RETAIL BANKING SECTOR INQUIRY
PRELIMINARY REPORT II
CONSULTATION FEEDBACK FORM

Name of organisation: CONFEDERACIÓN ESPAÑOLA DE CAJAS DE AHORROS (*SPANISH CONFEDERATION OF SAVINGS BANKS*)

Type of organisation: ASSOCIATION

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

☐ Yes

☑ No

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 study made by the European Commission on the cross-border consolidation of the EU financial sector (October 2005) set out the keys to the current level of fragmentation of the European financial system. The importance of this analysis lies in the fact that it is based on the contributions of the market players, so its conclusions reflect the views and experience of the industry. The authority of this study should, therefore, be stressed and there is every reason to take it into account in this new investigation.

According to the aforesaid study, the main obstacle to greater integration (or, more precisely, hampering greater cross-border consolidation) is the **absence of synergies** that make mergers attractive. In other words, the incentives for mergers on a national scale do not exist on a cross-border level.

- The main reason for this lies in the economic and cultural differences that are still very pronounced among the Member States. Consumer habits still vary widely, after many decades over which each market has developed separately (based on internal phenomena or events). This is clearly reflected in both the “product mix” and the laws regulating the market (e.g. on consumer protection), both adapted to the prevailing situation in each country. All this affects the entry of new rivals and has a clear bearing on the levels of fragmentation.

  It should be borne in mind that the European financial market stems from an initial situation of fragmentation, responding to historic and cultural reasons.

- Based on this starting point and the efforts made to achieve greater integration, the European Commission’s report highlights a second factor, which explains the lack of incentives for consolidation and is linked to the supervision of cross-border groups. The numerous reporting requirements imposed by the different supervisors and use by the latter of extensive discretional powers in mergers are mostly responsible for the lack of incentive for Community-wide consolidations.

- Finally, legal impediments have also been pinpointed, especially in the legal and tax areas that seriously hamper the restructuring of groups with cross-border activity.

Each of these three factors is very different and should be tackled individually.

As regards the differences we have described as economic and cultural, and seeing that “cultural” harmonisation requires considerable, constant efforts, which may take years to bear fruit, greater integration can only be achieved by stepping up efforts to harmonise retail financial products. The experience of the first UCITS Directive (85/611/EC) proved that product harmonisation is more effective than supplier harmonisation. The possibilities could thus be studied of harmonising basic products (personal loans, current accounts, mortgage loans, etc.) to simplify their cross-border marketing. However, if cross-border marketing of these products is to be successful, the harmonisation regulations must be simple, transparent and not excessively protective of customers’ interests. The product must be “commoditized”, on comparable conditions.

The first steps have been taken in respect of supervision (e.g. to amend the supervisory powers in mergers and acquisitions under the Banking Directive). But further cooperation among authorities and convergence of their practices is still required. The different committees that have been set up (CESR, CEBS and CEIOPS) will play an important role in these aspects.

Finally, with regard to legal impediments, particularly taxation issues with adverse effects for business restructuring, further tax harmonisation is required. Other supposed legal hindrances, such as those deriving from the legal structures, will be discussed in Q4.

In short, as proved in the Commission’s 2005 study on barriers to cross-border mergers and acquisitions, fragmentation is due, above all, to the behaviour of the different players in the economy, especially owners and customers (“economic and attitudinal barriers”). If an institution really wants to take over another entity, there are no legal impediments. The physical barriers and supervisory requirements can hamper cross-border activity, but by no means prevent it.

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

The report shows that there are considerable differences among Member States in the degree of concentration, regardless of the criteria taken. One of the main reasons for the different levels of concentration is undoubtedly the diversity of financial service suppliers, in both number and corporate structure.

Spain has one of the lowest levels of concentration. In all the ratios used in the study, Spain is always among the countries with the lowest levels of concentration, on both a national and regional scale. This is compatible with a high yield and low level of costs, as analysed hereinbelow. In short, the Spanish financial system is characterised by its high degree of competitiveness and its plurality, which has not only reduced its profitability and efficiency, but has even favoured them.

The presence of savings banks (*Cajas de Ahorros*) is one of the key factors of this situation. This is one of the main conclusions of the report made this year by the International Monetary Fund (IMF) on the Spanish financial system (Spain Financial Sector Assessment Program 2006):*"The savings banks (Cajas) have been a major force in extending services and in creating a highly competitive environment in the Spanish financial system*[1]*"*. In this regard, it should be highlighted that 3,6% of the population in Spain (1,5 million inhabitants) would be excluded from financial services if savings banks were not operating in their territories as they are the only institutions in many geographical locations.

To understand the full meaning of this assertion, it should be noted that there are three main types of credit institutions in Spain: commercial banks, savings banks and credit cooperatives. According to the Report on Banking Supervision in Spain 2005[2], there are 53 domestic commercial banks operating on the Spanish market, 47 savings banks and 85 credit cooperatives. This plurality does not prevent a significant concentration of business: two institutions have cornered almost half of the market share corresponding to the commercial banks sub-sector.

Therefore, considering the Spanish financial system overall, **savings banks are essential for guaranteeing the development of a financial activity in competitive conditions**. The savings banks, institutions of widely varying sizes, largely offset the polarisation of the two largest domestic commercial banks, avoiding any abuse of market power.

The Herfindahl-Hirschman index can be used to assess the degree of competition or concentration of financial markets. The value of this index should be below 1,800 (threshold set by the Federal Reserve as the limit for authorising a merger).

According to December 2005 figures, the Herfindahl-Hirschman index for Spanish credit institutions overall is 1,434, very close to what are considered optimum values. If we

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[1] Pag. 27. Financial Sector Assessment Program. Spain. Technical note on regulation, supervision, and governance of the Spanish Cajas (May 2006).

[2] http://www.bde.es/informes/be/supervi/2005/ms2005.pdf

recalculate the index ignoring the existence of savings banks on the Spanish market, we obtain values of around 3,000 points, which clearly shows that if were it not for the savings banks, the Spanish market would be an oligopoly.

It has been demonstrated (and Spain is one of the good examples) that concentration is not always the best measure of market competition. **Market contestability** (as the possibility of entry into a market and compete with market incumbents thereby improving service and convenience and reducing prices) is the key factor for competition nowadays. Contestability has been a dominating trend in national and regional banking markets in Spain in the last 15 years with all institutions (and, in particular, savings banks) opening branches and competing with other local institutions both at their own and outside their original territories.

In Spain, there is tough competition among savings banks, among other reasons because the so-called "regional principle" is not present. In Spain, there are very low levels of regional concentration, owing to the expansion of many institutions outside their traditional operating areas, such that the average number of savings banks with branches in the different regions, or "Autonomous Communities", of Spain has increased considerably, reducing in practically all regions the market share of any one institution.

In short, savings banks are highly competitive on the financial markets with no abuse by any particular institution in any of its operating areas, which guarantees that consumers and users are offered financial services on excellent conditions.

This low level of concentration offers obvious advantages for customers in terms of services, prices and efficiency. An empirical demonstration of these advantages is set out in the report (ARS Project) published by Deloitte in 2006 on the Spanish financial system. The "ARS Project" studies and compares the financial systems of Italy, UK, France, the Netherlands, Germany and Spain, and reaches the following conclusions regarding the advantages of greater competition for consumers.

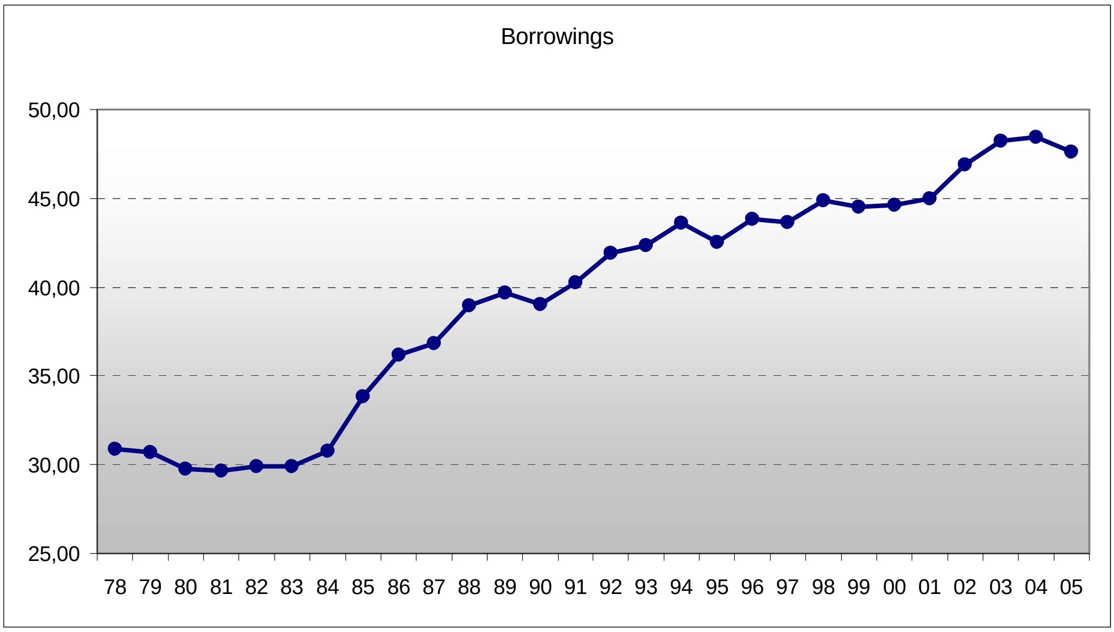
- **Accessibility of services**. Greater competition enables better access by consumers to financial services. Spanish financial institutions have invested the largest sums in distribution structure and service structure and **Spanish customers have more channels of access to banking services:**

    - The Spanish branch network is more ramified and gets closer to the population. The Spanish market has the largest number of branches per capita (9.6 branches for every 10,000 inhabitants, compared to 4.4 in France or 5.3 in Italy).
    - Spanish financial institutions offer a larger number of different types of branch and ATM services.

- **Better financing conditions**. The ARS Project reveals that the Spanish financial system is the toughest and most demanding for making the banking business profitable, among other reasons, because the prices of loans are more favourable for customers. The same study shows that Spain has a lower per capita bank cost (smaller income for financial institutions), fostering a more favourable environment for customers with a higher service level at a lower price[3].

- **Incentives for innovation**. The greater competition in the Spanish banking system is a powerful incentive for innovation. With the progress this has brought in management and cost cutting measures, high levels of efficiency have been maintained. Indeed, Spanish financial institutions, whatever their nature, have had to make a **greater effort to improve efficiency in order to guarantee the sustainability of their business and services model**.

The foregoing shows that the ownership structure does not determine the level of efficiency, which is rather determined by market pressure. In Spain, savings banks (private foundations), *cajas rurales* (cooperatives) and commercial banks (companies limited by shares, listed or otherwise) have all had to make the same effort to improve efficiency. As a result, efficiency differs from one institution to another, but the foundations do not generally fare any worse than cooperatives or companies. The intense growth of Savings Banks' market share over the past three decades illustrates this (the following graph shows the evolution of savings banks' market share in deposit operations).



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?

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[3] There is a recent paper showing the importance of bank competition at the local and regional levels to guarantee SME financing in Spain which, in turn, emphasizes the role of specialized regional intermediaries for small firm financing: Carbó, S., Rodríguez, F. and G. Udell (2006): "Bank Market Power and SME Financing Constraints", Proceedings of the 42nd Bank Structure Conference of the Federal Reserve of Chicago. This study employs a broad range of concentration and other market power measures to show that higher competition in regional markets improves the financing conditions of SMEs and that savings banks (as representatives of relationship banking and proximity banking) are, therefore, a unique tool for small firm lending in regional markets.

There are several complex reasons for the varying rates of profitability (in short, efficiency) in EU retail banking, which really need to be studied in greater depth. Broadly speaking, the following can be mentioned:

- **The growth model**. The strategy followed in structuring commercial networks has a considerable effect on the cost structure of intermediaries. This strategy is essentially defined on the basis of two factors:

    - The structure of the population and economy. In countries with a more dispersed population, financial institutions are forced to establish a wider-reaching branch and ATM network to meet their customers' needs. Spain is a clear example of this, since its exhibits one of the largest per capita ATM and branch network in Europe and, at the same time, always maintains its "cost/income" ratios below the mean EU values.

    - Consumer preferences. In Spain, for example, consumers place a high value on the closeness of branches and personal service, which has led credit institutions to establish extensive networks to meet those needs. Perhaps, one of the main differences with other European counterparts is that Spanish credit institutions have more branches but they are significantly smaller in size (e.g. number of employees per branch). This way, they control their operating costs and cover a higher proportion of the population).

- **Characterisation of demand**. Customers' purchasing power determines the average amount of the deposit accounts held by financial institutions, which in turn affects brokerage costs. Long-standing habits also have a bearing, especially in the use of cash as an instrument of payment (which generates more costs than electronic means, since it requires extensive branch networks and greater back office processing). In any event, Spanish credit institutions have made an effort to change these habits through two steps: i) stimulating the use of ATMs; ii) stimulating the use of cards at the point of sale (POS).

- **The situation of the labour market** determines the salary cost and, consequently, to a large extent the behaviour of the cost structure.

- But the main reasons are perhaps those relating to the **level of concentration and competition**. As mentioned earlier, the greater the competition, the more the incentives to reduce distribution costs and, consequently, improve efficiency. In other words, the existence of a certain market power, deriving from high levels of concentration, usually dampens the motivation to incorporate new innovations to enhance efficiency. On comparing the markets of Spain, Germany, Italy, UK and France over the period 1996-2002, the lower unit operating costs are found in Germany (0.019) and Spain (0.026)[4], precisely two of the countries with the lowest levels of concentration.

[4] Carbó, Humphrey and López del Paso (2006), "Electronic Payments and ATMs: Changing Technology and Cost Efficiency in Banking", in Balling et al (eds.) SUERF Colloquium Volume "Competition and Profitability in European Financial Services: Strategic, Systemic and Policy Issues", pp. 96-113. Routeledge.

The above is merely an outline of the complexity of the reasons behind the different efficiency levels among the different Member States. It should be mentioned that many of those causes go beyond a pure defence of competition, since they derive from structural situations (distribution of the population, consumer behaviour), convergence of which, a priori, would appear to be difficult.

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?

No, no other types have been observed. Nevertheless, the preliminary report makes a number of assertions that we consider incorrect and which ought to disappear in the final report.

The European Commission seems "hostile" to non-corporate forms of business organisation, which we consider incompatible with the respect for all systems of property ownership contemplated in the EU Treaty, especially when the Commission's report last November on barriers to cross-border consolidation made it clear that this "biodiversity of legal structures" is not an "artificial barrier" to financial integration in Europe. Moreover, this plurality was praised in a recent report approved by the European Parliament[5]. However, the Commission's preliminary report contains statements such as: "Another regulatory issue that also affects market entry concerns specific rules on the ownership and activity of certain types of banks such as savings banks and co-operative banks".

These assertions are not true, at least as far as the Spanish model of savings banks is concerned. The legal nature of savings banks has been analysed in great detail by the IMF in the FSAP on Spain. We recall here the characteristics of Spanish savings banks (*Cajas*):

- They are private credit institutions with a foundational nature, competing on equal conditions with the other players on the financial market. The fact that their general assemblies (equivalent to the general shareholders meetings of public limited companies) decide to apply a large proportion of their profits to social and welfare work does not prevent them from maximizing profits. On the contrary. This fact was highlighted by the IMF.

  *"Cajas are required to allocate at least half of their profits to reserves, and they channel the remainder back into the community toward projects that fall under their social mandate (obra social)[6]. **Cajas seek to maximize their profits** -and thus, their allocation to the obra social- through their day-to-day business operations and **compete fiercely** with banks and other credit institutions for the provision of financial intermediation services.[7]"*

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[5]http://www.europarl.europa.eu/oeil/FindByProcnum.do?lang=2&procnum=INI/2006/2081

[6] This requirement, initially set by national legislation (Real Decree-August 27, 1977), has to be respected by all the autonomous Communities.

[7] Pag. 6. Financial Sector Assessment Program. Spain. Technical note on regulation, supervision, and governance of the Spanish Cajas (May 2006).

- Although the IMF is a monetary authority, it also mentioned the important social role of savings banks:

  "The obra social has typically been focused on low-income groups, the elderly, and less populated areas. A recent study shows that the obra social benefits 96 percent of the Spanish population, with the disadvantage groups receiving most of the benefits.[8] *Spanish citizens, on average, make use of services or public goods provided by savings banks about three times per year. The study concludes that the extensive provision of social and cultural services by the private sector -strictly, by savings banks- in Spain cannot be found in any other country. Finally, it suggests that the private provision of public goods through the obra social complements well the government's provision of such goods.*[9]*"*

  It should be stressed that the funds assigned to "*obra social*" are distributed by the savings bank directly. In other words, unlike other types of social and welfare institutions, the part of the profits used for social and welfare purposes is not equivalent to a dividend (paid out to the entities controlling the savings bank for use as they deem fit), but remains in the savings bank and its general assembly, in which all its stakeholders are represented, decides on the distribution among the different welfare projects. This distribution represents a control mechanism itself. Specifically, the "*obra* social" and the social goal of savings banks itself is a distinctive signal for customers, a reference for stakeholders and a guarantee of retail competition for the entire banking sector.

- Their assets may be purchased by any other credit institution, insofar as they are private institutions. As pointed out by the IMF: "*caja´s assets and branches* ***can be purchased by individuals, private companies and commercial banks****.*"

  The possibility that all or part of a savings bank's assets may be purchased by third parties is especially useful in times of crisis. In these cases, Spanish law grants extensive powers to the Deposit Guarantee Fund, which expressly include the power to transfer the business of a distressed savings bank to another credit institution (commercial bank or savings bank).

- They are financial instruments issuers and, as such, subject to market discipline insofar as they obtain funds, without constraint, on the international capital markets, as pointed out by the IMF.

  "Over the past ten years, the cajas channelled over 70' percent of after-tax-profits into their revenue reserve every year. Since 1985, however, savings banks can raise capital by issuing subordinated debt (Tier 2 capital) and preferred participations -

[8] PricewaterhouseCoopers, 2005, Valoración del impacto de la obra social. The study was responsored by the Confederation of Spanish Savings Banks (CECA).

[9] Pag. 7. Financial Sector Assessment Program. Spain. Technical note on regulation, supervision, and governance of the Spanish Cajas (May 2006).

which are considered part of Tier 1 capital (qualifying preferred participations) or Tier 2 capital (non-qualifying preferred participations).[10]*"*

- In corporate governance, they have a dual structure (board of directors and control committee). Both bodies are elected by the general assembly, which ensures that, through reciprocal oversight among all stakeholders, there have never been any financial scandals. They are, moreover, bound by the same reporting instruments and transparency requirements as commercial banks and cooperatives.

  In this regard, the IMF mentioned the obligation recently assumed by savings banks to publish an annual corporate governance report.

  "The transparency of cajas´ decisions is set to improve significantly, Starting in 2005, cajas that issue traded instruments must publish an annual Governance Report, which will enhance transparency and market oversight.[11]*"*

- There is no territorial limitation. All credit institutions are free to open branches anywhere in Spain. There are 17 Autonomous Communities in Spain and at present there are at least 19 savings banks operating in each autonomous community.

- The creation of new savings banks is free in Spain. Anyone can found a new savings bank, provided they comply with the requirements stipulated in the applicable laws and regulations (which coincide, *mutatis mutandis*, with those stipulated for founding commercial banks).

- The expression "Caja de Ahorros" [savings bank] is a legal name reserved in Spanish law exclusively for these institutions (just as the names "banco" [bank] and "cooperativa de crédito" [cooperative bank]). Therefore, since it cannot be used by other institutions, it is not an asset that can be marketed.

  By reserving these names, it is ensured that consumers are aware of the basic characteristics of the institutions offering financial services, thus enabling them to choose according to their preferences.

- Spanish savings banks do not benefit from any guarantees offered by public authorities. They are, moreover, subject to the same taxation on earnings as any other credit institution (except for cooperative banks that enjoy a more favourable system on corporate tax), and receive no grants or other specific public aids.

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

[10] Pag. 22. Financial Sector Assessment Program. Spain. Technical note on regulation, supervision, and governance of the Spanish Cajas (May 2006).

[11] Pag. 26. Financial Sector Assessment Program. Spain. Technical note on regulation, supervision, and governance of the Spanish Cajas (May 2006).

Competition laws and regulations in retail banking must follow the same lines as in any other sector, i.e.:

- Prevention and penalisation of restrictive or abusive practices and agreements affecting prices or services.

- Control of concentrations and abuse of dominant positions.

- Control of public aids.

The application of these general principles to the specific object under study (current accounts and related services) will be analysed later. What should be stressed here is that the competition laws and authorities must stick to this general framework and not go into debates clearly beyond their objectives. This is the case of the treatment given in the preliminary report of certain types of financial institutions, namely savings banks and credit cooperatives. The statements made in the report in respect of these institutions go beyond the stated purpose of the report, which is the behaviour of the retail banking market in respect of current accounts.

The problem of the legal nature of savings banks and the connection thereof with the degree of integration of the European financial system has been debated in another context and reliable conclusions have already been reached, backed by the Commission and the European Parliament, as mentioned hereinabove. In the case of Spain, the International Monetary Fund report on savings banks does not mention any competition-related problem deriving from the ownership structure.

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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?

In Spain, all credit databases are freely accessible on similar conditions for all banking institutions. There are, therefore, no barriers limiting or restricting access to such information.

In many countries, national payment structures have been administered by specialist enterprises, wholly or partly owned by the financial institutions. Where those enterprises are capital intensive, the financial institutions owning them have asked new participants to subscribe legitimate capital increases on the same conditions as the earlier institutions.

In Spain, in the case of payment cards, there are three independent systems, which, although logically interconnected and interoperational, openly compete with one another (Servired, EURO 6000 and Sistemas 4B). The existence of several payment systems facilitates the entry of new participants in any one of them, particularly foreign banks wishing to enter the Spanish market, which have been able to negotiate with any or all of the three systems and choose between them without any problem. Some of them, such as EURO 6000, in which some savings banks participate, even permit using the services without taking a stake in the capital, thereby avoiding the corresponding outlay. This is an example on how cooperation can make a payment network efficient despite of the typically small size of their members.

By joining any of these systems and distributing cards to customers, the new participant gives its customers access to the entire national network of POS and ATM on the same conditions as any local financial institution.

Furthermore, all Spanish cards issued by financial institutions are associated with MasterCard or Visa, and the ATM and POS are also open to these networks. Therefore, any card from any European (or international) financial institution associated with MasterCard or Visa can use the Spanish networks even though the foreign institution does not belong to any of the Spanish systems. Moreover, the regulations of both international networks contemplate the existence of “central acquirers”, which can acquire merchants operating in any country from a single location in Europe.

Nor are there any barriers particularly limiting access by certain types of institution to the payment structures referring to transfers and debits. All institutions are subject to the same rules. Moreover, the participation of Commercial Banks, Savings Banks and Cooperative Banks Associations in decision-making and consultation processes concerning payment structures ensures that all institutions, regardless of their size, are informed and their interests are defended.

In short, the Spanish system is a typical example of an open card payment system which allows interoperability and a full achievement of network economies associated to payment networks, which favours consumers.

D. Customer choice and mobility

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

In its report, the Commission mentions two types of factors accounting for the low mobility of retail banking customers:

- Barriers established by the financial institutions supposedly to hamper mobility. There are several such barriers, such as: cancellation charges, not providing information to customers, bureaucratic formalities, etc.

- “Natural” barriers. Consumer preferences are often biased by lengthy relationships, based on trust and confidence. Moreover, in Spain, the importance attached by consumers to on-hand branches and personal service also explains the mobility rates (since not all institutions are able to provide a service with the level of personalisation required by consumers). Personal contact is still an important reference for retail services (proximity banking). The main example comes from the low level of penetration of on-line financial services in Europe. This is particularly clear in certain market segments such as mortgages where customer relationships are highly valued by customers and personal service is broadly required.

It is difficult to say what kind of barriers most affect consumer behaviour. It should be noted that in Spain users of banking services have a procedure stipulated in law through which to channel their complaints and claims in respect of the services received. The Bank of Spain, as supervisor, has a special unit for this, the Claims Service, which settles any disputes in which the institutions and customers have failed to reach an agreement.

The Bank of Spain Claims Service publishes an annual report briefly describing its activities during the year. This report is useful to see the degree of customer satisfaction with banking services, compliance by institutions of best banking practices and the most controversial actions. There is no indication in the 2004 report of the Claims Service (the latest report available on its web site[12]) that Spanish users encounter any difficulty in closing current accounts. None of the claims analysed in the report refer to this issue.

This might be an initial indication that, at least in Spain, the relatively low mobility of retail banking customers is due to "natural" barriers, corresponding to consumer preferences. In any case, as mentioned in the report, mobility is higher in Spain than the EC average (6.91 years permanence in Spain against 9.74 in the EU).

This conclusion is, moreover, coherent with the report, which points out that mobility is higher on markets with lower concentration levels.

Finally, the absence of any indication of "artificial" barriers to mobility can be related to the corporate structure of financial institutions. In the case of Spanish savings banks, the presence of customers (as one of the stakeholder groups) on their governing bodies ensures adequate protection of customer interests, i.e. that the reporting mechanisms are best suited to their needs (thereby reducing hindrances to mobility).

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.

There are no such features in Spain. Spanish financial institutions have been setting up their own associations to administer the interconnection and interoperation structures. These associations are open to new members on equal conditions as the Spanish institutions. They are generally, moreover, not capital intensive so any initial outlay is not inhibiting for new members.

This notwithstanding, these associations have legitimate systems for weighting votes and representation according to the degree of use, which formulas have been established by consensus among all the member institutions and do not contemplate any discrimination based on the country of origin.

In the case of clearing houses –transfers and debits–, the current participation model does not make any constraints on competition. There are two levels of participation in the clearing house and clearing process, direct and indirect, thus favouring the participation of all kinds of institutions.

[12] http://www.bde.es/informes/be/merecla/2004msr.pdf

Direct participation is limited to institutions with a turnover equal to or greater than 0.5% of the total, purely for reasons of operating rationality and to avoid excessive technical complexity; other institutions participate through a direct participant. Bearing in mind that interchanges are bilateral, with no central node, it would be neither operative nor technically fiable for all institutions to participate directly.

Furthermore, the current model has the advantage of enabling the smallest institutions with smaller technical capacity to offer the same functions as the large institutions, without requiring a vast technical or economic effort, thanks to the commitment of direct participants to represent them. Indeed, the functions are exactly the same for direct and indirect participants.

Finally, in Spain, there are not typical "tie-in" arrangements (the obligation for merchants of accepting debit and credit of the same bank provider). The "honour-all-cards" rule applies and all merchants have to accept any card no matter the issuer. The "no-surcharge rule" also applies in that merchants can not surcharge customers using cards. According to theoretical and empirical predictions, all these facts foster customer mobility and convenience as well as the full accomplishment of network economies in the retail payment market.

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

Interchange fees play a vital role in bilateral markets, where the cost is balanced between the two customers parties to a transaction. Numerous academic studies indicate that this transfer of cost from one side of the market to the other can lead to an optimum distribution of the cost between the participants, thereby fostering development of the market and the economy overall.

In the case of payment cards, the function of interchange fees has been given special attention by prestigious academicians (Rochet, Evans, etc.), who consider generally accepted principles for bilateral market organisation applicable. These studies reveal that, by eliminating interchange fees, the market equilibrium may result in a welfare loss. The existence of some kind of interchange fees represents the optimal equilibrium compared to any kind of intervention of regulation of prices. Economic theory and experience with regulatory interventions in many countries indicate that bilateral markets should be treated differently than standard vertical (one-sided) markets. In these payment systems, heavy-handed regulation of prices is the public policy of last resort. It should only be adopted when there is a recognized market failure of the sort that cannot be remedied by less interventionist means. There is no evidence that such market failure exists in the markets for the provision of credit or debit card network services in Spain.

In these cases, traders obtain several benefits from charges made against a card: smaller cost, greater security of collection and even larger volume of sales (due to convenience and instant credit facilities offered by payment cards). These benefits justify a transfer of the cost borne by the card issuer to the acquiring merchants.

Similar effects may be produced in credit transfers or direct debits, albeit in a smaller proportion. In general, the transfer of costs between the two sides of the payment chain, embodied in the interchange fee, is important whenever the originator of the transaction obtains greater benefits for its activity from electronic payment than those obtained by the other party involved.

With regard to these transactions –credit transfers and direct debits–, the need for interchange fees might decrease insofar as institutions become free to establish commercial relationship and prices with its customer. Thus, the credit institutions will assume its costs, that will recover by passing them on in the price. The problem of eliminating interchange fees is that it would not be possible to offer a service marked by the absence of cost for the party receiving the transaction, which are widely used by customers.

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

In our opinion, the SEPA initiatives should be based on three pillars: standardisation of payment interchange instruments; freedom of financial institutions for the creation or contracting of payment services with suppliers; and the establishment of a set of rules ensuring that the actions by the service providers do not limit competition.

Standardisation is important in that it favours interbank operations. These standards should be decided within the sector, without prejudice to promotion by the European Commission, acting at times as arbitrator or stimulator of the process. Member States should undertake to converge their current national standards with the European standards to facilitate the greatest possible market integration.

A diversity of service providers is essential to guarantee competition and stimulate innovation. The final system is open to pan-European, interconnected national and global suppliers, the latter being service providers with a scope extending even beyond Europe.

From the point of view of competition, it will be necessary to ensure that the rules for participation in systems, networks or service providers are not abusive, nor limit the parties' contracting freedom.

Although the market will be able to establish the most adequate instruments and infrastructures, to provide the best service to customers, including local demands, the authorities should ensure that those infrastructures enable the implication of all participant entities in decision-making processes, and that they are balanced in their price policy. Both aspects are determinant in order to ensure there is no implications in terms of competition. *In this regard, participant entities should be allowed to participate directly in the ownership structure, according to criteria based on the proportionality of the volume of transactions; moreover, entities should be entitled to exercise their rights on an individual basis or jointly with other participants.*

F. Other issues

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

The most important factor to guarantee competition is a homogenous working and operating framework: same obligations and same possibilities.

The rules and regulations governing institutions are very important in respect of obligations. It is important within SEPA that the institutions from different countries have similar rules and obligations, otherwise those subject to stricter requirements will be at a relative disadvantage.

As regards possibilities, it is essential that the same options exist in the consideration of services and fees. The fee system must necessarily conform to free market rules and must be applicable to both private and public customers. The authorities cannot stipulate prices above the rates considered standard across the EU.

In short, legislation and service aspects must be reviewed from the point of view of competition among institutions and, therefore, the same rules; in other words, harmonisation within the EU.

General questions:

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

- [x] Yes, fully
- [ ] The report was too general
- [ ] The report was too technical

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

- [ ] about right
- [x] not sufficiently detailed
- [ ] too detailed

3. Did the information contained in the report was:

- [ ] generally new to you/the retail banking industry;
- [x] 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;
- [ ] challenge your/industry's views on the operation of the retail banking market
- [x] represent a mix of both aspects

5. Did the report raise the right policy issues;

- [x] yes, covered most of the key issues;
- [ ] no, there were some significant issues left out.