FEEDBACK FORM

Name of undertaking: Bank Austria Creditanstalt AG

Industry: banking and finance (potential acquirer, current issuer)

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Participated in the questionnaire:

X Yes

☐ No

Dear Sir/Madam,

With reference to the Interim Report I Payment Cards of 12 April 2006 (hereafter Interim Report), please find below our answers to the questions listed in the Feedback Form. In this context, we very much appreciate the public-discussion-approach adopted by the Commission and are confident that these discussions will lead to fruitful results for all participants.

In light of the importance of cash-less means of payment for the whole economy, we would, nevertheless, like to highlight the fact that the narrow focus of the Interim Report, as part of the wider sector inquiry into retail banking, meant that it did not capture a complete picture of the banking industry, with the result that a number of its conclusions may be misleading or confusing. We therefore disagree with the methodology and the results of the Interim Report. We believe that a wide range of other factors must be considered before any action is taken at an EU level in order to best serve the needs of the EU citizen.

We would however like to stress that the EU-Commission, the European Central Bank and the banking industry are working together towards the Single European Payment Area (SEPA) which focuses on the harmonisation of the payment card industry. On the eve of SEPA one should apply any further competition-measures with great care in order to avoid conflicts with the implementation of SEPA. Therefore, we believe that it would be fruitful to bring the Interim Report under the auspices of SEPA, as a basis for further discussions, as this is more likely to lead to more consistent development of the cash-less means of payment in the future.

Please note that the following is limited to answering the questions posed in the Interim Report in regard to Austria (we tried to keep responses as short as possible – they can therefore not be regarded as exhaustive) and an additional general comment.

If you have any further questions, please do not hesitate to contact us.

Specific questions from Executive Summary:

A. Financial analysis of the industry

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

No – first of all, as merchant fees, as well as taxes, prices, inflation, merchants' margins, transaction numbers, volumes, etc., differ from country to country, this has to be seen relatively. Merchant fees are the result of existing competition in the respective countries/markets. Secondly, merchant fees are a part of payment schemes and are subject to competition. It cannot, therefore, be said that they are excessively high. In particular, in comparison to the Czech Republic, for example, merchant fees in Austria are low. In addition, a reduction in merchant fees also takes place in other EU member states, a finding which is confirmed by the Interim Report (including the feedback loops due to additional cash-less payments) in the graph 21 (page 46) and the graph 23 (page 48).

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

As already mentioned in 1.) above, in each country this depends on the existing competitive conditions, such as size, maturity, risk levels, market practices (e.g. financing of POS-terminals) etc. Individual acquirers should be free to apply the appropriate fee basis best suited for the merchants they wish to attract. As there are sufficient (national and international) acquirers active or potentially active in each EU-country and, additionally merchants have countervailing power in this market, the level of fees is the result of market conditions. This is also shown by the differences in merchant fees charged by acquirers in different EU-countries as set out in the Interim Report. This can be explained by different market conditions due to the degree of business development in such states. These different market conditions need to be assessed and taken into account when analysing the differences in merchant fees. It is therefore not sufficient to compare the merchant fees charged by domestic payment systems with those in international systems (p.50 – comparing price differentials between large and small merchants in the international schemes with those in domestic schemes for credit cards. See also p. iv. In relation to debit cards – p.49). The competitive situation is much more complex and it may well be that some domestic systems charge less because they incur fewer costs or because they want to gain or hold market shares and they therefore reduce prices in order to match the reputation of the international schemes (which, in turn, were built up through high investment in the past and are maintained with considerable costs, eg, advertising). In addition, credit card brands (e.g. Visa, MasterCard, American Express, Diners etc.) guarantee and require a certain quality, technical and security standards to be met vis-à-vis customers, which are costly to maintain. Otherwise other international or domestic payment card systems would gain in market share.

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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 levels of interchange fees have to be seen as relative to the prevailing market conditions. The interchange fee is a transaction-based remuneration for the issuer and depends on the issuer's card-issuing offer to its customers in a two sided-business.

- The level of interchange fees is determined by market conditions and is subject to competition. This competitive pressure is indirectly exerted by the licensors of the payment card system, which want to keep the system attractive and will therefore only choose issuers that provide the issuing service at competitive fees in order to maintain the attractiveness of the system for the cardholders and the merchants (as the interchange fee would usually be reflected in the merchant fee).

- Acquiring banks are mainly interested in expanding their merchant base, their turnover and the number of transactions made, as huge potentials exist in the markets in terms of economies of scales and scope, which gives them sufficient incentive: The major competitor of cash-less payments is still cash. According to the European Payment Council, there are approx. 70 billion non-cash transactions versus 360 billion cash-transactions. In light of these facts, acquirers will always have the incentive to reduce merchant fees, because failure to do so will mean that further acquirers will enter the markets, if they see any profit chances*. Further, the current payment card infrastructures are not sufficiently technically developed to compete with the enormous number of cash-payments (mainly "micro-payments"), so that technological improvement will still characterise the business.

* Please note: If acquirers want to enter a market, they can do so at least with international schemes, as almost all national schemes are co-branded with either Maestro or Visa/Visa Electron. Moreover, due to the huge volume of cash-transactions, most acquirers are still busy with their home-markets – the Interim Report's argument of immature markets has been used for the New Member States, for not entering other EU-markets. This can be generalized for the whole of the EU. The alleged lack of market entry is not therefore due to the existence of barriers to entry, but instead to the fact that acquirers and issuers of payment cards still concentrate on their home-markets. Thus, as home-markets become more and more mature, the number of market entrants will increase in the future.

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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?

High profits are seen here obviously from a narrow perspective, not taking into account the situation of the whole payments business (in Austria). As a regular study from Mc Kinsey shows, the payments business in Austria is not profitable at all and shows negative figures.

Due to the network-characteristics of the business, new technology-levels can be adopted once in long reinvestment cycles. There are two reasons for this; first, investments in this area of business are costly and second, they can only be carried out according to standards which, for network-compatibility reasons, have to be agreed among all participants (world-wide), (e.g. the EMV-standard has been discussed for approx 5 years and its roll-out across Europe will take another 2-3 years)*. Smaller innovations can be assigned to optimization of operative processes.

The questionnaire, which was carried out in mid-2005, captured only a small slice of the technological and the business cycles and therefore could not capture the whole picture in terms of costs. The report did not, for instance, take into account the huge investments made in chip technology by the Austrian banks in 1995 to introduce chip cards and chip terminals all over the country and as a consequence of the now ongoing investments in the EMV-standard.

* present examples for incompatibility and non-standardization are mobile payments, which did not achieve the necessary masses.

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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 choice of the most efficient payment instrument (including cash and paper based transfers) is basically affected by the customers' behaviour (rational thinking, habits, advantages & disadvantages of every payment instrument, price of the purchased goods) and not purely by prices. In a two-sided market, price signals affect both sides, not only the consumer. Nevertheless, price signals are also relevant here to the market participants. If, for example, interchange fees were excessively high, this would also affect the market position of the issuers in the medium and long term (see above). In addition, consumers would receive price signals if, as a result of increased interchange fees, merchants fees were increased and merchants raised prices for products where credit cards were used and gave discounts for cash or other forms of payments (e.g. debit cards and other payment schemes). In addition, merchants would be more likely to accept other payment card systems in order to reduce merchant fees. This would, in turn, reduce issuers' revenues and put them under pressure as regards the payment card system licensor. It is therefore not reasonable that price signals (also on the interchange fee level) should not have an effect. Nevertheless, this does not mean that all issuers would necessarily charge identical interchange fees. This will depend on the particular conditions of the market and the characteristics of the payment card system at issue (as indicated in the Interim Report, one example is if a flat fee per transaction is charged in one system and in another there is a turnover-related fee).

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

No – cost-based pricing is theoretical and not pragmatic for several reasons

a.) First of all market prices are driven by competition b.) Merchants would have to publish prices in respect of every single payment instrument and scheme (including cash). – This would mean, for example, that in Austria there would need to be approximately 8 different prices per product,

c.) In order to make their best choice, customers would be obliged to carry cash and several payment cards (for every scheme one), (note: within one merchant segment, the prices charged by two different merchants might lead to two different choices of payment instruments, due to the merchants' own pricing policies),

d.) Pricing only partially affects the customers' decisions (e.g. in many countries cash-withdrawals at ATMs are charged for, whereas cash-less payments at POSes are not. - Interestingly, many customers still prefer to withdraw money at ATMs).

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

No – Austrian cardholders have recognized the benefits of cards and prefer to use credit cards for cross-border purchases, mainly due to the incentives provided by travel insurance and the pay-later convenience. In contrast, debit cards are mostly used for domestic purchases. In addition, Regulation 2560/2001 aimed to promote cross border usage and is still in force.

B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

As every Member State reports, on the basis of each of their country's characteristics, many cards and merchants use payment card models / -schemes which seem to compete successfully against cash. Moreover, as the market deploys several schemes, issuers are competing with both cash and each other. In this context, even eventual high concentration in regard to acquirers would not affect competition, as issuers would start to acquire on their own in order to remain competitive in the issuing business, if acquiring were to become too expensive for merchants. Moreover, foreign specialized acquirers can at any time enter the market (please note that as nearly every national scheme is co-branded with an international scheme, market entry can easily be achieved with an international scheme).

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

With regard to market structures, one has to take into account the level of development of each market. In the long run, the most efficient market structures and systems will prevail.

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

We believe that the best results can be achieved in a market that is purely driven by competition. In any event, all governance arrangements should be linked and applied in conformity with SEPA.

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

As the market for cards and merchants is still developing or is already sufficiently developed, the industry should focus on shifting purchases away from cash to cash-less means. This would have two results. Firstly, cardholders would save on transaction costs (e.g. cash-fees and transaction costs such as ATM-search- and way-costs) and secondly, merchants would receive better conditions.

Achieving good results depends on the deployment of the appropriate marketing tools, without creating economic free riding, and on technological advances in the fields of convenience, security and stability.

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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?

This is not a governance concern, but a competition issue. For instance, if merchant fees are too high, merchants are free to choose other partners, e.g. to join a domestic scheme, or to accept only cash-payments. Banks are also free to choose their co-operation partners, as there are several schemes in place.

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13. What access conditions and fees are indispensable?

Those which are best suited to meet existing market conditions. So it is up to the market, through competition, to develop the best access conditions and fees for itself. Thus, access conditions and fees for a scheme have to remain flexible in order to respond to changes in the market and in order to maintain competition.

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

Separation and consolidation are topics related to market demand. For example, some issuers personalize their cards on their own, whilst others have outsourced such activities to specialized companies. It should be left to the industry to decide how best to produce or to transact. As regards bank’s businesses, it is unforeseeable that they would be regulated in such a way so as to be obliged to outsource the processing of their savings books' transactions to third parties.

C. Future market developments

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

a.) Small national banks are outsourcing their operating activities to joint-ventures or specialized firms
b.) International banks are consolidating their scales on a supranational level or outsourcing them, as described in a.)
c.) Internationalization of systems due to cross-border mergers
d.) The whole industry will be changed by current initiatives such as SEPA, the Payment Directive, etc.

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

The EMV-standard has recently been agreed and is in the roll-out phase. Contact less payments and mobile payments are assumed to be the "future-favourites" in the payment card business at the moment.

D. Potential solutions to market barriers

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

We see no barriers, but very efficient tools for cheap production in small markets to deliver high quality and much security. It should be noted that such issues are the products of competition in the supply of services, which are demanded by customers/merchants and the ambitions for competitive advantages, which are indeed a part of competition.

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

In our view there are no 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?

Payment cards are sufficiently harmonised by the EMV-standard. As a result of the standard, banks have and will continue to invest billions of EUROs. Any further change or adjustment in standards would result in additional costs, which would lead to higher prices for users.

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?

It is good to co-brand national schemes with existing international schemes.

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

There is no need, as SEPA itself means more competition. As mentioned above, there is substantial existing competition between the different schemes.

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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?

As mentioned above, there is substantial existing competition. Nevertheless, there should be a level playing field, where PSPs are treated like banks and have the same obligations as banks, e.g. regarding money laundering, Basel II, etc.. PSPs should be obliged to be SEPA compliant, as efficient competition can be only carried out when all participants face the same rights and obligations.

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23. What governance requirements should SEPA schemes meet?

The requirements should be in line with those that exist in the rest of the world, as payment card business and its rules cannot simply be EU-specific. Eventual differences in future developments of schemes in other parts of the world would lead to an undesirable increase in administration, in order to ensure world-wide acceptance.

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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?

There are existing world-wide payment systems which function superbly. As the card business deals with money, the highest level of security must be achieved.

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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?

No.

General comments:

The complete picture of the payment card business could not be captured by the questionnaire, which was carried out in mid-2005, as it dealt with cash-less payment only.

As a result two considerations arise:

1.) The conclusion of profitable markets and lack of competition is contradictory for the payment card business - if either issuing or acquiring were as profitable on a country level, as indicated in the Interim Report, there would be much more EU-wide competition, irrespective of any market entrance barriers (if there are any at all), as all EU countries deploy international payment schemes.

2.) Disappointingly, in the light of the data provided by banks, only EU-wide comparisons of some ratios have been drawn, without taking every market's specific characteristics into consideration. Therefore, it is not yet possible to reach a definitive conclusion.

Due to the importance of the non-cash means of payment for each EU Member State economies, the existing ambitions towards harmonisation and competition in the payments sector should be in line with SEPA, in order to avoid conflictive developments in the future.

Please note that the above answers and comments are given on a voluntary basis and are without prejudice to the legal position of Bank Austria Creditanstalt AG.

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;
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!