FEEDBACK FORM

Name of undertaking: Netherlands Bankers' Association

Industry: Financial sector

Address: P.O. Box 3543, 1001 AH Amsterdam

Country: the Netherlands

Name of contact person: Mr. G. Boudewijn

Phone of contact person: 31.20.5502 827

Email of contact person: boudewijn@nvb.nl

Participated in the questionnaire:

□ No (some individual Dutch banks participated)

Specific questions from Executive Summary:

A. Financial analysis of the industry
Our main comments on the financial analysis, refer to the topics Interchanges, and Cash and Surcharging.

Interchanges
The report describes current and past practices regarding the use of interchange fees in several countries. The authors tend to draw some important conclusions based on differences in interchange fee mechanisms in the various countries in relation to the development of POS transaction volumes in these countries.
In this context the report mistakenly mentions the Netherlands and PIN several times as being one of the countries or systems operating successfully without an interchange fee. We ask the authors to correct the report and to reconsider the analysis and conclusions on this item.
From an outside view it may seem that the Dutch POS scheme PIN indeed operated or operates without an interchange fee mechanism. But this was and is not the case. In fact there has always been an “implicit” interchange fee till March 2004. Card issuers received the net financial result from the acquiring operation of the only acquirer Interpay/BeaNet, to cover costs on the issuer’s side.
From the moment on that the sole acquiring by Interpay/BeaNet ended (March 2004) and individual banks became acquirers for POS transactions, an explicit cost based interchange fee from acquirer to issuer was introduced that forms part of the cost base for acquirers. The underlying interbank agreement was notified to the Netherlands Competition Authority (NMa). The NMa however doubted the necessity of a multilateral interchange fee mechanism. Therefore the interchange fee structure will most likely be redesigned and be replaced by a system of bilateral interchange fees. The discussions with the NMa on this topic are ongoing.

Cash and surcharging
Regarding the possible distortion of customer behaviour and the choice of the most efficient payment instrument, special attention should be paid to the issue of surcharging. Surcharging by retailers has a considerable effect on the use of electronic POS payment methods. In the Commission staff working document “Annex to the proposal for a directive of the European Parliament and of the Council on Payments Services in the Internal Market (COM (2005) 603 of 1.12.2005) it is recognized that “*The overall cost of payment services could be reduced if the share of electronic payments would be increased and the use of cash reduced*.” (p. 10), and that “*The overall social cost of using payment services could be reduced if consumers and business selected the means of payments in a more rational way. When prices paid by users reflect the real cost value of the service, they provide an incentive for users to select services that meet their needs at the lowest possible social and private cost. This promotes the efficiency of the payment system*.” (p. 65).
It is desirable that the practice of surcharging by retailers is aligned with the above policy goal. Surcharging the *most* efficient payment method, i.e. debit card payments, without at the same time surcharging the *least* efficient payment method, i.e. cash transactions, will stimulate consumers to use expensive cash rather than their more efficient payment cards as their favourite payment method at the POS. The merchant may perceive the cost of electronic POS payments as higher than the cost of cash, because the cost of cash per transaction is not as transparent for merchants as the cost per electronic POS transaction. It is to the benefit of society and therefore consumers if the huge cost of cash payments were explicitly charged to market participants. However, externalizing the hidden cost of cash for a society is politically and psychologically not an easy task. This requires the involvement and commitment of the European and national governments, central banks, retailers and banks, in order to create common acceptance of surcharging inefficient payment methods (in practice mainly cash payments).
A second dimension of this problem is the general lack of attention for the cost of data communication (telco’s fees) in case of POS transactions. In the Dutch market, merchants bear a relatively high cost for this part of a POS transaction, and are inclined to minimize this cost not by putting united pressure on providers of data communication, but by (sur)charging customers if they want to use their payment card for low payment amounts (below € 10-€15), again with the wrong effect on market efficiencies. In the Netherlands retailers and banks are working together constructively on innovative plans to drive down the cost of cash for society, and are for instance investigating possibilities for cheaper datacom solutions to drive out surcharging at the point of sale. IP solutions and broadband datacom may be the way forward here. For the analysis of the Commission to be complete, we would advise the

Commission to more thoroughly analyze and compare the telecommunication component of the POS-costs.

B. Market structures, governance and behaviour

The NVB generally agrees with the starting points in the report of the separation of "payment scheme" and "infrastructure/processing" roles in order to potentially increase competition. For example the conclusions of Chapter IX (Integration of Card Payment Systems; page 94) describe the "vertical separation of the PIN debit card system in the Netherlands". The Dutch banking community has been very active in this respect by voluntarily setting up a new structure in the Netherlands based on separation of roles. The unbundling operation involved:

- transfer of the POS acquiring agreements from Interpay Nederland to the individual banks;
- setting up of a new company, named Currence Holding;
- transfer of the ownership of the payment schemes form Interpay Nederland to Currence Holding;
- the development of an explicit interchange fee (see under A above).

Experience shows us that the complexity of the process of unbundling the various roles (i.e. scheme-owner, processor, acquirer, issuer) should not be under-estimated and brings about new risks in the overall value chain (for instance who is responsible for communication of incidents and product issues to the overall public), new coordination costs and additional costs related to merchant acquisition and merchant servicing, which are eventually part of the payment cost base. Therefore, rigid unbundling of payment functions should not be a goal in itself, but a means to drive competition between market participants in their different roles and thus to increase efficiency.

C. Future market developments

D. Potential solutions to market barriers

Payments related legislation now differs in the various countries, leading to different opportunities for market participants operating in different countries. The SEPA Cards Framework (SCF) and also the Payments Service Directive (PSD) will form a more unified basis for future developments in the cards arena. The Dutch Banking Community is committed to the implementation of SEPA as defined by the European Payments Council including the SCF.

E. Lessons for SEPA

In Chapter XIII Paragraph 1 of the Interim Report 1, DG Competition states that the prohibition on co-branding may hinder national debit card payment systems from entering into competition with MasterCard and Visa. In this respect, DG Internal Market and the ECB have stated their concerns about the common practice of co-branding national debit products with international schemes. Both regulators feel that preserving the status quo of co-branding numerous national schemes with Maestro or Visa for cross-border usage will slow down the change process towards SEPA ("mini-SEPA"). We feel that these seemingly contradictive conclusions from the EC and ECB (on the one hand national schemes should compete with international schemes, and on the other hand national schemes to gradually disappear as from 2010) should not fuel arguments of strictly national schemes that may aim to preserve the existing market structure of co-existing national and cross-border schemes, thus not realizing the long term SEPA objectives. In our opinion, co-branding domestic and international card products is a necessary prerequisite, from a technical point of view, to migrate to SEPA in an orderly and organic way. Therefore, after 31-12-2010, there will probably still be co-branded PIN debit cards in the Dutch market, as an intermediate stage to reach the long term SEPA objectives.

<u>General comments:</u>

The conclusions of the reports are too generic, and tend to indicate they are valid for the whole EU. The report gives the impression for example, that the payment cards market does not operate well enough, profitability in general is too high (especially for issuers, but also for acquirers) and there are significant barriers for entry.
On these conclusions and the issues of interchange and cash/surcharging DG Competition should spend more time, to make clarify what the issues exactly. Reading the details of the report, we think that the conclusions on the above issues must be different per product and per country. In that respect the report does not do justice to existing differences.