FEEDBACK FORM

Name of undertaking: British Retail Consortium

Industry

The British Retail Consortium is the lead trade association representing the whole range of UK retailers, from the large multiples and department stores through to independents, selling a wide selection of products through centre of town, out of town, rural and virtual stores.

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Participated in the questionnaire: Yes

Specific questions from Executive Summary:

A. Financial analysis of the industry

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

In the UK as elsewhere, the high retailer fees (MSCs) that are currently paid by retailers bear no relation to the services rendered and impact directly or indirectly on the competitiveness of the retail sector and the economy as a whole.

The MSC for each transaction is made up of two elements (a) the processing fee for services provided by the card acquirer and (b) the interchange fee set collectively by the issuing banks (or by the card scheme on their behalf) which may vary dependent upon the card type, transaction value, where and how the transaction occurs, but which, for each transaction type, will be common across all issuers. Currently the MSC payable by UK retailers on transactions arising from all UK issued debit cards is a fixed fee per transaction where as all other transactions incur an valorem fee.

Because the interchange fee is set collectively, it forms a floor to the overall MSC and prevents genuine competition at acquirer level. The retailer is to a large extent “captive”. The choice is take it or leave it – by refusing to accept the cards. As card acceptance among retailers in the UK is now virtually universal, it would not be commercially feasible to refuse to accept cards. The payment of such MSCs, artificially inflated due to the interchange fee component, can and does in effect encourage inefficiencies since there is little or no incentive for issuers or acquirers to become more efficient. The retailers similarly have no choice but to pass on the costs to the consumer which depresses overall purchasing power. BRC would agree with the UK competition authorities and the Commissions own view that the impact of interchange fees acts like a tax on consumers.

Based on recent research by the BRC the level of MSCs paid in 2005 within the UK would equate to circa £1,600m (euros 2,336m) based on APACS annual turnover figures for debit and credit card purchases compared to circa £540m (euros 788m) if a fixed fee per transaction had been paid at the average debit card rate on all transactions.

If it were possible to establish an equitable and yet truly competitive pricing structure within the payments market this could rapidly ensure true competition throughout the market but also energise or drive out current participants who are complacent and inefficient. The BRC is not convinced that bi-lateral negotiations of interchange fees is practical due to the very large number of card issuers that exist worldwide and that the negotiation cost would greatly exceed any benefit. However the fact that such bi-lateral negotiations are not practical should not be used as an excuse to charge excess fees to the retailers which are then either retained as profit or used to subsidise competition between issuers for the finite pool of potential cardholders at no additional benefit to retailers.

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

The BRC can see no justification for variations in MSCs where common processing, authorisation, and services provided to the retailer are identical for a transaction no matter what the card type used. This is illustrated within the UK where all debit card transactions are charged at a fixed fee per transaction irrespective of the transaction value while credit cards which are processed through exactly the same terminals in the same way are charged on an ad valorem basis.

Again, UK retailers have recently seen MSCs in respect of the traditionally relatively low cost UK debit card scheme (ex Switch) increase significantly following its acquisition by MasterCard. This is justified on the part of banks and card schemes because of the addition of the Maestro brand and cross border acceptability. This brings no benefit to UK retailers to justify the extra cost. There are plans to subsume the Switch brand totally by mid 2007. Insofar as UK retailers are concerned the procedures for handling these debit card transactions – and the cost of these to the issuer and the card schemes - is no different today to what it was 18 months ago. Nonetheless the change was imposed on retailers unilaterally, including the acceptance of International Maestro cards, without negotiation of any sort.

There have been a number of instances where fees have been raised to add cardholder services or functionality which is of no concern whatever to retailers but is purely a matter for the cardholder. In the UK, for example the recent launch of Visa business debit cards has unilaterally imposed an additional fixed fee cost per transaction on the retailer without any justification being provided by the card scheme since the retailer processes the transactions at point of sale in exactly the same way as they do for all other Visa debit cards and sees no additional benefit.

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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?

The BRC can see no justification for the transfer of substantial revenues to the card issuers through the interchange fee arrangements nor justification for the concept of an ad valorem fee that is tied to the value of the transaction where the actual cost of processing of such a transaction is fixed and determinable, no matter the value of the transaction.

The payment made by the retailer should relate, as it does in all other businesses, to a fair recompense to the service provider, the bank card acquirer, for the services actually provided to the retailer. The existence of charging levels that result in the substantial transfer of funds to the card issuer cannot be justified.

Retailers should not have to bear the costs of services or functionality from which they do not benefit and which are matters between the cardholder and the issuer – the interest free period, loyalty schemes and "premium" card functions are clear examples. Nor is there any justification for retailers to bear elements of fraud costs over which they have no control. Above all, there needs to be greater transparency as to the basis for the costs charged.

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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 indicated in the response to question 3 a reasonable charge for a reasonable service is a totally acceptable business practise. BRC believes however, that there is clear evidence from the high and sustained level of profitability found by the Commission that the card issuing banks are using their market power – exercised collectively through fixing of a non negotiable "floor" of interchange - to extract excess profits.

In the UK at least there is little or no benefit to the retailer from greater card usage as the market is well established and mature and any increase in cardholder numbers is principally from multiple card holding without any equivalent increase in spend. The interchange is used both to lure consumers away from more cost effective payment methods and to move the existing finite cardholder base around between the various issuers with no benefit to the retailer paying for it.

The banks have been pro-active in developing technology and innovation only where their own business case indicates it will generate high profits. Where innovation has taken place, this is mainly in the development of add on services for new cards issued. The cost benefits are rarely passed on to retailers or consumers but are used to swell the profits of the card issuers. There is little evidence of innovation in relation to the retailer related activities. The introduction of chip and pin within the UK card market was driven by a major threat to the underlying confidence of the banks in the card market.

The exploitation of new communications and network developments, and particularly their utilisation by retailers, has resulted in significant increase in the number of transactions that are proffered for online authorisation, which now account for in excess of 75% of all

UK transactions by value and volume, direct to the card issuer via the card acquirer. The use of online authorisations greatly reduces fraud risks and should have resulted in a significant reduction in MSCs payable by retailers. It did not.

The BRC agrees with statements made on blended rates and their effects on price competition between card schemes. In the UK smaller businesses can be subject to blended rates and this has been used to dampen the benefits of any technology developments and any reduction in interchange have at best been very slow in being passed on to those retailers. In the interim the fess payable to the acquirers have stayed the same and their profits increased.

A most recent example of a reluctance of card schemes to embrace new technology quickly has been the slowness of their reaction to respond to the need, by retailers and consumers, for the acceptance of payments by card at a cost effective price when using the internet. The card schemes and banks were supportive of the Internet as a potential major sales channel but growth stalled when retailers found themselves bearing the full cost of fraud through chargebacks and card issuers became involved in dispute resolution and administration. As a result, major e-commerce retailers resorted to introducing fraud prevention measures of their own and at their cost. As retailers were already having to pay higher interchange fees for e-commerce transactions, they found themselves in the situation of effectively paying more and incurring greater cost for a lesser service from the card schemes, as e-commerce transactions had no payment guarantee. Internet technology has not been embraced quickly or its impact on any retail markets assessed early enough in the card scheme development cycle.

Much of the card scheme's development thinking and implementation is based on the protection given to them by the implementation of new or amended chargeback rules which have the impact of increasing card issuer profits and retailer costs.

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

The 'Honour All Cards Rule' (HACR) has in practise in the UK meant creeping MSC increases. An instance of this is through the change of brand Switch to Maestro. Another instance is the re classification of certain card types to higher priced commercial, business or corporate cards and the increase in number of card types that incur additional charges. These charges have resulted in substantial increases in cost to the retailer for exactly the same level of service.

The cardholder is encouraged by their bank to use less cost effective payment methods but the cardholder does not perceive the differential costs of different card types which are born wholly by the retailer due to HACR.. The UK move from Switch to Maestro did not affect consumer behaviour but retailers cost of processing significantly increased.

The lack of transparency in the cost components of particular payment types exacerbates the current market distortion on the cost of different payment types. These pricing policies give no signal to the consumer that the retailer incurs more cost for one payment type compared to another.

The BRC does not believe that the abolition of the non discrimination rule (NDR) would be any sort of remedy. The NDR has not applied within the UK for many years. The opportunity to surcharge dependent upon the payment type exists and within a few specialised sectors there is wide spread use of it. However, unless surcharging has become a sector norm most retailers would not be willing to risk the loss of customers. For the vast majority of the main retail sectors with high volume of transactions, for example supermarkets or petrol, it is simply not practical to implement a customer charging policy dependent upon payment method used. The key point is that the cardholder is not necessarily aware of the price differentials that the retailer pays for different payment methods so any attempt to surcharge is likely, as well as causing additional administration and delay at the point of sale, to be blamed on the "greed" of the retailer. For most retailers the threat to surcharge is not credible in their negotiations with their acquirer – who is unable in any event to negotiate on the fixed minimum value of the interchange element.

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

As previously indicated, the BRC view is that cost based pricing whilst a potential solution is not applicable to the vast majority of their members as it has the danger of provoking confusion to the consumer rather than improving, maintaining or promoting efficiencies at the point of sale (checkout).

The identification of the method of payment, in most instances, takes place at a late stage in the sales transaction within a retailer. In the majority of high volume retailers the ability to inform a potential purchaser as to the cost of goods dependent upon card payment type provided is not practical as visual recognition of card type alone would be insufficient. Therefore if cost based pricing was introduced the efficiency of processing the transaction at point of sale would be severely hampered.

The BRC members would prefer the consumer to make the choice of how payment is made but on the basis of proper information.

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

From a BRC perspective current pricing practises have no impact on consumers' cross border usage however they can and do have a major impact on the retailer who accepts those cards.

Under the HACR UK retailers have to accept all cross border debit cards from both MasterCard and Visa. This has meant that all retailers including SMEs are forced to accept debit cards that are charged on an ad valorem basis rather than a fixed fee per transaction as for standard UK debit card transactions. Frequently retailers are charged on the same terms for international debit cards as those for credit cards for the relative card scheme.

From a consumer point of view it is now much more visible that the debit card they hold carries a logo which allows them to use the card outside the country in which it was issued. Within the last two years UK retailers have seen an increase in the number of cross border debit card transactions

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B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

Two prime examples of structures that have worked well within the UK, providing reliable service at low cost, are the historic Switch local debit card scheme and the current Link cash machine network.

Switch established a fixed fee per transaction based network processing structure that met the costs of the parties involved whilst providing a service to cardholders. As acknowledged in the European Commission Report the success of local debit card schemes has frequently resulted in their sale and absorption by the major card schemes and this happened in the UK resulting in much higher prices to the retailer for no extra service.

The Link cash machine network is an example of a cost based fixed fee per transaction model where the card issuer makes payment to the service provider, in this instance the owners of the ATMs and locations, a fee for each transaction handled at that device. The level of the fee is determined by the location of the device and whether the cardholder has been specifically charged for the service provided in which case the card issuer makes no payment to the service provider.

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

Wherever a market structure exists where there is little if any differential between the two main card schemes, Visa and MasterCard, then the interests not only of the consumer but other related parties, e.g. the retailer, can easily be compromised. Without a major alternative, the relationship can become too close resulting in the encouragement of practices such as blended rates which further depress competition. The emergence of a successful domestic debit card schemes is a threat to this so alternatives such as Switch are simply bought out. .

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

Whilst there is a need for participants in any scheme/group of interested parties to conform to the minimum rules and regulations needed to ensure proper operation of that group it is important that these do not amount to artificial barriers to entry or cartels..

For a period of time the ATM market was a closed group excluding many, but since the admission of others, it has benefited from the input of the new entrants to its development. Rules permitting easy access to issuing and acquiring markets and which prevent the existing schemes stifling development of new competitive card schemes are vital and need to be kept under close scrutiny.

There is no inherent reason why card schemes should fall outside normal rules on collective price fixing. To the extent this is accepted as unavoidable for efficiency reasons, it should be subject to the strictest rules to ensure that adequate competition and incentives for innovation and to prevent abuse are maintained.

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

A realistic approach to service provision and the amount charged particularly with regard to the transparency of costs at all times together with a realistic profit margin will succeed in bringing a realistic perspective to all current arrangements. If we cannot rely on competition then rules should be laid down which prevent cross subsidisation so that costs lie where they fall and are paid for by those that enjoy the services.

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

    No response being given

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13. What access conditions and fees are indispensable?

Whilst it would be inappropriate for any organisation to allow ‘free loaders’ it is also important that no artificial barriers, for example pricing that bears no relation to benefit, is put in the way of membership of any card scheme. Key to this will be the removal of the existing barriers to entry in selected countries by other countries’ payment processors and/or acquirers such that they can be treated on an equal playing field compared to local providers.

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

Segregation of responsibilities to individual parties within the payments market is desirable and should facilitate improved efficiency within the overall market and card schemes. However, the end to end payments market should operate within an overall integrated process.

From a retailers’ perspective there are three key areas to be considered to facilitate the efficient running of a payments market:

1. significant competition should exist between acquirers and payment service providers such that retailers have a choice of supplier for their acquisition services
2. retailers’ customers should have a choice of card issuers and card schemes for their cards
3. payment must be made to a retailer on an agreed date in respect of card payments made by their customers for the purchase of the goods and/or services.

The adherence to international standards for the processing of transactions by any card scheme will simplify the infrastructure required and maximise the overall efficiencies achieved to support card transaction processing within the payments and retail markets.

C. Future market developments

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

Further attempts to neutralise domestic card schemes will be made. Such moves should be more closely scrutinised and controlled by regulatory bodies.

Within the UK the demise of the local debit card scheme, Switch, when it was entering maturity through its sale to MasterCard and its re- branding as Maestro, has led to a significant increase in the MSCs charged and the fraud levels on those cards. The key beneficiaries of the sale appear to be the original member banks who sold their interests to MasterCard for significant financial remuneration.

As more national based retailers look to become international players the ability for a national acquiring and / or payment service processor to provide international cross border acquiring services utilising existing payments infrastructure and processes is required. The impact of this provision should be to increase competition in local markets for the processing of all card types accepted in that country.

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

The most significant technological development is that of telecommunications. The ability to cost effectively and speedily communicate information is available now and could result in the near elimination of risk at point of sale. To achieve near 100% online authorisations within the European market, particularly within the UK, is technically feasible now. However it requires all parties involved in the payment transaction to exploit it.

Techniques used to validate the cardholder and the transaction, for example chip and pin or internet cardholder security verification methods (e.g. Verified by Visa or MasterCard SecureCode) should in theory nearly eliminate all transactional related losses and, were there greater transparency and competition, this would be reflected in lower transaction costs passed on to the retailers. The reluctance on the part of some card issuers rapidly to embrace new technology or innovate can to some extent be put down to complacency influenced by artificially high levels of revenue used to offset the inherent inefficiencies of some of the current processing methods used. (e.g. continued existence of cheques)

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?

No response being given

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

No response being given

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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?

Harmonisation is important and the set of standards created and managed by APACS within the UK is a prime example of the impact and benefits that the establishment of standards brings to all parties involved in the payments market. Any move to such standards can only be beneficial to the market if it results in the creation of efficiencies to all parties. It is important that these efficiencies are translated into lower costs for processing transactions not simply taken as profit.

During the recent launch of chip and pin within the UK the establishment of updated technical standards, including the use of EMV standards, for processing transactions enabled all suppliers to work on a common basis for the certification of their individual technical solutions with acquirers and card schemes. This approval process assisted the selling process to retailers and reduced the overall implementation and approval of individual retailer solutions.

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?

No response being given

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

A much tighter regulatory regime that would question and disallow, where necessary, the absorption of schemes or take over by an International Scheme.

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

Interoperability must be a key feature of the SEPA landscape. Technical protocols and standards must be defined such that they allow for pan-SEPA solutions to be provided by any payment service provider – bank or independent provider.

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23. What governance requirements should SEPA schemes meet?

No response being given

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

During the recent introduction of Chip and PIN within the mature UK card market, the impact and experience of defining and using the same standard for the acceptance of all card types achieved a relatively quick rollout. This was achieved through the establishment and working together of specific working groups representing all parties in the transaction. One of the successes was the development and adherence of standards for both implementation and certification processes within an acquirer and a specific card scheme but the establishment of cross card scheme and acquirer certification was not achieved – this needs to be achieved in all future developments. The ideal certification approval process is to achieve a single process that is acceptable to all card schemes and acquirers.

The establishment of EMV and internet card security standards whereby the card schemes work at a technical level to agree a technical standard whilst allowing individual card scheme front ends / consumer interfaces to be defined has taken years to be established but appears to now exist. Key to success is to establish at an early stage what is the differential between technical, commercial and customer implementation.

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

Self regulation of a market and the introduction of Codes of Practice are always preferable to legislative controls. However, based on past experience of the payments market the BRC believes that further (or the threat of) regulation will be required in order to bring a semblance of equity to the market place

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General comments on the BRC response to the Report Content:

The BRC has had the opportunity to review the submissions of EuroCommerce and the European Retail Round Table and there is much within those submissions that the BRC supports. The BRC has taken the opportunity to comment separately principally to bring out those areas where the experience in the UK, as one of the most mature card markets, has been different to that of our colleagues in other jurisdictions.

General comments on the presentation of information within the Report

In order to maintain confidentiality of respondents to previous questionnaires it was noted that information had been consolidated on a country by country basis. However it would have been very useful if all the tables had named the country concerned rather than including country numbers only. Unlike information specific to particular consumer concerns, this sort of aggregated national data does not require confidentiality or pose a competitive threat. Given this position it was difficult at times to interpret the results based on the card maturity of individual countries.

General questions:

1. Did you find the content of the report easily accessible and understandable?
    - yes, fully;

2. Did you find that the level of detail in the report was:
    - not sufficiently detailed;

3. Did the information contained in the report was:
    - 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;

5. Did the report raised the right policy issues;
    - yes, covered most of the key issues;