COMMENTS ON:
"INTERIM REPORT I. PAYMENT CARDS"
OF THE COMPETITION DG, EUROPEAN COMMISSION

1.-Introduction: general comments

From our point of view, the report has two general and important shortcomings. The first one is its insufficient use of economic analysis in evaluating competitive concerns. The second is the inadequate handling of the empirical evidence in drawing conclusions.

With respect to the first, it should be noted from the start that the standards that should be expected from a report like the present one are the same as in any economic analysis for antitrust purposes. Only well established concepts and models should be considered. That is, concepts and models over which there is sufficient professional consensus. The report has a touch-all-bases flavor that is not satisfactory. In principle, nearly all possible practices MAY constitute instruments for anticompetitive behavior. However, the analyst's role is not to point out general possibilities, but rather to assess which of these practices, if any, ARE restrictions to competition in the situation at hand. The report does not meet the proper standards in this regard.

One of the most established rules for analyzing an industry from a competition policy viewpoint is to start by defining relevant markets. This rule is generally ignored in the report. This is the source of much confusion and lack of sharpness of the analysis. Should we think of acquiring and issuing of payment cards as the two relevant markets? Should we consider as separate markets credit and debit cards? Are we willing to consider data-processing in the same footing in this respect? Should we consider each international, open-network as a separate market? That is, are VISA issuing, acquiring, and interchange inside VISA association three vertically related markets? Or, in the opposite polar case, are issuing and acquiring non-separable parts of the basket of services that banks offer to their customers? There are well established conceptual tests to help in defining relevant markets. For example, the hypothetical monopoly test.[1] None of these tests is performed in the report. For different issues different definitions may be called for. However, without a proper definition of "markets", talking about competition or lack of it is meaningless.

With respect to the data, one should analyze carefully its validity. In this regard, data obtained from surveys should be subject to careful scrutiny. Parties' answers to surveys that relate to costs are often unreliable. When they produce implausible results, as the ones reported, one suspects that the data analysis is not insufficiently rigorous. Finally, econometric techniques should be applied to the right model. In this regard, correlations cannot be taken as causal relationships when the theoretical model behind them indicates joint determination and simultaneity. We return to these issues in the more particular comments below.

2.-Main issues

As we mentioned above, the report is concerned about basically any business practice in the payment card industry, and finds competitive problems that relate to nearly all. We have attempted to identify the concerns that are presented in a more consistent way and that appear as more relevant. In particular, we first answer the following two concerns:

[1] For a discussion of the relevance of traditional market definition and measured of market power in two-sided markets, see for instance E. Emch and T. S. Thompson, "Market Definition and Market Power in Payment Card Networks, (2006), Review of Network Economics, (5).

i) Interchange fees are not determined by cost. Instead, they are used to transfer rents, determine price levels at other stages of the industry, and allow for monopoly profits.

ii) Profitability is extremely high.

In section three we will comment shortly on other points which appear less central to the main theses presented in the report.

2.i.-Interchange fees

The report argues that interchange fees (IF) are not justified by cost, and constitute anti-competitive tools. They are instruments to transfer rents from acquirers to issuers, with the goal of protecting these rents from competition. They serve as barriers to entry by foreing competitors. They are used as a price coordination (price-fixing) scheme.

First, the report argues (in our view, correctly) that the payment card industry presents two-sidedness. The defining feature of a two-sided market is that price structure, and not simply price levels, matters in general for welfare and competition analysis. In other words, it is not only the sum of the prices (per transaction, for instance) to customer and merchant that matters but their relative magnitude as well.

Despite this, in the analysis of practices, the report treats IF, merchant charges (MSC), and cardholder fees as prices in vertically related markets, and finds that IF are not justified by cost.

The economic analysis of two-sided markets is still in its early stages and there are few points of consensus as of now.[2] However, among these points of consensus, Rochet[3] -an author heavily cited in the report-, mentions two: price structure is skewed, regardless of the extent of competition; and cost-based regulation of IF is meaningless. MSC and card-holder fees do not, and should not, reflect each side's costs, given the externalities involved in two-sidedness. Thus, regulating (in any way) IF so that they respond to cost is not sensible. The whole structure (MSC, IF, and card holder fees) plays a balancing role, where balancing refers to getting both sides, customers and merchants, on board or, to put in other words, internalizing the externalities one side exerts on the other[4].

Let us now discuss the claim that IF are explained by an attempt to transfer rents to the less competitive side: issuing. This is intimately related to the claim that IF are just price-fixing schemes. Indeed, these are two sides of the same claim.

An agreement on a price by a buyer and a seller is not exactly price-fixing in a competition policy sense. These types of agreements are simply bilateral contracts. Price-fixing is an agreement on a price by horizontally related firms. IF are typically negotiated between banks operating in issuing and acquiring, and as such cannot be exactly termed "price-fixing agreements". Yet, one can still hold that there is an element of price-fixing if one side is (relatively) competitive (price-taker) and the other tainted with market power. In that case,

[2] The report (page 8,9) summarizes the economic analysis of IF as a debate between two opposite views: IF are "neutral", so that its level has no impact on issuing or acquiring, or IF are a way to transfer (generate?) market-power rents from one side to the other. We think this is not a fair characterization of the debate. IF may not be neutral even when there is no market power in any side.

[3] J.C. Rochet, "Regulating Interchange Fees; A Welfare Analysis", Conference of the Federal Reserve Bank of New York, September 2005, available at http://www.ny.frb.org/research/conference/2005/antitrust/presentations/rochet.ppt

[4] Indeed, for both merchants and consumers, the "value" of joining a platform depends not only on the price the platform charges to the corresponding side but also on the number of the joining members in the other side. I.e, merchants care about the size of cardholder membership and cardholders care about merchant membership.

one can argue that the agreement concerns, fundamentally, firms in the same side of the market, the one with market power.

Viewing IF as the price of transactions between issuers and acquirers, (abnormally) high IF would result of a price agreement where issuers had market power, relative to acquirers. The empirical evidence shows that acquisition is more concentrated than issuing. Moreover, the report itself is concerned with joint ventures in acquisition and "blending", arrangements that give acquirers further elements for exercising any market power. Thus, if anything, we should be in the presence of a "market structure" more similar to monopsony than to monopoly, and the result should be lower prices, i.e., IF lower than competitive.

This, in any case, is not a good model of what goes on in the payment card industries. Two elements are missing: two-sidedness and the fact that usually the same banks are active both in acquiring and issuing. The relative level of concentration happens to be also relevant for this more accurate view of the industry. Indeed, now concentration will be one of the key elements that determine the banks market power relative to their customers, rather than acquirers versus issuers. Other things equal, a more concentrated acquiring side, should indicate an acquiring side with market power vis a vis merchants, as the report quite consistently holds. A less concentrated issuing side should indicate less market power (more competition) in the market for cardholders. Thus, even if issuers, perhaps due to governance rules or any other scheme, somehow controlled the association, if some or all of these issuers had interests in acquiring as well, then they should favor IF lower than competitive (lower than cost). Low IF put a floor to the price of their cardholder operations and avoid that any rents they could obtain with mark-ups in the acquisition side are competed away[5].

To conclude, both rent-shifting and price-fixing should result in too low IF rather than too high ones.

The report bases part of the concerns about IF on an empirical study (Annex 5) which concludes that higher IF are not fully passed through to cardholders. According to the report, the study shows that a 10% increase in IF translates into a decrease of only 2.5% in cardholder fees.[6] This, the report argues, supports the claim that IF are instruments for rent extraction and not mere "balancing instruments".

This argument presents two important weaknesses. The first and most obvious one is that, even when taken at face value, these percentages, per se, mean nothing. Indeed, a cardholder fee is (mostly) a yearly fee, unrelated to transactions. Thus, there is no reason why a 10% increase in a per-transaction fee should result in a 10% decrease in a yearly fee for the change to be “neutral”, unless cardholder fees extract exactly the same revenue as IF’s.[7] Without information about relative revenues, this piece of data is meaningless. Most importantly, the array of services/rebates to cardholders of different networks/banks varies considerably. (The data adds in the cardholder fee, for instance, charges for insurance, interest free periods, etc.) Therefore, cardholder payments are in part prices for these heterogeneous services, and

[5] A similar argument is made in J. Gans and S King, "The Role of Interchange Fees in Credit-Card Associations: Competitive Analysis and Regulatory Issues", Australian Business Law Review, (20), 2001, pp. 94-123.

[6] In the text of the report there is some confusion about how to interpret the econometric results. In the Executive Summary, it is said that "The empirical evidence shows that if the interchange fee increases by one Euro only 25 cents are passed on to consumers in lower fees" (page vi). If the Annex is right in the description of the variables, this statement is wrong.

[7] Also, per-transaction prices and annual prices have different effects on demand. Thus, unless this is perfectly inelastic, we would not expect a profit-neutral change of structure to leave revenues unaffected.

then a change in IF should not be reflected in a change of the same proportion of cardholder payments for IF to be a "balancing instrument".

The second weakness is the econometric treatment itself. Indeed, the maintained hypothesis (the model) is that the observed variability of IF is exogenous and not jointly determined with cardholder fees in response to the economic environment. This cannot be supported by any sound economic model. Economic models of two-sided markets indicate that both prices are simultaneously determined and should therefore be jointly correlated with other unobserved variables. Some of these may have to do with characteristics of the network/country, [8] and we can hope that a fixed-effects regression takes care of them.[9] However, the remaining variations (over time) of IF cannot be considered exogenous, but rather determined jointly with cardholder fees (and MSC for that matter) due to changes in other "unobserved" variables (changes in country regulation, entry of new banks, etc.). It may be difficult to find instrumental variables to correct for this endogeneity, but in the presence of this simultaneity problem, the parameter estimates are biased and therefore no reliable conclusion can be derived.

Adding up all these shortcomings, it is difficult to know what one can make of the results of the econometric study offered in Annex 5.

To conclude this section, we may add that IF have attracted a lot of attention in this report and elsewhere. Perhaps this is inherited from other two-sided and network industries, like telecommunications. It should be noted, however, that in those markets interchange (or access) fees are usually prices for accessing bottleneck facilities, the control of which is in the hands of previously

[8] An overview of several of these differences for a set of countries is presented in S.E. Weiner and J. Wright, "Interchange Fees in Various Countries: Development and Determinants", Review of Network Economics, (4), 2005.

[9] In this regard, conducting the less powerful random-effect regressions presented in the report as well is pointless.

monopolistic incumbents. This is a situation very far from the one analyzed in this report. The regulation of that situation originated rich debates and innovative regulation approaches. As Rochet and Tirole[10] put it, in two-sided markets "more novel and innovative thinking about how to reconcile regulators' concerns and the industry legitimate desire to perform its balancing act" is called for.

2.iii.-Profitability

The report uses survey data to estimate the profitability of issuing and acquiring as separate activities. Firms were asked to provide information about costs and revenues related to these two activities. The estimates portray a landscape of extremely high average profitability in both activities, especially in issuing, and extremely high dispersion as well. In acquiring, 3 out of 83 respondents' answers implied a ratio of profit to cost above (or around) 150%, whereas for three other the ratios were negative and below -50%. Per country averages range from 62% to negative. In issuing the figures are even more extreme: 25% percent of banks had profit to cost ratios of more than 130% (some as large as 500%), and again a few had negative ratios below -50%.

The average profitability is surprising. But, what can we say about the appalling variance in profitability? The report fails to explain what factors may explain the differing values of profitability.

If we were to believe these computations, we should be eager to learn how we can explain the extreme variability of profitability across banks, countries, etc. In particular, given the emphasis place in IF and its role as rent extraction tools,

[10] JC. Rochet and J. Tirole, "Externalities and Regulation in Card Payment Systems", Review of Network Economics, (5), 2006.

we should be eager to learn what is the relationship between observed IF and reported profitability. The report offers no answers to this. Also, of all the "competitive concerns" mentioned in the report, only "blending" seems to show some pattern that parallels the pattern of profitability. Overall, it seems difficult to reconcile these extremely high profitability ratios with so little cross-border entry/acquisition activity as has been reported.

Of course, there is one very different explanation both to the astronomical levels of profit ratios and to the their extreme dispersion. This explanation is that respondents to surveys did not provide the correct answers. This possibility is mentioned in passing in page 63 only to immediately reject it. In the words used in the report, "the measure of profitability has to be considered reliable because it was made by those who best know their own business". This is more than arguable. According to the description of the survey one finds in the report, respondents were asked to provide figures for specific cost and revenue categories. There was an additional category called "other type of costs/incomes" aimed at capturing any costs not included in the other categories (depreciation,…). The problem is that, as the report recognizes, many (most?) costs are related to joint production of services (current accounts, savings accounts, etc.). It is not clear from the description of the survey offered in the report whether respondents were explicitly asked to impute these costs, and whether respondents were explicitly informed of the methodology that was to be used. Based on the inclusion of this "other type of costs/income" category, we suspect they were not.

Finally, we agree that the ones that know best should be the ones that run their business. However, it is difficult to envision high profile executives (the ones that really know best) spending sizable resources to make the right imputation in order to answer a survey. Even if they did and they did so truthfully, the answer would be different depending of the type of decision to be taken based in the computation. Was the survey clear as to the use that the data were to be given? Were respondents told that the goal was to compute profitability ratios for acquiring and issuing? If not, the disparity in figures is less surprising, as is their average. If yes, why not ask directly for the profitability ratio? Or else, why not check with the respondents whether they thought the figures were reasonable?

Instead the report claims, based on no further evidence, that the dispersion in profit ratios is explained by differences in cost structures and efficiency. Without evidence to support this interpretation, it is difficult to sustain it against the alternative hypothesis we have just offered. Yet there are minimal tests that could be performed: is there such a degree of dispersion when comparing ratios of revenue to costs without taking into account the item "other type of costs/incomes"? In case the variability was reduced significantly, we should suspect that the methodology to impute or account for these "other costs/revenues" is behind this variability.

3.- Other concerns: barriers to entry and competition

As we mentioned before, the report displays a wide array of "may-be's" competition concerns. It is difficult to organize a systematic answer to such a non-systematic analysis. It is important to underline, however, that the report itself recognizes that none of these potential barriers seems to have a clear relationship with profits or market-power measures, with the possible exception of "blending". Nevertheless, and as illustrations, we will consider a few of the concerns mentioned in the report.

Joining fees: Joining fees present a high variance across countries/networks. For the upper tail, this is taken to mean high (extraordinary) fees. With only this information, it is difficult to sustain this claim. We should understand what "services" joining an association buys, what previous investment (image, setting the network,…) may these fees recoup, etc. We should understand whether differences in these features across countries/networks can explain the diversity. In this regard, the only characteristic to which the report refers is the size of the country. Also, it should be noted that whether joining fees can be considered barriers to entry at all depends on the definition of the nature of competition (once again, the relevant market). We could take an extreme stand and envision network competition as the relevant market. Then, barriers to joining a network are pro-competitive: they enlarge the scope for entry of new networks and therefore facilitate competition.

Vertical integration to processors and terminal vendors. This is mentioned several times as a barrier to entry, although it is often unclear whether the concern is with competition in the payment card industry or in processing or equipment industries (page 119). We think the latter does not belong in the report. In any case, it is difficult to believe that associations have significant monopsony power in a properly defined market for data-processing or equipment. Thus, restricting attention to the payment card industry, there is no indication in the report of how an association may restrict competition by vertical integrating to processing and terminal provision.

Co-branding. The report is suspicious of the practice by some associations in some countries of forbidding its members from co-branding (or co-badging). Co-branding with non-banks can be hardly a competitive issue as its general acceptance shows. Only one national payment-card network forbids co-branding with non-banks, and another one allows it as long as it does not show in the card. This latter precaution may give us a hint of why non-banks co-branding may be disfavored by national networks. With respect to the general tendency to forbid co-branding with rival associations, the market definition considerations laid down when we talked about joining fees are in order again. Co-branding makes different networks more homogeneous, and as such facilitates competition between networks. Yet, the coordination necessary inside a network also facilitates coordination among members of otherwise different networks, and as such is anti-competitive. Thus, co-branding or the lack of it should be evaluated in the light of the relative importance of these two opposing forces. This is missing in the report.

4.-Concluding remarks

The report does not meet the required standards of analysis in critical aspects: the soundness of economic reasoning and the rigour of the treatment of empirical evidence. It is plagued with claims about "competitive concerns" that are not supported with sufficient empirical evidence. This comment has attempted to show what in our view constitute the main shortcomings of the report and leads us to conclude that the report is far from being a useful piece of analysis that may inform regulation.

FEEDBACK FORM

Name of undertaking: CAIXA D'ESTALVIS I PENSIONS DE BARCELONA ("LA CAIXA)

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 acquirer and current issuer.

Address: Av. Diagonal, 621-629. 08028-Barcelona

Country: Spain

Name of contact person: Claudi Rossell

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Participated in the questionnaire:

X 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?

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

A/ "High" merchant fees do not affect competitiveness within the European market. This is so because from a general point of view, payment cards are more efficient and less costly means of payment if compared to other means of payment such as cash or checks. [1]

A.1/ Cards provide a fast and flexible service to customers and merchants tend to benefit from a valuable payment guarantee. It is a more secure method of payment for both consumers and merchants if compared to cash or checks.

1 This also seems to be the opinion of the European Commission as provided in case COMP/29.373 Visa International

A.2/ Cash handling costs are significant. For the consumer, it implies the cost of having to look for an ATM or bank office to withdraw cash and then carry on the cash with the risk of theft. For the merchant, cash handling implies costs of banking, securely transporting, sorting and administering cash. Also when merchants accept cash, they are inevitably suffering the risk of accepting counterfeit notes or even internal "shrinkage".

A.3/ Payment with checks has disadvantages if compared with the payment by cards. Payment with checks does in principle not offer merchants any guarantee of payment, it implies a risk of theft and loss and cashing a check generally bears a commission to be paid by the merchant.

Practice has shown that checks, promissory notes and traveller checks are in disuse. Below you will find a chart which shows the number of checks and/or promissory notes cashed in Spain, the amount of the transactions made in checks and promissory notes and the percentage that checks and promissory represent in the Spanish National System for Electronic Compensation ("SNCE") for the years running from 2002 to 2005.

Data related to checks and promissory notes compensated in Spain for years 2002-2005

	Number of checks	**Amounts in Millions €.**	**% of means of payment**[2]
Year 2002	135,216,545	534,732.73	10.97
Year 2003	130,112,162	569,092.33	10.24
Year 2004	123,595,438	590.348,89	9.38
Year 2005	117,576,686	629,334.12	8.45

The chart above, and in particular its last column to the right, shows that the use of checks and promissory notes is continuously diminishing. Despite the decrease in the number of checks and promissory notes compensated in Spain, the amount of the transactions carried out in checks and/or promissory notes has increased. This situation is mainly due because (i) users of checks and promissory notes are generally big companies (e.g. hypermarkets) and not

2 These figures do not include payments by cards which do not go through the Spanish National System for Electronic Compensation ("SNCE").

consumers and (ii) promissory notes are primarily used for financial rather than payment purposes. Hypermarkets tend to use promissory notes to pay to its suppliers because of the current applicable commerce Spanish legislation.

The disuse of paper money is also reflected by the figures included in the chart below which relate to checks and traveller checks bought by "la Caixa " and payable by financial entities outside Spain.

Data related to checks and traveller checks bought by "la Caixa" and payable by financial entities outside Spain for years 2003 to 2006.

	Checks		**Travellers**		**Total Nº Docs.**	**Total amount in €**
	Nº Docs.	**Amount in €**	**Nº Docs.**	**Amount in €**		
Year 2003	376,992	1,086,029,058.41	1,761,679	143,531,284.34	2,138,671	1,229,560,342.75
Year 2004	353,971	1, 039,205,789.14	1,390,464	109,434,480.58	1,744,435	1,148,640,269.72
Year 2005	332,982	1,010,683,677.04	1,139,704	86,147,473.50	1,472,686	1,096,831,150.54
Year 2006[3]	136,533	415,307,382.41	199,527	15,231,838.10	336,060	430,539,220.51

As seen in the chart above, it seems that the decrease in the use of checks and travelers is continuous since the last three (3) years. As far as checks are concerned, the decrease is almost of a 10% but in traveler checks the decrease reaches the 20%.

- With regard to *traveller checks*, their use is mainly touristy. Although tourism has not decreased in Spain, the reason for the decrease in their use is that they are being substituted by other means of payments, such as debit and credit cards, or even cash since there are now 12 EU countries where the Euro is in place which facilitates traveling without documents to be changed in banks such as traveler checks.

3 Figures related to year 2006 are limited to the first five (5) months but "la Caixa" foresees that transactions in checks and travelers will continue to decrease in the same rhythm as in previous years.

- With regard to *checks*, it is to remark that their use is mainly commercial. They are not generally used by consumers. Checks are mainly used by companies located in France, Portugal, Germany, UK and the USA. The decrease in the use of checks is not as pronounced as with traveler checks but it has been proven to be in a continuous decrease. This continuous decrease is mainly due to the substitution of checks by other means of payment which are less costly and more efficient, amongst others, bank transfers, which because of legislative measures their prices have decreased.

The above are the tariffs used when transactions are carried out by tourists or other occasional clients. Nevertheless, when consolidated clients ask for these services (mainly hotels, apartments, currency exchange companies), “la Caixa” generally condones such amounts (approximately in a 50% of the occasions). Consolidated clients do not accept that they are charged normal tariffs and thus, “la Caixa” can not charge any amount for such services.

Therefore, the data above indicated certifies that less efficient and more costly means of payment, such as paper money, are losing importance within the EU economy in favor of the use of plastic cards.

A.4/ It is to remark that Spain is a country where cash transactions seem to prevail over card transactions what implies that great investments need to be done to attract consumers to use plastic cards instead of cash. Thus, Spain seems to be still in a developing phase.

The European Central Bank has recognized that in 2003 the number of terminals per one million of Spanish citizens was 23,514 units while in the rest of EU-15 was 13,464 units; despite of this fact, the number of card payment transactions per Spanish citizen as well as the volume of the transaction is lower than the European average.

B/ With regard to the “high” level of merchant fees observed in some parts of the EU, it is to note that the differences in price charged to businesses for card acceptance is not necessarily a result of market fragmentation and lack of competition but rather the specific characteristics of each particular EU Member State. Amongst other reasons, the following might justify such differences[4]:

- **Credit Cards vs. Debit Cards.** Credit cards are used more in some countries than in others. For instance, credit cards are used heavily in the UK and Ireland. Over 53% of EU transactions using credit cards take place in the UK and Ireland. The remaining 47% represents the remaining 23 EU countries. Statistics show that the fees charged to merchants are generally higher in credit card transactions than in debit card transactions which could be one of the reasons for price differences in such fees amongst EU countries.

- **Merchant Fee Components**. Due to the differing commercial practices in different countries, banks have also adopted different approaches with regard to the elements and services included in the merchant fee. Some countries such as Spain include terminals, terminal maintenance, telecommunications and terminal consumables within their merchant fees; other countries, such as France and the UK, only include telecommunications; others offer no features free of charge in their merchant fees. Moreover, the terms of payment differ from one country to another. In most countries, settlement is made one day after the transaction, but there are exceptions because in some countries settlement is made three days after the transaction of even six days after the transaction.

  Below is a chart which shows some of the differences country by country with regard to the elements and services included in the merchant fees. Please note that the list of services provided is not exhaustive.

4 Information mainly sourced from the industry analysis carried out by PSE Consulting "Normalisation of MSC Rates for Payment Cards in the EU" dated 31st March 2005.

Country	Which services are currently included in the Merchant Service Charge?				
	Terminals	Terminal Maintenance	Telecoms	Consumables	Settlement Days
Austria	N	N	N	Y	T + 2
Belgium	N	N	N	N	T + 3
Denmark	N	N	N	N	T + 1
Finland	N	N	N	Y	T + 6
France	N	N	Y	N	T + 1
Germany	N	N	N	N	T + 3
Greece	?	?	?	?	T + 3
Ireland	N	N	N	Y	T + 1
Italy	N	N	N	N	T + 1
Luxemburg	?	?	?	?	T + 1
Netherlands	N	N	N	Y	T + 2
Norway	?	?	?	?	?
Portugal	N	N	Y	Y	T + 1
Spain	Y	Y	Y	Y	T + 1
Sweden	?	?	?	?	T + 1
Switzerland	N	N	N	N	T + 2
UK	N	N	Y	N	T + 2

- **Different Country Frameworks.** Although all countries have international card schemes and rules for credit card issuance and acceptance, many countries have adopted different business models, practices and frameworks for debit card transactions. Some of the differences are indicated below:

(i) International Card Scheme vs. Domestic. Many countries have built their own proprietary frameworks and processing infrastructures to handle locally issued cards. This has produced a wide variety of cost based on which the multilateral interchange rate and merchant rate have been articulated. Other countries have opted for international card names and frameworks, which again has produced different costs and fee structures.

(ii) Discounts applied to multilateral interchange rates offered to certain merchants. Certain countries, such as Spain and Portugal, have instituted a system which offers discounts on multilateral interchange rates (and thus merchant fees) to high-volume merchants.

These major merchants may pay lower merchant fees than businesses in other countries. The system instituted in Spain is reflected in the Framework Agreement dated December 2, 2005 entered into between the three card payment systems (Servired, 4B and Euro 6000) and it is to point out that it has been supported by the Spanish Government. This system foresees a different interchange rate depending on the volume of the transaction. The higher the amount of the transaction is, the lower the interchange rate (and thus merchant rate) is.

(iii) Risk Management Cultures. Certain European countries, such as Ireland, France and the UK, have traditionally accepted higher levels of fraud and bad debt than other European countries. As a consequence, such countries operate a lower cost management structure, which in turn affects the merchant fees. The rest of Europe uses on-line systems which cost more to operate but produce lower levels of fraud and bad debt. Consequently, these countries authorize, at least, 30% to 50% of transactions and are now investing in EMV technology to comply with the SEPA objective for year 2010. The high cost of implementing EMV technology is probably already reflected in merchant fees into some extent.

As far as "la Caixa" is concerned and for information purposes, the amounts that "la Caixa" envisages to invest to implement the EMV technology are the following: 6,380,000€ (VAT included) for year 2007, 8,830,500€ (VAT included) for year 2008, 11,310,000€ (VAT included) for year 2009 and 13,775,000€ (VAT included) for year 2010. Thus, the total amount of investments foreseen by "la Caixa" until year 2010 to implement the EMV technology amounts to 40,295,500€. Additionally, "la Caixa" has invested 25,000,000€ in updating costs of ATMs and terminals.

(iv) Three-Party Model vs. Four-Party Model. Certain countries, such as Belgium and Germany, operate three-party or closed debit card operations which result in very different cost structures and commercial frameworks. Most of Europe uses the four-party model, card-issuer and card-accepter/acquirer being different. The three-party model, which costs less, results in lower merchant fees.

(v) Under-Used Payment Infrastructures. Merchant fees as well as interchange fees also reflect consumers' attitudes toward the use of cards. Certain countries have invested a great deal in card-processing technology, but consumers have been slow to switch from cash to cards. These countries have high transaction costs because consumers tend to use cash rather than cards. Fewer card transactions and higher overhead push merchant fees and interchange fees up in these countries.

Thus, in countries where there is a low plastic spending penetration, merchant fees tend to be higher than in a country where there is a high degree of plastic spending.

Likewise, in certain countries like in Germany, the low merchants fees applied may make the system less attractive and as a consequence thereof, the payments systems are less attractive to banks and not sufficiently developed.

(vi) Common Card Rates. Certain countries, such as France, Spain, Poland, Hungary, and the Czech and Slovak Republics, accept debit and credit cards on the same terms. This system sees a card as independent of an underlying account or banking product. This business model requires interchange and merchant fees be constructed in a different manner.

(vii) Cross-Border Multilateral Interchange Fee ("MIF"). When settling merchant fees, acquiring banks take into account the MIF costs they pay to foreign card issuers as a result of cross-border and intra-European transactions, except otherwise agreed between two or more banks. The levels of cross-border/intra-European transactions are different from country to country. For credit cards, this can mean up to 40% of the total volume handled. These different cost flows also produce differences in interchange and merchant fees.

(viii) Different legal regimes. Although to an extent harmonized by some European legislative instruments, there are still differences in the legal regimes of the 25 EU Member States. For instance, we refer to banking, consumer and tax national laws. These differences may also have an effect on the different level of fees charged to merchants.

C/ In light of the above and departing from the premise that cards are, in general terms, more efficient means of payment that cash and checks, one could say that merchant fees are a competitive issue for the EU economy. Figures show that the use of paper money is losing importance if compared to plastic cards. The diminishment in the use of paper money will be enhanced with the SEPA which has, amongst other objectives, to make sure that consumers can make cross border transactions with their plastic cards as if they were doing domestic transactions.

Without merchant fees, the system would probably not be so attractive to banks and would affect the correct development of card payment system enhancing then the use of less efficient means of payment such as cash and checks[5].

Likewise, the price differentials in merchant fees amongst the different EU Member States do not necessarily result from a market fragmentation and lack of competition but there are many reasons that might justify such differentials, mainly the specific characteristics of each specific Member State and which have been pointed above.

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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?

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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?

[5] Paragraphs 98 and subsequent of Commission Decision in case COMP/29.373 Visa International.

The Commission remarks that the issuing business is a highly profitable business stating that in year 2004 the weighted average profit-to-cost ratio was of a 65% in the credit card business and of a 47% profit-to-cost ratio in the debit card business.

A/ "la Caixa" believes that the formula used by the Commission to calculate the profitability of the issuing business is critizable. There are 3 main reasons which we summarize below:

1. The formula used by the Commission is based on the profit-to-cost ratio. In general accounting and financial praxis, the profitability of businesses is generally calculated on the income perceived by the business and not on the costs incurred. As an example, it is to remark that while the Commission points out an average profitability of the credit-card issuing business of a 65% and an average profitability of the debit-card issuing business of a 47% , "la Caixa" has calculated that its profitability in the issuing business would be of approximately a 26% (if calculated on a profit-to-cost ratio) and of approximately 20%, if calculated on the income received.

2. The fact of the issuing business being an efficient business as far as costs are concerned, makes the results obtained by the Commission using the above indicated formula even more contestable. It is to remark that in the issuing business there are very little costs due to the fact that the transactions are mainly managed electronically. High investments are done on a very early stage, but once the payment system and its inherent technology is sufficiently developed, the costs are few.

3. The great complexity related to the allocation of costs which are common to other activities as well as with regard to the decision on which other costs should be included in the category of "other type of costs", as mentioned in the Interim Report. From the information provided, "la Caixa" considers that the respondents must have probably not reported correctly some relevant costs related to the issuing business that affect considerably the level of costs associated with the issuing business:

   (i) *Staff costs*

   In general terms, staff costs include customer service and marketing and promotion personnel: membership, doubts, complains, advert campaigns, etc.

As far as “la Caixa” is concerned, it is to remark that (a) its staff costs incurred in the credit card issuing business in year 2004 represented a 32.39% of the total costs of such business and (b) its staff costs incurred in the debit card issuing business in year 2004 represented a 48.73% of the total costs of such business.

Thus, the staff costs can not be disregarded since they represent one of the major costs of the issuing business.

Although it is difficult to allocate the staff costs to the issuing business, “la Caixa” has worked hard to develop a formula which would facilitate such allocation of costs. In this regard, “la Caixa” has multiplied the number of transactions carried out with cards by the total time incurred by the employees in those transactions. Thereafter, it has applied as usual a corrective factor. It has been calculated that approximately a 75% of the time corresponds to effective work. The figure obtained therein is then multiplied by the average cost of each employee.

(ii) *Innovation costs*

As far as “la Caixa” is concerned and as prove of its innovation efforts, it is to remark the latest example of service/product offered to its cardholders which is named “CaixaProtect”. This product consists in a guarantee offered to cardholders which covers all fraudulent transactions and the risk of loss and theft of the card during a period of 12 months and up to a maximum amount of 10,000€.

Likewise and thanks to “la Caixa”’s innovation efforts, “la Caixa” is a pioneer of new technology, and this is the basis of its efficient service. One of “la Caixa”’s most outstanding and successful services is its home banking facility (*Línea Abierta*). This service allows cardholders to consult their accounts and make transactions 24 hours a day, 365 days a year.

Furthermore “la Caixa” operates a network of 7,300 ATMs, each one capable of processing 200 different types of transaction, providing service to customers

24 hours a day, 365 days a year. It is important to note that these ATM’s, in accordance to Spanish legislation, inform customers on all fees applicable to their transactions, even those applied by third banks, before a transaction is accepted by the customer. This is an important feature to keep the customer informed, but it implies high costs.

(iii) *Amortization of fixed costs*

Issuing and acquiring banks have initial high investments in technology, infrastructure, ATMs, terminals, etc. All these items, in accordance with accountancy rules, must be amortized annually and, therefore, represent annual accountancy expenditures.

It is to note that if “la Caixa” would calculate its profitability of the issuing business on the basis of the formula used by the Commission (profit-to-cost ratio), the profitability of “la Caixa” of the issuing business would be of approximately a 26%.

Likewise, if the profitability of “la Caixa” of the issuing business would be calculated on the income perceived (and not on the profit-to-cost ratio), then the profitability would go down even to a 20% approximately. Thus, from la “la Caixa”’s point of view, the profitability of the business is not as high as the Commission believes to be.

Thus, the figures of “la Caixa” profitability considerably differ from the figures/averages indicated by the Commission in its report. The above makes the results of a weighted average profit-to cost ratio of 65% in the credit card business and a 47% profit-to cost ratio in the debit card business in year 2004 somehow unrealistic.

With regard to the justification for substantial revenue transfers through interchange fees in card payment systems where there is an apparent profitability, one is to note that at least in the Spanish market, the profitability of the issuing business is mainly dependent of the interchange fees charged to acquiring banks. As an example, it is to remark that (i) the income received by “la Caixa” from interchange fees of its credit card issuing business in year 2004 represented a 33.17% of its total income of such business and that (ii) the income received by "la Caixa" from interchange fees of its debit card issuing business in year 2004 represented a 64.41% of its total income of such business

The fact of issuing Spanish banks having as main source of income the interchange fees is because Spain is a country where the use of cash prevails over cards and banks to persuade consumers to switch from cash to cards have to offer very good conditions to consumers. As a consequence thereof, the fees charged to cardholders are very limited in Spain.

C/ However, it is to note that the issuing activity in some countries such as Spain is increasingly becoming more competitive and, as a consequence thereof, the amount of interchange fees charged by issuer banks respond to the level of existing competition and not some kind of market power in a two-sided industry. On the offer side, the issuing business is sufficiently competitive within Spain as far as issuing banks compete aggressively in the fees charged to cardholders but also in the services offered to cardholders. In other words, Spanish banks do not stop innovating to offer better prices and services to its cardholders. On the demand side, merchants are lobbying and requesting more services and a reduction on interchange and merchant fees to both issuing and acquiring banks, respectively.

The Spanish Central Bank provides with some clear evidence of the existing competition in Spain: for years 2002-2005 the maximum interchange fee has decreased in a 21,5% (from 2.78 to 2.18%) and the maximum merchant fee has decreased in 16,67% (from 3.48 to 2.9%)[6]. Additionally, the indicated Spanish fees have decreased as of January this year because of the already mentioned Framework Agreement December 2, 2005 and the compromise is that they will continue decreasing until 2010. Below you will find the maximum figures for interchange fees agreed for the following 4 years.

Ranges	2006		2007		2008		2009-2010	
Euros (€)	Credit (%)	Debit (€)	Credit (%)	Debit (€)	Credit (%)	Debit (€)	Credit (%)	Debit (€)
0-100 Mill	1.40	0.53	1.30	0.47	1.10	0.40	0.79	0.35
100-500 Mill	1.05	0.36	0.84	0.29	0.63	0.25	0.53	0.21

[6] We refer to the following web page of the Spanish Central Bank: http://www.bde.es/sispago/estadisticas.pdf.

More than 500 mill	0.66	0.27	0.66	0.25	0.54	0.21	0.45	0.18

The exact percentage fee (in case of credit cards) or fix fee (in case of debit cards) will depend on the annual volume of card transactions of any company or trademark/s group within the immediate preceding year. The unquestionable premise is that interchange fees have been decreasing over the years and proportional to the increase of card payment transactions.

These figures are in accordance with "la Caixa"'s current average interchange fee for credit cards: 1-0.9%.

In light of the above and to conclude, one could say that the results obtained by the Commission might not be realistic because of the formula used to calculate such profitability and because of the complexity of the allocation of costs which are common to other activities. This is shown by the great differences between the profitability figures indicated by the Commission and the profitability figures obtained by "la Caixa".

Furthermore, in Spain the main source of income of the issuing business is the interchange fee (consumers pay very low fees) and the issuing activity in Spain is sufficiently competitive. As a consequence thereof, what the Commission seems to consider "high" profits obtained by the issuers is not the result of market power in a two sided industry but the result of the increasing competition between issuing banks continuously offering better rates to cardholders and merchants and offering new services and products to both addressees of their services.

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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?

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

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

A/ There are certain Spanish rules that distort price signals to consumers and thus, the choice of the most efficient payment instrument.

For instance, the fact of banks being prohibited from charging consumers any commission for cash transactions made within the same financial entity where the consumers bank account is held. In this vein, the Service of the Spanish Central Bank understands that, while the entities provide a service, acceptance of the cash deposits in an account of the receiving entity itself may not be considered the provision of a service outside the account service inherent in the account contract. This account service is deemed the credit entity's obligation to accept payments and collections using the account.

Rules like the above indicated which prohibit charging commissions for cash transactions might distort price signals to consumers and make difficult for them to choose the most efficient method of payment.

B/ With regard to the question on whether cost-based pricing would promote the use of efficient payment instruments and how such practicing could be implemented, "la Caixa" believes that a move towards cost-based price setting strategy would probably promote the use of efficient payment instruments. Nevertheless, this cost-based pricing should affect all means of payment and not only plastic cards. The problem that "la Caixa" sees in adopting such strategy are the existing legal provisions and banking practices which have been identified above and which prohibit charging certain commissions for certain services offered to cardholders.

With regard to cost-based pricing and whether the same would promote the use of efficient payment instruments, the Commission has already accepted as a general principle that under European competition rules, multilateral interchange fees are acceptable provided such fees reflect the real costs incurred by the issuing entities in rendering the services[7]. Based on the

[7] In fact, the Commission has clearly stated that for the feasibility of Visa system and the benefits provided by the same, Visa MIF is indispensable: "in the absence of direct contractual relationship between issuers and merchants, without some kind of multilateral interchange fee arrangement, it would not be possible for issuers to recover from merchants the costs of services which are ultimately to the benefit of

Commission conclusions in case COMP/29.373 Visa International, there are some real costs derived from the use of cards as a payment mean. These costs, although some of them being highly difficult to disassociate, have been allocated into consumers or merchants by issuing and acquiring banks, depending on the beneficiary of the same.

Merchant and interchange fees are the result of part of such allocation of costs, responding the second of them for the services provided by the issuing bank in benefit of merchants per payment transaction. With regard to the costs, the Commission has already accepted as direct costs the following:

(i) Cost for Processing Services: payment request from issuing bank to acquiring bank at the petition of merchant and confirmation to both of them (highly beneficial service to merchants in the context of international payment transactions).

(ii) Payment guarantees: insurance against fraud and cardholder default for merchants (highly beneficial service to merchants in the context of international payment transactions). Although this service may be seen as an additional service to the card payment transaction, the Commission has recognized that there is no cost-efficient alternative to the same[8].

(iii) Free funding period: this service encourages cardholders to increase their consumption by making additional purchases which otherwise they may not have made. Its inclusion in the interchange fee is justified as it primarily benefits merchants with whom such purchases are made[9].

Apart from the above, "la Caixa" considers that there are other costs associated with the issuing business that should also be taken into consideration. These are the following:

(i) Innovation: card payment market is still a market under development from an innovation viewpoint. Innovation benefits not only banks but also consumer's

merchants, and this would lead to negative consequences, to the detriment of the entire system and all of its users" (Commission Decision in the Visa case, paragraph 98).

[8] Commission Decision, paragraphs 86-88.

[9] Commission Decision, paragraph 89.

welfare in general terms. Since the implementation of a card payment system the sector has continuously provided the market with new products such as internet payments, cardholders' comfort, etc. Innovation requires enormous investments.

(ii) Compliance with legal requirements: legislations change continuously and, in some cases, to the detriment of market participants for the benefit of the market. For example, the current SEPA project would require not only an initial high investment but also to adapt certain non-directly related areas of banks. As an example, one is to note the investment that banks have to do to implement the EMV in all their cards and adapt their terminals. As commented above, the investments foreseen by "la Caixa" until year 2010 to implement the EMV technology amount to approximately 40,295,500€. Additionally, "la Caixa" has invested 25,000,000€ in updating costs of ATMs and terminals.

(iii) Staff Costs. "la Caixa" staff costs of the issuing business are quite considerable if compared to the rest of cost related thereto.

As indicated above, (a) "la Caixa"'s staff costs incurred in the credit card issuing business in year 2004 represented a 32.39% of its total costs of such business and (b) "la Caixa"'s staff costs incurred in the debit card issuing business in year 2004 represented a 48.73% of its total costs of such business.

(iv) Others: there are some other contingencies that banks, in general terms, must take into account. For example, failures of the system, updating of the system, etc.

C/ With regard to the question on whether current pricing practices have a substantial negative effect on cross border card usage by consumers, it is to note the following:

Initially, the costs per card payment transaction were high. However, experience has shown that the natural development of card payment systems in the EU is reducing the interchange and merchant fees progressively (in the end, that is the result of having in place a strong competition).

For example, we refer to the data provided by the Spanish Central Bank for years 2002-2005. In this regard, the maximum interchange fee has decreased in a 21.5% (from 2.78 to 2.18%) and the maximum merchant fee has decreased in 16.67% (from 3.48 to 2.9%).

The main reasons for such constant reduction of the interchange and merchant fees are the following:

A. Increase in the number of end-users (both card users and merchants): Consumers are attracted by a card payment system that (i) involves an increasing number of merchants, (ii) shares high fixed costs between a high number of end-users (therefore, price reduction), (iii) a system that compared to other payment systems is continuously improving, (iv) that continuously offers more additional services, etc. Similarly, merchants would be attracted by a card payment system that (i) attracts an increasing number of consumers, (ii) due to the increase of its activity shares high fixed costs between a high number of end-users, etc.

B. Increase of the number of issuing and acquiring banks: the greater the number of issuing and acquiring banks is, the greater the competition is.

C. Interaction of the demand and offer of card payment services: the more competition there is, it provides end-users (mainly merchant) with a negotiating power before banks. This is the case, for example, of the Spanish card payment market where banks and merchants, with the support of the Ministry of Economy and the Spanish Bank, have agreed the interchange fee to be applied during the years running from 2006 to 2010 ("the Framework Agreement"); the Framework Agreement provides with a continuous reduction of the interchange fee until year 2010 that varies depending on the activity sector and the sales volume[10]. Under this Framework Agreement, there is the general principle that the multilateral interchange fees may not exceed the costs incurred in the rendering of the services.

10 Framework Agreement between the financial sector and commerce dated 2 December 2005.

D. Increase in the services requested by consumers: banks offered continuously new products and services to consumers. We refer to the recent product offered by "la Caixa" as described in section 3 and 4 above ("CaixaProtect").

E. Existing transparency on the calculation of any fees: this transparency requirement is due to legal requirements, antitrust requirements and merchant's pressure.

All these factors, amongst others, are progressively reducing the interchange and merchant fees for national transactions as well as cross-border transactions. The level of decrease would clearly vary from country to country.

However, the interchange fees for cross-border card usage are still different from the interchange fees for national transactions. This is mainly due to the specific characteristics of each Member State and, in particular, in the way in which payment systems were created and built up in the EU.

Nevertheless, practice has shown and is showing that interchange and merchant fees for cross-border transactions have also been decreasing since year 2002 in Visa system[11]. Likewise, implementation of the SEPA and the harmonization of payments systems foreseen therein, may surely further reduce interchange and merchant fees for national and cross-border transactions.

B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

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

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

[11] See page 33 of the Interim Commission Report.

11. What governance arrangements can incentivise 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?

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

C. Future market developments

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

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

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?

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

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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?

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?

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

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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?

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23. What governance requirements should SEPA schemes meet?

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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?

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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?

General comments:

“la Caixa” welcomes the opportunity to submit its comments on the issues submitted for consultation by the European Commission in its Interim Report I Payment Cards under a sector inquiry on retail banking initiated by the European Commission under article 17 of Regulation 1/2003.

“la Caixa” is one of the major Spanish financial entities with more than 23,000 professionals in more than 5,000 branches within Spain. “la Caixa” has currently 4,400,000 cardholders, 135,000 acquired merchants and 7,300 ATMs. "la Caixa" terminals are also linked to the ServiRed network, with more than 25,000 terminals nationwide.

Out of the five sets of issues set for consultation by the European Commission on its Interim Report I Payment Cards (hereinafter, the “Interim Report”), “la Caixa” has solely focused on the issues related to the financial analysis of the industry, these being the following:

1. Are high merchant fees a competitiveness issue for the EU economy?
2. Are there compelling justifications for the comparatively high level of merchant fees observed in some parts of the EU25?
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?
4. Are the high profits observed due to innovation or do they arise from some kind of market power in a two-sided industry?
5. What pricing practices, rules and legal provisions distort price signals to consumers and the choice of the most efficient payment instruments?
6. Would cost-based pricing promote the use of efficient payment instruments and how such pricing be implemented?
7. Do currently existing pricing practices have a substantial negative effects on cross border card usage by consumers?

For the clarity of the answers, “la Caixa” has decided to divide the issues set for consultation in three (3) different groups by subject matter.

Summary

In summary, “la Caixa” is of the view that:

* The Interim Report has adopted very critizable viewpoints concerning some of the issues to be discussed. From an economic perspective, and broadly speaking, the report is not rigorous when defining concepts, carrying out comparisons, providing data, etc. Thus, answers to the questions raised in the Interim Report have been complicated and, to a certain extent, has required extra efforts.

* Plastic cards are in general terms more efficient means of payment that cash and checks and thus, one could say that merchant fees are a competitive issue for the EU economy. Figures show that the use of paper money is losing importance if compared to plastic cards. The diminishment in the use of paper money will be enhanced with the SEPA which has, amongst other objectives, to make sure that consumers can make cross border transactions with their plastic cards as if they were doing domestic transactions.

* Price differentials in merchant fees amongst the different EU Member States do not necessarily result from a market fragmentation and lack of competition. There are many reasons that might justify such differentials, mainly the specific characteristics of each specific Member State.

* The figures provided by the Commission regarding the profitability of the issuing business are unrealistic and baseless mainly because of the

formula used to calculate the profitability on the basis of profit-to-cost ratio. The profitability figures of the issuing business of “la Caixa” considerably differ from the average profitability pointed out by the Commission. These differences are probably due to the formula used and to the complexity of allocating costs that are common to other activities.

* The justification for substantial revenue transfers through interchange fees in card payment systems within Spain is due to the fact that in Spain interchange fees are the main source of income of issuers. This is so because Spain is a country where the use of cash prevails and banks to persuade consumers to switch from cash to cards have to offer very good conditions to consumers.

* What the Commission seems to consider “high” profits of issuers is not the result of market power in a two sided industry but the result of strong competition between issuers continuously offering better rates to cardholders and offering new services and products.

* There are certain Spanish rules as well as practices that distort price signals to consumers and thus, the choice of the most efficient payment instrument. Amongst other, prohibition to charge consumers a commission for cash transactions made within the same financial entity where the consumer’s bank account is held.

* A change towards cost-based price setting strategy would probably promote the use of efficient payment instruments. Nevertheless, this cost-based pricing should affect all means of payment and not only plastic cards. The problem that exists to adopt such an strategy are the Spanish existing rules, legal provisions and banking practices which prohibit charging certain commissions for certain services offered to cardholders.

* Currently existing practices do not have substantial negative effects on cross border card usage by consumers. The natural development of national card payment systems in the EU is progressively reducing the interchange and merchant fees (in the end, that is the result of having in place a strong competition). Likewise, once SEPA as well as the harmonization of payment systems foreseen therein are duly implemented, interchange and merchant fees will surely decrease even more.

General Comments to Interim Report

"la Caixa" would like to remark some aspects of the Interim Report that have made the task of answering the issues set for consultation difficult.

First of all, the Interim Report does mix important concepts and related figures that, for an economic and antitrust analysis, must be previously well defined[12]. In particular, we refer to the definition of the relevant market which in some cases it may include acquiring and issuing payment cards, credit and debit cards, etc. Obviously, none of the above elements are equivalent and the data provided concerning one of them must be distinguished from the other.

Further examples of such misunderstanding of some parameters compared amongst them are reflected in Annex 5 to the Interim Report. In this regard, Annex 5 makes a correlation between cardholder fees (generally a year fee unrelated to any card transaction) and interchange fees (an individual charge per transaction), two different types of "fees" totally unrelated for the purposes of the comparison: different concept, different markets, different scope, etc.

[12] For a discussion of the relevance of market definition and measured of market power in two-sided markets, see for instance E. Emch and T.S. Thompson "Market Definition and Market Power in Payment Card Networks", Review of Network Economics, 2006.

Secondly, it should be taken into account that the economic analysis of the so called "two-sided markets" is still in its early stages. Two-sided markets enjoy some characteristics that make them impossible to be analyzed from normal economic parameters. We mainly refer to the facts that (i) price structure is skewed regardless of the extent of competition and (ii) cost-based regulation of interchange fees is meaningless[13].

Moreover, it is recognized by the doctrine quoted along the Interim Report that two-sided markets do enjoy some specific economic rules and that common pricing rules are not applicable to the case. In particular, the fact that some costs inherent to card payment systems cannot be clearly allocated to the cardholders or merchants side and is preferable -from an economic viewpoint- that are finally allocated to the merchant. It is to note that such decision is not a question of issuing banks enjoying certain market power. All to the contrary since there is more competition on the issuing side market that on the acquiring market. Thus, it is an economic decision which enhances the implementation of card payment systems.

In light of the paramount importance of the economic analysis of the issues dealt with in the Interim Report, "la Caixa" is pleased to attach a brief report produced by our Economic Analysis Office.

General questions:

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

    X 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;

[13] J.C: Rochet, "Regulating Interchange Fees: A welfare Analysis"; Conference of the Federal Reserve Bank of New York, September 2005.

X not sufficiently detailed;

- too detailed.

3. Did the information contained in the report was:

X 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;

X 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;

X no, there were some significant issues left out.

Thank you for your contribution!