

Advocacy report on the market for payment acceptance services for foreign merchants

Indecopi (Peru)

Abstract

On August 4, 2022, the Commission for the Defence of Free Competition of Indecopi approved the publication of the Report on the market for payment acceptance services to foreign merchants. This document contains a set of recommendations for VISA, Mastercard, acquirers and payment facilitators that provide payment acceptance services to global merchants not domiciled in Peru with the aim of promoting adequate competition conditions in this market and promoting a framework of understanding between card brands and national actors in the card payment system to continue working on the development of payment services, financial inclusion, and the well-functioning of the market.

Here we present an executive summary of the report. The full report (in Spanish) can be consulted through the following link: <https://bit.ly/3CqcFc2>

Executive Summary

Since the COVID-19 pandemic, electronic commerce (or e-commerce)¹ experienced significant growth in Peru. The restrictions on the mobility of people in this period encouraged the purchase of products in national and foreign electronic commerce. To make purchases in these establishments, it was important to adopt alternative means of payment to cash, such as payment cards and mobile wallets. At the level of card use, transactions with a card-not-present (CNP) stood out, which are those operations where the consumer enters the main data of his card through the merchant's website. The intensive use of this type of CNP transactions not only allowed an increase in purchases e-commerce, but also its use in global streaming platforms such as Spotify, Apple Music, Netflix, among others, or marketplaces such as Amazon or Alibaba.

Acceptance of payments to foreign merchants

VISA and Mastercard, companies that manage the main card payment networks, identified that the payment transactions made by Peruvian cardholders on global platforms² were not being processed as cross-border operations, but as a domestic operations. In this regard, these companies indicated that the acceptance of a transaction for a foreign merchant (outside of the acquirer's country of domicile) must be processed as a cross-border operation and the corresponding international fees must be applied³.

The problem exposed with the registration of transactions in foreign merchants would be caused by the action of a group of payment facilitators (hereinafter, PAYFAC) established in Peru and specialized in providing payment acceptance services to global

¹ System of purchase and sale of products or services that is carried out exclusively through the Internet.

² Platforms that provide their services worldwide but are not domiciled in Peru.

³ In these cases, not only is the transaction subject to international charges, but the cardholder requires that their card be enabled to make purchases at a foreign merchant. In addition, the payment will be processed in the currency of the foreign merchant, causing exchange variations to increase the final cost of the transaction for the cardholder.

foreign merchants such as Netflix, Spotify, Amazon, among others. However, since 2019 the PAYFACs have processed these transactions as domestic and paid the national fees for the use of card networks.

Card brand programs to accept payments from foreign merchants

In 2021, VISA and Mastercard informed acquirers in Peru that the acceptance of payments for foreign merchants –businesses that do not have an office in Peru– is not in accordance with the jurisdiction rules established by them for authorizing «local» transactions. Therefore, transactions for this type of businesses had to be reported and processed as cross-border operations. In addition, the card brands pointed out that the way in which these operations have been processed has exposed their ecosystems to risks and potential security breaches and breaches of regulations that they must comply with in the different jurisdictions where they are present.

Acquirers and PAYFAC were informed by the card brands that, in the future, to be able to provide the payment acceptance service for foreign merchants, they should participate of their new programs: Expanded Merchant Location Pilot (EMLP) of VISA and Payment Intermediary Foreign Exchange Operators (PIFO) of Mastercard. Under these programs, PAYFAC may continue to use their networks as long as they report information that allows for the proper identification of foreign merchants, their location and characteristics of their business. Participation in these programs, while voluntary, would involve meeting new fees or recognizing international fees to accept payments from foreign merchants.

Outside these programs, local acquirers and PAYFAC will not be able to continue providing the payment acceptance service to foreign merchant and, if they continue to accept and process these operations as domestic, they will be subject to cumulative monetary sanctions and, ultimately, the acquirers could have their licences cancelled.

Alternatively, they were informed that they could request the acquisition license in the country of the foreign merchant so that they can provide services to these companies. In the case of PAYFAC, they could establish contractual relationships with acquirers located in the jurisdictions of the businesses they want to affiliate.

For local players, the conditions and charges that arise from these programs are onerous and would mean an increase in the cost of the activities of PAYFAC, who have specialized in providing these services to foreign merchants (such as Netflix, Spotify, Apple Music and Amazon).

Among VISA's EMLP and Mastercard's PIFO programs, the former's program would be the one that would generate the greatest impact for local stakeholders; as VISA is the main brand of card (whether debit or credit) issued in Peru and represents the largest number of transactions processed in the country.

For PAYFAC, accepting the costs of the programs will mean an increase in their services fees that may lead foreign merchants to opt for the payment acceptance services of an acquirer or PAYFAC located in their own jurisdiction, which in turn would mean that such transactions will no longer be processed locally. Additionally, consumers could be affected because they would no longer have the facility to make their payments in local



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currency and even use means payments different from cards such as bank transfers, cash coupons and can also be restricted from making their payments in installments.

Proportionality of the measures proposed by the card brands

Undoubtedly, the VISA program generates a valid concern for acquirers and PAYFAC in Peru, as without access to its payment network, they will not be able to continue serving Peruvian consumers who use a local payment mean to carry out their transactions with foreign merchants.

VISA and Mastercard have justified these rules and higher costs, indicating that international operations compared to domestic operations are exposed to greater risks of fraud, money laundering and financing of terrorism (LA/FT), chargebacks, commercialization of illegal products, security, and so there's the need to comply with the regulations of each country where they are physically present (e.g., data protection, consumer protection, among others). In addition, inadequate processing of these transactions could put the ecosystem of card networks at risk, affecting the reputation of these companies.

On their turn, acquirers and PAYFAC that operate in Peru have indicated that they have monitoring and security systems to mitigate these potential risks in transactions with CNP and that no major differences have been observed between domestic and international transactions that could give rise to the concerns expressed by the VISA and Mastercard. In addition, these companies have explained that they have rigorous onboarding procedures for any new business they affiliate. Therefore, if a change in risk patterns is observed, these companies can implement their protocols to manage and counter them.

Considering these positions, the Competition Authority requested detailed information on the evolution of fraud instances arising from the transactions challenged by VISA and Mastercard. No increment in fraud cases since PAYFAC provided their services to foreign merchants was found, nor an increment in the differential risk between domestic and international operations.

Following these initial results, the cost of the EMLP program was analysed with respect to a typical international transaction to see if the expected charges could be higher. The data showed that the charges resulting from the VISA EMLP program were higher than those that a foreign acquirer would face in a cross-border transaction, especially for purchases greater than USD 5. Therefore, the transactions in Global streaming businesses, marketplaces, games, SaaS, among others, would be subject to higher costs for PAYFAC.

Results and recommendations

As a result of this analysis, the Commission for the Defence of Free Competition approved two recommendations with the objective of promoting adequate conditions of concurrence and competition in the market for payment acceptance services to foreign merchants not located in Peru and promoting a framework of understanding between card brands and national players in the payment system, thus continuing to work on the development of payment services, financial inclusion, and the proper functioning of this market.

First, VISA and Mastercard were recommended to carry out a review of the costs of cross-border transactions resulting from their programs, carefully considering the monitoring systems and measures developed by the acquirers and PAYFAC to prevent the risks they are concerned about. Secondly, it was recommended that all the actors should jointly participate in assessing the actual risks of these transactions.

Finally, VISA and Mastercard showed openness to implement the two recommendations. Even before the issuance of the report, VISA announced the postponement and revision of its EMLP program. However, VISA pointed out that no new foreign merchants would be affiliated to PAYFAC during this revision process. Likewise, VISA agreed to present the results of its review by December 2022. Meanwhile, PAYFAC and acquirers also showed openness to participate in this process of reviewing the conditions for processing and, if necessary, implement further measures to ensure the security of transactions.

Although an additional analysis would be needed to determine whether the changes that the card brands will propose will effectively minimize the concerns expressed by the different parties⁴, the advocacy mechanism has proven to be worthwhile to address competition concerns in dynamic markets such as card payment systems⁵.

⁴ In parallel to the development of this report, the National Directorate for Investigation and Promotion of Free Competition has received complaints previously filed by PAYFAC against the implementation of card network programs by VISA. These complaints are currently pending decision by the Administrative Tribunal of Indecopi.

⁵ It is important to note that for the development of this advocacy report, it has been relevant to have issued a Market Study of the card schemes in 2021, allowing the preparation of this report in a short time.