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EXPERT FORUM OF
FINANCIAL SERVICES USERS

Providing expertise for policymakers

**RESPONSE TO THE COMMISSION'S
INTERIM REPORT II REGARDING
THE SECTOR INQUIRY ON RETAIL
BANKING, MORE SPECIFICALLY
CURRENT ACCOUNTS AND RELATED
SERVICES**

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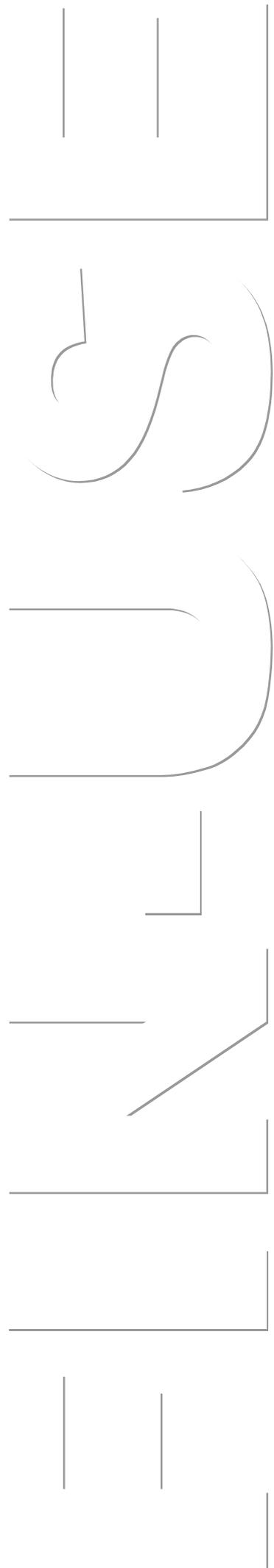
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PRELIMINARY REMARKS

Retail banking is of enormous economic significance to the economy of all Member-States. As the Interim Report states, it represents over 50% of total banking activity in Western Europe generating gross income of €250-275 billion, equivalent to approximately 2,5% of total EU GDP.

Although the Interim Report examines services more closely related to current accounts, one must keep in mind that financial services are not only of economic significance to consumers and SMEs. They are also indispensable and at the core of their everyday life and conduct of business. Financial services play a crucial role in the social existence of consumers and small businesses. The importance of credit availability (including access to one's own bank account as well as access to mortgages, credit cards, and overdraft credit), old age pension arrangements, insurance against risk, and the integrity of savings vehicles is undeniable.

FIN-USE welcomes the sector inquiry under Article 17 Regulation 1/2003 on retail banking and appreciates the factual findings of the Interim Report in the retail banking services. Nevertheless, FIN-USE believes that the findings would need to be complemented by information gathered from customers (consumers and SMEs) themselves through representative associations or through agencies, public or private, which are active in the field of consumer support in financial services. In any case, the Report provides valuable information that will serve as a good basis for developing a cohesive strategy for improving competition in the retail banking market. A strategy, which, according to FIN-USE, should aim at encouraging banks to meet customer needs more fully, which in turn benefits the economy as a whole and leads to greater welfare.

FIN-USE's comments on the Report are presented in the form of answers to questions put forward by the Commission under point 10.3. of the Report "*Issues for consultation*". Questions that are related to mainly economic analysis, like Q.2 and Q3 were not treated.

1. MARKET STRUCTURE AND FRAGMENTATION

Question 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?

Market fragmentation can be structural, regulatory and/or behavioural. One factor for the fragmentation of Europe's retail banking sector can be found in its history. In Europe, retail banking has traditionally been based on national legislation and retail



banks have operated within national boundaries. This has also influenced customer behaviour, which will take time and effort to change.

FIN-USE believes that an important factor of a structural nature for market fragmentation is the lack of an efficient infrastructure for non-cash payments. The current payment infrastructure in Europe is outdated and a reflection of a situation when Europe was divided into national states where payment infrastructure was more of a hub-and-spoke system, whereby the national central bank acted as the hub and neighbouring clearing banks as the spokes. Payments cross border had to be routed via a network of correspondent banks. This structure is nearly intact and it is therefore important that EU countries develop a new payment infrastructure given that integration in trade has advanced a lot. Payment infrastructure in many instances is lagging behind trade in goods and services leading to inefficiencies in the internal market and costs for consumers and other users. The Single European Payment Area (SEPA) is therefore a much-anticipated development.

With respect to regulation, according to the Report, the existence of widely differing consumer protection rules in EU Member States is often cited as a barrier to market integration in retail banking, (page 37 of the Report). FIN-USE does not agree with viewing national consumer protection laws as an obstacle to the creation of a pan-European financial services market. Legislation is the expression of each nation's social culture. Consumer protection legislation reflects important differences in the use of financial services among Member States. There are still important differences in national markets and therefore it should not be surprising if there are different needs for consumer protection. Complying with these laws imposes costs on market participants.

The question, however, is whether the benefits of these laws exceed their costs. FIN-USE believes that these laws, developed over many years and reflective of the diverse cultures that make up the EU, should not be lightly dismissed. Instead, an empirical case must be made for why the potential benefits of a bigger market outweigh the costs of doing away with existing consumer protection laws. To our experience, these laws not only protect the most vulnerable members of our society, but are also vital to the sustainability of the political and economic structures of the EU.

Instead of being an obstacle to reform in the financial services sector, as is implied in the Report, consumer protection rules can, according to FIN-USE, be a tool to enhance the confidence of consumers as they cautiously venture cross-border for financial products or services.



2. | ENTRY BARRIERS IN RETAIL BANKING

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

The most important entry barriers are well described in the Report and the facts are supported by statistical information. Consumer behaviour can also be seen as a significant entry barrier, not easy to describe in a Report. It is difficult for a new actor to gain trust as a solid and reliable bank - especially with private customers. In addition to that, consumer confidence in cross-border purchases is negatively affected by uncertainty as to the availability of legal protection, after-sales service and dispute resolution.

FIN-USE would like to add that being able to offer customers a branch network is very useful to keep and attract customers. Such networks are, however, very costly for newcomers to establish and thus may be an entry barrier.

Question 5: Where does competition law have a role in tackling entry barriers in retail banking?

For markets to be efficient and competitive, it is essential that all companies are given an equal ability to compete. On this issue, competition law has a role in tackling entry barriers so that, small as well as large banks, obtain fair access terms for the provision of payment services from infrastructure holders.

However, situations may arise where competitive problems exist but cannot be dealt with under competition legislation. If a retailer uses pricing in an attempt to prevent competitors from entering the market, this may infringe competition rules. It may only be prohibited, however, if the company seeking to exclude competitors has a dominant position in the market. If several non-dominant companies, acting independently of one another, set prices that deter other actors, this does not usually conflict with competition rules. This demonstrates that it is not obvious that competition law alone is an efficient means to provide non-discriminatory access to the payment infrastructure.

FIN-USE believes that this needs to be addressed since the importance of efficient access by banks to common platforms can hardly be underestimated. Banks wishing to meet end-users' demands in terms of financial services must be able to link basic payments services such as cards, giro transfers and direct account transfers to the customer's transaction account. This in turn assumes that the bank has access to the infrastructure underlying the payment systems on non-discriminatory terms. As the transaction account represents a gateway to other banking services, such as savings



products, deposits and credits, this issue crucially determines how competition develops in markets in the banking sphere.

In sum, FIN-USE believes that regulatory reform may be needed to ensure that banks obtain fair access terms and a level playing field to the benefit of end-users.

Question 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?

A. As regards credit databases.

FIN-USE recognises that credit databases are useful for lenders and that the management of such databases by incumbents may give rise to competition concerns. As these databases are operated in the form of joint ventures between banks and their associations, banks may be not so willing to allow full access to information to other institutions. Therefore, banks participating in the database have a competitive advantage. In order to tackle this problem, the Commission's most recent proposal contains provisions aiming to guarantee mutual access to existing private and public databases on a non-discriminating basis.

Nevertheless, FIN-USE cannot but emphasise the fact that credit databases are a sensitive issue for consumers. A more widespread use of information from databases brings to the fore the regulation of the databases, for example which criteria must be met before data are communicated and what information (and when) a registered consumer should be entitled to access. It would also be vital that different databases use the same definitions and parameters when determining different levels of default on payment, and apply the same maximum periods for data storage, after which the data must be destroyed. Furthermore, it is vital to press for the requirement to disclose information stored, to update the data and to report complete data.

Consequently, before access to databases in other Member States is enforced (to enhance competition in retail banking), the rights of consumers in relation to the credit recording systems should also be ensured. Consumers have a right to be informed about the existence and content of collected data and informational self-determination. They must have access to clear and straight-forward procedures to correct data and to have false information deleted, to block information in cases of disputes, to know to whom information is disclosed, to stop marketing as well as special safeguards for sensitive information and for the use of historical data.

B. As regards access to payment systems and infrastructures

The largest customers of the services of payment infrastructures are often also owners. The conditions on which small and new banks are given access to payment



services are therefore partly influenced by their competitors in the market. Therefore, for large banks as co-owners of payment infrastructures, conflicts of interest may arise between the two roles of being a customer and an owner at the same time. Because of this, there is a risk that access conditions for banks to connect to essential payment infrastructures discriminate small banks versus large banks. Such discrimination can be an important barrier to entry in retail banking markets, and thus a detrimental effect on competition. This could ultimately lead to higher end-user prices.

To eliminate the risk of discrimination, it may be worth exploring the unbundling of these roles and the creation of a clearer division for the respective responsibilities – especially since many of the infrastructure providers within SEPA remain owned and controlled by the larger banks (see also answer Q 5 and 10).

3. | CUSTOMER CHOICE AND MOBILITY

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

As the Report acknowledges, consumers should have the information they need to choose the best provider and product in the market, and the ability to switch providers when a better offer appears. Any obstacles that reduce consumers' ability to switch banks will correspondingly reduce the competitive pressure on banks to win and retain customers. FIN-USE therefore believes that, from a competition point of view, enhancing customer mobility should be a goal in itself. Reduced customer mobility keeps prices high and discourages product innovation. The factual findings of the Inquiry show that, on average, EU consumers have maintained their current account with the same bank for around ten years, although national surveys show a growing dissatisfaction of consumers with the services offered by the banks.

FIN-USE agrees with the Commission as to the five factors identified in the report that reduce customer mobility. Furthermore, FIN-USE underlines the following:

a. As to information asymmetry and low price transparency

FIN-USE believes that consumers do not have access to comprehensive information regarding the price of banking products. The information they get from the providers is partial, and mainly consists in reproducing the favourable characteristics of the product offered. These issues, together with the complexity and, in some cases, with "bundling" of different banking products, make comparing of prices and products very difficult. In addition to that, many banks adopt a non-transparent way of charging so that the consumer, even when he is aware of the price, does not understand as to which service such price is related.



FIN-USE believes that transparency in pricing and the main characteristics of products is crucial from a competition and a consumer protection point of view. Action should be taken so that low transparency is removed from retail banking. Such action should consist, *inter alia*, in establishing common rules as to the expression of pricing in current accounts, in adopting a comprehensive definition of APRC in consumer credit, so that it covers *all* kind of charges which the consumer has to pay for the credit, as well as in adopting a similar definition for home loans, and in establishing official sites comparing tariffs and charges et al. Central banks as well as the national competent authorities should supervise the market to ensure full transparency in pricing. FIN-USE agrees with the additional measure, stated in the Report, of the ex-post disclosure of prices and charges applied by banks.

Along with the importance of improved *price transparency*, it should be stressed that searching for the “best deal” involves more work for the consumer than just comparing prices. In order to make rational decisions when buying financial services, a consumer has to adopt an all-embracing approach. What services does the household utilise today and how much do they cost? What needs are the services supposed to meet – is some form of personal service required, for instance? Based on the answers to these questions, consumers can decide whether the services they are using in the household are competitive and actually meet the household’s real needs. Perhaps the household would benefit from switching banks or having more than one bank. Adopting an all-embracing approach to these questions is by no means a simple matter, and most consumers therefore need help and advice. Such support would involve providing consumers with the tools they require to act as their own financial advisers.

b. As to cross-selling and tying of banking products

Evidence in the Inquiry shows that cross-selling is very much pursued by banks especially with mortgages or loans and current accounts (consumer) and between loans and current accounts (SMEs). It also shows that indeed customer mobility is negatively correlated with profit ratios and market share.

Although cross-selling and tying of banking products can theoretically be also to the interest of the customer, in most cases it has negative effects to the customer and to competition in the market. Tying of products makes it difficult for the customer to compare prices and thus prices might be kept at a higher level than otherwise. It also happens that tied products are even less suitable for the consumer than the purchase of the products separately, but such advice is rarely given by the bank to the customer, since the bank promotes cross-selling (e.g. it is more suitable and less costly to purchase a home loan and a life insurance than a life insurance through which the home loan is paid).

Consumer associations receive many complaints from consumers in this respect: e.g. consumers who buy a car on credit and are obliged to take out Payment Protection Insurance at extremely high rates that increases the total cost of credit by more than 30%. In the case of tied products, switching costs may be much higher: e.g. in the



case of mortgages tied with life insurance, the cost of early repayment is much higher because the consumer who wishes to pay early in order to switch bank will lose premiums he has paid for the life insurance.

c. As to the closing charges

Banks charge customers for terminating their contractual relationship. Closing charges are in most cases unjustified since they can not be related to a service that is provided to the customer. In that case their sole purpose is to discourage the customer to switch bank and consist an obstacle to competition. The right of the customer to terminate a service and the right to partially or fully discharge his obligation under a credit agreement at any time before the period fixed in the agreement expires, is one of the most important tools for competition in the market. FIN-USE believes that early repayment fees should be implemented only if and to the extent they are related to a loss suffered by the bank due to the early repayment. Eliminating and/or reducing early repayment will encourage customer mobility and force banks to offer better prices and services to their clients.

d. As to the administrative burden

The administrative burden especially for switching bank accounts can be particularly heavy. As the Inquiry implies, proper regulation and provisions should be put in place which would require banks to facilitate the switching procedure and eliminate any cost for the customer. According to FIN-USE, one way of addressing this problem would be within the SEPA. This can be achieved by developing common technological solutions and standards that facilitate the possibility of introducing automatic transfers of all services associated with that account, such as direct debiting, wage and benefit payments, to the account in the new bank.

Self-regulatory codes can be very useful in Member States which have the culture of self-regulation, but can prove useless for other Member States in which service providers are not familiar with adopting and observing self-binding rules.

Apart from removing obstacles to customer mobility, FIN-USE believes that the Commission should also consider the fact that some banks refuse to open a current or a savings account for an increasing number of consumers, even if these products are basic requisites in society (salary payments, rent payments etc). In some Member States, access to an account is a legal right, but in others, it is not. This leads to financial exclusion of consumers on discriminatory and certainly non-transparent grounds.



4. DEVELOPMENT OF PAYMENT INFRASTRUCTURES IN THE CONTEXT OF THE SINGLE EURO PAYMENT AREA

Question 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.

Competition issues related to infrastructure access are well known in modern economics. The way payment services are operated often differs from other infrastructure markets in the sense that they are not operated by a public utility. Instead they are often operated by a number of banks that jointly own and set the conditions for access to this infrastructure. In practice, only large commercial banks and banks that have joined in the international cooperation of cooperative banks and savings banks have been able to provide international payment transfer services. Therefore, the 'Single Euro Payment Area' project is useful and well-founded. In principle, it creates the necessary groundwork for unified payment system that covers the whole EU in which all retail banks can join. However, the largest banks will still be central actors in providing payment transfer services between EU countries.

FIN-USE wishes to especially highlight the problem that some operators often have a dual function, namely owning and operating an infrastructure that is necessary for other market participants to utilise whilst, at the same time, also selling services in competition with other market participants. The incumbent operator might charge prices for access to the infrastructure that means that competitors in the downstream market are put at a competitive disadvantage. This might occur even if the incumbent's company downstream meets the same prices as its competitors. An economic loss in the incumbent's downstream company is more than off-set by the profits in the incumbent's upstream company.

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

Interchange fees are not necessary for the development of bank giro and direct debit system in the market. Interchange fees serve other purposes which, according to the Report, were not clearly justified by the banks. Even if we consider that, to some small extent, interchange fees have a role to play for the development of payment instruments, evidence in the Commission's Report shows that interchange fees affect competition between banks in many ways: the cost for providing the service to a customer is rendered opaque, with the consequence that they raise the final price for the customer. FIN-USE wishes to see further investigation on this issue as well as to all issues related to access to the payment systems (structure, fees, and eligibility criteria).



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

The development of the SEPA means radical change for the current infrastructure. Any delays or inconsistent implementation of SEPA will take a long time to rectify and the consequences for consumers and for business in the EU might be considerable. To avoid such consequences and to stimulate development towards increased customer choice and better payment services, FIN-USE concludes that the following basic issues need to be taken into serious consideration and dealt with in an appropriate way:

- The body setting the conditions for SEPA will be a joint venture by the participating European banks. This is a very delicate structure and the planned Payment Services Directive must make sure that conflicts of interest are dealt with appropriately and that new entry to the market is not hindered by the operation of SEPA. For example, the separation of scheme from processing is a vital component of the SEPA initiative. But without effective separation there is high risk that the desired competitive environment will not happen. FIN-USE believes that scheme and processor separation should be mandatory and there should be a mechanism in place to ensure compliance.
- FIN-USE is of the opinion that experience of the payment industry clearly shows that efficient supervision and enforcement measures are essential. In order for supervision to be efficient there must be high standards on transparency, and there is also a need for appropriate sanctions and appeal procedures. This facilitates prompt interventions on infringements. Supervision should be given priority, especially during the initial period. As supervision on terms of access will include analysis and assessments that are common practice in competition law, there are enough grounds to press for national financial supervisory authorities to cooperate with national competition authorities on this important aspect.
- FIN-USE believes that pricing of services provided by infrastructures cannot be determined through self-regulation alone. For entry conditions to be fair and non-discriminatory, the planned Payment Services Directive must make sure that the use of discounts are not motivated by differences in costs.
- FIN-USE stresses that information-sharing structures, such as in payment systems bodies etc, may constitute platforms for infringements of art 81. Even if this kind of cooperation sometimes improves efficiency, there are also risks involved. Competitors may gain a greater insight into one another's operations than is strictly necessary for the management of their joint activities, which may restrict competition since it provides knowledge of rival costs, structures and business plans.



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

FIN-USE believes that if users are to benefit from competition it is critical that good, unambiguous and reliable information should be available about products and services on offer. This should allow users to make informed decisions.

Consumers continue to receive insufficient price information regarding the payment instruments available to them. A problem here is the no-surcharge rules, which prevent price discrimination between payment instruments at the point of sale. FIN-USE is of the opinion that no-surcharge rules should be abolished. This would enable merchants to recover their costs for card fees whilst allowing for increased economic efficiency because cardholders will be provided with better pricing information on the costs of different payment instruments. Such a solution may also increase merchant acceptance, as those merchants who refuse payment cards because of costs may begin to do so. (see also FIN-USE response to the Commission's Interim Report 1 on Payment Cards).

CLOSING REMARKS

The findings of the Commission's Report show that, despite the convergence that has taken place in the euro area in the recent years, market fragmentation in retail banking and a large dispersion across Member-States in the level of monetary financial institutions vis-à-vis households and non-financial corporations' interest rates (MFI interest rates) continues to exist. The same findings are also found in the harmonised statistics on MFI interest rates published recently by the European Central Bank (*Differences in MFI interest rates across euro area countries, September 2006*). Among other potential explanatory factors for this divergence, like regulation and taxation, the factors cited for this dispersion are market structures and degree of competition in the relevant sector. At the same time, the Commission's sector inquiry in payment cards reveals high interchange fees in a market, which is still lucrative even if they are not applied.

Moreover, the recent ECA Report on Competition Issues in Retail Banking and Payments Systems Markets in the EU (*May 2006*) identifies low customer mobility and unnecessarily high barriers in access and governance of payment systems as sources of restrictions on the process of competition in financial markets, which have serious negative effects on prices, innovation and efficiency.

FIN-USE, therefore, voices its concerns as to the level of competition in retail banking. FIN-USE believes that further investigation is needed at all levels, national and European, so as to ensure that all factors that support anti-competitive practices are removed.