FEEDBACK FORM

Name of undertaking: The Nuance Group AG

Industry (network, current/potential acquirer, current/potential issuer, processor, other third party provider (e.g. merchant service provider), merchant (industry needs to be specified), other): Travel Retail

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Participated in the questionnaire:

Yes

Specific questions from Executive Summary:

A. Financial analysis of the industry

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

Yes absolutely, the high costs of interchange, scheme fees, authorisation and settlement fees are a big burden on retail business and this undoubtedly has an impact upon pricing for the consumer. The disparities in merchant service fees across different countries serve to highlight this issue further, particularly visible to the travel retail market which is accessing card acquiring contracts in many countries in the EU area. I believe these disparities prevent the harmonisation of pricing across the EU area as fluctuations in the cost base of each transaction have to be passed on to the customer at country level.

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

No, the exceptionally high charges in certain countries in my experience has developed over a long period of time where the monopolistic organisation (or perhaps oligopolies) of the card schemes prevented competition in the acquiring market. This was often the case in countries, Denmark being a good example, where the main card issuing banks owned the entire card processing platform in that country, effectively creating a 'closed card scheme' for domestic business with processing of international card traffic taking place as a side benefit. The counter to this is for example, the UK where 'duality' and deregulation opened the card market up to major acquiring competition and merchant service fees were driven down considerably in a very short space of time to fractions above interchange. There is no excuse for the disparity; there needs to be open and healthy competition between acquirers who are hungry for card transaction volume to reach this more acceptable situation. However, everything is relative, and the issue in the comparably 'cheapest' countries is still severely restricted by the high costs of underlying interchange and other fees charged as the cost base to the card acquirers.

Two further comments on this topic: firstly, interchange is the same across all EU area countries for intra-EU transactions and inter-regional transactions; there is no apparent substance behind any argument that promotes domestic interchange fees that are higher than the inter- and intra- fees, as they are in the higher-charging countries. Secondly, the higher-charging countries are even more punitive on retailers by enforcing much longer payment conditions than the more competitive countries, i.e. the time from the sale transaction to the time the retailer receives payment from the card scheme; this gives the retailer a higher financing cost than if he accepted a cash transaction, as the delay in cash-flow leads to higher borrowing and less cash available for shop regeneration. All of these negatively impact all consumers, and not just card-paying consumers in my opinion.

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3. In view of the apparent profitability of card issuing, is there a generally applicable justification for substantial revenue transfers through interchange fees in card payment systems?

If the card scheme's reward only came about through an interchange fee then, as long as interchange fees were reduced to a level to balance risk and reward and make a fair profit, I would consider it appropriate. However, the process developed by the card schemes to not only charge interchange fees but also to add scheme fees, authorisation fees and settlement fees on top of the acquirer's margin is completely out of line with reality; couple these costs with the wide variation in interchange fees resulting from different card types, such as Consumer versus Corporate cards, Business Payment Cards and Premium Brand cards, as well as the foreign exchange profit margins that the card Issuers earn by charging additional fees to their Card-holders, then it appears to be just a money-making machine at the expense of the retail community and its customers.

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

I am clear in my belief that this is entirely due to market power. In eighteen years of retail experience I have seen little or no innovation made from within the card industry. Chip & PIN has taken too long to develop and bring to market, and is just used as an opportunity for the over-rewarded card schemes to shift fraud liability back to the retailer, and hence, again to all of his customers. Issues that would really help retailers to process more sales more quickly, such as internet-encryption communications to gain very high speed authorisations and speed customer flows are largely ignored by card acquirers and not offered as part of the standard service (and in most cases incur additional charges).

Innovations such as Dynamic Currency Conversion (DCC) where the retailer can offer the currency exchange directly to the customer at the point of sale (for the customers' benefit of transparency and certainty) are becoming increasingly regulated by the card industry in such a way that it appears the card schemes are trying to make it almost impossible to fully comply with card scheme rules, and hence suffer the consequence that the retailer could lose the benefit of the additional income and the development costs of implementing a DCC system.

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

In my opinion, a card scheme rule-enforced lack of transparency makes it contractually impossible for a retailer to inform the customers about the most cost-effective payment methods without breaching a rule. Customers tend to select a payment method that they perceive gives them a 'reward' for doing so, or which in some cases gives them a perceived status level if they have a premium-brand card. What fails to ever get communicated is that the cost of these 'rewards' is being met by higher prices across their entire peer-group.

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

In my experience I have never been able to ascertain why a high value transaction should be charged any differently from a lower value transaction; the processing load on the authorisation and settlement networks, the amount of financial investment in those networks and platforms and the amount of work undertaken by the different parties along the chain is the same regardless of the size of the transaction. The retailer should pay a single one-off fee for the transaction that is transparent, negotiable (as a result of higher transaction volumes being consolidated into a single bank transfer settlement and a single electronic reconciliation statement) and reflects a fair investment/risk/reward to the card schemes for work undertaken.

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

Referring to my earlier comments about Denmark as an example, this is not always the case. From a retail perspective, the standard consumer card interchanges for intra-EU and inter-regional fall below the domestic country interchange, making it cheaper to process cross-border transactions in the high-fee countries, if the volume of foreign card transactions is **correctly incorporated into the acquirer's calculation of the blended MSF**.

However, from a strictly consumer perspective, I believe few card holders have any knowledge of the foreign exchange fee their card issuer charges for using the card abroad, nor do they have any transparency of how or when the card issuer, through the card scheme, will make the foreign exchange conversion back to their billing currency to arrive at the final amount they will have to pay.

The process of DCC should become more widely available and less regulated by the card schemes to allow the consumer the opportunity to make the choice based upon open and transparent information at the time they are making a purchase, making up their own minds about the source and reasonableness of the exchange rate and the published margin, and have immediate certainty that the price they select at the point of sale is the price they end up being charged on their card statements.

On the other hand, the retailer only has the opportunity to understand the additional costs of foreign card acceptance if he is of sufficient standing (or located in the right country) to negotiate his position with the card acquirers based upon the true mix of cards he accepts, maybe through the absolute transparency of an "interchange plus" pricing model.

B. Market structures, governance and behaviour

8. What market structures work well in payment cards?

The best examples of a payment card structure that is fair to all parties are local debit cards, where the customer may or may not pay a small fee for each transaction, but the retailer pays a single flat amount regardless of the size of the transaction. In my experience I have found that in most cases, such flat transaction fees offer a fairer risk/reward balance for all parties involved.

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

Closed card schemes offer the retailer, and ultimately all consumers, the worst value for money. In their push for greater market share these schemes have effectively increased their card-issued base to a much wider and thus lower quality (in retail spending terms) card holders. In my experience I have seen closed card schemes that ten years ago would deliver customers into the retail stores with a relatively high average sale transaction (say 50% higher than a normal card scheme) now diminish to the same or only marginally higher average sale transaction as the normal card scheme, without any reduction in the MSF.

Widening this to all credit card schemes, none of the schemes that involve un-transparent pricing based upon the size of the sale offer value for money for the retailer.

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

To some extent the 'duality' issue of allowing card acquirers to acquire two major card schemes under a single contractual agreement and the deregulation of the UK market in the very late 1980's early 1990's served as a good indicator as to how MSF could be dramatically reduced in a short period of time as the newly-deregulated card acquirers quickly fought to gain market share to recover the cost of investment in their platforms.

The sad issue is that since then, no other major competitive factors have been brought into play to increase competition between the card schemes. In fact, major investments by two of the biggest card schemes in world-wide sports sponsorships appear to have worked against competition and the consumer by enforcing one particular card scheme as the only card payment method acceptable at that sports event.

Using the UK model as an example of at least a step in the right direction, the preferred solution would be for card schemes to charge a published flat per-transaction fee and open the acquirer market on a pan-European basis. The retailers will then decide who to choose as an acquirer in each country and the market will settle itself to the most competitive fee structure (based upon the acquirer's competitive margin) for the ultimate benefit of the consumer.

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

It is my opinion that there is zero incentive for card schemes to adopt the approach that I propose in the section above. I believe that it will take brave and decisive action from the Commission and individual governments to enforce sufficient regulation and penalties as a result of the earlier decision regarding alleged price-fixing cartel activities. Enforcement, the threat of enforcement, or education (and thereafter mobilisation) of public opinion may be the only solution.

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

Cannot comment

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13. What access conditions and fees are indispensable?

Card schemes are a brand and clearly have the right to leverage income from the use of their brand name by their members – issuers and acquirers. However, this needs to be a transparent, open and same-for-all fee structure based upon the number of cards issued by each issuer (and hence the number of times the brand name is printed on a card) and the income paid to each issuer to offset the use of the brand name by the card acquirer, based upon a flat fee per transaction, which in turn is charged to the retailer along with the acquirer's transparent margin.

Therefore, none of the existing fees are indispensable.

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

The only comment I can make here is competition should be maximised. It should no longer be acceptable for all card issuing banks in one country to have ownership and voting rights in the single card acquirer. Issuers within the EU area should have issuing rights in all EU countries and likewise all acquirers should have complete cross-border access to sell their services to merchants in all EU countries.

C. Future market developments

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

I believe without enforcement there will be little or no change in the status quo of how card schemes operate.

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

With the introduction of SEPA, certainly settlement costs should be significantly reduced. The issue remains that settlement costs are only a small add-on to interchange and it is really the multiple and non-transparent interchange levels that need to be tackled.

D. Potential solutions to market barriers

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

Not able to comment

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

Not able to comment

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19. How much need and scope is there for harmonising technical standards in the payment cards industry? How large are the potential benefits and costs of harmonisation?

Switzerland is a very good example of how card schemes can work together to adopt a common technical platform that addresses the immediate issues of Chip & PIN and card holder number security, called EP2. While the initial cost to the retailer is quite high in terms of changing system integration programmes and adapting to card processing and reconciliation systems that do not contain the card number, the long-term benefits once working on that single platform kick-in. For example, six card schemes (that I know of) share a common platform of information delivery, which in turn allows automated processes with common data sources to cut future development costs, administration services and potentially reduce headcount.

Bringing that message to the EU, a single-standard platform across all card schemes allows a retailer to choose which schemes he has an economic benefit to adopt and which ones to drop, without major technological impacts. This is better for competition, as it is cheaper and easier for markets to decide who the best value-drivers are.

E. Lessons for SEPA

20. What lessons (best practice) for the design of SEPA schemes can be learnt from existing national and international payment systems?

I follow your best of breed comment absolutely.

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

Absolute transparency in pricing and an equal opportunity to all members to attack cross-border business.

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

Not able to comment

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23. What governance requirements should SEPA schemes meet?

Not able to comment

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

Not able to comment

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25. Do the removal of barriers to competition, the observance of pro-competitive governance and the creation of interoperable standards require (further) regulation?

Yes, and enforcement to ensure that the market is open to all on the same entry levels at the same cost.

General comments:

General questions:

1. Did you find the content of the report easily accessible and understandable?
    - yes, fully;

2. Did you find that the level of detail in the report was:
    - about right;

3. Did the information contained in the report was:

    - mostly known to you/the payment cards industry.

4. Did the market analysis in the report:
    - confirm your views on the operation of payment cards market;

5. Did the report raised the right policy issues;
    - yes, covered most of the key issues;

Thank you for your contribution!