Commission Européenne
DG Compétition
Financial Services
B-1049 Brussels
BELGIUM

Stockholm on June 20, 2006

Dear Sirs,

Please find below comments from Swedbank, Sweden regarding The European Commission Interim Report 1 Payment Cards issued on April 12, 2006.

1. General

Being supporters of the financial services business on a free and open market for competition under rules of the level playing field we also share this objective for the card payments business.
When we read the report we clearly see that the survey shows that Europe today is divided in many separate markets in the area of card payments and the boundaries that divide the separate markets from each other to a great extent are of legal, technical, cultural, evolutional and practical
character. The different regulatory environments in the EU member states give clear proof of that no thorough attempt has so far been made to join together the different card payment markets outside the realm of the international card schemes like Visa and MasterCard. Even within these card schemes there are discrepancies in how card payments work in the different European countries due to the above mentioned boundaries. We also want to emphasize that the card payments must remain a business to develop and grow through competition for customer satisfaction. Therefore we do not share your opinion on cost based pricing, since we interpret that to be an evolution to a utility like service. We make our best effort to differentiate our services from those of the competitor in as many ways as possible and therefore we work with value based pricing in competition with other providers.

To some extent we share your findings but in some other instances we do not consider your conclusions to be a good analysis of reason and consequence in the payment card area. Since many of the findings are from unidentified markets we find it difficult to comment on them in detail and therefore we focus on the overall level in the report.

2. Geographic scope

As a customer focused organisation we see that our cardholders want to be able to use their payment cards wherever they travel and there is no evident desire to have a payment card with usage restricted into Sweden or even the European Union. Most of our card holders expect their card to be accepted on global scale. Due to this fact the vast majority of payment cards we today issue, are connected to the international card schemes. If however, we would consider to build a European payment card we would at minimum have to see to that it is accepted in the EU 25 plus the Efta countries of Norway, Iceland and Lichtenstein and Switzerland, since these countries are all on the scope as travel and trade destinations for card users in Europe. We see little point for a payment card restricted to the Euro zone since our card holders do not in general decide on destination depending on currency used in destination country.

In a similar manner our merchant customers in their role as card acceptors are keen to sell goods and services to anybody that can pay and are without any willingness to discriminate on the customer country of origin or native country currency. Therefore there is little demand for acceptance agreements for domestic or euro-zone only cards. In order to cater for the merchant needs we have constructed our merchant offers to cover as many payment card schemes as we can, taking upon us as card acquirers the task of being connected to several international card schemes and relieving merchants from the need to connect to different sources for different card scheme acceptance agreements. If merchants want to split up their acquiring contracts between several acquirers they are however free to do so.

For these obvious reasons we consider it vital for the positive development of card payments to base the card business on wide international card solutions and avoid European only schemes. .

3. Competition and level playing field

Sweden can serve as an example for how a proprietary domestic debit card market has made a turn around and discontinued processing and acquiring monopolies over ten years ago and now has an open payment card business based on international card scheme products thus allowing cardholders from all over the world to pay at POS at every merchant location that accepts cards or use all the bank owned atm: s for cash withdrawals. In addition to this all the merchants accepting payment cards can access not only the residents in Sweden but also visitors from abroad for card payments.

Since 1995, when the EU competition legislation came into full force in Sweden we have conducted the payment card business in a market driven by business objectives both for the issuer side and for the acquirer side of the business and this has lead to a rapid development of the card payments in Sweden. On average our card payment business has expanded with approximately 20% per year measured in number of transactions. Also non banks issue substantial numbers of payment cards. Merchants in the grocery and petrol businesses are the predominant non bank issuers and account for double digit market shares in cards in Sweden. Both issuers and acquirers have good financial incitements for expanding their respective businesses and this is to our opinion the main reason for the rapid market growth during the last ten years.

In our card business in Estonia, Latvia and Lithuania the growth of card payments is even faster than in Sweden (30 – 40% annual growth rate) and in these countries the set up is also according to internationally accepted cards and a business model where banks compete with each other for both the issuing and the acquiring business.

An additional benefit to the market is the gradual reduction in usage of cash payments in retail environments when the electronic point of sale payments is expanded. The expensive and risky cash usage goes down benefiting society, merchants and banks and providing convenience to consumers. We estimate that in Sweden 55 – 60% of retail payments over the counter are done by cards and the remaining by cash. In some retail businesses like petrol purchases up to 90% is paid for by cards. The number of point of sale payments outperforms the atm cash withdrawals with four to one in favour of point of sale usage in Sweden.

Should the business model in card payments change to the detriment of issuers and acquirers the logical assumption is that issuers would to lesser extent see the purpose to push for card ownership and for usage at point of sale as would banks as acquirers fail to see ends meet at sustainable level to justify investments in build-up, maintenance and continuing development of the card payment services. We believe that a heavily regulated card business with a utility type business model would lead to the slow-down of the expansion of card payments and open up for expansion of cash payments with its associated cost and risk.

In our opinion competition on a level playing field between issuers, acquirers, service providers, suppliers, international card schemes and merchants is the best guarantee to get a market desired by the consumers in Europe and throughout the world.

4. Standardisation

To be able to exchange transactions between a multitude of acquirers and issuers the parties participating in card payments also need standardisation. This does not only count for the technical interfaces and practical procedures but also for the business model in the payment scheme. In order to get true cross border markets working in the EU / EES area there also needs to be a standardisation in the legal and regulatory field opening up for issuers and acquirers as providers in all the member states to allow freedom of choice of issuers for consumers and choice of acquirers for merchants throughout the EU. Today an issuer or acquirer meets not only diverse technical standards but also varying business models and a multitude of regulatory environments when considering establishing itself in another EU member state. It becomes less profitable to establish a card business unit in a new market due to these differences and therefore there has been little expansion into other countries within the EU. A paradox is that often these differences do not give any additional values to the card payments but simply produce the same output in a different manner. Therefore we are strong advocates for greater standardisation in the technical, practical, legal and regulatory environment as well as for the business model.

Of particular interest is the interpretation of the EU competition legislation which seems to both allow and ban same business set-ups in different member states. This leads to that banks that adjust to the domestic rules in their home market cannot use their economy of scale from the home market when entering another member state as card payment providers, since the set-up there will be another from both regulatory and practical point of view. Practices ruled as illegal in one country can be perfectly legal in another country under the same legislation. A basic demand for a common market in the payment cards area is a common set of rules. Therefore we see that the Payment Directive should be for 100% harmonisation giving the different member states no room for interpretation.

5. Comments on the findings of the report

5.1. Profitability

The claim that payment cards account for 25 % of the profitability of retail banks is not accurate for Swedbank. Only a small part of our profits come from the cards business but still that is an important source of income to us and profitable enough for us to keep investing in. It is true that credit cards are more profitable than debit cards counted per transaction or per card. One has to bear in mind that a credit card is a lending instrument and in general the profits of the lending business outperform the payment business. If one however takes into consideration the size of the profit, debit cards outperform credit cards because the debit card business is so much bigger than the credit card business measured in volume. Therefore the debit card business is of highest priority for us. Should the business model change for instance by eliminating the interchange payments from acquirers to issuers, this would constitute a new situation where we would have to reconsider the profitability of the issuing business and possibilities to expand it relying only on charging our card holders as the sole source of income. A new situation would then occur and as issuers we would strive to push risk cost and especially fraud risk cost to the acquirers and they would endeavour to push these costs to the merchants, most likely to the detriment of the card usage at point of sale thereby making both cardholders and merchants loose compared to the present situation.

5.2 Merchant pricing

We see that the pan European competition between acquirers and service providers and also international card schemes should provide the necessary pressure to set the price that merchant pay as users and beneficiaries of the payment card business on an accurate level. This however means that acquirers should get access to the different country markets through standardisation as mentioned above thus giving the merchants freedom of choice from a multitude of acquirers instead of only one as is the case today in some European countries. If merchants are considered to get “free” access to the value of the card payments then the consumers of Europe would have to foot the entire bill. Banks and other providers of card payments are market driven and if the profitability of card payments does not meet the expectations of the share holders, focus will be on other financial services leaving the card payment business in a dwindling mode. The fact that merchant price varies in different markets reflects the differences in the markets as volumes, quality of transactions, level of merchant participation in processing etc. These reasons also impact the price variations between small and large merchants. You also mention that fuel companies pay less than restaurants, this might reflect the fact that 70% of the fuel price is tax in most European countries and thus fuel companies actually may pay more of their true turnover that restaurants. Probably this is due to banks and fuel companies have found a level that both can live with in order to provide the service even without a profit taking into consideration the high tax share in fuel prices. You also exemplify with low fees for UK debit cards versus high fees in Poland. The volumes in the UK are much bigger than in Poland giving the UK market scale benefits and many years of time to pay back the investments made compared with a more recent and still emerging market like Poland. Other markets have had monopoly like structures in the debit cards area and also in the acquiring arrangements and probably this have impacted the pricing decisions in these markets. In the acquiring business the fixed cost element is the dominant one regarding processing cost and therefore scale and maturity are significant elements to differentiate markets like Poland and the UK from each other. In markets where the debit card business is under one provider with the same customer offer to everybody, one can get scale benefits in the cost but at the expense of customer demand for differentiation and customisation. The low cost of such monopolies can be challenged with that the service is not what the market wants to have and therefore of little value even if the production cost is low. It is also irrelevant to compare such products with customised services according to customer needs since they obviously serve different purposes as in many cases also can be seen by slow market uptake through point of sale usage volumes.

5.3. Barriers to enter

In material aspects the barriers to enter the card business are associated to the standardisation issues and regulatory interpretations in different markets. The access of services from the international card schemes are in our opinion on fair, equal and transparent base and therefore it gives all qualified providers the possibility to offer the services. The problems of access are more often associated to the domestic card schemes since it usually is not justifiable for a foreign entrant into a new market to invest for the access into the domestic card scheme. The entrant has low volumes in the early days and therefore the payback time is going to be long, the risk of making a loss increased, creating a barrier to enter into the market with proprietary solution.

The more the market is integrated with all the functions in card payments, the more difficult it will be to enter without using the local scheme services. Some of the behavioural barriers you list seem to be illegal under the present competition legislation and we therefore ask how the EU competition legislation is interpreted in the 25 member states. A common view from the EU Commission could remedy these discrepancies tolerated in some member states.

5.4. Interim findings

Several of the difficulties for a common market you bring up will be remedied by consistent implementation of the European competition legislation. An additional number of findings will be remedied by meticulous implementation regarding the spirit, intent and wording of the Sepa Cards Framework by the stake holders in the payment card business. Some remedies that you list seem to be in collision with the competition legislation. Among these the example of cooperative agreements between competing networks. In our opinion competitors should compete and not cooperate. Some other remedies seem to indicate a price regulation of the free market and this we believe will create more problems than remedies.

An example of such cooperation is the practice to co brand a domestic card with an international payment card scheme application. In the domestic market the card is accepted widely as a domestic card and abroad as an international payment card in the markets where acceptance has been built by banks based on these international applications. International cards are often not accepted in the market of the domestic card and thus the domestic card payment system piggybacks on other payment schemes abroad but effectively locks these out from its own domestic market. Cooperation like this is misuse of market power in the domestic market giving any visitors to such countries poor service but granting the cardholders from that country good service when abroad.

Another experience that we have is that monopoly providers from closed, domestic card markets are pushing into open competitive markets using their unfair scale benefits to compete with the issuers and acquirers in the open markets abroad in the neighbour countries.

Clearly there are market distortions due to the fact that domestic monopoly like providers has been allowed in a number of member states.

5.5. Your issues for consultation

1. Every market in the EU has the merchant fees this market has created the environment for and no common market exists as of today as pointed out above and therefore it cannot be argued that the EU has high merchant fees compared with other comparable areas like the United States. .

2. Every one of the 25 markets has its own justifications and among these are volumes, maturity, technical development level, socio economic factors, and regulatory environment among other things.

3. We do not see that there is apparent profitability in the cards issuing business that would justify a change in the present four party system business model. If that should happen the issuer business would be deprived of good part of its incentives to expand and develop and as stated above.

4. The accurate profit levels are set by competition for customer desire by banks as issuers and acquirers working with good economy of scale on a level playing field.

5. The domestic monopolies in some countries that deprive the market its freedom of choice and the competition pressure to constantly improve the services at best price for the customer.

6. Competition in a market economy regulates the price level and the providers would strive for maximal profit by outperforming their competitor. Regulated cost based pricing would eliminate the market driven development and produce a utility service.

7. Yes since in some countries there is a practice to charge foreigners for card payments at point of sale while this is prohibited for domestic card users and in some other countries there is the practice to offer payment at point of sale to be charged in the cardholders currency with a high conversion add on. Both practices make it more expensive for foreigners to use cards.

8. The four party model according to the international card scheme definition.

9. Highly integrated domestic card structures with monopoly like organisations.

10. Card payment systems should not be allowed to cooperate with each other. For instance the practice of co branding a domestic card with an international scheme application for use abroad establishes a market where the domestic card is received in other open and service oriented markets through co branding but where the cards from other open markets are not accepted in the domestic card country. The practice piggybacks on the good faith of the open market and closes its own market for competition and customer services.

11. Market economy with a single market and the implementation of the Sepa Cards Framework rules and more than one provider in the cards area.

12. International card schemes today give fair representation to smaller members among others through the creation of group members.

13. A level playing field for card payment providers – i.e. financial institutions according to the second banking directive and the Sepa Cards Framework.

14. According to the principles set forth in the Sepa Cards Framework.

15. Yes, the creation of a single market from the present 25 will cause a wave of consolidation.

16. Technology needs to be standardised on scheme level to ensure interoperability and common scheme front for a good level of security and anti-fraud measures. EMV chip and the further development of that platform also for the benefit of online payments.

17. Structural barriers should be tackled through the consistent interpretation of the EU competition legislation in all the 25 member states.

18. ?

19. For the creation of the single market the standards issues are essential both for the cardholder and the merchant side of the business. But standards are not only technology – also practices, business model, security procedures are part of the need for standardisation.

20. Joining conditions, business model, competition between schemes, universal standards

21. Schemes not to cooperate with each other – i.e. not to co brand between schemes that are accepted on the same market.

22. Legal discrepancies, regulatory interpretation differences, standardisation of technical interfaces and procedure rules within schemes, abolition of domestic only schemes, abolition of exclusive territorial rights,

23. The principles defined in the Sepa Cards Framework.

24. The cardholder user interface needs to be standardised, the card to payment device technical interface need to be standardised based on EMV chip protocol, the payment device to acquirer interface needs to be standardised to ensure that card holders can use their cards at payment devices and that merchant payment devices can connect to multiple acquirers.

25. Yes - a backing by the European Commission of the Sepa Cards Framework to be implemented in all the 25 member states as an industry self regulation is needed.

6. Future development of the report

We hope that the Sepa Cards Framework impact on the payment card business is taken into account in the final version of the report on payment cards in the retail banking sector. Also the fact that merchants and other non banks issue cards for payment purposes should be recognized.
The present report assumes that all payment cards are issued by banks. We would also like to see an analysis of the impact of consistent interpretation of the EU competition legislation and a full harmonisation of the coming Payment Directive. Only if the member states are compelled to uphold a level playing field in the regulatory area, the banks and payment institutions can deliver a common market for card payments. It is to our opinion unfair to measure the payment card business on the fact that the card operations in some member states have been conducted in either regulator tolerated or even approved monopolies restricting competition and entrance of providers from outside the domestic club structures and also denying consumers from abroad the possibility to use the card payments in such markets. The report also implies that these “closed” domestic schemes might be more efficient than the open international schemes measured on the cost which we find to be an irrelevant comparison of an unwanted item with an open payment scheme. . A final version of the report should also state the SEPA vision as spelled in the SEPA Cards Framework chapter

4.1.2 to be the objective for the development of the unified market in the cards area. The report should focus on showing the way to an open, competitive business driven market with a level playing field for the providers.

Yours Sincerely

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