

Consultation paper

Market review of UK-EEA consumer cross-border interchange fees

An update and draft terms
of reference

June 2022

We welcome your views on these draft Terms of Reference. If you would like to provide comments, please send these to us by **5pm on Tuesday 2 August 2022**.

You can email your comments to cardfees@psr.org.uk or write to us at:

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

We will consider your comments when preparing the final Terms of Reference for the market review.

We will seek to make the responses to this consultation available for public inspection.

When considering whether we can disclose confidential information, we will have regard to the sensitivity of the information and how best to fulfil our obligations to act fairly. If you consider that you are providing information in your response that is so sensitive that we should not disclose it, this should be made clear to us in your response. For these purposes, we will not regard a standard confidentiality statement, for instance in an email message, as a request for non-disclosure, and we do not accept blanket claims of confidentiality. In your response, you should identify the specific items that you consider to be sensitive and explain why. If you include extensive tracts of sensitive information in your response, we will ask you to submit a version of your response that we can publish.

We may also be required to disclose certain types of information, including sensitive material, to meet our legal obligations – for example, if we are asked to disclose a confidential consultation response under the Freedom of Information Act 2000. We will endeavour to consult you if we receive such a request under the Freedom of Information Act 2000. Any decision we make not to disclose information can be reviewed by the Information Commissioner and the Information Rights Tribunal.

You can download this consultation paper from our website:

<https://www.psr.org.uk/publications/market-reviews/mr22-2-1-UK-EEA-cross-border-interchange-fees>

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1 Introduction

- 1.1** We are carrying out a market review under Part 5 of the Financial Services (Banking Reform) Act 2013 (FSBRA) into interchange fees applicable to consumer card transactions between the UK and EEA (UK-EEA) within the two largest card payment systems in the UK: Mastercard and Visa.
- 1.2** This document sets out the draft terms of reference (ToR) for our market review. It reflects the work, that we commenced in November last year, gathering and analysing information to help us identify where we should direct our attention. We are looking for feedback on this document and, in particular, on the proposed scope of and approach to the market review.
- 1.3** Card payments are critical to the smooth running of the UK economy as they enable people to pay for their purchases and merchants to accept payments for goods and services. They represent a well-established method for consumers to make payments, and their use is growing. In 2021, there were 21 billion UK issued debit card payments totalling £702 billion. UK issued credit card payments in the same year numbered 3.5 billion and amounted to £182 billion.
- 1.4** An important use of debit and credit card payments is for international transactions (that is, cross-border transactions where the issuer of the card and the merchant acquirer and/or point of sale location are based in different countries). For example, in 2021, one in 12 UK-issued debit card transactions were international.

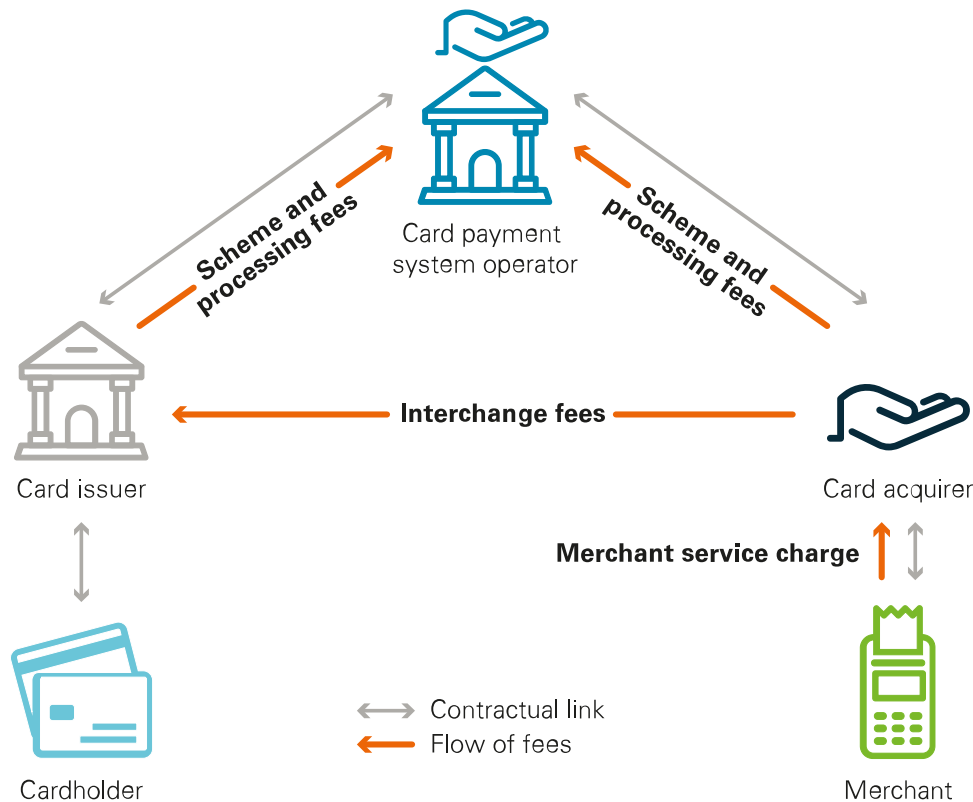
What are cross-border interchange fees?

Four-party card payment systems

- 1.5** As well as cardholders (individuals or businesses that use cards to buy goods and services), there are at least four other parties involved in four-party card payment systems:
- **Merchants:** Organisations that accept payment by card.
 - **Operators of card payment systems (such as Visa and Mastercard):** Organisations that license issuers and acquirers to recruit cardholders and merchants, respectively. They manage the 'scheme rules' that govern how card payments are made and set the basis on which issuers, acquirers, merchants, cardholders and other parties participate in the card payment system.
 - **Acquirers:** Banks or other organisations licensed by operators of card payment systems to recruit merchants to accept card payments.

- **Issuers:** Banks or other organisations licensed by operators of card payment systems to provide cards to cardholders. The issuer pays to the acquirer the money the merchant is owed for the transaction (less interchange fees) and debits the cardholder's account.

Figure 1: Simplified structure of a four-party card payment system



1.6 Figure 1 above shows the main flow of fees between parties in a four-party card payment system, including:

- **interchange fees (IFs)**, which acquirers pay to issuers each time a card is used to buy goods or services¹; this is a per-transaction fee and is usually levied as a percentage of the transaction value²
- **scheme and processing fees**, which are set by Mastercard and Visa³

¹ The IF is typically deducted from the transaction amount that is paid by the issuer to the acquirer. Acquirers then typically pass the IF on to merchants through the MSC, so it represents a cost to merchants of accepting card payments.

² The direction of an IF will differ in the case of ATM transactions. For the purposes of this Terms of Reference document, we are not including ATM transactions, which will not be covered as part of this review.

³ The terms 'scheme fees' and 'processing fees' include all fees acquirers and issuers pay to card payment systems operators. We note this is a change of terminology from our card-acquiring market review where we used the term 'scheme fees' to cover both scheme fees and processing fees. For further details on scheme fees and processing fees, please see our draft ToR for the Market Review into scheme and processing fees: <https://www.psr.org.uk/publications/market-reviews/mr22-1-1-card-scheme-and-processing-fees>.

- **merchant service charge (MSC)**, which is the total amount merchants pay to acquirers for card-acquiring services; this comprises interchange fees, scheme and processing fees and acquirer net revenue⁴
- **cardholder fees**, which cardholders may pay to the issuers

Cross-border interchange fees

1.7 Card transactions where the issuer, acquirer and the merchant point of sale location (the merchant location) are in the same country are typically defined as domestic transactions.⁵ The IFs applicable to these transactions are called domestic IFs. Transactions where the card was issued in a different country to the merchant location are typically referred to as cross-border transactions and the IFs are called cross-border IFs.

1.8 We distinguish between two types of UK-EEA cross-border transaction for the purposes of this market review:

- **Outbound IFs:** Transactions using non-UK issued cards – that is, EEA-issued cards, in the context of UK-EEA transactions – to make payments to a merchant located in the UK.
- **Inbound IFs:** Transactions using a UK-issued card to make payments to a merchant not based in the UK – that is, merchants based in the EEA, in the context of UK-EEA transactions.

Regulation of cross-border interchange fees

1.9 From December 2015 until the end of the transition period following the UK's withdrawal from the EU, in December 2020, IFs for both consumer domestic UK transactions and UK-EEA (intra-EEA) transactions were subject to caps under the EU interchange fees regulation (EU IFR). For all these transactions, a single set of caps applied, which were 0.2% of the value of the transaction for consumer debit cards (including prepaid cards) and 0.3% of the value of the transaction for consumer credit cards.

1.10 In addition, any card transactions made by using a card issued outside the EEA at a merchant located in the EEA were subject to caps on interchange fees, set out in the commitments offered by Mastercard and Visa to the EU in the context of the European Commission's inter-regional interchange fees investigation (the 'Commitments'). The Commitments, which were made binding in 2019, differentiate between card-present (CP) and card-not-present (CNP) transactions.⁶ The former are subject to the same caps as in the EU IFR (that is, 0.2% for consumer debit and 0.3% for consumer

⁴ Acquirer net revenue includes the costs the acquirer incurs (other than IFs and scheme and processing fees) to provide card-acquiring services, plus the acquirer's margin.

⁵ This is as per the UK Interchange Fee Regulation definition.

⁶ Consumer and business customers commonly use debit and credit cards to pay both in a 'face-to-face' and a 'non-face-to-face' (such as online or over the phone) way. The former are also referred to as card-present (CP) transactions while the latter are also known as card-not-present (CNP) transactions.

credit) while the latter are subject to higher caps (1.15% and 1.5% for consumer debit and credit cards respectively).⁷ The Commitments are due to expire in 2024.

Recent changes in cross-border interchange fees

- 1.11** In January 2021, once the UK had withdrawn from the EU, the EU IFR ceased to apply to UK domestic transactions and cross-border transactions between the UK and EEA. The on-shored UK Interchange Fee Regulation (UK IFR) applies the cap levels set out in the EU IFR to UK domestic transactions.
- 1.12** A subset of cross-border UK-EEA transactions now fall within the scope of the caps set out in the Commitments, which distinguish between CP and CNP transactions. The caps in the Commitments apply to transactions involving a UK-issued card to make a payment to a merchant located in the EEA (that is, inbound IFs), but do not apply to transactions using an EEA-issued card to make payments to a merchant located in the UK (that is, outbound IFs). Outbound IFs are not currently subject to any caps.
- 1.13** Since the UK's withdrawal from the EU, Visa and Mastercard have decided to apply the same levels to both inbound and outbound IFs for UK-EEA transactions – that is, where a UK-issued card is used to pay a merchant located in the EEA, and where an EEA-issued card is used to pay a merchant located in the UK:
- for CP transactions using consumer debit and credit cards, IFs have remained at the same levels as when the EU IFR caps applied (0.2% and 0.3% respectively)
 - for CNP transactions using consumer debit and credit cards, IFs have increased from 0.2% and 0.3% to 1.15% and 1.5% respectively⁸
- 1.14** The level of IFs set by Visa and Mastercard for UK-EEA CNP transactions correspond to the levels of the caps in the inter-regional Commitments accepted by the European Commission. Although the UK is no longer part of the EU, it remains part of the Single European Payments Area (SEPA), which is a point of difference between UK-EEA card transactions and other inter-regional card transactions involving cards issued outside the EEA used to pay merchants located in the EEA (for example, EEA-US or EEA-Japan transactions, where neither US nor Japan are part of SEPA).

⁷ The higher caps on CNP transactions reflect the cost to EEA merchants of accepting alternative payment methods for such payments, such as e-wallets (digital wallets) funded via non-SEPA bank transfers.

⁸ Visa and Mastercard announced and introduced changes to cross-border IFs as follows:

- At the end of 2020, Mastercard announced it would increase inbound IFs for consumer CNP transactions (from 0.2%/0.3% to 1.15%/1.5% for debit and credit cards respectively). These increases became effective in October 2021.
- In March 2021, Visa announced increases in both inbound and outbound IFs for consumer CNP transactions (effective from October 2021).
- Mastercard announced an increase to outbound IFs for consumer CNP transactions in early 2022. These increases to outbound IFs came into effect in April 2022.

Why we are carrying out this market review

- 1.15** As set out above, since the UK's withdrawal from the EU, Visa and Mastercard have increased the IF rates for UK-EEA consumer CNP transactions by a factor of five.
- 1.16** As IFs represent a cost to merchants of accepting card payments, they are likely to be passed on to some or all of their customers (at least in part) in the prices they pay for goods and services. Some merchants have raised concerns about the increases in Visa's and Mastercard's UK-EEA IFs and the impact that these may have on their businesses.
- 1.17** Given these concerns, we are conducting a market review into UK-EEA consumer cross-border interchange fees using our powers under FSBRA. Market reviews are one of our tools for investigating how well markets or aspects of the markets for payment systems, or services provided by payment systems, are working in line with our statutory competition, innovation, and service-user objectives.
- 1.18** We want to understand the rationale behind the increases in IF rates for Visa and Mastercard's consumer debit and credit UK-EEA CNP transactions since the UK's withdrawal from the EU, as well as the impact of these increases.
- 1.19** In parallel with this market review, we are also carrying out a market review of scheme and processing fees. Further information on this review can be found at <https://www.psr.org.uk/publications/market-reviews/mr22-1-1-card-scheme-and-processing-fees>.
- 1.20** The remainder of this document is set out as follows:
- In **Chapter 2** we set out the proposed scope of, and approach to, the market review, including possible outcomes.
 - In **Chapter 3** we set out our consultation questions.

2 Proposed scope and approach

Proposed scope of the market review

- 2.1** We are conducting this market review because we want to understand the rationale for the increases in cross-border UK-EEA interchange fees and whether the card scheme operators' ability to increase these fees is an indication that the market(s) or aspects of market(s) is not working well.
- 2.2** Visa's and Mastercard's increases in IFs relate to consumer debit and credit CNP transactions for both:
- transactions using a UK-issued card to make a payment to a merchant located in the EEA (inbound IFs), and
 - transactions using an EEA-issued card to make payments to a merchant located in the UK (outbound IFs)
- 2.3** In this market review, we propose to focus our investigation on UK-EEA cross-border IFs in the Visa and Mastercard card payment systems.⁹ It will cover both debit and credit consumer cards. We propose to focus only on IFs which were covered by the caps imposed by the EU IFR prior to the UK's withdrawal from the EU, that is, IFs applicable within four-party card payment systems to consumer debit and credit transactions within the EEA (when this included the UK). We will prioritise outbound IFs.

Proposed approach to the market review

- 2.4** We want to understand the impact of and rationale for the rises in IF levels for UK-EEA consumer debit and credit CNP transactions. For the reasons set out above, we are concerned that Visa and Mastercard's ability to increase these fees is an indication that the market(s) or aspects of market(s) is not working well for users, including in the form of higher prices paid by UK merchants and consumers. Although the scheme operators have already provided some explanation for the increases, we wish to explore further the basis for them.

⁹ For the purposes of this market review, the term 'interchange fee' means the fee paid by the acquirer to the card issuer on a per transaction basis only. We do not use the definition in the Interchange Fee Regulation which also includes certain other payments received by the issuer, including net compensation, that are treated as part of the interchange fee. Other payments flowing between the parties to a transaction will be considered as part of our market review of scheme and processing fees:
<https://www.psr.org.uk/publications/market-reviews/mr22-1-1-card-scheme-and-processing-fees>.

- 2.5** We expect our thinking to develop over the course of the review, including the possibility that our concerns (regarding potential harm to competition, innovation or service-users) are amended, not pursued further or new ones added. These concerns also do not imply any pre-judgement of the outcome.
- 2.6** To investigate these potential concerns, we propose to examine the following issues:
- The potential drivers and justifications for the increases in these IFs since the UK's withdrawal from the EU. As part of this, we shall examine the reasons provided by the card scheme operators and the considerations that Visa and Mastercard took into account when assessing the opportunity to increase these fees, including strategic, competition and regulatory aspects.
 - The impact of the increases in IFs for UK-EEA consumer debit and credit CNP transactions on competition, innovation and service users.

Possible outcomes

- 2.7** We will consider what actions, if any, to take should we identify a need to promote effective competition or address detriments to current or potential service-users.¹⁰ For example:
- making new, or amending existing, general directions
 - making new specific directions
 - requiring the operator of a regulated payment system to establish or change their operating rules, to notify us of rule changes or to seek our approval before making rule changes
 - making recommendations for industry initiatives or enhanced industry self-regulation
 - publishing guidance
 - carrying out an investigation into a potential breach of the Competition Act 1998
 - if applicable, open a regulatory enforcement investigation where it appears to us that there are circumstances suggesting that there may have been a compliance failure
 - making a market investigation reference to the Competition and Markets Authority (CMA) to investigate a market or a feature of several markets

¹⁰ We recognise that the Bank of England (the Bank) is responsible for supervising systemically important financial market infrastructures (FMIs) in the UK, including payment systems, to ensure financial stability and operational resilience. Visa and Mastercard are both recognised as systemically important FMIs and so are supervised by the Bank. More detail on the Bank's approach to the supervision of FMIs can be found on its website: <https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision>

2.8 We aim to ensure that any action we take is effective and proportionate to any detriments we identify. The following three principles will generally be relevant when considering intervention:

- **The efficiency principle:** This is an expectation that resources are used in the most efficient and economical way.
- **The proportionality principle:** This is where a burden or restriction that is imposed on a person, or on the carrying on of an activity, should be proportionate to any benefits that are expected to result from the imposition of that burden or restriction.
- **The transparency principle:** This requires regulators to exercise their functions as transparently as possible.

2.9 In the absence of a need to promote effective competition, and the absence of any detriments to current or potential service-users, we would not act.

3 Consultation questions and next steps

- 3.1** We welcome feedback on these draft ToR. We set out consultation questions below.
- 3.2** You can provide your comments in writing until **5pm on Tuesday 2 August 2022**.
- 3.3** We're planning a number of engagement events with stakeholders during the consultation. We'd like everyone with an interest to provide their feedback and help us shape our work. Further details of the engagement events will be provided to participants in due course.
- 3.4** Our scoping of the market review will continue following the publication of these draft ToR. We will also continue to liaise with other authorities (including financial regulators and the CMA) where appropriate.
- 3.5** After reviewing the comments on these draft ToR, we plan to publish the final ToR for the market review in Autumn 2022. We will set out our full timetable for the market review in that document.

Consultation questions

- 3.6** You are welcome to provide whatever comments you see fit, but it will be helpful if you can structure your responses in line with the following questions.

Scope

- 3.7** We set out in paragraphs 2.1 to 2.3 the proposed scope of the market review.

Question 1

- Do you agree with the proposed scope of the market review? If not, please explain:
 - how the proposed scope should be altered
 - why you think the proposed scope should be altered in this way
- Please include any evidence you think is relevant to your response.

Our proposed approach

3.8 We set out in paragraphs 2.4 to 2.7 our proposed approach.

Question 2

- Do you agree with our proposed approach? If not, please explain:
 - how the proposed approach should be altered
 - why you think the proposed approach should be altered in this way
- Please include any evidence you think is relevant to your response.

Question 3

- Do you have views on the potential concerns we propose to investigate (set out in para 2.5)?
- Are there other concerns with cross-border interchange fees that we should be considering?
- Please include any evidence you think is relevant to your response.

How to provide comments

3.9 Please send your comments by **5pm on Tuesday 2 August 2022**. You can email them to cardfees@psr.org.uk or write to us at the following address:

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3.10 We will consider your comments on these draft ToR when preparing the final ToR for the market review.

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