	0.3	1.8	1.9	2.3
Overall/domestic business	1.6	1.6	1.7	1.9	2.1

Source: MMC study.

*Year ending 30 September.

**Year ending 31 October (1988), period ending 30 October (1987) and year ending 20 November (previous years).

Notes:

1. Except in the case of TSB, the 1987 overall return on lending figures were particularly affected by exceptional provisions against sovereign debt.
2. RBS's returns on lending on domestic business were not ascertainable.
3. As TSB's business is largely domestic no distinction is drawn between its overall and domestic returns on lending.

7.73. Whether expressed as ROCR or return on lending, the credit card profitability of the big four banks (Lloyds, Midland, NatWest and Barclays) was higher and except for NatWest, considerably higher in 1984, 1985 and 1986 than the profitability of their businesses overall. Their returns on lending were also higher than the returns on lending they achieved in the rest of their domestic business.

7.74. Comparisons with the banks' overall businesses in 1987 are obscured by the exceptional provisions against sovereign debt in that year. Lloyds, however, still showed a high ROCR (35 per cent) on credit cards, and a much higher return on lending on that business than on its domestic business generally, but its credit card profitability was not so high in 1988, partly because of an increased provision for bad debts.

7.75. Midland's ROCR fell to 26 per cent in 1987 and 23 per cent in 1988 but its credit card return on lending remained higher than its return on other domestic lending.

7.76. NatWest's profitability, whether expressed as ROCR or return on lending, was generally lower than that of the rest of the big four throughout the five-year period but, as we point out in paragraph 4.28, its results were affected by the extent to which it allocated branch costs to its credit card business. Even so, it achieved a higher return on lending on credit cards in 1984, 1985 and 1986 than it achieved on the rest of its domestic business.

7.77. Barclays maintained its ROCR at 35 to 36 per cent in 1987 and 1988 after being in the 40 to 50 per cent range in the three previous years, and its return on lending on credit cards throughout the

five-year period remained well above the return it achieved on its general domestic business. In commenting on its profitability, Barclays told us that in its view capital resources in financial institutions carried greater risk than capital employed in industrial and commercial companies, and that high returns on lending achieved by certain consumer finance companies showed that there was no correlation between high profitability in that field and the extent of market power. It also told us that the rates of return achieved in its credit card business needed to be higher than it achieved overall in order to recoup the losses that it had incurred in the first 11 years (see Appendix 4.11).

7.78. As to the other banks, RBS showed a ROCR of nearly 40 per cent in 1986 and of 34 per cent in 1987 but told us that profitability in those years was affected by a change in its policy on providing for bad debts and temporarily high interest margins during a period of interest rate uncertainty. Its average total domestic assets were not ascertainable and we were therefore unable to calculate its return on lending on domestic business, but we observe that its credit card return on lending for all years exceeded its overall return on lending, and in 1986 and 1987 did so by a substantial margin. TSB has not shown exceptionally high profitability on its credit card business, although its profits have improved from a low point in 1985.

7.79. We also considered the extent to which the banks' high profitability on credit cards could be attributed either to the level of their MSCs or to the rates of interest which they have charged to their cardholders. As we explain in Chapter 4, any attempt to divide the banks' credit card costs and profits between those arising from the supply of services to traders and the supply of services to cardholders presents difficulties. They are described in the 1980 report, from which we have quoted in paragraph 4.30. They arise from the practical difficulty inherent in attributing joint costs to particular services, and because there is no clear division between the services provided to traders and cardholders. We therefore agree with our predecessors that there is no generally acceptable method by which the total costs of credit card companies can be divided into those which should be properly attributable to services to traders and those attributable to cardholder services. If no division of costs can be made, it follows that profits themselves cannot be divided into those derived from services to traders and from services to cardholders. We therefore considered whether, even if the results would not be generally acceptable, we ourselves should attempt such a division of costs. We eventually decided not to pursue this matter as any such division would have been arbitrary and, more importantly, because our conclusions, which are based on the prospects of increased competition, made it unnecessary to do so.

Conclusion on profitability

7.80. The credit card profitability of Lloyds for the years 1984 to 1987, Midland and NatWest for the years 1984 to 1986, Barclays for the years 1984 to 1988 and RBS for the years 1986 and 1987 was high, and indeed significantly higher than they achieved in the rest of their businesses. We particularly note from Table 7.2 that many of these banks have achieved returns on credit card lending considerably in excess of the returns they achieved in the rest of their domestic business. We believe this to be a consequence of the less competitive conditions that have prevailed in the credit card market than in domestic lending generally. We conclude that the level of the credit card profitability of Lloyds, Midland, NatWest, Barclays and RBS, which accounted for some 80 per cent of credit card lending in 1988, was sufficiently above that which might have been expected in conditions of normal competition to be against the public interest. We consider, however, that we do not need to make any specific recommendations because of the prospect of increased competition.

MSCs

7.81. Most MSCs lie in the range of 1 to 4 per cent of the transaction value. In considering the levels of MSCs, as well as other aspects of credit card operations, we recognise that credit cards perform two functions. First, they provide a means of guaranteed payment. Secondly they are a source of credit, which, for an initial period after the purchase of the goods or services concerned, is free of charge. Credit cards therefore serve two distinct groups of customers. The first group consists of the credit cardholders, who can use their cards as a means of making a guaranteed payment and

also as a source of credit. The second group is composed of traders, who receive guaranteed payment and whose business may be increased as a result of taking credit cards.

7.82. In negotiating MSCs one of the costs which a merchant acquirer also needs to take into account is the interchange fee payable to foreign card issuers whose cardholders use their cards within the United Kingdom. The levels of these fees are a percentage of the amount of the purchase or of the cash withdrawn are determined by the two international payments organisations. For purchases, they are 1 per cent both for MasterCard/Eurocard and for Visa.

7.83. United Kingdom Visa merchant acquirers also pay domestic interchange fees in respect of transactions generated by other United Kingdom-issued Visa cards. The rates concerned are also fixed on a percentage basis and are determined by direct negotiation between the parties (although, in the event of disagreement, Visa would prescribe the fee). The sums involved can be substantial.

7.84. As part of the investigation into the possibility of comparing the benefits received by traders with the costs of providing them with credit card services we have also examined whether the benefits can be quantified. There is no general agreement as to the extent of these benefits. The acceptance of credit cards largely removes a trader's risk of incurring bad debts on the transactions concerned. In addition, the acceptance of credit cards either leads to some increase in his turnover, or protects him against a loss of business to competitors who take credit cards, as is indicated by the replies to the Commission's survey (see paragraph 5.8). But the nature of these benefits is such that they cannot be precisely quantified and only the trader concerned can judge whether the benefits exceed his MSC payments.

7.85. Despite the impracticability of quantifying the benefits received by an individual trader some of the benefits, eg the protection against bad debts, are related to the value of the individual transactions paid for with credit cards. As a result we consider that either a value-related commission or a fixed charge for each transaction is an acceptable method of charging traders.

7.86. We note that for some time, although the average rates of MSCs for both the Visa and MasterCard/Eurocard systems have been falling (see paragraphs 3.92 and 3.94), the income per transaction generated by MSCs has increased in real terms. The general view of the credit card operators is that these rates of decline, particularly so far as the MSCs charged to larger traders are concerned, will become greater as a result of significantly increasing competition in merchant acquisition.

7.87. A further factor encouraging a decline in MSCs, particularly those charged to the larger traders, is technological advance, particularly the transfer of data by electronic means, which reduces the costs of supplying merchant acquisition services.

7.88. The range of MSCs which are charged gives rise to the question of whether there is an unfair distribution of charges. We therefore explored the extent to which variations in MSCs were linked to variations in the costs of providing services to traders. We note the arguments put to us by Barclays and the JCCC that in practice it is not possible to identify precisely the costs of dealing with particular types of trader in a way which takes account of a number of factors, eg the value and number of credit card transactions handled by an individual trader, which have a bearing on costs. Our conclusion is that in practice the MSCs actually charged bear only an imprecise relationship to the cost of providing merchant acquisition services.

7.89. We consider that the lack of competition in merchant acquisition has contributed to the level of profits which we have concluded to be against the public interest (see paragraph 7.80), although, as we have explained in paragraph 7.79, there are obstacles to ascertaining the contribution of MSCs as compared with that of interest rates. We consider, however, that we do not need to make any specific recommendations, because of the likely effects of the prospect of increased competition in merchant acquisition, as a result of which there should be further pressure on rates of MSC.

Interest rates

7.90. In considering levels of interest rates we have had regard to the following two considerations:

- (a) credit card borrowing has been insensitive to changes in interest rates; and
- (b) the income of card issuers, however, is sensitive to small changes in the rate of interest which they charge.

These two factors help to explain why the main card issuers have not hitherto used interest rate changes as a competitive strategy.

7.91. Despite the factors which we consider have discouraged competition over interest rates, there are, however, signs both of greater competition and a greater awareness by cardholders of the importance of interest rates:

- (a) five newcomers to the Visa credit card market, four building societies, Halifax and Leeds Permanent, National & Provincial and Town & Country, and also Yorkshire, are offering lower interest rates while seeking to recruit a similar type of customer to those of the big four banks;
- (b) Fleming and Chase also offer lower rates than the big four, albeit with a more selective recruitment policy;
- (c) the issue of both Visa and MasterCard/Eurocard credit cards by the big four banks could lead to further competition over interest rates. For example, Barclays' MasterCard credit card, called 'Assent', offers lower interest rates balanced, however, by the absence of an interest-free period; Midland's new Visa credit card, called 'Indigo', charges declining rates of interest as the amount borrowed increases; and
- (d) whereas the differential between base rates and the APRs charged by all the big four banks was 17.8 percentage points in May 1987, it began to fall in May of 1987 and by March 1989 had been reduced to a range of 12.3 to 13.8 percentage points (see paragraph 3.48).

7.92. For large sums there are cheaper forms of borrowing than credit cards available to most credit cardholders. For smaller sums, however, the difference in the cost of borrowing is less, while for very small sums credit cards are probably the cheapest source.

7.93. We consider that lack of competition in interest rates has contributed to a level of credit card profits so high as to be against the public interest, although, as we have already noted, as regards MSCs (see paragraph 7.88) it is in practice difficult to ascertain the contribution of interest payments as opposed to that of MSCs. We consider, however, that we do not need to make any specific recommendations, because of the prospect of increased competition between a growing number of card issuers, as a result of which there should be greater pressure on interest rates.

No Discrimination

7.94. The No Discrimination rule is undesirable because it restricts the freedom of sellers to set their own prices (for an explanation of the substance of this rule see paragraph 7.4). Specifically the rule has prevented the trader from offering a discount for cash or from imposing a charge for the use of credit cards. Instead, traders have had to offer goods or services at the same price, irrespective of the means of payment, whatever they might have preferred to do in order to promote the competitiveness of their businesses. Our survey of retailers suggested that a quarter of the retailers who replied would consider taking advantage of any relaxation of the No Discrimination rule.

7.95. It was put to us that any introduction of differential pricing would lead to confusion amongst consumers, particularly overseas visitors, and, more generally, an undermining of confidence in the use of credit cards as a close equivalent to cash. We think these concerns exaggerated because they underestimate the ability of consumers, particularly of domestic consumers, who make the great majority of credit card purchases, to look effectively after their own interests. We have also consulted the Department of Trade and Industry which told us that if the No Discrimination rule were no longer to apply the Department would provide guidance to traders on differential pricing as the Code of Practice for Misleading Price Indications did not cover the offer of different prices for different means of payment.

7.96. We conclude that the No Discrimination rule operates against the public interest because it restricts the freedom of retailers to set their own prices.

Subsidisation of cardholders by non-users

7.97. We have considered whether the payment of MSCs had caused price increases and whether there is a measure of subsidisation of credit card users by those shoppers who still do not use them. Clearly in principle this could be the case. But to the extent that traders give discounts to their customers who do not use credit cards (which could be a consequence of abolishing the No Discrimination rule) such subsidisation would be reduced.

Cross-subsidisation between cardholders

7.98. As we decided not to pursue the question of separating the costs of providing services to cardholders from those of providing services to traders (see paragraph 7.79), it means that we cannot determine the extent to which costs generated by those cardholders who do not pay interest are borne either by those who do or by traders. Possible ways of removing any cross- subsidisation as may exist could include the imposition of membership and annual fees for credit cards, a transaction fee added to the cost of purchases each time a card is used, or a shorter interest-free period. Our conclusion is that, at a time when the credit card market is becoming significantly more competitive and innovative, it would be mistaken for us to make recommendations which would work in the opposite direction by requiring card issuers to act uniformly in certain respects, eg by all of them charging a minimum annual fee. We consider that in the still more competitive market which is in prospect issuers will be more inclined to experiment with different ways, and combinations of ways, of charging for their services. There are already indications that this is happening.

Terms and conditions (other than interest rates)

7.99. It is reasonable to conclude that with some exceptions (the offer of payment by direct debit, the payment of interest on credit balances) there has been a significant degree of uniformity over credit card terms and conditions (other than interest rates) even on matters where the issuers are not subject to legal constraints. This raised the question of whether past conditions had operated against the public interest. We were naturally concerned about restrictions on consumer choice. We noted, however, that some of the terms and conditions reflected legal requirements applying to all credit card issuers. In addition, during the course of this inquiry, there had been individual departures from the previous norm. The degree of uniformity which had characterised the market at the beginning of the inquiry had been significantly relaxed so that we conclude that the extent of the remaining uniformity over terms and conditions does not now operate against the public interest.

Other exploitation of monopoly power

7.100. Paragraphs 2.82 to 2.95 recount the way in which Barclays introduced its 'Connect' debit card, which is a Visa card, and describe the complaints which have been made about Barclays' conduct. We have, therefore, considered whether Barclays' conduct, albeit in relation to a Visa payment card which falls outside our terms of reference, represented an exploitation of its monopoly

power, given that the overwhelming bulk of Visa cards issued by Barclays are credit cards. We consider that Barclays took advantage of its then existing merchant acquisition agreements to attempt to force traders to accept the 'Connect' card-although it did not offer the same benefits as a credit card on the same terms, including rates of MSC, as a credit card. We note, however, that in face of vociferous pressure from traders Barclays conceded a different, and much cheaper, basis of calculating MSCs for the Connect card. Barclays has, however, enforced the Visa Honour All Cards rule,¹ partly as a result of pressure from Visa (see paragraph 2.92), by withdrawing Visa franchises from the remaining two traders who continued to refuse to take Connect cards, even with a lower rate of MSC. We therefore conclude that Barclays exploited its monopoly in the way in which it launched the Connect card. As a result we have considered whether to recommend the ending of the Honour All Cards rule by both Visa and MasterCard/Eurocard, because without such a rule Barclays would not have been able to act as it did.

7.101. We accept that there are substantial arguments in favour of the rule:

- (a) it facilitates the entry of new card issuers and the issue of new varieties of cards by existing issuers; and
- (b) it helps cardholders, particularly when travelling abroad, by giving them confidence that their particular Visa or Eurocard/MasterCard will be accepted.

7.102. We also note that while a second Visa debit card has been issued in the United Kingdom by Lloyds-no similar MasterCard/Eurocard card has yet appeared. But three United Kingdom banks which belong to MasterCard/Eurocard-Midland, NatWest and RBS have collaborated to issue a debit card-Switch-outside both the Visa and the MasterCard/Eurocard systems which is therefore acceptable by retailers, such as Sainsbury's, who have not so far been prepared to take credit cards. As a result, a retailer who is not prepared to accept Visa credit cards, as the price of taking Visa debit cards, can at least accept Switch cards.

7.103. On the one hand Barclays used the Honour All Cards rule as a means of seeking to exploit its monopoly, and the continuance of the rule provides a means for further exploitation, whether by Barclays or by others. On the other hand we also have in mind the possibility that Barclays, and others, would be concerned to avoid any repetition of the poor publicity provoked by Barclays' actions, and of the criticisms contained in this report. Moreover we recognise the importance of the rule to an internationally operating credit card system. While we are therefore not recommending the abolition of the Honour All Cards rule, the DGFT will no doubt be alert for any further instances of its abuse.

Restrictive rules of MasterCard/Eurocard and Visa

7.104. We have explained (in paragraph 7.3) the importance to credit card issuers of membership of an international payments organisation. Both MasterCard/Eurocard and Visa require their members to be committed to a programme of card issuing (not necessarily of credit cards) before they can become merchant acquirers. This policy is effected by requiring the members concerned to submit plans for the issue of cards. These plans have to be approved by the organisation concerned. Furthermore the prospective merchant acquirer has to demonstrate his ability to implement this card-issuing commitment, for example by meeting an interim card-issuing target by a stated date. We have examined these rules against the background of our finding that one of the main defects of the United Kingdom credit card market has been the lack of competition in merchant acquisition and that obstacles to further competition should be removed.

7.105. We have considered whether these restrictions are obstacles to competition because of the delays in entering merchant acquisition which can result from them. Delays arise in two ways. First the international payments organisations examine the applicant's plans for card issuing, to determine whether they are adequate and credible, and then the applicant, even after admission to membership,

¹ For an explanation of this rule see paragraph 7.4.

has to delay entry into merchant acquisition until some progress has been made in fulfilling the card-issuing targets.

7.106. The argument has been put to us that it is reasonable for international payments organisations to secure a significant degree of commitment from new members and that the appropriate method is to require those who wish to become merchant acquirers first to issue cards. But the necessary degree of commitment to the organisation can be demonstrated by the preparation of a plan to issue cards and there seems no justification for delaying the member further from becoming a merchant acquirer until there has been some demonstration that the plan will be implemented. This is a restriction on competition and a barrier to entry to merchant acquisition. We, therefore, conclude that the present practices of Visa and MasterCard/Eurocard as regards the conditions under which their members can become merchant acquirers within the United Kingdom operate against the public interest.

Summary of adverse public interest findings

7.107. We have concluded (see paragraph 7.80) that the past levels of profits of five leading credit card operators (Barclays, Lloyds, Midland, NatWest and RBS) have been based on the exploitation of monopoly power, as the profits have been higher than could have been expected in conditions of normal competition, and that this has been adverse to the public interest. We have also concluded (paragraph 7.89) that lack of competition in merchant acquisition and over interest rates (paragraph 7.93) operates against the public interest. We expect, however, increasing competition to remove these adverse effects.

7.108. We have also concluded (see paragraphs 7.96 and 7.106) that certain of the rules of the two international payments organisations, MasterCard/Eurocard and Visa, with which their members carrying on business within the United Kingdom have to comply, are adverse to the public interest. As we have explained in paragraphs 7.94 and 7.95, the No Discrimination rule restricts the freedom of sellers to set their own prices. We have also explained (in paragraphs 7.104 to 7.106) that the rules of these two organisations which set the requirements determining whether their members can act as merchant acquirers create obstacles to competition because of the delay which they cause.

Consideration of remedies

7.109. In addressing the various issues raised by the reference we have repeatedly referred to the greater competition existing in the credit card market today than when our inquiry began, together with the prospect of yet further competition. Our main concern in framing our remedies is to encourage and enhance competition, as ensuring as wide a choice as possible for cardholders and traders. This, in our view, is more likely, in this area where competition is already emerging, to yield beneficial results than either regulation or imposed restructuring but it does depend on the active participation in the market by traders and cardholders.

7.110. It is vital that traders take full advantage of the increased competition between merchant acquirers in order to improve the terms under which they accept credit cards.

7.111. Cardholders will need to scrutinise very carefully the terms and conditions under which cards are offered, in particular the APRs. Cardholders need also to be more alert to the opportunities presented by the changing market, whether by taking advantage of discounts offered for alternative forms of payment, or by applying for credit cards which offer lower interest rates or other more attractive terms and conditions.

7.112. Because of the importance of encouraging a wider variety of credit cards we have welcomed the readiness of the Building Societies Commission to remove the ban on membership of MasterCard/Eurocard by building societies (see paragraph 7.52).

Conclusions as to remedies

7.113. We recommend that the following action should be taken for the purpose remedying those effects adverse to the public interest which we have identified and which we do not expect to be remedied by greater competition. Our recommendations are:

- (a) issuers within the United Kingdom of MasterCard/Eurocard (including Access) and Visa credit cards and merchant acquirers operating in the United Kingdom should no longer require traders authorised in the United Kingdom to accept MasterCard/Eurocard and Visa credit cards to comply with the No Discrimination rule and the MasterCard/Eurocard and Visa international payments organisations should cease to require their members to comply with the rule as regards their credit card operations within the United Kingdom; and
- (b) agreements between the MasterCard/Eurocard and the Visa international payments organisations and their United Kingdom members should not include rules or arrangements which have the effect of preventing United Kingdom members of these organisations from acting as merchant acquirers, as well as card issuers, from the date of their membership of these organisations.

H H HUNT (Chairman)

J G ACKERS

K S CARMICHAEL

A FERRY

S MCDOWALL

S WAINWRIGHT

S N BURBRIDGE (Secretary)

26 May 1989