BOX III.1

Setting Final Limits to card's Interexchange fees

Interchange fees (IF) are a key price for the functioning and development of the payment card market. IF remunerate card issuers and corresponds to a fraction of the fees that acquirers charge to the stores. Thus, high IF may encourage card issuance, but discourage card acquiring and acceptance by merchants; and the opposite may occur with low IF[1]/. Thus, it follows that IF need to be able to balance these effects properly.

Last April saw the publication in the Official Gazette of the interchange fees limits that will apply in the next few years, which come with a significant reduction with respect to the existing ones. The Committee for the Fixation of Interchange Fee Limits ("Committee" or CTDI in Spanish), a technical and autonomous body created by Law No. 21.365, established a schedule to reduce the current IF limits gradually, to allow a gradual adjustment of market players to a system with regulated fees[2]/. Thus, after an initial reduction in October 2023, IF will reach levels of 0.35% for debit cards and 0.8% for credit and prepaid cards in October 2024 (Table III.1). The transition to the definitive IF that will be in force as of October 2024 includes some additional restrictions, which are available on the Committee's website, together with the methodology used to calculate the limits[3]/.

TABLE III.1 LIMITS TO INTERCHANGE FEES
(percent)

Type of card	Current IF	Stage 1 (oct. 23)	Stage 2 (oct. 24)
Debit	0,60	0,50	0,35
Credit	1,48	1,14	0,80
Prepaid	1,04	0,94	0,80

Source: Central Bank of Chile based on CTDI data.

It is difficult to determine exactly what will be the effects of the new limits on interchange fees for each participant in the payment card market. Although several countries have set limits on IF, each has its own idiosyncratic situations and therefore the effects in those countries will not necessarily be the same or of the same magnitude as those that should occur in Chile. Therefore, the impact study that the Committee undertook at the time of setting the definitive limits is of utmost importance. The following is a qualitative outline of the possible effects of this measure for each type of participant in the Four-Party Model:

- **The effect on acquirers will depend on the degree of pass-through to merchants.** A full pass-through of lower IF to merchants should have no material effect on acquirers, because IF are ultimately a revenue stream for card issuers, not for acquirers. However, if acquirers were

[1]/ For a more detailed explanation, see Box I.1 in Payment Systems Report (PSR, 2022), and Box IV.1 in Financial Stability Report of second half 2022 (FSR, 2022).

[2]/ Existent limits refer to the IF limits established transitorily by the Committee in February 2022.

[3]/ Website CTDI.

to keep their prices to merchants unchanged, the lower IF would in practice increase their acquiring margin[4]/.

- **The degree of pass-through of lower IF to merchants has an impact on the expansion of merchant networks.** IF corresponds to one of the costs that make up the charges that acquirers make to merchants for each card transaction they process (the others are branding costs and the acquirer margin). Assuming all other costs remain unchanged, all acquirers should be able to offer lower fees to merchants. To the extent that this actually happens, merchants that currently accept payment cards could face lower costs and pass them on to consumers, while those that do not accept cards, precisely because of the costs involved, could begin to accept them, which would ultimately allow them to expand their acquiring networks[5]/.

- **Card issuers will receive less revenue from the use of their cards.** By construction, a direct effect of lower IF is a reduction in issuer's revenues for a given level of transactions. Of course, how to deal with these lower revenues will depend on each issuer, but evidence from other jurisdictions has shown that they are likely to be compensated through increases in fees or prices of other financial products[6]/. On the other hand, the change in relative prices may lead to a change in the composition of the products that financial institutions offer to their customers, since the revenues associated with prepaid cards will be greater than those associated with debit cards, and it cannot be ruled out that the use of electronic funds transfers as a means of payment will be boosted, at least for transactions in which this service generates higher revenues than IF from debit cards.

- **Cardholders may have fewer benefits associated with the use of their cards.** Loyalty or rewards programs that provide card users with various benefits such as points to be used to purchase airline tickets or other products are now commonplace. Since part of these benefits are financed by IF received by issuers, it is possible that in the future these benefits will diminish along with the IF.

Beyond the specific effects on the different participants of this market, the Committee's ruling provides clarity on one of the fundamental variables for this market to operate. The magnitude of the effects on the different agents - and their responses to the new scenario - will have to be analyzed in detail by the Committee once the final fees are in place. However, knowing the value that this key price will have for the market's operation, and the fact that its implementation will be gradual, allows market agents to make better-informed decisions.

[4]/ Through a survey of retailers, Wang, Schwartz, and Mitchell (2014) find that capping the U.S. debit card interchange fee, known as the Durbin Amendment, had limited and uneven effects on debit card acceptance costs for merchants. Two-thirds of them reported no change; one-quarter reported an increase, especially for low amounts traded; and less than 10% reported a decrease in costs. The impact is also uneven across sectors.

[5]/ Chang, Evans y Garcia-Swartz (2005) find that in Australia, IF fixing resulted in a very small reduction in costs for merchants, and that this did not translate into lower prices for consumers.

[6]/ Mukharlyamov y Sarin (2019), find that in the United States banks lowered their interchange fee income as a consequence of the Durbin Amendment, but the reduction was almost entirely offset by an increase in fees or commissions on other products such as current accounts. Other authors find relatively similar results in the U.S. and in other jurisdictions.