Sector Inquiry Identifies Widespread Competition Barriers in Retail Banking

Elena CAPRIOLI, Elke GRAEPER, Agata MALCZEWSKA, Tanya PANOVA, Jean ALLIX, Andras JANECSKO, Paul MCGHEE, Lukas REPA and Antonio Carlos TEIXEIRA, Directorate-General for Competition, unit D-1

On 31 January 2007 the European Commission published the Final Report of its sector inquiry into European retail banking markets. The inquiry has identified a number of deficiencies in the way these markets work that cause higher cost for consumers and small businesses and deter entry by new players. These deficiencies concern the markets for payment cards, (non-card) payment systems and certain core retail banking products. Particular indicators are large variations in merchant and interchange fees for payment cards, barriers to entry in the markets for payment systems and credit registers as well as obstacles to customer mobility and product tying.

On 31 January 2007 the Commission also adopted a Communication summarising the results of the inquiry and describing areas for further investigation and antitrust enforcement to open markets and stimulate competition.

The decision to open inquiries into certain financial services sectors — namely business insurances on the one hand and retail banking on the other — was taken in June 2005. Retail banking covers a wide range of activities and markets. Some of these markets and players have been repeatedly under antitrust scrutiny, for instance, payment cards and payment card networks. Others, such as the wide variety of the markets for core retail banking products seemed to be relatively untouched by competition investigations. Against this background, the retail banking inquiry was split into two main parts: first, the markets for payment cards, on which an Interim Report was already published on 12 April 2006 and, secondly, the markets for current accounts and related services. Preliminary results of the latter part of the inquiry were published on 17 July 2006 in a separate Interim Report.

With the publications of the preliminary findings of the sector inquiry the Commission invited market participants to submit comments. This wide and open consultation as well as the public hearing that took place on 17 July 2006 has resulted in extensive and valuable feedback. All received comments contributed to the elaboration of the final report that covers both parts of the retail banking inquiry.

Main conclusions

The findings clearly confirm that markets remain fragmented along national lines. Fragmentation means that the potential of a 450 million citizen market is not fully exploited, that consumers have limited choices and often pay more than they should for current accounts, loans or payments. Despite all efforts at European level to further integrate the EU financial services markets, access to several product and geographic markets still appears to be difficult. The inquiry has found a great variation of prices, profit margins and selling patterns between countries and, at the same time, a contrasting homogeneity within the individual Member States. This suggests the existence of regulatory or behavioural barriers. Indeed the inquiry has identified a variety of such barriers, be it of the one or the other kind or, most often, a combination of the two. It also indicates that widespread co-operation within markets or networks may lead to the alignment of prices and other parameters.

(1) The content of this article does not necessarily reflect the official position of the European Communities. Responsibility for the information and views expressed lies entirely with the authors.
(2) Currently Directorate-General for Internal Market, unit B-1 (Policy development and coordination of the internal market).
(4) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52007DC0033:EN:NOT
(6) Alongside the decision to open the energy sector inquiry where the final report was published on 10 January 2007 (http://ec.europa.eu/comm/competition/sectors/energy/inquiry/index.html).
Payment cards

The European payment card industry provides payment means with an overall value of €1 350 billion per year. These payments annually generate an estimated €25 billion in fees for banks. The inquiry has identified several competition concerns in this important sub-sector.

First, the payment card industry is highly concentrated. This results in high fees and high profitability. Moreover, the operative rules of some of the networks also bring about significant entry barriers. It is not only the international networks that cause concerns in this respect. Several national card schemes run by the main domestic banks also raise competition problems in setting a range of discriminatory rules.

Secondly, there are large variations in payment card fees across the EU. The results of the inquiry suggest that retailers in some countries pay fees that are up to four times higher than in other countries for accepting the same major credit card.

Thirdly, the inquiry gathered significant evidence on multilateral interchange fees (“MIFs”), i.e. the fees that are paid by the acquiring bank to the issuing bank for each payment card transaction at the point of sale of a merchant. This evidence rebuts to a large extent the industry’s arguments for the economic benefits of high interchange fees. It shows that several card networks can and do operate efficiently with low or even no interchange fees. The report does not condemn the existence of MIFs as such, because any concrete decision concerning interchange fees will have to be taken on a case-by-case basis. The sector inquiry has, however, highlighted the necessity to critically review academic justifications for this pricing mechanism. The present MIF in many of the schemes examined indeed seems problematic.

The publication of the interim report as well as the subsequent consultation with industry and other stakeholders seems to have already yielded positive results in a number of Member States where players have taken initial steps to address the Commission’s concerns (10).

Finally, the sector inquiry has highlighted several market barriers that need to be addressed by all involved in the Single Euro Payments Area (SEPA), a project driven by the European banking industry and strongly supported by the European Commission and the ECB. In view of the inquiry’s results regarding current network structures competition authorities have already engaged to closely monitor the process.

Current accounts and related services

Despite significant growth and diversification that has taken place in the banking industry over the last two decades, traditional retail banking has remained the industry’s most important sub-sector, representing over 50% of total EU activity in terms of gross income. Structures of the markets for current accounts and related services are, however, still fragmented. Suppliers rarely offer their services on a cross-border basis, and markets remain divided along national lines. This is due to factors such as cultural differences and historically grown industry structures. However, the report has also identified regulatory and behavioural barriers that are of particular concern from the viewpoint of competition policy.

The inquiry found, for example, access barriers in key infrastructures, particularly in (non-card) payment systems and credit registers. These schemes and platforms are often run by the incumbent banks that have a very limited interest in facilitating third parties’ market access. For newcomers, however, non-discriminatory access to these facilities is indispensable to compete.

Another focus of the analysis concerned product tying. This practice that, for instance, ties the opening of a current account to a mortgage or a SME loan, is widespread in most Member States. Depending on the circumstances of the case, tying may reduce customer choice, render price competition intransparent or create obstacles to customer mobility.

Finally, the inquiry also analysed the area of co-operation between banks. Retail banks co-operate to set standards or operate infrastructures such as the above mentioned payment systems and credit registers. Certain types of banks, namely savings and cooperative banks, traditionally have even closer co-operative ties. Co-operation can result in economic and consumer benefits. There are, however, also competition risks. The variety of ownership and company structures, the difference of the scope and scale of the co-operation as well as certain national regulatory provisions render a uniform assessment impossible. The Commission is likely to gather further information to assess whether cooperation between banks that have significant market positions appreciably restrict competition either between themselves or in relation to other actual or potential competitors.