

Market review into the supply
of card-acquiring services

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

Onestopmoneymanager



Onestopmoneymanager Ltd

Response to the Payments System Regulator:

PSR MR18/1.2 - Final terms of reference: market review into the supply of card-acquiring services

Submission by:
Onestopmoneymanager Ltd
West Sussex

29th January 2019

Submission to:

Payment Systems Regulator
Card-acquiring market review team
12 Endeavour Square
London
E20 1JN
cards@psr.org.uk



Please see my comments below regarding the ToR.

1.2 As I noted in my response and in my opinion and experience, the reason acquirers have not passed the savings realised from the IFRs may be due to a number of reasons. Firstly, merchant acquirers large and small have a significant amount of overheads and must pay fees to the schemes per transaction, not to mention yearly license fees and other program fees. Smaller merchant acquirers are simply not able to compete with larger acquirers due to the fact that by virtue of sheer volume, larger acquirers can afford to 'absorb' the loss of passing the lowered scheme fees on (usually for what is identified as low risk merchants). Lower risk merchants (established retail stores and large retail companies for example) will usually only work with the large acquirers due to this reason and by virtue of the longstanding reputation larger acquirers hold versus a newly established boutique merchant acquirer. Scheme fees have also been increased and the card schemes have been focusing on merchant jurisdiction restrictions, which are subject to fees and non-compliance assessments which are often significant and can lead to the loss of the merchant from the acquirer. This is a particular concern for UK based merchant acquirers, particularly given the implications of a potential no-deal Brexit.

The PSR validates that the fees charged to merchants by merchant acquirers may be due to increasing fees and ancillary costs levied by the card associations. Additionally, card not present acquiring is a high-risk business particularly in the current climate of Brexit uncertainty which has had a knock-on effect on the economy. Merchant acquiring is an extension of credit risk assumed by the acquirer and often a merchant can become delinquent, intentionally or unintentionally. Merchant acquirers must take the risk profile into consideration for each merchant as in an insolvency situation (merchant side) for example, the merchant acquirer is financially liable for refunding card holders by virtue of the card scheme rules and Section 75 of the Consumer Credit Act 1974. The merchant acquirer has no protection.

Additionally, From the 17th August 2017, one card scheme modified acquirer international fees for card-not-present transactions which then must be passed on the merchant if the merchant acquirer by virtue of its size and market share cannot afford to absorb. In addition to this a number of other fees were increased and introduced.

It was my understanding that the IFRs looked to even the playing field for merchants and consumers. However, it should be considered how viable it is for merchant acquirers to pass on such savings from the IFRs when they are subjected to increases and new charges elsewhere from the card operator.

1.14-1.17



By suggesting that the PSR will not investigate whether the fees charged to merchant acquirers by card scheme operators will, in my opinion, hamper your investigations as to why IFR reductions are not always being passed onto merchants and ultimately consumers by merchant acquirers. Smaller acquirers are finding it increasingly hard to compete with larger acquirers. In order to understand and address the dynamics of effective competition, models of oligopolistic behaviour, which is intrinsic to your review given the dominance of Visa and MasterCard must come into equation. Such charges and fee increases, which arguably restrict competition without producing any objective countervailing benefits, in my opinion leads to increased prices which transfers wealth from the merchants and consumers to the card association¹ as merchant acquirers have no choice but to pass on the cost as they too are businesses and must make a profit to operate.

1.21

Appears to contradict 1.14

2.25

I would strongly urge the PSR to examine several initiatives which could be considered unfair to merchant acquirers and merchants and even restrict access to the card payments market.

a) The location of the merchant

Recently the schemes have been focusing on the location of the merchant as previously adhered too. The requirements include meeting the below parameters to comply with the rules. This includes the merchant's permanent location as being determined where the merchant employees or agents are accountable for the sale or distribution of the goods or services purchased in the specific transaction work such as the actual location where the merchant conducts business activities amongst other requirements. If the scheme determines a merchant acquirer to be non-compliant with their requirements, the merchant acquirer must terminate that merchant and may be subject to non-compliance fines which can be extremely significant. With the cross-border nature of the internet, this type of program could lead to an unfair disadvantage to both merchants and merchant acquirers.

b) For new merchant acquirers that wish to become Principal Members and wish to acquire 'high-risk' transactions such as dating, adult or licensed gambling. It appears they are now required to have significant amounts of collateral, which is a barrier to market.

2.30

¹A Jones, *EU Competition Law: Text, Cases, and Materials* (Oxford University Press, 2014) 666



According to the card scheme rules, the merchant acquirer assumes the financial risk for each merchant which it acquires transactions for. This can lead to a significant financial liability for the merchant acquirer particularly as chargebacks for card-not-present transactions can come up to 540 days after the transaction was made under certain reason codes. This is often abused by cardholders that have 'buyers remorse' and remains a contingent liability for the merchant acquirer. Merchant acquirers must include a risk factor when they provide a rate to merchant and they must take into consideration in addition to the scheme fees, the new charge as aforementioned by one card scheme on certain international and EEA transactions. A merchant acquirer must pass on such costs to the merchants and ultimately the consumer otherwise they would be making losses.

2.52

Given the aforementioned location requirements, the PSR may wish to consider whether this will impact UK merchants as often with digital goods and services sold online in particular, it is hard to justify such requirements when the principle of free movement of goods and services has been enshrined in EU law for a long time now. With the current instability of the financial services market due to the uncertainty of Brexit, this poses a real concern for both UK merchants and UK merchant acquirers.

2.53

We agree that this is relevant consideration also. When a card issuer and merchant acquirer are the same entity, the transaction between them is known as an ONUS transaction as is subject to an even lower interchange fee. The two largest UK issuers and merchant acquirers can effectively dominate the market through sheer volume and the benefit of being subject to lower fees by virtue that they are both the card issuer and the merchant acquirer.

2.54

We believe we have given a number of items here in this response and indeed or other response that may be of interest to the PSR, as in our opinion they are intrinsically linked to the fees that merchant acquirers charge the end merchant.

3.8

We consider the aforementioned collateral requirements for smaller acquirers wishing to become Principal Members is concerning. Additionally, both Visa and MasterCard have recently amended their rules for marketplace providers and Payment Facilitators, meaning that it is generally not possible or viable for smaller acquirers to board them due to the risk



and collateral requirements from the card associations. Although not directly relevant to the card operators this statement is relevant to the supply of card acquiring services. The PSR should note that major UK banks appear to be reluctant to provide corporate or business banking services to merchant acquirers, payment facilitators and even authorised payment institutions, citing that these entities are not within their risk or business appetite. Lack of denial of access to banking services is proving a challenge for a number of UK merchant acquirers. These actions almost contradict the onus of PSD2 and the innovations it seeks to progress.

Tax barrister

From: [REDACTED]
Sent: 25 February 2019 12:01
To: 'cards@psr.org.uk' <cards@psr.org.uk>
Cc: [REDACTED]
Subject: RE: VAT appeal on merchant acquirer fees

[REDACTED]

Reference the VAT issue . We have noted your final TOR's.

We note that barriers to entry are covered at 3.7 onwards

We have come across the concerns of the Post Office Regulator at the time, POSTCOMM, when the same issue, an exemption , applied to lot of post office services. The exemption can act as a barrier to entry - if an operator has to raise say £100m to set up, they have instead to raise £120m. See POSTCOMM document at para 5.4 onwards attached.

As you may know, the exemption was removed for price negotiated postal services

For your information, three acquirers have refused to help us. When we asked them if they would reduce pricing to merchants if they could get their VAT back, they all said "No comment".

My client now believes even more that acquirers may be using the exemption as a barrier to prevent competition, if not a key barrier. Please can you include these thoughts in your review.

Basically if our appeal proceeds and we win, we will seek to have the recoverable VAT in the hands of the acquirers passed down to merchants, or we would accuse them of profiteering.

It would greatly help my client and the market if you could include this and even come up with a view on the profiteering point. Up to 80 % of some estimated £0.25 bn p.a. could flow back to business and the market become more competitive (the remaining 20% would have to suffer a price hike as they are either not VAT registered or cannot recover VAT, like insurance companies and banks.

The VAT is really important at 20% its on the pareto boundary.,

Moreover, we think making it recoverable is an important piece to attract new entrants to the market and improve merchant choice.

Accordingly we would be grateful if you could keep the VAT in your considerations

If you need to know any more information or require any further information please do not hesitate to get in touch

Regards

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

From: [REDACTED]

Sent: 08 November 2018 19:11

To: cards@psr.org.uk

Subject: VAT appeal on merchant acquirer fees

[REDACTED] I'm a Tax Barrister and I've just seen the Review on Acquirer services.

[REDACTED] I have a client who is a merchant, a small guy, who is trying to challenge the whole industry treatment of VAT on this. The acquirers have not challenged this for their own reasons. This is REALLY important please and could help a lot of merchants in reducing costs to them of between 1 and 2% we think, if all the VAT savings achieved by acquirers were all passed on to them.

We do not ask for you to take sides, the VAT liability of acquirer fees is in the competence of the Tax Tribunal (we believe) but there is a lot of money involved if my client wins and what would happen to those monies is of vital importance. We seek your views on this from a competition perspective and potential super-profits in the hands of Acquirers and whether and to what extent these would or should be passed on to merchants, if he were to be successful? In other words, if my client wins, who really wins here? Is it Wall Street, or Main Street? My client runs a successful bar in London and definitely on the BRICK, not CLICK side of things. He thinks there is excessive VAT in the hospitality sector, and this is a hidden VAT burden in addition to that.

The EU VAT Directives and EU VAT case law say that a payment transfer is exempt, except when it is a transfer of a debt owed to a supplier of goods or services, and then it is excluded from exemption as it is debt collection. It is like factoring, not a VAT exempt service but is taxable. The consequence of exemption is that an economic operator cannot recover the VAT he incurs on his costs. So either absorbs them or passes them on, or a bit of both.

The United Kingdom Government has argued for taxable debt collection in cases like *Axa* where dentist customers paid in to Axa and Axa transferred those payments to the supplier of the services, namely the dentists. They confirmed that position publically and only recently, in a case called *DPAS* before the Court of Justice of the European Union (the "CJEU"). But the HMRC insist that Acquirer services to businesses in Main Street are exempt. Yet just like factoring, which the CJEU has said is fully taxable as debt collection, under a master agreement, the seller of goods and services can assign the debt owed for goods and services he supplies, and receives (1) advance payment, (2) risk transfer of debtor default, and is relieved of the tasks of (3) debt collection and (4) sales ledgering of receivables. That is taxable debt collection in our view, the same as factoring but at mainly the retail stage, one below the wholesale stage for factoring, in any supply chain vertical.

HMRC say we have no legal standing to take the appeal to the Tribunal as we cannot show a financial stake in the outcome of this appeal. We say the modern case law on standing only requires that we be a person affected by the Decision of the State and outcome of the appeal, and not a busybody with no interest. So actual or potential reduction in acquirer costs would mean we were directly affected by the outcome of this appeal.

From one acquirer's published accounts, we have estimated there is a 1% to 1.43% element of irrecoverable VAT in their turnover for exempt acquiring services (the terminal rental is separate and taxable at the standard rate). [REDACTED]

Therefore, we wondered if you could include the VAT treatment of possible recoverable VAT in your review? The acquirer we have looked at has some estimated £21 million irrecoverable VAT p.a. so with 20 acquirers and other merchant payment facilitators perhaps a quarter of a billion p.a. at stake? [REDACTED]

In competition terms, either for existing or new entrants, there would presumably be some pressure either commercially, or from a regulatory perspective to avoid super-profits in what is not necessarily a pure competitive market with only some 20 Acquirers , so that all or the main part of this VAT recovery would be passed on to merchants.

We are of course not asking you to take sides in any dispute, but rather in a review -where as you say acquirer costs may have a bearing on charges to merchants- a wondered if you would be prepared to state your position on what you might expect acquirers to do in competition terms, if they were suddenly flushed with some £0.25bn or more p.a. of now recoverable VAT. Because they are adding it on their acquirer charges they recover the formerly irrecoverable VAT on their cost base - and the majority of merchants can claim VAT charged by the Acquirer back as well , as they too charge VAT and it is borne ultimately by you and me when we buy goods and services at the retail trade stage. The idea of VAT is that it is not a cascade tax favouring vertically integrated producers, but is neutral viz a viz integrated and non-integrated verticals. That happens in terms of tax incidence by operation of the deduction mechanism so that sectors with a number of vertical non-integrated stages are not at a disadvantage, if they charge output VAT downstream they can recover input VAT on their upstream input costs..

If however 'there is irrecoverable VAT and that too is passed on by the retailer to the final consumer , the latter do not just bear the £0.25bn passed on from acquirer to merchant, but 20% on top that's another £50million !

Best wishes