Payment Systems Regulator

Market review of UK-EEA cross-border interchange fees

Stakeholder submissions on discussion of impacts working paper

18 July 2023

MR22/2.4 Submissions

Contents

British Retail Consortium 3
Coadec (rebranded as the Startup Coalition) 4
Electronic Money Association 5
Lloyds Banking Group 6
Mastercard 7
Revolut 8
SaltPay (now known as Teya) 9
Visa 10

Names of individuals and information that may indirectly identify individuals have been redacted.

British Retail Consortium

BRC

BRC response to PSR working paper on cross-border interchange fees

ABOUT THE BRC

The BRC's purpose is to make a positive difference to the retail industry and the customers it serves, today and in the future.

Retail is an exciting, dynamic and diverse industry which is going through a period of profound change. Technology is transforming how people shop; costs are increasing; and growth in consumer spending is slow.

The BRC is committed to ensuring the industry thrives through this period of transformation. We tell the story of retail, work with our members to drive positive change and use our expertise and influence to create an economic and policy environment that enables retail businesses to thrive and consumers to benefit. Our membership comprises over 5,000 businesses delivering £180bn of retail sales and employing over one and half million employees.

Overview

The BRC welcomes the PSR's consultations on the market reviews of scheme and interchange fees. The PSR's earlier Market Review on the supply of card acquiring services involved a thorough study that confirmed the BRC's own findings that the benefits of legislation to reduce card fees have not been passed on to most retailers, and that the fees levied by the card schemes have been increasing aggressively for several years. As the PSR stated in 2020, card scheme fees have "more than doubled over the period from 2014 to 2018, with most of this increase occurring between 2016 and 2018, after the IFR caps came into force" (PSR, 2020).

Our most recent data shows that cards account for 90% of retail spending, with the value of card payments in 2021 totalling £377.9bn (BRC Payments Survey). It is therefore crucial to the retail industry that card fees are fair and competitive, and the BRC is very encouraged to see the PSR acting on this finally.

Following the UK's departure from the European Union, cross-border interchange fees have increased very significantly for retailers. There have been new opportunities for anti-competitive behaviour and abuse of the card schemes' dominant market position. UK-EEA multilateral interchange fees for card-not-present transactions have increased fivefold, from 0.2% to 1.15% for debit and 0.3% to 1.5% for credit, and there has been no evidence or reasoning to explain the dramatic rise in fees. CMSPI, the payments advisory firm, estimates that these changes to interchange have added £30.8 million in annual costs to UK retailers, at a time of soaring inflation (particularly as these rates are expressed in percentage terms rather than in a flat rate fee) and coinciding with increased online and international expenditure following the COVID-19 pandemic.

Response to the working paper

Relocation

Fees are based on two things: where the card is located, and where the merchant is located. Card schemes therefore charge cross-border fees dependent on where the merchant is located versus the card. For physical, card-present transactions, this means transactions must be routed through location of the physical store. For e-commerce, merchant location is based on their principal place of business or other permanent locations where they conduct 'substantial business activity'.

Looking at businesses that are primarily in-store retailers, relocation is not really an option. Given that the fee is based on the merchant location it would mean them relocating all of their stores to a different country. Retailers are highly unlikely to move their physical stores and principal business outside of the UK, especially those with a large British presence.

For ecommerce companies, relocation is, in theory, an option. However, the company has to have substantial business operations in that country in order to route the transaction as a domestic transaction. So here, whilst it may be an option for some very large ecommerce businesses that are able to set up substantial operations in multiple other countries, for many companies this is very difficult and therefore the transaction will be charged dependent on the main place of business.

There is nothing in regulation that prevents merchants from routing their transactions through their different acquirers in different countries, but card scheme rules negate the importance of acquirer location. If a merchant has an acquirer in another country, there is an argument to be made that it would make sense for the merchant to be able to route any transactions made with cards from that country through their acquirer in the corresponding country, and therefore be charged as a domestic transaction. There is an existing exemption for airlines, that we believe to be similar to this. This would significantly reduce the need, and impact, of cross-border fees.

We therefore see that the outlined impact of retailers relocating to an EEA country to avoid cross-border interchange fees for purchases by EEA consumers within the UK, or on the UK website, as highly unlikely given the complexities that sit behind it.

Pass-through to consumers

One potential impact mentioned is price rises in stores to counter rising fees. The reality is that this is unlikely. Profit margins within the retail sector are typically very tight, and competition strong. Tourists using foreign cards represent a subsection of consumers, for many retailers it would not be worth risking raising prices and losing customers to their competition in an attempt to counteract fees from a subsection of their consumers.

The other potential impact cited in the paper is price differentiation across different country's website domains. As far as we are aware, price differentiation is not new and has been occurring in the industry for many years. We understand this is based on domain as opposed to IP address, though some websites will route you to the country's domain site using your IP address.

Wider concerns

Regardless of whether or not the above impacts have substance, card schemes should not be allowed to exploit a regulatory loophole to substantially increase fees not relative to costs. It serves as further evidence that the fees charged by the card schemes are exploitative and opportunistic, and that competition is not working in the payments space.

It is imperative that the PSR considers the anti-competitive behaviour of the card schemes, and the apparent willingness to abuse a regulatory loophole with no reasoning or indication that their costs have increased fivefold.

With a developing global economy, the question comes as to why the card schemes are permitted to restrict domestic routing through local acquirers. If this was allowed, merchants could utilise acquirers in different territories to allow all transactions to be routed through their home country and pay domestic fees rather than cross-border fees.

While we understand the limitation that this market review is to look at cross-border interchange fees following the abuse of the regulatory loophole, we continue to urge the PSR to consider a broader examination of interchange fees and whether these are fit for purpose within the UK landscape.

A Supreme Court ruling in 2020 declared interchange fees in the UK market as unlawful. Some countries have abolished domestic interchange fees, including The Netherlands, Denmark and Canada, and in a market where card issuers generate sufficient income from other sources, it seems evident that interchange fees are no longer necessary in such a mature card market as the UK.

Conclusion

While relocation and pass-through to consumers are theoretical responses to the extortionate hike in cross-border interchange fees, we have not seen evidence that this is the case. Instead, we believe this overlooks the key issue - card schemes should not be allowed to exploit a regulatory loophole and utilise anti-competitive behaviour, with no justification for the substantial rise in fees.

We believe the cross-border interchange fees should be capped at 0.2% and 0.3%, as they were under the IFR. There has been no reason to increase these fees following EU withdrawal. However, we believe this should be a temporary intervention while a broader review into the market is conducted.

We believe that the market is currently operating under historic regulation and fee structures against the backdrop of far-reaching technological change and accompanying consumer behavioural developments, and a further review should look into:

- Cross-border acquiring should be allowed if the UK wants to be a global competitive economy. This would allow merchants to route transactions through domestic channels, and cross-border interchange fees would therefore be much less of a concern. This is being done with a lot of Open Banking providers.
- Interchange fees need to be looked at more widely. They were introduced to incentivise card use, and in the UK where 90% of transactions are made on card, it is clear that this incentivisation is no longer necessary. Further, in 2020, the UK Supreme Court ruled that interchange fees within the UK were unlawful. Interchange fees are no longer necessary in the UK market, and in fact create a hindrance to the development of innovative competition in the market.

Coadec (rebranded as the Startup Coalition)

www.coadec.com

COADEC RESPONSE

MR22/2.4 Market review of cross-border interchange fees working paper

---

About Coadec:

The Coalition for a Digital Economy (Coadec) is the policy voice of tech startups and scaleups in the UK. Since 2010, Coadec has worked to engage on behalf of tech startups in public policy debates in the UK across a range of priority issues for startups including access to finance, immigration and skills, and technology regulation.

Coadec is part of the Axe the Card Tax campaign, a coalition of trade bodies representing 240,000 businesses across the UK campaigning for measures to support payments innovation.[1] The coalition is calling for actions to promote competition in the payments sector, to reduce the costs of accepting payments, and to ensure there is a level playing field that enables the UK's burgeoning Fintech sector to compete with incumbents.

Response Summary

Coadec welcomes the PSR's market review of UK-EEA consumer cross-border interchange fees. It is our view that Mastercard and Visa's ability to increase these fees with no legitimate justification is unmistakable evidence that the market is not working well – and the PSR must intervene.

We recognise that the Treasury itself has a role in reviewing the functioning of UK interchange fees, namely, of the functioning of the IFR in the UK, which is why the Axe the Card Tax campaign is calling for a parallel review of card payment fees to be launched by the Treasury itself.[2] The PSR will nevertheless have an essential role in establishing whether the market is functioning correctly efficiently *under the current regulations.*

While we are pleased to see the progress made in the PSR's thinking outlined in this working paper, we remain certain that there is sufficient evidence for the PSR to compel Visa and Mastercard to reverse the increase in cross-border interchange fees until this review is concluded. We also believe the review should be expanded to other manifestations of cross-border interchange (i.e. non-European and commercial card) and that the PSR is overstating the ability of, particularly small, businesses to react to this change.

---

[1] www.axethecardtax.com

[2] We note also that such review is considerably overdue, as the Payment Card Interchange Fee Regulations 2015 (PCIFR 2015) calls for such a review within five years of the Regulations coming into force (see Part 7).

Detailed Response

Coadec's thoughts on the broad set of issues discussed in this paper, including the way UK service users may be affected by the increases, and whether we have missed anything out.

Coadec broadly supports the review of cross-border interchange fees by the PSR and agrees with the general themes highlighted in this working paper that 1) multilateral interchange fee (MIF) rates for UK-EEA CNP transactions have increased, 2) that this is in spite of year on year reductions in the volume and value of these transactions and 3) the implication that there is no intuitive rationale for these fee rises. This third point has also previously been stated by Chris Hemsley during an evidence hearing to the House of Commons Treasury Select Committee.[3]

Hence, absent such cost justification, we see only three possible explanations for the interchange fee increases:

(1) Mastercard and Visa agreeing with each other (or otherwise coordinating) to increase their UK-EEA cross-border interchange fees, at the same time and by the same amount – this would of course be a serious breach of UK competition law; or
(2) Mastercard and Visa increasing their UK-EEA cross-border interchange fees independently of each other, but nevertheless each representing a "*decision of an associations of undertakings*" (i.e. of Mastercard and Visa's issuers respectively, given issuers' common interest in higher interchange fees) – this would also be a breach of competition law; or
(3) Mastercard and Visa are each exercising an abuse of a dominant market position, of setting excessive and/or unfair prices, i.e. by raising prices so significantly without apparent constraint. This would also be a breach of competition law.

In our view, the most likely explanation for the interchange fee increases is a combination of (2) and (3).

In the PSR's MR22/2.1 Market review of UK-EEA consumer cross-border interchange fees, the PSR stated that it wants to understand the rationale behind the fivefold increases in interchange fee rates for Visa and Mastercard's consumer debit and credit UK-EEA card-not-present transactions since the UK's withdrawal from the EU, as well as the impact of these increases.[4] In particular, the PSR asked whether the card scheme operators' ability

[3] Letter from Chris Hemsley, PSR Managing Director, to Rt Hon Mel Stride MP, Chair, Treasury Select Committee, 17 December 2021, answer to Q1.
[4] PSR Consultation paper: Market review of UK-EEA consumer cross-border interchange fees: An update and draft terms of reference (MR22/2.1), June 2022 (PSR Cross-border interchange consultation), para. 1.18.

to increase these fees is an indication that the market(s) or aspects of market(s) is not working well.[5]

The Market review notes that:

"Mastercard announced at the end of 2020 that it would increase inbound IFs for consumer credit and debit CNP transactions. Visa announced in March 2021 that it would increase both inbound and outbound IFs. Both the Mastercard and Visa increases became effective in October 2021. Mastercard subsequently announced in late 2021 that it would increase outbound IFs, which became effective in April 2022."

The PSR's review is welcome, however it provides little analysis as to whether it is an acceptable market outcome for Visa and Mastercard to significantly increase the fees for outbound and inbound IFs, merely a statement that they have done so.

The PSR has responsibility for enforcing UK competition law – primarily the Competition Act 1998 (**CA98**) – in relation to payment systems.[6] The PSR also of course has regulatory duties – under the Financial Services (Banking Reform) Act 2013 (**FSBRA**). In our view, those regulatory duties also require the PSR to act in response to Mastercard and Visa's dramatic interchange fee increases.

Coadec believes that the PSR should order that Mastercard and Visa reverse their UK-EEA cross-border interchange fee increases, at least until such time that the schemes are able to demonstrate that such increases are compatible with both competition law and the PSR's statutory objectives. Below, we have outlined four reasons why this must happen.

(1) Mastercard and Visa's UK-EEA cross-border interchange fee increases is potentially the result of a price-fixing agreement between Mastercard and Visa

The card schemes' dramatic increases in their UK-EEA consumer cross-border interchange fees in 2021 could have been the result of a direct agreement between Mastercard and Visa to raise those prices. This is also more likely given the quick succession of Mastercard and Visa's UK-EEA interchange announcements – Mastercard's at the end of 2020 and Visa's March 2021, with both increases effective from October 2021[7] – and identical levels of interchange fee increases.

This first explanation assumes, however, that in the absence of such (illegal) price-fixing, there would be a competitive constraint on the level of interchange fees, such that the

[5] PSR Cross-border interchange consultation, para. 2.1.
[6] Concurrently with the Competition & Markets Authority (CMA).
[7] See Consultation paper, footnote 8.

payment scheme that set a higher interchange fee might suffer a loss of business (e.g. a loss of acquirers and/or merchants to the scheme that set a lower interchange fee).

In reality, however, Mastercard and Visa do not compete with each other to attract and/or retain acquirers and/or merchants on the level of interchange fee, either UK-EEA cross-border or any interchange fees,

On the contrary, competition in payment card markets and other similar "*multi-sided markets*" is characterised by what the European Commission has called "*reverse competition*", namely, where Mastercard and Visa actually compete with each to increase the level of interchange fees, in order to attract and/or retain card issuers and cardholders, namely:

> "***IFs are subject to reverse competition*** *meaning that competition between card schemes to attract card issuers (banks) leads to ever higher interchange fees (and consequently, MSCs). IFs are basically revenues offered to banks by card schemes in exchange for issuing their cards rather than the cards of the competitors. Therefore, an increase in MIFs offered by one card scheme leads banks to issue the cards of this particular scheme.*"[8]

> "*In the context of card payments, reverse competition means that card schemes compete with each other by offering higher MIF revenues to banks that issue their cards. This results in higher fees for card payments in general, which are passed on merchants and, ultimately, consumers (rather than lower fees which would be the case under normal competition). As a result there is a welfare loss for merchants and consumers and a restricted market entry for new players, as ever increasing levels of MIFs are considered as a minimum threshold by banks that issue cards.*"[9]

The Commission provided multiple case studies (and analysis) of such reverse competition.

Accordingly,in our view Mastercard and Visa's dramatic increases in their UK-EEA consumer cross-border interchange fees is an unambiguous example of such reverse competition.

Such reverse competition of course does not vindicate Mastercard and Visa's interchange fee increases. On the contrary, it shows why such price increases are likely to harm consumers[10] and competition, are also likely to be unlawful, and also why it is less likely that there is an explicit "price fixing" agreement explanation for the fee rises.

[8] European Commission Staff Working Document: Impact Assessment accompanying the Commission's proposal for the EU Interchange Fee Regulation, SWD(2013) 288 final (IFR Impact Assessment), Volume 1/2, page 19.
[9] IFR Impact Assessment, Volume 1/2, page 86.
[10] I.e. both merchants and end-consumers.

(2) Mastercard and Visa's UK-EEA interchange fee increases are the result of likely unlawful anti-competitive agreements between Mastercard and Visa card issuers respectively

UK and EU regulators and courts have now found repeatedly that the setting of payment card interchange fees is the result of anti-competitive agreements between Mastercard and Visa's respective issuers.

Moreover, the European Commission, and the EU's and UK's highest courts, have specifically found that UK-EEA cross-border interchange fees "*violate [EU and UK competition] rules on restrictive business practices*".[11]

There is no plausible reason why the UK's withdrawal from the EU should change these legal findings.

In particular, the courts and regulators have repeatedly found that decisions on the level and structure of intra-EEA interchange fees[12] are decisions of "*associations of undertakings*" – namely, decisions of associations of Mastercard and Visa issuers within the meaning of Article 101(1) Treaty on the Functioning of the European Union (**TFEU**) (and also Section 2 CA98). This is essentially because issuers "*share a common interest as regards the MIF because it yields guaranteed revenues for their issuing business*".[13] This conclusion is also irrespective of Mastercard's or Visa's successive changes of structure from membership associations to public companies.[14]

The European Commission, and UK and EU Courts, have also repeatedly found that the Mastercard and Visa have failed to show that their intra-EEA MIFs (or any MIFs) meet (any of) the cumulative conditions required for exemption under Article 101(3) TFEU, in particular:

i. the existence of "*objective efficiencies*" resulting from the MIFs;
ii. that all customer groups in a payment card system – i.e. cardholders and merchants – must receive a "*fair share of the benefits*" that result from the MIFs; and
iii. that the MIFs are "*indispensable*" to achieving these benefits.[15]

---

[11] European Commission press release: Antitrust: Commission prohibits MasterCard's intra-EEA Multilateral Interchange Fees (IP/07/1959), 2007. See also summary at Sainsburys v MasterCard; Asda, Argos, and Morrisons v MasterCard; and Sainsbury's v Visa UK Court of Appeal [2018] EWCA 1536 (Civ) para. 12-36.
[12] I.e. of which UK-EEA interchange fees were previously.
[13] European Commission Mastercard Decision, para. 3.
[14] See European Commission Decision 2007 Case COMP/34.579, COMP/36.518 and COMP/38.510 (European Commission Mastercard Decision 2007), para. 3; and also Dune v Mastercard and Dune v Visa [2021] CAT 35, para. 90-103.
[15] For example, see European Commission Mastercard Decision, para. 5-12, and also all subsequent EU and UK MIF decision judgments.

Furthermore, in the European Commission's most recent MIF decisions (in 2019) concerning Mastercard and Visa's EEA-to-rest-of-World inter-regional MIFs[16], its "*preliminary conclusion*" was that Mastercard's and Visa's inter-regional MIFs infringed Article 101 TFEU.[17] This was because the Commission found that Mastercard and Visa's inter-regional MIFs constituted "*a decision of an association of undertakings that had as its object and effect an appreciable restriction of competition in the market for acquiring card payments within the EEA*"[18], in particular, that inter-regional MIFs amounted to "*horizontal price fixing*", which is "*by its very nature harmful to competition*".[19]

The Commission noted also "*the lack of competition between Visa and MasterCard in the acquiring market*" and that the Mastercard and Visa "*Honour All Cards Rule[s]*" which means that "*a merchant, which accepts 'ordinary' Visa cards […] cannot refuse payments that carry a higher interchange fee, for example because the card […] is inter-regional and therefore carries a higher MIF*". Last, the Commission found that the inter-regional MIFs were capable of appreciably affecting trade between EEA Member States and did not appear to meet the requirements for exemption under Article 101(3) the MIFs.

All such findings are directly applicable to the UK-EEA cross-border MIFs, or more so.

Mastercard and Visa nevertheless proposed "*Commitments*" to cap their inter-regional MIFs at 0.2% for debit card present (**CP**) transactions, 0.3% for credit card CP transactions, 1.15% for debit card card-not-present (**CNP**) transactions, and 1.50% for credit card CNP transactions (**the Mastercard and Visa Inter-regional MIF Commitments**), which the Commission accepted.

Our understanding is that Mastercard and Visa's UK-EEA inbound MIFs are subject to those EU Commitments.[20] Hence, Mastercard and Visa have evidently decided to increase their UK inbound CNP MIFs to the levels set in these Commitments – and also to increase their UK-EEA outbound CNP MIFs to the same levels, as highlighted in the Working Paper.

While this does not make such interchange fee increases lawful, we agree with the Commission's preliminary conclusion that Mastercard's and Visa's inter-regional MIFs infringed Article 101 TFEU and are "*by their very nature harmful to competition*".

---

[16] European Commission Decisions of 29 April 2019 Case AT.40049 – Mastercard II (European Commission 2019 Mastercard Inter-Regional MIF Decision) and Case AT.39398 – Visa MIF (European Commission 2019 Visa Inter-Regional MIF Decision), concerning inter-regional MIFs applicable to merchants located in the EEA with consumer debit and credit cards issued outside of the EEA.
[17] European Commission 2019 Mastercard Inter-Regional MIF Decision, para. 2; and European Commission 2019 Visa Inter-Regional MIF Decision, para. 3.
[18] European Commission 2019 Visa Inter-Regional MIF Decision, para. 32.
[19] European Commission 2019 Visa Inter-Regional MIF Decision, para. 34.
[20] As UK-EEA inbound MIFs means MIFs applicable to merchants in the EEA with consumer cards issued in the UK, i.e. now outside of the EEA.

Hence, whether classified as (former) EEA-MIFs or as UK-EEA inter-regional MIFs, in our view, Mastercard's and Visa's UK inter-regional consumer card MIFs are the result of unlawful anti-competitive price-fixing agreements between Mastercard and Visa card issuers – and Mastercard and Visa should therefore repeal the interchange fee increases.

(3) Mastercard's and Visa's increases in their UK-EEA interchange fees represent excessive and/or unfair pricing abuses

The PSR notes that, since the UK's withdrawal from the EU, Mastercard and Visa have increased the IF rates for UK-EEA consumer CNP transactions by a factor of five, i.e. from 0.2% to 1.15% for debit cards (a factor of 5.75, or 475%) and from 0.3% to 1.5% for credit cards (a factor of 5.00, or 400%). Moreover, in combination with the Mastercard and Visa scheme and processing fee increases, the cost to merchants of UK-EEA CNP transactions has increased by a factor of up to 11 (or 1,000%).[21]

Such price increases are not merely evidence that the market is not working well. On the contrary, such price increases are evidence of likely excessive and/or unfair pricing, in abuse of dominant market positions, contrary to Article 102 TFEU and Chapter II CA98.

For example, by comparison, the Competition & Markets Authority (**CMA**) fined pharmaceuticals company, Advanz, £100 million, after finding that Advanz had charged "*excessive and unfair prices*" for supplying a pharmaceutical product[22], following Advanz having "*inflated*" its prices by 1,110% between 2009 and 2017.[23] In particular, the CMA found that Advanz had "*abused its dominant position in breach of the prohibition imposed by […] the '**Chapter II prohibition**' of the Competition Act 1998 […], by charging excessive and unfair prices*".[24]

The CMA also accused pharmaceutical firms Pfizer and Flynn of similar "*illegal pricing*", for abusing their dominant positions to "*overcharge the NHS*" for vital anti-epilepsy drugs, following price increases of "*between 780% and 1,600%*" over a four-year period.[25] The CMA fined other pharmaceuticals firms £260 million for similar pricing abuses.[26]

---

[21] Since 2015, Visa's scheme and processing fees for UK-EEA consumer debit and credit card CNP transactions have increased from 0.01% to 1.16%, hence the total of Visa's UK-EEA consumer debit CNP interchange fee plus scheme and processing fees has increased from 0.21% to 2.31%, i.e. by a factor of 11, or 1,000%.

[22] Liothyronine tablets, a thyroid drug.

[23] CMA Press release: CMA fines pharma firm over pricing of crucial thyroid drug, 29 July 2021.

[24] Decision of the Competition and Markets Authority: Excessive and unfair pricing with respect to the supply of liothyronine tablets in the UK, Case 50395, 2021, para. 1.4.

[25] See CMA Press release: CMA accuses pharma firms of illegal pricing, 5 August 2021, concerning suspected unfair pricing of phenytoin sodium capsules by pharmaceuticals firms Auden Mckenzie and Actavis UK.

[26] See CMA Press release: CMA finds drug companies overcharged NHS, 15 July 2021, concerning excessively high prices of hydrocortisone tablets.

In each of these cases, the CMA found (and/or provisionally found) that each of these firms:

i. have dominant market positions; and
ii. abused their dominant positions, in breach of the Chapter II prohibition CA98, by charging excessive and unfair prices – on the basis pricing increases of between around 800% and 1,600% over four- to eight-year periods.

In comparison, Mastercard and Visa's UK-EEA cross-border interchange fee (and scheme and processing fee) prices increased between 400% and 1,000% in less than just one year.

Hence, in our view, Mastercard and Visa's UK-EEA cross-border interchange fee increases represent similar excessive and unfair pricing abuses of their respective dominant market positions.

Mastercard and Visa have dominant (or moreover parallel monopoly) market positions in the supply of acquirers and in turn to merchants, essentially because Mastercard and Visa do not compete for either acquirers or merchants. For example, the European Commission said in its most recent MIF decisions that "*The Commission's preliminary view [is] that merchants' lack of countervailing bargaining power might be due to several factors, in particular the must-take nature of Mastercard cards [and must-take nature of Visa cards…] and the [resulting] lack of competition between Mastercard and Visa [for acquirers and merchants].*"[27]

Our view that Mastercard and Visa have such dominant monopoly positions is consistent with past regulatory decisions[28] and also with the European Commission's current review of the EU market definition[29], especially concerning market definition in "*multi-sided markets*", such as payment card systems.[30]

(4) Mastercard and Visa's UK-EEA interchange fee increases are incompatible with the PSR's statutory competition objective, in particular, of ensuring efficient interchange fee pricing

[27] European Commission 2019 Mastercard Inter-Regional MIF Decision, para. 36; and European Commission 2019 Visa Inter-Regional MIF Decision, para. 37.
[28] European Commission Mastercard Decision 2007 found that "The Commission […] retains as [the] relevant product market […] the market for acquiring payment card transactions [but…] It can be left open […] whether acquiring for Mastercard products is a product market on its own [separate from Visa]" (para. 307).
[29] See European Commission Staff Working Document Evaluation of the Commission Notice on the definition of relevant market for the purposes of Community competition law, SWD(2021) 199 final.
[30] In particular, the Commission's expert advisers to the Commission's review (Professors J.-U. Franck and M. Peitz) highlight that multi-sided platforms are likely to act as monopolists on the "multi-homing" side of the market, i.e. where users (such as acquirers and merchants) "must take" all platforms (i.e. to Mastercard and Visa), in contrast to the "single-homing" side of the market, where users (such as issuers and cardholders) have the option to choose between platforms.

The PSR is carrying out its market review under Part 5 of the Financial Services (Banking Reform) Act 2013 (**FSBRA**) ("*Regulation of payment systems*").

FSBRA also defines the PSR's general duties, namely, "*to advance one or more of its payment systems objectives*": the competition objective, the innovation objective, and the service-user objective.[31] Of these, the competition objective requires the PSR to "*promote effective competition in the market for payment systems, and the markets for services provided by payment systems*", including between different operators of payment systems (**PSOs**), and between different payment service providers (**PSPs**). In doing so, the PSR may have regard to "*the level and structure of fees, charges or other costs associated with participation in payment systems*".[32]

What this means should of course be with reference to the Government's stated intentions in enacting FSBRA and establishing the PSR, in which the Government said that:

> "*4.14 […Designated PSOs, such as Mastercard and Visa] will be required through statute to adhere to principles on:*
>
> - *Efficient and transparent pricing;*
> - *Non-discriminatory access;*
> - *Good governance;*
> - *Maintaining and developing the payment system; and*
> - *Co-operation.*
>
> *4.16 On efficient and transparent pricing, the requirement will be that prices are set at the appropriate level to benefit current and future end-users of the payment system. [Payment system operators] will be required to ensure that their pricing structures are transparent to their users, and that they are derived through a fair and transparent methodology. […Each PSO] will, when requested, present its pricing methodology to the regulator, who will then review it and require amendments as appropriate. Where the regulator is not satisfied that the [PSO] is using an acceptable pricing methodology, and having given it sufficient opportunity to remedy the situation, the regulator will have the power to intervene to directly set prices for (1) direct access to a payment system [e.g. scheme and processing fees], […] (3) interchange fees.*"

It is evident though that Mastercard and Visa have not derived their UK-EEA cross border interchange fees through "*a fair and transparent methodology*" at all, nor presented such a methodology to the PSR for review. Accordingly, it is highly unlikely that such interchange fees "*at the appropriate level to benefit current and future end-users of the payment system*".[33] On the contrary, such interchange fees are likely to harm end-users, especially merchants, as well as cardholders.

---

[31] Section 49.
[32] Section 50.
[33] Which is essentially the same test as required under Article 101(3) TFEU.

The PSR must therefore intervene – as the Government said it should do – to set Mastercard and Visa's UK-EEA cross-border interchange fees directly, using the powers given to the PSR for this purpose.[34]

Has the PSR missed anything out of its consultation?

We are concerned that the PSR has disregarded other interchange fees that also now fall outside the UK Interchange Fee Regulation (**UK IFR**) as part of this review, namely:

- cross-border interchange fees between the UK and the rest of the World; and
- commercial card interchange fees.

Under the Commitments made by Mastercard and Visa to the EU, EEA merchants benefited from reductions in cross-border interchange fees between the EEA and the rest of the World. UK merchants would have also benefited from such Commitments had the UK remained in the EU.

Hence, in addition to the increases in Mastercard and Visa's UK-EEA cross-border interchange fees, the UK's withdrawal from the EU has also meant a failure to secure reductions in UK-to-rest-of-the-World interchange fees, leading to a double whammy for UK merchants.

In our view, the PSR should therefore bring such UK-to-rest-of-the-World cross-border interchange fees into the scope of the review.

Coadec's thoughts on the PSR's observations on relocation practice as a way to mitigate increases in cross-border fees & the PSR's observations on price differentiation and whether the ability of a merchant to do this may be constrained by any rules on price surcharging

The Market review suggests that one incentive for Visa and Mastercard to not increase the either inbound or outbound IFs is "the merchant's ability to turn consumers to an alternative payment method. At Coadec, we've heard extensively through our ecosystem members, as well as through insight from our partners on Axe the Card Tax campaign coalition, that the current state of the Card market means that merchants often have little to no choice but to accept cards, regardless of the rate of cross-border interchange. Indeed, there is also some

[34] Namely, to vary agreements relating to payment system fees and charges, FSBRA Section 57.

discrepancy between the bargaining power of large firms compared to small firms, sometimes meaning that some large businesses are able to pay a lower rate of fees[35].

The Terms of Reference of the PSR's MR22/1.1 market review of card scheme and processing fees outline the factors including "high barriers to entry and network effects" and "limited payment acceptance alternatives for merchants and the "must take" status of Mastercard and Visa" as prospective reasons behind the scheme and processing fee rises, but they are also critical to understanding the ability of businesses to react to any fee rises, including cross-border interchange fees.

The market review suggests that merchants are empowered to mitigate fee increases through relocation, but for many businesses this is simply not an option. Brick and mortar businesses, that are not primarily based in e-commerce, have very few options in regards to relocation due to the physical nature of their business. This is true for SMEs who often lack the financial capability to be able to relocate but is also true for large British businesses with a focus on their British presence.

However, even for e-commerce companies, the option of relocation is not a viable one. Inter-regional fees are paid whenever the customer card is located in a different region than the merchant location, with the merchant location being based on their principal place of business or other locations where they conduct 'substantial business activity'. The requirement for 'substantial business activity' makes relocation significantly more difficult and an option only for the very largest e-commerce companies. Whilst relocation might reduce the cost of accepting cards for the largest merchants it is unavailable to large swathes of UK businesses who remain forced to pay an effective card tax.

The focus on this market review should be on the justifiability of the increased fees, alongside tracking whether the fees have actually increased, which it already has evidence of. By focussing on the ability for some merchants to mitigate the impact of cross-border interchange fees, however, the PSR risks legitimising the significant rise in cross-border interchange fees and places an impetus on UK businesses to avoid the harm of increased costs. Instead the focus should be on requiring a detailed justification from Visa and Mastercard on why these fees have been allowed to continually increase.

[35] For context, see the BRC's 2022 Payment Survey which outlined a total Merchant Servicing Charge (MSC) of 0.273%, much lower than the 0.61% figure that Coadec has produced using evidence from Eurocommerce. A critical difference between these two fees is that Coadec's data is pulled from a much more diverse set of businesses, including much smaller businesses. In contrast the BRC data is from the largest retailers in the UK. For fuller context, also see Mastercard's written evidence to the PSR, which cited evidence from Boston Consulting Group, which had data in the middle of the BRC and Coadec data, further demonstrating the spectrum of fees.

Further, the Market Review notes an additional mitigation strategy that merchants have is to accept “alternative payment method(s)”. While, on the one hand, this points to the importance of a competitive and accessible market, on the other it fails to account for the lack of credible alternatives on offer today. This is both a consequence of the complexity and cost of payments, but also the regulatory and financial barriers facing payments Fintechs: it is a fundamentally unlevel playing field.

The reality is that many merchants have no choice but to accept the dominant payment methods, regardless of increases to their costs of cross-border interchange fees.

Further in practice, it is likely inevitable that acquirers will already differentiate on the fees incurred per transaction, with little to know visibility, let alone comprehension, on behalf of the small business retailer. Measures such as the remedies proposed in the final Card Acquiring Market Review report may help in injecting much needed clarity in this space, but will still not empower retailers to differentiate.

Electronic Money Association

Electronic Money Association
Surbiton
Surrey
KT6 4BN
United Kingdom
Telephone: +44 (0) 20 8399 2066
www.e-ma.org

Cross-border interchange fees market review team
Payment Systems Regulator
12 Endeavour Square
London E20 1JN

By email to: cardfees@psr.org.uk

19 January 2023

Re: PSR MR22/2.4 Market review of cross-border interchange fees; working paper

We welcome the opportunity to provide feedback on the PSR's working paper which sets out a discussion of the impact of the UK-EEA cross-border interchange fee increases, as part of the PSR's cross-border interchange fee market review.

The EMA is the EU trade body representing electronic money issuers and alternative payment service providers. Our members include leading payments and e-commerce businesses worldwide, providing online payments, card-based products, electronic vouchers, and mobile payment instruments. Most members operate across the EU, most frequently on a cross-border basis. A list of current EMA members is provided at the end of this document. The EMA has been operating for over 20 years and has a wealth of experience regarding the regulatory framework for electronic money and payments. A list of current EMA members is provided at the end of this document at ANNEX II.

We would be grateful for your consideration of our comments to the matters set out in the working paper, which are set out below at ANNEX I.

Yours faithfully

Electronic Money Association

ema

ANNEX I

Impact on Merchants - Merchant relocation

The PSR's working paper (WP) considers whether merchants may be able to take mitigating actions to reduce the impact of the interchange fee ("IF") increases on their business. The first of such mitigating actions could be merchant relocation, i.e. where a merchant located on either side of the UK/EEA could relocate (part of) their operations and online sales to the other side, so that online card transactions which were classed as cross-border (and subject to a higher IF) would now be classed as a domestic UK or domestic EEA transactions (subject to UK or the EU Interchange Fee Regulation ("**IFR**") caps), as the case may be. [WP 3.14]

The EMA agrees that, generally speaking, IF increases are unlikely to be the sole reason for merchant relocation. Merchant decision to relocate some of its operations would be influenced by a myriad of factors, including the additional costs of setting up operations elsewhere, tax implications, supply issues and the size of the merchant's non-domestic customer (target) market.

The EMA also agrees that the largest, well-resourced merchants are more capable to carry out relocation in practice. For relocation to make commercial sense, the merchant's non-domestic market share/sales would have to be sufficiently large to justify the additional costs arising from relocation. Largest merchants are also more likely to have the resources to invest in setting up relocated operations.

2. Impact on Merchants/Consumers - Pass-through to consumers and price differentiation

The PSR's working paper considers the merchants' ability to pass on higher card acceptance costs to customers through higher prices, including on a targeted basis (i.e. with respect to transactions where IF rate is higher) though price differentiation. [WP 3.21-3.26]

The PSR considers two possibilities for price differentiation by merchants. Firstly, merchant's ability to charge a different price depending on where the cardholder's card is issued. Another possibility would be for merchants to differentiate on the basis of different versions of their website depending on the customer's language/country where the customer is located (territorial pricing). Where merchants cannot price differentiate, they may pass-through higher IF costs through charging higher prices overall.

Impact of surcharging rules on merchant price differentiation

The surcharging rules do not, in principle, prevent merchant from price differentiating, in the form of charging additional charges with respect to UK-EEA cross-border card transactions to recover the costs associated with such payments.

As regards EEA-based merchants, the ban on surcharging imposed under Article 62(4) of The Second Payment Services Directive (EU) 2015/2366 ("**PSD2**") requires Member States to ensure that "*payee shall not request charges for the payment instruments for which interchange fees are regulated under Chapter II of Regulation (EU) 2015/715* [i.e. IFR] ..." As UK-EEA cross-border card transactions no longer fall within the scope of the IFR, EEA merchants could, in principle, impose a charge for payment by a UK-issued card.

PSD2 Art 62(3) imposes a further prohibition on excessive surcharges, whereby "*any charges applied shall not exceed the direct costs borne by the payee for the use of a specific instrument.*" A similar prohibition exists under Article 19 of the Consumer Rights Directive 2011/83/EU, which prevents traders from charging consumers *"fees that exceed the costs borne by the trader for the use of"* any particular means of payment. These excessive surcharge restrictions limit the charges that EEA merchants can charge for the use of UK-issued cards, but do not prohibit the recovery of costs associated with such transactions, such as the merchant service charge the merchant pays to their acquirer (including the IF).

It should be noted that some differences in Member State implementation of PSD2 surcharging prohibitions may exist, which could prohibit surcharging beyond the intra-EEA transactions. This may warrant further exploration.

The position concerning Outbound IF, i.e. transactions involving the use of EEA-issued cards at UK merchants, is similar to that set out above. The ban on surcharging for card-based payments set out in Regulation 6A(1) of the Consumer Rights (Payment Surcharges) Regulations 2012,[1] only applies where the payment service providers of both the payer and the payee are located in the UK[2]. UK merchants could, therefore, impose a charge where the card used for payment is issued in the EU. Such charges would be limited by the rules prohibiting excessive surcharges, i.e. Regulation 6A(2) which prohibits charges which exceed the costs borne by the payee (merchant) for the use of that specific payment instrument.[3] This excessive surcharge prohibition covers situations where only one of the PSPs (e.g. merchant's acquirer) is located in the UK.[4] BEIS Guidance on the Consumer Rights (Payment

[1] As amended by the Consumer Protection (Amendment etc.) (EU Exit) Regulations 2018/1326
[2] Regulation 6B(2) of the Consumer Rights (Payment Surcharges) Regulations 2012
[3] Similar prohibition, derived from the Consumer Rights Directive, exists under Regulation 4 of the Consumer Rights (Payment Surcharges) Regulations 2012
[4] Regulation 6B(3) of the Consumer Rights (Payment Surcharges) Regulations 2012

Surcharges) Regulations 2012[5] confirms that merchant service charges, including interchange fees, are recoverable under the charges merchants are permitted to charge in such cases.

[5] Paragraph 9.2, available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/718812/payment-surcharges-guidance-update.pdf

ANNEX II: List of EMA members as of January 2023:

AAVE LIMITED
Account Technologies
Airbnb Inc
Airwallex (UK) Limited
Allegro Group
Amazon
American Express
ArcaPay Ltd
Banked
Bitstamp
BlaBla Connect UK Ltd
Blackhawk Network EMEA Limited
Boku Inc
Booking Holdings Financial Services International Limited
BVNK
CashFlows
Checkout Ltd
Circle
Citadel Commerce UK Ltd
Contis
Corner Banca SA
Crypto.com
Curve
eBay Sarl
ECOMMPAY Limited
Em@ney Plc
emerchantpay Group Ltd
Etsy Ireland UC
Euronet Worldwide Inc
Facebook Payments International Ltd
Financial House Limited
First Rate Exchange Services
FIS
Flex-e-card
Flywire
Gemini
Global Currency Exchange Network Limited
Globepay Limited
GoCardless Ltd
Google Payment Ltd
HUBUC
IDT Financial Services Limited
Imagor SA
Ixaris Systems Ltd
MANGOPAY
Modulr FS Europe Limited
MONAVATE
Moneyhub Financial Technology Ltd
Moorwand
MuchBetter
myPOS Payments Ltd
NOELSE PAY
NoFrixion Ltd
Nuvei Financial Services Ltd
OFX
OKTO
One Money Mail Ltd
OpenPayd
Own.Solutions
Papaya Global Ltd
Park Card Services Limited
Paymentsense Limited
Paynt
Payoneer Europe Limited
PayPal Europe Ltd
Paysafe Group
Paysend EU DAC
Plaid
PPRO Financial Ltd
PPS
Ramp Swaps Ltd
Remitly
Revolut
Ripple
Sable International FX Limited
Securiclick Limited
Skrill Limited
Soldo Financial Services Ireland DAC
Square
Stripe
SumUp Limited
Swile Payment
Syspay Ltd
Transact Payments Limited
TransferMate Global Payments
TrueLayer Limited
Trustly Group AB
Uber BV
VallettaPay
Vitesse PSP Ltd
Viva Payments SA
Weavr Limited
WEX Europe UK Limited
Wirex Limited
Wise
WorldFirst
WorldRemit LTD
Yapily Ltd

Lloyds Banking Group

LLOYDS BANKING GROUP PLC

PSR Market Review into cross-border interchange fees

19 January 2023

Executive Summary

Lloyds Banking Group welcomes the opportunity to respond to the Payment Systems Regulator's (PSR) working paper on the Market Review of Cross-Border Interchange Fees, issued in December 2022. This review, together with the Market review on card scheme and processing fees, provides an opportunity for the PSR to give clarity and certainty needed to support continuous investment, innovation and encourage competition.

Lloyds Banking Group has no involvement in setting interchange fee levels. They are set by the card schemes within the constraints of the Interchange Fee Regulation and commitments given by the schemes. Though not customer facing, interchange fees underpin the benefits for merchants and consumers (including fraud protections, customer services and discretionary benefits), creating the right conditions to support investment and innovation. Cross-border interchange enables foreign businesses to sell goods and services to domestic UK customers and businesses.

Interchange fees contribute towards offsetting the significant costs issuers incur in relation to processing and servicing card payments e.g. authorising and processing transactions, customer service costs, costs of fraud detection and reimbursement, consumer protections and many other relevant costs. In some cases those costs can be higher depending on whether transactions are domestic or cross-border, for example cross-border fraud levels tend to be two to three times higher in both debit and credit cards [redacted] The increase in cross-border interchange fees contributes towards meetings these higher costs. In addition, interchange fees support innovation and competition to provide consumer and merchant benefits such as contactless payments, card and gambling controls, virtual cards, mobile wallets to name a few.

Reflecting upon the historical cross-border transaction data shared in the working paper, drawing specific and reliable conclusions on the impact of interchange fee increase on transactional volumes and values is particularly difficult. The data provided in the working paper covers a period that was marked by significant economic turbulence including impacts of the Covid pandemic, EU Exit, increased inflation and exchange rate fluctuations. All of these factors may impact the volumes/values of CNP payments between UK cardholders and EEA merchants and between EEA cardholders and UK.

Interchange fees support card payments and therefore choice for both consumers and merchants in what payment methods they use for domestic as well as cross-border payments. Merchants have a broad choice of payment methods they can accept including cards, BNPL, PayPal and bank transfers. The universal acceptance of cards together with the customer protections provided make them particularly attractive to consumers.

We would like to reiterate our view that continued legal uncertainly about the levels of interchange, whether domestic or cross-border, may deter investment and therefore erode the benefits merchants and consumers receive. The PSR could use the opportunity of this review to provide legal certainty over the level of interchange (both domestic and cross-border) in the future, ensuring card schemes remain on a commercial and sustainable footing and providing clarity for emerging alternatives such as account-to-account payments.

Mastercard

Mastercard response to PSR Working paper ‘*Market review of cross-border interchange fees : A discussion of the impact of the UK-EEA cross-border interchange fee increases MR22/2.4*’

19 JANUARY 2023

Overview

The PSR has published a working paper in relation to its market review of cross-border interchange fees, focusing on recent increases in rates of certain interchange fees following the UK withdrawal from the EU. Specifically, the PSR has set out some of the information it has gathered on fees that acquirers pay to issuers every time consumers use a Mastercard or Visa debit or credit card for online transactions between the UK and the European Economic Area (EEA). The PSR is attempting to understand whether the recent increases indicate that the market works well for users.

Mastercard considers that the payments market, including in respect of payments between the UK and EEA, is working well and the card payment services are generating considerable merchant and consumer value within this market. Mastercard saw no evidence in the PSR working paper which contradicted this view and is open to engaging further with the PSR on the topic of cross border payments.

As the PSR has not yet put forward any clear conclusions regarding the functioning of these payments, Mastercard is currently only able to comment on the working paper at a high level. This short response summarises the value of interchange fees more broadly, explaining that interchange fees contribute towards issuer costs and setting out some of the different considerations for card-not-present cross-border transactions (such as the UK-EU transactions).

Importance of interchange fees

The PSR's approach appears not fully to recognise the purpose of interchange and the vital role which it plays in promoting card payments, to the benefit of all participants in the ecosystem. It seems to assume that interchange represents only a cost to acquirers (and potentially merchants or their customers if it is passed-through), without any commensurate benefit. Therefore, it implies that the benefits on the acquiring/acceptance side of the market will be maximised by setting interchange at the lowest level.

In paragraphs 3.28 and 3.29, the PSR makes brief reference to the fact that higher interchange may be passed through from issuers to cardholders, who may therefore derive direct benefits as a result. It weighs these benefits against the presumed negative impact/cost on merchants and their consumers and implies that if direct costs exceed direct benefits, the market may not be working efficiently.

Whilst it is true that cardholders may receive direct benefits from interchange, a limited focus on 'issuer pass-through' understates the criticality and overall positive impact of interchange, which is much broader than the PSR recognises and which generates direct benefits for acquirers/merchants, as well as issuers. As we explain, interchange is essential to the effective functioning of a two-sided market, in which acquirers/merchants are active and willing participants, as a result of the commercial benefit which they derive from the card transactions which occur.

Payment card schemes such as Mastercard, Visa and American Express (Amex) are two-sided platforms that bring together buyers making payments (cardholders) and sellers accepting payments (merchants). As with any two-sided market, network effects play a crucial role. Merchants want to accept a card lots of cardholders use. Cardholders want to use a card lots of merchant accept.

In the case of payment card schemes, merchants tend to get a greater monetary benefit from the transactions than cardholders. In this context, it is important to consider the costs which occur on both sides of the market and the role of interchange in ensuring that they are fairly recovered. In particular, the issuer typically faces higher costs than the acquirer, which may lead to two possible outcomes:-

- In theory, the issuer in the four-party scheme could recover all of these costs simply through charges to cardholders whether in the form of annual fees, transaction fees (or higher fees) or higher APRs on borrowing (in the case of a credit card). However, this would make a card issued by that four-party scheme uncompetitive with other card schemes without such pricing, and other payment methods that do not impose such charges.

- The alternative might also be that without interchange revenue, the issuer decides to reduce its issuing services to its least profitable customers. This would not only reduce competition, but also most likely affect more disadvantaged consumers, who do not generate revenue for issuer through taking other services.

In order to avoid these outcomes and remain competitive, a four-party scheme needs to ensure that the terms of dealing between issuers and acquirers allow issuers to recover the costs they incur as a result of managing cardholders and card transactions and provide sufficient revenue to issuers such that the fees to cardholders are competitive. This is where the interchange fee comes in. It is a mechanism that helps to balance the costs and revenues on both sides of a four-party payment card scheme. The interchange fee will contribute to the costs incurred by issuers to deliver certain functions that are inherent in the scheme, reducing the proportion of its costs that the issuer will have to recover from cardholders.

Considerations for card-not-present cross-border transactions

There are a number of types of interchange fee that are applicable to consumer card transactions, differentiated by the locations of the merchants and issuers. Broadly, these can be grouped into two categories:

- domestic MIFs, which are relevant for transactions in which the issuer and the merchant are located in the same country;
- cross-border MIFs, which are applicable to transactions in which the issuer is located in a different country to the merchant. [1]

In setting the default domestic interchange fee of a particular country, the commercial incentive of card schemes will be to set interchange fees to promote uptake and use of payment cards, and to compete effectively with other payment products present in that country. From the card scheme perspective, the ideal interchange fee will balance the costs and benefits of the scheme across its user base, with interchange fees set high enough to encourage the holding and use of cards among cardholders and set low enough to promote the acceptance of cards among merchants.

The landscape of alternative payment methods, the costs and benefits to merchants of accepting those payment methods, the preference of consumers, and the costs incurred by issuers (for example, processing

1 In general, Mastercard distinguishes between 'intra-regional' payments (transactions made between two countries in the same 'region', which is a group of countries defined by Mastercard) and 'inter-regional' payments (transactions made between two countries in two different regions).

costs and guarantees against fraud and cardholder default) are determined by factors specific to the geography within or between which the payment takes place.

These costs should be taken into account when determining the level of interchange fees. The cost assessment reflects a conservative estimate of the opportunity cost to merchants of operating their own store card product. The costs may include:-

- **Providing a payment guarantee**: the payment guarantee relates to two different scenarios i.e. where the genuine cardholder defaults and also where the card is used fraudulently by a third party. By accepting payment using a Mastercard card (provided the systems' verification, authorisation and processing procedures have been completed) payment of the transaction is guaranteed to the merchant, which no longer bears the risk of loss through default or fraud or needs to make credit or identity checks of the cardholder. In other words, it acts as the merchant's 'insurance' which necessarily generates certain costs to the issuer's costs e.g. authorising transactions, preventing fraud, fraud losses, credit scoring, payment collection and credit write-offs following a cardholder's default.

- **Funding for delayed payment**: credit card products allow customers to make purchases and delay payment, which is of significant value to both cardholders and merchants. They allow the cardholder to pay a part of the outstanding amount and defer the remainder of the balance to a later date. Credit cards do not charge interest on payments during the statement period, which are repaid by the due date (but rather only on any revolving outstanding balance). It is possible for cardholders to obtain up to 100 days of interest free credit on card transactions and (dependent on the average transaction value). Offering a deferred payment facility may therefore represent a significant cost to the issuer which of course can (and has recently) increased as interest rates rise.

- **Processing of incoming transactions**: this cost component relates to the receipt, balancing and settlement of card transactions. These costs are directly incurred in providing payment services and the payment guarantee. In addition, the cost of handling disputed transactions is included in this component.

By contrast, the economic context of cross-border interchange fees differs substantially. For example it will include:

- **the range of services and higher issuer costs**—card-not present cross-border transactions are expected to involve higher issuer costs and risks of providing such transactions (though higher fraud risks, for example) and the range of services that they commonly provide to acquirers and merchants differs (in particular, direct currency conversion services);

- **larger numbers of issuers and acquirers**—issuers may face additional complexities when processing transactions across borders as there are a larger number of issuers and acquirers that must interact with each other to facilitate the payments than in the case of domestic transactions;

- **competitive landscape**—cross-border card-not-present transactions also differ in terms of the types of merchants in which they generally take place at, the average transaction values that they support, the competing payment methods (i.e. the alternative payment methods that consumers could alternatively use), with a greater competitive threat of three-party card schemes, and the potential

for merchants to steer the payment method or indeed differentiate the price[2] for inter-regional card-not-present transactions.

Factors informing the 2021 interchange fee changes

In 2020, the forthcoming end of the Brexit transition period required Mastercard to consider whether and how to amend the EEA cross-border interchange fees, assuming those rates were no longer to be regulated (by the IFR or other means). This was a unique (rather than a typical) scenario and therefore the decision-making processes Mastercard followed in relation to this change to interchange fees differ from the processes followed in relation to any other interchange fee changes (in the UK or elsewhere). In particular, there were a wider range of commercial, regulatory, political and competitive factors to consider.

In that context, it is also relevant to note the commitments (dated 23 September 2019) which Mastercard gave to the EC in relation to the interchange fees which apply on interregional consumer card transactions i.e. transactions on non-EEA issued consumer cards being used at EEA merchants.

As Mastercard does not receive interchange fee revenue, its approach to setting rates is always based upon balancing the interests of all participants in the payments ecosystem. In this case, Mastercard separately considered options for UK-issued cards used at EEA merchants and for EEA-issued cards used at UK merchants:-

- **UK-issued cards at EEA merchants** - Mastercard applied the interchange fee rates contained in the commitments given to the EC in 2019 in relation to interregional transactions, which had been accepted based on a consideration of the alternative transaction methods available for those transactions, recognising cash was not such an alternative for card not present transactions. For interregional card not present transactions, the evidence indicated that a per transaction interchange fee of 1.15% for debit cards and of 1.5% for credit cards could make merchants, taken together, indifferent between accepting a non-SEPA bank transfer or an e-money transfer and a card payment. As the UK was now outside of the EEA, there was no objectively justifiable reason to apply different rates to UK-issued cards compared with any other non-EEA issued cards (for transactions at EEA merchants) and the rates had been set by the EC by robust application of its Merchant Indifference Test (MIT) framework.

- **EEA-issued cards used at UK merchants** - in the absence (or in advance) of any potential alternative regulatory benchmark which applied specifically to the UK, Mastercard decided to apply the same rates as those contained in the commitments in relation to such transactions. Again, this reflected the insight that a benchmark based on cash would not be suitable for the growing proportion of these transactions which were card not present, (and with an awareness of the competitive considerations related to rival payment services who also provide cross border transactions). Again, the rates had been set by the EC by application of its MIT framework based upon an analysis of this type of transaction. In addition, the intra-EEA interchange fee which had previously applied in relation to such transactions since 2009, had not been updated to reflect market developments (particularly the growth of online transactions with higher fraud risks).

Conclusion

[2] As the PSR notes in its working paper

We consider that the payments ecosystem between the UK and EEA (of which card payments are an important part) is working well. We note the PSRs observation of a reduction in volumes. This is a reflection that Brexit (among other economic factors) has led to trend of declining imports and exports between the UK and EEA[3], and that merchants relocating to limit the trade frictions or for regulatory considerations outside payments has magnified the effect of this on card payments. However, we are aware of no evidence linking any part of this fall to interchange fee changes. Indeed, Mastercard's commercial imperative and a key consideration underlying its decision to review rates in this case, is to increase (or minimise any decrease in) volumes, and therefore improve revenues and financial sustainability for Mastercard. It would clearly not be in Mastercard's interests to adopt an interchange policy or make changes to interchange rates, which might be detrimental to card payment volumes.

Mastercard's interchange fees are continually reviewed by the European Interchange Committee. In respect of UK/EEA interchange fees, Mastercard considers that the current levels are appropriate given the balance of value they provide to cardholders and merchants, the costs of providing these transactions, the competitive and consumer choice environment in which they take place, and the dynamics of the payment eco-system more broadly.

All queries in relation to this response should be to Simon Grossman, Vice-President – Regulatory Affairs, Mastercard, 1 Angel Lane, London EC4R 3AB – simon.grossman@mastercard.com – 07890 591 702

[3] https://researchbriefings.files.parliament.uk/documents/CBP-7851/CBP-7851.pdf, p6

Revolut

Revolut

PSR Working Paper on Inter-regional Interchange Review
Revolut Comments

EXECUTIVE SUMMARY

We appreciate the opportunity to provide comments on the working paper summarising the PSR's current approach to the review of UK-EEA inter-regional interchange. Overall, we appreciate the detailed evidence based approach being followed by the PSR, and recognise the PSR has identified many of the key factors which will require investigation. We have made some recommendations to expand the data collection and analysis, noting particularly (i) the lack of evidence that inter-regional interchange fees are having a material impact on UK or EEA merchants costs, (ii) the lack of evidence on pass through of costs or savings from merchants to consumers, (iii) the flaws in the original decision to apply uniform caps to domestic and cross border payments (notably those involving FX), (iv) the need to expand data beyond 2019-22 (due to Brexit / COVID impacting the sample), (v) the need to assess Outbound and Inbound IFs separately, (vi) the need to assess new costs on issuers and (vii) the need to update and tailor a Merchant Indifference Test (MIT) specifically on UK <> EEA payment data before any decisions can be made.

While we understand the need to assess inter-regional interchange given the changes post-Brexit, we would strongly recommend that instead of re-imposition of blunt price caps the PSR may wish to focus on (i) boosting the viability of alternative payment methods for cross border payments (e.g. instant payments / stablecoins), (ii) intervening to reduce costs on issuers / acquirers for cross border card based payments and (iii) increasing competition and innovation in payments in the UK domestic market. We believe these would have a more material impact on reducing merchants' cost of acceptance than re-imposition of inter-regional interchange price caps.

SECTION 1: Comments on analysis in the working paper

1.1 Real world impact on merchants is negligible

While we agree that merchants can be directly impacted by increases in inter-regional interchange (e.g. the 75-100M GBP Outbound and 100-125M GBP Inbound estimates provided), the real world impact of such increases on a merchant's total costs is negligible in the vast majority of cases.

As recognised in the paper (e.g. Section 3.11) larger merchants on IC++ pricing are most directly exposed to increases in MIFs, however the paper also recognises that such merchants are also best placed to mitigate the impact of such increases through relocation (e.g. Section 3.16). This flexibility could be reinforced, and choice increased for a broader

set of merchants, if the main international schemes were to relax some of the stringent requirements on the merchant location as the merchant of record.

Smaller merchants, who (as recognised by Paper) are often on blended merchant acquiring models, are less directly exposed to inter-regional interchange. We have not seen evidence of blended rates being increased for smaller merchants over the 2019-2022 period due to increases in inter-regional interchange.

We would add that for the vast majority of merchants, even were they to choose not to relocate, the actual impact of the increase in inter-regional interchange on their total costs (e.g. production, operations, marketing, shipping, etc) for all goods and services is too small to have a measurable impact on their overall cost of doing business. We therefore would challenge assumptions of the increases in inter-regional interchange having a real world impact (e.g. Section 3.31).

1.2 No evidence of negative end user impact

While the Paper does reference the risk of impacts on card holders through merchants passing through increased card acceptance costs (e.g. Section 2.6, Section 3.22), we note no evidence for this has been identified. This is consistent with other well resourced investigations (e.g. EU Commission IFR Review 2020[1]) which have similarly failed to find primary data supporting evidence of merchants passing through savings or costs to consumers from changes in card acquiring costs.

We do however see that changes to interchange fees can impact provision of services by issuers to card holders (e.g. current account or other consumer fees being increased in the EU post 2015).

Any decision to intervene in the market would need detailed data collection and analysis on both (i) the real world likelihood of consumers benefiting from reduced inter-regional interchange fees thanks to merchant pass through and (ii) the real world risk of consumers being harmed by reduced inter-regional fees due to issuers being forced to cut services or investment in new services slowing.

1.3 Outbound and Inbound IFs must be analysed independently

While the paper recognises the differences between Outbound and Inbound IFs in some contexts (e.g. the comments on the different level of pressure for relocation on EU / UK merchants) we would recommend the PSR goes further and analyses the underlying UK to EEA and EEA to UK payment flows independently, with the expectation that interventions (if any are required) would likely need to be different.

The UK payments market and the EEA payments market are fundamentally different. Within the EEA there is a wide variety of acquiring solutions, from local card schemes (e.g. Card Bancaire, Girocard, Bancontact, etc) to local instant payment solutions (e.g. IDEAL, Swish, Bizum). Many of these operate at scale domestically, with very different economics than the

[1] https://ec.europa.eu/competition/sectors/financial_services/IFR_report_card_payment.pdf

international card schemes. This means the choices and costs EEA merchants face are radically different than in the UK, where today Visa and Mastercard debit and credit cards remain the primary way to pay.

Payments in both jurisdictions are developing rapidly, with instant payments (through open banking) and stablecoins both likely to increase their penetration significantly over the next 24 - 36 months. The difference in regulatory interventions post Brexit in the two jurisdictions are likely to accelerate the market divergence (e.g. EU Instant Payments Regulation, PSD3, etc).

In addition to the difference in payments markets, the % of their total trade that EEA and UK merchants do across the UK-EEA corridor is very different. This means the impact of inter-regional interchange increases on a merchant's total cost of acceptance will vary significantly for EEA and UK merchants.

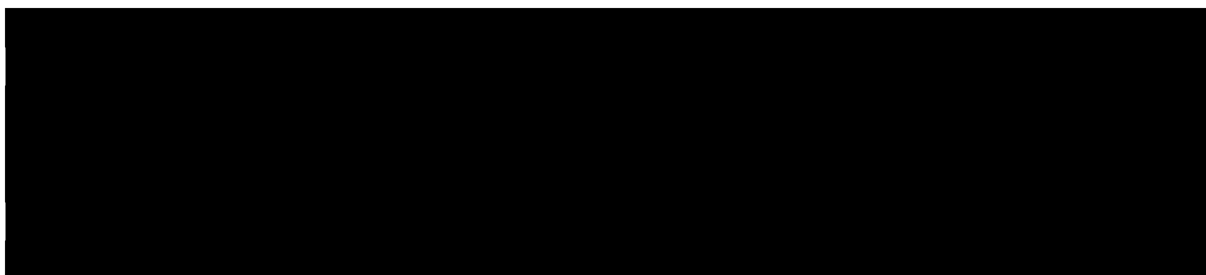
The original 20bps and 30bps caps were developed to apply to the whole EEA market, the majority of which was a single currency (EUR) and a single trading area (EU Single Market).

Were the Merchant Indifference Test to be re-conducted today separately for UK and EEA markets, and with a particular focus on card not present merchants, it is highly likely different results would be seen. The market is evolving at pace. Cards continue to create value for end users (e.g. payment protection, fraud and liability cover, etc) that is not available with other payment types (e.g. cash, instant payments, stablecoins, etc). Competition to cards from new payment types is emerging, and likely to grow as technical solutions are found (e.g. UK-EU API triggered instant payments become a viable alternative) and consumer habits change. The reality is that cross border payments have clearly evolved significantly since 2015, and the change will likely accelerate in the next 24-36 months.

We do not see sufficient evidence to support the re-imposition of caps on either flow, but particularly do not see a rationale for the UK regulator to impose caps on Inbound IFs given the clear benefit such flows bring to UK issuers and consumers (via increased inter-regional interchange and therefore funding for fraud prevention tools, cashback, etc) and the complexity of the EU market which would require lengthy and detailed analysis (incl. detailed data collection and cooperation from EU PSPs not operating in the UK).

1.4 Costs for issuers have changed since 2015

As noted in Section 2.7, interchange fees can offset costs for Issuers. Since 2015, costs for Issuers have evolved significantly, requiring any decision to re-impose caps to be based on a new assessment.



1.5 Cross border transactions remain different than domestic ones

Costs and risks associated with cross border transactions continue to be higher than for domestic transactions. There were legitimate reasons why the EU agreed to increase MIFs for EEA to non-EEA markets, and these reasons now apply equally to the UK as it is outside the EU's single market.

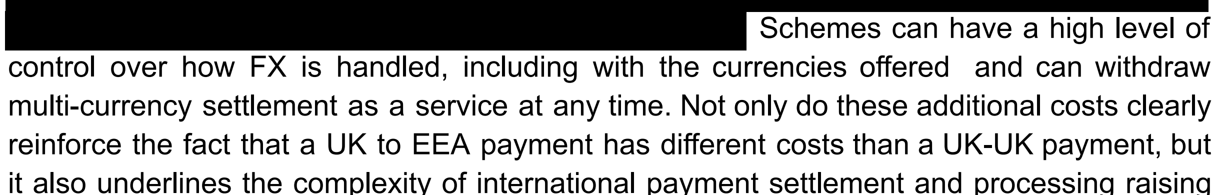
The original approach used by the EU for intra-EU transactions of a single flat rate regardless of border or currency did reflect the relative costs that Issuers and Acquirers bear for domestic versus international transactions. This is particularly true for transactions involving FX (i.e. countries outside the Euro).

Facilitating a payment within the EU's single market is different than facilitating one outside of it. The disruption of cross border trading related to Brexit has made the UK-EU corridor particularly challenging since 2019. The increased friction and administrative costs not only potentially justify higher IFs post Brexit, but also are likely the primary driver for merchant behaviours like differentiation. We would therefore challenge any argument that differentiation is evidence that inter-regional interchange is creating negative outcomes for end users (as suggested in Section 3.24).

We would also challenge the argument that UK merchants face a disadvantage compared to EEA merchants due to inter-regional interchange (as suggested in Section 3.30). First, the challenges UK merchants face in serving EEA based consumers are diverse and we have seen no evidence that inter-regional interchange is a material barrier to their ability to compete. Indeed, it appears tariff, tax, shipping and administrative costs appear often cited as a cause of concern. We are unaware of any merchant who has decided to stop selling to EEA consumers primarily due to increases in inter-regional interchange fees post-Brexit. Second, while Brexit has changed the position of UK merchants, they are treated similarly to other non-EEA merchants from an inter-regional interchange point of view - meaning they are not at a disadvantage to any other non-EEA merchants.

1.6 UK issuers are more exposed to some cross border costs than EEA issuers

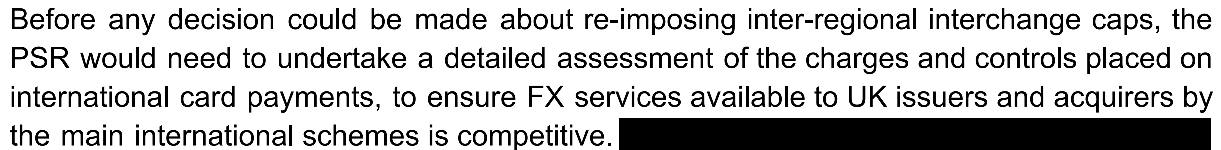
One key area not yet covered in detail by the PSR's approach relates to the additional costs UK Issuers face in facilitating payments to EEA jurisdictions (notably those using non-settlement currencies).



Schemes can have a high level of control over how FX is handled, including with the currencies offered and can withdraw multi-currency settlement as a service at any time. Not only do these additional costs clearly reinforce the fact that a UK to EEA payment has different costs than a UK-UK payment, but it also underlines the complexity of international payment settlement and processing raising

serious risks that any intervention to only one part of the payment flow (i.e. interchange) will lead to unintended outcomes.

Before any decision could be made about re-imposing inter-regional interchange caps, the PSR would need to undertake a detailed assessment of the charges and controls placed on international card payments, to ensure FX services available to UK issuers and acquirers by the main international schemes is competitive.



1.7 There are new alternative payment methods

The original Merchant Indifference Test relied upon the assessment of the cost of cards versus other available payment methods. While the availability of other payment products is recognised obliquely in certain areas (e.g. Section 2.5) we would recommend the PSR expand data collection and analysis in this area.

Since 2015, the availability of alternative payment products has increased significantly. We would particularly stress the impact of Open Banking API triggered instant payments, together with BNPL providers facilitating credit funded purchases.

Consumers now can easily be proposed to use non-card payment methods, and this will increasingly be the case for UK-EEA transactions. In addition to instant payments, Asset coins (Bitcoin, Solana,..), Stable Coins and Central Bank Digital coins will transform cross-border spending over the next 5 years.

1.8 A longer period for assessment is needed

We understand the focus on the 2019-2022 period given the changes made at that point to inter-regional interchange and the availability of data, but we would stress the risk of making conclusions based on such a data set given the many other factors which will have impacted the volume and mix of payments over that period - notably Brexit and COVID. This is recognised in certain areas (e.g. Section 3.10), and we would agree non-payment related external factors may be having a material impact on the payment flow data. The size of the impact of external factors will only be apparent over a longer period. We would therefore recommend the PSR extends its data collection through 2023 and 2024 at least before making a decision on any potential interventions.

SECTION 2: Data collection and potential remedies

2.1 MIT for 20/30 Bps is not UK specific and is out of date

While we recognize there can be a debate about the effectiveness of the Merchant Indifference Test (referenced in Section 2.12) as a methodology on which to base price caps, what is clear is that the MIT process on which the 20/30 Bps caps were applied is (1) out of date and (2) was not tailored to the specifics of the UK card not present payment market.

Were the PSR to consider re-introducing caps for inter-regional interchange between the UK and EEA, a comprehensive exercise would be to be carried out using the most recent data to refresh and localise the MIT. This would need to be conducted for both the UK payments market (to determine the need and impact of capping Outbound IFs) and for the EU payments market (to determine Inbound IFs). The latter exercise would be particularly challenging given the diverse nature of the EU payments market, and its likely rapid evolution in the near future due to the planned strong regulatory interventions of the EU Institutions.

While Section 2.11 correctly reminds us that caps were set for EEA transactions when the UK was within the EEA, caps were not set for EEA to non EEA territories. Were the Interchange Fee Regulation being adopted today, or caps reviewed, they would not apply to the UK.

2.2 Inter-regional interchange is not the most pressing issue facing payments in the UK

Overall, while the recent increase in the inter-regional interchange rates appears significant in absolute terms, in reality the total impact is negligible on both a merchants cost of acceptance and its total costs for cross border trade. This is particularly true for smaller merchants in the UK. Reducing a UK merchant's domestic card acceptance costs by just a few basis points would likely be much more material benefit. We therefore believe the PSR would better prioritise other interventions to boost acquiring, scheme and processing competition in cards, reduce core costs such a fraud (e.g. by evolving Strong Customer Authentication rules, accelerating Digital ID initiatives, etc) and encourage alternative payment methods (e.g. by intervening to support cross border application of instant payments via FPS / SEPA Inst).

2.3 More proportionate solutions

In general, we see blunt price caps and controls as a last resort for regulators given they can lead to unintended outcomes, and in a two sided market often simply shift the burden of paying for payment systems from large merchants to consumers and small merchants. As has been seen in the detailed assessment of the EU's IFR impact, in reality large merchants have been the ones to primarily benefit from the imposition of interchange caps with consumers and small merchants often seeing much more limited or no benefits. More general regulation of payment schemes (e.g. separation rules) also appears to have not had the desired impact. In fact market share by international card schemes increased in the EU since 2015, while their scheme fees increased.

Price capping a portion of the merchant acceptance costs on just one payment type can distort the market in unexpected ways, without solving underlying issues of competition and

innovation. This is particularly a risk given the complexity of cross border payments, notably those involving FX (which can be a material cost for merchants and consumers). We therefore believe broader investigation is warranted into the drivers of cost and barriers to competition in this area, as well as how intervention on non-cost related issues could create value for end users (e.g. actions to accelerate settlement time for merchants).

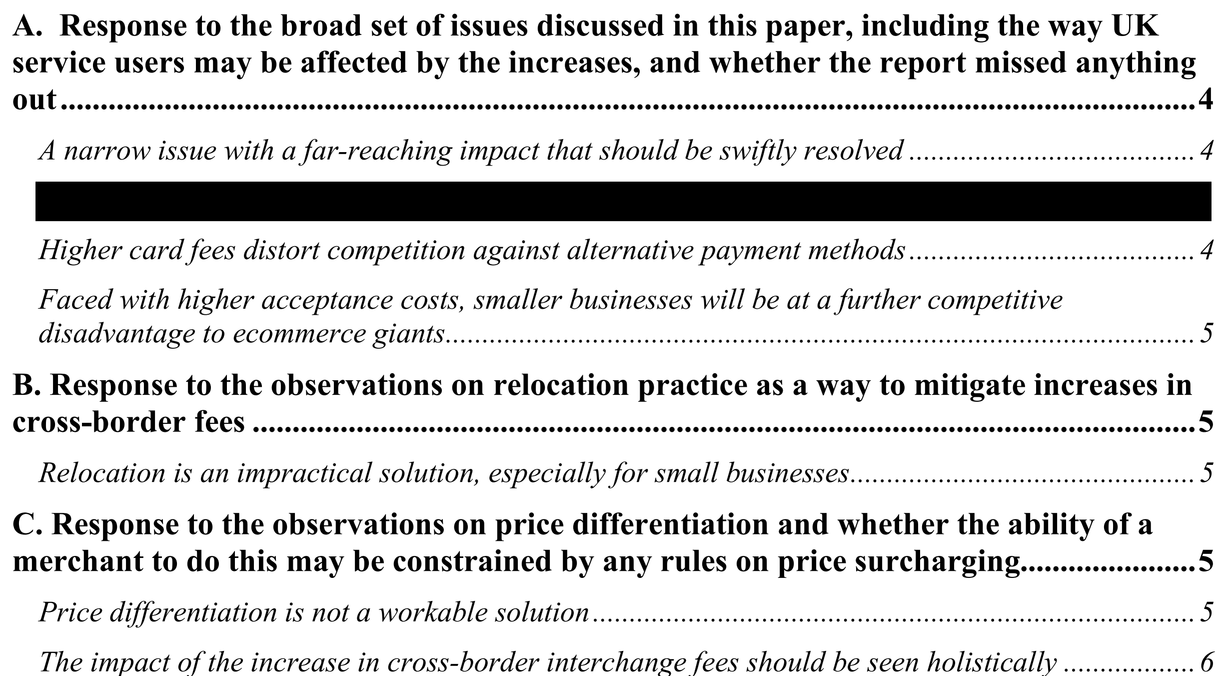
In conclusion, we therefore would stress our recommendation that rather than considering re-imposing inter-regional interchange caps, the PSR looks instead to boost competition and innovation by encouraging alternative methods for cross border payments. We would support a strong short term focus on instant payments, leveraging bilateral dialogue with the EU and global work to deliver on the Financial Stability Board's 2027 Roadmap for cross border payments. Medium term we see stablecoins (or full CBDCs) also being a useful tool to boost competition in cross border payments, leading to reduced costs and settlement times. Alignment of definitions, standards and regulation between the UK and EU for these emerging payment solutions would be a more effective way to ensure long term improvements in choice for merchants and consumers.

SaltPay (now known as Teya)

SaltPay’s comments on MR22/2.4 A discussion of the impact of the UK-EEA cross-border interchange fee increases

19.01.2023

Table of Contents



A. Response to the broad set of issues discussed in this paper, including the way UK service users may be affected by the increases, and whether the report missed anything out 4

A narrow issue with a far-reaching impact that should be swiftly resolved 4

Higher card fees distort competition against alternative payment methods 4

Faced with higher acceptance costs, smaller businesses will be at a further competitive disadvantage to ecommerce giants 5

B. Response to the observations on relocation practice as a way to mitigate increases in cross-border fees 5

Relocation is an impractical solution, especially for small businesses 5

C. Response to the observations on price differentiation and whether the ability of a merchant to do this may be constrained by any rules on price surcharging 5

Price differentiation is not a workable solution 5

The impact of the increase in cross-border interchange fees should be seen holistically 6

About SaltPay

SaltPay is a payment services and software provider, arming local businesses with the technology they need to automate and grow.

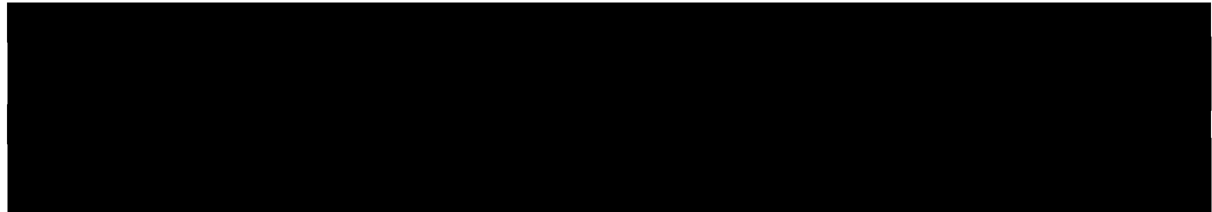
We believe that local businesses are essential to any growing society. SaltPay was founded in 2019 with the goal to create affordable, fast, and secure payment solutions that can help these small and medium-sized businesses to better manage and grow their operations. Taken for granted by banks and traditional service providers, as well as the majority of the fintech sector, small businesses have especially struggled to get access to the financial services and software they need.

We deliver one of the few end-to-end, cloud-native solutions on the market as a principal member of Visa and Mastercard both on the issuing and acquiring side, differentiating ourselves from the competition with our own terminal software, sales, logistics and customer service teams delivering dedicated local support. On top of issuing and acceptance, we provide a number of software solutions to help merchants automate and grow; ranging from ePOS and inventory management to customer loyalty, tax-free provisioning, website building and e-commerce solutions.

We're a UK-based, pan-European business with global presence. We are home to over 2,200 employees in 19 offices across 15 countries, serving over 300,000 merchants, including a material presence in the UK. In addition to our SMB solutions, we also offer enterprise services and software such as issuer payment processing, cloud-native payments, and business management Software-as-a-Service to global FinTechs, payment providers, banks, and MNOs.

A. Response to the broad set of issues discussed in this paper, including the way UK service users may be affected by the increases, and whether the report missed anything out

A narrow issue with a far-reaching impact that should be swiftly resolved



. Therefore, SaltPay would like to emphasise that the conclusion of this review, and the implementation of the appropriate remedy should not be unnecessarily delayed, so that end-users of payment systems can begin to benefit from a more competitive and efficient market.

Higher card fees distort competition against alternative payment methods

In paragraph 2.10, the PSR states that the "EU IFR sought to address the problem of 'high and divergent' IFs in the EU and to facilitate cross-border card payment services". We believe it is also important to highlight that one of the main stated goals of the IFR was mitigating the unlevel playing field between payment service providers. It its impact assessment, the Commission recognised that:

> *"the structure of the current payments market, most notably the two-sided nature of the payment cards market and the existence of the MIF-based pricing model, acts as a major factor against the introduction of new and alternative payment solutions. The incumbents – in particular banks issuing cards and card schemes - are vitally interested in protecting and, if possible, increasing the revenues from card payments, above all from MIFs, […]* any payment solution offering lower profit opportunities will be seen by banks as less interesting to implement from the commercial perspective."[1]

Hence, the PSR should also be evaluating the impact of these latest and any further potential increases to cross-border fees on competition between payment systems, namely the uptake of alternative payment methods to cards, such as A2A payments. Any increase in funds from the payee to the payer

[1] EC IFR Impact Assessment Volume 1/2 p.71

side of the card market will make banks less likely to adopt any alternative payment methods and their willingness to cooperate in the development of a framework for Open Banking payments.

Faced with higher acceptance costs, smaller businesses will be at a further competitive disadvantage to ecommerce giants

One aspect that PSR does not address in the working paper is how the increase in cross-border interchange fees can further disadvantage small businesses moving into ecommerce. The vast majority of merchants, as well as the vast majority of acquirers, are price-takers in the card payment system, and therefore do not have the ability to renegotiate the increases. Only the largest of merchants are able to negotiate lower fees directly with the schemes, given the bargaining power afforded by their processing volume. This was the case with the public dispute between Visa and Amazon over cross-border card fees which reportedly ended in the firms striking a new global deal.[2] Therefore, we recommend that the PSR account for how the increase in cross-border IFs has further reduced the ability of UK small businesses to compete with large e-commerce providers and has potentially led to an increased the dependency of small businesses on large e-commerce platforms rather than investing in or utilising their independent offering.

B. Response to the observations on relocation practice as a way to mitigate increases in cross-border fees

Relocation is an impractical solution, especially for small businesses

SaltPay supports the PSR's understanding as per paragraph 3.16 that smaller merchants don't have the capability of carrying out the necessary relocation to avoid being subject to this increase in fees, and are thus disproportionally affected by the rise, alongside the merchants serving them. It is important to underline relocation practices are restricted by the schemes' cross-border acquiring rules. Scheme rules currently state that regions are assigned based on the presence of the merchant in a given geography, rather than their acquirer or payment processor. For CNP transactions, a merchant must have an entity established in the given country, making it inaccessible for most small businesses. This restriction limits competition between cross-border acquirers, who could offer a transaction routing service to merchants to minimise their acceptance costs if the region was based on the acquirer's location. Therefore, acquirers are widely prevented from mitigating this rise in fees.

As above, these limitations place small businesses at a further competitive disadvantage compared to large merchants and ecommerce giants. While we agree with the PSR that what likely explains the asymmetrical change in UK-EEA transaction value and volume is the greater appetite for UK merchants to establish presence in the EEA than vice versa, it is important to note that neither is an option for small businesses. When combined with the additional post-Brexit factors mentioned by the PSR in paragraph 3.10 such as new VAT and tax rules and additional bureaucracy on managing imports/exports, it is likely that many small merchants permanently lost access to overseas consumers they previously had business with, which also serves to reduce options for consumers - an unnecessary cost to Brexit.

C. Response to the observations on price differentiation and whether the ability of a merchant to do this may be constrained by any rules on price surcharging

Price differentiation is not a workable solution

SaltPay believes that price differentiation at point of sale for online transactions is impractical and unlikely to act as a mitigating factor to the increases in cross-border interchange fees. Firstly, SaltPay agree with the PSR's statement in paragraph 3.23 that discriminating at point of sale on the basis where a customer's card is issued is not workable in practice since customers tend to only input their card detail in the final stage of a transaction. One of the main metrics that merchants seek to optimise in their

[2] https://www.theguardian.com/technology/2022/feb/17/amazon-visa-resolve-credit-card-dispute-global-deal-payments

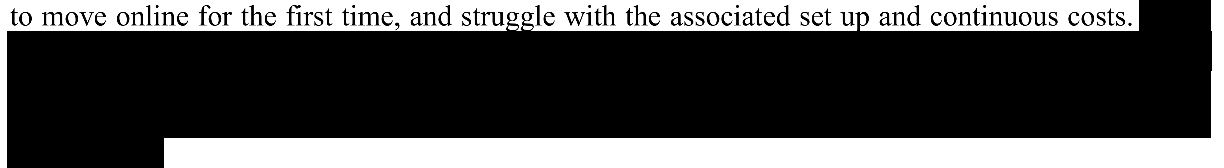
ecommerce offering is cart conversion. Any additional friction at the online point of sale is likely to lead to increased rates of cart abandonment, and therefore won't be adopted by merchants. Furthermore, while discriminating on the basis of where the consumer is located may be possible, we also don't consider it an adequate solution since, as soon as this practice began, consumers would catch on and either shop at a different merchant or circumvent the practice via the commonly utilised Virtual Private Networks (VPNs). This practice may also conflict with consumer protections around pricing transparency, given consumers will receive different prices using their location as a proxy for their payment method. It also does not account for cases where consumer is located elsewhere but has a domestic card.

More fundamentally, while SaltPay supports proportionate price differentiation and believes the practice should be freely allowed for all payment instruments as a steering method that could improve competition, we believe that it is not currently a sufficient tool to mitigate rises in fees. Competition in ecommerce is in many ways more competitive than physical retail, given the prevalence of targeted ads and dynamic pricing adjustments, the dominance of ecommerce giants, and the almost inexistent friction in browsing through multiple options before finalising a purchase. This renders online retailers more sensitive to the preferences of consumers. Consumers are currently averse to price differentiation at point of sale. This is in part due to misconceptions around the cost of payment acceptance. If a merchant decides to pass on their additional cost of acceptance to their customers by baking into the price of the good or service, customers are unlikely to notice and as it remains as a largely invisible cost to consumers. However, if that pass-through is made via surcharging, i.e., distinguished from the original price of the good or service, consumers are more likely to react more adversely to it.

A good example of this was the very public backlash that ensured once the current surcharging ban came into place in 2018, and some merchants looked to pass their expected loss in savings down to consumers. For example, Takeaway food app Just Eat was heavily criticised after introducing a 50p service charge on all its orders in 2018 in light of the new regulation coming into force.[3] The Treasury, making its announcement of the surcharging ban in 2017, named its news story: "Rip-off card charges to be outlawed".[4] While the practice can certainly be exploited by business who charge customers significantly beyond their cost of acceptance, this has to be separated from price differentiation between payment methods as a tool for merchants to send a price signal to consumers over their payment choices, thus increasing competition between payment methods. The two should not be bundled, even in terminology. Nevertheless, given the current misconception around surcharging, SaltPay does not believe it will serve as an adequate mitigating factor.

The impact of the increase in cross-border interchange fees should be seen holistically

In paragraph 3.25, the PSR addresses the important point that not having the ability to price differentiate, merchants will look to pass the increases to consumers by raising their prices for all their customers, regardless of where their cards are issued or indeed whether their payment option is card. This could mean a UK merchant raising prices for all its local UK customers as well as its international customers in the EEA (for outbound IF transactions), and vice versa. Alternatively, businesses could attempt to absorb this additional cost, cutting into their profit margin. Either way, the increase in question should be seen as an additional unnecessary cost almost all businesses must bear in some way. All of this must be placed in the context of the effects of the recent pandemic, which saw many small businesses having to move online for the first time, and struggle with the associated set up and continuous costs.



[3] https://www.theguardian.com/business/2018/jan/09/new-just-eat-50p-surcharge-branded-a-rip-off-by-customers ; https://www.bbc.co.uk/news/business-42621989
[4] https://www.gov.uk/government/news/rip-off-card-charges-to-be-outlawed

Visa

VISA Europe's response to the Payment Systems Regulator's Working Paper on the impact of changes to cross-border interchange fees

January 2023

Visa Europe (referred to as 'Visa' in this response) is pleased to respond to the Payment Systems Regulator's ('PSR's') Working Paper on the impact of UK-EEA cross-border interchange fee increases (the 'Working Paper'), published on 15 December 2022.[1]

We welcome the opportunity to comment on the PSR's initial thinking. Throughout the market review process, we encourage the PSR to continue to engage stakeholders on its thinking, and to ensure the engagement fully involves a broad and representative set of stakeholders.

We note that the Working Paper sets outs the PSR's early thinking and does not share detailed analysis. Accordingly, our comments on the Working Paper are similarly high level. We expect to have further opportunities to engage with the PSR in advance of the publication of the interim report once it has had the opportunity to consider the detailed evidence we have already provided to the PSR.

We are, of course, happy to engage further with the PSR on UK-EEA cross-border interchange fees.

This document has three sections:

- A foreword to our response, that provides some background to Visa's decision to increase certain UK-EEA cross-border interchange rates.
- Our observations on the PSR's overall approach to assessing the impacts of increases in these rates.
- Our further observations on the Working Paper.

Foreword

Payments is one of the most dynamic sectors in the UK. Visa believes that there are three critical elements in a thriving payments system – security, value and innovation. These elements must be carefully balanced. Prioritising one over the others can have unintended consequences to the detriment of consumers and merchants.

We are proud to partner with many of the UK's leading financial institutions, including FinTechs, in enabling British merchants, businesses and cardholders to transact reliably, safely and securely, every day, while also supporting the safety, security and efficiency of the UK economy. The

[1] MR22/2.4 Impact of the UK-EEA cross-border interchange fee increases working paper

regulatory framework in the UK recognises the crucial role that payments play in ensuring the financial stability of the UK's financial sector.

We recognise that increasingly merchants and consumers have a range of options available to them to make payments, and we believe that the benefits of paying with Visa are significant, competitive and compelling. We continue to invest, innovate, and constantly improve, so that merchants and consumers can continue to have confidence to pay and be paid, safely and securely.

As further context to our response, we offer the following key points:

- Visa does not earn revenue from interchange. Interchange ensures that there is a value transfer between the financial institutions who provide services to both consumers and merchants.
- Interchange underpins many of the card services which are typically free to cardholders in the UK today. It enables competition from a wide range of players – from established retail banks to neo-banks and FinTechs. Interchange supports their ability to issue and manage cards and digital credentials. It enables those players to fortify security against bad actors trying to steal information or commit fraud; and it supports innovation, including the development of new products and services, making it easier for consumers to manage their financial lives safely and securely.
- UK interchange fee levels are amongst the lowest levels in the world.
- Visa's decision to revise UK-EEA cross-border interchange fees was taken against the backdrop of significant change to the UK and European Union ('EU') legal and commercial relationship following Brexit.
- This change resulted in a necessary reassessment of interchange fees between the UK and the EEA. In addition, Visa has consistently considered that interchange levels of 0.2/0.3% are not appropriate, in particular for cross-border and Card-Not-Present (CNP) transactions. Visa therefore reviewed the interchange rates applicable between the UK and the EEA, as it would for any other non-EEA country within its Europe Region.
- In reviewing UK-EEA cross-border interchange, Visa considered a number of factors including the capped rates agreed with the European Commission in October 2019 for UK to EEA transactions and that rates of 0.2/0.3% do not apply to cross-border transactions elsewhere in the Europe Region outside the EEA.
- The changes made to interchange rates for CNP cross-border transactions did not impact the vast majority of transactions with UK merchants. Visa data shows that for UK merchants, there was no change to 98% of transactions.[2]
- In addition, these changes harmonised the interchange rates for non-UK consumer cards being used online with UK merchants. For example, whether a consumer debit card is issued in the US, Australia or France, the UK merchant will pay the same level of interchange on a cross-border ecommerce purchase.

---

[2] Visa Net Data Jan – June 2022

Our observations on the PSR's overall approach to assessing impacts on UK service users

In this section, we set out our observations on the PSR's overall approach to assessing the impacts of increases in UK-EEA interchange on UK service users.

The PSR's analysis of impacts should reflect the significant evidence that demonstrates why interchange caps of 0.2/0.3% are not appropriate

The PSR's Working Paper aims to assess the likely impact of an increase in interchange rates from their previous levels of 0.2/0.3% on UK service users. We welcome the fact that the PSR is looking to understand the impact on all participants in the card system (in particular, consumers, as well as merchants and acquirers).

However, the PSR's approach in the Working Paper seems to assume that the previous rates as prescribed in the EU Interchange Fee Regulation were automatically appropriate for cross-border CNP transactions. We have provided significant evidence to the PSR that demonstrates why interchange rates of 0.2/0.3% are not appropriate, in particular for cross-border and CNP transactions. This is due to the nature of the underlying analysis that established the rates of 0.2/0.3%, which has been widely criticised, and the very different characteristics of these transaction, for example:

- fraud rates are higher for CNP transactions than Card Present, and for cross-border transactions versus domestic transactions;
- the wide range of alternatives that facilitates cross-border payments in a globalised market, and
- the significant value that cross-border transactions provide to consumers and merchants.

Indeed, a recent paper from Visa's Economic Empowerment Institute underlines how cross-border transactions differ in terms of the 15 payment attributes that drive value for end users in a specific use case or context.[3]

We expect the PSR's analysis of the impacts of changes to UK-EEA cross-border interchange fees to reflect the evidence we have provided.

The PSR should also engage with the various players involved in this fast-evolving competitive landscape and the range of alternative payment methods available to merchants to properly understand the impact of changes to interchange fees. Today, in addition to paying by cash or card, a consumer can move money account-to-account, use a digital wallet to make purchases, use a merchant payment programme and, increasingly, can use a buy-now-pay-later product. These services are delivered by banks, FinTechs, and global technology and ecommerce platforms – all providing consumers, merchants and businesses with increased choice. Merchants will pay charges

---

[3] https://usa.visa.com/content/dam/VCOM/regional/na/us/sites/documents/veei-lets-give-voice-to-end-users.pdf

for accepting these alternative payment methods and these charges can be quite high and often higher than the acceptance costs of Visa cards, and may also carry greater risks due to, for example, weaker fraud protections.

<u>Any analysis of interchange should take into account relevant factors for issuers, cardholders, merchants and acquirers</u>

Interchange fees play an essential role in balancing the costs and incentives of a wide variety of issuers, cardholders, merchants and acquirers in multi-sided payment systems. We note that the Working Paper misses certain key factors associated with interchange, such as the role it plays in:

- promoting the use of safe and secure transactions (for example, by enabling issuers and cardholders to fortify security against bad actors trying to steal information or commit fraud);
- encouraging investments by issuers in innovation designed to improve cardholder experience and extend financial services to more consumers, and
- enabling merchants to reach a bigger customer base and offer the trust, speed, convenience and efficiencies associated with digital payments.

Any analysis of interchange needs to take into account a wide range of factors to which interchange is relevant for issuers, cardholders, merchants and acquirers.

Further observations on the Working Paper

In this section, we set out further observations on the Working Paper. These relate to the impacts of interchange fee increases on merchants and the PSR's observations on its quantification of these increases.

The changes made to interchange rates for cross-border transactions did not impact the vast majority of transactions with UK merchants. Paragraph 3.30 of the Working Paper refers to impacts on UK merchants that sell to EEA consumers generally when in fact there was no change to interchange in respect of bricks-and-mortar UK merchants who accept face-to-face consumer card transactions with an EEA card. Neither was there any change in interchange for bricks-and-mortar and online UK merchants who accept domestic consumer card transactions. The changes that Visa made to interchange relate to a subset of CNP transactions, where the merchant is based in the UK and the cardholder is in the EEA; or the merchant is based in the EEA and the cardholder is in the UK. Most of these transactions are concentrated to a relatively small number of large multinational merchants with operations in multiple jurisdictions, including on both sides of the UK-EEA border, who may have the ability to relocate (as described below) to mitigate the impact of interchange fee increases. Overall, Visa data shows that for UK merchants, there was no change to 98% of transactions.[4]

[4] Visa Net Data Jan – June 2022

In the Working Paper, the PSR considers the actions that merchants may be able to take to mitigate the impact of interchange fee increases. One option is 'relocation', whereby the merchant organises its operations to shift transaction volume across locations such that fewer transactions are subject to cross-border interchange fees and more transactions are subject to domestic interchange fees. Relocation may not involve moving physical operations but be related to changes such as where the merchant assesses sales tax or the legal jurisdiction for the transaction that governs the contractual relationship between the merchant and the cardholder as the purchaser of the goods or service.

In paragraph 3.6 of the Working Paper, the PSR suggests that the number and value of transactions using EEA cards at UK merchants 'may have been higher without…[interchange fee] increases, since fewer transactions could have been relocated'. In considering changes in the number and value of transactions over time, we ask the PSR to keep in mind that the drivers behind relocation decisions are complex and include multiple factors such as new VAT and tax rules, additional bureaucracy on managing imports/exports and the proportion of a UK merchants' sales that use EEA cards. In addition, some transactions using EEA cards at UK merchants may have shifted to alternative payment methods, meaning any decline in the number and value of UK-EEA transactions may not be as great as the PSR's analysis might suggest. To the extent cross-border transactions have become domestic transactions as a result of relocation, it must also be remembered that these transactions still occur and so there is no drop off in merchant sales.

In paragraph 3.10 of the Working Paper, the PSR observes that the large declines in the number and value of transactions involving EEA cards at UK merchants from 2019 to H1 2022 (as shown in Figure 4 of the Working Paper) are not mirrored in the number and value of transactions involving UK cards at EEA merchants (as shown in Figure 6 of the Working Paper). The PSR also suggests that this could be because UK merchants have greater motivation to establish a presence in the EEA than vice versa. We would caution against making direct comparisons of the patterns observed for three reasons. First, the data over this time period is skewed by COVID-19. Second, timing of relocation due to Brexit may differ between businesses, for example given the degree of uncertainty of the final trading agreements up to the end of the transition period in December 2020. Third, merchants differ across different jurisdictions (for example, in terms of the sectors they operate in and the factors that affect the value and number of transactions they accept) and so it is not appropriate to make direct comparisons between EEA and UK merchants.

PUB REF: MR22/2.4 Submissions

© The Payment Systems Regulator Limited 2023
12 Endeavour Square
London E20 1JN
Telephone: 0300 456 3677
Website: www.psr.org.uk

All rights reserved