FEEDBACK FORM

Name of undertaking: MBNA Europe Bank Ltd

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 Issuer

Address: Chester Business Park, Chester, CH4 9FB

Country: UK

Name of contact person: Jim Walshe

Phone of contact person: +44 1244 672763

Email of contact person: jim.walshe@mbna.com

Participated in the questionnaire:

- Yes
- No

Specific questions from Executive Summary:

A. Financial analysis of the industry

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

No, but we expect that merchants will see it as in their interests to challenge merchant service charges and they are likely to raise concerns with the European Commission and other competition authorities as a lever in their customer/supplier price negotiations.

---

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

We do not believe this condition exists in the UK.

---

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?

Card issuing is not as profitable as it looks!

We do not recognise ourselves in the picture of industry profitability described in the interim report, and believe that monolines may be examples of the ‘outliers’ in the data that were set aside in compiling the interim report conclusions. We believe that it is important that all industry participants have the opportunity to compete in an open, free market without market distortion from price regulation that would adversely impact an important sector of suppliers of payment cards to consumers.

---

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

We refer you to our previous answer on the subject of banking profits; however, there has been considerable innovation in the payment cards market, and examples of these, which have benefited consumers in our market over the past 10 years, include:

- 24-hour Customer Service. We answer customer calls 27x7x365, a new development in the UK when we began offering it in 1993.

- No annual fee. We do not charge annual fees to customers, the absence of which is a common feature of the UK card market today but a new feature when we introduced it in 1993.

- Credit Card Cheques. An innovative way for customers to access their lines of credit when they need to make payments to suppliers who do not yet accept payment cards.

- Promotional interest rates. The spread of promotional (ie discounted) interest rates throughout the UK market since we introduced them in 1993 has contributed to a significant lowering of interest rates charged in the UK market.

- Chip & PIN. The introduction of cards bearing chips to the EMV standard, followed by the introduction of PINs for use by customers at the point of sale, has been a major project which has been led by the UK banks. Investment in the project by UK banks has been of the order of £1.1billion, and there have been two major results from this:
  - the financial infrastructure of the EU is now better-protected from attack by fraudsters.
  - the EMV standard is fast becoming the default world standard for chip card rollout, with developments in Asia and the Americas using this standard.

---

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

Price regulation

The impact of price regulation is to protect the weak and inefficient players in a market. There will be a tendency for the maximum price set by any regulator to become at the same time the minimum price for that good or service. Efficient players have then no incentive to reduce prices, while inefficient players are able to cover their costs thanks to the price regulation. Price regulation can be seen to operate against the interests of consumers.

Barriers to entry

Barriers to entry are not only price barriers; we believe that any market arrangement that involves the provision of confidential information to competitors as a condition of entry (such as the chef de fil arrangements in operation in France) is intrinsically unfair. This is one of the roles of the payment card schemes, who can act to facilitate new entrants into European markets without the need for information from a new entrant being released to competitors.

Bilateral interchange arrangements

Bilateral interchange arrangements act as a barrier to new entrants into the payment cards market in any country where they operate. This is because a new entrant has to negotiate rates with all existing market participants, who will become the competitors of the new entrant. The esisting market participants have a vested interest in keeping rates for new entrants at disadvantageous levels, and the new entrants have weak bargaining power as they do not have a market position.

---

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

We do not believe that cost-based pricing is an appropriate model for the development of efficient payment instruments. We believe that pricing based solely on costs leads to the mindset that payment processing is a utility operation, with the consequence that innovation will be stifled and the investment by the participants will be of the minimum required to offer the service.

We believe that payment cards are a market sector where there is scope for participants to offer value-added services, as we have done consistently during our time in the UK market. In a free market without barriers to entry, the issue of ‘excessive profits’ goes away as wherever profits are being made, supply will increase as other players seek to join to offer similar services. The result will be that the consumer will benefit in a healthy market with multiple firms actively competing for their business by offering better services and products.

---

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

Current consumer pricing for card payments within the Euro-zone already treats crossborder transactions the same as intra-country transactions. The pricing differentials to banks charged by the major payment schemes are being eliminated in response to the SEPA Cards Framework initiatives. A greater barrier to crossborder use by consumers is the inability of issuers in any EC market to offer payment card services in other countries within the EC on the same terms as local market participants, and an example of this is the ‘chef de fil’ arrangements that apply for new entrants to the domestic French card payments market.

B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

We believe that market structures that allow participants to compete vigorously for the business of customers work well.

---

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

Market structures that do not deliver efficient outcomes or consumer benefits include barriers to entry, which are a form of protectionism of market participants in one EC country against entrants who can offer improved customer propositions.

---

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

We believe that it is the job of card issuers to compete for the business of consumers, and the job of acquirers to compete for the business of merchants. Some market participants undertake one of these roles, some do both. Payment schemes compete against each other for the business of both issuers and acquirers. We believe it is the role of Government, and the European Commission, to facilitate this open competition by removing barriers that limit the ability of firms to innovate their products and services.

---

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

We refer you to our answers above.

---

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

We refer you to our answers above.

---

13. What access conditions and fees are indispensable?

Multilateral Interchange Fees are indispensible as they create a level playing field in the market. If not available to all participants, including new entrants, it is possible for existing market participants to maintain advantageous rates between themselves while providing disadvantageous terms to new entrants. This has the effect of limiting competition for consumers’ business by artificially restricting the supply of products and services to those offered by current market participants.

---

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

We believe that it is desirable that schemes provide governance and the interoperability infrastructure, thus facilitating the operations of their members, who compete for the business of customers and merchants.

C. Future market developments

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

We expect that there will be a change as domestic payment schemes seek to offer their customers international card usage over the next few years.

---

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

Technological change will be used to increase the security of the payment cards system. Very significant investments (of the order of £1.1billion) have been made by the UK banks in introducing Chip & PIN technology and we expect that this technology will require further investment to keep it up to date and secure as computing power advances. At the same time, it is likely that market players will use the technical infrastructure to deliver new services to customers. Examples could well include electronic ticketing, and there are early examples of this in transport applications in the UK today. This could spread to event ticketing over the next few years.

D. Potential solutions to market barriers

17. How can structural barriers to competition, which may arise for instance from the integration of different functions within a payment system or from acquiring joint ventures, be tackled?

We have no information on acquiring, as our business is a monoline card issuer.

---

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

We do not believe so, no.

---

19. How much need and scope is there for harmonising technical standards in the payment cards industry? How large are the potential benefits and costs of harmonisation?

We believe that there is already significant harmonisation of technical standards in the payment cards industry. Authorisation and clearing messages are transmitted between participants using the standard ISO8583, and chip cards are issued using the EMV standard.

An example may serve to illustrate the wide application of standards.

Let us imagine a customer with a payment card issued by a bank in Europe through one of the international payment card schemes. This customer goes into a jewellers shop anywhere in the world, and buys an expensive watch, value €1,000.00. The merchant takes the customer's card and a message is sent to the customer's bank to verify that the card is good. Seconds later, the acceptance message is returned and the satisfied customer is able to walk out of the shop with his new watch. Although the merchant has never met the customer before, he knows that he'll be paid for the watch he has just sold.

This is all able to take place due to the investment of banks and payment schemes in a payments infrastructure using harmonised standards.

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?

We have no comment to make here.

---

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

We have no comment to make here.

---

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

We have no comment to make here.

---

23. What governance requirements should SEPA schemes meet?

We have no comment to make here.

---

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

We have no comment to make here.

---

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

We believe not. We are in favour of a balance between a regulatory structure that ensures the safety and soundness of our financial system - and the free markets that allow customers to direct the growth of the industry through the choices they make.

General comments:

We would like to make one additional point, about a potential unintended consequence of any regulation that lowers the interchange fees in operation in the EU25 markets. This experiment has already been conducted, in the Australian market, when the Reserve Bank of Australia (RBA) required interchange fees to fall by approximately 0.40%.

The lower interchange fees came into effect on 1 November 2003, and almost immediately merchant service fees fell by a similar amount. In remarks given by the Governor and Assistant Governor of the RBA to a conference on interchange held in May 2005 by the Reserve Bank of Kansas, the RBA said that they were confident that these lower merchant service fees would flow into lower prices for goods and services, and they calculated that the consumer prices index would be 0.1 to 0.2% lower as a result.

However, in the Review of the Reserve Bank of Australia (Annual Report 2004) published in September 2005, the RBA says that consumers are not just cardholders; they include merchants. 'In aggregate, this group of people are better off to the tune of AUS$580million' they said. The bank goes on to say that they acknowledge that cardholders are not as well off after their reforms.

We believe that, although it may have been the intention of the RBA that interchange falls be passed onto customers, this has not happened and in their September 2005 document the RBA tacitly admits that their reforms have benefited merchants without a corresponding benefit to consumers.

Many merchant representatives in the EU markets do unfairly characterise interchange as 'a tax on consumers', but we are doubtful if the market outcome in the EU would be any different from that seen in Australia.

We can supply copies of both papers cited should that be required.

General questions:

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!

21st June 2006

Antonio Carlos Teixeira
D1 - Financial Services
DG Competition
70 Rue Joseph II,
Brussels

Dear Antonio,

Following our meeting on 2nd June, here is our response to the questions asked in the Interim Report into Payment Cards. Thank you for your time that day, and as you suggested, we have formatted our comments along the lines of the questionnaire. I'd like also to add a note of explanation as well.

About us

MBNA Europe Bank Ltd is a wholly owned subsidiary of Bank of America following the merger of MBNA Corporation and Bank of America Corporation on 1 January 2006.

MBNA Europe was established as a credit card issuer in 1993 and now, with over £10 billion outstanding and more than 7 million open accounts, has over 14% of the UK credit card market. MBNA also has a growing loans portfolio and offers retail finance and deposit products. MBNA's European HQ is in Chester in the UK and it employs a total of over 5,000 people in Europe. In addition to its UK operation, MBNA has a business in Ireland (where it is 3rd largest credit card issuer) and in Spain, where it launched an operation in October 2002. MBNA is the largest affinity marketing company in the credit card industry with over 800 affinity partners in the UK; including AOL UK, Manchester United Football Club and WWF, the environmental charity.

Monoline

MBNA is a monoline, a credit card bank that makes the majority of its profit from issuing credit cards. We do not acquire merchants, and we do not offer other products such as current accounts or mortgages, nor do we operate through a branch network. Our main focus is to help customers to buy the things they need today and pay for them out of future income, and we achieve this through a single product, the credit card.

This singleminded focus on the credit card product means that we have no alternative product lines with which to cross-subsidise the card product. It is especially important, therefore, that the card business is able to generate sufficient returns for us to continue to provide superior service.

MIF helps competition - and that's good for consumers

We strongly believe that the existence of Multilateral Interchange Fees lowers the barriers to entry into the Payments Cards markets within the EU, and this facilitates increased competition for customers' business.

We believe that competition helps consumers and leads to stronger financial institutions, and attached is an extract from a speech given by our Chairman and Chief Executive, Ken Lewis, to the American Chamber of Commerce in Germany on 8th June this year. Mr Lewis talked about the development of banking in the USA over the past 200 years, and described how the free competition allowed in our bank's home state led to banks there becoming stronger while also benefiting customers throughout the USA.

Impact on Customer service

We believe that the withdrawal or reduction of interchange fees would have a disproportionate effect on monoline players, leading us to contemplate reductions to our service levels and impeding our ability to compete on an equal basis with financial institutions that can cross-subsidise their card products from other areas of their business. We believe that the credit card product should be allowed to stand on its own and earn its providors a return on their capital.

I'm in Brussels on an occasional basis, and would appreciate a few minutes with you once you have had a chance to review our response. I appreciate that you'll be reading about 300 responses so I will not expect an immediate reply!

If possible, could we meet in the weeks just after the Public Consultation, say around 24th July?

Best regards,

Jim Walshe
Industry Relations Manager

Ken Lewis addresses American Chamber of Commerce in Frankfurt

On June 8, 2006, Bank of America Chairman and Chief Executive Officer Ken Lewis spoke at a luncheon for 200 members of American Chamber of Commerce (AmCham Germany) in Frankfurt, Germany. Celebrating its 100th anniversary in 2003, AmCham Germany is one of the oldest and largest bilateral economic organizations in Europe that represents the interests of its 3,000 American and German members. AmCham Germany's mission is to promote unrestricted competition, trade and investment between Germany and the United States.

Extract from speech:

I'll tell the story of how we, at Bank of America, came to be where we are.

It is an interesting and unexpected fact that three of the largest ten banks in the United States of America are headquartered in the state of North Carolina … and two of the top four, including Bank of America, are in our hometown of Charlotte. Charlotte is growing fast, but even today is not one of the largest cities in the country — it ranks 20th in size, and as recently as 1990 was ranked 33rd.

So it's interesting and unexpected that two leading financial services corporations would be headquartered in Charlotte.

It is not, however, an accident.

North Carolina's bankers grew up in the 20th century with a distinct advantage over their peers in most other states around the country — they were allowed to compete against each other throughout the state. That competition made North Carolina's bankers strong, and it taught them a lot about how to analyze and execute on acquisition opportunities.

Our state has had liberal bank branching laws for almost 200 years, dating to the early part of the 19th century. Evidently, there was a bank in Wilmington, a mid-size city on our Atlantic coast, that wanted to open a bank branch in the town of Fayetteville, about 145 kilometers away. They appealed to the state legislature, which approved the request. It's been almost 200 years now since that decision … and the state's bankers have used the time well, continually building and learning to operate larger and more complex financial institutions.

Meanwhile, most other states in the U.S. tightly restricted the ability of banks to open branches or to merge with or acquire other institutions. To give just one example, Illinois maintained an outright ban on branch banking from the signing of the Illinois Constitution in 1870 until 1967. After '67, the rules expanded the range of opportunity every few years — a second facility within 3500 yards in 1976, a third within the same county in 1982, and so on. The ban was finally dropped altogether in 1993.

Restrictions like these all over the U.S. created small, isolated markets in which bankers cordially divided the available business amongst themselves before, according to rumor, hitting the golf course in the early afternoon. The resulting lack of competition gave rise to the reputation of banking as a relatively sleepy industry, not fit for innovative and ambitious businesspeople.

When the more ambitious and experienced banks from states like North Carolina were successful in the 1980s and '90s convincing legislatures to allow branching and mergers across state lines, the results were immediate and predictable. The race to consolidate the industry was on. And bankers from states like North Carolina, which had been practicing the art of the bank merger for decades, had a tremendous head start.

Today, consolidation has decreased the number of commercial banks in the U.S. from a peak of more than 14,000 in 1984 to just over 7,600 in 2004, the lowest number since the FDIC began reporting this figure in 1934. That's a drop of about 46%. Savings institutions have decreased even more sharply over that period.

This consolidation has greatly increased the efficiency of our industry, and has also increased competition. That sounds counterintuitive, but remember that what the country had before consolidation was 14,000 banks that, for the most part, were not allowed to compete against one another. The ability of banks to branch into new communities has increased competition in markets that lacked choice previously, even as the total number of banks has decreased ... proving that banking markets are still, to a large degree, local.

These changes also have had a tremendously positive effect on access to financial services. While the number of commercial banks dropped by almost half over the past 70 years, the number of bank offices has increased more than five-fold, to more than 74,000, an all-time high.

So, today, with half as many banks in the United States, customers have tremendous choice. They can choose from different kinds of banks within the same market, and they can choose from myriad nonbank financial service companies both locally and nationally to handle any number of financial needs.

What we have achieved in the U.S. is, in my view, a beneficial balance between a regulatory structure that ensures the safety and soundness of our financial system … and the free markets that allow customers to direct the growth of the industry through the choices they make. The result is that the financial services industry in the United States is as strong today as I can remember it being in my 37-year career.

==