EuroCommerce

FEEDBACK FORM

RETAIL BANKING SECTOR INQUIRY

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EuroCommerce

SPECIFIC QUESTIONS FROM EXECUTIVE SUMMARY

A. Financial analysis of the industry

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

   High merchant fees certainly have an impact on the competitiveness of the EU economy. This is the case for a number of reasons:

   a) Excessive fees represent an unnecessary and unjustified additional cost in the supply chain. At a time when suppliers and retailers of consumer and other goods are working together to eliminate inefficiencies in the supply chain (through efforts such as ‘efficient consumer response’ (ECR) or the introduction of radio-frequency identification), payment transaction fees remain stubbornly high. This penalises all those active in the supply chain – supplier, retailer and consumer – as well as impacting detrimentally on the competitiveness of the wider EU economy.

   b) High fees limit the competitiveness of the retail sector: A study by McKinsey found that high merchant fees are one of a number of factors limiting the competitiveness of the retail sector in Europe[1]. The merchant fees paid by retailers can amount to significant sums; for example, a leading European retailer estimates that it pays €150 million in interchange fees for card payments (excluding store cards). It is also worth mentioning that retailers operating their own payment card (store cards) are able to do so at a fraction of the cost charged to them by Visa/Mastercard and this without the economy of scale that benefit these two operators.

   c) High fees reduce the purchasing power of consumers: In a highly competitive sector with low margins such as retail, it is inevitable that these higher card processing fees are passed on to consumers through higher prices for goods across the board. Once a consumer and a merchant have agreed to make a transaction, they have effectively the same interests insofar as it relates to the act of paying. The more costs associated with making a transaction, the less consumers can spend on buying goods and services – and that is clearly contrary to their interests as consumers. It is similarly contrary to the interests of merchants – with less to spend on goods and services, consumers will buy fewer, or less profitable goods, and services, or both. In practice, merchants and consumers are jointly buying payment services; clearly then, they both want to minimise their costs in making such ‘purchases’. The providers of payment services - financial institutions and networks - might be advantaged should they pay more, but merchants and consumers are not[2], and nor is the overall competitiveness of the EU economy.

[1] Study by McKinsey & Company, “Retail’s contribution to Europe’s prosperity”, 2005
[2] Professor James L. Brown, Director of the School of Continuing Education/Center for Consumer

EuroCommerce concurs with the Commission when, in its 2003 Communication on payments in the internal market[3], it stated that efficient payment instruments and methods are essential to consumers and the retail trading sector in particular; further, that efficiency of payment systems and instruments is indeed a very practical requirement in order to meet the general expectations of payment service users, notably with regard to the price of payments amongst other factors. Current MIF agreements, which make transactions by payment cards more expensive than they should be, can hardly be called efficient and is therefore to the detriment of merchants, consumers and the wider economy. Further, the high level of the fees can in some cases dissuade retailers (especially smaller retailers) from accepting payments by card. This harms the competitiveness of small and medium-sized merchants in particular.

In Australia, in 2003, a regulation required that interchange fees in the credit card system be reduced and the no-surcharge rule be removed[4]. After 18 months, the Australian competition authorities found that retailers had passed the savings made as a result of the lower fees to consumers:

"Overall, the reform process to date has promoted more soundly based competition in the Australian payments system. The subsidies paid to many credit card users have been reduced, as reward points have been cut and some surcharging has occurred. The decline in interchange fees has also reduced merchants' costs, and we have no doubt that this is flowing through into lower prices of goods and services than would otherwise have been the case. Lower interchange fees have also seen a re-orientation of competition in the credit card market. With less interchange revenue available, issuers are now competing for cardholders by lowering interest rates, rather than through reward points."[5]

Contrary to what the banking industry had wanted us to believe, the lower level of the MIF did not cause the collapse of the payment card system. Furthermore, the profits of the banking sector did not suffer because card issuers eliminated many of the "free" gifts offered to cardholders.

d) High fees limit investment by banks and non banks in innovation: As the Commission's interim report notes, the current excessive MIF arrangements provide banks with a substantial portion of their profit. They have little incentive therefore in investing in more efficient means of payment. Instead, innovation is centred on developing services which deliver yet more income through

Affairs of the University of Wisconsin at the EFTA conference in NYC at 1 October 2003. Similar remarks were made by Professor Brown in his expert report of 4 April 2000 in the Visa check / Mastermoney antitrust litigation (Master file no. CV-96-5238, chapter III).

[3] In COM(2003) 718 final

[4] Under the Standard, the weighted average of interchange fees must be no higher than a cost-based benchmark for each scheme, calculated from the costs of transaction processing, authorisation, fraud and fraud prevention and funding the interest free period. The new interchange fees are a little over half their previous level, significantly reducing banks' costs of providing credit card services to merchants.

[5] The Evolution and Regulation of the Payments System, Philip Lowe, Assistant Governor (Financial System), Address to Payments System Conference 2006, Melbourne Business School Melbourne - 14 March 2006

unjustifiably high interchange fees. The emergence of the business card market is an example of this; such cards carry an even higher interchange fee than standard consumer credit cards, yet retailers are obliged to accept them because of the honour all cards rule (which obliges retailers to accept all products belonging to either a debit or credit card scheme).

e) High fees make it more difficult for more efficient new entrants to enter the market: more efficient systems are inevitably eschewed by existing financial institutions since they do not offer the excessively lucrative returns provided by the currently anti-competitive interchange fee system.

f) High fees allow incumbents to use their income to reinforce their market position through marketing budgets which new market entrants simply cannot match under normal competitive circumstances. The unjustifiable high fees collected by Visa/Mastercard and their member banks allow them to reinforce their market domination through advertising and sponsorship. Whilst we are not questioning the commercial freedom of payment schemes to market their products, this should not be done at the expense of merchants and consumers who end up having no choice but to pay the bills for this through higher fees and prices.

g) High fees do not only take the form of high services charges, banks also derive significant income from delaying payment of transactions balances to merchants. In some countries it can take up to 45 days for the merchants to receive payment. This must be seen in the context of banks being able to debit customers in real time when they make a transaction.

h) High merchant's fees are not the only competitiveness issue for the European economy, high consumer fees also impact on the EU's economic well-being by limiting purchasing power. Fees the consumers face can be explicit such as annual cardholder fees but there are also hidden fees which generate income for the banks. These fees include foreign exchange charges and late payment penalties.

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

We believe that it is clear from the evidence included in the Interim Report of the European Commission that the excessive level of fees are due to an abuse of market power by the banks. The inclusion of "extraneous costs" in the interchange fee has allowed banks to levy unjustifiably high fees for decades. This is a result of the lack of transparency over the supposed 'services' provided to retailers by payment systems. The lack of transparency has not received sufficient attention in the past from competition authorities. The unacceptable variation in fee levels across the EU is further evidence that the merchant fee is not truly cost-based and reflects a lack of competition in card markets in certain member states.. The variation in fees is not linked to any objective reason such as risk or longer free interest rate period, rather it is based on banks maximising their income on the local market. The report of the Commission shows that in some member states, such as in Central Europe, there is no difference in the level of fees charged for debit and credit cards, even though the costs for these two types of cards are quite different. The report also shows that the fees levied vary, within the same country, for different sectors: "acquirers in the same country pay roughly half the interchange fees costs for a credit card payment at a petrol station than for a credit card payment to an airline". There is no logical – or compelling – justification for this difference: the actual cost of processing the transaction stays the same, within the same country, irrespective of what the merchant is selling!

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?

   There is no justification for substantial revenue transfers through interchange fees from acquirers to issuers. The interim report makes clear that in 20 out of 25 member states there is no need for such substantial revenue transfers. The excessive nature of the transfers is a result of the lack of transparency surrounding the interchange fee system. It is not acceptable that retailers and consumers have been required to finance the excessive profits of the card issuers which result from excessive interchange fees. The only fee which is justifiable for retailers to pay is the cost of processing services with the prerequisite that the costs are transparent. Furthermore, excessive transfers have resulted from the use of ad valorem fees as opposed to fixed per transaction fees. A transparent cost-based system must have at its heart a fixed fee since processing remains constant whatever the amount of the transaction.

   The current excessive transfers of revenue allow issuing banks to give "free" advantages to cardholders and effectively cause the price of goods sold in shops to be higher, even for customers not using a credit card. This transfer of revenues artificially increases the profits of card issuing and renders the acquiring part less attractive. The relationship between retailers and banks is much broader than just the acquiring business and thus, typically, the negotiation between the corporate treasurer and his banker covers other banking instruments. Some of these instruments (credit lines, corporate treasury services) are very profitable and allow banks to cross subsidise their acquiring business with retailers. This again, makes the acquiring business even less attractive to non banks.

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

   The high profits arise from market power and from the distorted price signal that is given to the consumer, thus enticing customers to use their credit card over other and cheaper payments means. They certainly do not originate from innovation. If this was the case the highest fees would be observed in the more sophisticated market (Western Europe). The highest fees are, on the contrary, present in the less advanced markets.

Where innovation has taken place, benefits have not been passed on to all stakeholders in the payments chain. An example is the introduction of EMV chip card technology largely aimed at reducing fraud; retailers are required to make extensive investments in new terminals and systems but do not see any permanent reduction in fee levels, whilst those fees currently include the cost of fraud. Innovation, therefore, serves to further increase the profits banks derive from the interchange fees, and is not aimed at facilitating better service and lower prices for retailers and consumers.

Furthermore, in certain member states, retailers were given incentives to invest in EMV technology as they were told that the chip-based terminals would also handle store software applications such as store cards and store operated loyalty programmes. After implementation, some retailers have been told that they cannot operate store software on EMV terminals.

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

The lack of transparency is the main cause of the distortion of the price signal that is being sent to consumers. In most cases, merchants are not allowed to differentiate in terms of price between customers who pay with different means of payment. Merchants are also prevented by payment card scheme rules from offering discounts or surcharging consumers depending on the payment instrument used by their customers.

The result of this "non-discrimination rule" is that the consumer is under the false impression that all payment instruments – cash, cheque, debit or credit card – bear the same cost. Because of the "free" advantages associated with credit cards, many consumers choose to use, unknowingly, the most expensive means of payment. Some member states have banned this restriction; as a result, a leading retailer operating in 18 countries has launched a campaign in one such member state to increase customer awareness of the cost of credit cards. Customers were able to avoid a modest surcharge for using credit cards by switching to cheaper payment means such as debit cards. After a month, 130.000 customers had switched from credit to debit cards. This shows that if customers are made aware of the price differential, they will choose a low cost means of payment. The current scheme rule on no discounting/surcharging which still applies in the majority of EU member states prevents retailers from allowing customers the freedom to make a choice between low cost and high cost means of payment.

It should be stressed that the significance of abolishing the 'non-discrimination rule' should not be measured solely by how many companies actually choose to discount or surcharge. Rather the abolition of NDR empowers merchants in their negotiations on fee rates with acquiring banks. The threat of surcharging could be seen as an example of using stakeholder 'advocacy' to challenge the level of fees. Abolishing the NDR may also increase merchant acceptance as some merchants who currently do not accept cards due to the costs involved begin to do so.

The lack of price signals at the point of sale is exacerbated by another payment card scheme rule – the 'honour all cards rule' (HACR) which requires merchants to accept all cards carrying a certain scheme logo. For instance, the greatest increase in card use in recent years has been in the commercial card sector. These cards, issued to companies, typically carry an interchange fee up to twice as high as that for consumer cards. Because of the NDR, these higher costs are therefore passed on to all customers, even though it is the commercial cardholder who benefits.

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

The price of the different payment instruments should be transparent and should use a "cost plus" structure (i.e. the cost of processing plus a reasonable profit margin for the acquirer), which means that the merchant would know what he is paying for, would only be paying for services actually requested and received and the price of the service would be based on the actual cost of the service. Merchants should not be obliged to purchase services in a non-negotiable package through the interchange fee. "Unbundling" of the services merchants buy from payment schemes has been shown to be feasible by the German EC-Karte debit system; under that scheme, merchants can choose whether they buy just processing or additional anti-fraud services.

As a matter of principle, processing fees should be levied on a fixed per transaction basis. There is no justification for an ad valorem fee for a card transaction, processing costs remain constant whatever the amount of the transaction. This is of fundamental importance to the practicality of passing price signals to card users. The difficulty of calculating a discount or surcharge based on an ad valorem fee precludes merchants from encouraging consumers to switch to more efficient means of payment.

Merchants should be allowed to inform their customers of the real cost linked to the different payment means. They should also be allowed to offer discounts or surcharge customers according to the payment instrument used by the customer. The proposed Commission payment services directive addresses this and is an example of how legislation can be a helpful vehicle in implementing policy here.

EuroCommerce believes that the Commission payment services directive proposal, if adopted in its current format, will bring more competition to the payment market, which in turn, should have a positive effect on the fees levied for card payment. If this does not have a sufficient effect on the level of fees, EuroCommerce strongly believes that the Commission should promote, through legislation, the use of the most efficient payment means. This should be done through the implementation of the "user pays principle" and full transparency.

The introduction of new entrants into the payment system will also mean more innovation as new players have more incentive to innovate in order to have an edge on existing players.

When looking at efficiency and price signals, the focus should not only be at price signals at the point of sale. Cost-based pricing can also be implemented between the card-issuer and card holder.

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

   Existing pricing practices do have a substantial negative effect on cross-border card usage. The high-level of fees associated with cross-border transactions means that where possible, most retailers simply cannot afford to accept cross-border cards. This means that consumers are restricted in using their cards cross-border. This is especially the case with cross-border debit cards which tend to carry significantly higher fees than domestic cards.

   Of particular concern in this context is the obligation to accept costly, cross-border Maestro cards for merchants operating in countries where Maestro has become the domestic debit brand. The worst case scenario would be that cross-border Maestro fee levels become the benchmark for SEPA-compliant Maestro debit transactions.

B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

   EuroCommerce believes that the best market structure for payment cards is the structure of the efficient national debit card systems where there is no interchange fee or a cost-based, transparent, fixed per transaction fee and where all the users pay for the costs associated with the services they freely request and receive. If such a structure were transposed to the credit card market, then competition on the acquiring side would be promoted through facilitating market access to new entrants.

   An alternative system worthy of further study is that used in Denmark. Merchants pay a modest fixed amount per year for card processing services; the fee varies according to annual card transaction numbers. The annual fee for small shops is €100 per year with a maximum of €1500 for larger retailers.

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

   The lack of competition on the acquiring side and the non negotiable transfer of revenue from acquiring to issuing through the four party system raises the price of goods all over Europe (and worldwide). It also prevents millions of SMEs from accessing electronic payment systems.

As demonstrated by the findings of the interim report, there is no economic justification for the transfer of excessive revenues from the acquiring side to the issuing side, especially in mature markets. This structure, through the high revenues it generates for issuing banks, promotes the use of the least efficient means of payment and forces the merchant to include the fee cost in the price he charges to the consumer.

For competition to be meaningful, new entrants should be given a real opportunity to enter the payment market on an equal footing. This would imply that the access to clearing houses should not be limited to banks and the fees charged to gain access to these clearing houses should not be such that they negate this access. For example, a non-bank sought to enter the French market but could not get access to the clearing houses without going through banks, who charged them such a high fee that the operations were no longer commercially viable. Moreover, access to equity in clearing houses must be open to all market participants and not just banks to ensure that clearing houses treat all operators fairly.

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

Decisions affecting competition should not be made by only a certain class of members but should involve all the members of the scheme. The requirement for some members to share sensitive business information should be eliminated because this gives a clear competition advantage to a selected group of members over the rest of the members. If the affiliates of the scheme feel that an audit of the financial stability of their members is needed, then an independent body should be put in place. European oversight may be necessary here to ensure that non-banks are given fair treatment.

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

EuroCommerce believes that the anti-competitive rules currently associated with many payment card schemes are unnecessary and serve only to exclude more efficient market entrants and maximise fee revenue.

A number of changes to scheme rules are indispensable to drive a more user-centric payment card market:
- Real transparency over fees and their component costs would empower payment system users in getting a fair deal from their service providers. Changes in legislation requiring greater transparency must be reflected in both scheme rules and the reality of how acquirers and issuers operate.
- Central/"cross-border" acquiring: current scheme rules undermine the commercial viability of cross-border acquiring by requiring local interchange fees to be applied. For instance a retailer operating in Portugal may want to have his transactions processed in Belgium where card fees are lower. However, scheme

rules would require a Belgian acquirer to apply Portuguese interchange fees. Only when the Belgian acquirer is allowed to levy the Belgian fee will cross-border and central acquiring become commercially viable. For multi-national retailers, there would also be significant economies of scale and operating efficiencies in having their transactions processed "centrally". Without such a change the internal market in payment services will always remain illusory.

- routing of payments by merchants: currently merchants in most cases are unable to "route" transactions directly to the banks that issued the cards used. It is technically possible for a retailer to operate a "switch" and group transactions according to the issuing bank of the card used; they are not allowed however to liaise directly with the issuing banks to process the transactions. Clearly fees would be lower if such "routing" were allowed. In March 2005, in their decision over the 2003 Terms and Conditions of CO.GE.BAN for the service Pagobancomat, both the Italian Competition Authority and Bank of Italy have concluded that this forced routing of payments constitutes a barrier to competition and to entry and an obstacle to the deployment of technology.[6]

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

Current governance arrangements would need a fundamental overhaul to ensure that minority participants and members are not discriminated against by those dominant operators who have an interest in sustaining the anti-competitive status quo. Despite being the main payment services users, we are not party to the secret rules underpinning the payment card schemes. However, we believe that attention should be paid to the following:

- Publication of all fee levels agreed within the context of the scheme. This would provide the transparency necessary for both merchants and minority scheme members.
- Within the context of the internal market, there can be no place for local, regional or country-specific scheme rules. These should be abolished as a matter of principle.
- Rules requiring new entrants to issue a certain number of cards before being allowed to acquire transactions should be abolished. They serve only to protect the 'cosy', anti-competitive nature of the relationship between today's dominant players to the detriment of payment card scheme users. Also, such rules prevent new entrants seeking to specialise in their market offering as acquirers.

13. What access conditions and fees are indispensable?

We believe that the joining fee for scheme members should be proportionate to the service received and not a means to exclude non-financial institutions from joining. The existing joining fees, which vary from zero to several million euros

[6] Provvedimento no 54 del 30 marzo 2005, Banca d'Italia, Norme per il funzionamento del servizio Pagobancomat

- do not seem to be based on that principle. The existing structure of the fee – changing with increasing volume – also constitutes a barrier to entry.

Financial institution status, physical establishment and exclusivity requirements should disappear if a level-playing field is to be established between financial and non financial institutions and between old incumbents and new entrants. This would help open cross-border acquiring and issuing activities to new entrants (physical establishment should not be mandatory).

It is not solely a question of reviewing the access fees and conditions; it is also overseeing how they are implemented. Existing scheme members will want to minimise the number of new entrants in order to maintain their lucrative status quo. As a result, there must be some oversight involving all market players of how access rules are applied.

For example, the existing European "passport" for banks has not improved market access for foreign banks wishing to enter other EU markets. It is not just a question of changing the rules, but of making sure that they are implemented in practice.

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

EuroCommerce strongly believes that there should be more competition in the payment services providers market; separating the scheme, infrastructure and financial activities in order to allow for the entry of more players in the market is certainly a good way to obtain more efficiency and better prices for all the users of the system. The bottleneck effect (as used to be the case in the telecom market when national incumbents controlled the access to the telecom networks) should be avoided: a company should not be in a position to control the network access of its competitors. It is also important that all the payment operators are given access to the clearing houses, again this access should not be solely controlled by banks.

In any case, steps aimed at increasing competition and efficiency should not be left to self-regulation by the banks alone. The SEPA experience so far has shown that this can result in a lack of consultation of end users. Where necessary, Commission intervention may help redress imbalances in self-regulation.

It should be noted though that a high level of integration does not automatically mean a high level of fees: some countries like Belgium have only one payment service provider for debit cards and yet the fees are amongst the lowest in the EU. This is because until the late nineties, the Non Discrimination Rule was not in place and merchants could surcharge their customers when using Bancontact. This forced the payment service provider to limit the level of the fees.

C. Future market developments

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

    It is very likely that with the implementation of the payment services directive and the implementation of SEPA, some national players will disappear/ be bought by bigger international players. It is vital that this process does not further destroy competition and that it does not result in the expansion of the expensive payment systems run by Visa/MasterCard. The announcement by Belgium's banks that the low cost national debit system will be rebranded as Maestro before 2008 has confirmed merchants' fears that SEPA would lead to a migration of efficient national debit schemes towards less efficient and more expensive international schemes. This goes against the stated aim of SEPA which is to deliver more efficient payments and contribute to general EU competitiveness. The Belgian example can be contrasted with EC-Karte, Germany's national debit scheme, which has chosen the interoperability route. The EC-Karte will henceforth be accepted in points of sale in Portugal and Italy.

    Retailers expect to see banks or payment service providers focusing on one aspect of the business (acquiring or issuing or processing) and to become the best in class in that field who would then drive competitiveness. This would benefit all users of payment systems, including consumers and SMEs.

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

    If implemented, more - and transparent - competition will lead to more innovation, which will benefit both retailers and their consumers.

    Innovation is certain to bring significant change to the payments market in Europe in the foreseeable future. Mobile payments, contactless payments and such like will impact the way consumers, merchants and service providers interact. Policy-makers should not seek to impose one technology over another. Rather they should ensure that there is sufficient transparency and competition in the relevant markets. New methods of payment should not be built on the same anti-competitive basis as existing card schemes.

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?

    In order to eliminate structural barriers to competition, all infrastructures should be non-proprietary or at least interoperable in such a way that facilitates market access to new entrants and to non bank payment service providers.

Also, merchants do not believe that these membership requirements should include the obligation to be a financial institution or to be controlled by one, as this hinders non-bank payment services providers from entering into competition with acquirers. EuroCommerce also does not understand the reason – other than limiting competition – for the requirement for a local establishment to become a member of the domestic card payment system. This seems to be in contradiction with the proposed payment services directive and internal market principles.

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

    There is no justification – other than a wish to maximise profit and the wish to minimise competition – to the behavioural barriers to competition. The barriers that have been identified by the Commission, for acquirers or for issuers (high level of joining fees, prohibition of co-branding with non banks) have only one goal: hindering the market access of new operators.

    There should be no confusion between rules necessary for financial stability (prudential requirements for banks) and behavioural barriers aimed solely at limiting competition.

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?

    We believe that interoperability should be the target, not necessarily full harmonisation. However, should the Commission conclude from the study that broader harmonisation is necessary, then harmonisation should be proportionate to the needs of all players. Retailers should be included in the debate, especially concerning the distribution of costs.

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?

    The SEPA schemes should be based on existing best of breed national cards; competing SEPA card schemes should not necessarily be based on a four party system with a multilateral interchange fee. The best model should be based on the very efficient national card schemes where there is no fee going from the acquiring bank to the issuing bank. It is worth mentioning that the report observes that several national card schemes function perfectly well without interchange fees, which counters Visa and MasterCard's continuing claim that interchange fees are indispensable to the functioning of the scheme.

Merchants particularly do not wish to have Maestro becoming the benchmark for SEPA cards as this would mean that the most efficient countries would be penalised. We also do not want, as it is often announced, the SEPA standard to be based on the average fee levied in Europe today. We believe that the fee should be cost-based, transparent, fixed per transaction and should relate to that part of processing that benefits the retailer only.

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

Competition between schemes in SEPA depends heavily on the implementation of NLF – including its Title II – that will allow non bank payment service providers to compete with banks. SEPA should not become a mere promotional tool for Visa/MasterCard and should not result in the disappearance of existing efficient national cards systems. Competition is only going to be effective if it goes hand in hand with full transparency and the user pays principle. Furthermore, it is important to ensure that requirements for entry for SEPA compliant cards are not set so high that there are de facto no new entrants. We do not want SEPA to end up being a monopoly or duopoly situation. For instance, EMV provides a useful platform which would ensure interoperability for all market participants, as long as the standard is non proprietary and open to all users.

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

In order to achieve effective competition between banks and other payment services providers, there should be a full implementation of NLF as it stands now – including its Title II. Also, all the behavioural barriers to effective competition identified by the Commission in the Governance arrangements of the card schemes (such as requirement to be a financial institution and become a member of a domestic card payment system) should disappear.

We also firmly believe that the report of the Commission proves that the MIF is not the only system on which a payment system can be based and therefore, we urge the Commission to take all the necessary steps to encourage the development of alternative systems.

23. What governance requirements should SEPA schemes meet?

Governance of SEPA schemes should not differentiate between the different types of financial institutions but should open membership to all operators; they should not have specifications forcing operators to become members of the domestic card payment system of the countries where they wish to operate.

As stated above, the decision made by the scheme concerning competition or the level of fees should be made by all the members of the card scheme and not by a limited class of members.

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

We are not party to the information necessary to fully answer the question. However, we believe that interoperability is a pre-requisite for the successful roll-out of SEPA.

Certification procedures should not be used as a hidden form of discrimination against new entrants. European oversight may be necessary.

Merchants should be involved in the design of security standards to ensure that their needs are taken into account. For example, merchants were not consulted by Visa/MasterCard concerning the implementation of the new PCI-DSS Standard. This standard aims at securing databases containing information on bank card numbers and at limiting fraud. Of course, merchants share the concerns of Visa/MasterCard on fraud but object to the very expensive method chosen unilaterally by Visa/MasterCard and being imposed to European merchants. Non-compliance with this standard will lead to penalties through the acquiring bank.

The PCI-DSS standard was designed for the United States payment market where magnetic stripe credit cards are still widely used; it does not cater to the specifics of the European market: less distance selling than in the United States, widespread use of CVV codes, and much greater EMV (chip card) deployment.

Furthermore, Visa and MasterCard want to impose an audit of the merchants' information system by an external auditor of their choice. This would create confidentiality and competitive issues. And last but not least, the constraints associated with the implementation of this standard will greatly frustrate other business applications used at the point of sale by retailers.

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

EuroCommerce firmly believes that the Commission should closely monitor the self-regulated process of SEPA implementation and should be prepared to step in and impose regulation if this process does not promote the most efficient payment means.

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General comments:

EuroCommerce wishes to thank the Commission for this very comprehensive and thorough report. Although we cannot in fairness say that we are surprised by its contents, we are pleased that the findings of the Commission confirm what we have been stating for many years: competition in the cards payment market is not working and does not promote the most efficient payment instrument.

We can only but agree with the statement of the Commission that the MIF is a tax on merchants, which at the end of the day is paid by all the European consumers. Furthermore, the payment system market would be profitable - in most cases - without the need for excessive transfer of revenue through the interchange fee. Retailers and their customers should only pay a fee which is cost-based, fixed per transaction and relates to that element of processing which benefits retailers.

Merchants would like to believe that self regulation will work and will succeed in introducing more competition and more efficiency in the payment market. However, experience has taught that self regulation is not always the best approach (see Regulation 2560/2001). We are therefore asking the Commission to closely monitor the industry-led process and if needed, to take swiftly all the necessary regulatory steps.

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:
   - about right;

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:
   - confirm your views on the operation of payment cards market;

5. Did the report raise the right policy issues;
   - yes, covered most of the key issues.