NON-CONFIDENTIAL VERSION

BARCLAYS BANK PLC RESPONSE TO

THE INTERIM REPORT II ON

CURRENT ACCOUNTS AND RELATED SERVICES

OF 17 JULY 2006

EXECUTIVE SUMMARY

Barclays fully supports the objective of the European Commission to remove barriers to competition in the EU25 retail banking sector and allow companies the freedom to enter domestic financial services markets in all EU25 Member States through acquisition, branching or cross-border services.

Barclays has, however, some significant concerns with the preliminary findings in the Interim Report, primarily in relation to the financial and economic analysis undertaken for the purpose of assessing the level of competition in the EU25 retail banking sector. In this regard, Barclays has identified specific weaknesses in the European Commission's analysis that render it unreliable.

Areas of concern

The European Commission's financial and economic analysis is not sufficiently robust. In particular, the following inappropriate measures have been employed to analyse the intensity of competition:

- The absence of a clear and consistent definition of the relevant product market;
- The use of a profitability measure that is not widely used by banks or competition authorities; and
- The use of comparisons of data across banks and member states which do not compare ‘like with like’.

Areas of Agreement

Barclays agrees with the European Commission that the following issues require concerted, co-ordinated action by all stakeholders:

- the lack of national access to credit and fraud data that acts as a potential barrier to entry for new entrants in a number of EU25 Member States;
- country-specific rules, regulations or practices that impede the ability of new entrants to compete or offer pan-European products and services need to be addressed; and
- public ownership of banks and other forms of government/state intervention which distort competition.

Barclays also agrees with the European Commission's findings concerning some of the positive features of the UK retail banking sector, such as competition and availability in the provision of credit data, widespread multi-banking, minimal cross-sectoral restrictions and low barriers to competition in the UK. We are also pleased to note the European Commission has recognised the benefits and effectiveness of self-regulation in the UK.

Appropriate way forward

Barclays considers that consumers, businesses and the UK economy as a whole benefit from effective competition in the UK retail banking sector. The challenge for the European Commission is to work to remove the unnecessary barriers to competition presently featured in some EU25 Member States, without inadvertently undermining the effectiveness of the UK sector.

In addition the European Commission must address the flaws in the methodology and analysis identified above before seeking to rely on its findings going forward.

We trust the views and perspectives of Barclays are a useful contribution to the public consultation process and we welcome any further opportunities to participate in the process leading to the final report of the European Commission at the end of 2006.

1. INTRODUCTION

Barclays is a UK-based international financial services group engaged primarily in banking, investment banking and investment management. In terms of assets employed, Barclays is one of the largest financial services groups in the EU25. Barclays has been involved in banking for over 300 years and operates in over 60 countries with more than 110,500 permanent employees. For more information about Barclays, please visit www.barclays.com.

Barclays strongly believes that measures that enable banks to operate as easily in their home Member State as in other Member States will benefit not only consumers, but also businesses and the EU25 economy as a whole. Such measures must enable, rather than prevent, the market to find the optimum solution. Regulation, which may bring unintended consequences, should only be considered as a last resort and after careful impact assessments.

Barclays sets out its response to the Interim Report II on Current Accounts and Related Services ("**Interim Report**"), which was published by the European Commission ("**EC**") on 17 July 2006 below. After setting out Barclays areas of agreement with the Interim Report, this response provides general feedback on financial and economic analysis as well as feedback on specific findings. In addition, the response focuses on the specific findings relating to Spain and the UK as Barclays has its main EU25 retail banking activities in these jurisdictions.

In the interests of keeping this response as short as possible, Barclays has not commented on all the points raised in the Interim Report. Any silence on a particular point should therefore not be interpreted as any indication that Barclays agrees with any statements or analysis set out in the report.

In particular, Barclays is still considering the impact of SEPA on the EU25 retail banking sector and accordingly detailed comments have not been included in this response. Barclays does however note that it supports the creation of an open market in which SEPA will be able to thrive, and recognises the important role the European Payments Council has in helping to achieve this.

2. AREAS OF AGREEMENT

Barclays agrees with a number of general statements made by the EC in the Interim Report, as well as a number of specific statements made in relation to the UK and Spain:

2.1 Access to credit data

Barclays supports the EC's finding that the lack of access to national credit and fraud data may be a potential barrier to entry for new entrants in a number of EU25 Member States.[1] Credit data should be as accessible across the EU25 as it is within the UK.

[1] See pages 141-148 of the Interim Report.

Information asymmetries between new entrants and incumbents represent significant barriers to entry. For example, the biggest single difficulty for a new lender is the lack of data for credit scoring purposes.[2] Whilst this is referenced within the draft Consumer Credit Directive[3] and the EC's Mortgage Credit Green Paper[4], Barclays believes that this is an area worthy of specific attention by the EC. Lack of credit data means that new entrants are significantly disadvantaged.

Barclays believes that the UK model for accessibility of credit data could effectively serve as a template across the EU25 to alleviate potential barriers to entry. As acknowledged by the EC, credit data is readily accessible in the UK with a number of credit data providers providing choice in relation to the source of credit data. For example, lenders can purchase credit data from a choice of third party providers, such as Experian, who also provide other credit risk products to businesses.

Effective access to credit data stimulates competition in retail banking as lenders develop sophisticated credit tools and compete on the quality of risk analysis. Off-the-shelf and bespoke score cards can also be purchased by lenders and entry is facilitated by the ready availability of credit data.

2.2 *Public ownership of banks*

Barclays agrees with the EC's finding that public ownership of banks (including golden shares) may constitute a regulatory barrier to competition.[5]

2.3 *State assisted products and entities*

The EC is concerned that discriminatory privileges for specific banks may distort competition in the EU25 retail banking sector. In this respect, Barclays notes that the EC is currently investigating whether Crédit Mutuel has been overcompensated for distributing Livret A and Livret bleu products in France.[6]

2.4 *Burdensome national regulation*

The EC recognises that divergent national rules may act as a barrier to market integration in the EU25 retail banking sector. In particular, the EC observes that the

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[2] See '*Accentuating the positive: sharing financial data between banks*', OXERA paper, December 2005, previously provided to the EC on 3 February 2006 (see e-mail from Alan Ainsworth to Paul McGhee, 3 February 2006).

[3] See Modified proposal for a Directive of the European Parliament and of the Council on credit agreements for consumers amending Council Directive 93/13/EC (COM(2005) 483 final).

[4] See '*The Integration of the EU Mortgage Credit Markets*', Report by the Forum Group on Mortgage Credit.

[5] See page 38 of the Interim Report and EC Press Release IP/06/865 "*Free movement of capital: Commission calls on Hungary to modify privatisation framework law*", 28 June 2006.

[6] See EC Press Release IP/06/746 "*State aid and Freedom of establishment: Commission examines fees paid for the distribution of French savings bank and initiates proceedings over special rights to distribute them*", 7 June 2006.

national implementation of consumer protection rules may lead to unequal burdens on market participants.[7]

Barclays acknowledges the tension between national legal frameworks and the integration of the EU25 retail banking sector. Although such regulations may not have a direct discriminatory impact, they may impose excessive burdens on cross-border providers of financial services (such as rendering certain business cases unviable, imposing high compliance burdens and hindering the development of pan-European product and service offerings). The following are examples of such regulation:

- the high tax burdens and associated notary fees in Italy;
- the lack of flexibility in labour market and high social charges and tax on salaries in France; and
- the high burdens relating to stability rules in Portugal.

Barclays agrees that burdensome national regulation may be a contributing factor to any fragmentation of the EU25 financial services sector. It is therefore vital that the EC also tackles such regulation under the internal market provisions of the EC Treaty.

In addition, some national regulations may fall to be addressed within the scope of EU competition law. For example, Spanish consumer and data protection laws establish stricter requirements than exist in other EU25 Member States. These laws may prevent standard direct marketing activities, which may hinder the entry of entrants that are reliant on this distribution channel and reduce product competition.

2.5 Specific UK findings

Barclays agrees with the following statements made by the EC in relation to the UK, which support Barclays belief that there is effective competition in the UK retail banking sector:

2.5.1 *Benefits of self-regulation*

The EC finds that self-regulation, such as the UK Banking and Business Banking Codes, pursue objectives that are generally desirable and which may not efficiently be attained by legislation.[8]

Barclays supports measures which promote competition, such as the UK Banking and Business Banking Codes, which, among other measures, assist individuals and small and medium sized enterprises (SMEs) to switch banks as speedily as possible. As acknowledged by the EC, there is a very high level of compliance with these codes in the UK.[9]

[7] See page 37 of the Interim Report.

[8] See page 28 of the Interim Report.

[9] See page 117 of the Interim Report.

Barclays agrees that the UK self-regulation measures may serve as an effective example for emulation by those EU25 Member States where such measures do not presently play a significant role. Self-regulation measures may help to ensure a competitive and open environment in other EU25 Member States.

2.5.2 ***Minimal cross-sectoral restrictions and lowest barriers to competition***

Barclays agrees with the EC's finding that the UK has minimal cross-sectoral restrictions and the lowest barriers to competition in the EU25.[10] As demonstrated by BSCH's acquisition of Abbey National (Abbey), features of the UK banking sector facilitate new entry through acquisition.

2.5.3 ***Multi-banking and multi-sourcing***

Barclays notes the EC's finding that UK consumers, on average, have more than two current accounts per capita (i.e. multi-banking).[11] Multi-banking[12] and multi-sourcing[13] practices are direct evidence of effective competition and customer choice in the UK.

2.5.4 ***Competition in the provision of credit data***

As explained above, Barclays agrees that there is competition between 'credit bureaux' in the UK and 'other databases' and that credit data is readily available.[14]

2.6 Specific Spain findings

Barclays agrees with the following statements made by the EC in relation to Spain:

2.6.1 ***Low national concentration***

The EC notes that the Spanish banking sector is one of the least concentrated among the EU25 Member States.[15] As explained above, Barclays considers that it may be inappropriate to rely on the concentration ratios used by the EC as they are not calculated with reference to any markets. However, Barclays agrees with the view that the national concentration levels in the Spanish banking services sector are low.

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[10] See page 38 of the Interim Report.

[11] See pages 23 and 68 of the Interim Report.

[12] Receiving one type of banking service from more than one bank e.g. operating two current accounts with two separate banks.

[13] Using products or services from more than one bank and/or financial services provider e.g. operating one current account with one bank and one lending product with a different bank/financial services provider (also known as multi-homing).

[14] See pages 142 and 146 of the Interim Report.

[15] See page 48 of the Interim Report.

2.6.2 *Customer churn*

The EC finds that Spain is one of the EU25 Member States with the highest customer churn.[16]

Although Barclays generally questions the EC's methodology in relation to customer churn, as multi-banking and multi-sourcing are not taken into consideration, Barclays agrees that there is high customer churn in Spain.

2.6.3 *Credit data*

Barclays agrees with the EC's findings that both negative and positive data are accessible via the Bank of Spain's public register. In addition, further data is available via private credit reference agencies and the debtors' public register.

3. FEEDBACK ON FINANCIAL AND ECONOMIC ANALYSIS

Barclays wishes to express its concern that the European Commission has not undertaken a sufficiently robust analysis to assess the level of competition in the EU25 retail banking sector. In this regard, Barclays has identified below the specific weaknesses in the analysis which serve to undermine its reliability.

The EC reaches many conclusions regarding retail banking service providers and customers' behaviour without a clear and consistent definition of the relevant product market. The EC claims that it is not necessary to define the relevant market.[17] However, its conclusions, such as those relating to market concentration, are of limited relevance in the absence of an appropriate market definition.

As discussed below, the absence of a market definition analysis leads to flaws and unwarranted conclusions in relation to the market structure and concentration, the financial performance of retail banks, pricing, and customer choice and mobility.

3.1 Data measurement

Barclays considers that the EC's conclusions on retail banking profitability and customer behaviour are based on data which may suffer from various measurement problems. Although some of these problems are acknowledged in the Interim Report, the EC should not seek to rely on this data as part of any subsequent investigation.

3.1.1 *Differences in services banks provide across banks and Member States*

The EC acknowledges that the data supplied by banks is affected by differences in the services they provide or in their interpretation of what constitutes "*retail banking*". It accepts that data was provided by different

[16] See page 102 of the Interim Report.

[17] See page 44 of the Interim Report.

banks *"according to their [banks'] own firms-specific definition of retail banking"*.[18]

However, the analysis in the Interim Report implicitly assumes that services, costs and pricing policies are homogeneous across individual banks and EU25 Member States. As products, costs and pricing policies are not homogeneous, the analysis would not be comparing "like with like" and would not therefore provide the basis for robust conclusions.

For example, in its pricing analysis[19], the Interim Report uses individual charges like interest rates and account management fees to compare prices across regions. This analysis ignores differences in product offerings and pricing strategies across banks and Member States.

As such pricing strategies vary across banks (particularly in highly competitive markets where banks will use product innovation to differentiate themselves from competitors) any comparison of the prices of individual services will be highly misleading

3.1.2 ***Differences in the way data has been compiled across individual banks or the EU25***

The EC uses data on income from retail banking services to assess market concentration and profitability.[20] This analysis requires that all banks provide data on a consistent basis using the same definition of *"retail banking"*.

However, as noted above, the EC leaves the banks the freedom to define retail banking in their own terms. The Interim Report acknowledges that "*the inclusion and exclusion of customers from these segments [private, retail and corporate banking] depends to a large part on cultural habits, market development or the individual business strategies of banks"*.[21] It is therefore clearly inappropriate to draw conclusions based on comparisons of this data across individual banks or the EU25.

In addition, the EC's analysis of profitability relies on the OECD data, which is not consistent across banks because, again, they depend on banks' definitions and methodologies of measuring costs, income and assets.[22]

[18] See page 60 of the Interim Report.

[19] See page 90 of the Interim Report.

[20] The EC specified 9 retail banking products: personal current accounts, deposit and savings accounts, consumer loans, mortgages, credit cards, SME current accounts, SME loans, SME credit lines and SME leasing (see page 60 of the Interim Report).

[21] See page 13 of the Interim Report.

[22] The OECD document outlining how figures on income, costs and profitability were calculated frequently contains phrases like "*this item generally includes...*" and "*may include in some cases...*" (http://www.oecd.org/dataoecd/50/44/2373422.pdf (see page 1 of OECD data)).

Again, it is clearly inappropriate to draw conclusions based on comparisons of this data across individual banks or the EU25.

3.1.3 *The use of inappropriate measures of the intensity of competition*

Although EC focuses on specific retail banking services, it then uses such analysis to draw conclusions regarding all retail banking services. It does not substantiate the implicit assumption that the services examined are representative of all retail banking services.

The EC acknowledges that the number of current accounts *"is certainly not suitable for calculating market shares"*[23]. Barclays agrees that this is the case because this variable fails to capture the volume of transactions or the value of balances. In addition, any market share analysis based on this variable ignores competition in the provision of other retail banking services such as consumer term loans, mortgages and credit cards.[24] Therefore, the concentration measures that the EC uses to support its conclusions (based solely on the number of current accounts)[25] will clearly be a misleading indicator of competition in retail banking as a whole.

The EC uses gross income from current accounts to assess market structure and concentration.[26] Again, the Interim Report does not substantiate the implicit assumption that gross income from current accounts would be representative of income from the provision of all retail banking services.

The EC's conclusions on price dispersion are based on the analysis of individual charges applying to individual products and services (e.g. interest rates for outstanding amounts charged to specific customer groups).[27] There is no reason to believe that these individual services are representative of the wider range of retail banking services.

In a similar manner, the EC relies on switching rates of current accounts to reach conclusions on customer mobility in retail banking across the EU25 as a whole.[28] However, there is no reason to conclude that switching levels of current accounts are representative of switching levels for other retail banking services.

In addition, the EC's switching analysis will have underestimated the level of switching by not considering multi-sourcing, multi-banking and inactive accounts:

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[23] See page 44 of the Interim Report.

[24] See page 60 of the Interim Report.

[25] See pages 50-51 and 53-56 of the Interim Report.

[26] See page 49 of the Interim Report.

[27] See page 82 of the Interim Report.

[28] See page 98 of the Interim Report.

- UK customers increasingly use more than one bank or other financial institution to provide their retail banking services. For example, they may have a current account with one bank, a mortgage with a second financial institution and a credit card account with a third provider. The EC's analysis of current account switching ignores competition in these other services.

- In addition, the EC notes that UK customers have on average 2.4 current accounts.[29] As in practice some customers may have a dormant current account where they have switched to a new current account provider without closing their current account at their previous bank, the EC's analysis does not pick up such "hidden" switching.

3.1.4 *Data measurement errors*

The data used by the EC suffers from significant measurement errors.

For example, the Interim Report calculates concentration ratios using data that fails to cover all banks and/or retail banking services. The estimated coverage of the number of current accounts in different Member States varies between more than 90% and less than 30%, that of gross retail income between more than 90% and less than 50%, and that of gross income on current accounts between more than 90% and less than 20%. Such low rates of coverage are not representative and are likely to introduce significant measurement errors in the analysis.[30]

Given the low rates of coverage the EC is forced to use extrapolations. However, depending on the approach to extrapolation used, the CR3 concentration ratio for the UK in terms of share of current accounts varies between 73% and 39%. Variations of such scale might be indicative of significant data measurement errors.

3.2 Feedback on individual streams of analysis

3.2.1 *Financial performance of retail banks*

The EC finds that profitability of retail banking varies widely across the EU25.[31] In particular, the EC applies a pre-tax profit to gross income ratio as a measure of profitability,[32] which is not widely used by banks or regulators.

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[29] See page 23 of the Interim Report.

[30] See page 46 of the Interim Report.

[31] See page 81 of the Interim Report.

[32] See, for example, page 59 of the Interim Report.

In particular, Barclays assesses the profitability of its retail banking business on the basis of the return on economic capital.[33]

The EC does not methodologically justify its choice of profitability measure. Economic and financial literature suggests that Internal Rate of Return and Net Present Value are the conceptually correct measures of profitability of an economic activity.[34] In the absence of such justifications, the conclusions based on this profit ratio have no economic significance.

The EC does not provide any benchmark to assess the relative level of profitability, in particular, whether the observed profit levels are higher or lower than would be expected in competitive retail banking markets.

The EC also does not consider the impact of the business cycle in its profitability analysis.[35]

The potential inaccuracies attributable to the use of pre-tax profit to gross income ratio are further entrenched by the EC's methodology employed in examining the relationship between profitability and other market conditions.[36] For example, the EC visually analyses the relationship between these variables without providing any statistical tests to assess the strength of the alleged relationships between the variables.[37]

In addition, even where statistical tests are provided, such tests are statistically unreliable, unfounded and/or unsound. The EC provides no theoretical framework for the various models implemented, or explanation as to why certain statistical pitfalls are avoided.

First, despite concluding that the profits and cost-income ratios variables are clearly negatively correlated,[38] the EC neither comments on or provides a measure of the strength of the relationship between these variables.

Second, the EC considers that there is a positive relationship between profits and sizes of a bank. The conclusion is based on a variable's positive coefficient in a model where the profit ratio is defined as being a function of the bank's size. [39] This model is flawed in several ways.

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[33] See Barclays' response to the Commission Interim Report on Payment Cards for an extensive critical discussion of this profitability measurement.

[34] The financial literature shows that it is possible to establish a theoretical link between the IRR economic concept and accounting rates of profitability such as ROCE (See *Assessing profitability in competition policy analysis*, OFT Economic Discussion Paper 6 (page 41)).

[35] See page 72 of the Interim Report.

[36] See pages 76-80 of the Interim Report.

[37] See pages 76-80 of the Interim Report.

[38] See pages 75-76 of the Interim Report.

[39] See pages 77-78 of the Interim Report.

- the EC fails to provide a rationale as to why the size of a bank determines its profits, why it is not the other way around, or why profit and size are not determined simultaneously. These issues cast doubt on the statistical validity of the Interim Report's findings;
- the EC fails to provide a measure of statistical significance of the relationship it claims to have found; and
- the explanatory power of the Interim Report's models is extremely low with only 0.3% to 0.4% of the variation in profit ratios being explained by variations in banks' sizes.

Third, the EC examines the relationship between cost ratios and bank size. The EC again does not provide any theoretical rationale for such a relationship between cost ratios and bank size.[40] Further, the Interim Report does not contain a statistical measure of significance of its findings. The explanatory power of the model employed is also extremely weak with only 2% of the variation in cost-income ratios being explained by variation in the size of a bank.

Fourth, the EC states that "*the inquiry has shown that banks' profitability tends to be lower in markets where customers are more mobile*".[41] This statement is incorrect as it contradicts the EC's own finding regarding the relationship between profitability and customer churn which concluded that "*we do not observe a clear pattern in this relationship*".[42]

3.2.2 *Specific Issues relating to the UK and Spain in the profitability analysis*

The EC's observation that banks' profitability in the UK and Spain increased depends on the period considered.[43]

The profitability data for Spain also exhibits at least one significant outlier.[44] Excluding this outlier from the analysis suggests that profits for Spanish banks have not increased between 1988 and 2003.

In the case of the UK, profits stayed approximately constant between 1996 and 2003.

3.2.3 *Customer choice and mobility*

The EC comments that customer mobility in retail banking appears fairly low and that banking relationships are long.[45]As part of its analysis of the

[40] See page 79 of the Interim Report.

[41] See page 10 of the Interim Report.

[42] See page 111 of the Interim Report.

[43] See page 59 of the Interim Report.

[44] See Table 1 of the Appendix to the Interim Report.

relationship between customer mobility and market performance, the EC finds that customer mobility is negatively correlated with typical indicators of market power. In particular, the EC finds that customer mobility tends to be lower in EU25 Member States where banks are more concentrated and more profitable.[46]

Despite concluding on the relationship between these variables, the EC fails to provide any statistical measure, which must have been readily available, to assess the strength and statistical reliability of the alleged findings. In this manner, the EC provides neither a theoretical rationale for its model specifications nor an explanation of why common statistical pitfalls are avoided.

In relation to its analysis of the relationship between current levels of longevity and current levels of cross selling, the EC concludes that there is a negative relationship between the two variables.[47] If at all, current levels of longevity should be affected by past levels of cross selling. The analysis of longevity and cross-selling might also suffer from an endogeneity problem,[48] in which case the statistical findings would be invalid.

Although the EC acknowledges that changes in the demographics affect the churn analysis, it does not control for these effects.[49]

The EC's customer churn analysis may underestimate the level of switching as it does not consider inactive accounts. The EC does not take into account the possibility of consumers having more than one current account, one or more of which might be inactive. For example, as explained above, the EC notes that UK customers have, on average, 2.4 current accounts.[50] This suggests that the EC has underestimated the real level of current account switching.

The EC's conclusions relate to current accounts only and thus do not consider the level of mobility vis-à-vis other (non-current account) products.

The EC concludes that customer mobility in retail banking appears low at 7.8% of retail customers and 12.6% of SME customers in 2005.[51] It is not clear that this figure actually is low since the Interim Report does not provide

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[45] See page 120 of the Interim Report.

[46] See pages 111-113 and 120 of the Interim Report.

[47] See page 113 of the Interim Report.

[48] An endogeneity problems arises when an independent variable included in the statistical model is potentially a dependent variable, and is correlated with variables which are not reflected in the model but are instead reflected in the error term.

[49] See page 99 of the Interim Report.

[50] See page 23 of the Interim Report.

[51] See page 9 of the Interim Report.

a benchmark, such as the level of switching that might be expected in a competitive retail banking market, against which to compare these numbers. In any event, Barclays finds that the customer churn in Spain (14% per year) is among the highest among EU25 Member States and is considerably higher compared to the EU15, EU25, and NMS averages.[52]

3.2.4 *Pricing*

The EC finds that the prices for payment services vary significantly across the EU25.[53]

Barclays considers that limited reliance should be placed on this finding, as it does not relate to a relevant product market. In addition, the EC conclusions concerning variation in prices are not based on a comparison of like-for-like products. In particular, the EC does not explore the link between prices and the level of usage. If the provision of some banking services is subject to economies of scale, then differences in prices might be explained, at least in part, by differences in the level of usage in individual EU25 Member States.

In addition, price comparisons in terms of interest rates outside of the Euro-zone, in particular, the UK, are irrelevant since the interest rates set by the relevant central banks might differ.

3.2.5 *Access to payment systems*

The EC finds that payment system fees could potentially be considered as a barrier to entry for new or small players. In particular, regressive fees may influence banks with low transaction volumes (such as new entrants) in their choice of market entry.[54]

Despite regressive fee structures being very common in financial services and other industries, the EC does not provide a rationale for its conclusion that such fee structures are anti-competitive. The EC does not consider justifications for these fee structures, such as high fixed costs and economies of scale.

The EC does not indicate what proportion of costs per transaction is represented by a transaction's price. This makes it impossible to establish the relationship between fees and costs.

The EC does not discuss the link between costs and prices per transaction for the company that facilitates the transaction.

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[52] See page 100 of the Interim Report.

[53] See page 90 of the Interim Report.

[54] See page 138 of the Interim Report.

The EC's terminology in its conclusion on transaction fees implies that incumbents are always and exclusively large banks. Such a finding is not supported by the data.

3.2.6 ***Interchange fees***

The EC questions the need for interchange fees for direct debits and credit transfers.[55]

The EC does not provide any evidence that interchange fees are anti-competitive.[56]

4. FEEDBACK ON SPECIFIC FINDINGS

Barclays disagrees with a number of specific statements made by the EC in the Interim Report, some of which are made in relation to the UK and Spain:

4.1 Specific UK findings

Barclays sets out comments on the EC's specific UK observations below.

4.1.1 ***Customer Churn***

Customer churn is an important competitive constraint because Barclays has to compete to replace customers lost through customer churn.

The EC finds that the UK has among the lowest rates of consumer churn.[57] However, it is unclear as to what customer benchmark or data has been used.

Barclays disagrees with the EC's UK churn observations, as the EC's methodology fails to take into consideration the widespread multi-banking and multi-sourcing practices in the UK.[58] In any event, Barclays agrees that there is high customer churn for SMEs in the UK.[59]

4.1.2 ***Barriers to switching***

The EC cites a recent UK survey reporting that 23% of banking customers were dissatisfied with their current account and that of this share three-quarters believed that switching was administratively too difficult. In fact this figure is sourced from a 2005 press release of Abbey,[60] which is not

[55] See pages 133-134 of the Interim Report.

[56] See general comments on interchange fees in the Barclays response to the Interim Report on payment card services, 21 June 2006 (paragraph 7.2).

[57] See page 102 of the Interim Report.

[58] See pages 23 and 68 of the Interim Report.

[59] See page 102 of the Interim Report.

[60] See footnote 130 of the Interim Report.

representative of either Barclays consumer satisfaction or indeed overall UK satisfaction levels.

The EC also cites a 2005 Consumers' Association survey which reported that 44% of switchers experienced some inconvenience and 15% lost a payment.[61] Barclays disagrees with these figures, as it is well documented that most UK customers do not encounter any difficulties in switching banks, and that switching has been facilitated by recent market developments such as adherence to switching timescales and technological improvement.

In relation to SMEs, the Warwick Business School Survey[62] stated that *"results indicate that all sizes of SMEs find switching banks to be relatively easy. If the inertia of non-switching is indeed due to perceived complexities of the switching process, the above evidence suggests these perceptions are unfounded."*[63]

Independent market studies have found that individuals in the UK can also easily switch banks and do not face any obstacles or difficulties.[64]

The EC itself acknowledges that in the UK there is a very high level of compliance with the UK Banking and Business Banking Codes.[65] As acknowledged by the EC, multi-banking and multi-sourcing practices are widespread in the UK.

Barclays notes that the EC is keen to hear the views of market participants on the appropriate tools to address information asymmetry and transparency, particularly for consumers, in the EU25 retail banking sector.[66]

In this respect, Barclays considers that consumers and SMEs have a number of information channels available in order to compare retail banking products and services in the UK. For example, in addition to being published on the Barclays website, comparative tariff details are available online from the British Bankers Association and Moneyfacts (moneyfacts.co.uk) for SMEs. Further, there are a significant number of third party comparison websites that

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[61] See page 93 of the Interim Report.

[62] *"Finance for Small and Medium-sized Enterprises - A report on the 2004 UK survey of SME Finance",* Warwick Business School Survey.

[63] See section 6.3 of the Warwick Business School Survey at page 92.

[64] See, for example, *'Which? Heralds changes to the banking code as green light for switchers'*, Which? Press Release, 27 February 2003.

[65] See page 117 of the Interim Report.

[66] See page 118 of the Interim Report.

collate and compare the prices of a wide range of products from a number of providers (e.g. uswitch.com and moneysupermarket.com).[67]

4.1.3 ***Access to payment systems***

The EC finds that some features of the UK payment systems sector may present difficulties for new entrants. For example, the EC states that the eligibility criteria for a UK payment scheme, such as the need to become a shareholder of the owner of the infrastructure, may, in certain cases, make it more difficult to join the system as a direct member.[68] The EC also finds that the corporate governance of UK payment systems may raise barriers to entry for new or small players[69] and that the cost of access to payment systems is prohibitive.[70]

Barclays considers that any concerns with the UK payment systems have been, or are being, addressed by the on-going scrutiny of the UK Office of Fair Trading Payment Systems Task Force ("**Task Force**"). Barclays and other UK banks are co-operating fully with the Task Force. The Task Force is identifying, considering and seeking to resolve any competition, efficiency and incentive issues which may exist relating to payment systems. The Task Force has already issued a number of recommendations affecting the access and governance arrangements of BACS, such as user participation and membership criteria.[71]

4.1.4 ***Higher account management fees***

The EC finds that in the UK account management fees are on average higher but that average fees per payment are lower than the EU25 average.[72]

Barclays does not charge personal customers management fees for core retail banking services. Personal customers who choose value added account packages (offering features such as travel insurance and car breakdown cover) pay a fee for these additional benefits. In SME banking, all business start-ups have free banking for a year with no management fee. Established businesses have a choice of tariffs:

- the standard tariff has no management fee and pays credit interest. Transactions are charged at competitive rates.

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[67] See "*Customers can click on advice beyond compare - online information: websites that take the hard work out of choosing the best financial products are a valuable and growing service"*, Financial Times, 16 September 2006.

[68] See page 130 of the Interim Report.

[69] See page 130 of the Interim Report.

[70] See page 141 of the Interim Report.

[71] See "*BACS Access and Governance*", A report prepared for the Payment Systems Task Force by the OFT, March 2006.

[72] See page 152 of the Interim Report.

- the Free Automated Tariff charges a monthly fee, however customers have unlimited free automated transactions.

In addition, the EC will be aware that comparative reports relating to the global and EU25 retail banking sector have consistently found that the price of core retail banking products and services in the UK are amongst the lowest.[73]

4.1.5 ***Competition in the UK SME banking sector***

The EC reports that the Competition Commission conducted an investigation into the UK SME banking sector between 2000 and 2002, which showed a high concentration level, restricted competition between suppliers and some high barriers to expansion.[74]

At the time of this investigation, Barclays considered that competition for the banking business of SMEs was intense, evidenced by the fact that the prices paid by Barclays SME customers had been steadily falling in real terms for a number of years for a standard basket of services. Barclays considers that competition in the UK SME banking sector has further increased since 2002. This is attributable to a number of market developments, such as the increasing number of financial services providers (including banks), increased levels of switching, and increased multi-banking and multi-sourcing.

4.1.6 ***Concentrated nature of UK banking sector***

The EC states that the UK banking sector has a relatively low CR3 compared to other EU25 Member States but a relatively higher CR5.[75]

As explained above, Barclays considers that it is inappropriate to rely on these concentration ratios as they were not calculated with reference to any relevant markets. In particular, the concentration ratios for individual product areas may vary considerably. In addition, as explained above, these concentration ratios are likely to be flawed because the EC has not used comparable data across banks when calculating the ratios.

4.1.7 ***Geographic scope of UK banking sector***

As part of its regional analysis of the UK banking sector, the EC does not appear to view England and Wales, Scotland and Northern Ireland as separate markets. Barclays agrees such segmentation is not appropriate and adopts a UK-wide approach to pricing. Barclays thus believes that the relevant geographic scope of each of the UK retail and SME banking sectors to be UK-wide.

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[73] See, for example, Capgemini World Retail Banking Report, 27 May 2004.

[74] See page 24 of the Interim Report.

[75] See page 48 of the Interim Report.

4.1.8 *Profitability in the UK banking sector*

The EC observes that profitability has increased in the UK banking sector since the mid 1980s.[76] In particular, according to the EC, UK banks sustain pre-tax profitability ratios of about 40% and are "always" above the EU25 average.[77] The EC has based this statement on data covering only the last three years, and accordingly the use of "always" is incorrect.

Barclays has fundamental objections in relation to the EC's profitability analysis. In particular, the EC's analysis implies such profitability should be viewed negatively without providing a benchmark of what should be expected either in a competitive market or a comparable industry.

As explained above, Barclays disagrees with the approach to assessing profitability used in the Interim Report. As a matter of principle, Barclays does not agree that conclusions on the effectiveness of competition can be drawn from an analysis of profitability. In any case, the approach used in the Interim Report does not reflect either business realities or sound economic principles.

The EC has also not explained whether the profitability figures relate only to UK banks' retail banking operations or their overall global operations. In this respect, Barclays highlights that its non-retail banking activities significantly contribute to its overall profitability.

As acknowledged by the EC, the UK is among the countries with the lowest cost income ratios, consistently reporting levels at or below 60%.[78] Such cost ratios imply that the profitability of UK banks could be explained by their efficiency.

4.1.9 *Gross income from credit cards*

The EC finds that UK banks derive the highest gross income from credit cards (€137 per customer).[79]

As previously discussed with the EC, the UK credit card market is mature and is the largest in the EU25 with an estimated 60% of credit cards issued in the EU25 being issued in the UK.[80] As credit cards are used more intensively in the UK (in terms of number transactions and balance amounts), it is natural that the gross income deriving from credit cards will be higher. In any event,

[76] See page 59 of the Interim Report.

[77] See page 73 of the Interim Report.

[78] See page 74 of the Interim Report.

[79] See page 65 of the Interim Report.

[80] See presentation of Alan Ainsworth to the EC, 26 January 2006 and also Barclays response to the Interim Report on payment card services, 21 June 2006.

the level of gross income does not suggest anything about the nature of competition in the UK credit card sector. In particular, it might simply reflect the fact that customers in the UK have a stronger preference for using credit cards than customers in other EU25 Member States.

There is intense competition in relation to the issuing of credit cards in the UK. Consumers switch readily between providers and forms of consumer credit in the UK (e.g. from store cards to credit cards via balance transfer) often at no, or little cost. In addition, UK consumers typically hold a number of credit cards from different issuers.

There are many issuers of credit cards and other forms of consumer credit in the UK. These include US players (e.g. Bank of America (MBNA), Capital One and GECF), large EU25 banks (e.g. Banco Santander), large retailers (e.g. supermarkets) and smaller providers (e.g. egg).

4.1.10 *UK Mortgage sector*

The EC finds that despite differences in long-term interest rates and housing market structures, there is little variation in the level of gross income per customer in mortgage products among Germany, France, Italy and the UK.[81]

Barclays considers that the EC should not take any action on the basis of this analysis as the EC is looking separately at the cross-border provision of mortgages.[82]

4.2 Specific Spain findings

Barclays sets out comments on the EC's specific observations on Spain below.

4.2.1 *Cross-sectoral restrictions*

The EC notes that Spain has among the strictest cross-sectoral restrictions in the EU25, particularly in relation to restrictions on providing insurance services, even through a subsidiary.[83]

Barclays has not experienced any barriers in relation to the provision of insurance services to its customers, which it does through a number of subsidiaries.

In addition, Barclays notes that the Spanish legislation applicable to insurance services has recently been amended. Legislation implementing the Directive on insurance mediation[84] came into force in July 2006.[85] The directive is

[81] See page 70 of the Interim Report.

[82] See '*The Integration of the EU Mortgage Credit Markets*', Report by the Forum Group on Mortgage Credit.

[83] See pages 36-37 of the Interim Report.

[84] Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation.

aimed at harmonising subsisting differences between national provisions in relation to insurance mediation. Its implementation may therefore have a future impact on the preliminary conclusions reached by the EC in its interim report.

For these reasons, Barclays considers that the EC should not take any action on the basis of its preliminary conclusions in the interim report in relation to Spain.

4.2.2 ***Profitability in the Spanish banking sector***

The EC notes that profitability has significantly increased in the Spanish banking sector between 1981 and 2003.[86] In particular, according to the EC, Spanish banks sustain pre-tax profitability ratios of about 40% and are "always" above the EU25 average.[87] The EC has based this statement on data covering only the last three years, and accordingly the use of "always" is wrong.

Barclays has fundamental objections with the EC's profitability analysis. In particular, the EC's analysis implies such profitability should be viewed negatively without providing a benchmark of what should be expected either in a competitive market or a comparable industry.

As explained above, Barclays disagrees with the approach to assessing profitability used in the Interim Report. As a matter of principle, Barclays does not agree that conclusions on the effectiveness of competition can be drawn from an analysis of profitability. In any case, the approach used in the Interim Report does not reflect either business realities or sound economic principles.

The EC has also not explained whether the profitability figures relate only to Spanish banks' retail banking operations or their overall global operations.

In addition, similarly as in the UK, the EC acknowledges that Spain is among the countries with the lowest cost income ratios, consistently reporting levels at or below 60%.[88] Such cost ratios imply that the profitability of Spanish banks could be explained by their efficiency.

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[85] Ley 26/2006 de mediación de seguros y reaseguros privados, 17 July 2006.

[86] See page 59 of the Interim Report.

[87] See page 73 of the Interim Report.

[88] See page 74 of the Interim Report.

4.2.3 *SME credit lines*

The EC finds that SME credit lines generate over one quarter of Spanish banks' gross SME income.[89]

Barclays notes that the findings mirror the nature of the Spanish SME banking services sector. SMEs in Spain operate their business primarily through credit lines, which provides them sufficient liquidity to run their business.

4.2.4 *Spanish mortgage sector*

The EC finds that Spanish banks derive the highest gross income from mortgage products (€1,787 per customer).[90]

Barclays notes that the level of gross income does not suggest anything about the nature of competition in the Spanish mortgage sector. This figure should be taken into consideration with any peculiarities of the Spanish mortgage sector.

The mortgages sector in Spain is very competitive, with a wide range of the banks and savings banks offering mortgages, as well as a number of Internet banks and new entrants (e.g. ING Direct).

In addition and as mentioned above, Barclays considers that the EC should not take any action on the basis of this analysis as the EC is looking separately at the cross-border provision of mortgages.

4.2.5 *Access to payment systems*

The EC finds that some features of the Spanish payment systems sector may present difficulties for new entrants. For example, the EC notes that minimum levels of activity required for a Spanish payment scheme, may, in certain circumstances, make it more difficult to join as a direct member.[91] The EC also notes that the corporate governance of Spanish payment system may raise barriers to entry to new of small players.[92]

Barclays disagrees with the EC's analysis and does not consider that the Spanish payment systems present difficulties for new entrants. In effect, there are currently several foreign banks operating in the payment scheme and banks can operate both through the established payment systems as well as though other means, such as bilateral agreements.

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[89] See page 66 of the Interim Report.

[90] See pages 69 and 70 of the Interim Report.

[91] See page 130 of the Interim Report.

[92] See page 130 of the Interim Report.

4.2.6 ***Geographic scope of Spanish banking sector***

As part of its regional analysis of the Spanish banking sector, the EC does not appear to identify any particular regional markets in Spain.

Barclays agrees that a segmentation of the Spanish market is not appropriate and adopts a Spain-wide approach to pricing. Barclays thus believes that the relevant geographic scope of each of the Spain retail and SME banking sectors to be Spain-wide.

4.3 ***Savings and co-operative banks***

Despite the current infringement proceedings relating to Sparkassen in Germany[93], Barclays notes that the EC does not highlight the anti-competitive elements of the ownership restrictions applicable to savings and co-operative banks in various EU25 Member States.

For example, Italian co-operative banks are shielded from takeover. In particular, where the shares of such banks are listed, Italian banking law provides that a shareholder is only entitled to exercise one vote irrespective of the size of its shareholding.[94] It is therefore impossible in practice to acquire control of an Italian co-operative bank. Nevertheless, Italian co-operative banks can and have been consolidating, and several co-operative banks now feature amongst the top 10 Italian banks.

In Spain, savings banks can acquire non-savings banks, while non-savings banks cannot acquire savings banks. Instead of share capital, savings banks in Spain have "Participation Quotas", which are a hybrid between bonds and equities. Participation Quotas are issued by the founding entity, usually a local or regional government and other public institutions. Savings banks account for approximately 50% of the Spanish banking sector.

[93] See EC Press release IP/06/870 '*Banking: Commission calls on Germany to modify its rules on use of the name "Sparkasse"*', 28 June 2006.

[94] Article 30, Italian Banking Act 385/1993.

5. CONCLUSION

Barclays has significant concerns that the EC has not undertaken sufficiently robust analysis to assess the level of competition in the EU25 retail banking sector. In particular, the EC has not defined the market and has used an inappropriate methodology to assess the impact of profitability.

However, Barclays agrees with the EC's findings in relation to access to credit data, country-specific rules, regulations or practices preventing pan-European product and service offerings, public ownership of banks and ownership restrictions for savings and co-operative banks. These issues require concerted, co-ordinated action by all stakeholders. In particular, in relation to access to credit data, Barclays believes that the UK model for accessibility of credit data could effectively serve as a template across the EU25 to alleviate potential barriers to entry.

Barclays would welcome any further opportunity to participate in the consultation process leading to the final report of the European Commission at the end of 2006.

Barclays Bank PLC
9 October 2006

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