

Posteitaliane

Divisione BancoPosta
Direzione Marketing

Roma, 3 Luglio 2006

UE- Interim Report – Payment Cards

FEEDBACK FORM

Name of undertaking: Poste Italiane S.p.A.

Industry (network, current/potential acquirer, current/potential issuer, processor, other third party provider (e.g. merchant service provider), merchant (industry needs to be specified), other): Poste Italiane is a debit and prepaid card issuer and offers financial services (checking accounts, postal savings etc) also in co-branding with other financial institutions.

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Participated in the questionnaire:

Yes

Specific questions from Executive Summary:

A. Financial analysis of the industry

1. Are high merchant fees a competitiveness issue for the EU economy?

In our opinion, the impact of merchant fees on competitiveness should be assessed taking into account the system in place in each Member State to guarantee a fair remuneration to issuers and acquirers for the services they provide. In Italy, for instance, merchant fees are an essential part of the revenue mechanism, to which – currently – there is no viable alternative.

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We do believe that the system could produce revenues through other mechanisms; however, the mere elimination or reduction of merchant fees – especially in relation to debt and prepaid cards – cannot be considered as a solution in itself, unless the fees are replaced by other sources of revenues.

In our view, the current lack of harmonisation in the revenue systems across Europe, rather than merchant fees as such, is an issue for the competitiveness of the EU economy.

2. Are there compelling justifications for the comparatively high level of merchant fees observed in some parts of the EU25?

The different levels of merchant fees across Europe can be explained by taking into account the lack of homogeneity in the revenue systems currently in place. Also, not every market in Europe has reached the necessary degree of maturity to allow merchant fees to decrease. We believe that merchant fees will progressively lower, as the use of payment cards becomes more and more widespread among consumers.

3. In view of the apparent profitability of card issuing, is there a generally applicable justification for substantial revenue transfers through interchange fees in card payment systems?

It should first be noted that card issuing is not necessarily a source of profits. This is so only under some conditions and for some products. Debit cards, for instance, do not generate profits when they are delivered to the clients. Secondly, card issuers pay a fee for cash withdrawal, while obtaining revenues for payment transactions. Any change in the way the system is currently working should therefore take into account the fact that sources of revenues are limited and that – should these be abolished – another mechanism shall be established to guarantee the economic viability of the system, at least for basic services such as debit cards.

4. Are the high profits observed due to innovation or do they arise from some kind of market power in a two-sided industry?

We believe that innovation is key to the profitability of the system and to competition. Card issuers and acquirers continually engage in the design and provision of innovative services for final users.

Poste Italiane, for example, could limit its offer to products and services targeted to mass market customers, since they need basic, simple, cheap and transparent products. Instead, Poste Italiane constantly invests in innovation and believes that innovation can be bring added value to the market, to the offer and to customers.

An example of innovative product is *Postepay*, the prepaid card launched in 2003, which now makes Poste Italiane one of the leading companies in the prepaid cards sector. This

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card is unique in its product segment: in fact, it allows customers to access Poste Italiane's website to pay giros, reload mobile phones credit, etc. Another example is *PostepayImpresa*, a prepaid product which allows companies to apply for cards and recharge them through the corporate banking platform.

A remarkable technical choice in favour of innovation proved to be the totally on-line-to-issuer platform. This means that all debit and prepaid transactions must be authorised by Poste, verifying availability of funds on the card, while they are taking place. This choice has allowed Poste to offer cards to any customer, without any scoring problem, by virtue of the virtual annulment of risks for merchants.

5. What pricing practices, rules and legal provisions distort price signals to consumers and the choice of the most efficient payment instrument?

In our view, there are some pricing practices that should be eliminated, such as the surcharge on petrol payments or the commission on value change. The first one was introduced, when acquirers and issuers were integrated in the same financial institution, to balance the lower MSC paid by petrol merchants. Since the MSC is lower, the issuer can ask customers for a compensation. It is up to the issuer to introduce this surcharge. Poste Italiane decided not to do it.

The commission on value change can be charged when issuers want to cover the risk that can be generated by transactions in foreign currencies (non-Euro). In this case, one option for the issuers could be, for example, to request customers to pay a percentage of the transaction amount when payments take place outside Euro zone.

6. Would cost-based pricing promote the use of efficient payment instruments and how could such pricing be implemented?

Cost-based pricing is the system already in place for "basic" products, such as basic debit cards. However, we do not believe that it can be considered as a fit-for-all solution. "Gold" products, through which a large array of different services is provided, cannot be placed on the market according to cost-based pricing methods.

7. Do currently existing pricing practices have a substantial negative effect on cross-border card usage by consumers?

Pricing practices may produce an impact on cross-border usage mainly outside the Euro area, and limited to cash withdrawal. This operation may cost up to 3 times as much as in the Euro zone. The difference in price can be linked to the high interchange fee level that the issuer has to pay for this kind of transaction. However, it is important to specify that pricing doesn't rely on cost drivers only.

Most of all, in our opinion, the introduction of clear and homogeneous rules across the EU and the EEA may facilitate the cross border usage of payment cards.

B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

We strongly believe that harmonised rules should be introduced to facilitate the working and the structure of the SEPA. Competition would best develop in a clearly regulated environment.

9. What market structures do not appear to work well / deliver efficient outcomes?

In our opinion, domestic circuits are not the appropriate structure to achieve the SEPA. To the extent that these are governed by national rules, which are not always consistent, domestic circuits can generate obstacles.

Domestic circuits can also constitute a barrier to the penetration of international circuits in the retail market, since merchants may be discouraged from accepting them, as they benefit from lower MSCs for payments made through domestic circuits.

10. What governance arrangements can facilitate competition within and between card payment systems?

The introduction of uniform rules for the whole EEA area may have a beneficial impact on the reduction of technical and behavioural barriers. We also trust that, to reduce structural barriers, uniform standards should be defined for entities willing to enter the market.

11. What governance arrangements can incentivise card payment schemes to respond to the needs and demands of users (consumers and merchants)?

The production of reports would be useful, as it would give operators the opportunity to exchange information, understand the perception expressed by customers and identify best practices. On the other hand, qualitative researches should be encouraged and promoted by institutions.

12. What governance arrangements can allow minority participants or minority members to receive appropriate information and participate appropriately in decision-making?

Minority members should participate in the decision-making process. A consultation mechanism should be introduced in this respect, with a view to guaranteeing that the positions of all stakeholders are appropriately taken into account within sector regulatory bodies and associations.

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13. What access conditions and fees are indispensable?

In our view, while access fees are not indispensable, specific technical standards and requirements should be met as far as quality of service is concerned.

14. To what extent is separation between scheme, infrastructures and financial activities desirable to facilitate competition and efficiency?

Our view is that, at this stage, separation is not necessary. We believe that any financial institution should be free to develop its own system, if they want to. However, interoperability should be guaranteed, in order to avoid abuses and exclusionary practices (the “walled garden” scenario, for example).

C. Future market developments

15. Are significant structural changes to be anticipated in the payment cards industry?

We foresee that, in the medium term, the opening of the market will allow for more players and prices will lower significantly. Safeguards should be introduced to achieve and maintain a given quality standard in all Member States. Again, we stress the importance of the creation of a consistent and workable regulatory environment.

16. What are the anticipated impacts on the industry of innovation and technological change?

Innovation and technological change will allow the development of new segments of activities and service offers. We strongly believe that the industry has to earn from this change.

D. Potential solutions to market barriers

17. How can structural barriers to competition, which may arise for instance from the integration of different functions within a payment system or from acquiring joint ventures, be tackled?

We think that structural barriers can be overcome by the definition of technical standards. For example, if one non-bank institution is not allowed to enter into the system, this does not mean that any non-bank institution should not be allowed either. Rules should be set to define which requirements must be met to operate in the market.

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18. Are there compelling justifications for the identified possible behavioural barriers to competition?

The only barriers that can be justified are those which are necessary to ensure that – in the absence of a common regulatory framework – minimum quality standards are met.

Some of those barriers, however, do not have any acceptable justification. For instance, the requirement for a local presence in the accessed market does not seem to be proportionate to the aim of protecting consumers or the functioning of the system.

19. How much need and scope is there for harmonising technical standards in the payment cards industry? How large are the potential benefits and costs of harmonisation?

In our opinion, harmonisation is important, especially if based on essential aspects of the business. In theory, benefits seem to be higher than costs and harmonisation appears to be an important point in both developing a common SEPA and opening the market to competition. This harmonisation would also benefit market approach and interoperability.

E. Lessons for SEPA

20. What lessons (best practice) for the design of SEPA schemes can be learnt from existing national and international payment systems?

In our opinion, the choice of the international circuit as a model for a common standard is the best way to allow all actors to be part of the scheme. The international circuit is already SEPA compliant.

21. How could competition between schemes in SEPA be strengthened?

We think that in some cases, such as the SEPA, having a set of rules is indispensable to make the system work and to ensure that all customers are offered the same standard of quality.

The absence of a single scheme can encourage competition between schemes, but on the other hand, there is a risk that the scenario remains static and the present situation does not evolve. Competition within the same scheme seems to us more desirable.

22. Which structural and behavioural barriers to effective competition between banks and payment service providers should be removed to achieve SEPA?

As mentioned above, barriers that should be removed include: the need for a local presence of foreign banks (compliance with EU rules should be sufficient in this respect), differentiation between domestic and international fees, economic entry barriers.

23. What governance requirements should SEPA schemes meet?

The control on banks activities and on the introduction of too many domestic circuits, which is an obstacle to harmonisation.

24. By what means can interoperable communication protocols, security and other technical standards be achieved and certification procedures be limited to the minimum necessary?

They can be set by studying all different systems, identifying the best practice and the easiest way to standardise the system.

25. Do the removal of barriers to competition, the observance of pro-competitive governance and the creation of interoperable standards require (further) regulation?

Yes, in our opinion this is the basic point. A number of barriers is yet to be removed.

General comments:

General questions:

1. Did you find the content of the report easily accessible and understandable?
yes, fully;
2. Did you find that the level of detail in the report was:
not sufficiently detailed (the report is an analysis of the existing situation and not of future one) ;
3. Did the information contained in the report was:
mostly known to you/the payment cards industry.
4. Did the market analysis in the report:
Represent a mix of both aspects.
5. Did the report raised the right policy issues;
yes, covered most of the key issues;