

21 June, 2006

**INTERIM REPORT I PAYMENT CARDS, SECTOR INQUIRY UNDER ARTICLE 17
REGULATION 1/2003 ON RETAIL BANKING/ 12 APRIL 2006****COMMENTS BY LUOTTOKUNTA**

Luottokunta is pleased to submit the following comments regarding the European Commission's Interim Report I on payment cards published on 12 April 2006.

Luottokunta is impressed by the in-depth investigation into the European payment card markets and would like to contribute to the useful and constructive work conducted by the Commission.

In this respect, Luottokunta wishes to clarify certain features of the card markets in Finland where, contrary to what may be presumed, both interchange and merchant fees in acquiring and issuing business have been and are extremely competitive in comparison to other Member States.

As an example, the interim report notes that the weighted average MSC rates charged for international payment card networks across the EU was approximately 1,5 – 2 percent for Visa and MasterCard from the year 2000 to 2004. The respective rates charged by Luottokunta are less than 1 percent, thus being one of the lowest rates in the EU, and have been constantly declining.

In addition, the interim report notes that in several Member States small merchants pay on average significantly higher MSC rates compared to larger merchants. Rates applied by Luottokunta have, however, been neutral in regard to both small and large merchants.

In assessing card issuing and acquiring in Finland, Luottokunta notes certain critical issues, namely *governance*, *market concentration* and *barriers to entry and competition*, concerning which further analysis for the final report seems essential.

1. Governance

Luottokunta, as a co-operative company with both Finnish banks (aggregate ownership of 51,5 % at year end 2005) and merchants (aggregate ownership of 48,5 % at year end 2005) alike as its members, is by nature different from other European payment card acquiring or issuing joint ventures. The board of Luottokunta consists equally of four (4) representatives of member banks and of four (4) representatives of member merchants in addition to the managing director of the company.

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As a result for being able to efficiently accumulate the high volumes in the Finnish market and, having a virtually equal weight of banks and merchants in its governance, Luottokunta has been and is able to add value for each of the parties involved: cardholders, banks and merchants. This has made it possible to achieve low interchange fee and MSC rate levels in Finland.

Major retailers have representatives as board members of Luottokunta. Further, all merchants, regardless of their size or volumes, are free to join Luottokunta as owner members. The pricing of the acquiring services provided by Luottokunta has not been linked to the merchant's size or ownership in Luottokunta.

2. Market Concentration

The interim report has analysed the concentration levels of the payment card acquiring markets in various Member States by calculating their Herfindal-Hirschman Index (HHI) values. The report notes that an HHI of up to 2000 is assumed to raise no substantial competition concerns. Respectively, the report assumes that a HHI of over 2000 raises substantial competition concerns in the acquiring and issuing business.

Finland (with Luottokunta named as the sole acquirer) is listed therein with the maximum concentration level of 10 000. This is interpreted to indicate that acquiring in Finland is lacking competitive pressure and thus resulting in prices above a competitive level.

The level of market concentration does not seem to correlate as such to the pricing of the network, which the interim report rightfully confirms on page 86. Indeed, as stated above, the prices charged by Luottokunta are one of the lowest in the EU even though the markets are, according to the report, one of the most concentrated. When evaluating the market concentration, a very small market (such as the Finnish market) may, however, not be compared *as such* to larger markets, but the amount of service providers need to be examined proportionally in relation to the volumes in the market. In this evaluation the investigation of aspects like cost efficiency and distribution of profits among the merchants and the banks within a respective market are essential.

3. Barriers to entry and competition

The interim report notes on page 110 that the Finnish acquiring market is among the most difficult ones to enter into. However, as correctly noted on page 143, the countervailing demand power in the Finnish market has enabled the current low prices and benefit to all parties involved, despite the assumption of barriers to competition. As for barriers to entry, the report does note that the reasons might lie in geographical obstacles rather than in the market behaviour of the incumbent acquirers and issuers. However, besides market

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concentration and the geographical entry barriers, no other findings presented in the report seem to indicate that barriers to competition existed in Finland.

Luottokunta would strongly urge the Commission to expand upon the analysis regarding the aforementioned barriers. For example, regarding competition, the interim report notes that five (5) cross-border acquirers have successfully entered the Finnish Markets (in 2004), representing the fifth highest amount of cross-border acquirers in the EU. If the distant geographical location in itself formed a barrier to entry, the diverse presence of cross-border acquirers should indicate that other barriers (such as the market behaviour of incumbents, technical standards or entry fees) for acquirers of international cards transactions are very low or non-existent. Luottokunta, as the incumbent acquirer in Finland, has certainly taken decisive efforts in making its issuing and acquiring governance arrangements, technical platforms and pricing policies as open and transparent as possible to accommodate new entrants and competition into the Finnish markets.

We highly appreciate the opportunity to submit these comments, and hope that they prove useful for the final report to be prepared by the Commission.

LUOTTOKUNTA

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