

SaltPay's Response to the AdC's Call for Information on "Digital Ecosystems, Big Data and Algorithms"

16.12.2021

The digitalisation of the economy has enabled the proliferation of platform-based business models. The value proposition of these models is to connect different sides of a market to facilitate the exchange of goods and services. These platforms¹ thrive from leveraging network effects, economies of scale and scope, and switching costs. When combined, these features create a tendency for extreme concentration in these multisided markets.² The market power that these large digital platforms enjoy provides them with the capacity to restrict competition and the fact that they often compete with other companies within their own platforms provides them the incentive to do so.

These business models have enabled technology firms such as Apple, Facebook (now Meta), Alphabet, and Amazon to harbour large quantities of both consumers and merchants as active users. When coupled with the vast amount of user data they have restricted access to, these firms are well placed to expand the reach of their ecosystems to the financial sector.³ In fact, BigTech's investment in fintech companies reached \$2.2B in 2020.⁴ Apple, who now offers an Apple Card⁵, acquired in 2020 for \$100m Mobeewave, a payments start-up that turns iPhones into mobile contactless payment terminals.⁶ In May 2020, Facebook announced the formation of a new team, Facebook Financial (F2), to build a cohesive payments strategy across its companies.⁷ It has also launched a "Shops" feature, which is an online storefront targeted at small businesses and designed to grow its e-commerce offering.⁸ Alphabet has developed strong merchant relationships through its Google Retail Service, and Google Pay already has more than 150 million monthly users in 30 countries.⁹ Amazon is progressively building up its banking ecosystem by offering a range of services to its merchants and customers including credit cards, checking accounts, and loans.¹⁰ It also has both physical and online payments solutions such as Amazon Pay, an online payments

¹ Examples include Google, Facebook, Microsoft, and Apple, as mentioned by the AdC in its Call for Information.

² For example, Google holds 95% of the search engine market share in Portugal (source: StatCounter).

³ "Rise of BigTech platforms in banking", Ryan Jones and Pinar Ozcan

⁴ <https://www.cbinsights.com/research/report/famga-big-tech-fintech/>

⁵ <https://www.apple.com/apple-card/>

⁶ <https://www.pymnts.com/apple/2020/apple-buys-mobeewave-for-100m/>

⁷ <https://www.bloomberg.com/news/articles/2020-08-10/facebook-financial-formed-to-pursue-company-s-commerce-ambitions>

⁸ <https://about.fb.com/news/2020/05/introducing-facebook-shops/>

⁹ <https://www.cbinsights.com/research/report/famga-big-tech-fintech/>

¹⁰ <https://www.cbinsights.com/research/report/famga-big-tech-fintech/>

processing service, and Amazon One, a physical payment system that works by reading users' palm print, offered in Amazon owned retail stores in the United States.¹¹

The digitalisation of the economy is thus progressively disintegrating the distinction between the online and physical world in financial services, as companies look to become one-stop shop financial ecosystems that offer consumers and merchants ways to make and accept payments irrespective of location or medium. What matters in this full-stack approach BigTech firms are pursuing is having full control over the customer experience. For example, by providing payment services, these tech firms can bypass industry incumbents such as schemes and banks and capture a greater portion of the economic benefits the ecosystem provides.¹² This means any competitive issue, be it access to financial data or access to payment infrastructure, is relevant for increasing competition in digital markets because they ultimately affect any potential challenger's ability to get merchants and consumers into their own ecosystem.

Importantly, while BigTech firms are well positioned to continue disrupting the financial sector without depending on incumbent players such as banks or schemes, FinTechs still depend on them to gain access to both sides of the market. In this context, we see it as the role of the AdC to enable competition in the current payments landscape to not only unlock the efficiencies for consumers and merchants in the present, but also to prepare the market for the disruption and the potential competitive issues that Big Tech firms will pose to the Portuguese market once they inevitably enter the financial sector.

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The two-sided nature of a payments market means that the main characteristics of multi-sided markets that make the market prone to competition law infringements by digital platforms also create the same competition issues for card schemes. Indeed, the traditional payments market structure relies on the use of a platform (a scheme) to connect issuers and acquirers, harnessing cross-externalities between the two sides, reducing transaction and search costs, and improving the overall efficiency of the system. The strong network effects at play, where an additional cardholder using a given scheme's issued card makes it more attractive for an additional merchant

¹¹ <https://www.cbinsights.com/research/report/famga-big-tech-fintech/>

¹² <https://www.forbes.com/sites/ronshevlin/2019/09/03/can-apple-or-amazon-become-full-stack-banks/?sh=2caec1ae1041>

to accept that scheme's payment method, creates a strong tendency towards concentration. Globally, Visa and Mastercard share a duopoly in card schemes and in Portugal the domestic scheme Multibanco enjoys quasi-monopoly status, using the AdC's own terminology.¹³

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We acknowledge the AdC's recent consultation into the financial sector¹⁴ and agree with its broad conclusions.

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Barriers to entry and expansion, and exclusion strategies in the digital sector

1. What are the main difficulties experienced in setting up firms and in expanding into new digital markets in Portugal?

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[Redacted]

[Redacted]

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[Redacted]

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Other relevant barriers to entry and expansion in the Portuguese payments space include the lack of direct access to SICOI, switching and entry costs, [REDACTED]

These issues are addressed in greater detail in questions 4, 5, 6 and 12 respectively. [REDACTED]

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2. Which products/services do you use and for which you consider there is a reduced capacity for substitution by other products/services (including the possibility of self-supply)?

Nothing to contribute.

3. If the respondent is a firm:

a. How does your activity depend on the products/services you identified in question 2?

Nothing to contribute.

b. What other alternatives are available in the market to the aforementioned services (including the possibility of self-supply)? What are your main advantages and disadvantages compared to the products/services your company uses?

Nothing to contribute.

c. Is the acquisition of these products/services preceded by negotiation? If so, please describe the negotiation of the terms and conditions associated with these products/services.

Nothing to contribute.

d. Do you consider that the terms and conditions for the use of these products/services limit, in any sense, competition in the market?

Nothing to contribute.

e. Did the acquisition of these products/services imply any limitation in contracting alternative or related products/services (e.g., exclusivity clauses)? (e.g. tying acquiring processing to hardware)

Nothing to contribute.

f. Do you consider that the company that provides these products/services uses them to favor other products/services of its own? How? What is the impact of this favoring on your company's activity?

Nothing to contribute.

4. Do you consider that business activity in the digital sector is disturbed by any unnecessary legal or regulatory requirements? Why do you consider these requirements unnecessary?

Payments service providers who cannot open a liquidation account in TARGET2-PT can only access SICOI indirectly, with a bank with the required liquidation account acting as an intermediary in exchange for a fee. These intermediary banks are often competitors of the PSPs, which creates a patent conflict of interest. PSPs are often charged disproportionate intermediation fees that complicate the access to SICOI, an essential infrastructure for their ordinary course of business. Indeed, in a survey conducted by the AdC, several entities pointed to issues in accessing SICOI as a major barrier to entry in the payments market. The AdC has acknowledged in the past the risks that this conflict of interest poses, and we reiterate the need for the AdC to remain vigilant regarding any potential exploitation by intermediary banks of their position of strength.

We acknowledge that banks acting as intermediaries take on a risk on behalf of the entity they are representing and accept that they should be compensated for that. However, this compensation cannot be disproportional to this risk. As such, to address the underlying issue, there should be i) regulation of the terms of engagement between PSPs and intermediary banks and ii) development of technical alternatives for PSPs to be able to access directly to SICOI's Instant Payments subsystem, as the AdC has already suggested in the past. Below we flesh out the rationale for these proposals:

1. The terms of engagement between direct and indirect participants need to be regulated to reduce the degrees of freedom of intermediary banks to exploit their role. The solution could be the setting of cost-based price limits on the intermediation fees that direct participants can charge, in conjunction with an increase in the monitoring of the compliance of Article 68 of the Bank of Portugal's Law Decree 91/2018. The intermediary would be required to substantiate, based on the costs and risks he's incurring, the level he's charging the indirect participant to access SICOI. This would increase transparency in the intermediation process, which would reduce the opportunity for banks to exploit the

indirect participant's dependence on them, while guaranteeing that the direct participant is adequately compensated for the role it plays in providing access to SICOI.

2. The second recommendation asks for direct access to be granted to PSPs to the Instant Payments subsystem of SICOI. The requirement of setting up a liquidation account in TARGET2-PT pertains to the need to account for the settlement and credit risk posed by the transaction that is being routed through SICOI. The nature of Instant Payments excludes this risk due to the immediate nature of the transaction flow. As such, there is no good reason why PSPs should not have access to this subsystem already. Note that Lithuania's Central Bank has already developed a platform, CENTROLink (see [here](#)), that allows every payment operator (incumbents and Fintechs alike) to access an instant payment settlement and clearing house in equal technological conditions.

5. **Do you consider there are switching costs in the digital markets that you are concerned about? Which ones? What kind of intervention could reduce these costs and facilitate consumer mobility?**

When contracting with Payment Service Providers, SMEs are often locked into long fixed-term contracts that automatically renew for successive fixed terms and include high termination costs. Both of these make it more difficult for SMEs to exit their contract and move to a more competitive supplier. We believe that the only reason a SME should remain with their current provider is because they believe they offer them the best product and service, not because they can't afford the termination costs or because they are locked into contracts.

In Portugal, termination costs vary from a range of 75€ to 500€, with more than 60% of the market stuck to prices above 100€. For comparison, a regular automatic payment terminal including some refurbished, commonly used model by most providers, costs around 120€ when new which means that the common termination costs are higher than the new client acquisition cost.¹⁸ Also note that, as mentioned earlier, most SME contracts renew automatically and have a typical length of 12 or 24 months.

¹⁸ Includes terminal cost, installation costs, commissions among others.

The EU's Revised Payment Services Directive (PSD 2)¹⁹ imposes restrictions on the termination costs that can be charged by PSPs to their users. As transposed into Portuguese law in Article 94 of Decreto-Lei n.º 91/2018, termination costs for framework contracts can only be charged if the contract has been in force for less than six months. However, under Article 76, PSPs and users can agree to derogate from this requirement when the user is not a consumer or microenterprise. Therefore, SMEs are not mandatorily protected by this requirement, even though termination costs can equally act as barrier to their ability to search and switch providers, as was identified by the UK Payment Systems Regulator in its recent review of the card-acquiring market.²⁰

Additionally, small businesses often sign up with the same PSP to acquiring services in conjunction with services for terminal provision and maintenance. Although both services are effectively tied and thus simultaneously terminated, termination costs incurred by merchants related to terminals are not subject to restrictions because the provision and maintenance of terminals falls outside of the scope of PSD2. Therefore, even though they deter microenterprises and SMEs from switching PSPs altogether, they are not regulated by the directive.

Finally, SMEs can be locked into long fixed-term contracts with PSPs that automatically renew for successive fixed terms after very short notice periods. Similarly, this constitutes an unnecessary barrier to switching providers and removes the incentives of PSPs to continually improve the pricing and services they offer. Added to this, the fact that the lock in periods for both the acquiring and terminal contracts often will not align can act as a disincentive for SMEs to terminate either of these contracts given the complementarity between the two underlying products.

In order to reduce these costs and facilitate SME mobility in the payments market, the AdC should advocate for the expansion of the mandatory restriction on termination costs under Article 55 of PSD2 and the addition of a restriction on the automatic renewal of fixed-term contracts under any revision of the Directive. On a national level, the AdC should consider linking terminal and acquiring contracts such that merchants do not incur additional termination costs when wanting to switch providers. These changes would improve competition between different payments service providers, giving more choice to SMEs and stimulating innovation.

¹⁹ Directive (EU) 2015/2366

²⁰ <https://www.psr.org.uk/our-work/market-reviews/market-review-into-the-supply-of-card-acquiring-services/>

6. Are there entry costs in the digital sector that you are concerned about? Which ones? Do you think these entry costs have a negative effect on competition? What kind of intervention could minimize this impact?

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Algorithms

7. Are there any examples of the use of algorithms by firms that you believe the AdC should pay attention to? If yes, why?

Nothing to contribute.

8. In your opinion, are there other pertinent benefits or concerns related to algorithms that you feel are important to highlight, in addition to those identified in this document?

Nothing to contribute.

9. With regard to the prevalence of monitoring and pricing algorithms, are the figures referred to, in this document, in line with your perception?

Nothing to contribute.

10. How do you expect the use of these type of algorithms to evolve in Portugal?

Nothing to contribute.

11. Is there any situation that has raised competition concerns associated with the use of algorithms?

Nothing to contribute.

Other

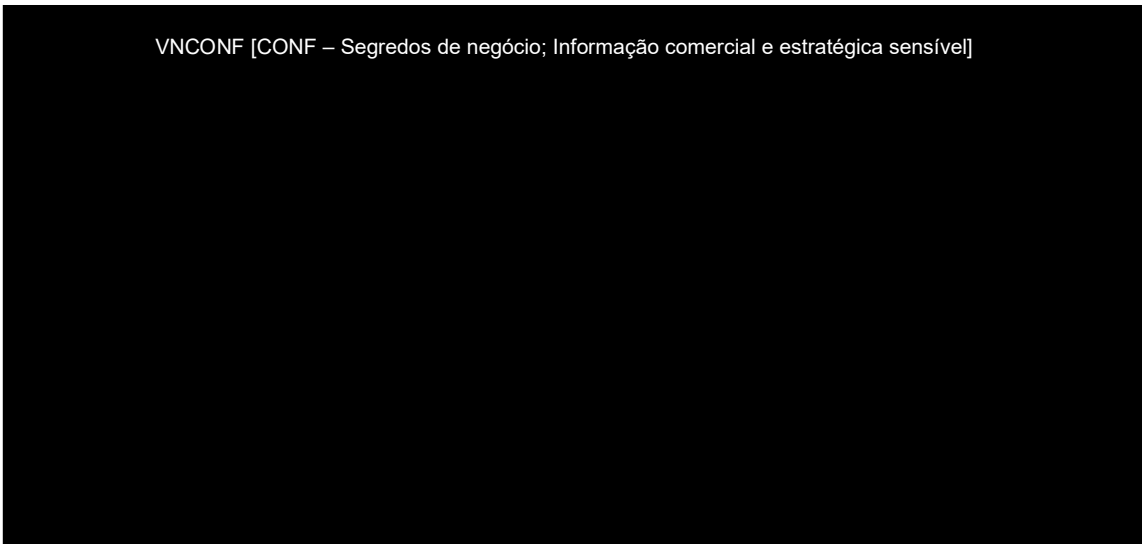
12. Please share other relevant information

The Portuguese Government, in its role as a consumer of payments related goods and services, should maintain technological neutrality in matters of public procurement and acceptance of payments.

With regards to public procurement, this entails setting the requirements of requests for proposals in such a way that any firm that has the capacity to supply the service is eligible to participate. When essential technical infrastructures are involved, the Government should guarantee these are open to any third-party payment service providers that, if given adequate access, can supply the service in question.

Recently there are two examples of this.

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The ability to compete in public tenders is fundamental for new entrants in the payment space. As pointed out by the Portuguese Competition Authority, network effects and economies of scale constitute a significant barrier to enter the digital financial sector. The large scale inherent to any project the Portuguese Government is tendering for, provides the opportunity for more efficient new fintech operators to overcome these barriers and develop some scale and a network of clients that they can then leverage to compete with incumbent operators.

The AdC has played an important role recently regarding issues of this kind and we urge it to continue intervening when technological neutrality in public tenders has not been assured. We expect that this has drawn closer attention of the AdC to this issue and would hope for clarifications regarding the competitive impact of the design of these tenders and public services.