FEEDBACK FORM

Name of undertaking: CO. GE.BAN. Convenzione per la Gestione del marchio Bancomat

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): Scheme

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Participated in the questionnaire:

- X 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?*

First of all, it must be borne in mind that merchant fees are determined not only according to the profit margin that the acquirer bank shoots for but also and above all according to the costs sustained to provide the service, which include membership in the payment scheme, amortization of the cost of equipment provided to merchants (POS and PED terminals), bank interlinking fees, credit risk and the interchange fee to the issuer bank. As a consequence, the level of the merchant fee cannot but reflect the overall level of costs sustained by the acquirer bank and, secondly, the latter's profit in remuneration of the service rendered.

While it is within each bank's own power to set the charges to customers for the service of acquiring, in some cases high merchant fees may reveal very wide profit margins for the acquirer, especially where the bank can achieve economies of scale thanks to the merchant's large volume, with lower service costs. In such cases, high merchant fees may well signal a malfunctioning of the market, translating directly into a competitive disadvantage for merchants, who are charged higher prices than they would have to pay in a fully efficient market.

This outcome is not necessarily the result of collusion, however, but rather appears to depend on the configuration of national banking systems, and more specifically on whether the market in acquiring is concentrated or fragmented, as well as on the degree of development of credit and debit card markets in view of the business strategies banks use to win the public over to the use of cards in place of other payment instruments.

On the first point, the Commission's Interim Report shows that in member states with fragmented markets in services for card acquiring, relative prices are lower than where the market is concentrated.

On the second point, more competitive merchant fees are found in markets where - thanks to the development of the domestic payment circuit - consumers perceive credit and debit cards as to some extent substitutes for one another. The Interim Report confirms that within the EU the level of merchant fees charged by international circuits is extremely variable, depending on the level of development of the market in terms of use of cards by the public and their acceptance by merchants. Merchant fees are higher in some states where the payment system is evolving (e.g. Hungary, the Czech Republic, Portugal) than in others where the market is more mature (e.g. Sweden, Finland, Italy). As for Italy in particular, the Interim Report confirms *i)* that the acquiring market is the third least concentrated in Europe, behind Spain and Latvia; and *ii)* that merchant fees in the domestic circuit are particularly low.

Recognizing that the fees charged to merchants must be the product of the acquirers' independent pricing policies, in view among other things of the contractual constraints (such as multilateral interchange fees) imposed by the payment circuits, it is COGEBAN's opinion than any Community law or regulation to govern price dynamics and in particular to eliminate the marked disparities between merchants found in some national markets would risk:

a) discouraging the development of the acquiring market, in particular by weakening acquirers' marketing effort to spread the acceptance of cards by merchants, to the detriment of the entire payment scheme;
b) worsening the banks' acquiring service, especially in national markets that are still being consolidated, inducing them to lower their service levels and thus impoverishing the overall quality of supply.

In this context, COGEBAN believes that the measure proposed by the Commission, i.e. informational activity to make merchants more aware of the fee differentials applied by the acquirer banks, can concretely foster market transparency to the benefit of the users of the acquiring service, diminishing informational asymmetries, which adversely affect the negotiation of merchant fees..

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

The Interim Report notes that merchant fees show a very significant range. A number of arguments have been put forth in support of the differentiation among fees. First, considering that merchant fee differences between countries within the Union is the joint result, among other factors, of the evolution of national banking systems, the evolution of payment cards within each system, and the dominant model of retailing, let us note that historically some markets have been more interested in developing payment cards than other instruments such as cheques.

Second, the existence of structural and commercial characteristics that differ from country to country has produced uneven levels of investment and efficiency for products that are often themselves different. Let us recall that not all national systems have created domestic payment card schemes. Where this has been done, in some cases the pricing of debit cards has simply been patterned on the equivalent products offered by international circuits, while in others there is sharper price competition.

Typically, international schemes charge three types of fee to participants:
1) scheme membership fees
2) brand use fees
3) processing fees.

As to these fees, charged to banks, there are enormous differences in levels (by a factor of as much as 1 to 100), depending mainly on the number of transactions but in any case far beyond the reasonable benefits of economies of scale, large as these are. The international circuits seem to enjoy greater freedom to choose the fees charged for the brand license than those for transaction processing. Only for the latter are the circuits subject to competition from domestic processors. Fee differentiation, then, regardless of the greater or lesser efficiency of individual banks, tends to constitute sharp penalties both on new market entrants and on banks in younger, as yet unconsolidated markets.

Finally, the total cost of transactions via payment card includes the costs of fraud and credit risk, items that vary enormously among the various European national markets. In Italy, last year debit card fraud (not counting the costs of investigations and the material replacement of cards) reached very high levels for debit card usable on the international circuits.

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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?*

As a premise, we must note that the Interim Report's measure of profitability is questionable in the extreme. The methodology of calculating profitability is simply not clear. A preliminary "methodological session" needs to be agreed on in order to understand, discuss, and then "refine" the results.

Specifically, the methods for calculating the following cost items need to be checked:
- reimbursement for frauds perpetrated on customers;
- cost of handling frauds;
- costs of handling customer complaints (including frauds);
- cost and depreciation of technical infrastructure for procedures;
- cost of legal support;
- cost of administrative support;
- cost of management support.

Last year in Italy alone, and for debit cards only, the number of frauds amounted to some ; and the processing of every single case of fraud may take several man-hours of work for the issuer bank (at an average cost of €0.70 a minute), so it's easy to see that correct evaluation of the profits from this business depends crucially on whether or not these cost items are counted among the issuer's costs. It is simply inconceivable that a comprehensive analysis of profitability of the payment card service can exclude these components, which instead are fundamental factors in the management of payments via cards.

If these items were not counted in the cost analysis, the results would be greatly overestimated with respect to the profits actually made by the issuer banks. In view of the size of the figures given in the Interim Report, presumably these items were not taken properly into account, so the question could well be poorly posed.

Examining the necessity of interchange fees in any case, the point is that it has been subjected to a lengthy academic debate, with an outcome of broad balance between advocates and opponents of their retention. As the average size of card-based transactions in Europe is less than €60, cards must face the direct, primary competition of cash. Recent market surveys have found that cardholders see cash as the "simplest" and "cheapest" way of making a purchase. However, for banks, for retailers and for oversight authorities, cash is a most inefficient instrument: counterfeiting, theft, counting, and so on, entail a high cost to the community.

If, therefore, we want the user of various payment instruments not to consider cards to be less attracive than cash, we must create conditions that make their cost at least comparable with that of cash: essentially, this means making card payments cost-free to the cardholder.

Payment via card entails significant costs to the issuer, both in terms of processing and in risk, so this is not a cost-free activity. This means that – in a market economy – these costs must be offset by adequate earnings.

For every transaction, the banks sustain a whole series of costs:

a) authorization costs: transmitting and handling an authorization application by the authorization centre or by banks that directly authorize cardholders' applications;
b) accounting costs: interbank accounting, clearing and settlement, costs of debiting and providing account statements to the cardholder for authorized payments;
c) other costs directly stemming from the production process: those of communication, R&D and product management in connection with technical and regulatory developments;
d) complaint handling: the costs of dealing with cardholders' protests;
e) indirect costs: the pro rated share of direct operational costs for physical structures (premises, equipment, utility bills, supplies), coordination (management staff not involved directly in operational process and non-management administrative personnel) and central units (the general management, legal service, management control, supervisory reporting, planning, research, organization, inspectorate, personnel, external relations, image and institutional advertising departments);
f) fraud and default: the total amount paid to reimburse fraudulent payments to metchants and for uncovered transactions.

The interchange fee serves chiefly to compensate the issuer bank for these costs. Failing such remuneration, the issuer would recoup the costs through fees to the cardholder or subsidizing this activity with the proceeds of others.

Today, issuer banks ordinarily charge an annual fee to the cardholder in a competitive issuing market that depends on the services provided (differentiation of services between debit cards and T&E cards and the corresponding difference in fees).

The annual fee is an incentive for the issue of the cards, but not for their use. If the intent is to favour their more widespread use, the issuing bank must receive an incentive that is linked to the use of the card. The interchange fee should not only recoup the issuer's costs but should also perform this incentive function, serving as a rebalancing factor between the profits generated by the two sides of the business, issuing and acquiring.

In payment systems, in fact, the individual payment scheme should be seen as a self-contained system competing in the market with other schemes, and with internal mechanisms for sharing the profits that the circuit generates.

The interchange fee should thus be not only a tool for recouping the issuer's costs, via a mark-up over the acquirer, but should also be the mechanism for equalizing profitability between the acquiring and the issuing sides of the business. In this way the issuer bank will have an interest not only in issuing a payment card and earning the annual fee, but also in promoting its use by the cardholder, thus earning from the acquirer a transaction fee that not only defrays its costs with mark-up but is also an incentive.

The Italian situation today, which is similar to that found in other European countries, is one of an essentially saturated market in terms of number of cards, but of insufficient use of the cards in circulation. Italian banks are wondering how to increase the level of use of cards instead of cash. Lotteries are being designed, tax breaks for users of cards have been imagined, and other initiatives are being considered.

In conclusion, the interchange fee is necessary not only to avoid burdening the cost of the individual transaction on the cardholder – counterproductive if the intention is to promote increased use, as the level of the cost would be so high as to reduce rather than increase card use – but above all to induce issuers to incentivize the use of cards by their customers.

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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 section of the Interim Report on profits seeks to determine the causes of the high profit margines found in many European countries and what relation, if any, they bear to the presence of a level of market power for operators on the issuing and acquiring sides. A significant portion of the analysis is given over to the level of interchange fees and the evidence that the fees further increase profit margins. As noted in the response to question 3, in our view the interchange fee is necessary to the expansion of the payment card system and works at the same time to make it more efficient and as a stimulus for issuer banks to undertake initiatives to incentivize card use.

The point here is that some Member States show a high concentration on the credit card issuing and acquiring sides. The European experience seems to show that market power in one supply segment often produces advantages in related markets. The Commission observes that frequently the supply of issuing and acquiring services for credit cards is combined with the supply of the same services for debit cards (it is common for acquirers to engage in "blending", i.e. offering equal merchant fees for credit and for debit cards or for international and domestic cards).

Italy is distinguished in this regard by a special situation, with a very large number of operators active on both the issuing and the acquiring sides of the payment card market, especially for debit cards, and thus limited market power for the main operators (as is confirmed in the Interim Report, p. 85). Blending is definitely less common in Italy than in other countries (p. 44), owing in part to the lower costs that Italian banks sustain for transactions in the PagoBancomat POS circuit.

As for high profits, a comprehensive evaluation can be made only after correclty defining the methods of calculating the relevant costs and income. This means, among other things, being careful to properly include the costs to banks generated by the risk of fraud and other indirect costs, such as marketing and advertising (see answer to question 3).

Moreover, in our view the amount of profits in the payment card market is not a reliable parameter for deducing the existence of market power or excessively high interchange fees. On the issuing side in particular, issuers often combine credit cards with other banking services, as in the framework of a current account. Consider, say, the issue of cards in two names linked to a single, joint account, which is very widespread in Italy. The annual fee paid by the cardholder thus often covers two cards, so it would be wrong to attribute the profit to a single card. Winnowing out the individual cost and income items in such a context is complicated, but in our view it is needed for a correct, complete evaluation of the true profitability of the services provided.

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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?*

In the Visa International decision of 9 August 2001 (in *OJEC* n. L 293 of 10.11.2001), the Commission held that the Visa rule prohibiting merchants from charging additional fees of their own to consumers who pay by card and from offering discounts for those paying in cash (the non-discrimination rule) had no significant effect on competition. The fact is that even where the non-discrimination rule was eliminated, the negative reaction of consumers to any such "surcharge" led most merchants to abandon any discrimination against card-based payments.

The Commission's decision also recognized that giving merchants the freedom to charge an extra fee for card payments could influence consumers' decisions on which of various cards to use as well as favouring cash over alternative payment modes, including credit and debit cards. In the Visa case the Commission did not rule out the possibility that abolishing the non-discrimination rule could make the market more efficient. But the following observations apply. While on the one hand the possibility for merchants to cover merchant fees by charging a fee to the customer may provide an incentive for acceptance of cards at retail outlets, on the other – as the experience of circuits in which the rule was abolished demonstrates – an extra fee is reflected in a reduction in card transactions and in many cases a contraction in the retailers's sales, insofar as credit and debit cards can be replaced by other instruments, such as cash, as the Commission recognized in the Visa decision.

A surcharge on card payments can falsify consumers' perception of the advantage of credit and debit card payments, with a short-term negative impact on their use and a longer-term impact on their acceptance by retailers, in the final analysis reducing the circuit's network externalities.

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

First, let us note that there are various methods of pricing, no one of which can be considered "right" in absolute terms. In setting sales prices, in fact, firms generally take account to some extent of the cost component. Often this factor is supplemented by valuations of the value of the product or service, clearly intended to maximize the profit margin.

This said, it is not easy to say how far exclusively cost-based pricing could encourage more efficient payment instruments. For bank services, in fact, the allocation of costs would be especially complicated, as there are fixed, overhead costs that can hardly be assigned to individual products. Moreover, banking services and products are often sold jointly, which aggravates the difficulty of separating out the costs attributable to payment cards. Furthermore, banks could find that strictly cost-based pricing would not justify investment in innovation, marketing and service quality, and would leave the market, to the detriment of the entire system.

In any case, it is not among the prerogatives or powers of the payment scheme operator to determine banks' pricing policies, including prices for payment card issuing and acquiring. This is up to the bank itself. Thus imposing strictly cost-based pricing would conflict openly with the EC and national treaties on competition. Instead, in order to promote efficient payment instruments, what is needed is to ensure the greatest possible contestability of the issuing and acquiring markets.

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

Regulation 2560/01 put payments made at domestic level on an absolutely equal footing with those made towards other Member States. As a result, the use of cards in a different Member State from that of issue entails no additional charge to cardholders. Nevertheless, some national markets have pricing practices/rules that can adversely affect consumers' use of cards for cross-border transactions. In such domestic markets as the UK, for instance, the merchant is allowed to apply a surcharge for the use of the card rather than cash. This could be considered as a lack of respect of the Regulation itself, being the use of his card in that country higher than in his country due to surcharge.

The practice of surcharging can distort consumer's perceptions of the relative advantage of cross-border payments using cards, in particular in respect of Member States not belonging to the single currency area, where the prices of products and services appear less transparent than in the euro area.

On surcharging, it has been repeatedly noted – not least, in the Visa case (see answer to question 5) – that the practice could favour the use of cash. The size of the surcharge imposed by the merchant, in fact, is generally a considerably higher percentage than he himself pays to the acquirer.

What is more:

1) often, it is only when he actually pays that the cardholder learns of the surcharge. This unquestionably undermines transparency in card use, as the cardholder pays a higher amount than he supposed when he decided to buy. Further, the lack of a posted announcement of the surcharge on the part of the merchant prevents cardholders from selecting outlets that do not have the surcharge;
2) even if merchants were required to inform customers in advance of a surcharge (by posting announcements in shop windows, say, or on price tags), the choice of payment instrument presumably comes after the decision to purchase a given good or service. So the thesis that the entire decision-making process by the consumer concerning both the choice of the product/service and that of the payment instrument and the outlet at which to make the purchase takes place all at once in a single moment, is not necessarily correct.

B. Market structures, governance and behaviour

8. *What market structures work well in payment cards?*

The "four corner" model (cardholder – issuer – acquirer – merchant), compensating for its greater complexity and ramification, has made payment systems work better. By their nature, in fact, these circuits draw their efficiency not only from external competition with other schemes but also – indeed, above all – from internal competition between the various players in issuing and acquiring activities.

It is thus essential that access to issuing and acquiring business not be restrictively regulated or excessively costly, in order to allow as many operators as possible to compete. On this philosophy the Italian domestic circuit has brought no fewer than 600 banks into issuing business and 430 into the acquiring side.

It is also necessary, for proper institution of the "four corner" market model, that the governance of the circuit be "non-operational" for typical business activities (processing, issuring, acquiring). This guarantees that the circuit's rules not favour the activities performed by the circuit itself.

The rules recently issued by the EPC on the SEPA Card Framework call precisely for this unbundling of roles. For there to be effective separation and no cross-subsidies between rulemaking and circuit operation, it is also necessary for there to be separate ownership of governance and processing entities, with separate accounts and financial statements. In the absence of this further provision, which the SEPA Card Framework lacks at present, there would be a risk of subsidies between the governance and the processing entities.

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

No comment

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

Apart from the indications in the answer to question 8, action is needed to prevent international circuits from introducing limits to co-branding that limit the competition from domestic circuits and from the nascent pan-domestic circuit.

To facilitate competition between circuits, rather, cardholders should be allowed to choose, at the moment of payment, which circuit will handle the payment.

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

First, one must distinguish governance arrangements designed to learn the needs of cardholders from those designed to learn the needs of merchants. For the former, the Italian domestic circuit for years now has had customer forums to gather data on consumers' needs. Further, the high security standards of the entire circuit make an appreciable contribution to populatizing the use of cards among consumers.

Further improvement could follow from the possibility of using the same card to enjoy new services and products, both banking and not strictly financial (e.g., on-line payments).

As to the methods used by the domestic circuit to respond better to the needs of merchants, let us note that merchants are normally assured of the successful outcome of the transaction, regardless of subsequent discovery of fraud, as these episodes are managed exclusively by the banks that are victims of the fraud.

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

For the Italian domestic circuit, the COGEBAN statutes, to guarantee minority rights within the Council, which is the directive body, make the following provisions.

Banks with legal home office in Italy, the Republic of San Marino or another EU country that are not members of a banking group and the parent companies of banking groups belonging to the circuit are classified in descending order by market share and subdivided into three classes as follows:

- Class 1: the top-ranked members who cover wholly one third of the market;
- Classes 2 and 3: successive members to those in Class 1 which, cumulatively within each Class, represent a market share of half the residual market share.

Ex officio members of the Board, in addition to the Chairman and Vice-Chairman of COGEBAN, are representatives of the Class 1 members and twice as many representatives for each of the other two Classes.

Considering that the Chairman and Vice-Chairman of COGEBAN are entitled to just one (joint) vote, while each Board Member belonging to Class 1 has two votes and the Board Members of the other two Classes have one vote each, it is clear that minority rights are adequately safeguarded, as well as the appropriate participation in the decision-making process.

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13. *What access conditions and fees are indispensable?*

Above all, in our view the indispensable condition for access – one required by the Italian domestic circuit – is that circuit members must be banks. This condition is based on the necessity that all transactions in the circuit must be executable, and is thus strictly related to the need that card ownership be based on a funding relationship that guarantees coverage. As is easy to see, what is at stake here is the security of transactions and the reputation and popularity of the plastic payment instrument, which has become an integral part of the modern lifestyle.

In this regard, in a recent instruction the Bank of Italy as competition authority for the banking industry dwelt upon the question. The Bank held: “As concerns the provision in the COGEBAN statute that only banks doing business in Italy may belong to the association and get a sub-license to use the PagoBancomat brand, this is warranted by the functiioning of debit cards. The use of this type of card involves direct debiting of the bank account of the cardholder for every transaction, which necessitates strict functional linkage between the debit card and the cardholder’s current account. This linkage means that the monetary settlement of the payment always necessitates the interposition of a bank, which by law is the only institution that can raise sight funds or engage in any form of fund-raising related to the issue or administration of generally spendable means of payment (1993 Consolidated Law on Banking, Article 11). As to the potential operation in the reference market of financial intermediaries entered in the special register referred to in Article 107 of the Consolidated Law on Banking, it should be noted that while by law they have the possibility of issuing and administering payment cards (see also the decrees of the Minister of the Treasury of 6 July 1994 and 13 May 1996), for any functioning of debit cards issued by non-bank institutions the interposition of a bank to effect the monetary settlement of the transaction would in any case be necessary” (instruction 54, 30 March 2005, point 75).

To guarantee solvency for transactions between issuer and acquirer, it is further necessary that these be subject to prudential supervision, as banks are. If future European directives opt for allowing non-bank operators access to the market, the latter too will have to be subjected to prudential supervision similar to that for banks, in order to prevent economic damage for operators and customers and damage to the reputation of the circuits.
We will return to this subject in question 18. To assure proper functioning of all the market access mechanisms, it is also necessary that all operators in a circuit pledge to comply with the rules laid down by the governance, in order to preserve interoperability and equal opportunity for all competitors.

As regards fees proper, there are two different models of circuit management. One has a "non-profit" governance structure, which decides the rules for the circuit and checks their enforcement. As a non-profit institution, it distributes the costs among the members according to its budgeted expenditures. Many domestic circuits as well as the Visa international circuit take this approach. In the second model, the circuit is organized as a profit-making company. Here the fees charged to banks must take account of the profit margin that the governance entity requires. This model is adopted by MasterCard and by the domestic circuits in which processing is still linked to governance.

In addition to circuit fees, the card circuits also ordinarily charge fees for processing and for the use of their brand. As noted earlier, in line with the EPC's call to keep governance separate from processing activities and put the latter in competition, the international circuits seem to be oriented to raise the charges for brand use and lower processing fees (where these circuits compete both with domestic and with other international processors). For this reason, as was said in the answer to question 8, it is necessary that the separation between processing and governance be accompanied by accounting separation, separate balance sheets for the entities responsible for the respective activities, in order to facilitate the detection of cross-subsidies within a circuit.

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

In a large market like that for payment cards with established, standardized operating practices, we consider that the best way to facilitate efficiency is specialization of activities and a high degree of competition between operators, who must be allowed access to the business on an equal footing.

To achieve such equality, the requirements are:

- specific standardization of the contents of the business (e.g., processing, terminal management, etc.), so that every operator, including potential ones, disposes of the know-how and instruments needed to perform its activities properly.
- a distinction between the roles of governance and processing, guaranteeing competition for processing business among the various European infrastructures. Accordingly, no scheme should be able to arbitrarily indicate any particular operator, much less to favour its own structure by pricing practices that are distorted in respect of the economic fundamentals.

To this end, it is essential that where a circuit's governance structure owns or operates processors no cross-subsidy is allowed between scheme and brand fees and processing fees. At the very least, therefore, the operation of the scheme must be separate, with transparent accounts, from that of the processor owned or operated by the scheme.

C. Future market developments

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

Structural changes are risky and always very costly, not only for banks but also for users (especially merchants). So structural changes should be made only if and when the results are certain and only where the existence of real benefits has been determined in advance and accepted by all the participants in the circuit.

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

Market accesss barriers arose between the various domestic payment card circuits by their historically different growth, from country to country. Some Member States, in fact, have developed standards that do not permit foreign operators to have access to the domestic market. To remove these barriers the EPC is working on a solution to the problem of different standards in different countries: the European standard to be set should be applicable in every payment card circuit and in every part of the SEPA.

However, the standard should not replace present national and international standards but be introduced alongside them, serving as a reference for the development of new products. It is thus necessary that all circuits, domestic and international alike, allow the use of the new European standard, but that they leave it to individual operators to make the final choice of standard, in line with their needs.

We believe that the idea of simply replacing existing standards should be discarded, especially on the acquiring side. This procedure would require very substantial investment by banks and merchants.

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?*

The Commission's Interim Report identifies a series of structural barriers within the Community, limiting competition in the payment cards market. Essentially, they stem from vertical integration (a single system operator that supplies the whole range of services making up the supply of payment cards) or horizontal integration (as in joint ventures owned by competitors).

First, let us note that these different forms of integration may well be functional in terms of efficiency, with savings that can be passed on to the final customer. Vertical integration, in fact, facilitates technical interoperability between functions and makes planning easier. These factors are especially important in the phase of consolidation of a payment cards market, as both encourage the rapid spread of the cards' use.

Horizontal integration too, in the form of joint ventures between competitors, can under certain conditions help improve overall efficiency and make for optimal diffusion of different payment instruments. In its *CartaSì/American Express* decision (decision No. 13434 of 28 July 2004), the Italian competition authority authorized the temporary constitution of a joint venture between the two main payment card competitors, in consideration of the better prospects for the growth of these products due to partial intgegration of the two companies with complementary services and distribution networks.

In this light, we believe that vertical and horizontal integration represent limits to the development of the market only insofar as they do not favour efficiency. To determine whether this is the case, in our opinion the instruments already available to the competent authorities are sufficient, namely prior authorization for mergers and the power to intervene where operators signal market distortions that depend directly on excessively integrated architecture. Regulatory measures such as the Commission hypothesizes in the report, could prove not only inconsistent with the particular situations in being but also intrusive, unless they are backed up by an analysis of the structure of individual markets and the reasons why they are configured as they are.

In our view, therefore, action should not focus on intervention to destructure existing systems but instead on measures to facilitate cross-border business and the potential supply of services by new entrants. For it is likely that actions which eliminate regulatory constraints or limitations on pricing practices on the part of potential new operators will decisively stimulate competition also in those markets now characterized by limited variety of supply owing to a high degree of integration between operators. But where integration is so great that it is impossible to identify the scope for real competition between or within systems, then regulation is certainly more justified.

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

The Commission identifies a whole series of practices that could constitute behavioural barriers to new market entrants. These include the nature of the payment card market operator, in particular the necessity that this be a financial institution that does business through a legal office in the same country in which the activity is performed..

In our view, these limitations are justified by the necessity that the institutions engaged in inssuing and acquiring comply with special requirements of solvency and stability (see answer to question 13). The status of financial institution entails compliance with strict rules and subjection to constant monitoring by the authorities. Supervision is especially important for the kind of activity involved here, which entails provision of credit services and the handling of highly sensitive information. For this reason, permanent presence in the national or at least EU territory can be viewed as an essential sign of recognizability, a guarantee of security that serves the overall reliability of the system.

As to the Italian domestic payment circuit, for membership in COGEBAN's PagoBancomat scheme the institution must be a bank and consequently subject to the supervisory provisions for the payment system (Article 146 of the Consolidated Law on Banking).

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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?*

See the answers to questions 15 and 16.

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?*

See answer to question 12.

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

The Interim Report highlights the need to overcome the duopoly of international schemes by making the most of domestic circuits. In this sense, the pressure on domestic circuits to achieve SEPA certainly needs to be relaxed, since the banks belonging to these circuits could decide to bring them into the international schemes, as happened recently in the case of Belgium.

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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?*

The barriers that really limit competition are standards that do not permit cross-border acquiring. Vertical integration, with a view to cross-border business, loses the role it plays in closed systems.

23. *What governance requirements should SEPA schemes meet?*

Governance rules should be determined independently by the individual schemes. And in any case, the governance of the schemes needs to be kept entirely distinct from the management of operational activities, so as to induce the schemes to put their processing business in competition. To prevent cross-subsidies between circuit/brand fees and processing fees, separate accounts between processors and governance entities must be ensured.

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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?*

It is the general interest of the entire European banking industry to devise solutions that allow interoperability and functionality of schemes, with today's often long and expensive certification procedures reduced to a minimum. At present, in our view the best tools for ensuring broader and more sustainable interoperability are:
- development of standards of interoperability to flank the standards already in being, especially as regards acquiring;
- institution of mutual recognition of certification between domestic schemes;
- greater use of self-certification for authorized operators.

In practice, both international and domestic payment card schemes should permit application of SEPA standards together with those already in place in each national payment system.

If instead it were decided to impose compulsory European standards in place of the existing standards, this would require very substantial investment by both banks and merchants, with the risk of slowing down the migration to SEPA.

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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?*

At present, the most effective instrument to foster competition in card business, in our opinion, would be represented by an informative approach by the Commission, that could communicate what are their opinion on the subject. Finalization of Sector Inquiry could, also be to this extent, a useful instrument in order to give the market the Commission viwpoints.

General comments:

General questions:

1. Did you find the content of the report easily accessible and understandable?

- X yes, fully;
- 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. Was the information contained in the report:

- generally new to you/the payment cards industry;
- X 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;
- challenge your/industry's views on the operation of payment cards market;
- X represent a mix of both aspects.

5. Did the report raise the right policy issues;

- X yes, covered most of the key issues;
- no, there were some significant issues left out.

Thank you for your contribution!