

**RETAIL BANKING SECTOR INQUIRY
PRELIMINARY REPORT II
CONSULTATION FEEDBACK FORM**

Name of organisation: ABN AMRO

Type of organisation: Financial Institution

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Have you received a request for information as part of the sector inquiry:

Yes

Introduction:

ABN AMRO welcomes the opportunity given by the European Commission to comment on this interim report on retail banking. As a general comment, the interim report shows that in many cases the conclusions and the necessary actions are difficult to assess because of the current fragmentation and specificities of national markets.

Despite the completion of the Financial Action Plan, retail markets are still very fragmented along national lines. With the single currency and the development of e-banking products, the demand for retail products by non-resident citizen of one of the other Member States will necessarily increase in the near future. However, as highlighted in the interim report, there are still some barriers to entry, in particular for cross-border business. Those barriers are both due to structural and historical developments, but also coming from regulatory obstacles. It is therefore important that in tackling regulatory barriers, DG Internal Market and DG Competition are joined up in any action to open up the EU market. ABN AMRO supports measures that will create an integrated retail market, with a focus on the Euro area, since we believe it will bring more choice and quality for local customers. However, any actions undertaken should be done in accordance with the better regulation principle in order to achieve proportionate measures.

Below, please find ABN AMRO's responses on the questions raised by DG Competition.

Specific questions from Executive Summary:

A. Market structure and fragmentation

1. What are the main reasons for market fragmentation in Europe's retail banking sector? Please identify whether they are mainly of regulatory, structural or behavioural nature.

The so-called "natural" barriers such as language and cultural preferences do not represent the major hindrances for retail market integration. This is something financial institutions can manage by offering tailor-made products. ABN AMRO has a long and positive experience in operating and supporting business outside our initial home market, the Netherlands. This is for instance the case with our retail business in Brazil, in the United-States and in Asia.

In this response, we would therefore highlight regulatory obstacles. Banks do face some regulatory challenges that clash with market reality. Companies wishing to expand outside their home borders must contend with different regulations and in some instances multiple market supervisors. When entering a new market, barriers such as national discretion in supervision rules, different consumer protection rules, heterogeneous tax treatment and financial reporting rules create high hurdles for new comers. This is also sometimes a mean to protect national markets. There is a threat of lack of level playing field between foreign and local players. In some cases, national authorities interpret the rules to the benefit of their own national champions.

Also, the integration of the banking market very much depends on the national central bank oversight. In this respect, we welcome very much the recently move of some national supervisors to recognise that the rules have to be applied in the same way for cross-border players as for national players.

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2. What are the main causes and implications of the different level of concentration in the EU retail banking markets?

The market structure is intrinsically linked with the historical and regulatory developments of the banking sector in each country. The Netherlands are one of the highest concentrated markets in Europe. On the contrary, Germany, Italy and Spain are still very fragmented domestically. It is also linked with the development of national economy. Some EU national markets are characterized by a fragmented economy, led by small and medium enterprises. This is the case in Italy where SMEs play a critical role in the Italian economy. This pattern is very much reflected in the Italian banking industry.

With domestic consolidation, many synergies can be reaped -, for example on the distribution side, IT systems, etc., - for the benefits of the consumers. On the contrary, a fragmented market will imply high costs based and inefficient infrastructures.

B. Banks' financial performance and pricing

3. What are the main reasons for the varying rates of profitability and income in retail banking across the Member States?

We believe the comparison of rates of profitability and income in retail banking across Europe will not lead to any meaningful conclusions.

There are mainly three elements that make rates of profitability and income vary across EU Member States:

- the cost of living is still different, despite the introduction of the single currency; there is therefore no uniform pricing possible;
- the pricing also varies depending on the development of the market;
- the regulatory framework is not harmonised with regard to contract law and consumer protection rules. When developing pricing models compliance costs and regulatory framework are taken into account.

ABN AMRO believes that as long as competition plays at a level playing field for all actors, one should let the pricing be done by market forces rather than by regulation.

C. Entry barriers in retail banking

4. Are there other types of entry barriers in retail banking that have not been identified in the preliminary report?

The preliminary report highlights a range of entry barriers that “need further exploitation”. ABN AMRO supports the conclusions of the preliminary findings related to:

- Payment systems; this is currently a highly fragmented market, with in some countries, a difficult access to the payment network. We believe that the creation of Single Euro Payments Area (SEPA) will drastically change the competitive landscape;
- Credit database; harmonisation of the data held and a better access for new comers is needed (see question 6);
- Regulation and State intervention; we call for streamlining and a more effective banking supervision, as well as the elimination of direct state intervention to protect national markets. The same rules should apply for all national and foreign (EU) players. The ownership structure of banks is also a key factor when entering a market.

However, the report does not mention in detail other important entry barriers which relate to consumer protection rules. Although those barriers do not fall directly under the competency of DG Competition, there are relevant for creating an integrated retail market.

The divergence of consumer protection rules and contract law within the 25 Member States hinder the provision of cross-border retail products. In the context of integration of retail financial markets, it becomes primordial to put in place a common set of rules on retail banking (such as consumer credit) while ensuring a high degree of consumer protection.

The European Commission has indicated that this is the aim of its modified proposal for a Consumer Credit Directive. However we would like to stress that in its current form, the proposed Directive itself is not sufficient to create a truly single market for consumer credit.

To achieve this objective, the following issues still need to be tackled:

- Full harmonization of consumer protection rules has to be achieved. For instance, in Italy there is a requirement that all credit contracts are validated by an official representative verifying face to face that the customer is who they say they are (physical verification). This is not a requirement in Spain. If a bank issues cross-border credits from Spain into Italy, the bank will have to comply with this rule, which make it more difficult for cross-border products to be offered. The current proposal for a Consumer Credit Directive will not encourage further cross-border market in consumer finance since credit institutions will still have to comply with local regulations and issue contracts under local law.
- Enforcement procedures are not yet harmonized. There are currently carried out by local courts in the country of residence of the client. The recovery speed varies dramatically and therefore leads to very different approaches across countries, (e.g. in Spain recover procedures are very slow while in the UK they are much faster and easier).
- Contract law and especially the differences between rules on nullity of credit agreements may have unexpected and disastrous consequences on creditors acting cross-border. This should be tackled at EU level.

All those issues constitute significant barriers to the development of cross-border credit provision since they lead to different operational processes and systems configurations for each market. Thus, as far as those further obstacles are not addressed, a genuine cross border market will not develop and credit institutions will continue to act on the basis of market specific approaches with local market infrastructure.

To conclude, we would like to highlight that market outlook in a specific country is key for entering a new market. In some EU markets where sales margins are relatively small it is difficult to enter market for newcomers. Interest development, state of economy, openness to outsiders, and presence of international competition are also key factors to be taken into account.

5. Where and how does competition law have a role in tackling barriers to entry in retail banking?

At Member States' level, the problems are often not the rules themselves, but of how they are applied. Competition law should therefore ensure equal market access without discrimination based on nationality, and increase level playing field with non-equity based banks (end of special treatments, mergers and acquisitions reciprocity rule). When the rules are applied differently for different companies and different sectors, the process of decision-making by the market is compromised. There must be a level playing field where everyone – local and foreign parties – is treated on an equal footing. In some cases – and not only in the banking sector, this is also true for corporates – national authorities interpret the rules to the benefit of their own national champions.

This is why ABN AMRO calls for more transparency in the procedure and supervisory approval process when conducting mergers and acquisitions (M&A).

The clearer and more transparent the procedure is, the less chance of discretionary – and sometimes unjustified- decision there is. We welcome in this respect the proposal¹ of the European Commission to improve the supervisory approval of M&As. We believe that the closed list of criteria will help market participants in their process of cross-border acquisitions. However, the cooperation between the competent authorities should be further strengthened in the process of “joint determination” of the proposed acquisition.

6. Access to credit databases and payment infrastructures are sometimes cited as a barrier to entry in retail banking markets. Are there significant barriers to access which merit further investigation?

Access to databases with potential new customers is a key to success. However, credit bureaus have developed very differently across the EU. There is therefore no uniformity in Europe, in particular in terms of type and quality of data held. Some credit bureaus collect only negative information, whereas some collect positive information. In the Netherlands, the credit bureau is both a positive and negative database. On the contrary, in Italy, there are many private credit bureau, and it is difficult (and costly) for credit institutions to get a proper overview.

Moreover, in some EU markets a high (excessive) degree of consumer protection might prevent the emergence of necessary services such credit bureaus, fraud databases, mailing lists, etc. In the Southern countries, due to restrictive consumer protection and /or privacy laws, credit bureaus are underdeveloped which hinders the access to those markets. In Italy for instance, before launching an inquiry to the credit bureau, credit institutions must get the pre-approval of the consumer. In this case, it is very complicated for new comers in the market to use the credit database.

In the current proposal for a Consumer Credit Directive², we welcome the obligation imposed on each Member State to ensure access for creditors from other Member States to their databases under non-discriminatory conditions in case of cross-border credit. However, the proposal should also require from all Member States the establishment of a positive central database. If some countries possess only negative databases, while the other have both positive and negative database, credit institutions across the EU will not have access to the same type of the information. In case of cross-border credit, access to the similar central databases should be ensured in all Member States. For example, the Netherlands have both positive and negative databases for consumer credit.

In addition it would be useful if each Member State set up fraud databases. For example in Spain there is no such database and the data privacy legislation prevents banks from setting up one by themselves by way of cooperation.

ABN AMRO calls for the creation of a task force at EU level which will have as a mandate to define minimum standards for credit bureaus. Based on the task force’s recommendations, the European Commission would be able to propose an harmonisation of the type and quality of the data held and equal access to all credit bureaus in Europe. This would ensure a level playing field for all market participants. In the case of cross-border credits, access to credit bureaus shall be ensured under the same conditions in all Member States. We believe that the governance structure and ownership is not such a problem as long as it respects the minimum standards that would be defined by the task force.

¹ Proposal for a Directive as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of shareholdings in the financial sector, 12 September 2006;

² Modified Proposal for a Directive on Credit Agreements for Consumers, 7 October 2005, article 8

D. Customer choice and mobility

7. What are the main reasons for the low mobility of retail banking customers?

This is due to the specific pattern of banking (especially relationship banking): customers tend to have fairly long relationships with their bank due to the specificity of the products (e.g. mortgages). We see there is a pivotal moment for customers to change banks when they have to decide on long term products such as mortgages. The banking relationship goes much further than just having an account but goes in essence to getting the best deal fitted to the customer's profile in a whole range of products. We believe that not so many consumers are willing to get different credit institutions providers for all the different banking products. Consumers are usually willing to get one single provider in order to have one single overview of their financial position. In this view, long term products like mortgages, credits, investments, etc play a determinate role for the customer choice of a bank (and the possible shift towards another bank) and to a much lesser extend the conditions linked to the current account. In this way bank account mobility follows more the long term pattern of the above-mentioned products.

In the Netherlands a special bank transfer arrangement called "overstap service" ("switching service") was put in place to make sure that no administrative barriers exist for customers (consumers and SMEs) to switch accounts.

Moreover, some new trends will probably increase the customer's mobility in the retail banking sector. For instance we can notice the emergence of cross-border demand and a change in the mix of distribution channels with direct distribution via internet as driving forces.

E. Development of payment infrastructures in the context of the Single Euro Payment Area

8. Are there features of the payment industry that limit competition either at the level of provision of clearing and settlement services or the provision of retail banking services? Please indicate areas that merit further investigation.

Access to payment and clearing and settlement infrastructures are an important determinant of the overall costs of providing certain retail financial services. It can represent a barrier when entering a new market. Access to card network for new credit institutions entering the market should be ensured on equal footing with local providers. This is not currently the case in some countries.

In our view, access to clearing and settlement services (only by financial institutions) must be based on transparent and fair criteria, e.g. liquidity/collateral requirements. In some countries today, C&S are exclusively provided by domestic banks, a form of protectionism that should disappear in SEPA.

9. Are interchange fees necessary for the development of payment instruments (credit transfers and direct debits) in the EU?

Interchange fees are paid by the creditor bank to the debtor bank, to compensate the latter for the cost incurred. This mechanism is only necessary when the debtor bank has no, or limited, possibilities to charge its own client. This is the case for card payments, for example, where charging the client for using his card would drive clients to unwanted behavior: namely, the use of cash instead of card.

Therefore, the Commission should take a holistic view on the payments market. Drawing conclusions from the economics of a single payment instrument like cards, in isolation, is ineffective. The Commission should, in our opinion, examine instead how cost based charging for every payment method (including cash withdrawals!) be realised in the EU to achieve the most efficient use of payment instruments by payment service users. Bank pricing should encourage the use of efficient, easy to use and secure instruments like cards and direct debits, and drive down the use of paper instruments and cash withdrawals. For banks themselves it is very difficult to change the existing pricing models; the first bank to change its fee structure would incur the 'first mover disadvantage' and runs a significant risk of losing clients (this has been proven in the 1990s in the Netherlands, for example).

For Direct Debits the interchange fee (if any) should be very low. These are mass payments that are processed fully STP. We use the opportunity to mention that in Germany, 5 billion direct debits are processed without an interchange fee in place (there is only a fee for exception handling). For regular Credit Transfers, there should not be an interchange fee at all because there is no rationale for interbank compensation mechanisms in this case.

We consider the differences of interchange fee structures in the EU as an obstacle to be overcome in order to fully realize the Single Euro Payment Area. The decisions of the competition authorities in the EU in relation to interchange fees have up to this moment not created the clarity wanted about interchange fees from the perspective of competition law. A clear point of view of the European Commission with regard to interchange fees in relation to competition law would therefore be very welcome. An interchange fee for the society is lower than in the absence of such an interchange arrangement. The cost of society will be lower if more cards and electronic payments are used and less cash and paper based instruments. Any interchange arrangements should foster usage of more efficient payment instruments.

In a wider context, a research³ on the cost and benefits in payments in the Netherlands was published last July to analyse the efficiency of the pricing system in payments. The principle of cost-based pricing in payments is well understood to be key to arrive at a socially optimal and efficient payment system. Yet, its application in practice may be not always easy, as the externalisation of hidden costs can be perceived as a price hike by the public. This is particularly true in the Netherlands where business customers account for the majority of payments revenue, thus subsidizing the consumer segment (that perceives payment to be cheap or for free). While continuation of cross-subsidisation is unsustainable in the future EU-market, we recognize that any move to a more rational fee structure in payments can only be made if all stakeholders (consumers, retailers) are given a full insight into the actual profitability structure of the payments business in the Netherlands. We think it is important that customers get a good insight in the real cost of payments: more transparency on real costs will enable them to make the choice of the best payment instrument. Moreover, central banks have created a competitive environment for cash that resulted in an unlevel playing field for non-cash instruments. According to the McKinsey study, cash is a bleeder of at least 21 billion Euro.

³ Research conducted by McKinsey and ordered by the Dutch Central Bank and the Dutch Association of Banks. It is based on cooperation with five Dutch Banks (ABN AMRO, ING bank/Post bank, Rabo Bank, Fortis and SNS Bank).

10. Are there issues related to industry initiatives in the context of SEPA that should be assessed from a competition view point?

ABN AMRO is committed to the timely delivery of SEPA payment products to our clients based on the two EPC Scheme Rulebooks for credit transfer and direct debit, as well as the implementation of the SEPA Cards Framework. ABN AMRO worked actively in the framework of the EPC towards realising these SEPA payment instruments delivered by banks. In order to support the realisation of SEPA and assure stability in the implementation process, we favour **positive incentives**. We would welcome a partnership with EU institutions, national authorities and user's associations which show public commitment to the self regulatory initiative of the banking industry via the EPC. In this way a trickle down effect is created towards the final customers who will i) be aware of the upcoming changes ii) can prepare to take up the new products

We believe that the end users benefit the most from a highly competitive payment system which allows for the most efficient and attractive offer to flourish. In this respect we would like to refer to the sectoral inquiry launched by DG Competition on cross border payments and cards. The conclusions of these inquiries should be an integral part of the future next steps.

We also plead for a realisation of SEPA that would contribute to achieving the Lisbon goals: a self regulatory, competitive approach supported by positive incentives is in our opinion the best way forward to contribute to the Lisbon goal.

F. Other issues

11. Please provide comments on any other competition-related issues in relation to retail banking markets.
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General questions:

1. Did you find the content of the report easily accessible and understandable?

The report was too general

2. Did you find that the level of detail in the report was:

not sufficiently detailed

3. Did the information contained in the report was:

mostly known to you/the retail banking industry.

4. Did the market analysis in the report:

confirm your views on the operation of the retail banking market;

5. Did the report raise the right policy issues;

no, there were some significant issues left out.

The report lacks the consumers' perspective, in particular, when raising the issue of low mobility of retail banking customers.