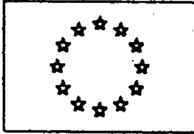

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 13.09.1995
SEC(95) 1403 final

Notice on the application of the EC competition rules to cross-border credit transfers

(presented by the Commission)

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Notice on the application of the EC competition rules to cross-border credit transfers

Introduction

1. This notice sets out the approach the Commission intends to take when assessing the compatibility of cross-border credit transfers systems with Articles 85 and 86 of the EC Treaty.

2. The application of the competition rules must take into account the overall Commission policy on cross-border payments. A major policy objective of the Commission is to ensure that, in the medium term, the transparency, performance and stability of cross-border payment systems equals that of the best domestic systems. The full benefits of the internal market and Economic and Monetary Union will only be achieved if it is possible for businesses and individuals to transfer money rapidly and reliably from one part of the Union to another.

3. Until recently most cross-border credit transfers have been processed through traditional correspondent banking relations. In such arrangements transfers have typically been processed and settled individually. For small value transfers this has meant that costs have been a large proportion of the amount transferred. Many banks in the EU have been cooperating to develop new systems to handle cross-border credit transfers. These systems, which typically use domestic clearing systems to distribute incoming cross-border credit transfers in the destination country, include:

   - those based on enhanced correspondent banking links between institutions in different Member States;
   - those based on clubs of particular types of institutions;
   - those relying on direct links between automated clearing houses (ACHs).

4. Some larger banks use their own network of branches and subsidiaries as their correspondent network. Another possibility is for a bank to seek directly to participate in an ACH or other clearing systems located in another Member State.

5. The Commission welcomes these efforts to improve the quality of service offered to customers. However, Commission surveys in 1993 and 1994 showed insufficient overall improvements in the transparency and performance of cross-border credit transfers. The

Commission therefore adopted a proposal for a European Parliament and Council Directive on cross-border credit transfers[1]. That proposal was accompanied by a draft of this notice.

6. This notice aims to assist market participants by indicating the Commission's approach in matters which raise competition issues. The Commission's general approach will be to view positively arrangements between banks that enable them to provide improved cross-border credit transfer systems, and in particular that enable them to meet the requirements of the proposed Directive. Such arrangements must however comply with Articles 85 and 86 of the EC treaty. Effective competition between banks and between systems has an important role in improving the efficiency of services and reducing prices to the consumer. This notice aims to clarify which forms of cooperation amount to undesirable collusion, and thereby clarify the dividing line between where cooperation is necessary and where competition is possible.

7. This notice updates and replaces the "Principles on competition for credit transfer systems" contained at Annex C of the Commission Working Document of 27 March 1992[2]. In the light of further experience in this field or in the event of significant changes in the conditions which prevailed when this notice was drawn up, the Commission may find it appropriate to adapt this notice.

1. Scope and definitions

8. In this Notice:

(a) "*automated clearing house (ACH)*" means an electronic clearing system, based on a set of procedures, whereby credit and financial institutions present and exchange data and/or documents relating to cross-border credit transfers, primarily via magnetic media or telecommunications networks and handled by a data-processing centre;

(b) "*credit transfer*" means a payment consisting of a series of operations beginning with the originator's payment order made for the purpose of placing funds at the disposal of the beneficiary. Both the payment instructions and the funds described therein move from the bank of the originator to the bank of the beneficiary, possibly via several other banks as intermediaries and/or more than one credit transfer system;

(c) "*cross-border credit transfer*" means a credit transfer by an originator via a bank or its branch in one Member State to a beneficiary at a bank or its branch in another Member State;

(d) "*cross-border credit transfer system*" means a system through which payment instructions and the funds described therein may be transmitted for the purpose of effecting cross-border credit transfers;

1 Communication of 18 November 1994, COM(94)436: "EU Funds Transfers: Transparency, Performance and Stability".

2 SEC(92)621 "Easier cross-border payments: Breaking down the barriers".

(e) "*cross-border payment instrument*" means a means of payment (including a credit transfer, a payment card, or a cheque) that can be used to make a cross-border payment. A cross-border payment can be face-to-face or remote, depending on whether the originator and beneficiary physically meet when the payment is initiated;

(f) "*multilateral interchange fee*" means a collectively agreed inter-bank transaction fee;

9. This notice applies only to cross-border credit transfer systems. For the purposes of this notice, a credit transfer system in a single Member State is a cross-border credit transfer system in so far as it carries cross-border credit transfers.

10. Articles 85 and 86 only apply where there may be an effect on trade between Member States. Cross-border credit transfer systems, precisely because they carry cross-border credit transfers, will be capable of having such an effect[3].

11. This notice is addressed to credit institutions and other institutions which participate in cross-border credit transfer systems and execute such transfers. For the purposes of this notice, such institutions are referred to as "banks".

2. The market

(1) Relevant market

12. In order to assess the effects of an agreement on competition for the purposes of Article 85 and whether there is a dominant position on the market for the purposes of Article 86, it is necessary to define the relevant market.

13. The relevant product market comprises all those products which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use. The structure of supply and demand on the market must also be taken into account. The relevant geographic market is an area where the conditions of competition applying to the relevant product are sufficiently homogenous and which can be distinguished from neighbouring areas because, in particular, conditions of competition are appreciably different in those areas. The Commission can precisely define markets only in individual cases. It can, however, indicate how it will approach defining the market for assessing cross-border credit transfer systems.

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3 Case 172/80 *Züchner v. Bayerische Vereinsbank* [1981] ECR 2021, paragraph 18.

14. For any particular cross-border credit transfer the originator's bank will not normally choose the beneficiary's bank. That does not however mean that there is no possibility of competition between banks for customers. Competition may exist, to varying degrees, at different levels. In order to determine the relevant market in a particular case, it will be necessary to consider the extent of competition on these different levels. *Intra-system competition* will occur when banks participating in a particular system compete for customers by offering the best combinations of prices and conditions for effecting and receiving cross-border credit transfers. *Inter-system competition* will occur when banks participating in different cross-border credit transfer systems compete for customers. *Intra-instrument competition* will occur when different but interchangeable types of cross-border credit transfers are offered by banks, for example urgent and non-urgent transfers or transfers that carry additional information and those that do not. *Inter-instrument competition* will occur when cross-border payment instruments other than cross-border credit transfers are interchangeable with cross-border credit transfers.

15. First, the widest extent of interchangeability would be with other remote cross-border payment instruments. While the product market might include payment instruments other than cross-border credit transfers, payment instruments that can be used to make remote cross-border payments have different characteristics and end uses from payment instruments that can only be used to make either face-to-face payments or national payments.

16. Secondly, within the category of remote cross-border payments (or within the category of cross-border credit transfers) there may well exist separate narrower markets. Systems used to make small value (retail) payments may well not be interchangeable with those for large value (wholesale) payments. The same is true for payments made to retailers and other providers of goods and services as opposed to payments made to individuals, or urgent payments as opposed to non-urgent payments.

17. Thirdly, a particular payment instrument (or even a particular segment of the instrument) may on its own constitute a relevant market. For example, in the *Helsinki Agreement* decision the Commission found the directly relevant market to be that of foreign Eurocheques drawn in the trading sector in France[4]. It may well be appropriate in individual cases to consider cross-border credit transfers (or particular segments, such as retail cross-border credit transfers) as the relevant market.

18. In addition to a relevant market on which banks compete for customers, there will also be a relevant market on which different cross-border credit transfer systems, ACHs and banks compete to offer other banks different channels for handling cross-border credit transfers. For example, different banks in a particular Member State can compete to act as a correspondent bank to banks in other Member States. The correspondent bank will deliver incoming cross-border credit transfers to the beneficiary's bank. Competition for banks on this market can also be described as *inter-system competition*.

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4 Commission Decision of 25 March 1992 *Eurocheque: Helsinki Agreement* OJ No L 95 of 9.4.1992, paragraphs 8, 76; upheld on this point by the Court of First Instance, Cases T-39/92 & T-40/92 *Groupement des cartes bancaires "CB" and Europay International v. Commission* [1994] ECR II-49, paragraph 104.

19. The geographic market appears to be still largely national since the conditions of competition applying to cross-border payments differ between the Member States.

(2) Competition on the relevant markets

20. Competition between banks for customers will only be effective when there is transparency of prices and conditions vis-à-vis customers. The competition will be more intense where customers have low switching costs, for example if banks offer to send transfers on behalf of those who do not hold accounts at the banks in question.

21. There would currently appear to be a certain amount of inter-system competition for banks between different cross-border credit transfer systems that deliver credit transfers from the originator's bank into the country of the beneficiary's bank. At the same time in many Member States there may well be limited or no such competition faced by domestic clearing systems used to distribute incoming cross-border credit transfers in those Member States.

22. A restriction of intra-system competition in a particular system will have less serious effects where this is compensated for by the wider competition of other systems (inter-system competition) or of other instruments or both. Conversely, where this wider competition is weak or non-existent it will be particularly important to ensure that potential intra-system competition is not restricted. Moreover, if similar (intra-system) restrictions occur within competing systems, less reliance can be placed on the existence of the wider competition to compensate for the loss of intra-system competition.

3. Non-price competition

(1) Membership in a system

23. The question of membership in cross-border credit transfer systems has to take into account aspects of Community law other than the competition rules. In particular, where systems are set up by legislation or guided by public authorities, the principles of freedom of establishment, freedom to provide services and free movement of capital and payments contained in the EC Treaty and in the Second Banking Directive[5] will be applicable. Those aspects of public regulation are not dealt with in this document.

24. Private arrangements between banks setting up new or linking existing cross-border credit transfer systems will have to comply with Articles 85 and 86 of the EC Treaty.

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5 Second Council Directive of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions (89/646/EEC), OJ No L 386, 30.12.1989, p. 1.

25. Where a cross-border credit transfer system constitutes an "essential facility" it must be open for further membership (as distinct from ownership) provided that candidates meet appropriate membership criteria (see paragraph 26 below). An essential facility is a facility or infrastructure without access to which competitors cannot provide services to their customers[6]. A cross-border credit transfer system will be an essential facility when participation in it is necessary for banks to compete on the relevant market. In other words, lack of access to the system amounts to a significant barrier to entry for a new competitor. This would be the case if a new competitor could not feasibly gain access to another system or create its own system in order to compete on the relevant market.

26. A cross-border credit transfer system that constitutes an essential facility may apply membership criteria provided that these are objectively justified. Membership can take the form of direct or indirect participation[7], with membership criteria for direct members and indirect members differing in relation to differences in the nature of their responsibilities. The membership criteria should be written, accessible, and non-discriminatory. They may, for example, lay down requirements for members concerning their financial standing, technical or management capacities, and compliance with a level of creditworthiness. The payment of an entry fee may also be required. An entry fee must not, however, be set at so high a level that it becomes a barrier to entry. In any event, the level of an entry fee must not exceed a fair share of the real cost of past investments in the system. The membership criteria may not make membership in the system conditional upon acceptance of other unrelated services.

27. A requirement of a minimum number of transactions could constitute an entry barrier for smaller banks. A cross-border credit transfer system that constitutes an essential facility should wherever possible permit membership of banks with only a small number of transactions. One acceptable way of achieving this would be to allow the indirect participation of such banks. Where indirect participation does not exist, there must be objectively justified reasons for any requirement of a minimum number of transactions.

28. Refusal of membership or definitive exclusion from a cross-border credit transfer system that constitutes an essential facility should be accompanied by a written justification for the reasons for the refusal or exclusion and should be subject to an independent review procedure.

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6 On the notion of an essential facility, see Cases 6 & 7/73 *Institutio Chemioterapico Italiano and Commercial Solvents Corporation v. Commission* [1974] ECR 223; Commission Decision of 4 November 1988 *London European - Sabena* OJ No L 317, 24.11.1988, p. 47; Commission Decision of 11 June 1992 *B&I Line v. Sealink* [1992] CMLR 255; Commission Decision of 21 December 1993 *Port of Rodby* OJ No L 55, 26.2.1994, p. 52; *IGR Stereo Television* Eleventh Competition Report, point 94; *Disma* Twenty-third Competition Report, points 223 and 224.

7 Indirect participation is a form of membership which gives to institutions some functions and responsibilities of direct participation without going so far as to entrust them with the settlement responsibilities which are reserved to direct particpants.

29. A system which is not an essential facility is not obliged to be open to further members nor to have objectively justified membership criteria. Systems, whether or not they are essential facilities, may be capable of obtaining an exemption under Article 85(3) if they prevent, in order to ensure adequate volume, individual members from taking part in other systems.

(2) Operation of a system

30. Agreements between banks must not lead to any exclusivity arrangement: customers must remain free to change banking connections from one institution to another, or to bank with several institutions simultaneously.

31. Banks within a cross-border credit transfer system can agree standards relating to the operation of the system, the kind and quality of transactions to be processed by the system, and security and risk management rules.

32. Agreements on operational standards, including the following, will normally fall outside the scope of Article 85(1).

- standardised message formats and routing identifiers (but agreements on eligible hardware should be avoided except where necessary for the operation of the system);
- the minimum information necessary for a transfer to be sent through the system;
- settlement arrangements, for example the modalities of how settlement is to be achieved, of agreeing settlement totals, and of agreeing the point at which settlement can be considered final.

33. The following agreements on standards might fall within Article 85(1). Where they do so, they will normally be capable of exemption under Article 85(3) when they are non-discriminatory and limited to what is required to improve the functioning of the system.

(1) Agreements on transaction standards, including:

- rules on transaction times, for example stipulating that value will be received by the beneficiary bank of a credit transfer by a certain deadline if a payment order is received by a certain time (but such arrangements must, in particular, not lead to concerted value dating practices vis-à-vis customers);
- maximum and minimum amounts to be processed by a system.

(2) Agreements on security and risk management rules, including:

- criteria for the granting of settlement status and the management of settlement accounts;
- arrangements relating to liquidity standards (for example, a requirement to post sufficient collateral to cover exposures);
- prearranged sharing of losses from defaults of participants.

34. Agreements must be limited to inter-bank relations and must not lead to concerted practices vis-à-vis customers.

4. Price competition

(1) Start-up costs of cross-border credit transfer systems and operating costs of central bodies

35. The costs incurred by the setting up of a cross-border credit transfer system and those arising out of the operation of a central body (for example, an ACH), can be shared amongst participating banks by means of, for example, an ACH tariff (which might vary according to volumes or other pre-established conditions) charged to participating banks. If setting up costs have been necessarily incurred by participating banks acting in their capacity as beneficiaries' banks, it might be justifiable to pay for those costs by means of a collectively agreed interchange fee (as to which, see below).

(2) Pricing in cross-border credit transfer systems

36. A transaction in a payment system will typically involve at least four parties: the originator (the customer making the payment), the originator's bank, the beneficiary (the customer receiving the payment), and the beneficiary's bank. Their four mutual relationships constitute the framework in which pricing occurs within the payment system: originator-originator's bank, beneficiary-beneficiary's bank, originator's bank-beneficiary's bank, and originator-beneficiary. The pricing arrangements on the four different relationships interact.

37. In respect of a cross-border credit transfer, the originator's bank and the beneficiary's bank may well not have direct contractual relations. In that case, the transfer will be handled by a chain of banks. Each pair of banks in the chain will be linked by a bilateral agreement and/or, within a system, by a multilateral agreement. Inter-bank pricing may be part of the relationship between each pair of banks.

(a) Pricing between banks and customers

38. Various pricing methods are found, separately or in combination. These include explicit prices, such as transaction related fees and annual fees, as well as less transparent prices such as value dating practices, lower interest on account balances (and/or higher interest on loans and overdrafts) than would otherwise be the case, and less advantageous exchange rates.

39. Here, as in other areas of banking competition, participating banks must not make agreements fixing the type or level of pricing vis-à-vis customers. Legislation sometimes, however, limits the extent to which banks may price vis-à-vis customers, subject to the case-law of the Court of Justice of the European Communities concerning the combined application of Articles 5(2) and 85 of the Treaty.

(b) Multilateral interchange fees

40. The Commission considers that a *bilateral* interchange fee agreement will normally fall outside Article 85(1). In contrast, a *multilateral* interchange fee agreement is a restriction of competition falling under Article 85(1) because it substantially restricts the freedom of banks individually to decide their own pricing policies. The restriction is likely also to have the effect of distorting the behaviour of banks vis-à-vis their customers. There will be another restriction of competition under Article 85(1) when there is an agreement or concerted practice between banks to pass on the effect of the interchange fee in the prices they charge their customers.

41. Sufficiently strong inter-system competition could restrain the effects of the interchange fee on the prices charged to customers. In such a situation the restrictive effect of the multilateral interchange fee within the one system might not be appreciable (and so fall outside the scope of Article 85(1)), provided that the competing systems do not themselves also contain similar multilateral interchange fees.

42. Where there is limited or no inter-system competition, a multilateral interchange fee will normally be considered to have the effect of restricting competition to an appreciable extent, and thus to fall within the prohibition of Article 85(1).

43. Where agreements on multilateral interchange fees fall within Article 85(1), it is only where they are shown to be actually necessary for the successful implementation of certain forms of cooperation, positive in themselves, that they may be capable of obtaining an exemption under Article 85(3). It is not for the Commission to impose any particular arrangements on banks. Where, however, banks introduce multilateral interchange fee arrangements, the Commission (in applying the criteria set out in Article 85(3) for obtaining an exemption) will examine the economic benefit which these arrangements seek to achieve and consider whether consumers (including both those who are customers and those who are not) will receive a fair share of the benefit and whether the particular interchange fee arrangements are actually necessary as a means to achieve that benefit.

(c) Handling cross-border credit transfers

44. An example of a cross-border credit transfer being handled by a chain of banks is as follows: the originator's bank might pass the transfer to a first intermediary bank in the same Member State. The intermediary bank will take care of the cross-border link by passing the transfer to a second intermediary bank (a correspondent bank) in the destination Member State. The correspondent bank will deliver the transfer to the beneficiary's bank. This will typically be done through a domestic clearing system, in which case the correspondent bank acts an entry point into the domestic system. An ACH can take the place of the first intermediary bank or the correspondent bank or both.

45. Inter-bank pricing may be part of the relationship between each pair of banks in the chain. In the example given, each of the first intermediary bank and the correspondent bank will normally be able to agree bilaterally with respectively originator's banks and first intermediary banks a price for handling cross-border credit transfers. Such bilateral price agreements fall outside Article 85(1). Alternatively, if a group of banks were to agree a multilateral interchange fee to cover either of these links in the chain, this would in principle fall within Article 85(1). However, the restrictive effect of the multilateral interchange fee might not be appreciable (and so fall outside the scope of Article 85(1)), provided that there were competing systems which did not themselves also contain similar multilateral interchange fees.

46. The final pair of banks in the chain are the correspondent bank and the beneficiary's bank. They might use a domestic correspondent link, but they will typically both be members of the domestic clearing system (or ACH) that is used to distribute the incoming transfers in the destination Member State. Here, inter-system competition is likely to be limited or non-existent, because of the need to use a system which can ensure delivery to all possible beneficiary banks in the destination country. (There would of course be no inter-system competition if banks were to agree that only one particular system would be used to handle incoming transfers.) A multilateral interchange fee that applies to cross-border credit transfers handled by such a system raises competition concerns under Article 85(1).

(d) Double charging

47. Double charging occurs when the originator of a cross-border transfer requests to pay all the charges of the transfer (a so-called "OUR" transfer[8]), but nevertheless either an intermediary bank or the beneficiary's bank makes a deduction from the amount transferred or the beneficiary's bank makes a charge to the beneficiary exceeding the charge that would be made for a domestic transfer;

48. The Commission considers that the possibility for customers to make OUR transfers constitutes an economic benefit for the purposes of Article 85(3). In certain circumstances, an agreement on a multilateral interchange fee applying to cross-border credit transfers may be indispensable in order to avoid the practice of double charging cross-border transfers, thus enabling banks to offer OUR transfers (see paragraph 53 and following below). If that is the case, the fee will be exempted under Article 85(3).

49. The Commission considers that a multilateral interchange fee applying to cross-border credit transfers would not normally be indispensable in order to enable banks to offer SHARE or BEN cross-border credit transfers. In respect of a SHARE transfer, the originator's bank can charge its customers a price to cover its own costs, intermediary banks can deduct from the amount of the transfer a price to cover their own costs (or charge the originator's bank for those costs), and the beneficiary's bank can charge its own customers a price to cover its own costs. In respect of a BEN transfer, the originator's bank

8 Transfers can be described as "OUR", "SHARE" or "BEN" depending on how the customers request the charges to be allocated:

- OUR: all charges to originator (<u>our</u> charges);
- SHARE: <u>share</u> costs between originator and beneficiary;
- BEN: all charges to the <u>ben</u>eficiary.

and intermediary banks can deduct from the amount of the transfer a price to cover their own costs and the beneficiary's bank can charge its own customers a price to cover its own costs.

50. Banks should remain free individually to decide whether to offer any or all of OUR, BEN and SHARE cross-border credit transfers[9].

(e) Costs for cross-border transfers

51. To carry out a cross-border transfer may require extra tasks as compared to a domestic transfer:

(1) In relation to the system as a whole, a new system may need to be set up, or an existing system modified, to process cross-border transfers.

(2) In relation to the transfer itself, extra tasks might include:

(i) a cross-border transfer may need to be reported to the balance of payments authorities as an incoming payment;

(ii) the payment may need to be converted into the currency of the beneficiary;

(iii) regulation may require that the beneficiary is provided with more information (for example, details relating to the payment order) than is normally given for domestic payments;

(iv) the details of the beneficiary, their account number and the bank sort code need to be verified since this information is often incomplete or incorrect;

(v) the payment order needs to be reformatted if it is to be processed by the clearing circuit in the destination country;

(vi) additional clearing and settlement operations may be needed.

52. Whenever the originator's bank or a correspondent bank or ACH are able to carry out those extra tasks, the transfer could be entered into the domestic clearing system of the destination country as if it were a domestic transfer. This means that there would for the beneficiary's bank be no difference between receiving a transfer that has originated in another country and receiving a purely domestic transfer. In such a situation, the problem of double charging should not arise, and a multilateral interchange fee related to the cross-border nature of the transfer would not seem necessary.

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9 The proposed Directive would make OUR transfers the default solution where nothing has been specified by the originator of the transfer.

(f) Avoiding double charging where cross-border transfers give rise to specific costs

53. Nevertheless, the Commission recognizes that there may continue to be circumstances where a beneficiary's bank will necessarily continue to face additional costs for the receipt of a cross-border transfer as compared to a domestic transfer. In particular, that will be the case in those Member States which require that the beneficiary's bank report an incoming payment to the balance of payments authorities, or which require that beneficiaries receive more information from their bank than is normally given for domestic payments. That will also be the case where beneficiaries' banks have incurred the costs of setting up new systems (and here again the position will vary as between the different Member States). In such circumstances it may be justifiable for banks in the destination country to agree a multilateral interchange fee, to cover those additional costs, in order to avoid double-charging. Such an interchange fee might be agreed between participants in an ACH, or generally between all or most banks of a particular country.

54. An arrangement between participants in an ACH would cover the necessary extra costs of beneficiary's banks by means of an interchange fee agreed between the ACH and the participating beneficiary's banks. This multilaterally agreed interchange fee would be based on the actual extra costs of the beneficiary's banks, and could be included in the overall (bilateral) fee charged by the ACH to sending banks (or sending ACHs). The ACH would remunerate beneficiary's banks for their necessary extra costs by redistributing to them the interchange fee.

55. An arrangement between all or most banks of a particular country would again cover the necessary extra costs of beneficiary's banks by means of an interchange fee agreed between all participating beneficiary's banks. For any particular transfer, one of those banks would be acting as the correspondent (entry point) bank for the sending bank. Again, any multilaterally agreed interchange fee would be based on the actual extra costs of the beneficiary's banks, and could be included in the overall (bilateral) fee charged by correspondent banks to sending banks (or sending ACHs). The correspondent bank would remunerate beneficiary's banks for their necessary extra costs by redistributing to them the interchange fee.

(g) Conditions for a multilateral interchange fee

56. Where a multilateral interchange fee falls within Article 85(1) but can be exempted as being necessary to avoid double charging, it should meet the following conditions.

    (1) The level of the fee should be set (and revised regularly) at the level of the average actual additional costs of participating banks acting as beneficiary's banks.

    (2) The fee should be defined as a default fee, allowing members of the system to negotiate bilateral fees above or below the reference level.