

FEEDBACK FORM

Name of undertaking: Europay Austria Zahlungsverkehrssysteme GmbH

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): issuer, issuer supporter, acquirer

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Participated in the questionnaire:

☒ Yes

☐ No

Specific questions from Executive Summary:

We hereby follow the invitation of the European Commission, Competition DG, Services, Financial Services (Banking and Insurance) and wish to provide feedback on the Interim Report I Payment Cards, Sector Inquiry, under Article 17 Regulation 1/2003 on retail banking. The questions of Feedback Form in part 1 of our statement will be answered first. Moreover, in view of the relevance of this matter for the European we feel obliged to make a number of principal comments. We wish to insure that the future policy of the European Commission will have a strong foundation. Therefore we have added in part 2 a discussion on economic conclusions on payment cards and raised methodological issues. We have chosen this procedure in order to contribute to the further development of a European payment system with state-of-the-art technology, according to the main goals of the European Union.

A. Financial analysis of the industry

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

The Merchant Fees, which are known in Austria as the "discount", are a cost factor among many others for trading and service enterprises. These are included within the framework of the remuneration demanded from their customers (the consumers). These discounts were massively reduced in Austria in the past 26 years for MasterCard transactions and in the past 20 years for Maestro transactions. As far as we have seen, this did not have any effect on consumer prices however, which means that the reduction of the Merchant Service Charge only led to an increase in the merchants' profits. It can be expected that future reductions of the Interchange Fees which may lead to lower Merchant Service Charges will have the same consequences too.

In the "Interim Report I Payment Cards", the consequence of a differently high Interchange Fee and a differently high Merchant Service Charge based on this has not been examined. Such differences would have express themselves in differently high product prices or a differently high price level in different countries in order to be economically relevant. This is obviously not the case.

The fact that there is no recognizable correlation between the amount of the consumer prices and the amount of the Interchange Fee indicates that the level of the Merchant Fee in the magnitude as observed today is no "competitive issue" for the EU's economy. Any intervention of the unfair competition or regulatory authorities in this area would hardly bring any benefits for the consumers. This applies even more so because, as the development in Austria has shown, cost benefits from increases in efficiency have already been passed along in form of reduced Merchant Fees to the trading and service businesses.

The quality of the data mentioned in the "Interim Report I Payment Cards" on the level of the Interchange Fee seems to be highly dubious as a result of the surveying method. The problematic aspect is especially that relevant cost factors such as depreciations or attributable overheads were included under "other costs" and no uniform method for calculating such values were stipulated. Since the Issuers usually process a large number of payment products, these cost values were presumably only stated in part and determined according to different methods. That is why it is not surprising that the stated costs are partly clearly beneath the stated revenues and show a higher spreading. Such figures do not seem to be representative in any way for Austria.

Moreover, taxes have been completely omitted, so that an interpretation of the difference between the revenues and costs mentioned in the questionnaires are factually unfounded as an economic profit. Since businesses in the individual countries need to calculate differently high tax burdens, there is an additional spreading of profits before taxes. The "Interim Report I Payment Cards" does not consider this important fact.

The long-term temporal character of networks is omitted in the analysis of "annual profits". In these networks it is necessary to make high investments initially and in expansion, which are included in later years only partly by annual depreciation. In this respect, profitability would have to be calculated through over longer periods of time in order to adequately evaluate profitability.

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

The Commission has based its hypothesis that the Merchant Fee is too high in a number of countries from a comparison of the countries. There are a number of reasons for the differently high Interchange Fees (and the resulting Merchant Fees). The most relevant aspect is the different historical development of payment cards in the respective countries: type of card and numbers differ; economies of scale differ; risk and development costs differ.

Depending on the development of payment systems, there are predominantly debit cards and very few credit cards. In other cases there are predominantly credit cards and few debit cards.

Sometimes there is a balance between debit and credit cards. And in other cases there are credit cards as charge cards and credit cards as revolving credit cards.

The risk costs are differently high in the various countries, as are the interest rates for consumer credits. This is due to the fact that the customers in the different countries have different habits of indebtedness. Financial standing deteriorates more rapidly than in other countries and the card payment methods can differ. Similarly, the processing costs are relevant for the different Interchange Fees, which is caused, among other things, by dependence upon number of transactions and the thus linked different economies of scale and the interest costs which are differently high in the various countries. The existing differences of the Merchant Service Charge for different merchant categories and for merchants of different size categories depend on different factors, e.g. different risks depending on merchant category, differently high billing sums, differently high numbers of transactions and respective cost depression. All these factors are neglected in the Interim Report.

In order to come to a proper comparison, it would have also been necessary, in addition to the absolute levels of the Merchant Service Charge, to include in the comparison a consideration of the payment terms, transaction amounts, minimum fees and risk factors specific to market sectors and the market in general and finally the cost coverage for the technical infrastructure.

There are serious general doubts against the method of surveying data chosen by the Commission in the course of preparing the Interim Report and against the conclusions drawn from the same. Further information on this topic is provided in the comprehensive discussion in Part 2.

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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 (allegedly) high profitability of issuing as mentioned in the "Interim Report I Payment Cards" is in remarkable contrast to the finding of the Commission that issuing markets are highly competitive. The finding that there is a high profitability for issuing in Austria seems to be especially implausible, however. It is still a fact here that payment systems in Austria (which includes all services linked to a giro account) are clearly negative in their result. According to a survey conducted by McKinsey in the year 2002, the deficit in the business with private giro accounts is €152 million. Even by considering the Interchange Fee the result of payment systems is negative. The debit card is always a part of the giro account, and this mostly applies to credit cards too because approximately 90% of the credit cards are settled through the giro account. Their issuing cannot be evaluated separately from the payment systems in its entirety. The conclusion of an excessive profitability of the card-issuing banks as a result of the Interchange Fee is therefore incorrect for Austria.

Interchange Fees are necessary for the functioning of a network like that of four parties in this case. If there were no Interchange Fee, the Issuers would have charge the cardholders various fees (e.g. transaction fees, higher card fees), although their liquidity ensured by the card profits the merchants by generating sales by these cardholders. Without the Interchange Fee

there would not be any card payment system in its present form or it would be inefficient, which would only promote cash transactions.

Balanced Interchange Fees are the basis for a further expansion in the direction towards a cashless society. If the Interchange Fees were too high, there would not be the high level of acceptance which enables transaction growth. If the Interchange Fees were too low, then this would lead to a higher burden on the cardholders, which again would obstruct transaction growth.

Moreover, the "Interim Report I Payment Cards" does not show clearly why currently there are differently high Interchange Fees, even though there are different Interchange Fees throughout Europe and in most countries: the International Interchange fee where cross-border transactions are concerned, and the Domestic Interchange Fee where national transactions are concerned. MasterCard International has not only already brought into line the Scheme Fees for domestic and international transactions in view of the single euro payment area, but has already announced the successive adjustment of the Domestic and International Interchange Fee until the beginning of 2011.

The International Interchange Fee is currently sometimes higher/sometimes lower/sometimes the same level as the Domestic Interchange Fee.

- a) When the International Interchange Fee is higher than the Domestic Interchange Fee, the reason for this is mostly that the costs of a cross-border transaction are usually higher than the costs for a national (mass) transaction.
- b) When the Domestic Interchange Fee is higher than the International Interchange Fee, the reason is mostly that a standardized cross-border transaction is linked to lower costs than a national transaction not on mass basis.
- c) When the Domestic Interchange Fee has the same level as the International Interchange Fee, the costs of a national transaction correspond approximately to the costs of a cross-border transaction.

4. Are the high profits observed due to innovation or do they arise from some kind of market power in a two-sided industry?

As mentioned under Section 3, no high profits are realized in Austrian payment systems (including the card business).

High profits on card basis are generated, as far as can be seen, only in countries where credit interest earnings obtained as a result of revolving credits are also included in the revenues of card payments. This is not the case in Austria. There is no retail bank in Austria where profits from card business have a substantial level in comparison with the bank's overall profit. These differ from bank to bank for economic reasons. In contrast to this, high profits by interest earnings are generated in European countries where credit cards are equipped with revolving credit facilities (especially in the United Kingdom).

The comparison of profits with and without Interchange Fees is economically naïve. If Interchange Fees were to be abolished, then this would lead to a fundamental change in the card markets. In order to evaluate the effects of an abolishment of Interchange Fees, it is not simply possible to deduct the fee from the earnings from the otherwise unchanged prices and

quantities. Highly complex simulations and model calculations are necessary in order to evaluate the effects of an abolishment of the Interchange Fee. Even if a card system would not collapse without the Interchange Fee, the originating structure would be inefficient. Competitive advantages from such a situation would then arise for three-party systems (Acquirer = Issuer) because all transactions would then be on-us transactions and profit would be generated in one enterprise.

The analysis of Interchange Fees of the "Interim Report I Payment Cards" does not correspond to the approach of the EU Commission in the decision on cross-border payments on Visa cards. The Interchange Fee was interpreted there (correctly) as a performance fee and a cost-based determination was demanded. It is to be assumed that a profit is permissible in this case too. Such an approach can never lead to an Interchange Fee of zero and is thus in contradiction to the tendency of the "Interim Report I Card Payments". The EU Commission does not represent a uniform line in the analysis of the Interchange Fees.

In summary, the presented empirical evidence presents the conclusion in an inadequate manner that high persistent profits, especially in the case of issuing activities and credit cards, indicate a misuse of market power.

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

The growth of cashless payments in Austria and by Austrians shows that the consumers appreciate the advantages of cashless payment. The consumer recognize this in their ability to pay at all times, a substantially lower risk in loss of card in comparison with loss of cash, the avoidance of having to exchange money, the short-term or long-term grant of a credit, clear expenditure accounting and various benefits linked to the card.

It would be desirable from a macroeconomic viewpoint if cashless payment would gradually take the place of cash. It has been proven by respective cost surveys that both the microeconomic and macroeconomic costs of cash are higher than the costs for cashless payments. The costs for cash are virtually always ignored. This is clearly shown when merchants make a price mark-up for cashless payment. Europay Austria allows every merchant who wishes to make a price mark-up for card payments according to the rules of MasterCard International. This is an obstruction however for the further development of cashless payments and a discrimination of cashless payments because the merchant also incurs costs through cash payments. Consequently, the merchant would have to charge different prices depending on the type of payment. This does not make sense, which is why the promotion of price mark-ups for cashless payments only is not future-oriented. Consequently, one would have to charge lower prices for customers for example who do not wish to be advised prior to a purchase than for such customers who do wish to be advised.

On page 10 and the following pages, "Interim Report I Payment Cards" deals with competition between the types of payment (cash, debit, credit, electronic purse, transfers). It is confirmed there that cash is the most expensive means of payment. From the viewpoint of national economy it would therefore be desirable that the use of cash is reduced for the benefit of electronic forms of payment (such as debit cards). This currently fails for the reason that the end customer is not given any price signals in Austria concerning the use of cash, which

means that the customers are not aware of these costs (apart from cash withdrawals at ATMs outside of the euro zone). Accordingly, there is a likelihood of economic inefficiencies by the failure to pass on price signals or the incorrect way of doing so. It can be said in summary that the fees that the merchant has to pay and which includes the Interchange Fee as a cost element cannot be excessive from an economic viewpoint because (in an opportunity consideration) they are not higher than the costs for cash.

In Austria, cardholders do not pay any fees for transactions, irrespective of whether they make their transactions in Austria or in the euro zone, neither for payment transactions nor for cash withdrawal transactions. It cannot be any cheaper for a cardholder. In Austria, the national payments system is used in a very traditional manner in order to promote overall customer relations (see page 52 of "Interim Report I Card Payments"). In this context, the EU regulation on cross-border payments has led to problems in form of an artificial cross-subsidization because transactions in the euro zone (including Austria) must now be cost-free for the cardholder, but costs are still incurred which need to be covered. Economic pressure has thus arisen for the banks to compensate the deficit in the regulated area by additional income in other areas. The EU regulation thus hinders competition-based pricing in the payment systems, including card business.

Additional obstructions arise from the national consumer protection laws. The unilateral change of the fees without the affected consumers' consent is not permissible. Pursuant to § 6 Section 1 Subsection 1 of the Austrian Consumer Protection Act, contractual provisions are null and void which grant the enterprise upon demand a higher fee than the fee determined at the time of concluding the contract. In order to agree upon a higher fee with the cardholders, it would either be necessary to conclude a separate supplementary agreement with each individual cardholder in connection with the existing contracts or all contracts would have to be terminated with the affected cardholders and concluded again at higher fees.

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

In a free market system the prices should be formed on the market. Since cards, transactions, sales and earnings can only be expanded when there is an acceptance by cardholder and merchant, card payment schemes will act in a customer-oriented fashion in their own interest: only if they offer Issuers and Acquirers suitable products with a respective price structure will they be able to make their own offer for cardholders and merchants that will be accepted by the market. If the card payment schemes make unappealing offers, Issuers and Acquirers will not be competitive and will thus slow down further development of the respective payment scheme. If a) the Interchange Fee is too low so that the Issuers are unable to conduct profitable card business by including their own earnings and costs, and if b) the Interchange Fee is too high so that by including the own costs the Acquirers are unable to make an appealing offer to the merchants (in that case an insufficient number of merchants will be gained), then this will be bad not only for the card payment schemes and the Issuers and Acquirers, but also for cardholders and merchants. An additional factor is that the card payments, irrespective of whether they are debit or credit, will be in competition with other

means of payment and especially cash in this case, leading to the necessity that card payment offers are made attractive both for the cardholders as well as for the merchants. We therefore believe that already at this point pricing is made in a competition-oriented way, according to the needs of the market and customers, and the prescription (by the authorities) of a "cost-based approach" is not necessary.

When cost-based pricing in the Interchange Fee is demanded, a) all transaction costs with processing costs (including depreciation and taxes), financing costs and risk costs should be compensated thereby, and b) consider other economic considerations beyond the pure cost compensation (e.g. consideration of competition, launch of innovations, profit mark-up).

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

Cardholders in Austria do not pay any fees for payment or cash withdrawal transactions insofar as the transaction was made in the euro zone (including Austria) or in an opt-in country. Insofar there are no negative effects on card use within the euro zone.

B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

The current structure relating to the credit card MasterCard and the debit card Maestro has proven its worth in Austria. The structure is roughly the following:

a) Maestro-Debit

There is no national Austrian debit scheme. On the other hand, virtually all Austrian debit cards are Maestro cards. Europay Austria offers Issuers support in issuing and acquires merchants/transactions. In the issuing support which is governed within the framework of the "Bankomat"/"Europay" contract, Europay Austria offers the Issuers a number of additional functions on their cards such as Quick, the Austrian electronic purse, loyalty programmes, digital signature or youth identifiers. Every Issuer is free to market Austrian Maestro cards in Austria independent of Europay. Every Acquirer is free to acquire Maestro merchants/transactions in Austria. As already mentioned in "Interim Report I Payment Cards", there are several other Maestro Acquirers in Austria in addition to Europay Austria.

b) MasterCard-Credit

Europay Austria is Issuer of MasterCards and offers issuing support to interested Issuers. Moreover, Europay Austria operates as an Acquirer for MasterCards. Europay Austria currently does not issue any credit cards other than MasterCards and does not offer issuing support for any other credit cards. A digital signature is included in the issuing of own cards and in the issuing support. Every Issuer is free to market MasterCards independent of Europay Austria. Every Acquirer is free to acquire MasterCard/merchant transactions in Austria. As already mentioned in "Interim Report I Payment Cards", there are a number of other MasterCard Acquirers in Austria in addition to Europay Austria.

c) Other card systems

In addition to Maestro-Debit and MasterCard-Credit there are various other payment schemes outside of the Maestro/MasterCard world such as American Express, Diners Club and Visa in the field of issuing and acquiring, and JCB in acquiring only.

With this solution the small country of Austria was enabled to offer good service to cardholders and trading and service businesses, to generate economies of scale and keep costs down for cardholders and trading and service businesses.

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

We doubt whether the generalizing comparison made by the Commission can be made in a meaningful manner. Apart from the different historical development of payment systems, it is not possible to lump together all countries in view of the different level of the economic development in the many countries of Europe. It is necessary to take into account the different historical development and the level of economic development and to try to come to a unification not in an abrupt way, but over years in parallel with the economic adjustment.

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

Within the card payment schemes of MasterCard International it is already possible with a respective SEPA-wide licence to conduct both the issuing as well as the acquiring for all products of MasterCard International. This licence can be obtained against a fee by any "eligible" interested party. This ensures competition in each country. It would moreover be important that there is no discrimination of the payment schemes among and against each other.

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

Cf. Section 6 above.

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

The licensees of a card payment scheme should be included in the further development of the system in the form of committees. A focussing of this participation on the "big players"

should not occur because this would otherwise lead to a preferential treatment of the same to the detriment of the smaller licensees. Moreover, communication by the card payment schemes would be appropriate not only through what can currently be implemented on the market and in operation, but also by way of projects in the medium run.

13. What access conditions and fees are indispensable?

The current access conditions to the card payment schemes are sensible and acceptable. The card business (issuing and acquiring) is a banking business. The access of non-banks (e.g. the planned payment institutions) would lead to a discrimination of the banks conducting issuing and acquiring, because they need to fulfil all banking requirements and are subject to banking supervisory bodies, which is not the case for non-banks. The risks with respect to the functioning of card payments would increase.

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

Each card payment scheme must be able to decide itself within the terms of the highest possible efficiency to be achieved in the case of a free market solution which services it wishes to offer to its licensees. Each licensee should be free however to provide such services either by itself or by entities other than the respective card payment scheme.

Each Issuer and Acquirer must be able to decide itself according to its cost and earnings structure and within the terms of the highest possible efficiency to be achieved in the case of a free market solution which services it wishes to offer itself, which services it wishes to outsource when it believes that others can provide these services cheaper and better, and which services it insources when it believes that it would be able to provide them cheaper and better.

C. Future market developments

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

The development of the card markets in Europe must be seen historically. Local/regional/national players have built a market (first movers) and have become local champions. This was done under the burden of a) mostly unknown products which had to be popularized and b) an often small market where economies of scale were only difficult to generate. This led to the consequence that there is a fragmented market in Europe. The merging of the fragmented market into a common market will lead to a shake-out on the market where large players would replace the local champions, which would mean more than a tendency towards market concentration.

The trend towards more Acquirers that are in competition with each other on local/regional/national markets which has been seen recently in the past years will continue. Europay Austria was the only MasterCard and Maestro Acquirer in Austria for a long time. In the meantime there are in Austria a number of Acquirers from outside of Austria which are far larger than Europay Austria. If an Acquirer, as is the case in Austria with Europay Austria, has a high market share, then this is especially due to the fact that in the 80s right up to the mid-90s of the last century this Acquirer has created this market position with much effort and considerable costs in a market that had to be prepared first. It can be expected that this competition will increase. Acquirers that will newly enter the market will do so from their domicile country or will establish branches in the respective country.

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

The card payments industry has developed dynamically in the past 25 years: starting with manually filled-in slips, imprinter slips, magnetic stripe technology, authorization phones, transaction terminals, proprietary chip technology and EMV chip technology. This development will continue (e.g. e-commerce, m-commerce, contactless payments) as long as Issuers and Acquirers will be capable of realizing long-term profitable projects as a result of their cost/earnings situation, governance and regulation.

Competition for customers does not only consist of price competition. The Austrian banks are trying on the issuing side to add additional features to their products Maestro and MasterCard that should provide them with a competitive edge. Europay Austria is trying on the acquiring side by service quality in the widest sense (such as full service, processing speed, hybrid card readers, prompt response to exception transactions, fraud prevention, flexibility in settlement, e-commerce offers) to achieve a competitive edge.

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?

Cf. Section 15 above.

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

Cf. Section 15 above.

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?

There are two standards in the payment cards industry which are similar but not the same. These are the standards of MasterCard International and Visa International. The desire of Issuers and Acquirers is that they should be the same.

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?

In a SEPA environment it should be possible for an Issuer to issue cards in the same way as it issues in its own country.

In a SEPA environment it should be possible for an Acquirer to sign up merchants and settle transactions in the same way as it currently does in its own country.

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

Competition between the payment schemes will especially take place at the level of the Issuers. The better the product offer of the payment schemes will be and the more earnings an Issuer can generate, the more likely he will issue this product to its customers.

Acquirers will offer their customers (the trading and service businesses) all payment products in a one-stop one-shop manner, either for their own account or by procurement. This means that each Acquirer will try to become licensee of all payment schemes and conclude respective co-operations in order to enable making its merchants a full offer with all products of its licensors.

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

According to the rules of MasterCard International for MasterCard and Maestro, there are currently no barriers for competition anymore: licences for all SEPA countries are possible on a central acquiring basis as well as a SEPA licence for virtually all countries in Europe. Every Issuer can thus issue cards in each country in each currency. Every Acquirer can sign up merchants and settle transactions.

23. What governance requirements should SEPA schemes meet?

For payment schemes, there should be equal admittance under acceptable conditions and thus no obstructions for access for all potential Issuers and Acquirers. Such an admittance should be a level playing field where all participants are subject to the same legal rules and measures by supervisory authorities in view of equal treatment of all market participants and with a view to the integrity of the payment schemes, which is due to the fact that the card business is a banking business.

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

The operating software of each POS terminal is different. The application software of a POS terminal depends on the Acquirer's products that are accepted or enabled by such POS terminal. These are not only products such as credit or debit cards, but also fleet cards, e-purses, loading of prepaid cards for mobile phones or loyalty programmes. Accordingly, such application software cannot be standardized. It should be possible however that each Acquirer should be able to install its application software on each POS terminal with a given operating software and can thus route its transactions to its host.

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:

Fundamental discussion of topics of the "Interim Report I Payment Cards" (along its Table of Contents) which were not considered in the questionnaire.

Section A Industry Background and Outline of the Inquiry

I. Organization of POS Card Payment Systems

There is no national Austrian debit scheme. Virtually all Austrian debit cards are Maestro cards which are issued by Austrian banks. Each Issuer is free to market Maestro cards in Austria, independently of Europay Austria. Europay Austria is an Issuer of MasterCards and offers issuing support upon demand to Issuers who issue Mastercards themselves. Any Austrian bank is free to issue MasterCards without support by Europay Austria. Any Issuer can market MasterCards in Austria independently of Europay Austria, as long as the issuer has a license from MasterCard International. Any Acquirer is free to acquire Maestro merchants/transactions and MasterCard merchants/transactions in Austria. As mentioned in

the "Interim Report I Payment Cards", there are a number of other Maestro and MasterCard Acquirers in Austria competing with Europay Austria. Europay Austria is a bank and consequently is subject to the banking supervisory authority (FMA) and the payment systems supervisory authority (OeNB).

II. Economics of the Payment Card Industry

The Interim Report contains a brief review of the scientific economic literature on payment cards. It is essentially undisputed that payment card systems are one among several payment technologies exhibiting relatively complex relationships between the involved parties. They are characterized by network effects and strategic elements reflecting different competitive situations.

As a compensation for the costs incurred and earnings made in the system, a special payment, the so-called Interchange Fee, can be used. For theoretical reasons the existence of such a payment is essentially undisputed; its (justified) level depends on the circumstances of the system. This is an important empirical question which still requires in-depth clarification.

In the competitive race between payment technologies the few existing empirical studies suggest that cash payments cause higher costs than card payments and electronic payments. Hence from the point of view of society it is advisable to limit the use of cash in payments.

The Interim Report does not deal further with the question whether there is sufficient information on the costs (prices) of the alternatives for the choice of a certain payment technology and whether the decision on the choice is determined or even decisively influenced by other factors which may be risks, anonymity, etc.

III. Data and Methodology

The procedure used in the survey by the questionnaire seems to pave the way for inconsistencies. As explained further below under VII., uniform methods for obtaining key data (such as for calculating depreciation and proportionate overhead costs) are missing. The report also lacks important information on the different taxation of firms in individual countries. Inadequately considered exchange rate effects distort the results for those countries which are not members of the euro zone. In summary, the conclusion seems compelling that a considerable part of the variation in profits, costs, etc. analyzed in later sections of the report is caused by inadequate data quality. Moreover, there seem to be systematic distortions ("profits" are overstated, because profit reducing items are only inadequately accounted for).

Section B — Financial Aspects of the Industry

The Interim Report postulates that uniform cost-based prices must exist in the EU in the payment card business. In view of the considerable differences in personal income, earnings rates, etc., which are factors that also substantially determine the costs and the use of payment technologies, this benchmark is highly problematic. In the empirical analysis data from the questionnaire are weighted across the 25 EU countries. It is unavoidable that when forming an average over heterogeneous entities these differences will also be reflected in the measured quantities. The different stages of development of the examined economies also imply different market situations, different degrees of maturity in the various card markets and thus completely different entrepreneurial challenges. It is not enough to simply form aggregate

values when questions are posed that cannot be answered without a differentiated analysis of the underlying individual entities.

IV. Interchange Fees

This section analyzes differences in the rates of Interchange Fees to draw conclusions about the role of the Interchange Fee in competition. However, both uniform rates (e.g. in the case of MasterCard and Visa) and varying rates (e.g. in the comparison between different countries) are interpreted as evidence showing a lack of competition. It thus remains unclear which pricing structure the Interim Report would be considered as corresponding to functioning competition. Hence from the degree of variation of prices and Interchange Fees alone it is impossible to draw any definite conclusions about the competitive structure in a market. This approach is inappropriate for analyzing competitive issues.

The analysis of Interchange Fees on the basis of weighted averages masks the extent to which changes of the underlying fees or transaction volumes explain the development of the weighted averages. If, for example, a partial segment subject to a higher fee grows faster, the weighted Interchange Fee will rise although the rates have not changed. For analyzing competition the development of nominal fees is more meaningful, because they represent directly the decisions of the operators of the card networks. The Interim Report at best provides partial information about the development of these rates. The comparison of weighted averages between the different networks is only meaningful when the turnover in the individual partial segments is proportionally the same, which is hardly to be expected. Conclusions on the functioning of competition between MasterCard and Visa on this basis therefore appear overstretched. This criticism applies even more so for the comparison between the individual countries because the payment habits differ strongly from nation to nation (e.g. Portugal versus Lithuania versus Germany) and even in the case of (economically implausible) identical rates for different types of transactions one can expect considerable differences in the weighted Interchange Fees. These differences merely reflect the different economic and payment structures. A competitive analysis on the basis of such a comparison does not make sense.

As a result of the national differences in market size (e.g. exploitation of economies of scale), maturity of the card networks, technology, quality of the services provided, general cost levels due to differences in productivity, regulation (e.g. prohibition of Interchange Fees) and taxation, it can be assumed that the nominal rates of the Interchange Fee in the individual countries will reflect these essential economic differences and hence will differ. Competitive structures are only one additional possible factor among many for explaining the differences. The Interim Report, however, assigns all differences in the Interchange Fee to this one factor without dealing with the other factors and establishing their relative importance. Similarly, different rates of the Interchange Fee for individual market sectors or groups of merchants are interpreted exclusively as a problem arising from competition without checking the influence of the large number of other possible economic reasons (such as different costs, risks, etc.). It cannot be derived from the analysis in this section that banks use the Interchange Fee primarily as an instrument for raising excessive revenues from payments of price-insensitive merchants.

V. Merchant Charges

This section also analyzes weighted averages to make comparisons of merchant charges between countries and networks. National differences in the level of the merchant charges are interpreted as being primarily caused by different competitive structures without taking into account other essential economic determinants, such that similar criticism applies as in Section IV.

Special emphasis is placed in this section on the different level of merchant charges between smaller and larger merchants. Looking at absolute rates, the differences in the rates have decreased in the EU. The Interim Report stresses, however, that relative differences have not decreased. For a merchant the absolute rate is clearly more relevant because a decrease of the absolute rates will influence his profit directly. The relative distance to a larger merchant's fee thus becomes less important because the relevance of merchant charges as a cost factor decreases overall.

Higher differentials between smaller and larger merchants in credit cards as compared with debit cards are interpreted as an indication of market power of MasterCard and Visa. The fact that other economic factors could explain these differences (e.g. higher size-dependent risks in credit cards, additional differences between larger and smaller merchants in cross-border transactions as compared to domestic payments, different network sizes etc.) is considered in the introduction to this section but remains essentially neglected later in the analysis. The Interim Report also does not deal with the consequence of differently high Merchant Service Charges. They must be reflected in different product prices and price levels in the various countries in order to be economically relevant. It is presumed, however, that other economic reasons are far more important for the price differences.

VI. Cardholder Fees

Differences in the cardholder fees between the different countries are interpreted as possible indications for lack of competition and lack of market integration without checking possible other explanations such as different market sizes (exploitation of economies of scale), different development stages of the card networks in the individual countries (e.g. differences in technology), differences in quality in the services provided, different national cost levels as a result of differences in overall productivity, different structures in payment systems (e.g. joint offerings of cards and accounts), different regulations (e.g. prohibition of Interchange Fees...), different taxation, ...

An analysis of the correlation between card fees and Interchange Fees in MasterCard and Visa is provided resulting in evidence that there exists only a weak negative correlation between these rates ($\rho = -0.27$). Based upon this evidence the conclusion is drawn that higher Interchange Fees are passed on only partly in the form of lower fees to cardholders. A simple correlation analysis between two values does not allow considering further relevant influencing factors (as was noted correctly in the text on page 56). In particular, the factors mentioned above should be included because higher costs, lower scale effects or higher taxes tend to increase both Interchange Fees and cardholder fees. Neglecting this effect in a simple cross-country correlation analysis gives the impression that higher Interchange Fees only lead to small reductions of card fees.

Although an econometric panel analysis is conducted in Annex 5 which goes beyond simple correlation analysis, the control variables employed there capture only insufficiently (e.g., country dummies) the effect of other key economic determinants. Since these missing variables are correlated with the Interchange Fee (e.g. higher cost levels, higher Interchange Fees), a serious "omitted variables problem" arises which may result in biased estimates. The fundamental criticism remains that the differences between individual countries in costs, economies of scale, taxes, etc. are insufficiently accounted for. It is therefore not possible to draw any conclusions about the appropriate level of fees based upon this analysis.

VII. Profitability

Regarding the methods employed in the survey, the quality of the earnings and cost data used for the analysis seems to be highly dubious. It is especially problematic that in the questionnaires important cost variables such as depreciation or attributable overheads were included under "other costs" and no uniform method was used for calculating these variables by the respondents. As a result of serious data problems especially in the case of multi-product businesses (Issuers!), presumably these cost variables were only stated in part and were determined using different methods. That is why it is not surprising that the stated costs are sometimes significantly lower than the stated earnings and exhibit a substantial degree of variation. The average profit ratio for Issuers (credit cards, EU weighted average: 65%) seems to be too large and could be particularly affected by the data problems. At least for Austria such figures are not representative in any way.

The doubts about the quality of the collected data are confirmed in the following sections because no evidence is produced there to support a systematic correlation between "profits" and essential structural features of markets such as the degree of concentration.

There is no consideration of taxes, so that an interpretation of the difference between the revenues and costs entered in the questionnaires as economic profit is inappropriate. Since businesses in the individual countries need to reckon with differently high tax burdens, additional variation of profits before taxes exists. The Interim Report completely neglects this important aspect.

The long-term character of networks is not considered in the analysis of "annual profits". Payment card networks require high initial and expansion investments which are included in later years only partly in the annual depreciations. In this respect, profitability would have to be calculated over longer periods of time in order to evaluate it adequately.

The analysis of "profits" in this section lacks the consideration of important control variables such as taxes, market size, economies of scale, network maturity, quality differences, market structure, regulation, etc., so that a mere comparison of the ratio of "profit" and "cost" is not meaningful. This problem is also indicated on pages 65 and 68 in the text ("discrepancies arise because some Acquirers incur, among other things, significantly higher average transaction processing costs and staff costs than others..."). However, this important aspect is hardly considered in the interpretation of the data.

The comparison of profits with and without Interchange Fees is economically naive. If Interchange Fees were abolished, this would lead to a fundamental restructuring of payment card markets. In order to evaluate the effects of an abolishment of Interchange Fees, it is thus not possible to simply deduct the fee income from the earnings at otherwise unchanged prices

and quantities. More complex simulations and model calculations are necessary in order to evaluate the effects of an abolishment of Interchange Fees. Even if a card system should not collapse without the Interchange Fee, the arising structure would be inefficient, thus giving rise to competitive advantages for three-party systems. In any case, the economic burden is shifted to cardholders, which would be difficult to justify for a regulator.

The analysis conducted in this section on Interchange Fees does not correspond to the approach of the European Commission in the decision on cross-border payments concerning Visa cards. The Interchange Fee was interpreted there as a fee for service and a cost-based determination was demanded. Such an approach can never lead to an Interchange Fee of zero and thus is in clear contradiction to the procedure in the Interim Report. Obviously, the European Commission does not have a uniform approach in the analysis of Interchange Fees. In summary, the presented empirical evidence inadequately supports the conclusion that high persistent profits, especially for issuers and credit cards, indicate the exploitation of market power.

Section C — Organization of the Industry

VIII. Concentration of Acquiring and Issuing Businesses

Generally, a high degree of market concentration is found in the acquiring business. It is especially high in national debit card networks. This result contrasts with the financial analysis in Section B, according to which the national debit card networks work relatively efficiently as compared to others. The correlation analysis between market concentration and Merchant Service Charges also hardly shows any significant correlation. Either concentration is irrelevant and/or the data are unreliable.

According to the text, concentration plays no role whatsoever for the Issuers (the explanation is limited to four lines !!). However, the highest profits were found in the financial analysis of section B just in this category. Market concentration is presumably one of the most important indicators for lack of competition. The lack of any correlation between this central competition indicator and the alleged high profits therefore reinforces the doubts about the quality of the data and the economic interpretation as expressed in earlier sections in Section B. It would then be necessary to provide other important reasons which explain the alleged high profits. Such proof is not provided.

IX. Integration of Card Payment Systems

This section deals with partial aspects of the advantages of centralization or decentralization of different functions within a network (decentralization is not always advantageous!). There is no attempt of an empirical check of the hypotheses stated, although this should be possible in principle with the help of the collected data. In this respect, there cannot be any evaluation of the empirical relevance of the allegations made and their relative influence remains unclear.

X. Governance in Card Payment Systems

According to the core hypothesis of this chapter, several classes of membership can lead to the consequence that a small number of banks decides about the key issues in a network and thus limits competition. It is rather in national debit card systems where a small number of

banks has the authority to take such decisions. However, when relating this analysis to the financial analysis in Section B, it is especially the national debit card systems that have the lowest prices and fees. In this respect, this attempt at an explanation is inadequate for explaining profits from the card business. The doubts about data quality and about the economic interpretation in Section B as stated above are confirmed.

XI. Membership Conditions and Fees

In most countries banking licenses are a prerequisite for taking part in a card system as an Acquirer or Issuer. Despite this condition, there is obviously a relatively large number of relatively efficient card systems, as was shown by the financial analysis in Section B. Hence banking licences as a condition for participation can be compatible with functioning market structures. If card systems were also opened for non-banks, fundamental questions about competition would arise. Since banks are subject to a comprehensive supervisory and regulatory process, they would have a competitive disadvantage over non-banks. An intended liberalization in this area would thus create new competitive distortions. The security standards in such a new system would be lowered to the extent that bank supervision and regulation is effective.

XII. Cross-Border Competition

This section examines the market entry barriers for international acquirers. Technical, legal and other barriers are a bigger issue in national debit systems. Still, those systems are characterized as comparatively efficient according to the financial analysis in Section B. This finding consequently puts into perspective the meaning of such explanatory factors for the profit structures in card systems and the validity of the data and analysis in Section B.

Obstacles for the market entry of foreign Acquirers can have a large variety of causes. Market entry can be difficult in a mature, highly efficient market or be hindered by artificial market foreclosure. In this respect, the frequency and type of cross-border market entries should not be interpreted in a biased manner, but should be subjected to an in-depth analysis of the respective economic circumstances.

The development of cross-border acquiring activities is regarded as being too slow because "only" 9% of the Acquirers in the sample have tried entering a foreign market. This does not say anything about the size of this Acquirer. When large Acquirers are active in this area (as can be presumed in general), then a substantial market entry potential may actually exist.

Section D — Other Important Characteristics of the Industry

XIII. Network Rules Other Than Those on Interchange Fees

For most branches, surcharging is economically void and will usually also not be practiced as a result even when there is no prohibition of surcharging. In this respect, the discussion is of little relevance from a material standpoint.

XIV. Non-Price Competition Variables for Credit and Debit Cards

This chapter is primarily descriptive. It can be seen, however, that the suppliers of acquiring services do not offer a homogeneous product. There are considerable differences in the

quality of services, which clearly also leads to different cost structures. This heterogeneity in the services of the different Acquirers is completely neglected in the financial analysis of Section B, although it represents an important reason for the wide variation of the performance parameters which is considered there as being negative.

XV. Interest-Free Period and Float in POS Card Transactions

This is a purely descriptive chapter without any far-reaching conclusions.

Section E — Summary and Analysis

The far reaching conclusions of this summary clearly go beyond the partial analyses in the preceding chapters. The interpretation stresses competitive factors without considering other likely explanations for the issues under investigation. Countries in which a single Acquirer does business for one international credit card system are regarded as especially problematic. This setup was not dealt with in detail anywhere in the entire Report's text. As a result, these conclusions are not supported by the analyses of the "Interim Report I Payment Cards".

Political interventions, and especially regulatory ones, have to raise the welfare of society in order to be democratically legitimized. A sound analysis of the issues to be dealt with must therefore be a precondition for any policy measures to be undertaken.

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:

- generally new to you/the payment cards industry;
- X 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;
- challenge your/industry's views on the operation of payment cards market;
- X 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!