Fédération Bancaire Européenne
European Banking Federation

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FBE response to the interim report I on payment cards Sector Inquiry under article 17 Regulation 1/2003 on Retail Banking Competition DG - 12 April 2006

The European Banking Federation[1] takes the opportunity to respond to the European Commission's interim report on payment cards based on the Sector Inquiry on retail banking.

Our response will be of a very general nature as the inquiry was primarily addressed to card scheme operators and/or individual financial institutions. The European Banking Federation (FBE) as such does not conduct any card business.

Benefits to Society

Payment cards play a very important role in the economy of every country and community. The ratio of non-cash payments to the total volume of payments is stated as one of the criteria to measure the overall maturity of a country. The use of payment cards has enormous benefits to society as it leads to cost reductions and operational efficiency both on the micro-economical as well as on the macro-economical level. Numbers of reports are drawing the attention to the fact that the decline in cash use in the EU will lead to huge savings not only for various economic subjects but also for the society as a whole. Merchants for example will gain through reduced cost handling expenses, while society could benefit from criminality decrease and the reduction in grey market economy. It should be an objective of the European institutions to support the card industry in its efforts to gradually replace cheque payments and cash transactions with the use of payment cards. This is an important issue for Europe, considering the fact that 80% of payments are still made by means of cash and cheques. A coordinated effort should be made to persuade consumers to abandon cash and cheques in favour of electronic payments.

Any action that may have a negative impact on the issuance and the use of payment cards and/or limit the payment card offer should be avoided very carefully.

Support for Competition

The FBE supports the goal of the Lisbon Agenda to deliver an efficient and competitive financial services industry and appreciates the intention of the Commission's interim report on payment cards to identify possible means to enhance competition. We see competition as a very strong driver for the pricing policy of each bank or scheme. We are of the opinion that any administrative intervention or regulation of the pricing structure is totally inadequate as only a competitive market can determine the appropriate price level. We also believe such an approach would not be consistent with Article 4 of the Treaty, where it is stated that the Community's economic policy should be one that is conducted in accordance with the principle of an open market economy with free competition. Therefore, as the representatives of banking industry, we very much welcome any Commission initiative leading to the enhancement of competition and market efficiency.

[1] The **European Banking Federation (FBE)** is the voice of the European banking sector. It represents the interests of over 4500 European banks, large and small, from 29 national Banking Associations, with assets of more than EUR 20 000 billion and over 2.3 million employees.

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The SEPA Cards Framework (SCF) of the European Payments Council (EPC), which sets high level principles and rules with the aim to enable European customers to use general purpose cards to make payments and cash withdrawals in euros throughout the SEPA area with the same ease and convenience as they do in their home country, serves as clear evidence that enhancing competition is also the goal of the industry. Once implemented, there should be no difference if the customers use their cards in their home country or elsewhere within the SEPA. No general purpose card scheme designed exclusively for use in a single country, as well as no card scheme designed exclusively for cross-border use within SEPA, should exist any longer after 2010. In addition, SCF enhances competition between issuers and acquirers. This is beneficial not only for retail customer, but can or will also be advantageous for merchants. A further reduction of the cost of terminals, telecommunication costs and the like will be possible thanks to the economies of scale.

We understand and appreciate the desire of the Commission to improve its market knowledge of retail banking. We do not intend to comment on the detailed figures provided in the interim report, but we would like to express our concerns regarding the methodology and processes used in the collection of data for the interim report which raises some doubts as to its completeness, correctness and objectivity.

The specificities of the card as a payment instrument seem to have been ignored.

The notion of “payment guarantee” in particular, which is one of the essential characteristics of the payment card (and an element in its cost equation), is never mentioned.

The guarantee of payment represents an added value for the merchants for which they are willing to pay.

The cost of this guarantee varies with the risk premium and may explain partly the variances in acquiring or other fees in function of the nature of the commercial activity of the merchant, the level of fraud, the geographical location and the acceptance procedures. The cost of the guarantee (i.e. the cost of processing but also the cost of guarantee in case of fraud) undoubtedly must be included into the calculation of costs.

Furthermore, when analysing the profitability of issuing cards, the interim report focuses only on the payment function of the card when considering costs for financial institutions, totally ignoring the cash withdrawal function at ATMs or other value-added services related to the use of the card.

The data was not gathered in a consistent way

The questionnaire consists of 37 tables which had to be filled in within a time period of one month. The short time period and huge volume of data to collect constituted a problem for banks short of resources for tasks of such a nature and extent. Some of our members reported that it took each bank approximately 90 man-days to complete this task. For this reason as well as due to the fact that banks did not have immediately available the breakdown of their costs at the levels requested, banks mostly used estimates to complete the questionnaire, which weakens the accuracy of the results. As an example, we question the way of considering the costs of debit cards, which are to a large extent offered as part of an account’s package.

It is well known that banks use different methods in evaluating their profits; therefore any profitability comparison should be made using specific and declared criteria. The participating banks were allowed to subjectively decide which costs to include in the questionnaire and how to measure their profitability. As a result, there were reporting differences already at national level and probably even higher variations at the EU level. The problem occurred because the Commission did not submit a standardised completion format to the participants nor did it provide the appropriate guidelines in order to ensure the uniformity of the figures.

Furthermore, it is not clear whether the Commission has taken into account fraud prevention and consequential costs, disputes settlement costs, investment and infrastructure costs directly related to the running of the card business.

Some important costs were not taken into consideration for calculating the profitability at card issuer level because it was difficult for card issuers to take into account precisely all relevant expenditures. For example, expenses incurred at branch level (account maintenance costs, credit risk, bad debts, and IT related costs) and head office level (management, training and marketing costs, etc.) were often not included in the calculation. If these costs had been included in the calculations, then the profitability figures of the card issuers would have been much lower than the figures presented in the report.

The sample taken into account seems to be limited and leads to partial and/or misleading results

As an example we refer to a case in Italy. We see that only seven international card acquirers have been taken into account in the analysis, instead of eight. Such inconsistencies may lead to a distortion of the data presented in the interim report.

Different historical evolutions, market developments and practices were not taken into account

The report compares or consolidates across Europe data on very different systems and services, with no or undetermined weighting, and draws general conclusions therefrom which often give a negative picture of the card industry.

The report compares the fees without taking into account the different economical and technological levels of the different markets and their development in time**.**

The card payment markets are fragmentised and this fragmentation is the result of a historical evolution and the way in which payment systems were created and built up.

As an example, we found it very unusual to compare merchant fee levels in Hungary, Czech Republic and Portugal, being countries with relatively „young“ free market economies and card markets, with more mature markets, such as Sweden, Finland and Italy. In that context, it is quite natural that the merchant fees differ, as do the prices of a large number of goods and services in these markets when compared to others.

The interim report does not take into account the specificities of each Member State. The standard of living, the infrastructure and availability of card systems, the attitude of the consumers towards payment cards and the existence or absence of National Card Schemes were not considered in the interim report. This leads to over-simplified, and at times even erroneous, conclusions.

Bank practices within Member States vary and it is hard to make a comparison between them. Variances in fees between countries are mainly the result and reflection of the different nature of services offered from one system to the other and not, as the interim report seems to conclude, of a lack of competition.

The data presented does not reflect the current situation

The interim report describes the card market „as was“ in the 2000-2004 period. This was pre-SEPA and pre-SCF. Some of the findings of the interim report therefore seem to be outdated since the data was collected for the period of 2000-2004. The financial sector is one of the fastest developing sectors; therefore the data used in the interim report does not reflect the current situation or the most recent developments.

In particular, the interim report ignores totally the EPC’s SEPA Card Framework, which addresses most of the issues highlighted in the interim report and of which one of the principal objectives is precisely to enhance competition in the European cards’ market at all levels in the transaction chain. The absence of any reference to this document greatly weakens the overall conclusions of the interim report.

In addition, although the questionnaire covers data for the period of 2000 to 2004, the final findings do not mention the development of those fees over time. This would positively show that merchant fees in emerging markets, for example, tend to slope downward according to economic development and growth.

Benefits for merchants were not taken into account

As we mentioned in the beginning of this document, the use of payment cards leads to cost reductions and operational efficiency at the macro- as well as micro-economic level.

Merchants derive considerable benefits in terms of increased sales or reduced costs or risk through the acceptance of payment cards. We are surprised and disappointed that no mention is made in the interim report of the benefits for merchants when accepting payment cards instead of cash.

A few examples of these benefits are fuel distribution at gas stations enabling huge personnel cost savings, remote sales, travel or ticket reservations using cards, sales through vending machines accepting cards, etc..

Consumption has been greatly influenced by the increased use of cards and the security of contractual relations between merchants and their customers has been vastly improved.

The payment card was a determining factor for the development of retail cross-border payments in Europe; because of the guarantee given to the merchant, it has become the preferred means of cross-border retail and sales at a distance. However in the interim report, only the costs to the merchants are mentioned. This does not reflect a balanced stance.

As cash is the principal alternative to payment by card, it would have been greatly beneficial to compare the costs to providers, banks, consumers, merchants and society as a whole of cards and cash.

Limited indicative value of the Herfindall-Hirschman Index (HHI)

We consider that in order to increase the significance of HHI in giving an exact representation of concentration levels, other indexes should be used in combination with the HHI, which by itself has a limited indicative value.

The interchange fees have proven to be essential for the sustainability, innovation and development of the payments card business

We believe that if the business model on which card payments were built and developed and which includes interchange fees was to be modified, then the economic viability of issuing cards would be strongly affected unless issuers were to recoup their costs totally from the cardholders. This would not be a desirable development. These costs include processing, capital requirements, compliance, technology related expenses, resilience, the guarantee of the payment to the merchant (as there is a shift of the liability from the acquirer to the issuer) and the cost of funds (which covers free period of credit cards). It should be also taken into consideration when referring to countries operating without interchange fees whether the costs related to card issuing are not accounted for in another form of cost recovery.

There is a risk that the elimination of interchange fees may lead to a cost transfer from merchants to cardholders which could adversely affect the overall goal of SEPA.

In addition to our own response, we wish to refer to the response to the interim report submitted by the European Payment Council on 20 June 2006.