

## FEEDBACK FORM

Name of undertaking: **SISTEMA 4B S.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): **Processor**

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Participated in the questionnaire:

**Yes**

**No**

Specific questions from Executive Summary:

### **A. Financial analysis of the industry**

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

*Merchant fees to businesses are a substantial part of retail banking services provided to businesses and, therefore, if the growth of electronic means of payment is accepted as a booster of the Gross Domestic Product, we can state that it is a competitive element and, as such, it must be left to the free negotiation of market players. In that sense, there is a consensus on the studies done by the European Commission with regard to the direct influence of the proportional development of the use of electronic means of payment on the positive economic efficiency and the growth of the Gross Domestic Product. Specifically, for every 10% increase in the penetration of the use of electronic means of payment, there is an increase in the Gross Domestic Product, in the European Union as a whole, of around 0.5%. In the case of Spain, a GDP increase of around 0.9% would correspond to the abovementioned 10%.*

*Due to historical reasons, Spain is a country with a high number of bank offices per person, exactly double the European average, which provokes a tough competition among banks when offering financial services to merchants. The European Central Bank Blue Book of April 2004 states that in Spain the number of banks for every million people was 966 in 2003, whilst the average in the Euro zone was 544 and 487 in the European Union. The Spanish TPV network is one of the widest in Europe, as it is shown in the report of the evolution in Spain of cards as means of payment (1999-2004), Revista de Estabilidad*

*Financiera del Banco de España, ( Financial Stability Magazine of the Bank of Spain) no 8 May 2005 (hereinafter, the “ 2005 Bank of Spain Report”).*

*This market structure of Spanish payment cards makes Spain the only member State of the European Union where levels of concentration in the acquisition market of payment cards of an international network are acceptable, below 2000 points in the Herfindahl-Hirschman Index (HHI), whereas in the same market of debit cards only Latvia shares this position of economic decentralization with Spain below 2000 HHI points. A reduction of 57% between 2001 and 2004 can be noted in the Spanish case, in accordance with page 83 of the Interim Report of the European Commission.*

*Concretely, Sistema 4B holds an issuing market share of 16,4% considered over the total purchase volume for the year 2005 and the financial entity with a highest market share within Sistema 4B 6,6%; whilst in the acquisition market for the same year Sistema 4B holds a market share of 18,29% and its more important member 5,47%.*

*In this context, competition among bank offices, which bilaterally negotiate a global package of financial services with merchants, is so intense that sometimes it makes the merchant fee fall below the interchange fee.*

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

*Regardless of the different structure of markets, in both financial or commercial segmentation terms, we believe that the simple comparison of data does not allow the merchant fees to be deemed as high and much less to estimate that the report reflects the real differences in cost components and prices. Therefore, we cannot conclude that it is a restrictive element that prevents the creation of a single payment framework in the Euro zone and in the Europe of the 25.*

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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?

*In the case of Spain, the benefits of the issuing activity are not only justifiable due to their calculation based on costs, instead they are necessary for the implementation of a card payment system, given the small percentage of penetration of this means of payment in the consumption habits of Spaniards and the high investments which are necessary to create an efficient structure. The market penetration rate is around 13.8% of the total consumption versus 22% the average of the countries in the Euro zone, while in countries such as Great Britain or France, the percentages are between 32% and 25% respectively. This is due primarily to the atypical use that is given to cash versus the use of cards in Spain as a payment method, which makes the payment cards sector in Spain immature.*

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

*In the Spanish case, the justification to the improvement of results is the high investments required to set up an efficient infrastructure, thus all the arisen opportunities to displace cash have been profited and the sustainability of the system has been achieved. At the same time, many of the support services are being provided with an aggregation scale, which does not exist in other markets.*

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

*Price schemes are free and completely transparent, without any pre-existing rule which could prevent their determination. Additionally, the Bank of Spain obliges financial entities to notify all prices as maximum prices and put them in its website and banks websites, as well as notifying clients their implementation.*

*And so for any kind of prices, thus,, consumers are aware of the prices applicable to them.*

*It must be noted that in the Spanish market there are not any pricing practices, rules or legal provisions which distort price signals that consumers perceive nor the choice of the most efficient payment instrument*

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

*We understand that the free fixation of prices is made upon competitive bases, without any dissuasive or restrictive elements, privileging the absolute availability of any means of payment.*

*In the case of Spain, there is a framework agreement on the fixation of interchange fees of transactions made by credit and debit cards , dated 2 December 2005, subscribed by the three Spanish card payment schemes, with the blessing of the main merchant associations and under the auspices of the Spanish Ministry of Industry, Tourism, Commerce and Small and Medium Undertakings (State Secretary of Commerce), whereby the levels of the applicable interchange fees are set forth among the systems for the next years.*

*Said fees are of a maximum character and will be determined on objective criteria based on costs, transparency, differentiation between credit and debit and are sustained on a compromise of progressive reduction of the same level as the applicable rates.*

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*In any case, the framework agreement establishes the commitment of the payment schemes so that from 1 January 2009 onwards they will apply maximum interchange fees that adjusted to the costs identified by an individualised cost study for each payment scheme that should be finalised by 31 July 2008, which results will be submitted to the approval of the correspondent competition authorities and whereby the average interchange fees could not exceed said maximum value.*

*To do so, the Spanish schemes have agreed upon a progressive reduction of the interchange fees during the next three years upon the entry into force of the agreement, period that can be deemed a transitory or adjustment period. This progressive reduction responds to the need that the settling of the new model does not misadjust the convergence objectives foreseen with the European Union regarding card payment market penetration, being required in this respect to preserve the efficiency of the system and the sustainability of the payment and collection infrastructures.*

*Nonetheless, in accordance with the methodology of the Bank of Spain, the weighed average interchange fee in 2004 was 1,55%. Whilst the Spanish card payment schemes foresee that, upon the same methodology, the implementation of the new model will result in weighed average interchange fees of around 0,95%, 0,90% and 0,70% for the years 2006, 2007 and 2008 respectively.*

*In this context, we can say that the level of interchange fees determined in the framework agreement will reach in its application interchange fees even below the interchange fees accepted by the European Commission in its Visa Decision of 24 July 2002.*

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

*Considering the free fixation of prices, we do not believe that there are prices or additional charges applied for the use of cards in other countries.*

*It can be concluded that in Spain transactions made with cards issued by foreign entities or which take place abroad are not discriminated at all. The same interchange fees apply to domestic and foreign transactions, insofar the cards used in transactions with a foreign element bear the MasterCard or Visa trademarks.*

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## **B. Market structures, governance and behaviour**

8. What market structures work well in payment cards?

*It is necessary to distinguish between the market structures for the marketing of products and the market structures for the provision of services.*

*The marketing structures are those of full competition among banks, in both activities, issuing and acquisition.*

*With regard to services, first, it would be needed to know which are the banks' vocation and in-house processes and which are outsourced.*

*In this scenario, it would be convenient to differentiate the typology of active players in the industry, differentiating Marketing Processors from Interbank Processors.*

*Regarding the services, it exists a broad cooperation framework among entities, which limitation is only the balance of efficiency distribution.*

*This approach of technical cooperation has its justification on the broad diversity of operational situations that require a mutual and maximum collaboration on security and fraud prevention issues.*

*The existence of vertical integration or banks control in this cooperation structures is usually rather a multiplier of exigency requirements and reinforce of horizontal improvements than a restriction of competition and market access.*

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

*The efficient activity of the market depends very much on the efficiency perimeter. Up to now any substitution of interbank operators by services provider companies has been deemed that could substitute one rigidity by another one of the same nature but without control.*

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

*Insofar it is guaranteed the access neutrality and financial and operating rules absolutely transparent, governance of payment schemes just requires that the economic rules on interbank activity are homogeneous and balanced so that there are not privileged agreements and internal considerations on interbank services.*

*The corporate governance model of Sistema 4B favours competition among its members, since there are not categories of members with different rights and obligations, nor one-way movement of information, as all the members contribute and share the same information. There are only formal differences in corporate terms between partners and non-partners.*

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

*The incentive of the schemes is to support its members' initiatives, with the broadest universal services offer, preserving competition among entities.*

*Moreover, flexibility is a characteristic of Sistema 4B model, since it allows access to its structure to entities that are not banks (i.e. Cetelem and Carrefour Financial Entity, both active in issuing and, in the past, Carrefour active in acquisition, being able to act in the issuing market if it wished).*

*This characteristic allows the members of Sistema 4B to issue without the need of acquiring, thus, there is not a vertical integration (i.e., Openbank, Iberiacard and RBC – Dexia Investors Services España SA that issue but not acquire).*

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

*Comparing to what happens in other big schemes or in other commercial business, players/licensees must only have notice of the new initiatives and/or regulation with enough time in advance, and so pursuant to the notice period conditions set forth in their membership agreements.*

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13. What access conditions and fees are indispensable?

*Access conditions should only be those determined in each market for the mere establishment of a given financial entity.*

*Regarding membership fees, they should be the equivalent to the members' participation in the total volume of the scheme, calculated upon the immobilised capital that may maintain the financial partners, if any.*

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

*In corporate terms we do not deem indispensable the separation between scheme, infrastructures and financial activities, since coordination would require important overhead expenses. With regard to operational treatment, card payment schemes are strongly integrated with the operative treatments that regulate it and their back-office, including the liquidation and settlement management.*

*Regardless of the abovementioned, it seems appropriate the analytic separation and, therefore, the economic management of a segregated activity.*

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## **C. Future market developments**

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

*The most significant change is, firstly, the one arising from the bank concentration and, thus, from the different vocation that may adopt each financial entity in this business, its territory expansion and the access to services that may have in each of its locations.*

*Secondly, the outsource strategy in an activity of 24x7 that is intense on operative and technical proceedings due to the multiplicity of environments where cards are accepted and the different technical and security solutions in each of them.*

*Thirdly, and due to the fragmentation of providers in the chain of value, which burdens the one-to-one offer, it will be required powerful CMR tools to evaluate and propose segmented solutions, many of them a posteriori in terms of proposal.*

*Fourthly, competition among operators of a given sector, including merchants and telecoms, will induce shared management strategies more complex.*

Last, the geographic dimension, in many cases of several countries, and the issuing entities will lead to a repositioning of service providers, which may be able to absorb many business proceedings, and in an extreme case, some businesses historically reserved to financial entities.

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

*The structural change procedure of the card payment industry would lead to an unavoidable slow down of innovation. Radicalism and size of changes, the increasing diffusion of cards and the high investment associated to innovation will not necessarily lead to mimetic changes, thus, each entity will have to think about the convenience of innovations. As a consequence, the cooperation models allow at least to share a big number of innovations in the technical and security field, without affecting free competition and by knowing that it will be available when needed.*

*On the contrary, the part of the innovation located outside the possible cooperation frame would mean a cost of capital to its access that could be restrictive.*

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#### **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?

*Acquisition joint ventures facilitate a very fast access to the market, favouring its development. Therefore, what favours the access to the market is that many operative*

*functions are integrated to facilitate the entry of potential players in competitive conditions, which requires that economic interbank functions are fully transparent to allow each player to build its own business plan.*

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

*Except isolated issues, there are no rational elements that induce to barriers to competition pursuant to the structural organisation of the different market players.*

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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?

*The technical harmonisation level and the transactional scope is very high and, thus, the development of the international schemes and specially, more concretely, upon the development of the EMV. In the field of devises and, as a consequence of the internationalisation of providers, we move forward to a de facto standardisation.*

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## **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?

*Cooperation already shows what are the real movement among countries within the SEPA.*

*Differentiation of products, with regard to self-regulatory framework, so that each market player is the one that can offer segmented services without differentiated proposals and consumer-oriented. Although it is not available to all final clients but to any player that may market it.*

*The commitment of the Spanish financial system in general, and of Sistema 4B concretely, for the achievement of the SEPA project in favour of more competition among entities and the unification of technological and security standards is solid.*

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

*The question is to know whether competition is among the card payment schemes or the financial entities. Competition in the SEPA framework passes through aggregations that have the operational size to be able to act in more than one market and*

*progressively establishing services in accordance with the efficiency of each process and the proximity to a consumers market dispersed by its own nature.*

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

*If the PSP refer to direct participating entities in the payment schemes, we should underline the importance of the end-to-end solvency and security. If we consider the irruption of the PSP alien to the financial system, the captivity risk and the risk of an insufficient defence of consumers' interests might affect the level of confidence in the payment systems, going even beyond the card payment system.*

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23. What governance requirements should SEPA schemes meet?

*Transparency and a good dispute settlement system, as well as a shared strong commitment for the prevention and fight against fraud, both at an information obtaining level and at the coordination level to apply efficient measures against fraud.*

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

*Independent certifying procedures, mutually recognised, are the best guarantee of interoperability with the scope as defined in SCF and which reference can be the scheme of EMV.*

*It is necessary for all the process services and euro payment infrastructure providers of the European Union to have open and common standards available, in order to guarantee operative compatibility and an effective competition.*

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

*We do not believe that it is required to create more regulation. What is important is that the financial rules on remuneration and liability guarantee the sustainability of the system. If it is not sustainable and open to any solvent player participating in the payment market will give rise to a fragmented participation of players that looking for efficiency in the processes and maximisation of their exploitation, might be against the interests of consumers and the necessary creation of confidence on the payment systems in its overall. This problem is particularly important in Spain due to the low use of cards as a payment method.*

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General comments:

*Due to the structural differences that characterise the Spanish card payment market, it is deemed that both the economic analysis and the proposed general measures do not reflect rigorously the reality of the Spanish cards market.*

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General questions:

1. Did you find the content of the report easily accessible and understandable?
  - yes, fully;
  - X the report was too general;
  - the report was too technical.
2. Did you find that the level of detail in the report was:
  - about right;
  - X not sufficiently detailed;
  - too detailed.
3. Did the information contained in the report was:
  - X generally new to you/the payment cards industry;
  - mostly known to you/the payment cards industry.
4. Did the market analysis in the report:
  - confirm your views on the operation of payment cards market;
  - X challenge your/industry's views on the operation of payment cards market;
  - represent a mix of both aspects.
5. Did the report raised the right policy issues;
  - yes, covered most of the key issues;
  - X no, there were some significant issues left out.

**Thank you for your contribution!**