

Swedish Bankers' Association

Svenska Bankföreningen

12 January 2006

European Commission
Directorate General Internal Market
e-mail: markt-h3@cec.eu.int

Comments on the Commission's Consultative Document to contribute to the Preparation of a Report on the Application of Regulation (EC) No 2560/2001 on Cross-border Payments in euro

Introduction

The Swedish Bankers' Association (SBA) appreciates the opportunity given by the Commission to send comments for inclusion in the report on the application of the Regulation (EC) No 2560/2001 (Regulation). SBA supports in general the comments that will be sent by the European Payments Council (EPC). The comments provided below on Article 3 to 6 Objectives and Impact of the Regulation on Credit transfers are concentrated to some specific Swedish concerns and especially focused on problems related to the extended application of the Regulation to SEK. In the additional comments, with main focus on the RBR study, the answers reflect opinions from the Swedish banks on the general application of the Regulation and statements in the working document.

Article 3 to 6 Objectives and Impact of the Regulation on Credit transfers

The principle objectives of the Regulation, as described by the Commission, are

- To act as a driver for the financial services industry to make the necessary changes in existing cross-border payment infrastructure.

This objective has been achieved as the financial market, through their work under the EPC umbrella, is developing payment instruments and infrastructure that will become as effective and reliable as the existing domestic ones. It is however very important that the Commission and other governmental stakeholders, on EU and national level, support the initiative. It is essential that any future legislation supports the creation of the new infrastructure that has to be built on the common currency of the EU - the euro. In addition the public sector has to be in the forefront by accepting and using the new Pan-EU payment instruments.

- To equalise the price of cross-border payments under EUR 12 500 and in euro so that the charges paid for cross border payments were the same as the charges paid for a national payment.

This objective has been achieved as prices for cross border payments have decreased significantly and are now in line with prices for equivalent domestic payments. However the payment pattern in the EU has not changed after the introduction of the Regulation as more than 98% of payments are still within national communities.

- To ensure that customers were better informed about charges levied on cross-border payments

The requirements of the Regulation have all been implemented by the banks in Sweden and sufficient information is presented at branches, in brochures and through the Internet applications. Swedish authorities have, in their evaluations on how financial institutions have implemented the Regulation, concluded that Swedish banks fulfil their obligations regarding customer information in a satisfactory way.

Customer awareness of the Regulation is high for those customers that use cross-border payment instruments. However, as 98% of payments still remains within the national community a major part of Swedish consumers are not using these payment instruments at all and are for that reason unaware of the Regulation and its scope.

What has caused some information problems though was the uncertainty in how the only opt-in currency, SEK, was to be handled. This has led to a number of different interpretations, by governments, financial institutions as well as customers, and to the Commission issuing several interpretive notes to clarify the situation.

The interpretation of the Swedish opt-in was, by many consumers, that SEK was to be treated equal to EUR, which is not the case. The understanding was that there would be no difference in transferring SEK between two EU countries in comparison with transferring EUR. The correct interpretation of the Regulation is however that there is a major difference; the SEK is only treated favourably in Sweden whereas the EUR is treated favourably within the EU. For example a Swedish customer who makes a payment in SEK to another EU country expects that a lower (domestic) price is applied in both ends, sending and receiving. This is not the case as the SEK payment only has a lower (domestic) price in Sweden and not in the receiving country. The confusion about SEK is still creating complaints from consumers, and could best have been avoided if the opt-in article had not been included in the Regulation.

Financial institutions in Sweden are supporting the SHA which is the predominant charging option for cross border payments. The OUR (and to some extent also BEN) option still exists but is not recommended as the total charge is most likely to become higher than if the SHA option is used. Financial institutions have however experienced difficulties as Swedish regulators still are supporting the OUR option, in line with the Directive 97/5/EC, and reports on the evolvement of charges for cross border payments are still based on the OUR option. For future reports it is essential that national authorities are supporting the SHA option and that evaluations on price evolvement is no longer based on the OUR option.

- To remove all national reporting obligations for balance of payments statistics for cross-border payments up to EUR 12 500 and to remove any national obligations as to

the minimum information to be provided concerning the beneficiary which prevent automation of payment execution

This objective has been achieved for payments below EUR 12 500 and SEK 125 000. With consideration to the increase of amount in article 3 to EUR 50 000 as of 2006-01-01 the objective is not reached. Despite of the intention of the Regulation national reporting requirements is still discriminating cross border payments. With this in mind it is difficult to understand how the Commission place a burden of effort on the financial community to create an effective internal market when national authorities are still allowed to treat intra EU payments differently in comparison with domestic payments. Regardless of the intention of article 6 in the Regulation national authorities are still differentiating between the two. The intention of the Regulation will not be fulfilled unless national authorities are forced to acknowledge the importance of creating the internal market and that national objectives will have to stand aside.

For Sweden this is especially burdensome as the reporting obligation requires financial institutions to send information concerning the payment to the beneficiary, retrieve information on the purpose of the payment and report this information to the tax authorities. This reporting obligation not only prevent automation of payment execution which result in high cost manual handling it also introduce additional costs such as paper advice, postage, manual registration of purpose code, database storage etc. This means that the objective of the Regulation that the price for a cross border payment to be the same as for an equivalent domestic one is impossible to achieve as there is no similarity between the two types of payment instruments.

Based on the above the SBA strongly recommends the Commission that Article 3 and 6 should always be kept in line, either by lifting reporting obligations in line with article 3 or by bringing article 3 in line with reporting obligations. It should also in article 6 be clearly expressed that all kinds of national reporting which prevent automation is comprised, not only BoP.

- To facilitate the execution of cross-border payment through the use of IBAN and BIC for automated processing of cross-border credit transfers.

This objective will be achieved in full by the end of 2007. The usage of IBAN and BIC have increased significantly from when the Regulation was introduced and customers have been informed by their respective banks of their IBANs, through brochures, on statements and when making cross border payments. However, as IBAN and BIC are only used for cross-border-payments the customer awareness is high for customers using these instruments but low for customers only making domestic payments.

Additional comments on specific items in the consultative document

7.1.2 Payment card purchases

- According to research, cardholder charges relating to card purchases have not changed and are in general free across all Member States. Some exceptions were however identified in the study namely: card payments at petrol stations (Italy and Portugal) and merchant fees/surcharges (Denmark, Netherlands, Sweden and United Kingdom).

Payment card surcharges by merchants in Sweden is limited to a very small number of merchants who surcharge in violation of their card acceptance contracts since a Competition Authority resolution in June 2004 reinstates the non discrimination rule in Sweden. These merchants are being policed by the acquirers.

- At the same time, whereas transaction fees appear unaltered, annual card fees have risen, according to research. In some cases, this is in excess of the rate of inflation. Moreover, while some banks provide a basic debit card as part of the service, others have introduced annual fees.

In the Swedish market the annual card fees in general are going down and even zero fee cards are being issued.

8.1.2 Direct Debits

SBA strongly recommends that the scope of Regulation is **not** expanded to include direct debits. The purpose of creating a Pan European Direct Debit scheme and payment instrument is that customers can reach all accounts in the EU through the same instrument, nationally and cross border. This would enable customers to choose a bank in any country to carry out all their direct debits based on best service and best price. To include the direct debits in the Regulation would enforce a price regulation that is tied to domestic environment totally contradicting to the efforts made by the EPC to create the new Pan EU payment environment.

8.2.1 Result of RBR Study

Cross-border Credit Transfers

- *“At least 80 % of bank-to-bank cross-border credit transfers currently take place through traditional correspondent banking arrangements or via intra-bank transactions.*

No, regarding payments in euro, most payments to and from Sweden are settled through EBA (EURO1, STEP1 or STEP2). For payments in euro below €12 500 with IBAN and BIC STEP2 is the Pan-European Automated Clearing House (PEACH).

Payments in SEK are settled through traditional correspondent banking to 100 %.

- *No multilateral cross-border credit transfer network has a large proportion of the total volume of cross-border credit transfers.*

EBA with EURO1/STEP1 and STEP2 has a large proportion of the volume from Sweden.

- *Both EURO1/STEP1 and STEP2 are growing rapidly. It is likely that STEP2 will gain a significant proportion of cross-border credit transfers below €12,500 transacted through multilateral bank networks in the next one to two years – currently EURO1/STEP1 and STEP2 combined represent approximately one-eighth of this volume.*

The statistic may vary from country to country but for Sweden EBA is already the main clearing and settlement mechanism for euro and it has, by far, outgrown correspondent banking settlement.

- *As well as growth from the migration of cross-border volumes from other networks and methods, the volumes of transactions handled by EURO1/STEP1 and STEP2 will increase as the result of the migration of national traffic.*

This is the most likely scenario as the only existing Pan European Automated Clearing House is EBA. It is important to understand that any change in infrastructure is based on the usage of a common currency and that therefore all future legislation in this area must always focus on euro.

- *One of the main drivers encouraging the migration of traffic to STEP2 is the need for banks to reduce costs in response to the requirements of the Regulation.*

It is correct that STEP2 reduce costs but most important it contributes to reachability in Europe. Any bank that is a member, indirect or direct, of STEP2 can reach all other banks in Europe.

- *Using STEP2 or the other multilateral bank networks – either those operated by EBA Clearing or those with targeted membership – may not always be cheaper or more efficient for banks than correspondent banking or intra-bank transactions.*

In general transactions through a multilateral clearing and settlement system are more cost efficient. However, there are payments of specific nature that may be more cost efficient to send through correspondent banking mechanisms or through own branch nets.

- *There are limited technical barriers to creating a new multilateral bank network to compete with those now operated by EBA Clearing, and even to being a new PEACH operator to compete with EBA Clearing's STEP2, and the cost of doing so is relatively small. Far more difficult, however, is creating the requisite commercial framework and operating regulations and, more importantly, having the ability to access directly or indirectly all bank accounts in the EU. In addition it is not clear that any new multilateral bank network, including a new PEACH operator, would grow to gain the necessary economies of scale, particularly in terms of transaction processing.*

In many countries there is more than one service provider that offers clearing and settlement service for domestic payments. This is often possible because those service providers offer different services like high volume payments, low volume payments, value added services etc. At the moment the number of cross border payments in euro is small and is therefore not attracting competitors as the possibility to reach economy of scale is low. In the future, when domestic and cross border payments are using the same clearing and settlement mechanism(s), the volumes will create a market for competition similar to the one seen today on national level.

Payment Cards

- *Cross-border acquirers have not gained a significant share of acquired transactions in any country, and have not had any significant impact on MSCs.*

MasterCard and Visa only in 2005 removed the issuing before acquiring rule and therefore the cross-border acquiring activity has not been picked up yet. In Sweden other countries

monopoly acquirers are present and enjoying the benefits of an open and free market in a neighbour country.

– *MasterCard Europe and Visa Europe offer similar products in the areas of credit, charge and debit cards. However, there are a number of areas where they offer different products and services*

MasterCard and Visa do not offer any products, they offer basic card transaction switching services including operating regulations between issuers and acquirers. The issuers and acquirers offer products to customers and compete with each other for the respective markets cardholders and merchants with many product features including but not limited to functionality and pricing. MasterCard and Visa compete with each other regarding the switching services offered and the pricing on these as well as on functionality issues.

– *Acquirers compete on many facets of their services to merchants, and although they cannot compete on interchange fees, this does not preclude all price competition.*

Interchange is a cost component between acquirer and issuer, and should not be referred to or described as a “competing instrument” as above.

In a market where issuers and acquirers sign bilateral interchange agreements between each other the acquirers do compete with each other also with the fact that their interchange cost vary. Sweden is such a market.

– *There is considerable product differentiation between issuers, particularly between issuers of credit and charge cards.*

For a complete and true comparison between the different card type products, it should be mentioned that the product differentiation between direct debit products is reflected mainly in the connected bank account offers. This is correctly described in the following paragraph.

– *The degree of governance duality is high in the payment cards industry. The impact of this on competition between payment card networks has not been established in either the US or Europe, although it is clear that this duality has positive impacts on cardholder choices.*

– *Most large banks in the EU are members of both MasterCard Europe and Visa Europe – at least 80% of the largest issuers have dual membership – and many banks that are MasterCard or Visa members are also members of a national debit card scheme. Several also have some form of relationship with a T&E organisation.*

Banks use both MasterCard and Visa in order to get a competition on the pricing and other services between the networks for the business volumes of the bank thus providing the customers with best possible card product at best possible price.

– *There are a number of joining and membership restrictions within the payment card networks that could result in barriers to competition within networks, notably in acquiring.*

This is not a true description of the international card networks - MasterCard and Visa. There is an abundance of new members to prove that neither small nor big banks are stopped to take up payment card business. Obstacles can indeed be found in the area of the domestic payment card schemes which in practice in most markets constitute a one size fit all monopoly and usually uphold a business model that discriminates on new members and foreign entrants.

– *The degree of competition within and between card payment schemes is also affected by national practices and restrictions. National restrictions are particularly important for entrants into cross-border acquiring. There are a number of obstacles that make it more difficult for a cross-border acquirer to compete successfully with indigenous local acquirers for the business of national-only merchants.*

The use of the same term “card payment schemes” for both natural cross border functioning international schemes and for pure domestic only payment systems is misleading and may cause wrong conclusions. The statement above is true only for the domestic only card schemes and does not apply for MasterCard and Visa card business that is open for cross-border acquiring and issuing.

– *Competition in processing is stronger than that for other payment card services, as other banks, third party processors and suppliers compete with the payment card schemes to provide processing services to the schemes' member banks. Payment schemes do not generally restrict their members from using other banks, third party processors or outsourcing suppliers to perform any or all of their acquiring or issuing processing functions.*

Some domestic only payment card schemes actually restrict key processing elements to themselves and thereby blocking competition.

– *The major obstacle to creating a new multilateral international payment card scheme in Europe is the difficulty of constructing a convincing “business case”. This is due to the very large investment required to create a new scheme with the same card-base, acceptance network, infrastructures and economies of scale as the existing schemes. We observe that no new multilateral four-party international card payment scheme has emerged worldwide in the last thirty years.*

No new multinational scheme has emerged since new issuers and acquirers can get fair and profitable access to the MasterCard and Visa services and conduct business under these schemes. No need to establish new schemes for the mere establishment.

– *The creation of a new arrangement whereby pan-European debit card functionality is provided by making national debit card schemes inter-operable and allowing reciprocal usage of their cards is a major task. In addition to the investment required, major obstacles are the definition of operating regulations and technical standards, the agreement of a commercial framework, the need to change ATMs and merchant terminals and re-negotiate merchant contracts, and the creation of switching and clearing and settlement infrastructures for “foreign” authorisations and transactions.*

The two paragraphs above follow an extraordinary line of reasoning built on a fact that a number of new - today not available - functionalities are demanded. That is not correct. All tools mentioned are in place. There is no need for a new card scheme. What has been lacking

for those concerned is the recognition of available tools and a commitment to tear down self chosen barriers for a SEPA market.

It has not been shown that any cardholder or merchant would want a pan European card product. Customers tend to want a global payment card instead since cardholder travelling is usually not restricted to the European Union only. People want to go to other continents and expect that their payment cards work there as well as in Europe. Merchants want to sell to anybody who wants to buy the items on offer and therefore are willing to accept global cards.

– *Where multiple acquirers operate, the desire and ability of a merchant to switch to another acquirer, for both national and cross-border transactions, varies per country. In general, this depends upon the merchant's size and its commercial and technical relationship with its acquirer.*

Willingness to change the acquirer also depends on price variations and service offer variations between acquirers. In countries with only one acquiring service processor the differences tend to be so small that there is not much meaning for a merchant to switch.

– *There have been significant innovations in the payments cards industry, however this may not be an indicator of the level of competition. Innovation has resulted from competition, co-operative initiatives and other factors such as SEPA.*

SEPA has not so far fully impacted the innovations in the payment card industry. MasterCard and Visa are in competition with each other launching new features and services while the domestic card networks often tend to run a one size fit all on their national monopoly markets.

– *MasterCard Europe and Visa Europe co-operate on the technology standards that underpin the payment cards industry, such as those for smart cards and electronic purses, contactless cards, new delivery channels and fraud prevention. In general, these co-operative initiatives facilitate the operation and growth of the card payments industry.*

MasterCard and Visa cooperate only on infrastructure related issues, i.e. issues that impact payment terminals, ATM:s and other components. In most other areas they compete.

– *The payment cards industry is characterised by the combination of co-operation in the development of unsponsored (common) standards and competition through the development and use of sponsored (proprietary) standards.*

As previously mentioned, international schemes should not be mixed up and compared to domestic cards systems. This leads to conclusions which are not correct like those presented above.

The payment cards industry is characterised by the combination of local, national and international card schemes. The characteristics of the industry are competition through co-operation in the development of unsponsored (international) standards and competition restrictions through the development and use of sponsored (domestic) standards.

– *The existence of sponsored standards in some aspects of the payment cards industry could create barriers to entry. However, the development of the underlying unsponsored standards such as EMV may help to remove barriers. Overall the impact of standards on competition is mixed.*

Monopoly solutions by the domestic only payment card schemes tend to create barriers that block new card products as those products will not get the infrastructure support they need to be issued or acquired.

ATM Cash Withdrawal Networks

– *ATM surcharging allows an ATM owner to charge a commercial rate for the use of its machine and thus it attracts new ATM deployers and fuels the installation of additional machines in convenience “off-site” locations.*

Since the ATM owner also receives an ATM withdrawal compensation fee from the card issuer the ATM owner that surcharges cardholders is compensated twice for the same service and this is a dubious practice and possibly even fraudulent. The issuer has paid for the acceptance already and demanding payment from a cardholder seem like misuse of consumer dependence or local market dominance.

8.4 Review clause

New payment instruments and infrastructure are being developed by the EPC with its first step of introduction in 2008 and its second step in 2010. For this reason the SBA would recommend that the Regulation is reviewed in 2009 and that it is repealed in 2010. The review should focus on the original purpose of the Regulation, same price for equivalent payment products regardless domestic or cross border.

Yours sincerely,

SWEDISH BANKERS' ASSOCIATION
SVENSKA BANKFÖRENINGEN

Leif Trogen
Director,
Head of Bank Administration Department

Henrik Bergman
Senior Adviser