

consumers
 innovation
 vigorous competition drives productivity growth, innovation and value for all
 competition in the economy
 productivity
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productivity
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Study of Competition in the (non-investment) Banking Sector

Draft Recommendations & Consultation Paper

14th December 2004



The Competition Authority
 An tÚdarás Iomaíochta

CONTENTS

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|---|-----------|
| CONTENTS | i |
| GLOSSARY OF TERMS | ii |
| INTRODUCTION | 1 |
| PERSONAL CURRENT ACCOUNTS | 3 |
| <i>Competition Issues Identified</i> | 3 |
| <i>Recommendations</i> | 5 |
| Recommendations to improve switching | 5 |
| Recommendations to improve entry and innovation | 7 |
| Recommendations to improve consumer information | 7 |
| Further Recommendations to improve switching | 8 |
| THE PAYMENT CLEARING SYSTEM | 10 |
| <i>Competition Issues Identified</i> | 10 |
| <i>Recommendations</i> | 12 |
| Recommendations to facilitate entry to the clearing system | 12 |
| Recommendations to facilitate a more efficient clearing system | 13 |
| LENDING TO SMALL AND MEDIUM ENTERPRISES | 16 |
| <i>Competition Issues Identified</i> | 16 |
| <i>Recommendations</i> | 18 |
| Recommendations to facilitate switching of current accounts and working capital loans | 18 |
| Recommendations to improve customer information | 18 |
| Recommendations to facilitate switching of secured loans | 19 |

GLOSSARY OF TERMS

ACH Automated Clearing House

A system whereby electronic clearing of monetary transactions is conducted through a central clearing house, or hub, rather than bilaterally between each financial institution.

CBFSAI Central Bank and Financial Services Authority of Ireland

The corporate entity established under the Central Bank and Financial Services Authority of Ireland Act, 2003. The CBFSAI is composed of two constituent but independent entities, the Central Bank and the Irish Financial Services Regulatory Authority.

IBF The Irish Bankers' Federation

The IBF is the representative body for the banking industry in Ireland.

IFSRA The Irish Financial Services Regulatory Authority

Established under the Central Bank and Financial Services Authority of Ireland Act, 2003, IFSRA is responsible for the regulation of financial services providers, promoting consumer awareness and the best interests of users of financial products and services.

IPCC The Irish Paper Clearing Company

The IPCC is the clearing company which is responsible for overseeing and setting standards for the exchange between financial institutions of paper items, such as cheques.

IPSO The Irish Payment Services Organisation

IPSO is the representative, strategic and technical support body for the Irish financial payments industry. The Clearing Companies operate under the umbrella of IPSO, each responsible for its own operating rules, settlement procedures, standards and access criteria.

IRECC The Irish Retail Electronic Clearing Company

IRECC is the clearing company which is responsible for overseeing and setting standards for the exchange between financial institutions of lower-value electronic transactions.

PCAs Personal Current Accounts

PCAs are accounts that enable the account holder to make and receive payments for bills, wages, and purchases. These are known as money transmission services. PCAs can also be used to store funds or to obtain credit, for instance, through an overdraft.

Plastic cards

This is the generic term for the various cards used to facilitate payments, often in lieu of cash or cheques. They include credit cards, debit cards, ATM cards, charge cards and combined cards (e.g. Laser/ATM cards).

Regulating Better

The Government White Paper designed to improve national competitiveness and policy implementation by ensuring that new regulations and legislation are more rigorously assessed in terms of their impacts, more accessible to all and better understood.

RFP Request For Proposal

A request to suitably qualified parties to submit tender bids for a particular proposal.

SMEs Small and Medium Enterprises

According to the European Commission, SMEs are enterprises which employ under 250 staff and have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million. A Small Enterprise is defined as an enterprise which employs under 50 staff whose annual turnover and/or annual balance sheet total does not exceed €10 million.

INTRODUCTION

1. The Competition Authority is pleased to issue for public consultation the *Study of Competition in the Provision of Non-investment Banking Services in Ireland: Report and Recommendations* carried out by LECG, consultants to the Authority. This Report represents the most substantial part of The Competition Authority's study of competition in the provision of non-investment banking services in Ireland. It follows extensive research, including detailed analysis of documentation provided to the Authority, interviews conducted with senior bank executives, and meetings with third parties.¹
2. The Report shows that competition in the Irish banking sector is not working well for consumers. There are, for example, high switching costs for customers who want to move between banks. There are also high barriers facing banks that want to offer new services to customers. Small businesses are not getting competitive working capital loans. The sources of these problems are both the structural arrangements, the behaviour of the banks themselves, and unintended consequences of Government regulation.
3. The Competition Authority's Study focuses on two areas: Personal Current Accounts ("PCAs") and lending to Small and Medium Enterprises ("SMEs"). These sectors were chosen due to their fundamental importance to the relationships between banks and their customers. The Authority selected these two areas for scrutiny following an initial analysis of both Irish and international banking. The analysis showed that current account and small business lending products tended to be less competitive than other banking products in selected overseas markets.² Given the central importance of the clearing system for the exchange of funds between accounts, and the need for cooperation between banks, potential barriers to entry in the clearing system are also examined as an essential input into producing a competitive current account product.
4. In total, the authors make 40 recommendations to enhance competition among banks for the benefit of both personal banking customers and small and medium enterprises. Recommendations P1-19 refer to personal current accounts; Recommendations C1-13 refer to the clearing system, and Recommendations S1-8 refer to SME lending.
5. The Report focuses on competition in markets, rather than on profitability analyses, in order to detail more clearly the structural and behavioural inhibitors to greater competition in markets, and thus how to remove them. The recommendations have been tested, evaluated and refined in the course of oral hearings and meetings. The remainder of this consultation document outlines the report's main findings and recommendations in response to those findings.

¹ Summonses to a number of relevant parties were issued in December 2003, on foot of which the Authority received 120 file boxes of documentation. Data in electronic format relating to competition in these areas was submitted voluntarily. These data were analysed, and once the analysis of these data was complete, the Authority held oral hearings under oath with ten parties, along with numerous other meetings with interested parties from July to October of 2004. Authority staff logged almost 46 hours of summons hearings. The purpose of these hearings was to detail and clarify areas of interest noted during the analysis of summons documentation.

² LECG's background analysis (the "Phase 1 Report"), and the rationale for the decision to focus on these two areas (Market Definition and Competition Analysis Consultation) are available on the Authority's website at www.tca.ie/banking.html

6. The Competition Authority invites all interested parties to respond to this consultation. The consultation is being carried out publicly in the interests of fairness, consistency and transparency. The responses the Authority receives will inform its thinking in the compilation of the final Report on Competition in the Provision of Non-investment Banking Services in Ireland, which the Authority will publish in the first half of 2005.
7. The Authority is seeking responses to the Report in general and to certain recommendations in particular. Respondents, in compiling their submissions, should give consideration to the general questions below and also the focussed questions listed in the following pages, and, as far as possible, structure their submissions accordingly. Submissions should focus on new arguments and information not previously submitted to the Authority (and thus already examined by LECG).
 - I. Is the Report's analysis at any stage based on erroneous factual information? If so, how does this affect their recommendations?
 - II. Are there any major obstacles to the timely implementation of the recommendations?
 - III. Could the recommendations have any unintended negative consequences for competition?
 - IV. Are the recommendations addressed in each case to the appropriate party?
 - V. Are the recommendations fit-for-purpose? Will they solve the problems they address?
 - VI. Will the recommendations facilitate adherence to the precepts of "Regulating Better"³ - transparency, consistency, accountability proportionality, effectiveness and necessity?
 - VII. Have any obvious recommendations which would benefit competition been omitted?
8. Submissions should be sent, preferably electronically, to doc@tca.ie. Submissions in hard copy may be sent to:

Dave O'Connell,
The Competition Authority,
Parnell House,
14, Parnell Square,
Dublin 1.
9. Submissions will be accepted until 14th February 2005 and will be published on the Authority's website (www.tca.ie). Accordingly submissions should **not** contain any confidential information or business secrets.

³ "Regulating Better - A Government White Paper setting out six principles of Better Regulation", Department of An Taoiseach. See <http://www.betterregulation.ie/index.asp?locID=22&docID=-1>

PERSONAL CURRENT ACCOUNTS

Competition Issues Identified

1. Banks use current accounts as gateway products⁴, and it is more likely that a customer will avail of a bank's other services (mortgages, share dealing, car loans etc.) if they already use the bank's gateway product. Banks compete much more fiercely for new current account customers, particularly at secondary school and university level, than for customers who have already established a firm current account relationship with another bank. Existing customers are seen as already "locked in". Current accounts are also of central importance to consumers. Virtually all personal banking customers hold a current account and, as such, better competition in current accounts will have a broad positive effect.
2. There is not enough competition in personal current accounts in Ireland. The market is highly concentrated and a small number of players control the vast majority of the market. Between them, the two largest providers of personal current accounts in Ireland control over 70% of the market.

Estimated market shares measured by value of personal current accounts

2003

| Bank | Market share range |
|---------------------|-----------------------|
| Allied Irish Banks | 35% - 40% |
| Bank of Ireland | 30% - 35% |
| National Irish Bank | 0% - 5% |
| permanent tsb | 15% - 20% |
| Ulster Bank | 5% - 10% |

Source: Table 2, LECG Report 2004, pp 27.

3. There are numerous obstacles to switching, leading to customers becoming "locked in" to their current account provider. Consumers do not change their current account provider due to inconvenience, especially with regard to direct debits and standing orders, and uncertainty about payment of bills, while the switching process is taking place. Since the Authority commenced its Study, the Irish Bankers' Federation (IBF)

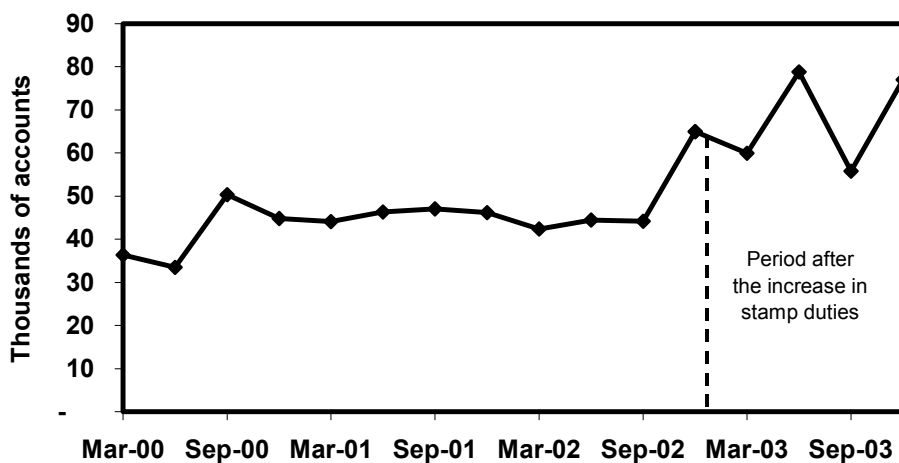
⁴ "Gateway products" are products offered by firms in order to establish a relationship with a consumer for the implicit or explicit purpose of selling the consumer additional products.

has established a Switching Code, which will become effective in 2005⁵. Further initiatives are required to improve ease of switching in the Irish market, and these are identified in the report.

4. The way in which stamp duty is levied on plastic cards restricts competition by discouraging switching, from bank to bank, and also from higher-cost payment mechanisms (cheques) to lower-cost payment mechanisms such as plastic cards. Following the increase in stamp duty in December 2002, the number of personal current account closures rocketed by 40% to 65,000 in the final quarter of 2002, and stayed substantially above average account closure levels throughout 2003.

Number of personal current accounts closed per quarter

Q1 2000 – Q4 2003



Source: Figure 7, LECG Report 2004, pp 45.

5. The current account market in Ireland is characterised by numerous barriers to entry and innovation. These include the structure of the clearing system, price controls and the levying of stamp duty on plastic cards.
6. The control of bank charges sharply constrains innovation and competition on bank charges and fees. These price controls also act as a barrier to entry, as banks fear they will not be permitted to recoup their entry costs. Consumers are therefore being denied the benefits which greater competition brings in terms of better service and greater innovation. Although well-intentioned, price controls do not ultimately work in the best interests of consumers. The Competition Authority understands that Kenya appears to be the only other State that controls bank fees and charges under statute.
7. While recent controversy has focused attention on the enforcement of these regulations, the issue of overcharging is separate to the issue of whether price controls benefit consumers. Sustained instances of high charges are less likely to be successful and profitable in a market characterised by ease of movement by the consumer, and

⁵ A Banking Code was first implemented in the UK as long ago as 1991, and updated most recently in March 2003, almost two years before the IBF's Code is scheduled to take effect. The UK Code includes provisions for switching.

greater innovation and price competition by the banks. Once consumers can readily switch their current account and new providers can enter this market, customers who feel they are being overcharged can simply walk away and take their business elsewhere. In any case, the existing regime does not fully control prices as it does not cover all aspects of the pricing bundle attached to current accounts; interest rates paid on current account balances are not (and should not be) covered by price regulation and so lower bank charges are merely reflected in lower (or zero) interest being paid. There is little competition on interest rates paid on PCAs.

8. Detailed analysis of competition issues in the personal current account market can be found in Sections 2 and 3 of LECG's Report. The relevant recommendations are designed to enhance competition in the current accounts by improving switching opportunities and reducing barriers to innovation.
9. Since LECG issued its Report to the Authority, the Minister for Finance has indicated that he intends to alter the stamp duty regime applying to plastic cards. It is proposed that the 2005 Finance Bill will provide an exemption from the double stamp duty charge arising from the switching of financial cards such as credit cards, charge cards, ATM cards and Laser cards. According to the Department of Finance, this measure is estimated to cost €0.2 million in 2005 and €3 million in a full year. This is a welcome first step towards addressing the issues raised by LECG in Section 3 of their Report, however questions regarding the manner of implementing this, and other related, changes remain, and are addressed in this consultation document.

Recommendations

Recommendations to improve switching⁶

| Recommendation | Action by |
|--|-----------|
| P1: The Irish Bankers' Federation (IBF) should update its Switching Code with the goal of reducing the timescales. A modified Switching Code should be released by the end of 2005. | IBF |
| P2: In its monitoring of the Switching Code, the Irish Financial Services Regulatory Authority (IFSRA) should make public its findings regarding the Switching Code's effectiveness. Any such report on the Code's effectiveness should include the performance of individual banks in completing their functions under the Switching Code in an accurate and timely manner. IFSRA's monitoring of the Switching Code should be on-going and not a one-off assessment. IFSRA's initial reporting on the Switching Code's effectiveness should be released by June 2005 and should be updated prior to the first notifications called for in Recommendation P10. | IFSRA |

⁶ For ease of reference, these Recommendations follow the numerical order in which they were set out in LECG's Report. In this particular section, the issue of switching is addressed both in Recommendations 1-8 and Recommendations 16-18.

| Recommendation | Action by |
|--|-----------------------|
| P3: The Irish Payment Services Organisation (IPSO) should develop standardised direct debit mandate agreements that will allow a customer's direct debit instructions to be transferred to a new bank when switching account providers without the need for new agreements between originators and the customer. This should be completed by September 2005. | IPSO |
| P4: The Department of Finance should bring forward legislation to alter the structure of stamp duty levies on cards and credit card accounts so that consumers that switch providers during the year are not double taxed. | Department of Finance |
| P5: The Department of Finance should bring forward legislation to alter the structure of stamp duty levies on cards and credit card accounts so that consumers that "upgrade" or "downgrade" their account during the year are not double taxed. | Department of Finance |
| P6: The Department of Finance should consider implementing Recommendations P4 and P5 by collecting stamp duty annually on one date, common across all financial institutions. | Department of Finance |
| P7: If the Government is concerned about the potential loss of revenues resulting from Recommendations P4 and P5, then the Department of Finance should determine the level of stamp duties required to render Recommendations P4 and P5 revenue neutral. Changes in the structure and levels of the stamp duties on cards and credit card accounts can be made at the same time. | Department of Finance |
| P8: The Department of Finance should prepare an analysis of the costs imposed by the stamp duty levy on electronic cards, charge cards, and credit card accounts. If the distortions induced by stamp duty are large, the Department of Finance should consider whether some or all of the revenues raised should be raised through other, less distortionary means. The Department's analysis should be published. | Department of Finance |

Relevant Consultation Questions

P2 Question: Can a voluntary Switching Code reasonably be expected to deliver competition in personal current accounts, or should IFSRA implement a statutory code? What benefits would outweigh the increased costs of implementing a statutorily-regulated regime? Should sanctions, including fines, be used to foster adherence to the Code?

P3 Question: Should a standardised direct debit mandate be obligatory, rather than optional? Is IPSO the appropriate body to receive this recommendation? Would there be any legal obstacles involved in implementing this recommendation, and if so, how could they be overcome?

P4 Question: What type of information should be exchanged between banks to enable the implementation of this Recommendation?

P8 Question: Should the manner in which Stamp Duty is levied be altered, or should it be abolished altogether? If it is to be retained, how can double taxation best be avoided?

Recommendations to improve entry and innovation

| Recommendation | Action by |
|--|------------------------------|
| <p>P9: The Department of Finance should bring forward legislation to focus the Irish Financial Services Regulatory Authority's (IFSRA) regulatory structure on consumer protection and not on the economic regulation of fees and charges to control market power. The economic regulation of fees and charges should end six months after the adoption of this legislation.</p> | <p>Department of Finance</p> |
| <p>P10: Upon adoption of the legislation discussed in Recommendation P9, IFSRA should require entities that will no longer be covered by fee and charge regulation to notify consumers that this regulation will end, provide the date this regulation will end, and provide a listing of all current fees and charges applicable to their accounts. IFSRA should also require that customers be notified of any changes in fees and charges two months prior to the imposition of these charges so as to provide customers sufficient time to switch providers if they wish to do so. These additional consumer fee notification requirements should continue for six months following the ending of fee and charge regulation, after which time current consumer notification requirements would again apply.</p> | <p>IFSRA</p> |

Relevant Consultation Questions

P10 Question: Is a light-handed approach to pricing of fees and charges appropriate? How can the alternative "consumer protection" model of regulation best ensure a fair deal for consumers?

Recommendations to improve consumer information

| Recommendation | Action by |
|--|--------------|
| <p>P11: As part of its consumer protection function, the Irish Financial Services Regulatory Authority (IFSRA) should require banks to provide interest rate information for PCAs and other personal accounts to their actual and potential customers. This includes, for example, posting personal current account and other personal account interest rate information on bank websites. Institutions should also be required to provide the account's current interest rate on each statement issued to a customer. Banks should make this information available within the next six months.</p> | <p>IFSRA</p> |

| Recommendation | Action by |
|---|------------------|
| P12: IFSRA should promote personal current account interest rate awareness, for example, by including interest earnings in its representative consumer profiles. | IFSRA |
| P13: IFSRA should provide in its comparison tables the prices charged by non-banks if these entities provide money transmission services. | IFSRA |
| P14: Banks should make available upon customer request a statement providing at least a full, one-year account history. This account history should be provided in either electronic or hard copy form at the customer's request. Each bank should make this service available to its customers prior to the lifting of its fee and charge regulation under the Consumer Credit Act, 1995, so that consumers can use this information to support credit applications if they decide to switch suppliers when the regulation of the fees and charges for their accounts ends. In any event, each bank should offer this service by the end of 2005. | Banks |
| P15: IFSRA should publish information regarding the availability of the account information called for in Recommendation P14 by financial service providers. IFSRA should also publish information regarding the fees charged by institutions for this information. This information should be published within an appropriate period following the implementation of Recommendation P14. | IFSRA |

Relevant Consultation Questions

P11 Question: Should this recommendation be extended, such that information on interest rates is displayed by reference to European Central Bank rates? If so, what is the most appropriate means of disseminating this information to customers?

P14 Question: Should information on current account histories be provided free-of-charge, or should it be chargeable? If it is chargeable, would this constitute a barrier to switching?

Further Recommendations to improve switching

| Recommendation | Action By |
|--|------------------|
| P16: The Irish Bankers' Federation (IBF) should develop standardised procedures for identifying customers to meet anti-money laundering requirements. These procedures should be developed with the oversight of The Money Laundering Steering Committee. | IBF |
| P17: The IBF should modify its Switching Code to include the transfer of copies of the identification information necessary for money laundering held by the old institution to the new institution. | IBF |



| Recommendation | Action By |
|---|-------------------------------------|
| P18: The Money Laundering Steering Committee should consider amending its Guidance Notes to allow for accounts to be opened and funds to be deposited prior to customer identification. This change would not, however, allow funds to be withdrawn or otherwise transmitted prior to the satisfactory identification of the customer. | Money Laundering Steering Committee |
| P19: The Money Laundering Steering Committee should develop a means to open accounts by remote methods while also allowing institutions to verify the identity of their customers in an acceptable manner. This should be developed in consultation with the Irish Bankers' Federation. | Money Laundering Steering Committee |

Relevant Consultation Questions

P16 Questions: Should other parties, e.g. the Garda Fraud Squad or the Criminal Assets Bureau have an input in this area? What legal changes would need to be made in order to implement standardised procedures for identifying customers to meet anti-money laundering requirements? How can the *bona fides* of account holders be assured under these proposals?

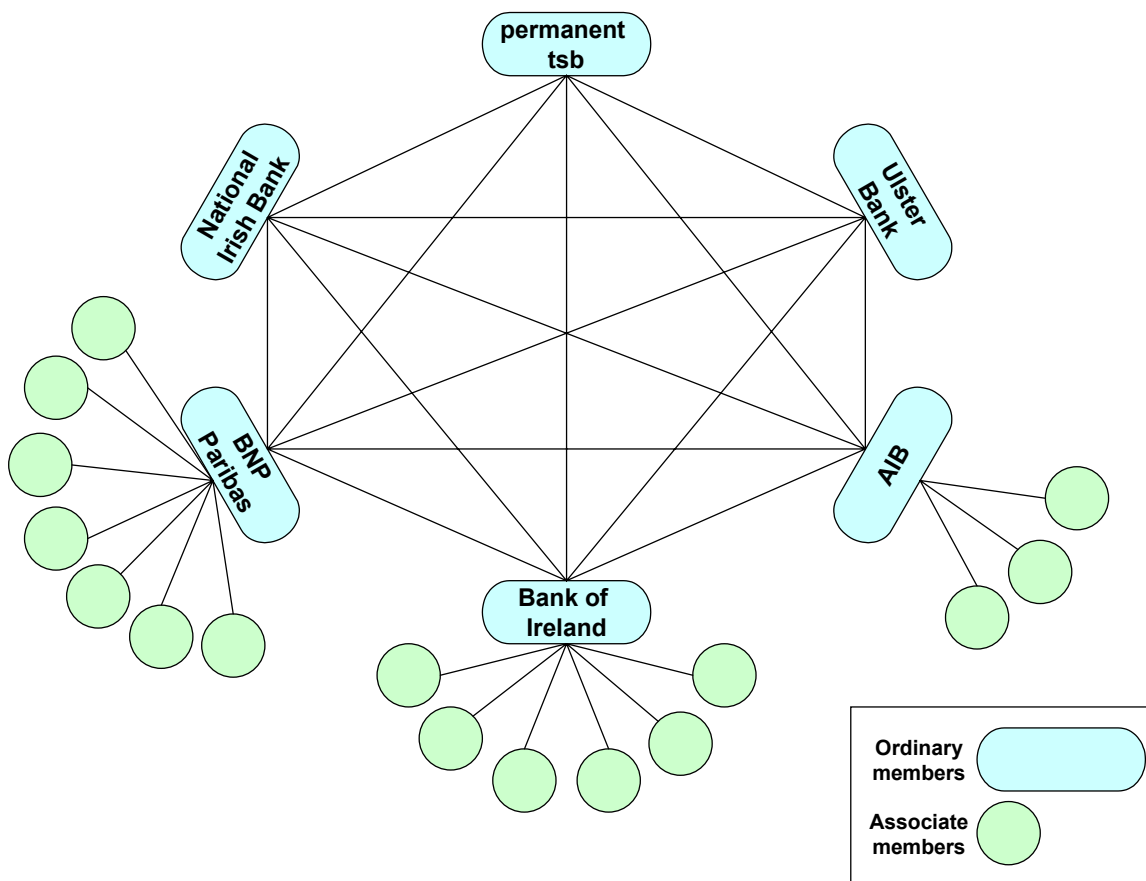
THE PAYMENT CLEARING SYSTEM

Competition Issues Identified

1. The Payment Clearing System is the system of arrangements among financial institutions which dictates how paper and electronic funds are transferred between accounts and between institutions. In Ireland, the clearing systems for paper and most electronic transactions involve a web of bilateral agreements between the banks under the umbrella rules of the Irish Payment Services Organisation (IPSO). Payment clearing systems in Ireland are regulated by the Central Bank and Financial Services Authority of Ireland (CBFSAI). The Irish Paper Clearing Company (IPCC) is responsible for paper clearing, while the Irish Retail Electronic Clearing Company (IRECC) is responsible for most electronic transactions.

Current payment clearing structures

Connecting lines indicate bilateral clearing relationships.



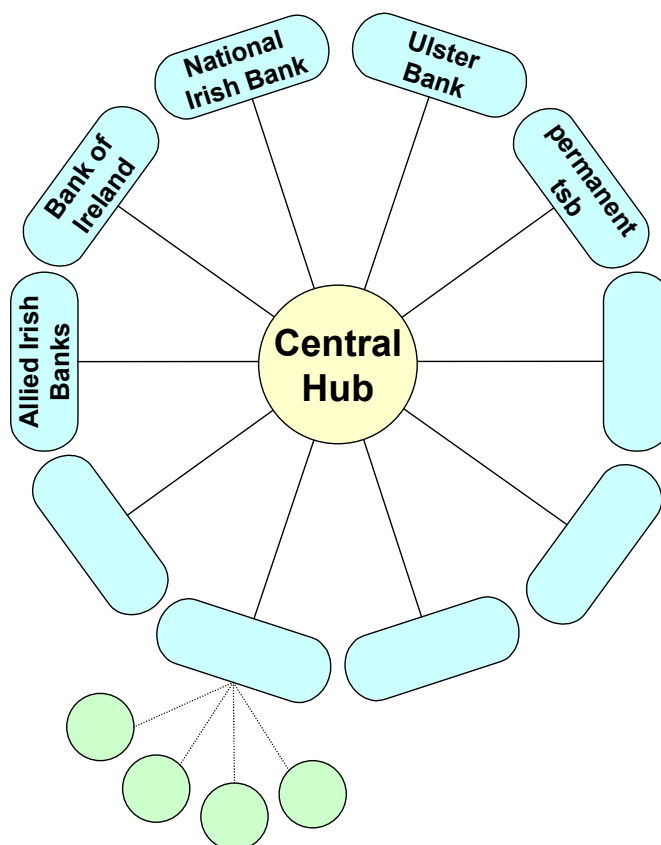
Source: Figure 8, LECG Report 2004, pp 71.

2. 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. Gaining timely access to clearing services is therefore a prerequisite for entry into money transmission services, and thus personal and business current accounts. Indeed, none of the non-clearing banks currently offer a personal current account product to new customers⁷.

3. While there have been some steps in the right direction since the commencement of this Study, whereby potentially restrictive membership requirements have been removed, barriers to competition still persist in the payments clearing system. Enquiries indicate that credit unions are considered to be ineligible for clearing company membership, foreclosing the market to a potential competitor. The absence of clear procedures for evaluating and admitting new members also 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. Some of the detrimental effects of this system can be solved by establishing a centralised Automated Clearing House (ACH) functionality for Ireland. An ACH would remove the delays and obstacles to membership engendered by the necessity to establish a web of bilateral agreements with each clearing bank.

Structure of a potential Automated Clearing House



Source: Figure 9, LECG Report 2004, pp 85.

⁷ First Active, which offers a current account mortgage, is part of the RBOS Group along with Ulster Bank, which is a clearing bank.

4. The model of corporate governance followed at IPSO and clearing company levels creates potential competition concerns which could be relatively easily resolved. Also, moves to reduce both the reliance on cheques and the speed at which cheques are cleared would increase the potential for competition in banking in Ireland.
5. Detailed analysis and recommendations on competition in the payments clearing system can be found in Sections 4 and 5 of the LECG Report.

Recommendations

The recommendations fall into two broad categories; firstly, entry to the clearing system and secondly, the future of the clearing system.

Recommendations to facilitate entry to the clearing system

| Recommendation | Action By |
|--|-------------------|
| <p>C1: The Board of Directors of the Irish Paper Clearing Company (IPCC) and the Irish Retail Electronic Clearing Company (IRECC) should each adopt a policy statement indicating that credit unions are eligible for both ordinary and associate membership in the payment system run by IPCC / IRECC. Alternatively, the Articles of Association, Rules for Membership, Outline Guide to Membership, and any other relevant documents should be modified to reflect the fact that credit unions are eligible for both ordinary and associate membership in the payment system run by IPCC and IRECC. These changes should be prepared for Central Bank and Financial Services Authority of Ireland (CBFSAI) approval within four months of the release of the Authority's final report. The CBFSAI should approve the new or revised documents reflecting this clarification.</p> | IPCC, IRECC |
| <p>C2: The Irish Payment Services Organisation (IPSO) should make generally available, for example by posting on its website, the Articles of Association, Rules for Membership, Outline Guide to Membership, and Fair and Equitable Principles regarding impact costs for the clearing companies. Any other documents regarding membership criteria and procedures should similarly be made public. These materials should be made available within one month of the release of the Authority's final report.</p> | IPSO |
| <p>C3: The Board of Directors of IPSO should be expanded to include other stakeholders, particularly users of money transmission services. This should be completed no later than three months after the completion of the Authority's final report.</p> | IPSO |
| <p>C4: The Boards of Directors of IPSO, IPCC, and IRECC should be combined into one entity. This should be completed no later than three months after the completion of the Authority's final report. Committees operating under this new Board should be appointed to handle specific technical matters requiring specialised skills.</p> | IPSO, IPCC, IRECC |

| Recommendation | Action By |
|---|-------------------|
| C5: Summaries of IPSO, IPCC, and IRECC Board and committee meeting minutes should be publicly available, for example by posting on IPSO's website. | IPSO, IPCC, IRECC |

Relevant Consultation Questions

| |
|--|
| <p>C1 Question: Could Credit Union membership of either IPCC or IRECC negatively affect the operational status or the stability of the paper or electronic clearing systems? If so, how could these difficulties best be overcome?</p> <p>C3 Question: What are the respective costs and benefits of enlarging the IPSO Board of Directors to include other stakeholders? Should organisations who provide broad consumer representation be present?</p> <p>C4 Question: Will creating just one Board of Directors for IPSO, IRECC and IPCC assure a sufficient degree of corporate oversight? How should the committees under this Board be appointed? Should non-bank stakeholders be represented on these committees?</p> <p>C5 Question: What format should these minutes take? Is the publication of minutes the most appropriate means of keeping meeting discussions focussed? Would other alternatives, such as holding meetings in public, or posting recordings of meetings on IPSO's website, be better suited to this purpose?</p> |
|--|

Recommendations to facilitate a more efficient clearing system

| Recommendation | Action by |
|---|------------------|
| C6: The Board of Directors of the Irish Retail Electronic Clearing Company (IRECC), with the support of the Irish Payment Services Organisation (IPSO), should prepare and publish Requests for Proposals (RFPs) for the provision of ACH functionality for Ireland. These RFPs should include the possibility of handling truncated cheques and be issued no later than four months after the completion of the Authority's final report. | IRECC, IPSO |
| C7: The Board of Directors of IRECC, with the support of IPSO, should prepare a cost/benefit analysis of the various options for ACH functionality derived from the RFPs detailed in Recommendation C6. Both private costs and benefits, such as the cost of the technology and reductions in processing costs and public benefits, such as ease of entry and the impact on the safety and soundness of the clearing system, should be considered. A decision on the way forward in this area should be taken by the IRECC Board based upon this cost/benefit analysis and should be made in consultation with the Central Bank and Financial Services Authority of Ireland (CBFSAI), in its role as regulator of payment systems in Ireland, the Department of Finance, and The Competition Authority. The decisions of the IRECC Board in this regard need not be unanimous but instead should be based upon the voting procedures set out in IRECC's Articles of Association. The Board's analysis should be made public. | IRECC, IPSO |

| Recommendation | Action by |
|---|--|
| C8: The Department of Finance should bring forward legislation expanding §45(A) of the Bills of Exchange Act, 1882 (as inserted by §132 of the Central Bank Act, 1989) to allow for the electronic re-presentation of items unpaid upon first presentation. | Department of Finance |
| C9: The Department of Finance should bring forward legislation that (a) assigns ownership of an original paper cheque to the institution that first receives it into the banking system; (b) overrides the right of customers or the paying bank to demand the return of cheques; (c) allows the bank with ownership of the paper cheque to provide an image of the cheque instead of the paper original to anyone requiring it; and (d) gives the imaged cheque the same legal and evidential status as if it were the original document. | Department of Finance |
| C10: The Irish Paper Clearing Company (IPCC) and IRECC should update their clearing rules, procedures, and standards to reflect truncated items. In particular, standards and procedures for the creation, transfer, and management of imaged files should be developed. | IPSO, IRECC |
| C11: IPSO should prepare a cost/benefit analysis of the various options for the use of truncation technology. This analysis should be completed within six months of the release of the Authority's final report and should be released publicly. | IPSO |
| C12: A decision on the way forward with regard to truncation should be taken by the IPCC Board giving consideration to the cost/benefit analysis referred to in Recommendation C11 and should be made in consultation with the CBFSAI in its role as regulator of payment systems in Ireland and the Department of Finance. The decisions of the IPCC Board in this regard need not be unanimous but instead should be based upon the voting procedures set out in the IPCC Articles of Association. | IPCC |
| C13: The Departments of An Taoiseach and Finance should issue a position paper regarding their proposed implementation plan for the National Payments Strategy. This position paper should indicate which parts of the National Payments Strategy they will adopt, modify, or reject. It should also provide details for any new proposals. A proposed implementation timeline and paper transaction reduction targets should also be included. This position paper should be issued within the next five months so that the Government's policy can be adequately reflected in the analyses and decisions referred to in Recommendations C11 and C12. | Department of Finance, Department of An Taoiseach |

Relevant Consultation Questions

C6 Question: Should any Request For Proposals focus on an Ireland-only Automated Clearing House (ACH), or should it consider more generally means by which Ireland could access cross-border ACH functionality?

C7 Question: What other considerations, if any, should be noted in IRECC's analysis of an ACH? Who should be responsible for implementing the findings of this analysis?

C9 Question: What pieces of legislation would need to be amended to allow for the implementation of this Recommendation, and for the implementation of cheque truncation, more generally? Does statute currently provide for electronic images to have evidentiary weight? Would changes be required to the internal rules of relevant bodies, such as the representative bodies for solicitors and auctioneers?

C10 Question: What legal restrictions are there to the adoption and use of cheque truncation? What specific legislative language could be recommended to remove the legal impediments to the use of truncation technology? How should the process of updating IPCC and IRECC clearing rules, procedures, and standards to handle truncated items be managed?

C13 Question: What role should other parties, particularly the Revenue Commissioners, play in the development of the Department of Finance's Position Paper on the National Payments Strategy? What would be a reasonable timeframe for this?

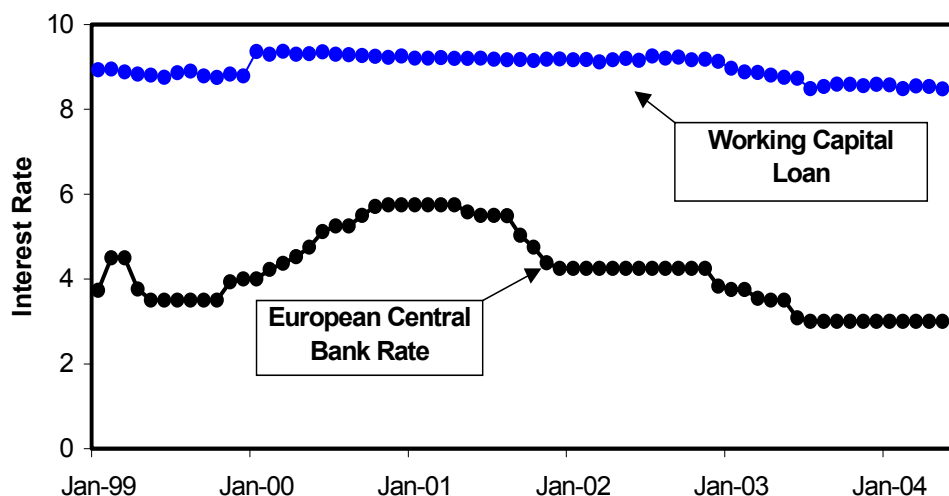
LENDING TO SMALL AND MEDIUM ENTERPRISES

Competition Issues Identified

1. SMEs require access to capital in order to develop and innovate, and bank lending provides one means of accessing capital. Competition in the provision of small business lending matters for the performance of the Irish SME sector, which has a significant impact on the economy as a whole.
2. Lending to SMEs takes many forms, but this Study has concentrated in particular on working capital loans, which are not readily substitutable with other loan products. Smaller SMEs tend to rely more on working capital than on other lending instruments due to their small size and their particular financing requirements. Consequently, the smallest businesses tend to suffer disproportionately where market power exists in the working capital market, as they have few or no financing alternatives. The supply of working capital is also closely associated with the supply of business current accounts.
3. Various analyses clearly demonstrate that there is little competition in small business working capital loans. Given similar loan sizes and credit risks, the interest rates on loans offered to small business customers tend to be higher where the customer has fewer alternative financing options. Further analysis demonstrates that, like the personal current account market, the SME working capital loan market is highly concentrated.
4. In addition, average monthly interest rate data shows that changes in the Central Bank rate (the Marginal Lending Facility) are not fully passed through to borrowers of working capital loans.

Average monthly interest rates

January 1999 – June 2004

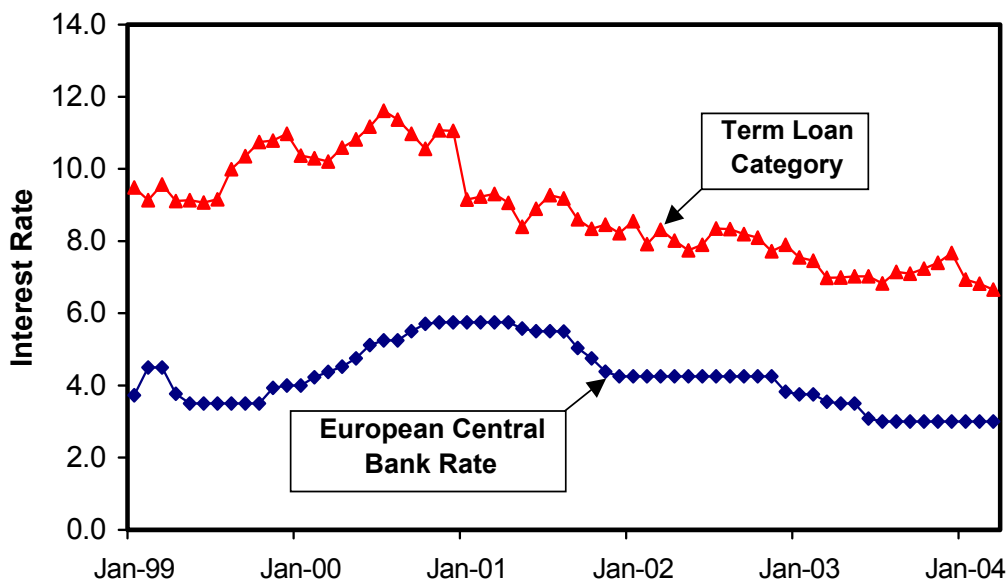


Source: Figure 10, LECG Report 2004, pp 128.

5. Indeed, if changes in European Central Bank rates were fully passed onto SMEs by banks, in the period January 2001 to January 2004, Irish SMEs would have saved €85m in interest payments annually.⁸ This indicates that banks are exercising market power, to the particular detriment of small enterprises. Using a similar form of analysis, the term loan market, with a greater number of market participants, appears to operate competitively.

Average monthly interest rates

January 1999 – June 2004



Source: Figure 10, LECG Report 2004, pp 128.

6. Barriers to entry and switching costs further inhibit competition in this market. Because of the linkage between working capital loans and business current accounts, a new entrant needs to offer a competitive current account in order to successfully participate in the working capital loan market. The barriers to entry evident with regard to personal current accounts and the clearing systems therefore apply equally to small business lending.
7. Due to the persistence of needless obstacles, little switching takes place in SME working capital lending. Firstly, SMEs may be reluctant to change lenders because they fear the loss of valuable credit histories and relationships with their existing bank. Secondly, obstacles to current account switching inhibit working capital lender switching. The analysis shows that these barriers are unnecessary. Working capital loans should not be tied solely to business current accounts, and concerns over loss of credit histories should be assuaged by facilitating access to credit history records. The financial and reputational effects for small businesses can be devastating if staff wage payments are not made on time or cheque payments to trusted suppliers bounce. Therefore, small businesses may feel that they cannot afford to change working capital providers.

⁸ See LECG Report 2004, pp 129.

8. The analysis undertaken by LECG with respect to small business lending can be found in Section 6 of their Report, while recommendations are included in Section 7.

Recommendations

Recommendations to facilitate switching of current accounts and working capital loans

| Recommendation | Action by |
|--|-----------|
| S1: The Irish Bankers' Federation (IBF) should expand its Switching Code to include SME customers. This should be accomplished within six months of the release of the Authority's final report. | IBF |
| S2: The Irish Financial Services Regulatory Authority (IFSRA) should monitor the implementation of the business code discussed in Recommendation S1 and make public its findings regarding its effectiveness. This public study should include the performance of individual banks in completing their functions under the business code in an accurate and timely manner. IFSRA's monitoring of the business code should be on-going and not a one-off assessment. | IFSRA |

Relevant Consultation Questions

S2 Question: Should the IBF preside over an expanded voluntary Switching Code, or should IFSRA implement a statutory code? What benefits would outweigh the increased costs of implementing a statutorily-regulated regime? Should sanctions, including fines, be used to foster adherence to the Code?

Recommendations to improve customer information

| Recommendation | Action by |
|---|-----------|
| S3: Upon adoption of the legislation discussed in Recommendation P9 regarding the ending of fee and charge regulation, the Irish Financial Services Regulatory Authority (IFSRA) should require entities that will no longer be covered by fee and charge regulation to notify business customers that this regulation will end, provide the date this regulation will end, and provide a listing of all current fees and charges applicable to their accounts. IFSRA should also require that business customers be notified of any changes in fees and charges two months prior to the imposition of these charges so as to provide business customers sufficient time to switch providers if they choose to do so. These additional business customer fee notification requirements should continue for six months following the ending of fee and charge regulation, after which time current notification requirements would again apply. | IFSRA |

| Recommendation | Action by |
|---|------------------|
| S4: IFSRA should prepare business current account comparisons targeted to small businesses. These comparisons should consider both fees and interest rates. | IFSRA |
| S5: Banks should make available upon customer request a statement providing at least a full, three-year account history for any business loan, deposit account, or current account. At a minimum, this information should be made available in electronic format. Each bank should make this service available to its business customers prior to the lifting of its fee and charge regulation under the Consumer Credit Act, 1995, so that businesses can use this information to support credit applications if they decide to switch suppliers when the regulation of the fees and charges for their accounts ends. In any event, each bank should offer this service by the end of 2005. | Banks |
| S6: IFSRA should publish information regarding the availability of the account information called for in Recommendation S5 by financial service providers. IFSRA should also publish information regarding the fees charged by institutions for this information. This information should be published within an appropriate period following the implementation of Recommendation S5. | IFSRA |

Relevant Consultation Questions

S5 Question: Should information on current account histories be provided free-of-charge, or should it be chargeable? If it is chargeable, would this constitute a barrier to switching?

Recommendations to facilitate switching of secured loans

| Recommendation | Action by |
|---|-----------------------|
| S7: The Irish Bankers' Federation (IBF) should develop and promote the use of a standard form of mortgage and ancillary security documents in conjunction with the Law Society. The IBF should release this standard form of mortgage by the end of 2005. | IBF |
| S8: The Department of Finance should bring forward legislation allowing the transfer of a mortgage to a new loan provider without any change in the mortgage's validity or priority over other mortgages. The Department of Finance should also prepare other legislative changes as necessary to facilitate the transfer of mortgage security among financial institutions. | Department of Finance |

Relevant Consultation Questions

S7 Question: What should be the key features of a standard mortgage? Should any other parties be consulted in this respect, for instance, the Registry of Deeds, IFSRA or the Companies Registration Office?

S8 Question: What specific legislative changes would be required in order to implement this recommendation? What would be the suggested wording of any new legislation or amendment to current legislation?

