FEEDBACK FORM

Name of undertaking: GRUPO SANTANDER

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): CURRENT/POTENTIAL ACQUIRER, CURRENT/POTENTIAL ISSUER

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Participated in the questionnaire:

☒ Yes

☐ No

- Grupo Santander has elaborated a document that comments the Interim Report. It is attached to this questionnaire. Many of our answers to this questionnaire must be read in the context of this document.

- Sometimes we give a joint answer to two o more questions.

Specific questions from Executive Summary:

A. Financial analysis of the industry

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

Grupo Santander cannot accept the assumption that MSCs are high. First, as we discuss in Section C of the document we attach, there are significant differences in MSCs across sectors and countries. Second, the Commission should clarify the meaning of "high" in this context. Third, this question is posed in a misleading way as it talks about prices without considering the quality and level of services that are being provided at that price. So, in fact, the relevant question should be how much the provision of card payment services to merchants (at current prices) contributes to the competitiveness of the EU economy.

In this sense, recent economic studies – mentioned by the Commission – corroborate that electronic payments and cards in particular are a significant drivers for economic growth. This is the reason why they are one of the ingredients contemplated in the Lisbon Agenda, aimed at promoting economic growth.

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

As we explain in Section C of our document, there are many different demand and supply factors that justify these differences.

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 we explain in Section E of our document, Grupo Santander considers that the Interim Report´s conclusions on the profitability of issuing should be revised. Both the profitability analysis and the statistical exercise contain strong biases and are flawed.

In any case, there are different reasons that explain why the interchange fee transfers rents to the issuing side. As the Interim Report says, there are strong externalities (indirect network externalities and usage externalities) in the card industry. Under these conditions, cost-based pricing would not lead to an efficient solution. Prices should take into account these positive externalities and for that reason the issuing side needs to be remunerated adequately. Issuing is a for-profit business and in order to foster card payments transactions banks need an incremental profit rate.

The Interim Report points out that there are systems that operate without setting any kind of interchanges fees. But as we explain in Section E of our document, the absence of interchange fees in some domestic systems does not imply that for other systems interchange fees are not an efficiency-improving device:

- Paper-based payments are more costly to process than electronic payments. Electronic payments may be less costly even when considering the interchange fee or the discount rate for acquirers and merchants, respectively. This is the main reason why acquirers and merchants agree on paying a fee and transferring rents to the issuing side in order to promote their use.
- Issuers could recoup costs by charging cardholders a fee per transaction. But this mechanism would probably discourage the use of electronic payments as consumer demand seems to be elastic to extra-charges per transaction.

If no fee per transaction is charged, issuers may recoup costs by charging a higher flat fee to cardholders. But under a flat fee scheme, they will not have any incentives to achieve a higher volume of card transactions, as their revenue per transaction would decrease.

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

As we explain in section E of the attached document, we identify a number of inconsistencies in the theory of market power drawn in the Interim Report. According to this theory, "*high interchange fees are a way to transfer profits to the side of the scheme where they are least likely to be competed away*". However:

- It seems that issuing is even more competitive than acquiring, so banks would not be transferring rents to the more protected side of the market to their own advantage.
- The lack of relationship between interchange fees and cardholder fees should not be necessarily interpreted as evidence of market power. Interchange fees have decreased in the last years, but cardholder fees have remained unchanged.[1] This means that, far from exerting market power, issuers have reduced their margins or increased their efficiency.
- High profits are not enough to infer excessive prices or the existence of an exploitative abuse.

Nevertheless, as mentioned before, we think that Interim Report's conclusions on profitability of the issuing business should be revised.

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

The Interim Report suggests that the non-surcharge rule disturbs competition between means of payment, as it can represent an entry barrier for alternative non-card payment instruments (for example, e-money and mobile phones). However, even when surcharge is allowed, the Interim Report acknowledges that merchants often decide not to apply it. This indicates that merchants have an interest in promoting the use of cards and are ready to pay for it. Besides, in many transactions, non-card electronic means of payment are not a perfect substitute for cards, and therefore pricing issues cannot disturb consumer choice. Moreover, nothing suggests that non-card electronic means of payment are more efficient than cards.

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

Cost-based pricing will not promote the use of efficient payment instruments. As the ECB and the EC have pointed out in different occasions, banks have a very important role in promoting the use of electronic payments and they will have to make strong efforts in order to make it. But neither banks are non-for-profit organizations nor cards are public utilities. This means that banks should expect non-negligible profits rates in order to foster the use of payments cards and get involved in new challenges.

Besides, this cost-base pricing strategy is very misleading and lacks economic foundation. First, it is not so easy to determine what "cost–based" means, specially in industries where fixed costs and long run costs do really matter. Second, even if we identify the correct measure of costs, we must take externalities into account, and, as explained before, these imply that cost-based pricing is not the most efficient solution (see answer to question 3).

The lack of consistency among the last EU competition authorities' decisions can be interpreted as a consequence of this misleading approach based on costs.

[1] Interim Report, page 57, 58 and 60.

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

Existing pricing practices have not impeded cross-border card usage by consumers. On the contrary, interchange fees within international multilateral systems such as VISA and Mastercard have promoted the cross-border use of cards. In fact, cards are used in more than 85 per cent of cross-border payments in Europe, what means that they have contributed to bringing down borders for European consumers.

B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

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

As mentioned before, efficiency and good performance will depend in each case on many variables. Nevertheless, as a general rule we can say that users are better off when they have different issuers and/or acquirers to choose among.

As we explain in depth in Section C of our document, there are many different supply and demand factors that determine the design of payment card systems. What particular market structure works better in a specific case will depend on many exogenous variables, such as the market size, the structure of the retail banking sector, the penetration and use of other means of payment, etc. Therefore, there is not a unique answer to this question.

However, due to their bilateral nature, card payment services works better under four-party systems, interconnected by efficient rules that provide issuers with the right incentives to promote card payment transactions. As a proof of this we observe that this kind of systems have grown more and brought more members (cardholders and merchants) on board.

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

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

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

13. What access conditions and fees are indispensable?

In order to facilitate competition, government arrangements should (a) impose objective and non discriminatory joining rules and (b) avoid the existence of high switching costs for those entities that want to move from one platform to another.
When government arrangements promote competition, they also provide incentives to issuers and acquirers to respond to their clients' needs. Otherwise these issuers and acquirers will lose their clients in favour of competitors.

When designing access conditions, joining fees and rules for minority members, it is necessary not to discourage new entrants, but also to avoid free-riding. Conditions for new members should not be unfair for those who have invested more and borne the risks of developing the system. SEPA Cards Framework ensures for all the schemes the objective of promoting governance arrangements based on non-discriminatory and transparent rules. In our view, this implies that minority participants receive appropriate information and participate in decision-making.

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

The answer to this question also depends on the characteristics of each payment card market. Vertical integration may be dangerous when it can lead to foreclosure and users do not reap the benefits of this vertical integration. However, when there is interplatform competition and concentration in acquiring, vertical integration is not worrying. In those cases, vertical integration can be even positive, as it may generate efficiencies and facilitate entry. We have included comments on vertical integration issues in Section D of our document.

C. Future market developments

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

Structural changes may come from different sources. First, Mastercard is in the process of becoming a for-profit equity corporation, in which banks do not have a controlling interest. VISA could well follow the same path. These corporate changes may have significant implications on the future operation of the market and the way systems compete. Second, the New Legal Framework is in the process of being approved and it may help to remove structural and behavioural barriers in those cases where they exist. Third, SEPA Card Framework has been approved and financial institutions have endorsed it. This means that in next years the sector will have to make strong efforts to enforce it. Moreover, the SEPA Card Framework will impact in the volumes handled under the existing national and international schemes respectively. Fourth, also in the SEPA context, progress will be made in technological convergence.

These are elements that may affect entry conditions as well as degree of vertical integration in the market.

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

This is difficult to assess in the long run, although probably we will witness the development of new electronic means of payment (e-payments), probably through the convergence and evolution of the existing ones. Besides, as new forms of fraud appear, banks and systems need to innovate continuously in order to prevent illegal practices and to ensure the stability of the systems.

In the shorter run, migration to EMV is still pending in some countries. For example, this is the case in Spain, where significant investments are still needed. By the end of 2010, the ultimate objective of the SEPA should have been reached. All card schemes will be compliant with the EMV standard.

D. Potential solutions to market barriers

For all this section we refer the answers to section D of the attached document, where we have analysed entry barriers in depth.

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?

First of all, it has to be acknowledged that both vertical integration and acquiring concentration are not *per se* entry barriers. They have to be considered in conjunction with all the other elements that determine the structure of the payment card systems in a given country, such as for example the potential difficulties to join a payment card scheme.

Second, the concentration issues are actually diminishing across Europe. In those countries where concentration in acquiring used to be higher, it is now diminishing as more acquirers enter the market.

Third, with respect to vertical integration, it can also be regarded as a source of efficiencies, because it avoids the problem of double marginalization, and in some cases it even operates as an incentive to entry. Nevertheless, to prevent its impact as a potential entry barrier, the SEPA Cards Framework establishes a separation of functions between governance and management of card schemes' brands and the remaining operations of service providers and infrastructures.

Finally, we want to stress that we do not agree on the classification of countries according to their degree of vertical integration assigned in the Interim Report. In particular, Spain is assigned a higher degree of vertical integration than countries like Netherlands or Denmark, but both the scheme ownership and the network ownership and issuing and acquiring are legally separated in all of them, including Spain.

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

The Interim Report identifies several behavioural barriers to competition. Nevertheless, we doubt that some of them can really be regarded as such. For example, blending is a practice that reduces transaction costs. By charging the same MSC to merchants independently of the card or the network, merchants will not have to deal simultaneously with several different MSCs. In fact, blending is a facility that merchants demand.

With respect to co-branding, we agree with the Commission that it can facilitate new entries into the payment card industry (entry not only by financial institutions but also by other market players such as merchants). But this practise is allowed in most countries, so it hardly ever operates as an entry barrier.

The SEPA Card Framework deals with behavioural barriers and plans their elimination. All technical and contractual provisions, business practices and standards which have resulted in a national segmentation of the euro area will have been eliminated by 2008 or 2010 at latest. Some other barriers to competition have already been removed. For example, international systems rules prevent differences in interchange fees for domestic and cross-border transactions. This non-discriminatory rule has been gradually enforced by most countries.

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 agree with the Commission that the existence of very different technical standards may represent an entry barrier and an obstacle to cross border activity. This may be the case of some closed domestic systems, where cross border acquisition is really difficult.

We believe that this is a common view in the industry, as the unification of protocols and process standardization has been agreed in the context of the SEPA Cards Framework. Particularly, appropriate technical provision and standards will be defined for cards, technical acceptance devices (POSs and ATMs), communication interfaces, processing platforms, etc. ensuring interoperability and thus flexibility and independence in the choice of service providers.

However, this process must pursue efficient solutions, in the sense that the benefits that technological convergence may produce should not be surpassed by the costs of introducing new technical standards. To this aim, it is important to asses at what level and to what extent convergence is needed in order to facilitate the interoperability from a business perspective.

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 payment card industry has worked intensively during the last two years on reaching the SEPA Card Framework In the context of the SEPA Card Framework, SEPA schemes will facilitate the phasing out of strictly national schemes by end 2010. This will require adjustments from existing infrastructures, thus allowing further standardization. Nevertheless, financial institutions will only have an interest in promoting them it if they have an economic incentive. So, these schemes will only be successful if they constitute profitable customer value propositions.

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

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

As the SEPA Card Framework means the phasing out of strictly national schemes and facilitate standardization, it will promote competition between schemes. Besides, the SEPA Card Framework makes a firm declaration of EPC policy aim at removing potential entry barriers and strengthening competition in this industry. The main areas of work are:

a) Governance issues: transparent and non-discriminatory participation criteria, not imposition of a certain processor.
b) Non-discriminatory principles: same treatment for all transactions within the same system, universal acceptance of any card from another SCF compliant scheme by merchants.
c) Technical standards: common process for the certification of terminals, cards, and network interfaces.
d) Unbundling of functions: Separation of SEPA card schemes' brand governance and management from the operations that have to be performed by service providers and infrastructures under these SEPA schemes is mandatory.

The transformation of (international) schemes in for-profit equity corporation can also have a positive impact on competition as it may force a more aggressive and competitive behaviour of these firms in the markets.

23. What governance requirements should SEPA schemes meet?

SEPA schemes must be organised under an open business model, allowing SEPA banks to participate in a non-discriminatory manner under sound business conditions. The Framework also prevents the existence of any scheme rules that may require as a participation condition the use of a particular provider of processing services or that any certification must be performed only by a proprietary certification body. The SEPA Cards Framework also establishes that scheme prices must be transparent, in the sense that the nature of the service they pay for should be unambiguous for the scheme participant.

The aim of these general principles is that governance rules must allow and facilitate objective entry conditions, which is different from subsidizing entry. If this were the case, there would exist a problem of free riding, as new entrants into the scheme would participate of a well established scheme without incurring in any (or very low) costs.

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

The SEPA Cards Framework itself contains some general principles on standardisation. In particular, it promotes the use of open and free standards that should be available to all users within the payment card value chain. Moreover, a task force is working to develop these general principles.

But once again, this standardization should be efficient in the sense that migration to these new systems should not be discouraged from a cost-benefit perspective.

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

The payment card industry has been working on these issues for a long time. In fact, it has been a great achievement that such a great number of market players have reached an agreement.

Now is time for enforcing all the principles that have been set out. (Self) Regulation must be now implemented and this process should take place with the support of the authorities, including the EU Commission.

Self-regulation is proving to be an efficient instrument not only for removing barriers, but in other areas as well. See for example the case of Spain. Certain decisions coming from the Spanish competition authority (TDC) implied a change in the treatment of interchange fees and generated a great deal of uncertainty among market players. Subsequently, both financial institutions and merchants have signed an agreement that allows an efficient transition, regulating a transitory period that, at the same time, implies a very significant reduction in interchange fees.

<u>General comments:</u>

As has been said at the beginning, Grupo Santander has elaborated a document that reflects our opinions and comments on the Interim Report. However, in view of the Commission's request, we have also elaborated our comments following the suggested lay-out of the feedback form. Notwithstanding, we want to stress that for a right comprehension of our views the attached document is indispensable.

<u>General questions:</u>

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

   ☐ 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;

   ☐ not sufficiently detailed;

   ☐ too detailed.

3. Did the information contained in the report was:

☐ generally new to you/the payment cards industry;

☐ mostly known to you/the payment cards industry.

4. Did the market analysis in the report:

☐ confirm your views on the operation of payment cards market;

☐ challenge your/industry's views on the operation of payment cards market;

☐ represent a mix of both aspects.

5. Did the report raised the right policy issues;

☐ yes, covered most of the key issues;

☐ no, there were some significant issues left out.

Thank you for your contribution!

Comments on the Commission´s Interim Report

by Grupo Santander

A. INTRODUCTION AND CONCLUSIONS

Grupo Santander is an international group which combines a solid local presence with strong global capacities and operates in three large geographic areas:

- Continental Europe, where its main subsidiaries are Santander, Banesto, Banif, Openbank, Santander Consumer and Santander Totta.
- United Kingdom, including Abbey's business.
- Latin America, mainly Brazil, Mexico, Chile, Argentina, Puerto Rico, Venezuela and Colombia

The Group's main business areas are Retail Banking, Wholesale Banking and Asset Management and Insurance.

Payment Services are included in the retail banking business. Grupo Santander provides payment services in seven European countries: Portugal, Spain, Italy, Germany, Poland, Norway and United Kingdom. The Group has local presence in all of these countries, although in some cases cross border services are also provided. This is the case of Portugal, where Santander Consumer provides cross-border issuing services since 2004.

Table 1. Grupo Santander European payment services[1]

Country	*Institution*
Germany	Santander Consumer
Italy	Santander Consumer
Norway	Santander Consumer
Poland	Santander Consumer
Portugal	Santander Consumer Santander Totta
Spain	Santander Santander Consumer Banesto Banif Openbank
United Kingdom	Abbey National

Grupo Santander mainly operates as an issuer, except for Spain and Portugal, where it has also a significant presence in acquiring.

In 2005 Grupo Santander created a global cards unit (Santander Cards), which reports directly to the CEO. This unit manages, in coordination with the local units, product development, information management, marketing, risk management and channels of distribution. The aim is to develop and transfer the best practices and to take advantage of the synergies and economies of scale at the Group level.

Considering its position as a European player, the Santander Group´s comments to the Interim Report could constitute a useful contribution to the debate on the construction of SEPA.

Grupo Santander agrees on the need to improve the market knowledge on payment services and, in particular, to provide a common framework to National Competition Authorities (NCAs) that ensures that the many ongoing competition procedures are coherent. The past few years have witnessed a great diversity among the opinions and decisions coming from different authorities, and sometimes even from the same authority. This lack of legal certainty is not irrelevant for the industry, as it generates big uncertainty about the business

[1] Grupo Santander main acquisitions:
- Germany: CC-Bank was acquired in 1987.
- Portugal: Banco Totta was acquired in November 1999.
- Italy: Finconsumo was 100% controlled in March 2001.
- Norway: Bankia Bank and Elcon Finance, acquired respectively in 2005 and 2004, first quarters, merged during the fourth quarter of 2005 under the new name of Santander Consumer Bank.
- United Kingdom: Abbey National Bank was acquired in November 2004.
- Poland: In the first term 2004 Santander Consumer bought Polskie Towarzystwo Finansowe (PTF).

model and has negative implications on investment. The Commission's Inquiry was welcome to the extent it helps clarify this panorama.

The Interim Report represents an effort to contribute to establishing this analytical framework and to the development of SEPA. But, unfortunately, in our opinion it contains some arguments and interpretations that could lead to a wrong diagnosis of competition conditions in card payment services. From its standpoint as an active market participant in many different countries, Grupo Santander wants to contribute to the debate and clarify different aspects that may be relevant for policy making purposes.

We can summarize our conclusions in three main messages:

1. Commission´s analysis is biased from a methodological point of view. Both the profitability analysis and the statistical exercise contain serious flaws that undermine its conclusions. Furthermore, as the EPC has already mentioned in its letter to the Commission, the Interim Report makes a judgment on the European card market "as is", omitting the relevant on-going changes that the SEPA Card Framework entails for the industry[2]. Interim Report conclusions are affected by all these biases and, accordingly, should be revised.

2. The SEPA Card Framework deals with barriers to competition and plans their elimination. It has been unanimously approved in March this year. Now is time for its enforcement which should take place with the support of the authorities, including the EU Commission.

3. Intervening on fees is not the right way to proceed. Cost-based pricing will not promote the use of efficient payment instruments. Prices should take into account all the positive externalities and, as a consequence, the issuing side needs to be adequately remunerated. As the ECB and the EC have pointed out several times, banks play a very important role in promoting the use of electronic payments and they will have to make strong efforts in order to achieve this goal. Banks are for-profit organizations and should expect non-negligible profits rates in order to have an incentive to foster the use of payments cards and get involved in these new challenges

This document is organized as follows. We first briefly describe in Section B Commission´s Interim Findings. Section C deals with differences across countries in the payment card industry. Section D provides our experience regarding the entry barriers identified in the Interim Report and how they are being removed. Section E discusses the way forward and explains why intervening on interchange fees is not the right option. Finally, Section F concludes.

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[2] Not only the SEPA Cards Framework. For example in Spain payment systems and merchants have signed an agreement in order to establish a transition period that allows moving towards a cost-oriented interchange fee setting model in a gradual, non-traumatic way for the parts involved, including consumers.

B. INTERIM FINDINGS[3]

In the summer of 2005, DG Competition undertook an Inquiry on bank financial services. Questionnaires were sent to different entities, Grupo Santander among them. From the answers to the questionnaires, the Interim Report highlights certain findings that in their view could confirm some of its concerns:

1. Differences across countries

Interchange fees, merchant service charges (MSCs) and cardholder fees vary considerably across countries. This could indicate that the market for card payment services is not working effectively in many Member States, to the detriment of business and consumers. The existence of barriers to competition and to market entry may be one of the main reasons of this fragmentation.

2. Barriers to competition

The investigation identifies a number of potential barriers to competition in the market for card payment services that may obstacle competition and the functioning of SEPA. The Interim Report classifies these barriers to competition into structural barriers, behavioural barriers and technical barriers. The following table summarises them.

Table 2. Barriers to competition identified in the Interim Report

STRUCTURAL BARRIERS
Vertical integration of card payment systems
Concentration in acquiring, particularly joint ventures between local banks to acquire merchants
BEHAVIOURAL BARRIERS
Double standars for domestic interchange fees
Lack of direct access to multilateral clearing platforms
Governance arrangements within card payment systems, as for example:
One-way requirement for some members to share sensitive business information
Reservation to a closed group of members the decision making on issues affecting intra-system competition
Payment systems membership requirements, as for example:
Financial institutions requirements
Local establishement requirements
Requirement to buy processing services
Prohibition of double membership in domestic card payment systems and/or international card payment systems
Level of joining fees for card payment systems and their structure
Prohibition of co-branding
Blending
TECHNICAL BARRIERS
Diverging technical standards across the EU
National proprietary communication protocols
Different security concepts and standars
Specifications owned by national banking organisations or by national processing centres owned by local banks or banking associations
Licence fees for obtaining the specification
Certification requirements

[3] Main findings of the analysis are presented in the Executive Summary of the document, section B, (pages iii-v) and Section E (page 141-144).

3. Financial analysis

According to the Interim Report, the size of the price differentials across countries indicates that there is potential scope for price reductions at least in some of the Member States. Merchant fees are determined to a significant extent by interchange fees. However, high interchange fees do not lead to lower prices for cardholders. As a result, high interchange fees can only result in higher profitability of card issuers. In fact, in many cases, even in the absence of interchange fees, issuers would earn positive profits.

On the basis of these interim findings, the Interim Report suggests that remedies should be adopted. The remedies may be advocacy, antitrust and/or regulation.

C. DIFFERENCES AMONG COUNTRIES

The Commission is concerned with the differentials in the prices charged to businesses for card acceptance and to consumers for card issuing, as well as in interchange fees. These differences are interpreted by the Interim Report in terms of market power. It implicitly assumes that those markets exhibiting lower prices are more competitive and constitute the right benchmark to assess the lack of competition in the rest.

This approach is misleading as it disregards the important differences that characterize payments systems across countries. Furthermore, price differentials across countries are usually observed in most sectors and products –even within the Euro area- and it does not imply that some markets do not work.

Reasons for diversity

It is true that competition may lead to convergence in prices when considering homogeneous products. But it is also true that price differentials do not prove *per se* lack of competition. There may be many other reasons that explain price differentials.

Prices are determined by supply as well as demand factors. Merchant service charges, cardholder fees and even interchange fees are not an exception. Differences in demand and supply patterns may cause price differentials across countries. As for payment cards, these differences may stem from many different sources:

- Country factors: Size of the market, population density, income levels, consumer habits, characteristics of the merchant side, importance of tourism, regulatory aspects, quality and costs of IT services…

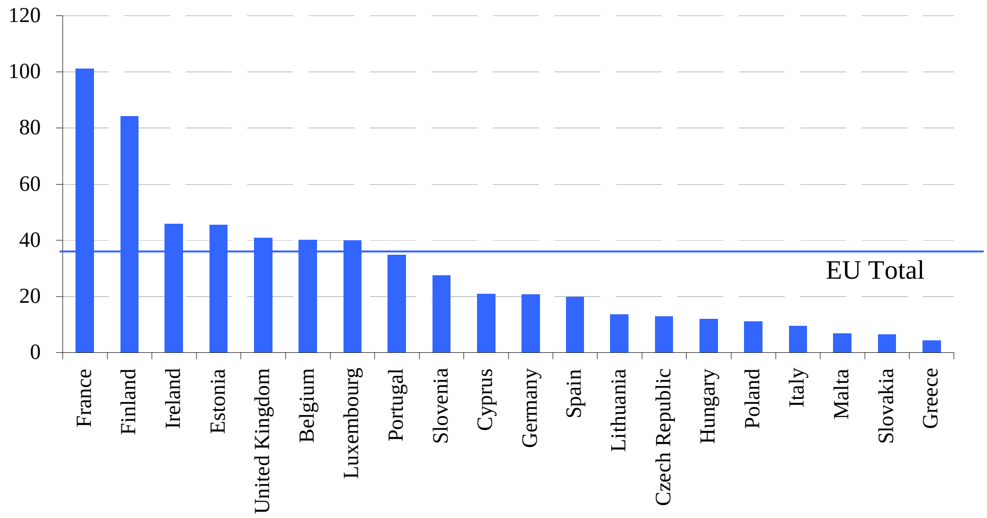
- Sector characteristics: Concentration of the banking sector, role of non-financial institutions, banks' portfolio of products, use of alternative means of payment, ATM network density…
- Payment card industry: Concentration in issuing and acquiring, inter-system competition, interoperability of the payments systems, number of POS, maturity of the card payment market, card penetration, card usage, fraud levels, value-added services, role of revolving…

Any comparison of payment services in different Member Countries reveals that (1) there are substantial differences among systems and (2) cards do not give access to homogeneous services across Europe. As a consequence, significant differences in prices across countries should be considered rational from an economic point of view.

As an illustration, the Interim Report states that the payment card industry is, in general, a relatively mature market.[4] In fact, however, the degree of maturity of this industry is quite different across countries. We can use a number of different indicators to evaluate the maturity of the payment card industry in a given country. One possible indicator could be the number of payment cards issued. The problem with this indicator is that it does not provide information about how often cards are used. To avoid this problem, we analyze the relative use of payment cards at point of sale terminals (POS).

[4] Interim Report, page 77, and with the exception of new Member States, which according to the Interim Report are characterized by quite immature and unstable payment card markets (Interim Report, page 80).

Figure 1. Number of POS transactions per card issued in the country at terminals located in the country[5] (2004)



Source: European Central Bank, Payment and Securities Settlement Systems in the European Union and in the Acceding Countries, Addendum incorporating 2004 data, Blue Book March 2006, Table 14.4.[6]

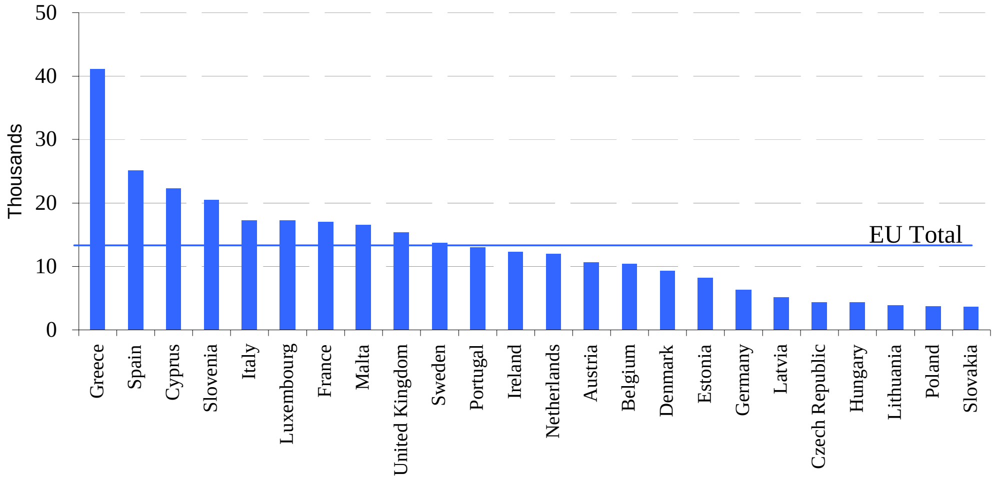
We observe strong differences among countries. On the one hand, in countries like France and Finland the use of cards at POS is relatively very high. On the other hand, countries like Greece or the New Members States exhibit a very low usage of payment cards at POS.

We may be tempted to presume that the previous figures are the result of a positive and strong correlation between the number of POS transactions and the number of POS. However, this conclusion does not necessarily hold. As we can see in Figure 2, countries with a relatively low number of POS transactions, like Greece and Spain, have a very high number of terminals in absolute terms. Without any doubt, this fact has implications on the level of costs that the provision of payment card services entails.

[5] We want to asses the maturity of each domestic market, so we are only considering pure domestic transactions (POS and ATM transactions at terminals located inside the same country where the card has been issued). This is a better measure of maturity, because this way we are excluding transactions made abroad by cardholders and also transactions made inside a country by tourists, what does not indicate the maturity of the domestic market.

[6] Note: There are no available data for Denmark, the Netherlands, Austria, Sweden and Latvia.

Figure 2. Number of POS terminals per million inhabitants (2004)



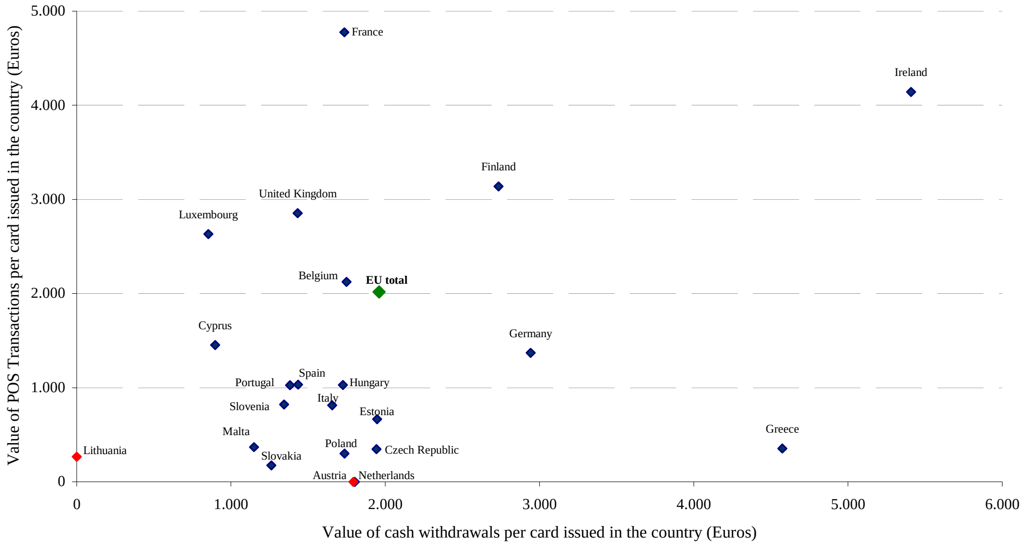
Source: European Central Bank, Payment and Securities Settlement Systems in the European Union and in the Acceding Countries, Addendum incorporating 2004 data, Blue Book March 2006, Table 11.3a.[7]

A second indicator of the maturity of the payment card industry could be based on the relative importance of the value of POS transactions and automatic teller machines (ATMs) withdrawals.

The next figure represents the value of POS transactions and of ATM cash withdrawals per card. We consider only POS and ATM transactions at terminals located inside the same country where the card has been issued.[8] This figure shows that in some countries the value of POS transactions is very high compared to the value of cash withdrawals. These countries, that can be considered the most mature, are UK, Luxemburg and especially France, where the value of cash withdrawals at ATMs is less than half of the value of POS transactions. Ireland seems to be an exception. It shows high values for both types of transactions, what indicates that payment cards are very frequently used at POS but cash has not yet been replaced.

[7] Note: There are no available data for Finland.
[8] See footnote 4.

Figure 3. POS transactions vs. ATMs cash withdrawals
Value of transactions per card (2004)



Source: European Central Bank, Payment and Securities Settlement Systems in the European Union and in the Acceding Countries, Addendum incorporating 2004 data, Blue Book March 2006, Tables 12.4 and 14.4.[9]

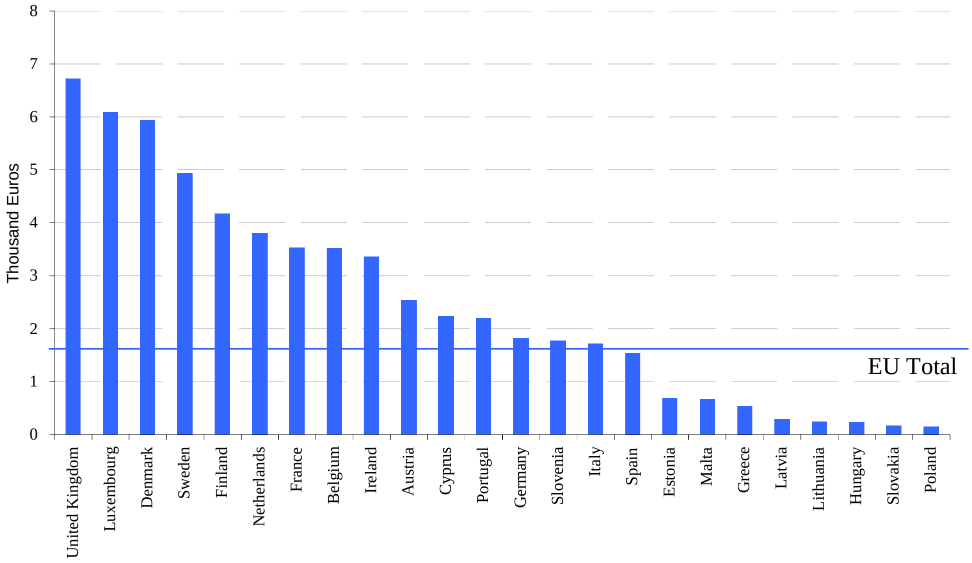
Finally, it should be noted that in most countries the value of ATM cash withdrawals is higher than the value of POS transactions. Many countries still display a relatively low value of POS transactions compared to cash withdrawals, but nevertheless they have low values for both. This may suggest that in these countries the use of payments cards is not widespread: Spain, Portugal, Greece, Italy and even Germany could not be considered mature markets yet.

The analysis of the value of payment card transactions per capita confirms both that there are differences across countries and that in many of them payment card systems cannot be considered mature yet.[10]

[9] Note: Red points represent those countries for which one of the variables is missing (the Netherlands and Austria for POS transactions and Lithuania for cash withdrawals). For Denmark, Sweden and Latvia there are no available data.

[10] However, when assessing maturity we should pay attention not only to the total value of transactions per card, but also to the number of transactions and the value per transaction.

Figure 4. Value of card payment transactions per capita (2004)



Source: European Central Bank, Payment and Securities Settlement Systems in the European Union and in the Acceding Countries, Addendum incorporating 2004 data, Blue Book March 2006, Tables 9.5 b.

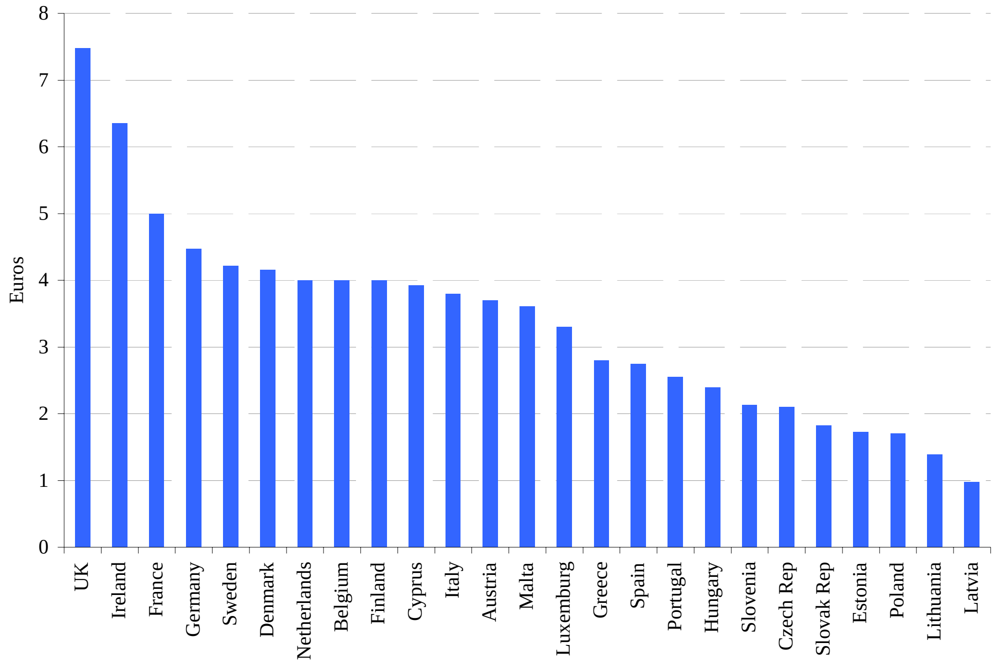
The differences shown are only the tip of iceberg of the strong dissimilarities that characterize any comparison across EU countries. Therefore, entry barriers or market power are neither the single nor the main factor than can explain differences in interchange fees and MSCs. We understand that the Interim Report does not adequately take all these factors into account and therefore, its conclusions on the reasons behind the observed price differentials are flawed. A comparison of interchange fees, merchant services charges and cardholder fees among countries would deserve a rigorous analysis controlling for many different variables.

Differences do not necessarily prevent cross-border competition

Prices differentials across European countries are not a specific feature of payment card systems. Price differentials in Europe are observed for many commodities and services and this does not necessarily imply that the internal market does not work for these products or that entry is prevented.

Large prices differences exist, for example, in the tobacco sector. Marlboro prices differ significantly across Europe: in the UK, the price of a package of 20 cigarettes is close to 8 euros while in Latvia and Poland is less than 1 and 2 euros, respectively. And this happens despite the fact that this is a homogenous product that is present in all EU countries. Many factors explain these differences: regulation, taxes, consumer preferences, etc.

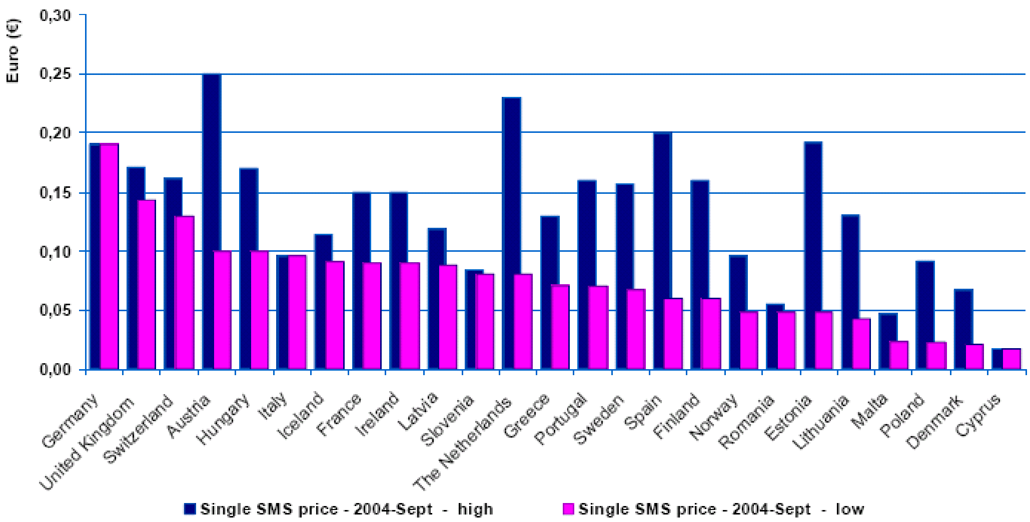
Figure 5. Marlboro Price Comparison. 20 cig. package



Source: TDC. November 2005.

The same prices differences are observed in the provision of many services. See for example SMS services. As Figure 6, illustrates, the price of an SMS varies considerable across countries. In Cyprus and Denmark, the minimum price consumers pay is close to 3 euro cents per SMS, while in Germany the minimum price is closer to 18 or 20 euro cents, 600% higher than in Cyprus or Denmark. These differences are even larger if the maximum prices are compared.

Figure 6. SMS unit prices, Europe (September 2004)



Source: IRG Market Data Analysis. 2004 Report.[11]

[11] Note: High and low refer respectively to the maximum and minimum price available for consumers.

Note that the differences in prices in these examples are even larger than the divergence of Visa and Mastercard domestic interchange fees across the EU. According to the Interim Report, the weighted averages diverged up to 250% across the EU for credit cards and up to 400% for debit cards.[12]

In sum, the existence of differences between countries with respect to, for example, the level of interchange fees and MSCs does not imply that cross-border competition is prevented. In fact, in order to analyze cross-border competition, the analysis should pay attention to the evolution of cross-border transactions and entry into national systems.

D. FOCUS ON BARRIERS TO ENTRY

The Interim Report describes entry barriers that may impede the right functioning of SEPA. As a pan-European financial institution, Grupo Santander wants to provide the Commission with our experience regarding those barriers. Besides, in our opinion the Interim Report does not pay enough attention to the relevant on-going changes that this industry is undergoing, including the SEPA Cards Framework.

Entry analysis

The Interim Report focuses on entry on cross border acquiring.[13] To do so, it examines how different acquirers try to enter foreign markets (directly opening branches or subsidiaries in another country, through the purchase of an existing foreign bank, by offering services under a cross-border acquiring program or through a joint venture with a local acquirer), and the characteristics of the merchants and acquirers that more often demand or provide cross-border acquiring services.

According to this analysis "*Only about 9% (14 out of 159) of the acquirers participating in the inquiry made an attempt (whether successful or not) to enter a cross-border market*".[14] The Interim Report concludes that this low percentage is a reflection of entry barriers. It is true that there may exist some obstacles to entry in certain payment card systems. However, some considerations should be made in this respect:

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[12] "Turning to Visa and MasterCard, the level of domestic interchange fees diverges considerably from one EU Member State to another, even though country-specific differences in these systems are less pronounced in relative terms than in the national card payment systems. In 2004, the nominal rates diverged more than 200% for debit cards and more than 300% for credit cards, and weighted averages diverged up to 250% across the EU for credit cards and up to 400% for debit cards." Interim Report, page 31.
[13] Interim Report, Chapter XII, pages 107 to 120.
[14] Interim Report, page 107.

- It is true that a percentage of 9% of attempts seems too low. However, the number of acquirers considered is also very low in relation to the total number of acquirers operating in EU-25, so this sample may not be representative.
- It is also important to note that the probability of success in cross-border entry is not low, at least in some cases (in the UK, only 6% of cross-border entry attempts are unsuccessful).
- The rate of success in entry is not so poor for those that made an attempt, which means that entry barriers may not the cause of these few attempts but other reasons explain it. One of these additional reasons can be the fact that in several European countries the payment card industry is not yet a mature market. As these domestic markets are still developing, financial institutions enjoy substantial business opportunities in them and, given the risks and cultural differences, they refrain from expanding their activities across-borders. Nevertheless, cross-border acquiring, along with the number of national merchants with cross-border acquiring services[15] and the volume of purchases processed by cross-border acquirers,[16] display an increasing trend.
- Even acquirers whose domestic market could be considered mature have additional reasons not to provide cross-border acquiring. For example, in the UK just around 5% of the card traffic is international and therefore only large operators would obtain an incremental economic benefit in respect of their existing card business by cross border acquiring. As such, entry into a new market as an acquirer requires a very strong business case in order to offset the infrastructure costs that will be needed.
- Another important aspect is that acquiring is only one of a long list of activities carried out by financial institutions. Hence, entry into a foreign market entails that several of these activities are carried out, and not only acquiring. Consequently, when an institution is deciding to enter or not another market, it normally analyses the business opportunities globally, not only in acquiring. So the decision to operate in other country depends on the balance of all this opportunities and the reason not to enter the market may come from other activities considered strategic for the specific institution or from a combination of them.

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[15] The Interim Report states that in 2002-2004, there was an increase in the number of cross-border acquiring contracts signed with national merchants: “Thus, in 2002, the share of contracts signed with national merchants accounted for only about 15% of all cross-border acquiring contracts, whereas in 2004 this share was roughly 70%”. Interim Report, page 113.

[16] “In 2004, merchants acquired cross-border were responsible for 6% of the total card turnover of the acquirers involved in cross-border activity. Furthermore, this followed an upward trend over the period 2002-2004, with the share of cross-border acquiring turnover increasing by more than 50%.” Interim Report, page 111.

- Finally, merchant demand for cross-border acquiring services is one of the main incentives for acquirers. Although it is true that these services are being increasingly requested, there are very reliant on merchant power inside the foreign country. Most cross-border contracts are with large or global merchants, which enter new markets sometimes through a joint venture. The new entrant may then prefer to adopt the banking practices of the local partner, thereby preventing the achievement of a cross-border acquiring contract.

With respect to entry into domestic payment card networks, the Interim Report simply describes a number of market entry barriers that may exist and may prevent cross-border competition.[17] But it does not analyze the actual effect of these elements on cross-border entry: neither the attempts to enter in a domestic network, nor the failures/successes are shown.

The Interim Report does not pay special attention to cross-border issuing. According to our experience, this is due to the fact that cross-border issuing is more widespread and easier than cross-border acquiring. As international networks want their cards and logos to be used and known in as many countries as possible, they remove any possible obstacles to cross border issuing that national systems may try to rise.

One example of the existence of cross border competition is Grupo Santander itself. Despite the differences across countries, it has been able to enter the payment cards industry in different European countries, usually through the acquisition of an institution, sometimes by establishing a local office in a foreign country.

In conclusion, the Interim Report infers lack of cross border competition based on price differentials across countries. But a more careful analysis on the evolution of entry and cross border flows should be made before reaching any conclusions about the degree of success in building-up the SEPA.

Regardless of what the result of this entry analysis would be, the exercise of identifying potential entry barriers is positive and useful in order to foster the creation of the SEPA. We discuss them in what follows.

Entry barriers to issuing and acquiring

Our expansion process has improved our understanding of how European card markets work and what the obstacles to enter new markets may be. From this standpoint, our experience may provide the Commission with a useful reference

[17] We do not analyze here if these elements considered in the Interim Report represent in fact barriers to competition. This consideration will be discussed in Section D of this document.

on what entry barriers really matter to market players when considering entry in issuing and acquiring.

Barriers to issuing:

As we have mentioned before, issuing is a relatively open activity, as much with respect to domestic as to cross-border competitors. Nevertheless, some entry barriers can be identified with respect to this activity.

a) Domestic institutions' competitive advantage:

   One of the main features of the issuing business is the importance of being familiar with the market (consumer preferences and habits, operative of the financial market, etc). In fact, the lack of market knowledge constitutes an important obstacle to entry. The main barriers to cross border card issuing do not come from national payment systems, but from cultural and environmental factors. It is also important to have significant human resources in the country, especially people who directly manage the relation with clients. Besides, some activities can not be realized from the distance.

   Being "trusted" and having a "local presence" are important factors for business in banking, and therefore newcomers typically opt for establishing a branch and develop a brand in the country. However, this may be a long and costly way to enter. For this reason, taking over a national institution may be a better alternative, especially when the bank plans to develop different lines of business. Reaching a cooperative agreement with an incumbent institution may be another alternative. In sum, this is not very different from other product markets, where firms gain a local presence through alliances and acquisitions.

   For this reason, being established in a market represents a first-mover advantage and a possible entry barrier for new entrants. But it is also true that there are many ways to compensate for this lack of presence.

b) Consumer protection:

   Related to the previous obstacle, the most important barriers to entry in issuing are not related to the payment systems but to other sources, such us regulation on consumer protection. Differences in regulation on this field may discourage entry. Newcomers must be aware of the national legislation regarding consumer protection in order not to infringe national laws without even knowing it. But legislation on consumer protection is very different across countries and is usually disperse in a variety of different rules. A deep knowledge of this legislation entails relevant costs in terms of resources and time, higher for newcomers, and therefore may discourage entry.

c) Authorizations:

Once established in a foreign market, cross-border issuers need to obtain an authorization from the national central bank in order to be allowed to operate in the market. Generally, these authorizations are given automatically and do not constitute a problem.

d) Access to card payment systems:

Newcomers generally become members of a domestic system. But sometimes domestic networks impose conditions to new entrants with the final intention of discouraging entry. As the Interim Report highlights, these conditions may refer to:

- Membership conditions, usually being a financial institution and/or physical establishment requirements.
- High joining fees. In principle, joining fees are not contrary to competition. In fact, they are rational from an economic point of view, as they compensate the benefits for the newcomer of accessing to an already developed system. However, they can constitute an entry barrier when they are so high that they jeopardize profitability and no issuer will join that network or when the fee structure is such that it "*discourages new or incremental card issuing*".[18]
- Some networks also impose conditions on the characteristics of the cards that new issuers plan to launch in the market. This may also discourage entry because the characteristics imposed on the new product may not adjust to the issuer's business strategy.

Nevertheless, it is important to note that many of the systems do not establish these barriers.

e) Obstacles to co-branding

Co-branding consists of a partnership between two brands for the promotion and trading of a card product and their added value services. It usually implies the co-existence of two different brands/logos on one card, one of them being generally the logo of a scheme. According to the Interim Report, the prohibition of this practice "*may hinder domestic debit card payment systems from entering into competition with MasterCard and Visa or retailers or other operators from entering into competition with the incumbent card issuer*".[19]

[18] Interim Report, page 106.
[19] Interim Report, page vii.

Co-branding can facilitate new entry in a market because the new logo will be more easily accepted by co-branding. Additionally, by co-branding different logos, the choice of consumers is multiplied. Furthermore, thanks to the practice of co-branding, entities that are not financial institutions, as for example merchants, can enter payment card markets. So by prohibiting co-branding entry could be prevented.

Furthermore, co-branding is allowed in several countries. And we do not usually regard its existence as a problem. For example, in the UK some banks issue cards under multiple schemes (for instance, Natwest is offering Visa, MasterCard and Amex) and also several instances of co-branded cards with non banks in the UK.[20] In Italy, as the Interim Report says, even national networks allow co-branding with each other.[21]

Barriers to acquiring:

In principle, acquiring activity should be more prone to cross border competition than issuing, because merchants (mainly those which operate in several countries) are often willing to demand centralized acquiring services for all their branches. Nevertheless, this is not usually the case, and cross border acquiring may not be as frequent as it should be. We offer some possible explanations below.

a) Regulatory barriers:

In some countries, entry barriers are not the consequence of the behavior of incumbents. They are rather an effect of the specific regulation applicable in that country. For example, some central banks require that those issuers or acquirers that are going to provide services inside their country must be financial institutions or have a local establishment.

In most cases, issuers and acquirers are required to be financial institutions, in order to provide stability to the scheme by ensuring that members have sufficient capital backing and are regulated outside the scheme itself. This is the case in Portugal (SIBS) UK, Spain (4B), Italy and also in Poland, although here regulation is experiencing some changes.

b) Pricing barriers:

Another entry barrier to cross-border acquiring identified in the Interim Report is the existence of interchange fee arrangements between system operators (this is what is called an “on-us agreement”[22]). According to the Interim Report, parties to these agreements can offer each other lower interchange fees, while foreign acquirers are charged a higher interchange fee

[20] Grupo Santander institutions have not found any trouble with respect to this practice.
[21] Interim Report, page 122.
[22] See page 31 of the Interim Report.

or a fallback interchange fee. These agreements can operate as an entry barrier, because as foreign acquirers have to pay higher interchange fees than domestic acquirers, the first ones can not be competitive with respect to the MSC charged to merchants.[23]

We understand that this practice may distort competition in the market, but only under certain conditions. As the Interim Report suggests, these differences may be an obstacle when there is concentration in acquiring. That is, when there is an incumbent that processes most of the acquiring business and newcomers have no other alternative than requesting its services in order to enter the market. Under these conditions, interchange fee differentials may rise rivals' costs and discourage entry. However, in countries where interplatform competition exists, interchange fee differentials should not be a problem for new entrants.

Besides, in the last years international systems have adopted rules that prevent differences in interchange fees for domestic and cross-border transactions. These non-discriminatory rules have been gradually enforced by most countries. Nowadays, there is no such discrimination in interchange fees in Norway and Poland. In Portugal, measures have been taken in order to abolish discrimination and therefore, today there is no obligation to pay different fallback fees. In Italy CartaSì (the main acquirer) was the issuer of most of the credit cards circulating, and so it could apply "on-us" conditions to a large range of merchants. Recently, concentration in issuing has decreased and there is no problem on this respect.

c) Concentration in acquiring:

The Interim Report considers that concentration in acquiring operates as an entry barrier, because those who want to enter a concentrated market will have to compete against an operator with a high market share and a well-known brand and try to "steal" clients that may be subject to high switching costs. The implications of this are more significant as network and usage externalities are relevant in this industry.

The Interim Report identifies concentration as a plausible barrier to competition only on the acquiring side of the market. In contrast, the Interim Report identifies no problems of concentration in issuing, because, as the Interim Report states, "*Generally, issuing is characterized by a high number of market players of varying size. No cases of a single issuer have been reported*".[24]

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[23] They will have to charge a higher interchange fee in order to cover the higher cost or they have a narrower margin.
[24] Interim Report, page 86.

The Interim Report establishes a threshold value of 2,000 for the HHI when considering concentration. As for acquiring, Spain is the only country that is below this level with respect to debit and credit international networks. All the other countries have a higher HHI. With respect to domestic networks, Italy and France have a very low concentration level (Italy with more than 400 acquirers).

In countries like the UK, three quarters of the acquiring market is dominated by two providers (Natwest Streamline with 42% and Barclays with 35%) and the remaining acquirers have less than 10% share.

Nevertheless, certain considerations should be made on concentration in acquiring as an entry barrier.

First, the effectiveness of concentration as an entry barrier depends on other variables, such as the degree of vertical integration or the difficulties to join the payment card system. When there is no vertical integration and non-discriminatory access to the platform, entry may possible. In other words, those systems in which entry is more difficult for new acquirers are those where, not only concentration in acquiring is observed, but also vertical integration is high.

Second, concentration is decreasing slightly in those countries where it used to be highest. In Portugal the former monopolist in acquiring Visa and Mastercard (not with respect to Amex and Multibanco, the domestic brand) currently competes with other acquirers, one domestic and several cross-border. Furthermore, the competition in acquiring the domestic brand is very strong. Poland and Norway are also good examples of this diminishing trend on the level of acquiring concentration. In the 1990s, PolCard was the only company providing acquiring services, but later, commercial banks started to offer these services too. The Norwegian acquiring market is dominated by two large acquirers, but in recent years two large Nordic banks have entered the market as national acquirers and are building significant market positions. In addition, in Norway exists very strong cross border competition for large merchants from other international acquirers.

d) Vertical integration:

The Interim Report states that vertical integration can rule out potential competition between technical and financial service providers, and that it can constitute an entry barrier for foreign acquiring. It also acknowledges that vertical integration can be a source of efficiencies (as it may avoid the problem of double marginalization).[25]

[25] Interim Report, page 94.

As we have mentioned when discussing concentration in acquiring, vertical integration is not a problem for competition *per se*. Assuming that there are many acquirers and they are free to join a system, inter platform competition may work correctly even with vertically integrated platforms. This is the case in Spain, where concentration in acquiring is very low and three platforms (Servired, 4B and Euro 6000) compete with each other in the provision of processing services. So, once more, the implications of vertical integration should only be assessed in conjunction with the rest of the elements that determine the structure of payment card systems in the country.

Vertical integration can operate as an entry incentive. For example, the existence of processors which operate under open and non discriminatory conditions, even if vertically integrated, can encourage entry in the market because institutions gain access to a whole network thanks to them. For this reason, when card payment systems operate under transparent and non discriminatory rules and there is competition between them, vertical integration should not be considered an entry barrier.

Nevertheless, to prevent its impact as a potential entry barrier, the SEPA Cards Framework establishes a separation of functions between governance and management of card schemes' brands and the remaining operations of service providers and infrastructures.

In order to analyze the vertical integration of POS card payment systems, the Interim Report establishes a methodology for the classification of systems according to their degree of vertical integration. According to this classification, level 1 corresponds to those systems where scheme ownership is *legally* separated from network ownership and the financial business of issuing and acquiring. As the scheme owner engages in further –technical or financial– parts of the cards business, more integration levels are added, six being the maximum.[26]

The Interim Report concludes that "*In the EU-25 a wide range of different card payment systems with a varying degree of vertical integration can be observed*".[27]

The degree of vertical integration assigned to different systems according to this methodology is unclear. For example, while The Netherlands and Denmark are classified at level 1, the Interim Report classifies the Spanish systems in level 3 or even 4, although in Spain the scheme ownership is

[26] The scheme owner can also perform switching, authorizing and processing, clearing and settle transactions, acquiring, sell and rent POS equipment.
[27] Interim Report, page 88.

legally separated from the network ownership and the financial business of issuing and acquiring.

e) Technical barriers:

The Interim Report points out that across the EU-25 different technical standards exist and that this can represent a barrier to cross border competition for acquirers, processors and terminal vendors.

Some of the technical barriers identified in the Interim Report are the existence of diverging national proprietary communication protocols, the differences between security concepts and standards in each country, the ownership of some specifications by national banking organizations or by national processing centers owned by local banks or banking associations, the levy of license fees for obtaining the specification, or the diverging certification requirements.

It is true that some domestic systems are technically "closed", with protocols and specifications that are not publicly known and it is not possible for operators outside the system to have access to them. This is the case for example of the domestic debit systems in France and Germany. Also in Italy there is at the moment a domestic communication protocol for the Debit Schema and in order to operate within the debit scheme, institutions have to comply with the technical rules imposed by Co.Ge.Ban. (which operates as an international network into the domestic field), fixing security measures, technical standards and special requirements.

However, as the Commission is well aware, the EPC has established a task force that is working to ensure interoperability in the SEPA context, through the unification of protocols and the standardization of processes.

Some of the factors mentioned by the Interim Report are not necessarily entry barriers

Not all the factors mentioned as possible entry barriers by the Interim Report operate as such. Next, we describe each of the factors that we consider do not represent barriers to competition.

- *Blending*

Acquirers usually charge the same MSC to those merchants that accept cards as a payment instrument, regardless of the network under which the card has been issued and the type of payment card used (credit or debit). This practice is known as blending and is very common across the EU, because merchants demand it. Blending may cover debit and credit cards from the same network, but also cards from different networks. For example, in Portugal most Visa and Mastercard transactions imply the same level of MSCs, but other international networks (AMEX, Dinners, JCB) have different levels of agreement. In Italy, a similar situation can be observed: blending is applied between Visa and Mastercard networks (acquirers offer a unique MSC for the Visa/MasterCard Credit schemes) but it does not between Visa/ MasterCard and domestic network or between Visa / Mastercard and other network schemes (for example American Express). Blending also exists in the UK, Germany and in Norway, where all acquirers do blending for Visa and Mastercard.

From an economic point of view, blending is a way of reducing transaction costs, as it avoids dealing with very similar but different MSCs at the same time. This is the reason why the Interim Report finds that "*blending occurs between networks with similar levels of interchange fees, and therefore with similar cost components for the MSC*".[28] In fact, merchants take advantage of this kind of practice and often promote it.

Blending can not be interpreted as a lack of inter-network competition, as the Interim Report suggests, for several reasons.[29] First, inter-network competition means that acquirers (and issuers) can opt for a network depending on, among other things, interchange fees, the reliability and quality of its services, or the size of the network. Blending does not affect any of these factors, as it has to do with MSC.

Second, acquirers compete for merchants, and merchants choose their acquiring services providers on the basis of different factors, not only on price (MSC). The Interim Report recognizes the importance of non-price competition factors in acquiring.[30]

Third, once the acquirer blends MSCs, it has incentives to try to be charged the lowest interchange fee possible for all payment cards. The lowest the interchange fee it has to pay, the more competitive it can be in MSC and the higher its margin. In this respect, competition in acquiring is consistent with the decrease in MSC that is taking place.[31] .

[28] Interim Report, page 43.
[29] Interim Report, page 43.
[30] "Non-price competition may play a significant role in acquiring", Interim Report, page 126.
[31] The Interim Report states that "over the period from 2000 to 2004 weighted average MSC rates on credit card transactions gradually fell across the EU-25 in all international payment card networks" (page 45) and also that "the weighted average MSC levels across all debit card payment networks decreased over the 2000-2004 period" (Page 47).

- *Surcharge*

Surcharging consists in passing the costs of accepting cards as a payment instrument from merchants to card users.[32] Hence, the surcharge prohibition restricts the freedom of merchants to pass on to cardholders the cost of accepting cards as a method of payment.

Although in many cases surcharge is not restricted, it is not a widespread practice[33]. In fact, according to studies mentioned by the Interim Report[34], only relatively few merchants make use of the possibility to surcharge. In Germany, for example, Mastercard allows surcharging but merchants seem to believe that the German consumers will not accept it, and only a few merchants use this opportunity. In some countries, surcharging is limited to particular merchant segments or even to credit cards (for instance in UK[35]). In Italy, fuel merchants used to surcharge, but this practice is disappearing.

The Interim Report considers that surcharging prohibition can constitute an entry barrier for alternative non-cash payment instruments (for example for e-money and mobile phones). However, as it is a matter related to pricing, it should be freely decided by market operators. Besides, as merchants decide not to surcharge, this means that they have an interest in promoting the use of cards before other electronic payments. As a result, cards are less costly and imply less transaction costs.

Removing entry barriers is the right way to promote competition

Removal of entry barriers is the standard approach in the creation of EU internal markets:

> *"When these obstacles are removed and national markets opened, more firms can compete against each other. This means lower prices for the consumer – with the added bonus of a greater choice of goods and services"*[36]

As barriers dilute, competition is reinforced in the market. As a result, prices (fees) are more competitive. Hence, regulatory measures, if needed, should have to do with removing market barriers, but not with price regulation as a way of liberalizing markets.

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[32] Surcharging is similar to applying cash discounts to customers who pay by cash. Both are discrimination mechanisms.
[33] In Portugal and Spain surcharging is not common.
[34] Interim Report, page 124.
[35] Nevertheless, in the UK the practice of requiring a minimum transaction value on a card is widespread between smaller merchants.
[36] Europan Commission. Overviews of the EU activities. Internal market. http://europa.eu/pol/singl/overview_en.htm

Although some barriers may still exist in the card payment industry, they are being progressively reduced. In many cases, these steps have been taken by the financial institutions and networks themselves.

Additionally, the European Banking industry has committed itself to the development of a Single Euro Payments Area (SEPA). With this intention, it created the European Payments Council (EPC) in June 2002, to act as the decision-making body of the European banking industry designated to manage the SEPA program. The EPC is working intensively to develop a set of fully fit-for-purpose European payments schemes for core and basic services covering direct debits, credit transfers and card payments.

The EPC has approved the SEPA Cards Framework, which constitutes an important step towards the elimination of entry barriers.[37] This framework establishes "*high level principles and rules which when implemented by banks, schemes, and other stakeholders, will enable European customers to use general purpose cards to make payments and cash withdrawals in Euro throughout the SEPA area with the same ease and convenience than they do in their home country*".[38] The framework deals with important matters in relation to payment systems such as <u>government issues</u> (each card scheme must allow banks of other SEPA countries to participate on the basis of transparent and non-discriminatory criteria; issuers and acquirers can not be imposed a certain processor); <u>non-discriminatory principles</u> (all transactions, domestic and cross-border, must receive the same treatment within the same system, including price; merchants should not be prevented from accepting any card from another SCF compliant scheme), <u>technical standards</u> (a common process for the certification of terminals, cards, and network interfaces will be defined) and <u>vertical separation between activities</u> (separation of card scheme governance, processing and other functions).

At the same time, the creation of SEPA must promote efficiency. It must be granted that resulting card payment systems are more efficient than all the previous domestic systems and less costly for users.

In sum, SEPA is already addressing the principal obstacles to competition that may still exist in some domestic markets. Hence, the industry itself is involved in the process of promoting the creation of a true Single European Market.

E. INTERVENTION ON FEES IS NOT THE RIGHT WAY TO PROCEED

The view of the Interim Report

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[37] SEPA Cards Framework, Version 1.2, European Payments Council, 4 January 2006

[38] SEPA Cards Framework, Version 1.2, European Payments Council, 4 January 2006, page 3.

According to the Interim Report, "*the sector inquiry provides indications that the interchange fees are not intrinsic to the operation for card payment systems, as several national systems operate without an interchange fee mechanism*."

"*Interchange fees are de facto used as a tool to extract rents from merchants*." This means that higher interchange fees increase merchant fees, but issuers do not pass the additional interchange fee revenue back to cardholders. According to the Interim Report, "*high interchange fees are a way to transfer profits to the side of the scheme where they are least likely to be competed away*".[39]

The Interim Report supports this conclusion in two main findings:

a) The statistical analysis shows that the relationship between interchange and merchants fees is more significant than between interchange fees and cardholders.

b) Findings on the profitability of payment card issuing that cast doubt on the assumption that in the absence on interchange fees issuers could not recoup their costs from cardholders.

On this basis the Interim Report suggests that remedies should be adopted. This could be advocacy, regulatory measures or antitrust. "(1) *Making information on fee differentials transparent may create some limited pressure on networks to lower fees but (2) effective remedies might require appropriate antitrust or regulatory actions"*.[40]

Grupo Santander considers that (i) facts do not necessarily support the conclusions of the Interim Report, (ii) the Interim Report leaves aside some important considerations from the business perspective and (iii) in any case, intervention in prices is not justified, and not the right way to proceed from an economic point of view

Justification for interchange

Interchange fees are a tool to shift costs and revenues from acquiring to issuing. In those countries where the Grupo Santander operates, interchange fees are set and paid by acquirers to issuers.

As the Interim Report says, there are strong externalities (indirect network externalities and usage externalities) in the card industry. Under these conditions, cost-based pricing would not lead to an efficient solution. Prices should take into account these positive externalities and for that reason the issuing side needs to be remunerated adequately.

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[39] Interim Report, page 9.
[40] Interim Report, page vii.

Cost-based pricing will not promote the use of efficient payment instruments. As the ECB and the EC have pointed out in different occasions, banks play a very important role in promoting the use of electronic payments and they will have to make strong efforts in order to achieve this goal. But neither banks are non-for-profit organizations nor cards are public utilities. Issuing is a for-profit business and in order to foster card payments transactions banks need an incremental profit rate.

As the Interim Report points out, there may be systems that operate without setting any kind of interchanges fees (multilateral or even bilaterally). But the absence of an interchange fee in some domestic systems does not preclude that for others interchange fees may be an efficiency-improving device.

- As the Interim Report states, there are substantial differences in costs between payment instruments. Paper-based payments are more costly to process than electronic payments[41]. Under these conditions, "*banks and merchants have an interest in shifting users to electronic payments in order to save costs*"[42]. This is the main reason why they agree on paying a fee and transferring rents to the issuing side. Electronic payments may be less costly even when considering interchange fee or the discount rate for acquirers and merchants, respectively.

- Issuers could recoup costs by charging cardholders a fee per transaction. But this mechanism would probably discourage the use of electronic payment instruments. In general, consumer demand seems to be elastic to extra-charges by transaction. This explains why, as the Interim Report notes, even when surcharge is allowed, merchants rarely apply it.

  This effect can be even more severe in countries where cash is a close substitute for electronic payments (due to cultural habits or a dense ATM network) and the card payment system is less mature.

- If no fee per transaction is charged, issuers may recoup costs by charging a higher flat fee to cardholders. But under a flat fee their incentives to achieve a higher volume of card transactions disappears, as their revenue per transaction would decrease.

In conclusion, the elimination of interchange fees could have significant implications in the business model of many financial institutions and far-reaching effects on the development and the efficiency of many card payment systems.

[41] Interim Report, page 10.
[42] Interim Report, page 12.

Moreover, setting interchange fees multilaterally may result in additional benefits[43] in terms of lower entry barriers. In particular, a multilateral system may contribute to:

- Prevent incumbent issuers and acquirers from 'holding up' potential new entrants from providing payment transmission services by refusing to agree with them on an acceptable interchange fee, and thus forcing them to resort to arbitration; and
- Reduce transaction costs relative to a situation where all issuer and acquirer pairs had to conclude bilateral agreements to set interchange fees, either through negotiation or arbitration, in order to provide payment transmission services. This fact is of particular relevance when the objective is to reach an efficient international interoperability system.

In any case, before reaching conclusions based on those systems that operate in the absence of interchange fee mechanisms, a deep analysis of the characteristics of those systems should be carried out. We refer to crucial variables such as:

- Characteristics of those card payment systems: debit or credit, number of participants, services provided to clients, interoperability features, performance (quality of the services, fraud levels, profitability…)…
- Characteristics of the banking system in that particular country: regulatory conditions, card penetration and usage, ATMs, sources of revenue for financial institutions, cross-subsidizing among activities, …

Without an in-depth analysis of all these variables and their differences with the rest of the systems and countries one cannot conclude whether interchange fees are efficiency enhancing or not in a particular market.

The facts do not support the conclusions of the Interim Report

The Interim Report concludes that for some countries and systems interchange fees may be high due to the exercise of market power. It supports this conclusion in two main findings:

- The statistical analysis shows that the relationship between interchange and merchant fees is more significant than between interchange fees and cardholders.
- Profitability is very high, especially for acquirers.

However, the arguments of the Interim Report are flawed due to factual as well as conceptual reasons.

[43] Usually multilateral mechanisms for setting interchange fees go together with other scheme rules such as honour-all-cards that may incentive entry.

Statistical analysis of interchange fees

Based on the data set collected from the Inquiry, a statistical analysis has been performed in order to clarify the relationship between the interchange fee on the one side and the cardholder fee and the discount rate on the other. According to the analysis[44], while there is a strong positive relationship between the interchange fee and the discount rate, there is no significant negative relationship between the fee per card and the credit card interchange fee at country and network level. This means that higher interchange fees increase merchant fees, do not translate in cardholders paying less.

The analysis of the Interim Report suffers from some problems related to data and the specifications:

- The data set may have some homogeneity problems. Due to many different reasons, the information on the same variable may not be homogeneous across different financial institutions. This may be due to conceptual (definition of the variable) as well as practical problems (how the data is stored and registered).
- The data only considers those fees paid by cardholders, but not all the promotions and discounts that they may receive from the issuer. In other words, the analysis does not consider the price paid by cardholders in net terms (after discounts), so the results of the analysis may be biased. These promotions have gained importance as competition among issuers becomes more intense and new non-integrated issuers appear.
- We observe some deficiencies in the statistical study. The impact of interchange fees on merchant discounts varies dramatically across countries, from negative to positive. The same happens in the estimated effect of interchange fees on cardholders fees:
    - One can understand the existence of differences across countries in the size of the effect (coefficients) but not in the nature of the relationship (sign). This calls into question the robustness of the analysis.
    - In view of this heterogeneity, any conclusion based of an average is meaningless, as it hides critical differences among countries.

But besides these aspects, the reasoning of the Interim Report fails to consider certain aspects that affect the reliability of its conclusions. The Interim Report maintains that high interchange fees are a way to transfer rents to the side of the

[44] This analysis is explained in Annex 5 of the Interim Report.

scheme where they are less likely to be competed away. But, at the same time, its analysis concludes that issuing is a competitive activity.[45]

- As the Interim Report says: "*The analysis of the level of concentration on the issuing side of the payment card market yielded no evidence of excessive concentration across the EU-25 Member States. Generally, issuing is characterised by a high number of market players of varying size. No cases of a single issuer have been reported*".[46]
- Apparently, entry is even easier in issuing than in acquiring. There are examples of foreign banks or new players that enter the issuing business in a particular country but do not develop acquiring in it. As we have explained in section C, the opposite is less likely.
- As we mentioned before, the increase of expenditure in promotions is a good indicator of a healthy competition.

Accordingly, it seems that issuing is even more competitive than acquiring, and therefore it cannot be argued that banks are transferring rents to the more protected side of the market to their own advantage. The lack of correlation between interchange fess and cardholder fees should not be interpreted necessarily as evidence of market power. In fact, the opposite could be argued. According to the Interim Report, interchange fees have fallen but cardholder fees have remained unchanged in the last years.[47] This means that far from exercising market power, issuers have reduced their margins or increased their efficiency. In both cases there is no indication of a market power exercise.

The profitability analysis also suffers from serious problems

The Commission has analyzed the profitability of the issuing and acquiring business across Europe in order to determine the importance of interchange fee revenues for issuers and to assess the exertion of market power in the industry.

The Interim Report first recognizes that a high profitability in an industry "*may be the reward for taking risks and innovating, superior efficiency or better management*" but then it is added that it "*could also be the result of having and exerting market power*".[48] Nevertheless, the Interim Report specifies that this is usually the case when there are high and persistent profit margins in relatively mature markets. In this respect, we should first point out that, as we have described in section C, the payment card industry is not a mature market, at least

[45] Interim Report, page 86.
[46] Interim Report, page 86.
[47] Interim Report, page 57, 58 and 60.
[48] Interim Report, page 62.

in some of the European countries considered, so it becomes more difficult that market power is the explanation behind the supposedly high profitability.

This is not the main problem of the profitability analysis. It suffers from a number of additional problems, some of them so serious that the results cannot be relied on. We can classify them into problems related to the data employed and methodological problems.

- Data:

Starting with problems related to the data used in the analysis we must first stress a problem of representativeness. According to the Interim Report, "*Information on acquiring and issuing was collected through a questionnaire sent out in July 2005 to a representative sample of 203 acquirers and issuers*".[49] Taking into account that in the EU-25 there were almost 9.000 institutions offering payment services to non-MFI[50] and that, for example, in Italy alone there are more than 400 acquirers; this figure is definitely not representative of the total industry.

This problem is even more serious if we take into account that the number of inquiries sent is not equal to the number of (complete) answers received. In fact, answers reporting figures for the acquiring business were only 83 for credit and 53 for debit. With respect to issuing, there are more responses (136 for credit and 71 for debit) but we have to take into consideration that there are also many more issuing than acquiring institutions.[51] So, given the few data points analyzed in comparison to the high number of market players, the conclusions reached on this point by the Interim Report can not be extended to the whole industry, or to each single European country.

- Methodology

Methodological problems are also related to the available data. The Commission sent questionnaires to a great diversity of financial institutions located throughout the entire EU. Although all the institutions operate in the same industry, this is, payment cards, the organization, concrete activities and regulatory environment could be very different from one country to another, or even within a country. So the homogenization of the data collected is very complex. The main issues are (i) the difficulties in the interpretation of costs and (ii) the diversity of criteria for cost allocation.

The Commission provided some instructions for the identification of issuing and acquiring costs and revenues. Although it provided a somewhat detailed list of

[49] Interim Report, page 13.
[50] Total number of institutions offering payment services to non-MFIs, i.e. the central bank, credit institutions within the country (irrespective of where they are legally incorporated) and other institutions. Blue Book, table 4.a.[
[51] The own Interim Report states that there are a high number of issuers across the EU-25. Interim Report, page 86.

costs and revenues, there is still some scope for interpretation. The Interim Report recognizes this problem itself, specifying that under the concept of "other type of income/cost" issuers and acquirers can include "*any other relevant type of income or cost in the acquiring and issuing of cards, as perceived by the respondents, which does not fall under the other categories*".[52] [Emphasis added].

In the Interim Report it is argued that there are significant differences in the costs of the financial institutions[53] and that these costs differences explain the differences in profitability. These differences in costs are attributed to differences in efficiency. However, they may also be a result of the differences in the interpretation of these cost and income concepts by each entity.

Another reason for these discrepancies is the allocation of costs. Issuers and acquirers are typically multi-product firms that do not only focus on issuing or acquiring of payment cards, but carry out a number of additional activities as for example the provision of current account services, loans, mortgages, ATM services, etc. In addition to the specific costs, all these activities involve common costs that are usually distributed among them following conventional accounting criteria. The Interim Report considers that given that the allocation of issuing and acquiring costs and revenues was carried out by each institution, the measurement of profitability is the most accurate because institutions are the ones that better know their own business. Nevertheless, we have to take into account that these institutions may apply different criteria when classifying and even measuring costs. Besides, they are located in different countries, each one with it own specific accounting regulation and auditing methodologies and duties. For this reason, the allocation of costs and revenues among activities may not be exactly the same for all of them. And the same will happen with respect to cost and revenue concepts.

In conclusion, the allocation of costs and revenues between activities and the concepts included in each category may be very different in the responses sent by different institutions, both across and within countries, and this could be the main reason for the different profitability levels observed.

Finally, the profitability measure taken as a reference in the Interim Report (profit-to-cost ratio) may not be valid from a competition standpoint. As the Interim Report recognizes, it is a very simple measure that do not take into

[52] Interim Report, page 63.
[53] In the Interim Report it is said that "[…] differences in the profit ratios within a country are mainly due to differences in their cost structures. These discrepancies arise because some acquirers incur, among other things, significantly higher average transaction processing costs and staff costs than others" (page 65), also that "[…] the differences in cost structures may explain to a large extent the discrepancies in profit ratios among top issuing institutions. Therefore, the differences observed in the profit ratios of some top issuing institutions in the same country seem mainly to reflect a different level of efficiency and not a fierce competition on prices" (page 68) and finally that "[…]differences in cost structures may to a large extent explain the discrepancies in profit ratios among issuing institutions" (page 74).

account the rate of return of the issuing and acquiring business, or the risk of these two activities.

Moreover, the case-law highlights that in order to explore whether prices may be considered excessive in multiproduct firms with high fixed costs, more complex concept of costs must be used. Cost concepts such as standalone costs should be used as the standard in order to avoid type I errors. The profit-to-cost ratio considered in the Interim Report does not necessarily meet this requirement, and therefore the analysis should not be relied on for antitrust purposes.

From a conceptual standpoint, Commission's analysis is not well founded to conclude excess prices and exploitative abuses:

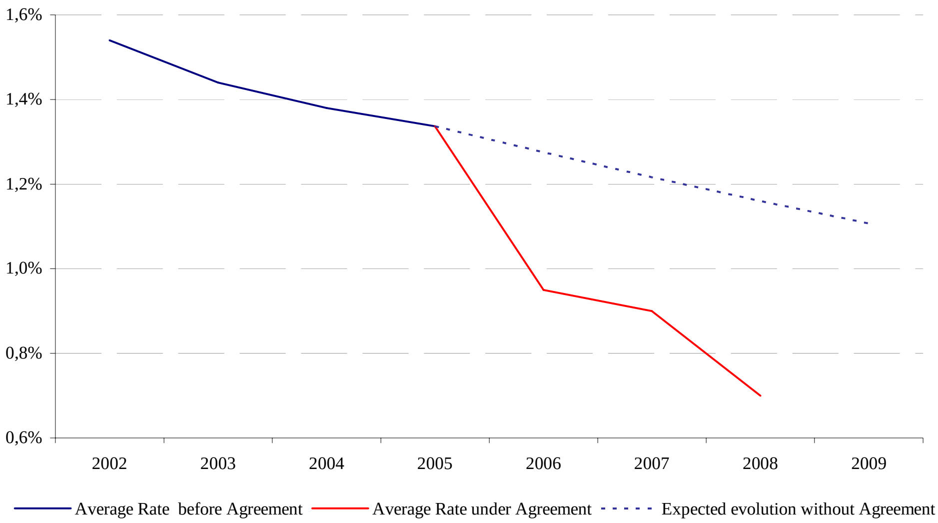
- High profits are not enough reason to conclude that prices are excessive.
- The notion of "high" should be clarified. One cannot conclude that profits are excessive in all the countries for all the banks and different services. In this regard, cross-subsidizing between services should be taken into account. As there are many complementarities among activities, a decrease in profits in one service may affect the supply of other services.
- The analysis does not take into account that banks provide their clients with several different services. In many cases the client relationship leads the bank to set the prices having into account the whole set of services. In this situation the stand-alone price of a particular service may not be the right input for measuring profits, as it could exist cross-subsidization between services.
- The Commission suggests that the payment service business is also profitable even in the absence of interchange fees. To perform this analysis the Commission includes the income derived from the credit activity linked to the card business (i.e. revolving). This component should not be included if the purpose of this exercise is to calculate the profitability of the payment services activity alone in the absence of interchange fees.
- Any analysis of excessive prices needs to adopt a long term perspective and, consequently, calculate profit rates for a very long period. As the Interim Report acknowledges, the information provided in many cases only has into account the year 2004, and therefore this exercise is mainly static. Furthermore, the Commission´s conclusions on the stability of profits should be reviewed.[54] A trend towards profit reduction is apparent in several graphs in the Interim Report.[55]

  This trend is extremely important, as interchange fees show a decreasing pattern in some countries. In Spain, for example, interchange fees have fallen

[54] See conclusions in page 76 of the Interim Report.
[55] See graph 37, graph 40 and graph 48 of the Interim Report.

sharply since 1999 and particularly in the last months thanks to the Framework Agreement signed with the merchants. This necessarily has implications for the payment card industry as a whole.

Figure 7. Spanish domestic interchange fees



Source: Spanish Central Bank and Framework Agreement

- The analysis does not take into account the opportunity cost of capital. If the profit ratio does not include the cost of capital, that is the cost of equity, the rate of return for shareholders, and the interest rate on debt, the ratio overestimates profits. This indicator also fails to include the risk premium that is required in this type of business.

- A complete analysis of supply and demand characteristics for the different services should be undertaken before reaching any conclusion that profits or fees are excessive. Demand patterns or differences in the nature and quality of the services may be some of the factors that explain differences in profitability across products and sectors.

Intervention on fees is a very distorting measure

Competition authorities are exhibiting disparate criteria regarding the treatment that interchange fees should receive from a competition policy perspective. See for example the case of Spain, where the decisions issued by the TDC (Spanish Competition Court)[56] discarded the interchange fee setting model and generated such uncertainty that payment systems and merchants opted for signing an

[56] Auto de incoación o expediente de modificación o revocación, Expediente. A 287/00, Sistema Euro 6000, 11 April 2005, Resolución del Expediente. A 318/02, Tasas Intercambio ServiRed, 11 April 2005; Resolución de autorización singular del Expediente. A 314/2002, Tasas Intercambio Sistema 4B, 11 April 2005.

agreement in order to establish a transition period that allows moving towards a cost-oriented interchange fee setting model in a gradual, non-traumatic way for the parts involved, including consumers.

In this regard, the impact of any antitrust intervention as well as the introduction of regulatory measures should be carefully evaluated. The Commission´s suggestions of reducing MSCs and directly charging cardholders[57] would have far reaching implications. Merchant service charges reductions will not be necessarily passed on to consumers in the form of lower prices, and cardholder fees could be even higher. Alternatively, cardholders could receive fewer benefits through promotional activity. We must confess that we do not understand why the Commission concludes that under these circumstances (lower merchant charges and higher cardholder fees), the use of electronic payments will be further stimulated.[58] On the contrary, we believe that these may have negative implications both from a microeconomic and a macroeconomic point of view:

- Banks would have fewer incentives to foster the use of electronic payments as the average income per transaction decreases. Banks may have incentives to reduce the provision of payment services (especially in credit cards) to those clients with less purchasing power or for those whose risk is higher.
- Cardholders would have to pay more and will face tougher access conditions to payment card services. At the end, this kind of measures would mean a transfer of rents from consumer to merchants.
- Tougher payment conditions and a reduced provision of micro credit will have a negative effect on consumption. This is especially worrisome in the current scenario, where interest rates are going up and further increases are forecasted.
- Convergence in interchange fees does not necessarily promote competition. In fact, it could weaken inter-system competition.

As we have mentioned before, intervention on interchange fees should be discarded as (i) it may have negative effects on consumers, and (ii) it does not really tackle the sources of potential problems for cross border competition. Removing entry barriers is usually considered a more efficient way of intervention to foster competition. Lower prices and efficiency would be enhanced as a result.

[57] See page 12 of the Interim Report.
[58] This seems to be the case in Spain, where the significant reduction on interchange fees has translated into lower merchant discount rates, but apparently not on lower prices for final consumers.

F. CONCLUSIONS

- Price differentials across countries are something usual in most sectors and products. They do not prove *per se* lack of competition. Differences in demand and supply patterns may cause price differentials across countries.
- A preliminary review of payment services in different Member Countries allows one to conclude that (a) there are deep differences in supply and demand characteristics among systems and (b) cards do not give access to homogeneous services across Europe. As a consequence, significant differences in prices across countries should be considered rational from an economic point of view.
- A more careful analysis on the evolution of entry and cross-border flows should be made before reaching any conclusions on the degree of success in building-up SEPA. One example of the existence of cross border competition is Grupo Santander itself. Despite the differences between countries, it has been able to enter the payment cards industry in different European countries, sometimes through the acquisition of an institution.
- However, some barriers to competition may still remain, especially in relation to cross border acquiring. Not all the factors mentioned as possible entry barriers by the Commission operate as such. We explain in our response our views on which barriers do really matter when considering entry in issuing and acquiring separately.
- Moreover, although some barriers may still exist in the card payment industry, they are being progressively reduced. The EPC has approved the SEPA Cards Framework, which constitutes an important step forward on the elimination of entry barriers.
- There may be systems that operate without setting any kind of interchanges fees (multilateral or even bilaterally). But the absence of interchange fee in some domestic systems does not imply that it is not an efficiency-improving device for others interchange fess.
- Removal of entry barriers is the approach always used for the creation of EU internal markets. As barriers disappear, competition is reinforced in the market and as a result prices (fees) are more competitive. Therefore, regulatory measures, if needed, should focus on the removal market barriers.
- Self-regulation is proving to be an efficient instrument not only for removing barriers, but in other areas. See for example the case of Spain. Certain

decisions coming from the Spanish competition authority (TDC) implied a change in the treatment of interchange fees and generated great uncertainty. Both financial institutions and merchants have signed an agreement that allows an efficient transition, regulating a transitory period that, at the same time, implies a very significant reduction in interchange fees.

- Intervention on interchange fees should be disregarded as (i) it may have negative effects on consumers and (ii) it does not really attack the sources of potential problems for cross border competition. Removing entry barriers is usually considered a more efficient way of intervention to foster competition. Lower prices and efficiency will be enhanced as a result.

We can summarize our conclusions in three main messages:

1. Commission´s analysis is biased from a methodological point of view. Both the profitability analysis and the statistical exercise contain serious flaws that undermine its conclusions. Furthermore, as the EPC has already mentioned in its letter to the Commission, the Interim Report makes a judgment on the European card market "as is", omitting the relevant on-going changes that the SEPA Card Framework entails for the industry. Interim Report conclusions are affected by all these biases and, accordingly, should be revised.
2. The SEPA Card Framework deals with barriers to competition and plans their elimination. It has been unanimously approved in March this year. Now is time for its enforcement which should take place with the support of the authorities, including the EU Commission.
3. Intervening on fees is not the right way to proceed. Cost-based pricing will not promote the use of efficient payment instruments. Prices should take into account all the positive externalities and, as a consequence, the issuing side needs to be adequately remunerated. As the ECB and the EC have pointed out several times, banks play a very important role in promoting the use of electronic payments and they will have to make strong efforts in order to achieve this goal. Banks are for-profit organizations and should expect non-negligible profits rates in order to have an incentive to foster the use of payments cards and get involved in these new challenges.