

**COMPETITION ISSUES IN RETAIL BANKING
AND PAYMENTS SYSTEMS MARKETS
IN THE EU**

The logo for ECCA (European Competition Commission for the Financial Services Sector) is displayed within a dark blue, horizontally-oriented oval. The letters 'E', 'C', and 'A' are rendered in a large, bold, serif font. The 'C' is the central focus, with a bright white-to-yellow gradient glow emanating from its center, creating a lens flare effect. The 'E' and 'A' are also in a dark blue color, matching the background of the oval.

ECCA

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FOREWORD

This is the report of the ECA Financial Services Working Group -also known as the Financial Services Subgroup- that was set up in May 2004 to consider competition issues in Retail Banking and Payment Systems Markets in the EU.

The Subgroup examined what competition issues in retail banking currently exist as perceived by the NCAs (National Competition Authorities). The report is based on qualitative research and as such its contents and recommendations reflect the opinions and experiences of National Competition Authorities.

I am very grateful to all the individuals involved in the Subgroup for their contributions and assistance in compiling this report and the recommendations that go with it: they are the outcome of an open, interactive and creative cooperation between National Competition Authorities.

I hope this Report and its Recommendations will be of use to the European Commission and for European NCAs, in their daily work, and thus advance competition in retail banking markets and payment systems throughout the European Union.

Albert Scholten,

Chairman of the ECA Financial Services Working Group

EXECUTIVE SUMMARY AND RECOMMENDATIONS

INTRODUCTION

Financial markets are of great importance to the European economy: well functioning capital markets reduce the cost of capital, channelling efficiently savings to investment and stimulating innovation. However, financial institutions do not only bring together the supply and demand of capital. They also have a direct influence on trade as suppliers of payment services. In many cases they are also responsible for, and owners of, the infrastructure through which transfers of money are effected. Unnecessary restrictions on the dynamic process of competition in financial markets may therefore have serious negative effects on prices, innovation and efficiency.

In 2005, the ECA (European Competition Authorities) Directors-General meeting adopted the proposal for the formation of the ECA Financial Services Subgroup, which was convened with the purpose of identifying common competition problems, focusing on three areas:

- consumer mobility,
- access to payment systems, and
- SEPA (Single European Payment Area)

The objective was to publish a report and possible recommendations on competition issues, to be addressed to the European Commission. In order to be able to publish a report that would reflect the views of all ECA members, the Working Group sent out a questionnaire to all 28 ECA members¹, and organised a subsequent Workshop in the Hague, at which the Draft Report and Recommendations were discussed. The final Report and Recommendations were then presented to - and adopted by - the Directors-General meeting in Nice on 18-19 May 2006.

SUMMARY OF THE ANALYSIS AND RECOMMENDATIONS

Retail banking markets are still mainly inward-looking. In these markets, a combination of high entry barriers, high concentration ratios, the existence of network effects, a lack of transparency and high switching costs for customers lead NCAs (National Competition Authorities) to the view that, despite their efforts in enforcing competition law, competition in national retail banking markets remains far from perfect. The methods that national public authorities employ to deal with these issues differs hugely between Member States.

With the finalisation of the FSAP (Financial Services Action Plan), the future implementation of the Post-FSAP, the growing number of pan-European retail banks and the introduction of new distribution channels (e.g. internet), the European

¹ Responses were received from 17 ECA members: Belgium, Denmark, France, Germany, Hungary, Ireland, Latvia, Lithuania, Malta, Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Sweden and the United Kingdom.

integration of retail banking markets is slowly being realised. It is widely recognized that, in the long run, the potential benefits for end users from the integration of European retail banking markets are huge, mainly because of economies of scale and scope. If the integration leads to increased competition, this may also have significant positive effects. The impact of integration may however be less positive, or even negative, if integration leads to reduced competition and/or a reduction in choice for customers.

As national markets become more integrated, there is a growing desire for a consistent European view on competition issues in payments markets. Below is a summary of the main problems that occur in the fields of the three subjects mentioned above, as well as a set of recommendations that could help to overcome these problems².

1. Customer mobility

NCA's agree that a lack of transparency, typically demonstrated through the inability of customers to compare services effectively, has contributed to low levels of customer mobility. Additionally, banks make it difficult, costly and often a lengthy process for customers when they do switch. As a consequence, it is not uncommon for customers to lose payments when changing bank.

Examples of switching facilities, such as those currently available in Ireland and the Netherlands, appear to have aided customer mobility. Similarly, comparison sites such as those in the Netherlands and Sweden have provided customers with the necessary product information. Therefore, if NCA's would like to facilitate greater customer mobility these models are a good basis from which to start.

Recommendations

In order to stimulate customer mobility in their national markets, the Working Group recommends NCA's, as far as possible within their respective roles in their own countries, to further consider the case for promoting:

1. Lower switching costs in retail banking markets;
2. The introduction of a consistent set of transparency rules that make it possible for consumers and SMEs to compare retail banking products, and
3. The implementation of retail banking switching facilities (e.g. objective and up-to-date comparison sites, comparison statistics, switching services).

² The objectives and the best practices in this Report are very much in line with the suggestions pursued by the 2005 International Competition Network Annual Conference in Bonn, focussing on an increasing role for competition in the regulation of banks by adopting ten best practices to be followed by jurisdictions and competition authorities worldwide (available at: http://www.internationalcompetitionnetwork.org/BANKS_Bonn_best_practice_suggestions.pdf).

2. Access & governance of payment systems

Technical standards and operational matters of payment systems are often set and managed through self-regulation. This may be managed through a scheme-setting body, which in many cases is also responsible for setting and enforcing access rules with regard to clearing and processing. The access conditions of these bodies can be categorised as follows:

- Setting the rules for licenses to provide payment services (banking licence or licence from other regulated financial institution);
- Adherence to (technical) conditions; and
- Payment of access fees (in some cases).

NCA's are of the opinion that in some Member States, access to payment markets may be restricted by unnecessarily high barriers, which may be reinforced through prohibitive access conditions and the bundling of payment services.

Recommendations

4. In order to create more open national payment markets in those cases where technical and operational matters of payment systems are set and managed through one or more central self-regulating bodies, the Working Group recommends NCA's to consider the promotion of:
 - a. transparent, open payment standards and objective membership criteria to payment schemes (i.e. non-discriminatory access rules);
 - b. if workable, a clear legal (and practical) separation between management and ownership of access rules for payment schemes;
 - c. unbundling in the supply of payment services (e.g. branding and processing) where other, less potentially anti-competitive, solutions are available; and
 - d. the introduction of stakeholder-involvement (within the normal provisions of competition law) to ensure the consultation of stakeholders (customers) on access rules.

This could be done as part of an investigation into possible breaches by national payments systems of art. 81 and 82 of the Treaty (or national competition law), or through advocacy, depending on both the legal mandate and the resources of each individual NCA.

3. Single European Payment Area (SEPA)

It is not clear to NCA's that the current process towards SEPA will lead to more competition, lower prices and better services for end users. More consultation is needed on SEPA. The tight deadlines imposed on the EPC mean that time for this consultation is already running out. This Working Group would echo the views of the Commission: "Effective competition...greatly promotes user adoption of the new

products and improves legitimacy of the process”³; and that it is “...preferable to involve users at an early stage of scheme development to ensure user requirements are met.”⁴

It is thought that prices may increase in the short-term – due to the substantial investment involved in making domestic payment systems SEPA-compliant – but fall in the medium to long-term, as economies of scale and scope are realised. It is clearly important that end users should benefit from these advantages of SEPA, though the degree to which these benefits will be realised may depend on the current level of competition within domestic banking markets.

Innovation and transparency of payment services are another area in which domestic conditions determine the extent to which users will benefit from SEPA. Although most of the details regarding SEPA have yet to be finalised, certain access & governance principles identified by NCAs as best practice in their own countries – e.g. independent directors, voting thresholds, objective access criteria – could help to avoid potential problems in achieving the SEPA vision.

Additionally, there are also a few principles included in the Commission’s SEPA Incentives paper which this Working Group would support:

- Market-based approach for SEPA migration;
- Separation of scheme and infrastructure; and
- Non-exclusion of non-bank payment service providers from governance.

NCAs believe that customer mobility is also an important issue in creating SEPA. Subject to the abolition of existing legal barriers to cross-border switching, the introduction of European account numbers and ‘number portability’ could – in the long run – be the best way forward, depending on the expected costs and benefits. An alternative would be to introduce a European switching facility, or at least the harmonisation of national switching facilities.

Clarity on the extent to which the Commission intends to implement these changes would give national authorities the possibility to adapt their national policy strategies on this point, as they may want to improve customer mobility within their own country.

Recommendations

NCAs are of the opinion that competition issues with regard to SEPA have not been properly examined so far. NCAs support the work of the Commission in improving openness, transparency and consistency in European payment systems through the New Legal Framework for Payments in the Internal Market. The Working Group:

³ p.8, ‘Consultative paper on SEPA incentives’, 13 Feb 2006

⁴ p.15, ‘Consultative paper on SEPA incentives’, 13 Feb 2006

5. Is of the opinion that the proposal for a New Legal Framework (NLF) for Payments in the Internal Market should be strengthened in order to ensure transparent and non-discriminatory terms of access for services provided by infrastructures. This can be achieved by an elaboration of article 23 in the proposed Directive COM(2005) 603 final.
6. Advises NCAs to be more active with regard to SEPA, to ensure that all participants benefit from competition in SEPA.

SECTION 1 INTRODUCTION

Background

The financial sector is of great importance to the European economy. Not only is the financial services industry of significant importance in its own right, but financial services have an impact on the performance of many other markets and the economy in general, for instance in the provision of credit and payments facilities. It is essential therefore that this market operates as efficiently and competitively as possible. The absence of sufficient competition in this sector can lead to significant consumer detriment that may be characterised by artificially high prices, a lack of innovation and inefficient capital markets.

Despite the recognised importance of the financial sector, it is often characterised by inefficiencies or restrictions on competition. The generally high degree of concentration and the existence of network effects and entry barriers contribute to the absence of perfect competition in this market. This situation is compounded by information asymmetries for customers as well as high switching costs. Furthermore, regulatory burdens on the financial sector affect the behaviour of market players. The extensive body of national regulations and international standards (e.g. Basel II) which govern financial institutions adds to the already considerable complexity of the sector.

Financial institutions come in various shapes and sizes. Across Europe institutions as diverse as financial conglomerates with global presence (e.g. HSBC, BNP Paribas, ABN AMRO), and smaller niche and local banks compete in national retail markets. Accordingly, numerous studies and investigations have been carried out, both by NCAs (National Competition Authorities) and the European Commission, with the aim of examining competition issues concerning financial institutions. With so much cross-European work there is a need for greater multilateral communication between institutions with regards to views and positions adopted on matters of financial law, regulation and policy. Where views on competition in this sector are highly divergent, the level playing field for the financial sector becomes endangered. This would be a harmful and unnecessary obstacle in view of the integration of financial markets within Europe.

Aim of the report

At their meeting in Trier on 6 May 2004 the ECA Directors-General established a Financial Services Subgroup with the intention of ‘enhancing co-operation between the European Competition Authorities through the exchange of knowledge, the sharing of enforcement experiences and the development of joint views on market structures and trends’. The overall aim of the Subgroup is to explore the opportunities for synergy among ECA members regarding competition issues in the financial services industry and to propose an agenda of activities for a new ECA Working Group.

In 2005 the Subgroup produced a comparative study⁵, based on the existing knowledge and research of the four original Subgroup members: the Netherlands, Ireland, Sweden

⁵ ECA (2005), *Comparative Study of Competition in Retail Banking and Payments Systems Markets*.

and the UK. The outcome of the study was presented in a report at the ECA Directors-General meeting in London, on 18 April 2005. The Directors-General adopted the proposal of the Subgroup to commence a project to identify common competition problems focusing on three areas:

- Access to payment systems
- Consumer mobility, and
- SEPA (Single European Payment Area)

Ultimately, the objective was to find recommendations and solutions to problems that have been identified in the area of retail banking, which are to be addressed, inter alia, to the Commission, in particular DG Competition and DG Internal Markets. For SEPA the aim would be to address suggestions to the Commission and, possibly, the European Payments Council. The ultimate goal was that the Commission takes account of the ECA Report as part of DG Competition's Financial Services Sector Inquiry. At the Directors-General Meeting in 2005, Denmark, France and Germany expressed their support for the preliminary work the Subgroup had undertaken and have participated in the production of this report.

Method

In order to make sure that the activities of the Working Group would complement rather than duplicate DG Competition's Financial Services Sector Inquiry, the Working Group met with the Commission in September 2005. Both parties concluded that as the Working Group's activities were directed to the NCAs (National Competition Authorities), and the Commission's questionnaires were directed to individual market participants the two studies would be complementary. Both the Commission and the Working Group agreed that the combined work would improve the robustness of the analyses and the understanding of the market as a whole.

This report is based on data collected by means of a questionnaire sent to all 28 ECA Member States (the EU 25 plus Iceland, Lichtenstein and Norway). The questionnaire was mainly focused on the three issues that were suggested for further investigation. The Working Group received 17 responses to the questionnaire: Belgium, Denmark, France, Germany, Hungary, Ireland, Latvia, Lithuania, Malta, Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Sweden and the United Kingdom. This implies the response rate was above 60% (64% when leaving out the three non-EU ECA members).

Although the responses to the questionnaire were good overall, the depth of answers was variable. Generally the quality of response to different questions depended upon the areas of the financial sector upon which NCAs had previously worked. Unsurprisingly, methodologies and indicators that were used by NCAs also varied from country to country. And in some cases (e.g. innovation) it was clear that the starting point of their analyses influenced their responses. For practical reasons, in those cases where not all NCAs responded to a question, it was assumed that the responses available reflect the opinion of all NCAs, unless stated otherwise.

In order to ensure that all NCAs would be given the possibility to express their views on the report, the Working Group sent out a Draft Report in early April 2006. All ECA members were invited to send in their comments and suggestions on the document. The Financial Services Working Group also organised a Workshop on April 21st in The Hague, to facilitate a more interactive exchange of views on the draft report and the recommendations it contains. All ECA members, regardless of whether they responded to the questionnaire, were invited to send representatives to the Workshop. The 19 NCAs that were represented at the Workshop (Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Iceland, Ireland, Latvia, The Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Sweden, United Kingdom) reached an agreement on the recommendations.

Early May the Working Group sent out this Final Report and Recommendations to all ECA-members, to be adopted at the Directors-General meeting in Nice on 18-19 May 2006.

SECTION 2 MARKET STRUCTURES, BEHAVIOUR AND RESULTS

2.1 INTRODUCTION

The responses on market structures, behaviour and results vary hugely amongst the different NCAs. Both the answers themselves and the indicators and variables provided by NCAs varied widely. For example, concentration rates were calculated in different ways (both C4 and C5 ratios, HHI). Furthermore, not all NCAs appeared to have access to data with regard to individual product markets, which undoubtedly influenced responses. In particular, responses concerning innovation and transparency depend heavily on the initial conditions prevalent in the domestic banking sectors of individual Member States. For this reason this section only contains a broad overview of the current market situation and developments over time.

While the ongoing process of harmonising the regulatory framework in the financial sector increases cross-border competition in the EU to some extent, competition in retail banking occurs predominantly at the national level. This is partially caused by the fact that, in some of these retail markets, regulatory obstacles for effective cross-border competition still remain. It is clear that in the markets for retail payments, as well as mortgages and consumer credit, the harmonisation process is far from complete. However, the integration of capital markets is at a more developed stage and with the finalisation of the Basel II framework and the introduction of International Financial Reporting Standards (IFRS), rules for capital requirements and financial reporting are fairly harmonised.

The standardisation that, according to the ECB report “EU Banking Structures” (October 2005), has taken place in the market for loans to large companies – so-called syndicated loans - shows that there may well be a business case for more standardisation in retail lending markets. At the same time the ECB’s observations lead to the conclusion that banking activities are still focused on retail markets, in particular the mortgage market and the market for consumer lending, which together represent an increasing part of banks’ profits. The development of Directives on both retail payments (the New Legal Framework for Payments in the Internal Market), and on consumer credit (as part of the Financial Services Policy Green paper), may substantially contribute towards the integration of retail banking markets and thus generate welfare improvements on a European level. In fact, competition in retail banking markets still tends to take place on a national rather than on an EU level. As the relevant geographic market is generally national, many current competition issues in the retail banking sector need to be addressed by national competition authorities.

2.2 CONCENTRATION, ENTRY AND EXIT

Market concentration

According to our survey, national banking markets (in terms of total assets) are moderately to highly concentrated.⁶ Concentration rates tend to be somewhat higher in retail banking markets than the rates in the banking sector overall. They are especially high for lending to SMEs (Small and Medium Sized Enterprises) and deposits made by SMEs, whereas concentration in the consumer credit market and the market for the provision of deposits and mortgages to consumers appears to coincide more with the concentration rates for the sector as a whole.⁷

Concentration rates are generally higher in the EU-15 than in the newer Member States. There is also a striking difference between small and large Member States - generally, concentration is significantly higher in the small Member States. Even if concentration ratios appear low nationally, they can still be high at a sub-national (e.g. regional) level – for example, Germany shows a low concentration rate on national level but competition in retail banking markets is still conducted on a regional level, where concentration rates – especially in rural areas – may be quite high.

Changes in Market Structure

Between 1995 and 2000 in over half the Member States, there was a large increase in concentration, which tended to be strongest in the smallest Member States⁸. Opinions indicated that this was mainly a result of anticipation of the liberalisation of European capital markets and the introduction of the Euro. Increases in concentration were also evident in the larger Member States although the rate of increase was lower.

After 2000, these increases in concentration slowed to a moderate growth in 48% of the Member States, mostly the EU 15 Member States. In most of the new Member States (except Hungary), concentration rates fell; this is likely due to the privatization of former state-owned banks and the entry of foreign banks into the market. Furthermore, in this period Sweden and the United Kingdom also witnessed a decrease in concentration rates.

It is worth noting that, despite general perceptions of substantial entry by foreign banks into national markets, in recent years it has only significantly affected a minority of Member States. Although almost all respondents stated there had been at least some form of foreign entry over the last decade, overall, entry and exit rates were significant in only 23% of the Member States⁹.

⁶ Low concentration: HHI < 1000, moderate concentration: HHI = 1000-1800, high concentration: HHI > 1800.

⁷ See Annex 1, Table 1.

⁸ See Annex 1, Table 2.

⁹ See Annex 1, Table 3.

While there is some evidence to suggest that data provided by individual NCAs are not always directly comparable, it appears nonetheless that foreign entry and exit rates do not fully explain the development of concentration rates. Generally, entry and exit rates have to be treated with caution, as they are often calculated from changes in Central Bank registers. These changes may be partly the result of restructuring by corporate financial entities, thereby misrepresenting the true level of entry and exit in the market. There seems to be a tendency for larger banks in the EU to arrange authorisation with the relevant authorities in all Member States, even if they choose not to enter every market straight away. This facilitates market entry by these institutions in all EU Member States at the moment it best suits them¹⁰.

Cross-border mergers and acquisitions often do not alter the concentration rate at a national level, whereas they do influence the EU-wide concentration rate. According to the responses from some countries, market entry and exit rates are affected by merger and acquisition activities of insurers and the retail banking sector, even if there is variable success in terms of gaining market share. This is a significant observation, as such mergers may only have a small effect on the overall concentration rates in the banking sector while actually affording the merged firms far greater market power in the financial market overall. Still, according to the responses from NCAs, cross-border mergers and acquisitions of local banks have been an important entry strategy for banks in over half the national markets, as can be seen in Table 4 of Annex 1.

Responses indicated that banks often enter a niche market (e.g. lending to large corporate customers), which may only have a small impact on concentration rates. Typically, entry into a niche market is through innovative services that allow for low costs, low prices, higher interest rates on deposits and more generous loans. Upon entry, niche banks tend to have narrow product offerings, but once they have established a market position they often try to broaden the scope of their activities to full service banking.

Branch Networks

The NCAs indicated that traditional branch distribution networks still play an important role in many Member States. However in some countries - especially those in Northern Europe - the number of local branches has decreased recently. This change is due to reduced need. It has been influenced not only by the proliferation of Point of Sale (POS) networks for electronic debit card payments and Automated Teller Machines (ATMs), but also by the introduction of new services such as e-banking, internet banking and e-brokerage. Consequently, there is a reduced need for branch facilities that has lowered costs for banks and made cross-border penetration of retail markets easier. Respondents stated that internet banking was one of the (innovative) products that often forms part of the entry strategy of foreign banks.

¹⁰ This was one of the results of the study conducted by the Netherlands Competition Authority that was published in the *Financial Sector Monitor* (2005).

2.3 PROFITS, AGGRESSIVE COMPETITION AND EFFICIENCY

Profit rates, aggressive competition and efficiency

According to the responses received, profitability is high in half the Member States and moderate - though generally increasing - in many other Member States.¹¹ In only two Member States are profits moderate and stable. A clear relationship between concentration and profitability cannot be found. It seems, however, that in the years prior to the liberalisation of capital markets and the introduction of the Euro, profitability was decreasing in more countries than at present.

The existence of high profits in retail markets can be caused by several factors, including low corporate taxes, high levels of efficiency or an absence of competition. Banking profits are derived from a wider range of markets than those covered in this report. Additionally, some retail product markets may be used as a 'gateway' to open other product markets for delivering other financial services.

Efficiency and aggressive competition

Responses demonstrated clearly that some aspects of retail banking were more aggressively competitive than others. Mortgages were the most competitive with 35% of NCAs reporting aggressive competition, while this figure fell to only 12% for consumer loans, savings deposits, the market for financing corporations and internet banking. Only 6% of the NCAs stated there was aggressive competition in the credit card market, with 4% reporting competition in all market segments¹².

¹¹ See Annex 1, table 5.

¹² See Annex 1, Table 6.

SECTION 3 CUSTOMER MOBILITY

3.1 INTRODUCTION

Customer mobility creates important incentives for both potential and actual suppliers and also reduces market power. Obstacles to switching may lead to customers becoming “locked in” to a particular financial service provider. Customers often find themselves facing barriers when attempting to choose a cheaper product or more favoured product. These circumstances allow the possibility for suppliers to raise prices above competitive market levels without losing market share.

With improved consumer mobility suppliers will be faced with more elastic demand. They will lose customers if their performance level is low compared to the rest of the market, or if they attempt to raise prices above competitive market levels. Thus, customer mobility constitutes a credible threat and disciplines suppliers. Hence, a lack of customer mobility will have a direct, negative impact on the level of competition. It is therefore essential that NCAs examine the degree of customer mobility in their respective countries.

The NCAs were asked to respond to questions on complaints - both formal and informal - relating to switching in the banking sector. Overall it was observed that customer mobility in the retail banking sector is low.

3.2 TYPES OF SWITCHING COSTS

Consumer mobility may be less than perfect for a number of reasons. Research and responses to the questionnaire identified four main barriers to consumer mobility:

- Direct switching costs
In many Member States a consumer must pay a fee in order to discontinue his relationship with a bank. Such fees have a direct impact on a consumer’s decision to leave their bank, and high fees effectively ‘lock in’ customers.
- Indirect switching costs
These costs reflect the difficulties and inconveniences that consumers may face when changing bank, for instance search costs and administrative costs they have to face in attempting to find a new account. In most Member States, it is the responsibility of the customer to inform all relevant parties (employers, customers, utility companies etc.) of their new account details.
- Lack of transparency
Lack of transparency hinders customer mobility as it makes it difficult for customers to compare services and price. Whilst in many circumstances banks offer very different (heterogeneous) services, between which it is naturally difficult to compare, it remains the case that banks often have complex pricing structures,

which also include basic banking features. For example, many banks bundle products together into packages and it becomes difficult for consumers to understand the ‘real’ price of individual components.

- High transportation costs
Significant transportation costs divide a market into smaller geographic markets, with consumer mobility limited to a local area. This may result in imperfect competition between the local markets. Although the proliferation of internet and non-branch banking has expanded the definition of what constitutes a ‘local’ market, this still remains a substantial factor.

3.3 ACTUAL CUSTOMER MOBILITY

Responses from ECAs stated that mobility in the retail banking sector is quite low. In Hungary only 16 per cent of customers/account holders has ever switched banks.¹³ In UK the estimated annual switching rate is 4 – 6 per cent of customers, and in France it is around 5 per cent per annum.

One of the indicators used by the Danish Competition Authority to assess competition in the economy is a mobility index showing the change in market shares from the previous year, which ranges from 0 to 100. The average mobility index for the service sector is approximately 15. Since 2000 the mobility index for the banking sector has been between 1.5 and 3 which is substantially below the average for the services sector as a whole.

In 2003, a study of the banking sector by the Norwegian Competition Authority looked at customer mobility over the period 1999-2001. The number of new customer relations constituted 7 to 8 per cent of the total number of customer relations. The Norwegian Competition Authority has additional figures for 2001 indicating that customer mobility (the number of new customers divided by the total number of customers) was 11.5 per cent.

Compared to other countries, a mobility ratio of 11.5 per cent in retail banking seems high. The increase in customer relations does not, however, necessarily mean that customers have terminated earlier bank relationships. The trend is for customers to shop around more, establishing several, parallel, customer relationships with different banks. Nevertheless, from a competition policy point of view this is a positive trend.

Actual switching behaviour

Consumer demand determines the importance of different parameters for competition in a sector. For example, if consumers particularly value the location of their bank, then location becomes a competitive parameter. In a market with a lack of competition, the product characteristics which consumers’ value most may not correspond to the suppliers’ perceived competitive parameters in the sector as there is no need to

¹³ According to a investigation on a sample of bank customers from 2001.

respond to customer demand. The reason for this may be that there is a common understanding among the suppliers not to compete on specific parameters. Another reason may be that the market suffers from a lack of transparency which means that customers find it too expensive or troublesome to search for a better supplier. To ensure competition among retail banks, knowledge of the sector's competitive parameters and especially factors that actually drive customers to switch banks is crucial for NCAs. Inter alia, these factors may be the number of brands, consumer trust, distribution channels, product categories and so on.

Of the thirteen responses received on this topic, the majority stated that product quality, service or product features are the most important factors for customers when choosing a bank or other relevant financial institution. Prices, trust and geography, convenience and number of counters are also important. Only two countries mentioned habit, tradition or reputation as the most important factors.

Most bank customers do not change from the bank account chosen for them by their parents. In the UK, the Competition Commission surveyed SME customers which revealed that:

- 41% of customer chose to open a business current account at a bank where they held a personal account or previous relationship with the bank;
- 16% chose their bank because it was the closest one to their business;
- 30% chose their bank because of service factors;
- 8% because it was recommended to them;
- 10% because of price factors.

3.4 REASONS AND WILLINGNESS TO SWITCH

Why do people switch?

Of the 13 countries that answered these questions, the majority stated that better prices, dissatisfaction with their current bank/better service elsewhere are the most important factors causing customers to switch. Very few NCAs mentioned better products, a broader product-range, denied loans or the possibility to obtain credit as the most important factors causing customers to switch provider.

Several respondents stressed that mortgages are a key product in the retail banking market. NCAs indicated that customers tend to seek mortgage offers from a number of different banks. Switching occurred more regularly when customers chose a mortgage lender that was not their principal bank. It is no surprise therefore to see that many NCAs described the mortgage market in their country as being aggressive.

For SMEs the UK Competition Commission report stated that:

- 31% of SME customers that have switched bank did so for reasons related to price;
- 27% switched because of a poor relationship with their bank;
- 20% switched because of a perceived better service at the new bank.

These findings are confirmed by a Danish banking survey, which reported that customers had several reasons for changing banks. The most important of these was a better offer on either interest or fees (accounting for 30 percent of all persons in the sample that had switched bank).

Full results of the Danish survey were that:

- 30 % were due to a better offer on interest or fees at new bank;
- 29 % were unsatisfied with their bank or generally unsatisfied;
- 12 % were due to geographical reasons;
- 7 % were due to being denied a loan;
- 6 % were due to socioeconomic reasons.

In addition, the UK and Danish surveys confirm that price and poor customer relationship with their current bank are two main reasons for switching to another bank.

Willingness and barriers to switch bank

Responses to the questionnaire showed that willingness for customers to switch can be based on either the 'push' factor of dissatisfaction with their current bank (e.g. poor product choice, lack of transparency) or the 'pull' factor of better products on offer with competing banks (e.g. lower prices, more attractive interest rates).

The responses from NCAs seem to show that business or personal consumers do not have a strong willingness to switch providers, but this willingness varies between different national banking markets. Overall, four issues seem important with regard to willingness to switch:

- Switching costs
- Insignificant gains from switching banks
- Personal relations with banking staff; and
- (A lack of) information/transparency.

In its survey of SMEs, the UK Competition Commission found a number of reasons for reluctance to switch supplier. These were:

- the perceived complexity of switching for little benefit;
- the perceived significance of maintaining a long term relationship with a bank to guarantee access to finance;
- the ability of the bank to negotiate lower charges for those customers who threaten to switch;
- limited price sensitivity demonstrated by SME customers; and
- the lack of price transparency demonstrated by the banks.

The Danish survey showed that 70 % of the customers would not shift banks even if it could be done without difficulties or costs. In summary the willingness to switch is highly influenced by good personal relationships with a customer's bank.

3.5 SWITCHING POLICIES AND RESULTS

Policy- actions

As part of the questionnaire, NCAs were asked to explain what had been the significant factors that have facilitated switching in their respective countries. Several NCAs stated that complexity in the way products are explained to customers is an important barrier to switching. A number of NCAs reported that greater transparency has increased the ability of consumers to switch banks. In Denmark, the establishment of a website (www.pengepriser.dk) made it possible for the customers to compare prices on banking services more easily. The website came about as a result of cooperation between the Danish Banking Association and the Danish Consumer Association. Similar facilities exist to cover several product markets (including banking) in Germany, Ireland, Sweden and the UK.

In the Netherlands and the Republic of Ireland the introduction of a switching code (and a switching service) has altered switching patterns.

Changes in switching behaviour and influential factors

In the course of its Banking Study, the Irish Competition Authority found that the personal current account (PCA) market was characterised by high barriers to switching, and, consequently, high levels of inertia. In particular, consumers considered switching to be a slow and cumbersome process. Consumers were particularly concerned that important payments, such as wages, bills or loan repayments, would not be completed during the switching process. In order to promote switching and competition in this market, the Authority recommended that the industry implement a Switching Code, which would simplify the switching procedure for consumers.

The Irish Bankers' Federation (IBF) launched a Switching Code in January 2005, and a version of this Code has now been adopted by all of the major retail banks, which has generally been successful in promoting switching. Permanent TSB launched a fee-free banking campaign almost immediately, with a stated aim of attracting 60,000 new customers to increase its market share beyond 12%. They claimed in May 2005 that they had opened 12,000 new accounts since the launch of the Switching Code (not all of these account openings would have used the Switching Code, however) and that 95% of consumers using the Switching Code were switching to Permanent TSB. The IBF confirmed that 10,000 customers had used the Switching Code between February and end-August 2005. This approximates to a switching rate in the region of 0.5%. Following the introduction of the personal Switching Code, a Business Current Account Switching Code will be launched at the end of June 2006. The benefit of the Switching Code lies not just in the numbers of consumers switching, but in the way it has changed banks' behaviour, by forcing them to react to increased consumer

mobility. Since the Code's introduction, all the main retail banks have introduced some form of fee-free personal current account product.

In January 2004 banks in the Netherlands also started to offer switching services (bank-Switch Support Service) to consumers. Under this system, the former bank ensures that all income, such as salary and benefits, are automatically credited to the new account for 13 months. The customer must take the initiative to inform his employer or the organisation(s) from which he receives a benefit of the amendments. With regard to debits, the new bank informs companies which submit instructions for automatic debt collection of the change in the account number. The Dutch Banking Association states in its Annual Yearbook of 2004 that some 45 000 (chiefly private) customers took advantage of this service in 2004 (some 0.6% of the total number of households in the Netherlands)¹⁴. On 1 October 2004, a special application form was made available for the commercial market. The service is planned to be evaluated by the Ministry of Finance in 2006. At that time it will be concluded if the switching-service forms a good alternative for bank account number portability.

CONCLUSIONS

NCA's agree that a lack of transparency, typically demonstrated through the inability of customers to compare services effectively has contributed to low levels of customer mobility. Additionally, banks make it difficult, costly and often a lengthy process for customers when they do switch. As a consequence, it is not uncommon for customers to lose payments when changing bank.

Examples of switching facilities, such as those currently available in Ireland and the Netherlands, appear to have aided customer mobility. Similarly, comparison sites such as those in the Netherlands and Sweden have provided customers with the necessary product information. Therefore if NCA's would like to facilitate greater customer mobility these models are a good basis from which to start.

RECOMMENDATIONS

In order to stimulate customer mobility in their national markets, the Working Group recommends NCA's, as far as possible within their respective roles in their own countries, to further consider the case for promoting:

1. lower switching costs in retail banking markets;
2. the introduction of a consistent set of transparency rules that make it possible for consumers and SMEs to compare retail banking products, and

¹⁴ The absolute value of this rate is not very high, but it is much higher than the Dutch Banking Association expected in advance.

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3. the implementation of retail banking switching facilities (e.g. objective and up to date comparison sites, comparison statistics, switching services).

SECTION 4 ACCESS TO PAYMENT SYSTEMS

4.1 INTRODUCTION

Payment systems enable the transfer of funds between economic agents. Payment transactions can be completed by different means, such as cash, cheques, credit, debit or charge cards, electronic fund transfer, direct debits or standing orders. Each of these means of payment requires a mechanism to effect transfers of funds from one account to another.

The mechanics and structures of payment systems in the various Member States vary considerably. Some systems use a third party operator; others involve networks of bilateral agreements between banks. Some payments systems have competing payments systems providers (e.g. Visa and Mastercard), while many have only one network per country. The time taken to complete the transfer of value also varies across systems and across countries. Generally speaking, ownership of the payment systems rests with the incumbent institutions, or at least the larger ones. While each Member State has procedures in place for admitting new members to payment schemes and infrastructures, there seems to be little uniformity.

In all jurisdictions, access to payment systems appears to be the most important feature that new entrants must have in order to render entry successful. This is particularly the case for those banks aiming to offer full-service retail banking. An extensive branch network, along with Automatic Teller Machines (ATM), telephone and internet banking facilities, and full membership of the payments clearing system, enabling cash withdrawal, card payments and credit transfers are identified as necessary for such entrants to be successful. Access to payment system infrastructure – or lack thereof – has given rise to competition concerns and therefore competition cases in many Member States.

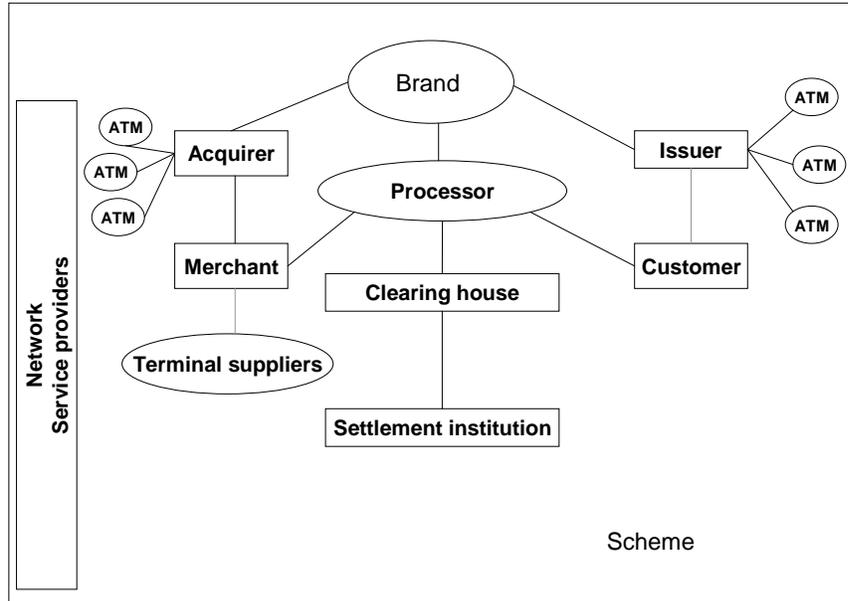
In order to create a greater understanding of these concerns and cases in national markets, we first define the different roles that can be identified in payment systems. In many of the European systems some of these roles are bundled, which appears to have a huge impact on the structure of the market, and the behaviour of the different parties within it.

Description of different roles in payment systems

Participants in payment systems are – apart from regulatory authorities (central banks, financial supervision authorities) – mainly financial institutions (banks), but also third party service providers such as network service providers (NSP) and processors. This section contains a short description of different roles that exist in payment systems based on the example of debit card payments.¹⁵

¹⁵ In reality there are more roles to be identified, but for the purpose of this report this short description of the main roles adds to the understanding of the competition issues with regard to payment systems in different Member States.

Chart 1. Basic roles in debit-card and credit card systems



1. Scheme

A scheme is a set of minimum standards for parties that intend to offer (electronic) payment services to consumers and companies in the market for (electronic) payments. It can for example set minimum safety-standards and standards that ensure interoperability between different payment systems. Institutions can only offer services or products related to (electronic) payments on the market if they have obtained a license from the scheme to do so. The scheme also certifies third parties, such as processors and terminal suppliers, who want to offer their services within the payments system.

2. Brand

A Brand owner is a party that offers card products to the market. The brand owner is responsible for the enhancement of technical product specifications and promotion of the brand.

3. Issuer

The issuer is a bank or an association that issues payment cards to its customers (consumers or companies). It is often also responsible for the authorisation of the payments. Most issuing parties offer their customers the use of ATMs (Automated Teller Machines), that may be part of their own ATM network, or the network of other parties.

4. Acquirer

In case of a debit or a credit card payment, the acquirer contracts merchants who wish to provide their clients with the possibility to pay with a card. The acquirer is responsible for the guaranteed payment to the merchant. Besides signing up merchants to a specific payment card system the acquirer can also provide other services e.g. data-reporting services. In exchange for these services the merchant has to pay a merchant fee to the acquirer. In the case of an interchange fee the acquirer pays a per-transaction fee to the issuer.¹⁶

5. Processor

The processor is responsible for the data-transport and switching of the payment transactions between banks.

6. Clearing House

The Clearing House calculates the net amounts owed between banks over a certain period of time (e.g. daily) and sends this data to the Settlement Institution and the separate banks.

7. Settlement Institution

The Settlement Institution, which is often the Central Bank, is responsible for the payment of the net amounts calculated by the Clearing House and settles the claims between financial institutions.

8. Network Service providers

Network service providers are responsible for the physical network through which payment transactions are processed. These may be wired networks (telephone-lines, cable) or wireless networks (mobile phone networks).

In most national payment systems different roles are combined in one entity, or provided by the state. The most common combinations of these roles are described below.

4.2 REGULATORY FRAMEWORK

Financial Supervision

In order to gain access to the payments market parties must meet technical, financial and operational requirements. First of all, national financial supervisory authorities - mostly central banks - have a very clear and direct influence on access to payment systems, because they issue banking licences. According to the EU Directives concerning Banking Coordination, the status of a bank or credit institution in the Member States is regulated by law. National laws on the legal status and financial

¹⁶ The acquirer may also be the owner of an ATM network that allows other banks' customers to use its ATM-network for cash withdrawals. In that case the issuing party pays an interchange fee to the acquirer for this 'guest-use'

supervision of credit institutions aim to protect the savings of the public and safeguard the smooth functioning of the credit system by laying down rules for the establishment and operation of credit institutions as well as their supervision.

Oversight

In addition to prudential supervision, oversight over payment systems is often seen as essential for the stability of the financial system. Moreover, payment instruments and systems must be secure enough to maintain public confidence in the currency.

In most Member States the central bank has the responsibility of oversight for payment instruments and payment and securities settlement systems. This is due to the fact that this oversight is part of the statutory task assigned to the European System of Central Banks (ESCB).¹⁷ On an international level, central banks participate in the Committee on Payment and Settlement Systems (CPSS). A forum for G 10 central banks to discuss issues relating to payment, settlement, clearing and securities system, the CPSS also sets standards for designing and overseeing payment systems (notably the Core Principles for Systemically Important Payment Systems¹⁸) and securities settlement systems (especially the CPSS/IOSCO Recommendations for Securities Settlement Systems). In addition, the CPSS provides a means for central banks to coordinate oversight.

Although few people would argue against the necessity of at least some degree of supervision, it is widely acknowledged that in the process of issuing banking licences and the oversight on payment systems, no competitive aspects are considered. Despite the fact the Standard IX of these oversight standards requires that "the system should have objective and publicly disclosed criteria for participation, which permit fair and open access", financial supervisors have an intrinsic incentive to focus their efforts on stability rather than on access to payment systems.

Payment schemes

Payment schemes tend to play an important role in access to payment systems. Although they are necessary for a well-functioning and secure payment system, they may create entry barriers. This is because scheme ownership is often in the hands of those parties that have an incentive to prevent new parties from entering the payment systems market. In many Member States these access requirements are self-regulated. However, some NCAs state that regulatory institutions can be closely related to scheme members - in some cases these institutions are mentioned to be a member of scheme-setting bodies; in other Member States, they give approval of terms and conditions of the payment system and membership is compulsory. Some other NCAs

¹⁷ The ESCB consists of the European Central Bank and the central banks of all EU Member States. Article 105 (2) of the Treaty defines as a basic task of the ESCB the promotion of the smooth operation of payment systems. This provision is reiterated in Article 3.1 of the Statute of the ESCB.

¹⁸ In this international context, the Bank of International Settlement (BIS) developed "Core Principles for Systemically Important Payment Systems (Core Principles)", which have been adopted by the governing Council of the ECB and have been transformed in the "Oversight standards for Euro Retail Payment Systems" of the European Central Bank.

mention that information on rules of payment systems and names of participants (direct and indirect), including any changes, have to be handed over to supervisory institutions.¹⁹

In most countries there is no general and complete legal and regulatory framework relating to payment systems, payment service providers or payment instruments. The only exception seems to be Slovakia.²⁰

The responses of NCAs show that scheme-regulating bodies can have as members:

- non-owning members of the payment system;
- owning members of the payment system;
- a board of owners;
- an association of members;
- members/owners and central bank or other overseer; and
- central bank, especially if the central bank is the operator of the system.

Most payment schemes are characterised by a high degree of self-regulation. The majority of national schemes require that issuers and acquirers must have a banking licence. Because of the home-country control principle in banking supervision, this barrier to entry seems to be quite low for new intra-EU entry of foreign banks, at least when entering the market directly. In the case of entry through a merger or acquisition this issue tends to be more complicated, since central banks, under certain circumstances, may forbid a cross-border merger or acquisition from taking place. It is clear, however, that for non-bank parties any scheme rule that permits only banks to participate as issuers or acquirers forms an insurmountable barrier, particularly as for some (mainly non-deposit based) payment products it can be questioned if this rule is essential for stability purposes.

If the overseer is a member of the regulating body, the ability to self-regulate is aided. The overseer can easily be consulted at an early stage of the decision-making process so that the scope for conflicts is reduced. In effect, the co-operation of the regulator and overseer at an early stage encourages responsibility in self-regulation.

4.3 ACCESS TO PAYMENT INFRASTRUCTURES

Introduction

Parties must also have access to the processing and clearing circuit in order to effect payment transactions if they want to offer their services through a national payment system. Access to clearing facilities therefore plays a crucial role in the effectiveness of market entry strategies outside of a merger or acquisition. Some of those systems are directly linked to the underlying form of payments, for instance credit and debit card

¹⁹ For more details see Annex 6.

²⁰ The rules for the only RTGS payment system in Slovakia are laid down in an Act of the payment system. The National Bank of Slovakia issues the rules for the access to the payment system and both coordinates and controls access of the participants.

schemes which not only offer licences and support, but also processing and clearing services for retail payments.

In practice there are two different types of clearing systems that can be distinguished: payment systems with bilateral clearing, and payment systems with central clearing facilities.

Bilateral clearing

There are only a few national payment systems with payments being completed on a bilateral basis. In a bilateral system the interbank clearing of retail payments is effected by direct contact between the payer's and the payee's banks without any further involvement of third party clearing facilities. Examples for this kind of payment systems may be found in Ireland, Germany and United Kingdom²¹. The common characteristic of those systems is a limited number of participants (however not necessarily limited in a regulatory sense) that could make bilateral retail payment clearing feasible from an economic point of view.

Central clearing facilities under private ownership

Central clearing facilities are often under private ownership, but in some payment systems they are operated by the central bank. Irrespective of their ownership, central clearing facilities function as a central hub with regard to retail payments and/or are intermediaries between the parties involved. In several cases these central clearing facilities also have the role of (central) payment processor.

The use of central clearing facilities operated by private companies seems to be a common standard for the clearing of retail payments in nearly all EEA countries. In some other Member States - such as Denmark, France, Ireland, the Netherlands, Norway, Poland and the United Kingdom - the clearing may be exclusively based upon these privately-operated clearing facilities, i.e. there are no additional or alternative clearing facilities for retail payments operated by the respective Central Banks.²²

Clearing of payments via a privately operated central hub can either be operated for all (or at least most) payment instruments and clearing facilities or for one or two specific payment instruments only. For example, in Norway the debit card clearing system (BankAsept²³) is a specific debit card system.²⁴

Even if Central Banks are often not directly involved in the day-to-day clearing operations of privately-operated clearing facilities, they act as settlement agents as all transactions normally have to be settled in Central Bank money at the end of the

²¹ See Annex 1.

²² See Annex 2.

²³ See Annex 2 for a description of the system.

²⁴ Similar debit card systems also exist in Belgium (Banksys), Denmark (Dankort), Latvia (BSC), Portugal (Multibanco) and Slovenia (Bankart, Activa).

clearing process. Central Banks may also be one of the system's direct participants and sometimes even among the system's shareholders.²⁵

Central clearing facilities under Central Bank ownership

In those cases in which the Central Banks are directly involved in the clearing system, they do not only operate those systems but are also their sole owners.²⁶ Central clearing facilities operated by the Central Bank are much less specialized with regard to the forms of payments that are cleared and settled by them than the privately-owned and operated payment systems. Most Central Bank clearing facilities offer their services for all or at least a multitude of retail payment instruments.

4.4 COMPETITION ISSUES IN NATIONAL PAYMENT SYSTEMS

According to the responses from NCAs, competition concerns arise particularly with respect to access barriers and a lack of price competition between incumbent participants of payment systems.

Some NCAs also identified vertical anti-competitive agreements between banks and retailers as a serious threat to competition. More specifically, three issues arose:

- Scheme governance;
- Dominant positions; and
- Bundling of roles.

Scheme Governance

In most countries access conditions are set by the incumbent members/owners. In two countries the incumbent members/owners are indirectly represented on the body regulating access conditions. In one country (Slovenia) the access conditions set by the incumbent members/owners have to be authorised by the central bank. In two countries the access conditions are set by the central bank, partly due to the fact that the central bank is the operator of the system.

In most payment systems the approval of prospective members' application is given by the existing members.²⁷ In those two payment systems in which access conditions are set by the central bank, approval of applications for access is also given by the central bank.

²⁵ The latter is the case for example in Denmark (PBS), France (SIT), Ireland (IPCC), Poland (ELIXIR, EuroELIXIR) and United Kingdom (C&CCC).

²⁶ One exception of this rule is the Malta Clearing House (MCH) which is jointly owned by the Maltese Central Bank and a couple of credit and financial institutions.

²⁷ A payment system can be based on multilateral agreements or a network of bilateral agreements. In systems based on multilateral agreements, membership approval is mostly given by a central board or institution. If a bilateral system is operated, prospective members need to engage with each existing member in order to agree the details of information exchange protocols. Therefore the membership applications are assessed by the existing members. This is for example the case in the Irish clearing system.

There are a number of issues that relate to scheme governance, including objectivity of scheme rules and management, direct and indirect membership and access prices. The impact on access of each of these categories is detailed below. For further details of specific responses of individual countries, please refer to Annex 7.

Objectivity of scheme rules and management

Although some barriers to access are natural and unavoidable - and may even lead to increased reliability and efficiency - others are not (strictly) necessary for the efficient running of payment systems and need to be carefully examined to determine their effect upon competition. In many cases these rules are set by incumbent members who do not have any incentive to keep entry barriers as low as possible. Unsurprisingly, fees for using the payment systems appear to be relatively high and discriminatory. Furthermore, prospective members do not have an opportunity to appeal against decisions, at least not with an independent arbitration body. Some NCAs stated that despite this, access has never been denied as long as the relevant access criteria were fulfilled. This may however be influenced by the perception of potential new members that their chances of being accepted are low.

Direct and indirect membership

In many Member States, there is a two-tier system of membership in payment systems – direct and indirect. However, the precise arrangements in each member state vary widely. In *Belgium*, for example, direct member banks are bound by contracts that protect the interests of indirect member banks. The Belgian NCA compares this two-tier system with the ‘Third Party Access’ prevailing in network industries like electricity, gas and telecommunications: Large banks have to supply a kind of ‘wholesale access service’ for the sake of smaller banks. There are similar systems in other countries, such as in *Germany*. In all these cases full membership is not regarded as necessary to achieve effective competition – as long as the access rules and approvals for non-members are set in a non-discriminatory way.

Access prices

Apart from regulatory obstacles to entry of a payment system, the costs - i.e. fees - for using it may prevent (or at least hinder) access of new participants.

The *Danish* CA is currently investigating a complaint from a smaller bank claiming that infrastructure prices are unreasonably high and hence favour larger banks. However, the *Polish* CA felt that costs of participation in its payment system did not present an obstacle for its participants.

Access in the eyes of NCAs

Many NCAs agreed that full membership of a clearing system is important for competition. Difficulties in access to clearing services on an equal footing can create barriers to entry into other markets, such as full-service retail banking. This is because clearing access is required to provide money transmission services which in some

markets, such as *Ireland*, act as a key gateway product, used to cross-sell other financial products and services to consumers.²⁸

Dominant market positions

As described in the first chapter, concentrations in the different national banking markets are moderate to high. These concentration ratios already form a risk to competition. In payment systems it can be argued that the risk of collusion is even higher, since cooperation between competitors is needed for the system to work.

In addition to the lack of competition between incumbent banks and new entrants, there may also be a similar lack of competition between those credit institutions and other players within the payment system. In some cases, central clearing facilities or processors (mostly owned by banks) have a dominant market position, since it is impossible to offer payments services without their cooperation. The existence of only one network service provider or a single payment processor (e.g. in *Latvia*) may lead to higher than competitive prices for network services. The same is true when banks, in their role as issuers or acquirers, or service providers (NSPs, Processors) have implemented identical fees for the different services and thus eliminated price competition.

In many cases different roles that are crucial for access to payment schemes (such as clearing and processing, branding and processing) are combined by a single body. In some cases there is even only one acquirer in the market that sets the prices for merchants.

Below, we consider the implications for competition of access to ATMs, service provider fees and interchange & clearing fees. Further details of country-specific investigations are given in Annex 7.

Access to Third-Party Automatic Teller Machines

For customers, access to an Automatic Teller Machine (ATM) network – wherever and whenever they prefer cash payment – is indispensable. Thus for banks, a widespread and dense ATM network is a competitive advantage, whereas smaller banks, without such a presence, heavily depend on access to other banks' ATMs. Due to this, competition concerns may arise firstly from restricted access to competitors' ATMs and secondly from excessively high customer fees for using a third party's infrastructure.

Service provider fees

There are several investigations underway in a number of countries with regards to the fees that processors charge for retail payments.²⁹ If these charges are found to be excessively high, this can be evidence of collusion on the part of the banks or can lead to a lessening of competition amongst those paying the fees and potentially higher prices for consumers.

²⁸ For further details, please see Annex 7.

²⁹ For further details of these investigations, see Annex 7.

Interchange and clearing fees

In theory, interchange fees may add to an increased welfare level. If interchange fees are set too high, this may reflect a lack of competition between suppliers or even from collusive behaviour, e.g. when there is an identical interchange fee for all transactions between issuers and any acquirers.

So far however, there has been little coordination between NCAs on the judgment of interchange fees, despite the fact that there are competition cases relating to interchange fees in many Member States. Some examples of investigations on interchange fees are described in Annex 7.³⁰

Vertical integration problems

NCAs in Malta and Portugal have identified anti-competitive agreements between petrol retailers and banks; both involving the abuse of a dominant position.³¹

4.5 POSSIBLE SOLUTIONS IN NATIONAL PAYMENT SYSTEMS

Applicability of Articles 81 & 82 (EC)

In most Member States there is no automatic participation of the competition authorities in the setting of access conditions and therefore no ex-ante review of these rules in the light of competition concerns. Since the Council Regulation 1/2003 EC came into force in May 2004, new rules have to be examined ex officio (since there is no more obligation to notify them) or following a complaint. Most national competition laws have been adapted to the system of legal exemption. However, national competition authorities still have the ability to investigate possible infringements of Articles 81 & 82 under respective national competition laws.

Providers of retail payment clearing and settlement systems are normally addressees of Article 82 of the EC Treaty because of their dominant market position as well as addressees of Article 81 as they are frequently jointly owned by several financial institutions. These rules could be applicable, for example, in the case of identical and/or excessively high multilateral interchange fees (as in Spain, the UK and Germany), excessive fees for debit card processing (as occurred in the Netherlands), as well as in discriminatory decisions on membership and discriminatory pricing of system access and use.

Those NCAs who have not yet taken a closer look at their national payment systems should be encouraged to do so, as the problems that seem to arise in this sector are likely not to be limited to certain Member States. At least a limited awareness for possible anticompetitive developments within the payment systems sector seems to be advisable. ECA and ECN provide a good basis for the exchange of experiences among the NCAs, e.g. concerning research methods and other matters.

³⁰ There are also investigations underway in some countries relating to charges for processing internet-initiated payments, with similar competition concerns to those set out above (for details see Annex 7).

³¹ The issues and details of both cases are set out in Annex 7.

Non-discriminatory access to payment and clearing systems

Competition concerns in this field may arise from:

- (1) access to membership in the payment and clearing systems;
- (2) possible disadvantages of being an indirect member in two-tier systems;
- (3) high transaction costs in bilateral clearing systems; and
- (4) discriminatory pricing for the access and the use of payment and clearing systems.

- (1) If membership in payment or clearing systems is obligatory, a non-discriminatory option for membership must be regarded as essential for all participants in that sector. Since there is some kind of self-regulation of systems in most countries, incumbent members of the payment system normally decide on membership of new members. In order to ensure non-discrimination, there should be clear and transparent procedures for evaluating and admitting new members as well as transparent decision-making within the body responsible. This can, in addition, be strengthened by the appointment of independent experts to the approving body.
- (2) Not being a member of any payment or clearing system may not necessarily be a competitive disadvantage, as long as there is a non-discriminatory access to the system as an indirect participant – comparable to third-party access to railway and energy infrastructure. As in the case of membership approval, incumbent members of the payment system normally also decide on access of indirect participants to the respective system. Similarly, non-discriminatory access should be guaranteed by transparent decision-making and the appointment of independent experts in the approving body. A possible solution to other problems regarding indirect access may be – as in Belgium – contracts to protect the interests of indirect members by obliging the member banks to supply a form of wholesale access service for indirect member banks.
- (3) Competition may be limited by the bilateral nature of some clearing systems – such as in Ireland – due to delays in gaining access for new members until every incumbent has concluded all necessary steps. Structural arrangements could be implemented which allow membership or entrance without having to negotiate with each and every incumbent member. A standard clearing contract with general criteria and simultaneous negotiations is one example of this.
- (4) In some cases, the high costs of joining a payment or clearing system - as a full or indirect member - constitute a barrier to entry (e.g. for smaller banks or niche players with very low volumes). In order to ensure non-discrimination, the setting of fees should be subject to clear and transparent procedures as well as transparent decision-making within the responsible body of the payment system, which may possibly be aided by appointing independent experts in the approving body. A standard fee for all participants may be – from a competition point of view – the best option for non-discriminatory access, as long as the fee level is not prohibitively high, thus creating a barrier to entry for smaller banks. As some extant cases (e.g. in Sweden) show, discount pricing systems for access and use may constitute a barrier to access, especially for smaller banks. Therefore, specific fee patterns might require careful examination to assess whether they are cost-

based (e.g. two-part pricing, which automatically leads to discounted prices for larger entities) or strategic tools used to restrict market access for competitors.

Unbundling of roles

Formal separation of roles (e.g. branding from processing, system provision from value-added services) in the payment system is another way of increasing competitive pressure on incumbent participants. From an economic point of view, only in some existing payment systems – if any (e.g. possibly in smaller countries) – is a one-supplier situation possibly justified. However, additional services to that respective system do not necessarily need to be provided by the incumbent provider, but can alternatively be supplied by independent firms (e.g. network service providers, independent processors, acquiring processors).

In some countries (e.g. Germany), these additional services are already supplied by independent undertakings. The Dutch Central Bank, in the so called Wellink Report (2002), recommended establishing decentralised access points with respect to the debit card and e-purse product bundle. Furthermore, to increase transparency and competition within the Dutch market for electronic payments, the system provider Interpay has transferred the ownership of brands such as PIN and Chipknip to a new company called “Currence”, that was established in 2005 by the eight banks (the stockholders of Interpay).³² This could be seen as an example of a first step towards “unbundling” of services within the payments systems market.

Genuine competition, however, can only arise when there is not just a formal separation between providers, but also – as a second step – a separation in ownership of the different players in the system. This might be a way to strengthen competition among the players in payment systems as well as enabling (at least partial) entry of independent suppliers for services within these systems.

CONCLUSIONS

Technical standards and operational matters of payment systems are often set and managed through self-regulation. This may be managed through a scheme-setting body, which in many cases is also responsible for setting and enforcing access rules with regard to clearing and processing. The access conditions of these bodies can be categorised as follows:

- Setting the rules for licenses to provide payment services (banking licence or licence from other regulated financial institution);
- Adherence to (technical) conditions; and
- Payment of access fees (in some cases).

³² For further details of these arrangements, please see Annex 7.

NCA's are of the opinion that in some Member States, the access to payment markets may be restricted by unnecessarily high barriers, which may be reinforced through prohibitive access conditions and the bundling of payment services.

RECOMMENDATIONS

4. In order to create more open national payment markets in those cases where technical and operational matters of payment systems are set and managed through one or more central self-regulating bodies, the Working Group recommends NCA's to consider the promotion of:
 - a. transparent, open payment standards and objective membership criteria to payment schemes (i.e. non-discriminatory access rules);
 - b. if workable, a clear legal (and practical) separation between management and ownership of access rules for payment schemes;
 - c. unbundling in the supply of payment services (e.g. branding and processing) where other, less potentially anti-competitive, solutions are available; and
 - d. the introduction of stakeholder-involvement (within the normal provisions of competition law) to ensure the consultation of stakeholders (customers) on access rules.

This could be done as part of an investigation into possible breaches by national payments systems of art. 81 and 82 of the Treaty (or national competition law), or through advocacy, depending on both the legal mandate and the resources of each individual NCA.

SECTION 5 THE SINGLE EUROPEAN PAYMENT AREA

5.1 THE IDEAL OF SEPA

In the introduction of the Consultative paper on SEPA Incentives of 13 February 2006 (referred to below as the “Incentives Paper”), the Commission expressed its expectation that “the realisation of the Single Euro Payment Area (SEPA) will result in tremendous gains in potential savings for society to bring benefits to all stakeholders. An efficient single market for payment services will increase competition, facilitate new business opportunities, the realisation of economies of scale and foster specialisation and innovation.” According to this same introduction, “the Single Euro Payment Area requires the removal of legal, commercial and technical barriers that keep national markets apart”.

Through several public statements on the proposed time schedule and pace of the SEPA process thus far, the Commission prompted the European Payments Council (EPC, a body comprised of European banks that is managing the transition to SEPA) into expediting its processes for developing new SEPA-compliant schemes, including both technical and commercial standards, for the purpose of achieving pan-European inter-operable payment solutions and infrastructures. In the Incentives Paper, the Commission also warns that “...products based on the schemes as currently developed may not be persuasive to all end users.”

Are the Commission’s fears well-founded? It is widely acknowledged that people do not change their payment habits overnight. However, if the transition is to be ‘market-driven’, than end users should at least be aware of the SEPA process and the advantages it may bring them, in terms of lower prices and improved service.

From the questionnaire responses, it seems that many NCAs are generally not very well-informed on SEPA issues. Across the whole of Europe, few people seem to be aware of the existence, aim, content, potential impact and the time schedule of the SEPA process. Furthermore, based on the information available to them, no single NCA could predict if, to what extent and under what specific conditions end users might gain from SEPA. What we do know is that any agreement that reduces competition has to meet with the exemption criteria under Article 81 of the Treaty. We have set out below a description of possible competition issues that may arise in the process towards the realisation of SEPA and main principles that could be used as solutions to these problems.

5.2 COMPETITION ISSUES AND WAYS TO ADDRESS THEM

Competition between schemes

There are likely to be two contrasting dynamic effects at work with regard to concentration in the payment systems market under SEPA. The first would be that SEPA’s focus on electronic payment methods – which are cheaper than paper-based and cash payment instruments – may lower barriers to entry to new entrants, which could lead to increased efficiency and lower prices to end users. The other effect would

be that economies of scale and scope will, once realised, lead to at least some consolidation in payment services, as acknowledged by the European Commission in its Incentives Paper³³.

It is not obvious, a priori, which of these effects is likely to dominate. SEPA could, by design, lead to the elimination of direct competition between schemes – i.e. it could be the case that not more than one direct debit or direct credit scheme remains – due to national schemes being brought under a single European-wide structure. However, it was suggested by one NCA that competition may additionally arise through the entry of different brands offering alternative payment products under the same scheme.

Competition between infrastructures

In the Roadmap³⁴, the EPC supported the separation of scheme and infrastructure as a matter of principle under SEPA. This is also supported by NCAs in their responses to the questionnaire, as it should lead to increased competition amongst infrastructure providers, provided that the contract for the scheme's payment processing is opened up to regular competitive tendering. The consequences of this competition should allow for increased efficiency and lower end prices to customers.

Additionally, it was suggested that this scheme-infrastructure separation should address the potential negative impact on innovation incentives for both scheme and infrastructure companies. For example, if there is to be competition between brands, brand-owners may have an incentive to choose only processing parties that are closely related to that brand-owner. This could lead to issuers and acquirers having limited opportunities to choose between different infrastructure companies (clearing houses and processors) in the market and hence a reduction in competition. This would have long-run dynamic implications for innovation, as there are then reduced incentives for the chosen infrastructure company to innovate as it can be assured of being chosen ahead of others without such innovation.

Under conditions of mutual governance in the current market, there can also be incentives for members of the current national payment schemes to choose infrastructure companies in which they have an investment to provide payment processing services to that scheme, even if that infrastructure company may not provide the best offering amongst its competitors. This would have the same long-run dynamic implications for innovation, as described above.

Retail bank competition

No specific ideas were put forward by respondents on the expected impact of SEPA on retail bank competition. This is likely to be because it will be very difficult to predict what may happen while so much of the details of SEPA schemes is not yet decided on.

³³p.6, 'Consultative paper on SEPA incentives', 13 Feb 2006. Available at: http://europa.eu.int/comm/internal_market/payments/docs/sepa/sepa-2006_02_13.pdf

³⁴ Roadmap 2004-2010: "Realisation of the Single Euro Payments Area" (Dec 2004).

It was felt that large corporates might have more buyer power under SEPA, which would enable them to squeeze the margins for retail banks serving this sector and would have consequent impacts on competition. Regarding competition for SMEs, it was suggested that there would be little impact for firms with mainly domestically-oriented trade, but potentially increased competition for firms which trade regularly with other countries.

It has also been suggested that national retail banking markets will persist for consumers and most consolidation in retail banking will happen through acquisition of foreign banks, whilst still maintaining extant domestic branding due to consumers' loyalty.

There were few responses on the mode of competition. However, one country raised the possibility that cross-subsidisation between payment systems might end under SEPA – for example, using revenues raised by administering credit cards to offer more attractive packages for standard account payment services (e.g. direct credits, transfers, cash provision).

The recent ECB³⁵ report on EU banking structures shows that international banks in the EU together hold, on average, 40% share of (the value of total assets) home market balances, and their importance has grown significantly since 2001. However, some of these banks hold an even more dominant position in certain countries than in their home country. In order to gain from economies of scale, these banks have the most to gain from, hence the largest incentive to achieve, cross-border product standardisation.

Barriers to trans-national trade

Almost all countries agreed that the introduction of SEPA would lead to lower barriers for international trade, particularly for business-to-business payments. This would therefore lead to substantial savings for SMEs and corporates involved in international trade. However, the impact of SEPA on retail prices is likely to depend on the degree of competition in their respective domestic banking markets, with a substantial degree of education required for consumers to reap the benefits of increased choice when making cross-border payments.

In summary, much is still unknown about the likely effects on competition under SEPA. The proposed separation of schemes and their respective infrastructure is likely to increase competition between payment processing companies, though competition between schemes would be abolished – the only competition to remain at this level would be between brands as part of the same scheme. Although most respondents agree that SEPA will reduce barriers to international trade, SMEs and corporates are likely to be the major beneficiaries of this through lower transaction costs, along with increased competition amongst retail banking for these sectors.

³⁵ page 37.

Harmonised Payment Schemes Rules

Development of scheme rules

A number of countries were not very familiar with the current specification of the SEPA scheme rules, which is likely to reflect the varied contribution each NCA has been able to make to its country's SEPA consultation (see below).

Many NCAs expressed a preference for SEPA schemes to be a 'minimum standard' framework, beyond which banks would be able to offer value added services through competition. However, many NCAs recognised the trade-off between this 'minimum' level and the reach of the SEPA schemes. It was appreciated that the current specification reflected the scope necessary in order to achieve Europe-wide application of scheme rules.

Impact on functionality

Despite this, some NCAs felt that this 'minimum standard' had not been set high enough and banks, by being SEPA-compliant, would in fact be offering a worse service relative to what was available in their respective countries now. Obviously, this assessment depends on the initial conditions in the country and so responses varied widely on this point – some felt SEPA would represent a significant improvement on current offerings, whereas others felt the innovation of their domestic banking sector would be stifled.

Concerns were also expressed about a lack of flexibility to innovate under SEPA scheme rules in providing local-specific payment instruments. The adoption of SEPA payment instruments will depend on the extent to which they are useful in delivering what end customers want to use and for some countries the current incarnation of SEPA scheme rules means that they will not be able to provide this. Many countries were keen to emphasise the need for a market-based approach in SEPA migration, which would lead to the adoption of the most efficient infrastructures and schemes.

Implementation costs

It was widely recognised that substantial investments would be necessary to implement SEPA, which would mostly fall on corporates and banks. This would entail the updating of legacy systems, IT infrastructure investment and would likely mean an increase in consumer prices, at least in the short run. Economies of scale and scope should lead to a reduction in prices over time.

It was also possible that there could be an asymmetric distribution of costs and benefits during the introduction of SEPA, with the majority of costs ultimately borne by consumers in the form of higher prices, whilst the banking and corporate sectors would be the main beneficiaries through lower transaction costs and cost savings in back-office payment processing.

Overall, the responses seemed to indicate that many NCAs are not content with the scheme rules as they stand. This does not bode well considering the recent adoption of

the rules by the EPC Plenary. There also seems to be a general lack of understanding around the details of the schemes, which may mitigate some countries' concerns. With implementation costs likely to be very high it would be better to invest wisely once and clearly within the boundaries of competition law and according to the wishes of customers, rather than have to reformat the schemes following the introduction.

Access and Governance

Evaluation of existing access & governance arrangements

There has so far been limited work done by NCAs on evaluating their domestic access and governance arrangements, though many countries are looking to do so in the near future. The UK, Ireland and the Netherlands have recently completed studies in these areas and set out some guiding principles from their findings, which they feel are relevant to the design of SEPA schemes, including the problems which these measures can remedy:

1. SEPA schemes should have independent directors, to represent those stakeholders who cannot effectively represent themselves. These directors should assist in balancing the views of different shareholders to ensure that small shareholders are not unreasonably affected by the decisions of larger scheme shareholders, as well as encouraging innovation by providing alternative, non-bank perspectives without having loyalties to a particular scheme member bank, that may have an interest in maintaining the status quo.
2. SEPA schemes should widen existing consultation processes to include end users, so that they are well-informed and able to provide input on how SEPA schemes should operate, including how these schemes intend to innovate. End users should also have the facility to feed these views into scheme boards.
3. Access criteria should be clear and objective. This was identified as a particular problem if existing members approve membership applications, as access criteria can lead to potential members being purposefully excluded, which can have negative impacts on competition and the pace of innovation.
4. Transparency can ensure effective monitoring against scheme objectives and worthwhile input to scheme processes and consultation. Well-specified scheme objectives are also of prime importance, as they determine the incentives facing scheme members and therefore how the scheme operates in fulfilling its mandate.
5. If voting thresholds are not set appropriately, bank members may be able to form either a blocking minority, to stop effective or innovative reforms, or a majority to force through changes even if other smaller scheme members may object.
6. Wider ownership of payment infrastructure companies beyond current owners or financial institutions could lead to greater incentives to innovate and can mitigate problems of mutual governance.

Customer mobility under SEPA

No NCA thought customer mobility to be more of an issue under SEPA than currently. When discussing the issue in the Working Group it was widely recognised that, bearing in mind the ideal of the Commission to create a single European market in which there is cross-border competition between payment service providers, customers (both private and business) should be able to switch to a bank in another Member State as easily as they can switch to a bank in their own country. The Working Group is well aware that there are still legal barriers to this, but remains convinced that effective competition, based on a European level playing field, can only exist once these legal barriers have been removed.

The creation of a consistent European system of bank account numbers would create the possibility of the introduction of ‘number portability’ on a European level, which the Working Group feels would be the ideal scenario. However, the Working Group is well aware that the costs of investment in achieving this would be huge. This, however, could be more than matched by the long run economic benefits of increased cross-border mobility and the creation of a level playing field in the European payment systems sector.

A short-run solution could be the harmonisation of existing domestic switching facilities, as national best practices have proved effective in increasing customer mobility.

Appropriate fora to influence decision-making within systems

Various suggestions were made for routes by which decision-making could be influenced under SEPA. EuroCommerce was frequently mentioned by respondents, though it was suggested that its membership was not wide enough in key sectors to provide an effective representation. The EPC could also be utilised for this purpose, but it was recognised that current demands mean that resource constraints might make contributing via the EPC unfeasible.

It was generally felt that a single organisation appropriate for engaging in payment systems issues had not yet emerged. However, the creation of a ‘payment systems user forum’ was not seen as a suitable solution. Rather, it was suggested that existing national representative bodies could be used, perhaps through a confederation of these, to discuss and report on payment systems issues.

Although many NCAs have not yet had time to consider in depth the access and governance conditions of domestic schemes, let alone those proposed under SEPA, there are already many suggestions that have been made to help in these schemes’ design. Further work may be necessary in a number of key areas to ensure that these suggestions are considered so that SEPA delivers the necessary incentives and achieves the EPC’s vision.

5.3 THE ROLE OF THE NATIONAL COMPETITION AUTHORITIES

Involvement in the process

There is a considerable contrast in the amount of consultation with which NCAs have been involved in the development of SEPA. At the time of the survey, which was a considerable way into the development of the SEPA schemes by the EPC, many NCAs (including France, Germany, Hungary, Lithuania, Latvia, the Netherlands, and the Slovak Republic) had not been involved in formal consultation with their domestic banks or banking associations. To these we must add the countries which felt that they were not in any position to reply to the section on SEPA as they were not sufficiently aware of the issues to submit a response.

Only a few NCAs (Malta, Denmark, Ireland and the UK) have had any type of formal communication with their national banking system while Belgium has had informal discussions only.

Role of NCAs in SEPA development

Almost all respondents stated that there is definitely a role for NCAs in the development of SEPA. NCAs have a role towards customers on a variety of issues. These include:

- Ensuring Financial Service Providers:
 - satisfactorily inform consumers about SEPA;
 - do not engage in abuse of a dominant position through sales practices;
 - do not engage in anti-competitive practices; and
- Giving consumers a substantive and full service.

NCAs feel SEPA needs to be developed in a way that avoids providing incumbents in the payments market with any advantage over potential new entrants, thereby creating potential barriers to entry. Any barriers to entry or exit must not negatively impact on consumers' interests. Barriers that do exist need to be evaluated properly to ensure that they are necessary.

There were few suggestions on how further involvement could or should occur. However, it was noted that if previous work had been done on payment systems by NCAs, it was only within their domestic systems. Given the concept behind the SEPA initiative it was suggested that in the future NCAs would need to be more co-operative and communicative in addressing competition concerns in payment services.

It was made clear that, in countries where NCAs do have some current involvement in SEPA, this involvement tends to be in the form of Government-wide interest groups, including Finance Ministries, Central Banks and other interested bodies. These forums are either government- or industry-led, varying between different countries.

One respondent added that the ‘New Legal Framework for Payments in the Internal Market’ will not bring about the expected ‘level playing field’ in the payment services market. The provision for national exceptions means that some domestic banks may find that their local requirements are far more detailed than their cross-border ones and they will not have the incentives to set up a dual system. This would in turn mean that NCAs would find themselves looking at competition concerns across more types of payments schemes than they currently do, which appears to run contrary to the harmonisation goals of SEPA.

In summary, the NCAs thought that they have a role in ensuring a better functioning system; however, given that there has been a considerable amount of communication between the EPC and National Banking Organisations, this raises concerns for the competition authorities. Currently, the mechanisms to ensure that NCAs could fulfil their roles are not in place. Hence there remain competition concerns about the current arrangements in establishing the SEPA schemes.

CONCLUSIONS

It is not clear to NCAs that the current process towards SEPA will lead to more competition, lower prices and better services for end users. More consultation is needed on SEPA. The tight deadlines imposed on the EPC mean that time for this consultation is already running out. This Working Group would echo the views of the Commission: “Effective competition...greatly promotes user adoption of the new products and improves legitimacy of the process”³⁶; and that it is “...preferable to involve users at an early stage of scheme development to ensure user requirements are met.”³⁷

It is thought that prices may increase in the short-term – due to the substantial investment involved in making domestic payment systems SEPA-compliant – but fall in the medium to long-term, as economies of scale and scope are realised. It is clearly important that end users should benefit from these advantages of SEPA, though the degree to which these benefits will be realised may depend on the current level of competition within domestic banking markets.

Innovation and transparency of payment services are another area in which domestic conditions determine the extent to which users will benefit from SEPA. Although most of the details regarding SEPA have yet to be finalised, certain access & governance principles identified by NCAs as best practice in their own countries – e.g. independent directors, voting thresholds, objective access criteria – could help to avoid potential problems in achieving the SEPA vision.

Additionally, there are also a few principles included in the Commission’s SEPA Incentives paper which this Working Group would support:

³⁶ p.8, ‘Consultative paper on SEPA incentives’, 13 Feb 2006

³⁷ p.15, ‘Consultative paper on SEPA incentives’, 13 Feb 2006

- Market-based approach for SEPA migration;
- Separation of scheme and infrastructure; and
- Non-exclusion of non-bank payment service providers from governance.

NCA's believe that customer mobility is also an important issue in creating SEPA. Subject to the abolition of existing legal barriers to cross-border switching, the introduction of European account numbers and 'number portability' could – in the long run – be the best way forward, depending on the expected costs and benefits. An alternative would be to introduce a European switching facility, or at least the harmonisation of national switching facilities.

Clarity on the extent to which the Commission intends to implement these changes would give national authorities the possibility to adapt their national policy strategies on this point, as they may want to improve customer mobility within their own country.

RECOMMENDATIONS

NCA's are of the opinion that competition issues with regard to SEPA have not been properly examined so far. NCA's support the work of the Commission in improving openness, transparency and consistency in European payment systems through the New Legal Framework for Payments in the Internal Market. The Working Group:

5. Is of the opinion that the proposal for a New Legal Framework (NLF) for Payments in the Internal Market should be strengthened in order to ensure transparent and non-discriminatory terms of access for services provided by infrastructures. This can be achieved by an elaboration of article 23 in the proposed Directive COM(2005) 603 final.
6. Advises NCA's to be more active with regard to SEPA, to ensure that all participants benefit from competition in SEPA.

ANNEX 1

Table 1 Concentration in national retail banking markets
(% of all Member States)

	Low	Moderate	High
Full service banks (based on total assets)	18	47	35
Consumer credits to households	8	58	33
Lending to SMEs	9	36	55
Deposits and mortgage loans to households	9	44	46
Deposits made by SMEs	13	37	51

Source: ECA Questionnaire.

Table 2 Developments in concentration ratio's as mentioned by NCA's
(% of all Member States)

Period	Large increase	Moderate increase	Stable	Decrease
1995-2000	56	33	11	0
2000-2005	0	48	5	47

Source: ECA Questionnaire.

Table 3 Entry and Exit over 1995-2005
(% of all Member States)

	Substantial	Low	No
Entry	23	69	8
Exit	29	43	12

Source: ECA Questionnaire.

Table 4 NCA's that mentioned a particular entry-strategy
(% of all Member States)

Mergers and acquisitions	54
Specialisation in niche markets	53
Market penetration through internet banking	41
Full service banking	29
Organic growth	11

Source: ECA Questionnaire.

Table 5 Profit rates
(% of all Member States)

	High	Moderate	Low
Current rates	49	51	0
	Increasing	Stable	Decreasing
Recent developments 2000-2005	77	23	0
	Increasing	Stable	Decreasing
Developments over 1995-2000	28	29	43

Source: ECA Questionnaire.

Table 6 Aggressive competition in product markets
 (% of all Member States that mentioned a particular product market)

Product Market	Percentage
Mortgages to consumers	35
Consumer credits	12
Savings deposits	12
Financing of corporations	12
Internet banking	12
Credit cards	6
Current accounts	6
All segments	4

Source: ECA Questionnaire.

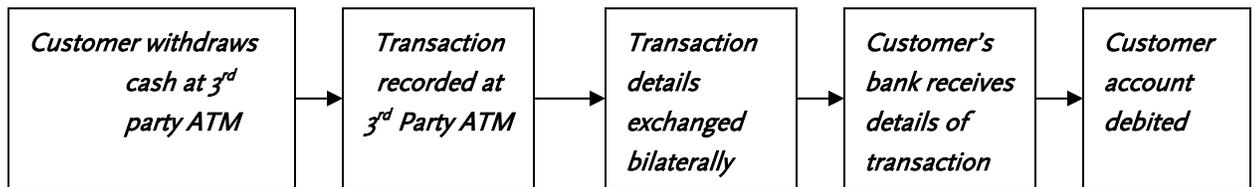
ANNEX 2

Bilateral Clearing in Payment Systems

Bilateral clearing of retail payments is probably most common in *Ireland*. In Ireland there are three different bilateral schemes depending on the means of payment (automated teller machine, paper based transactions, electronic transactions):

Firstly, there is a series of bilateral arrangements between the five Irish credit institutions that own and operate their own automated teller machine (ATM) networks. There is no central ATM clearing hub, but the five ATM networks are interlinked. An ATM card that has been issued by any of the five retail-clearing institutions may gain access to the system via any ATM (see figure 1). All of these networks accept a wide range of national and international card brands and schemes.

Figure 1: ATM cash withdrawal with bilateral clearing (Ireland)



Secondly, paper instrument based transactions (mainly cheques) are cleared through the Irish Paper Clearing Company (IPCC). IPCC has eight full members (AIB, Bank of Ireland, Bank of Scotland (Ireland), CBFSAI, BNP Paribas, National Irish Bank, Permanent tsb, Ulster Bank) and six associate members (ABN AMRO, Bank of America, Barclays Bank, Citibank, HSBC, ING Bank).

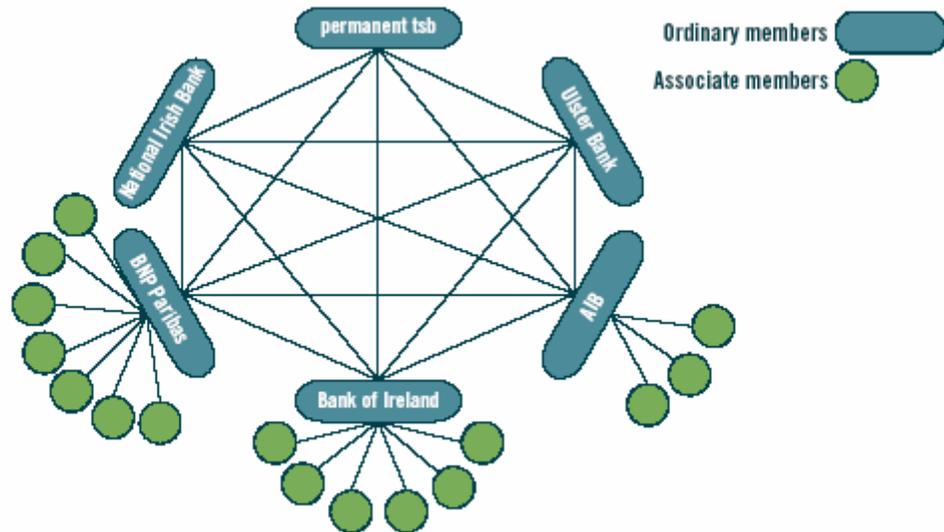
The bilateral payment clearing system is arranged as follows:

- Step 1: The buyer pays for a good or service using a cheque drawn on his/her current account in Bank A, accompanied by a cheque guarantee card, if requested.
- Step 2: The vendor accepts the cheque and lodges it to his/her account in his/her bank (Bank Z).
- Step 3: That evening, the cheque is processed through the Bank Z's in-clearing process, which processes all paper items from all banks, lodged in Bank Z's branches during the day.
- Step 4: Bank Z records a value against the cheque and sorts it along with all the other cheques drawn on Bank A. All cheques drawn on other institutions are then prepared for physical dispatch to the other banks' clearing operations.

- Step 5: The following morning, Bank A receives and processes all paper items drawn on it, transacted in other banks' branches. This is known as the out-clearing process.
- Step 6: During the out-clearing process, Bank A verifies that the cheque is authentic and that there are sufficient funds in the customer's account to complete the payment.
- Step 7: If no problems arise, funds are transferred from the buyer's account to the vendor's account. If the cheque "bounces", both the vendor and the buyer are notified. This stage is known as Exchange Settlement. Settlement is facilitated by the Central Bank and is conducted by fax. A first settlement, for all items of value under € 20,000 occurs at 10.30 a.m., while a second settlement for items exchanged on the 2nd exchange over that value occurs at 1.45 p.m..

Apparently, IPCC does not act as a central hub (see figure 2). It rather serves as a vehicle for the definition of rules and the establishment of information exchange protocols with all members of IPCC in order to bilaterally clear paper based payments.

Figure 2: Structure of IPCC and IRECC (Ireland)



The central clearing cycle takes three days. A float does arise. Because there is no central hub, the general practices of the main banks cannot differ from the central clearing cycle.

Thirdly, in Ireland large volume, low value electronic transactions are cleared by the Irish Retail Electronic Clearing company (IRECC). Retail electronic clearing operates on a three-day cycle; however, in September 2005, IRECC launched a next-day value

cycle project which will effectively half the time it takes to clear an electronic transaction. As with paper clearing, a float arises during the electronic clearing cycle. Also, because there is no central hub, the general practices of the main banks cannot differ from the central clearing cycle. The bilateral structure of the retail electronic payment clearing system is identical to that of the paper clearing system illustrated in figure 2. The Central Bank and Financial Services Authority of Ireland is a member of the IPCC, but not of IRECC.

In *Germany* bilateral interbank clearing is also known as "garage clearing". It consists of the bilateral exchange of files or data media between the main clearing institutions of the giro networks (operated by the commercial banks, the savings banks, the cooperative banks and Deutsche Postbank, respectively) containing data for banks which can be reached via the respective receiver. Historically these bilateral exchanges of data (e.g. via tapes) were executed on the premises of the branches of the Deutsche Bundesbank (Central Bank) and/or in a "garage/car park" of a commercial bank. Nowadays payment transaction data are increasingly exchanged via data telecommunication channels. The Bundesbank's RTGS system (i.e. central bank money) is used only to effect gross settlement of the bilaterally exchanged data (transfer of the total of the data files or carriers exchanged bilaterally). The banks only have to pay a Bundesbank fee for the settlement rather than for huge numbers of individual retail payments. The decision to operate in this bilateral manner is based on purely commercial reasons.

In the *United Kingdom* there used to be a system of bilateral arrangements with regard to ATM transactions comparable to the current Irish system. When banks started to develop their ATM networks they were concerned to supply to their own final customers and until recently the majority of ATM transactions were 'us-on-us' transactions where the cardholder used the issuing bank's ATM. The advantage of securing wider access to ATMs led to the negotiation of bilateral arrangements between the larger banks to secure access to a greater number of ATMs for their final customers. The LINK system was set up in the mid 1980s to enable small banks and building societies to share their ATMs. Rather than establish bilateral relationships between each of these institutions, a hub and spoke system with a central switch was developed. This system enables the addition of a new member relatively easily and cheaply. Since the late 1990s all of the main banks and building societies in the UK have been members of the LINK system, largely superseding the previous bilateral arrangements.

The creation of LINK may be taken as a good example for a payment system (or a group of similar payment system networks) increasing the number of its participants over time which at one hand enhances the system's functionality but at the other hand induces the need to make the system more cost-effective for all participants. This led to the formation of central clearing facilities that are operated either by private companies or by the respective Central Bank.

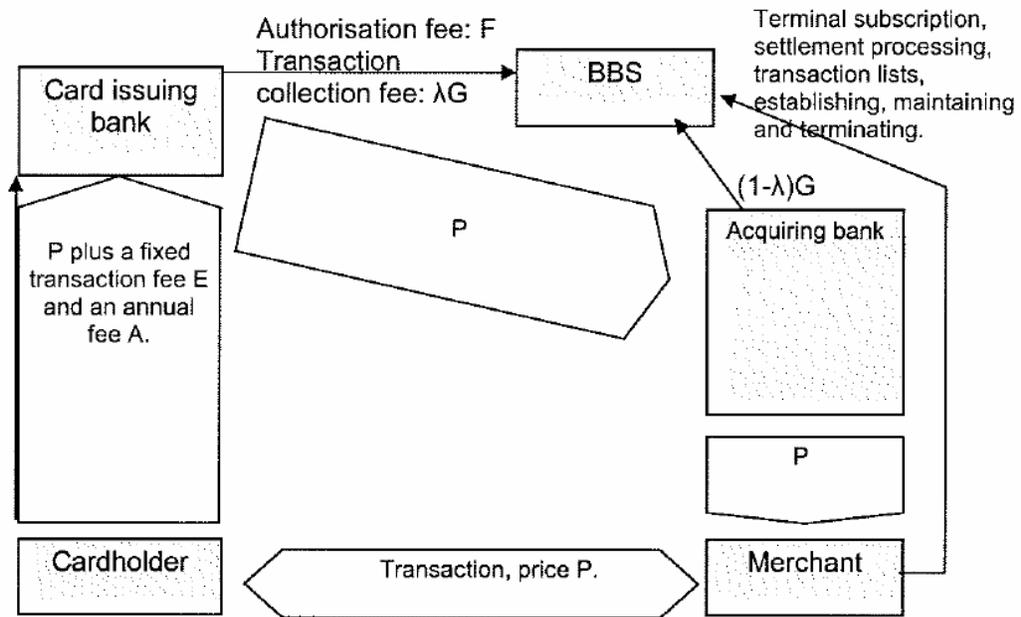
ANNEX 3

Private owned, single product, central clearing systems

Debit card payments

As an example for a privately operated clearing facility dealing exclusively with debit card payments, one may refer to the situation in Norway. BankAxept is the main Norwegian debit card scheme (both for POS and AM transactions). BankAxept is owned by the Norwegian bank's payment and clearing house (BBS), which again is jointly owned by 131 banks in Norway, according to transaction volume. BankAxept is open to all banks holding a Norwegian or foreign bank licence without restrictions on parallel membership in other payment networks or other national or international card schemes. BankAxept cards may also be co-branded with other payments schemes. The BankAxept scheme uses Bankenes Betalingssentral (BBS) as its main clearing infrastructure. BBS is jointly owned by a number of banks. It operates the central switch for authorisation requests concerning BankAxept POS transactions, generates transaction data for clearing and delivers these data to both acquiring bank and issuing bank for crediting and debiting retailers and cardholders accounts respectively. For ATM transactions there is no central operational switch for authorisation requests. This system is run by the banks individually, through a joint software program called BALTUS. BBS also operates systems on behalf of several credit card suppliers. Figure 5 illustrates a typical debit card payment process.

Figure 5: debit card payment process (Norway)

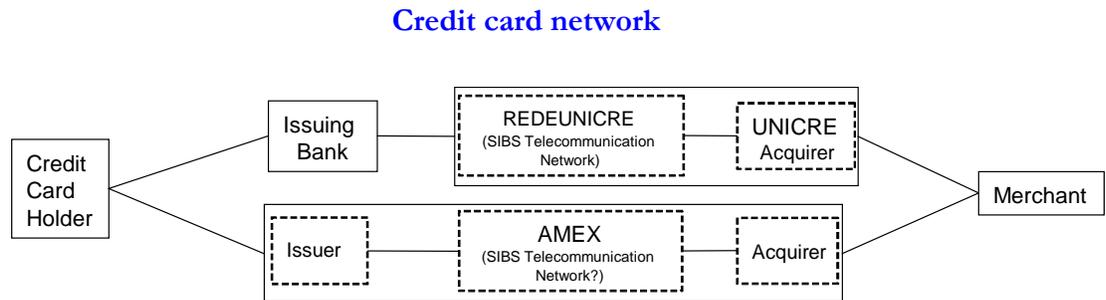


The transaction amount (P) is the main portion of the cash flows between the participants in the market. The cardholder pays a fixed transaction fee (E) plus an annual fee (A), which is different from bank to bank. The issuing bank pays an authorisation fee (F), and both the issuing and the acquiring bank pay a transaction fee (G) to BBS. Merchants pay for terminal subscription and settlement transaction, plus establishment, maintaining and terminating of the contract with BBS. The whole process basically is free from float as Norwegian banks are not allowed to charge float incomes.

Credit card payments

As an example for a privately operated clearing facility dealing mainly with credit card payments, one may refer to the Portuguese REDEUNICRE. REDEUNICRE is the network for Visa and MasterCard debit and credit cards and it is operated by UNICRE. UNICRE is owned by almost all of the Portuguese retail banks. UNICRE is one of the Portuguese acquirers for Visa cards and MasterCards and it still is the sole Portuguese acquirer for Diner's Club International, JCB and Tarjeta 6000 cards. In the REDEUNICRE network, UNICRE is responsible for overseeing the system even though the communication network and the clearing process are subcontracted to SIBS. SIBS is a private corporation, constituted in 1983 and owned by almost all of the retail banks active in Portugal. It was created as a cooperation between banks in order to implement an interbank service network that would allow for the development of the electronic payment systems in Portugal. REDEUNICRE is a four party double side market where the retail banks are the issuers and UNICRE is the single acquirer. By contrast, for instance the Portuguese Amex network has the normal configuration of a three party network, with one issuer and acquirer operating in Portugal. As is the case with REDEUNICRE, the communication and settling are subcontracted by Amex to SIBS. Figure 6 illustrates the Portuguese REDEUNICRE and AMEX credit card networks.

Figure 6: Credit card networks (Portugal)



A credit card payment scheme similar to REDEUNICRE exists for example in Denmark (PBS International), but in most of the cases the national credit card

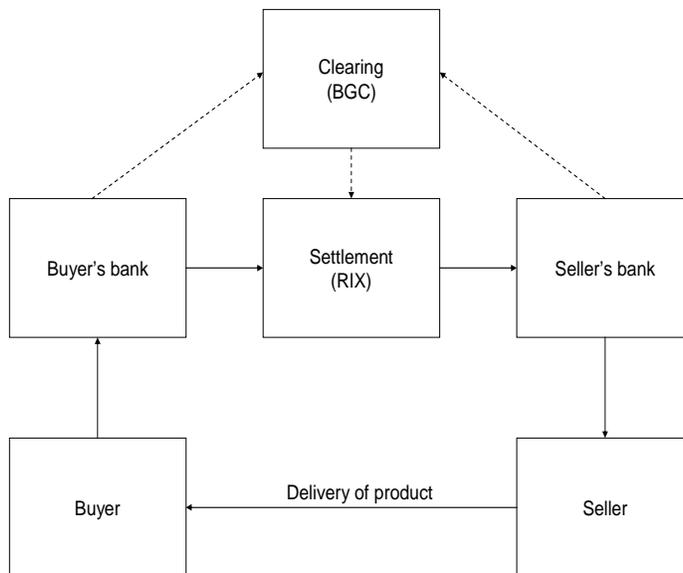
organizations and third party issuers of credit cards seem to operate their own credit card payment clearing and settlement scheme.

Credit transfers

As an example for a privately operated clearing facility dealing mainly with credit transfers, one may refer to the Swedish Bankgirocentralen (BGC), which is indirectly owned by SEB, Föreningssparbanken, Svenska Handelsbanken, Nordea and four other commercial banks.

Figure 7 illustrates a credit transfer where the seller delivers a product to the buyer. Dashed lines signify information transmission only. The buyer commissions his bank to transfer a certain amount to the seller account in another bank. The seller bank receives information from the buyer's bank about which customer is to be credited. When the seller is paid the payment process is completed for the buyer and the seller but not for the banks. The seller bank has a claim on the buyer bank. Information about this claim and other transfers are sent to a clearing institute, e.g. BGC, which calculates the net balance for all banks, i.e. clearing. Finally all debts active and passive between the banks are settled in RIX (the system of the Riksbank for settlements), which debits or credits the accounts held by the banks in RIX. There are four clearing and settlement cycles per day. A float may arise.

Figure 7: credit transfer with central clearing by BGC (Sweden)



Cheques

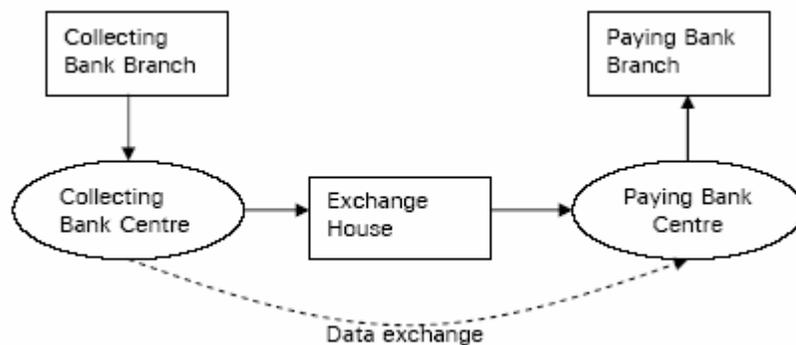
As an example for a privately operated clearing facility dealing exclusively with cheque payments and paper credits, one may refer to the British Cheque & Credit Clearing Company (CCCL or C&CCC). CCCL is owned and run by its members. Membership of CCCL is currently at 12, one of which is the Bank of England. The two-tier system is prevalent in CCCL clearings, with both settlement and indirect members accessing

the system. Both the cheque and credit clearing have the same members and these members cannot opt out of one or the other scheme. Yet, both the CCCL clearings are subject to their own rules, which are set by the board of CCCL.

The clearing process for cheques involves the transmission and settlement of payments between accounts held at different banks and different branches of the same account. This process operates on a 3-day cycle (see also figure 8):

- Day 1: Bank A's customer pays customers of bank B. At the end of the day bank B processes their received cheques. Each receiving bank records the values of cheques received for that day.
- Day 2: Bank B's clearing centres³⁸ receive all the cheques processed the previous day. The information from all these cheques is transmitted electronically through a secure data exchange network, known as the Inter Bank Data Exchange (IBDE), to bank A's clearing centre, allowing bank A to begin to update its customer's account. The clearing centres send the cheques to one of two Clearing Exchange Centres (CEC) - one in London, the other in Edinburgh - where the cheques are sorted between members. This process occurs between 6.30 a.m. and 11 a.m.. The CEC's send the cheques to bank A's clearing centre to verify settlement values between A and B.
- Day 3: Bank A receives the cheques drawn against it³⁹ and makes a decision about whether to pay or return them to the collecting bank. Inter-bank settlement, for the netted values of cheques exchanged between A and B takes place now over their Bank of England accounts. The cut off for this is 11am.

Figure 8: Clearing process for cheques (UK)



³⁸ These clearing centres can be either run by the banks themselves or outsourced to other agencies to do the work.

³⁹ In 1996, the Deregulation (Bills of Exchange) Order removed the need for cheques to be passed to the paying bank in physical form. Electronic transmission of cheque data is now valid with many banks retaining cheques at the clearing centres.

Within this clearing process, a float may arise. Outsourcing has become an increasingly cost-effective means to process CCCL transactions due to the increasing unit costs associated with lower transaction volumes. A long-term goal of outsourcing companies is that transactions are processed on an On-We basis. That is, the processing of cheques takes place internally within the outsourcing firm. At present this is not possible as the individual banks which outsource to the same firm operate on different technological platforms. Processing still has to go through the Inter Bank Data

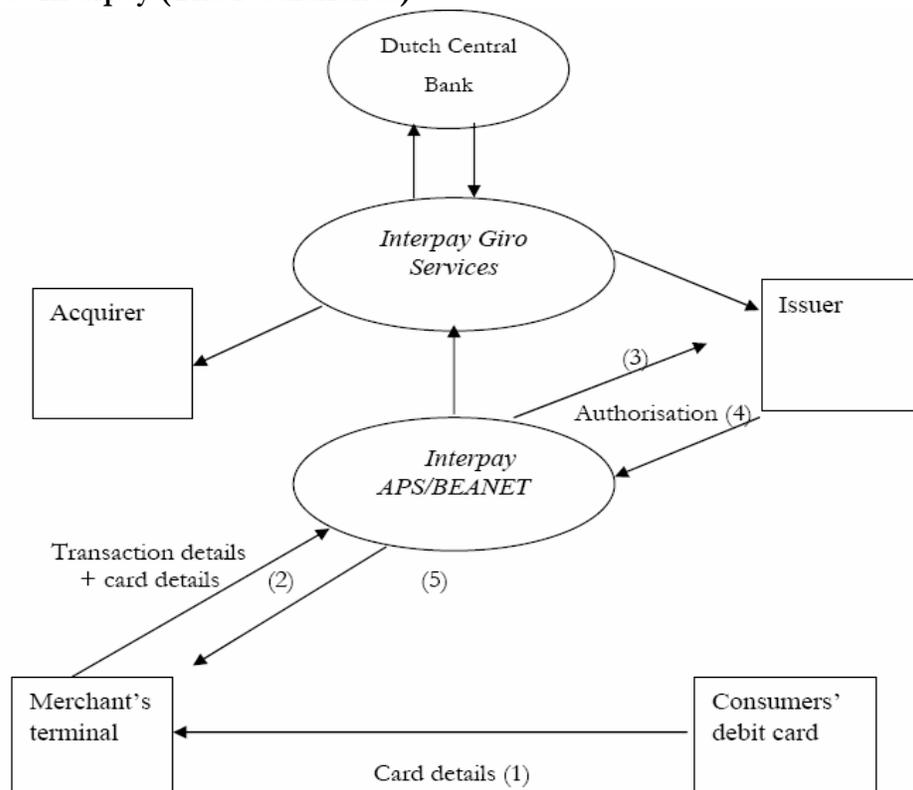
Exchange (IBDE) system which is operated by CCCL. It is only transactions where collecting and paying bank are the same that an internal process can take place. This is known as an On-Us process. For On-Us items, the debit and credit may well appear on both payer's and payee's statements on the day when the transaction is deposited, although this does depend on internal procedures at each of the members. Within the UK there are two outsourcing companies, Intelligent Processing Solutions Ltd (IPLS) and Electronic Data Services (EDS). IPLS is owned by Unysys, which hold a 51 per cent share and Lloyds, Barclays and HSBC, which hold a 49 per cent stake between them. IPLS has 7 client banks: Lloyds, Barclays, HSBC, HBOS, Clydesdale, Cooperative and Girobank; and it is estimated that IPLS account for 67 per cent of all transactions. EDS have 2 client banks, Royal Bank of Scotland and Natwest and are considered the second largest, processing 26 per cent of the total.

ANNEX 4

Private owned, multiple product, central clearing systems

As an example for a privately operated clearing facility dealing with all forms of payments, one may refer to the *Dutch* Interpay. Interpay is owned by eight Dutch major banks. Virtually all payment processing services (transfers and POS payments) in the Netherlands are done by Interpay as it is the only national payment facility. Interpay is also the main facility for credit card (Maestro/MasterCard) and transfer services between banks. The Netherlands has one PIN payment system. Interpay has a facilitating role here for clearing between banks and for years it also set the rules and technical standards that go with it. Direct debits and bank transfers are the main methods of conducting non-POS payments and giro collection forms are also used, but to a lesser extent. In the past Interpay's role was also to contract retailers for the acceptance and processing of PIN transactions, being the brand owner and administrator of national collective payment products. It developed regulations and technical standards and at the same time granted licences for issuers and acquirers. The important role of Interpay as a typical example of a debit card payment process is illustrated below (see figure 3).

Figure 3: Interpay (The Netherlands)



When a consumer pays with a debit card, the merchant's terminal reads the card details (1). All transactions are verified by means of a PIN (personal identification number) and authorised online. From the merchant's terminal the card details together with the transaction details flow to Interpay APS/Beanet (2), which acts as a switch and sends the data to the issuing bank of the cardholder (3). After having checked if the consumer has sufficient funds, the issuer gives permission to conclude the transaction. The results of the authorisation are sent back to Interpay APS/Beanet (4), which transfers the data back to the merchant's terminal (5). From Interpay APS/Beanet the data flow to Interpay Girale Services, which takes care of clearing. The Dutch Central Bank takes care of settlement.

The clearing and settlement of giral payments is being processed by the Clearing and Settlement System (CSS) of Interpay. On an average working day this company processes over 11 million transactions, with peaks of more than 40 million per day. Interpay determines the amounts the banks owe one another at least every half hour (clearing), but only on 'banking-days' (so for example not during the weekends). These clearing figures are then passed on to the Dutch Central Bank (DNB).

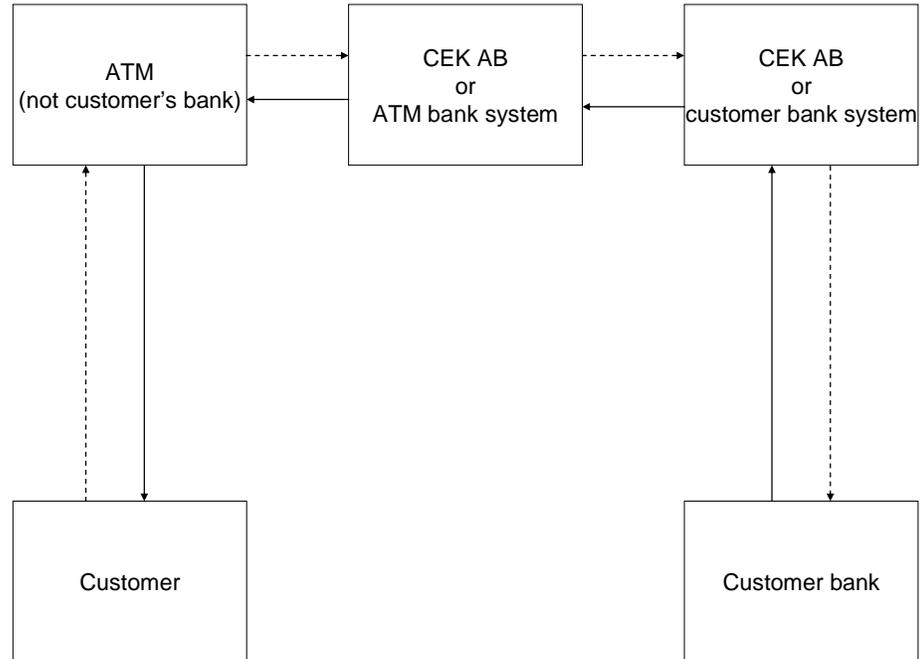
Concerning possible floats, according to the information of the NMa value-dating is a more commonly used practice in the Netherlands. This means that although in general there is no delay in the finalisation of a payment transaction, banks start giving interest at a later date (mostly one day after the transaction was finalised). Most of the time electronic payments within the Netherlands are processed within one (banking) day.

Multifunctional retail payment clearing and settlement systems similar to Interpay may also be found in Denmark (PBS, Sumclearing), France (SIT), Poland (ELIXIR, EuroELIXIR), Slovenia (ZC) and United Kingdom (BACS).

ATM cash withdrawals

As an example for a privately operated clearing facility dealing mainly with ATM cash withdrawals, one may refer to the *Swedish* Centralen för elektroniska kortbetalningar (CEK AB), which is owned by Nordea, Svenska Handelsbanken, Föreningssparbanken and Danske Bank. Figure 4 illustrates an ATM cash withdrawal, where the ATM owner bank and the bank of the customer are different.

Figure 4: ATM cash withdrawal with central clearing by CEK AB (Sweden)



The customer inserts the card in an ATM and types in a PIN code and the withdrawal amount. This information is sent to a separate clearing company, e.g. CEK AB or through the two banks' own system (dashed lines signify information transmission). The information is registered and sent back to the ATM, which returns bills if the account has cover. Finally, the customer bank receives information about the withdrawal and compensate the ATM bank, e.g. through CEK AB.

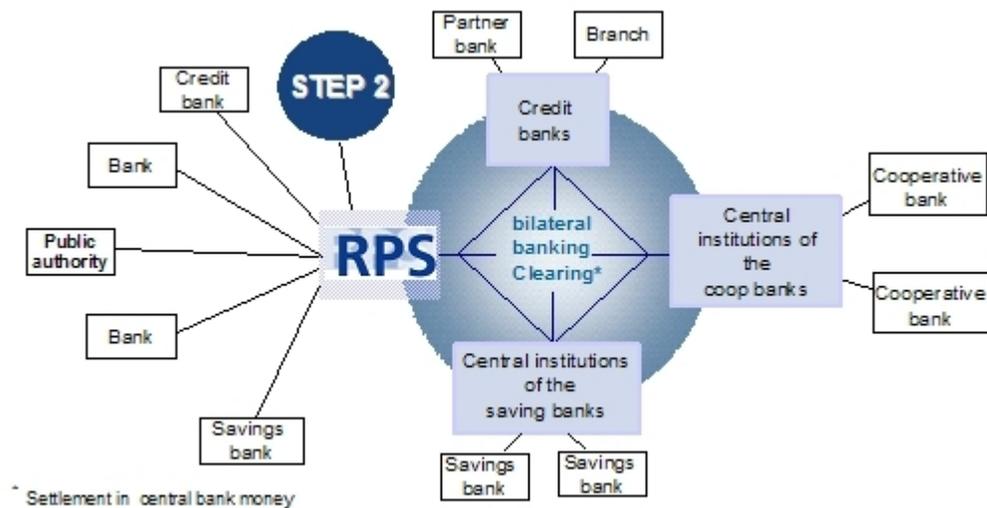
ANNEX 5

Central Bank owned, multiple product, clearing systems

In *Belgium* the Central Bank owns and operates the Centre for Exchange and Clearing (CEC). Via CEC, credit transfers, debit payments (connected with the use of credit cards, debit cards, e-purse and cheques), direct debits and bills of exchange may be cleared and settled. CEC currently has 20 direct and 60 indirect members. Indirect members are mostly smaller or niche banks. The clearing takes place permanently (real-time), but there is only one settlement cycle per day as requested by the participating banks. On average, there is no float.

In *Germany* the Central Bank owns and operates RPS (Retail Payment System) which may be used for the clearing and settlement of credit transfers and collection items (cheques and direct debits). Participants are all credit institutions holding an account with the Central Bank. There are three clearing cycles per day which last between one and fourteen hours, depending on the payment instrument and the date of its submission to the Central Bank.

Figure 9: Retail Payment System (Germany)



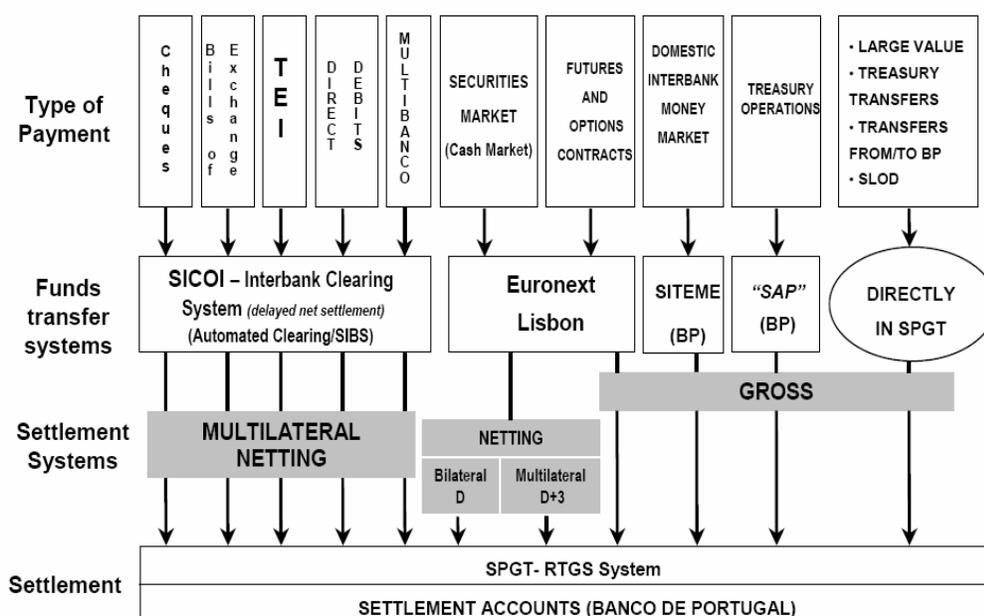
In *Hungary* the Central Bank owns and operates BKR. BKR clears all retail payment methods which are regulated by the Central Bank. Participants are all credit institutions including specialized credit institutions and the savings co-operatives. The system is working overnight with one clearing cycle per day which is split into two processing phases. There is a float with regard to retail customers' payments, but usually there is no float with regard to large companies' payments. However, the re-designing of the BKR is on the way, and it may become an intra-day system, where no float is possible.

In *Malta* the Central Bank co-owns and operates the Malta Clearing House (MCH). MCH is a clearing facility for paper based instruments (cheques) as well as for non-paper based instruments like direct debits, direct credits, standing orders and ATM cash withdrawals. Participants are the Central Bank and five credit institutions. Indirect

participation is possible via contractual agreement with one of the direct participants. There is one clearing cycle per day. The length of the clearing cycle is five days.

In *Portugal* the Central Bank owns and operates SICOI. SICOI is an interbank clearing system for cheques, bills of exchange (commercial bills), credit transfers (TEI), direct debits and transfers carried out through the Multibanco network (i.e. ATM cash withdrawals and POS transactions). Multibanco transactions are cleared real-time, credit transfers twice a day. For all other types of transactions there is one clearing cycle per day.

Figure 10: SICOI Interbank Clearing System (Portugal)

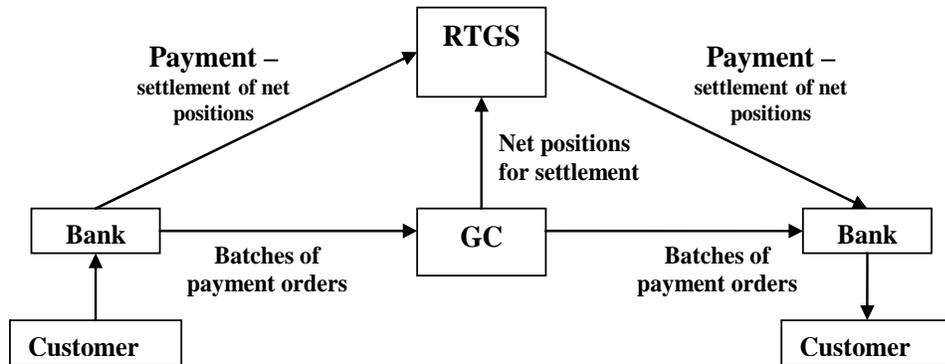


In *Slovakia* the Central Bank owns and operates SIPS, the Slovak Interbank Payment System. Direct participants have to keep own accounts with the Central Bank, indirect participants are non-banking entities without own account with the Central Bank. These entities provide for selected activities in SIPS which are delegated by direct participants, or the activities relate to a special regulation, usually a law. SIPS runs in real-time. The clearing day starts in the afternoon of the day before and ends in the afternoon on the next day. As SIPS runs in real-time mode a float may not arise. The difference between debiting one account and crediting another account inside the bank is limited to one day. Within this period of time, banks could possibly realise some float income.

In *Slovenia* the Central Bank owns and operates GC, the Slovenian Giro Clearing. GC is a multilateral net payment system processing low-value payments below 8,300 Euro. Direct members are commercial and savings banks and the Central Bank, indirect participants are treated as regular bank customers. There are five clearing and settlement cycles per day. The length of a cycle is two hours. There is only minimal float as a result of bank's working hours lasting longer than the operating hours of the

GC payment system. The law requires same day execution of customer payment orders.

Figure 11: Giro Clearing (Slovenia)



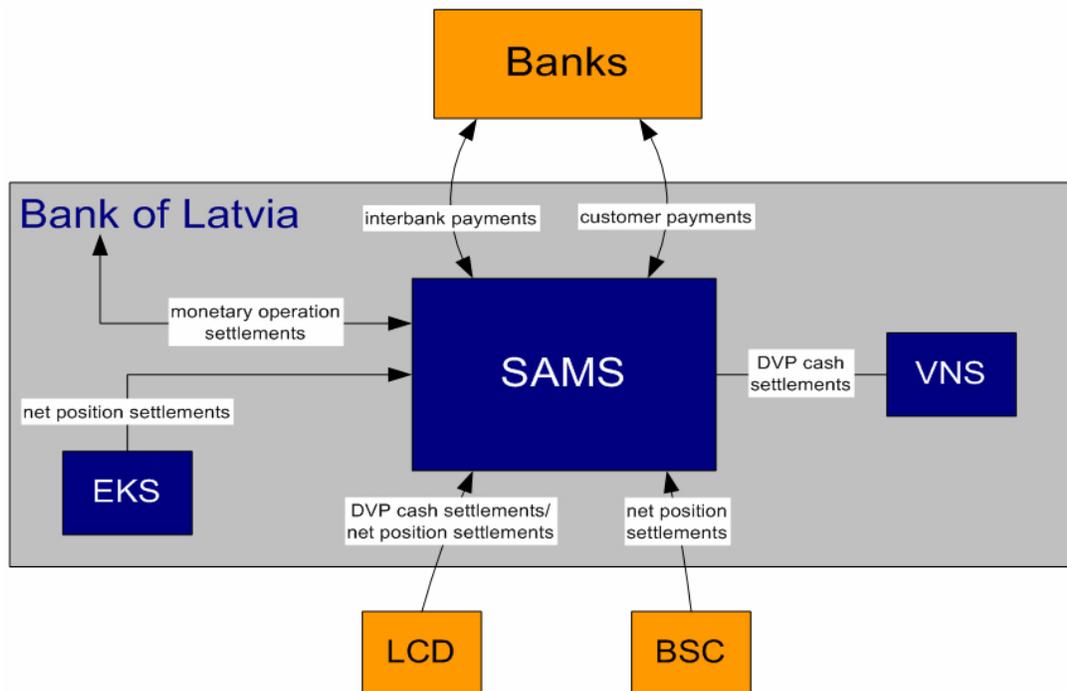
ANNEX 6

Central Bank owned, single product, clearing systems

Credit transfers

In *Latvia* the Central Bank owns and operates an electronic clearing system called EKS which processes retail credit transfers. EKS has two clearing cycles per day. The EKS data is transmitted to SAMS for settlement purposes. SAMS is also owned and operated by the Latvian Central Bank.

Figure 12: EKS and SAMS (Latvia)



In *Lithuania* the Central Bank owns and operates a clearing system for high- and low-value payments and securities called LITAS. LITAS currently has 24 participants, among them the Central Bank itself, the Lithuanian Central Securities Depository, commercial banks and brokerage companies. The participants may choose between real-time and set time processing (the latter is carried out thrice per day).

In *Malta* the Central Bank owns and operates MaRIS, the Malta Real-Time Settlement System for same day real-time gross settlement of payments between participants. This is both an large value payment system and a retail payment system for automated credit transfers. Participants of MaRIS are the Central Bank itself, the Malta Stock Exchange and five credit institutions.

ANNEX 7

Access to clearing systems

Access concerns of direct & indirect membership arrangements in Member States

Membership arrangements for payment systems in some countries either provide only full membership as standard or do not distinguish between principal/non-principal or two-tier/multi-tier structures⁴⁰.

In *Denmark*, for example, there are few alternatives to full membership of the national payment system PBS. However, small banks who are not shareholders in PBS have access to the payment system - on equal conditions, according to the NCA - through agreements with other shareholding banks. Nevertheless, competition issues relating to access to the Danish payment system will be handled in a forthcoming case (probably in the spring).

In *Norway*, the predominant retail payment system the national debit card scheme (BankAxept) is owned, via BBS, by member banks and the only condition for membership is obtaining a domestic or foreign banking license. There is a standard fee to be paid for joining the system, and there are no restrictions on parallel membership in other payment networks.

In *Lithuania*, there are no alternatives to full membership in both extant payment systems. According to the NCA, membership conditions of the two payment systems do not restrain competition among incumbent and potential members, so there are no barriers to entry because of open membership, the lack of influence of incumbent members on new members' applications and the absence of any membership fee.

Only *Ireland* recommends the removal of potentially restrictive membership requirements. In *Portugal*, access to the Multibanco network has been facilitated by a recent decision to open membership of the system to financial institutions that are not shareholders. The NCA sees this as an important decision with regards to access to the card payment market.

In the *UK*, the Cruickshank report of 2000 observed that mutually owned schemes were found to have anti-competitive restrictions on access. Scheme pricing, approval of new entrants by existing members or other membership criteria may be part of such restrictions. Access conditions for a number of payment systems (CHAPS, Cheques, BACS, LINK) are currently under review as part of the work under the Payment Systems Task Force.

According to the UK NCA, not being a full member of a payment scheme does not appear to significantly hinder competition in that country. Agency arrangements (i.e. indirect membership) are widely used, especially for the payment systems BACS and

⁴⁰ For further details of payment systems in other countries, see Annex 1.

CHAPS. The CA was told that in some instances (e.g. infrequent use of the system) agency arrangements can even be financially preferable to full membership for certain institutions. Furthermore, the CA has also received a complaint about LINK access criteria with regards to an application to be a third-party payments processor for the LINK switch.

In other Member States, either there have not been any competition cases or market investigations relating to the access conditions of payment schemes (e.g. *Slovakia*) or, as a result of several investigations into retail banking and payment systems, the NCA has not encountered any competition concerns (*Slovenia*).

NCA opinions on access arrangements in Member States

In the *Belgian* NCA's point of view, high costs of joining the clearing system as a full member may constitute a barrier to entry for smaller banks or niche players with very low volumes. According to the NCA, this has occurred in the Belgian market a few times in the last 10 years, but in 2005 the entry fees were lowered considerably.

In *Ireland*, financial institutions can either clear transactions directly as ordinary members, or - as associate members - contract with an ordinary member to clear on its behalf under the terms of an 'agency arrangement'. The advantages of full membership over associate membership include cheaper unit costs of clearing at high volumes and faster clearing cycles. The effect of these advantages is to provide faster transfer of value to and from customers' accounts. This allows clearing banks to offer their customers a speedier, more efficient service than non-clearing banks. While there have been some steps in the right direction since the commencement of the recent banking sector study, whereby potentially restrictive membership requirements were removed, barriers to competition still need to be removed in the payments clearing system. In particular, the absence of clear procedures for evaluating and admitting new members has the effect of limiting competition. Competition is also limited by the bilateral nature of the clearing system, which in effect delays entry by new members until the slowest incumbent has concluded all necessary steps. Entry to clearing systems has been delayed on more than one occasion due to these structural arrangements. The model of corporate governance followed at IPSO and clearing company levels creates potential competition concerns which are in the process of being resolved. Also, moves to reduce both the reliance on cheques and the time taken to clear cheques would increase the potential for competition in banking in Ireland.

The *Norwegian* NCA banned an exclusive agreement between BBS (the main clearing infrastructure, jointly owned by a number of banks) and the banks regarding electronic invoicing in 2001. In 2003 it banned an exclusive agreement between BBS and the banks regarding the processing of EFTPOS transactions.

According to the *Polish* NCA, full membership of banks in the clearing system is an important element for mutual competitiveness, due to the fact that this enables the

maximum shortening of the clearing cycle. Appreciating the importance of this factor, practically all banks are direct members of the National Clearing House Co., which gives them identical terms for the basis of mutual competition.

The *Swedish* NCA granted negative clearance for the Central Bank's pricing arrangements for participation in its clearing and settlement system. The pricing structure contained both fixed and floating charges, with marginal cost being relatively high for those participants undertaking a limited number of large transactions compared with participants undertaking many transactions. The discount system, in combination with the fixed annual charge, meant that small customers paid more per transaction than large customers. Even though the CA noted that this pricing structure was not optimal from a competition standpoint, it found that the pricing was objectively defensible.

In another *Swedish* case, the members of the Bankers' Association - which also rules on new entrants - applied for negative clearance or exemption for its inter-bank clearing system, focusing primarily on the clearing and settlement of cheques between banks. The entry charge was a one-off fee that, according to the applicants, was cost-based and a further (cost-based) uniform fee was charged for maintenance of the system. The CA did not consider either of these fees anti-competitive. As the agreements did not otherwise contain any components of a significantly anti-competitive nature, the cooperation was granted negative clearance.

In the *UK*, according to its CA, the costs of joining the clearing system as a full member may constitute a barrier to entry only in the case of CHAPS, which has an entry fee of around £70,000. However, given the credit and liquidity risks inherent in high-value RTGS systems, the CA regards this as not being entirely unreasonable. Nevertheless, this issue will be more fully explored in the context of the CHAPS Working Group, scheduled to start later in 2006.

In June 2005 the Payment Systems Task Force published its report on innovation in the BPSL payment system. The main recommendation of this report was that the current three-day cycle for internet & telephone banking and standing orders should be reduced to same-day. The Task Force instructed the banking industry to return to the Task Force within six months on how it intended to implement these changes. The banking industry has now replied to the Task Force and will implement the new system by the end of 2007.

Access to third-party ATMs: investigations in Member States

In *Germany*, there was an investigation concerning the access to so-called 'cash-pools', groups of ATM-operating banks with mutual access to ATMs either free of charge or at a comparably low fee. The CA's finding was that, in the light of the existence of several ATM pools (none of which were dominant in the market), access to any of those pools did not raise competition concerns.

In *Lithuania*, the CA investigated an agreement between two banks regarding cooperation in ATM services (i.e. mutual access), but, since there were no rules about fees in that agreement, it was regarded as compatible with competition.

In *Slovakia*, ATM withdrawal service charges were analyzed in 2003. There was a suspicion of a cartel agreement among banks regarding mutual determination of ATM withdrawal service charges. However, anti-competitive aspects of that agreement among banks were not proved. A complaints case relating to the access of small banks to ATMs is also relevant.

In the *Netherlands*, there was an application for an exemption concerning an agreement which governs guest use of ATMs of a different bank. As payment for the guest use, the banks were to pay each other a multilateral inter-bank fee. The NCA did not grant exemption for the fee included in the agreement, because this went further than necessary to achieve the advantages of such an arrangement. An exemption was granted for the other provisions of the agreement for a period of five years. The exemption is subject to an obligation to report.

In *Sweden*, a case concerned cooperation on ATMs within BankomatCentralen AB (BmC). This was initially registered as a multilateral co-operative between the leading banks where ATMs carrying the Bankomat mark were originally owned by BmC but where each bank had subsequently been given ownership of its own ATMs instead. In a preliminary statement of position, the CA took the view that the terms of entry to BmC and the price for employing its services, which were set out in the agreements originally submitted, discriminated against the smaller banks. This led the BmC's owner banks to make fundamental changes in the collaborative arrangement. The banks obtained access to each others ATMs by signing bilateral agreements, and each bank decided its own terms for granting access. As a result of the changes, BmC's involvement was reduced to ownership of the Bankomat trademark and security systems and the responsibility for developing and maintaining these systems. A revised co-operation agreement to this effect was submitted, and review of the case ultimately focused on this agreement. In a decision in March 1996 the revised Bankomat agreement was granted negative clearance.

The size of the entry charges and supplementary charges, however, was not subject to consideration, and nor were the terms of the bilateral agreements. The major banks submitted statements of intent for the case, to the effect that they were prepared to conclude agreements with other banks concerning access to the ATMs of each bank. Partly in parallel with its processing of the request for negative clearance for the Bankomat collaborative arrangement, the CA considered a complaint relating - inter alia - to the terms of the bilateral agreements on access to ATMs. Originally, it was a niche bank, SkandiaBanken, which argued partly that the network of bilateral agreements constituted an anti-competitive co-operation/concerted practice between the major banks under the Competition Act, and partly that the banks, either individually or collectively, were abusing a dominant position by applying unfair contract terms that denied newly-established banks access. In its decision of June 1999, the CA found no agreement constituting an infringement of the prohibition of anti-competitive cooperation and it was not considered justifiable to claim that any

individual bank enjoyed a dominant position in the market, or that the major banks as a collective did so. The CA therefore dropped the case.

As regards bilateral cooperation on ATMs, the smaller banks often appear to be at a competitive disadvantage in relation to the large banks in that they have to pay higher transaction charges. In dealing with the above-mentioned complaint, however, the Swedish CA was unable to prove that the agreement criteria had been met, as the terms of the various agreements were to some extent disparate. Nor was the CA able to show that individual or collective dominance was present.

Service provider fees: investigations underway in Member States

A competition issue investigated by the *Belgian* NCA has been the level of the tariffs charged for network services for electronic payments. In particular, retail traders have complained about excessively high and discriminatory tariffs. The Minister of Economics asked the NCA to launch an ex officio investigation into an infringement of the Belgian Competition Act. Two associations of SME undertakings in Belgium also filed a complaint against the provider of network services. This case should be settled by the end of the Summer or the beginning of the Fall 2006.

The *Dutch* CA took enforcement action in 2004, having found that the clearing network services provider, Interpay, and its eight constituent member banks had abused a dominant position by charging excessive rates to retailers for processing debit card transactions. With regard to the sale of network services for debit-card transactions, the banks have eliminated competition amongst themselves by using Interpay as a central payments office. In its assessment, the CA acknowledged that Interpay has incurred considerable expense in setting up the network necessary to provide retailers with network services. This network has made it possible for widespread use to be made of debit card transactions speedily and securely. In its assessment of the rates, the CA took into account the costs incurred by Interpay in doing so. Despite this, Interpay's rates were so high that since the introduction of the 1997 Competition Act they have generated a return which is five to seven times higher than the benchmark set by the CA. It was therefore concluded that this constituted an abuse of a dominant position.

In *Germany*, a planned merger between two service providers – one of them being dominant in the market – has led to competition concerns: Competitors may be squeezed out of the market and then the merged suppliers would be able to set service fees above competitive levels.

The *Swedish* CA has taken a number of decisions concerning infrastructure co-operation in the financial sector. These have primarily involved applications for negative clearance/notifications for individual exemptions. In most cases, negative clearance has been granted; in a couple of these, only after the terms of co-operation had been substantially altered.

A case that considerably influenced the Swedish CA's position on infrastructure cooperation further was the CEKAB case. CEKAB (Centralen för Elektroniska Korttransaktioner) was owned by four banks. The co-operation related to the collection and authorisation of transactions for all types of card payments, with annual charges and prices being the same for all customers. What was controversial in this case was the discount system, which was originally constructed to benefit the large owner banks. According to CEKAB, the discount was not given because the transaction cost was volume-dependent, but major customers had to be provided with substantial discounts as they would otherwise not make use of the service. In its decision of December 1997, the CA found that the construction of the discount pricing was discriminatory, and that negative clearance therefore could not be granted.

The banks appealed this decision to the Market Court, which concluded in a ruling in May 1999 that the banking sector offered other alternatives as regards payment management services and that access to CEKAB's services was not essential for the pursuit of activities in the relevant markets. Discounts that offered different customers different prices were in the Court's view not discriminatory, and therefore not anti-competitive, as long as they were business-motivated. A scale of discounts could not be expected to be fair in every detail. To some extent, circumstances such as a certain transaction volume, being essential for the continuation of operations, could be regarded as sufficient motive for providing increased discounts for greater volumes. The additional costs incurred by the small banks as a result of the discount structure were very modest proportionally, in the Court's opinion. Accordingly, the discount scale could not be considered anti-competitive under the Competition Act.

The Market Court ruling on the CEKAB case set the pattern for the way in which the CA dealt with infrastructure co-operation under the Competition Act: discount variations and other charge structures that undoubtedly placed the small banks at a disadvantage were approved on the grounds that they were not anti-competitive. This applies primarily to the Bankgirot and RIX cases. The Market Court ruling has been criticised in some quarters for being excessively brief in its statement of reasons and failing to provide adequate guidance for assessments of pricing in infrastructure systems from a competition standpoint. As the CEKAB case concerned one of the less important financial infrastructures, where the banks had recourse to alternatives, it is unfortunate that this was also one of the first cases that the CA had to deal with in the infrastructure sphere.

Interchange & clearing fees: investigations underway in Member States

The *Danish* NCA is about to examine the national Danish interchange fee.

In 2003, the *German* CA objected to the introduction of an interchange fee for debit card payments. At the moment, it is investigating national interchange fees for credit card payments following a formal complaint from the German central retailers' association.

Also in *Poland* the CA is currently pursuing a case of interchange fees for transactions made with payment cards (both credit and debit).

In *Portugal*, the Multibanco network works on a “honour all cards” regime, not differentiating between issuers, and there is no surcharge supported by the card holders for its use (this was established by a parliamentary decision).

Co-operation in the large international credit card systems, primarily Visa and Europay, has been reviewed by the *Swedish* NCA, which also turned down applications for negative clearance for the Visa and Europay systems in December 1994 and June 1995 respectively, on the grounds that their non-discrimination rules and the multilateral interchange fees were anti-competitive. Following the CA’s decision, Visa and Europay submitted fresh applications that also included notifications for individual exemptions. The Visa cases were notifications for negative clearance/individual exemption for the non-discrimination rule and the rules regarding a national multilateral interchange fee as applied in the Visa system.

The cases started in May of 1995 and the Swedish Competition Authority decided to postpone proceedings while waiting for the decisions of the European Commission. The cases were re-opened on 31 May 2001. The notifications were confined to the Non-Discrimination Rule (NDR) as stated in Visa International Operating Regulations (section 5.2.C), and the default fee set by the Visa EU Regional Board in relation to consumer card transactions (including mail order/telephone order transactions): If Visa members have no bilateral agreements for domestic interchange, the default fee set by the Visa EU regional board in relation to intra-regional transactions also applies to domestic transactions. Eventually, negative clearance was granted for the NDR, but there was no decision on the MIF.

In the *UK*, after notification to the NCA in 2000, the arrangements for multilateral interchange fees received an exemption until October 2006.

Internet payment fees: investigations underway in Member States

In 2000 the *Danish* CA examined PBS’ fees on payment transactions on the internet. The Authority reduced the transactions fee from DKK 1.95 + 0.15 % of the transaction amount to DKK 1.95 + 0.1 % of the transaction amount. The CA is currently examining the fees on internet payment transactions again. This investigation ends on 1 January 2006 when the Authority hands in its report to Parliament.

The *Slovenian* CA is also examining the fees (including commission) in electronic banking services (internet banking), because there are some indications that the prices are set too high. The CA has not addressed any solutions, because at the moment it is still at the analysis stage. It has sent out a questionnaire to various banks and at the moment is analysing the answers and other documents in connection to this.

Vertical integration competition investigations

In *Malta*, a bank had entered into a series of agreements with petrol stations which stipulated that petrol bought from automated machines could only be bought using the bank’s cards or cards issued by other institutions having a special arrangement with the bank concerned. The agreements were for a period of 7 years. In view of the duration

of this period, the unavailability of the option to pay using cash, and other elements in the agreement which effectively sealed the market to other banks, the Competition Authority informed the parties that the agreements in question were unacceptable.

In *Portugal*, there was a case related to a surcharge imposed by the single acquirer for credit cards, to be paid exclusively by the merchants, on payments with credit cards in gas stations. The conditions established by the acquirer were considered anti-competitive since they explicitly prohibited the merchants to pass on the surcharge to the consumer (abuse of a dominant position in directly fixing the transaction conditions on a different stage of the economic process).

Examples of 'unbundling' in the Netherlands

Interpay previously was the sole owner of the brands transferred to Currence (including PIN and Chipknip). Currence acts not only as the brand owner and administrator of national collective payment products, but also develops the regulations, grants licences, monitors compliance with the regulations, and coordinates efforts to combat fraud. Furthermore, independent experts have been appointed on the supervisory boards of both Interpay and Currence. With the establishment of Currence, the regulatory activities have been separated from the payment processing activities. Before, this task was carried out by Interpay. Today, banks must obtain a licence from Currence in order to carry out issuing and acquiring activities in the Netherlands. Currence also certifies third parties (such as processors, terminal and card suppliers) who want to offer other services within the Dutch electronic payments system. Currence also sets the (technical) standards for point-of-sale terminals that are supplied in the Netherlands by specialised companies, such as CCV and Alphyra. It can be concluded that Currence is the sole institution in the Netherlands which can give new entrants access to the market of PIN and Chipknip, by granting licences or certificates.

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