

Market review into the  
supply of card-acquiring  
services: Interim report

# **Annex 1**

## Industry background

September 2020

# Contents

Introduction	3
Types of card transactions	4
Card payment systems operating in the UK	8
Products merchants buy to accept card payments	19
Characteristics of merchants and how they buy card-acquiring services	22
Acquirers and payment facilitators serving merchants	29
Third parties that help merchants accept card payments	34
Pricing of card-acquiring services and other products	40
Regulatory framework, scheme rules and voluntary industry standards	61
Alternatives to Mastercard and Visa	69

Note: The places in this document where confidential material has been redacted are marked with a [X].

# Introduction

**1.1** This annex provides background information on the industry relevant to our assessment. It describes:

- the different types of card transactions
- the card payment systems operating in the UK
- the products that merchants buy to accept card payments
- the characteristics of merchants and how they buy card-acquiring services
- the main acquirers and payment facilitators serving merchants
- the third parties that help merchants accept card payments
- the pricing of card-acquiring services and other products that acquirers, payment facilitators and independent sales organisations (ISOs) offer
- the regulatory framework, scheme rules and industry standards that apply to acquirers and payment facilitators, focusing on those requirements that are most relevant to our assessment
- the alternatives to Mastercard and Visa cards for merchants

# Types of card transactions

**1.2** Card transactions can be categorised according to their characteristics including:

- the card type
- the card payment system
- the location (of the parties involved in the transaction)
- the channel
- the way the transaction is authenticated (secure or non-secure)

**1.3** Below we describe these different characteristics.

## Card type

**1.4** There are three main card types: credit, debit and prepaid. Cards can also further categorised according to whether they are consumer or commercial cards.

### Credit card

**1.5** When a consumer or business uses a credit card to buy goods or services, they borrow money (up to a specific amount) and pay it back later. In the UK, 68% of adults have a credit card.<sup>1</sup>

**1.6** For the purposes of our market review, we use the definition of a credit card set out in the Interchange Fee Regulation (IFR), an EU regulation that took effect from April 2015. In the IFR, a credit card means a category of payment instrument that enables the payer to initiate a credit card transaction, which is a card-based payment transaction where the amount of the transaction is debited in full or in part at a pre-agreed specific calendar month date to the payer, in line with a prearranged credit facility, with or without interest.<sup>2</sup>

### Debit card

**1.7** When a debit card is used to buy goods or services, the money is earmarked on the customer's payment account immediately. Debit cards are the most used payment card in the UK and 98% of the UK population holds a debit card.<sup>3</sup>

**1.8** For the purposes of our market review, we use the IFR definition of a debit card. In the IFR, a debit card is a category of payment instrument that enables the payer to initiate a debit card transaction excluding those with prepaid cards. A debit card transaction means a card-based payment transaction, including those with prepaid cards that is not a credit card transaction.<sup>4</sup>

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1 UK Finance, *UK Payment Markets 2020* (2020), page 6.

2 Article 2(5) and Article 2(34) IFR.

3 UK Finance, *UK Payment Markets 2020* (2020), page 6.

4 Article 2(4) and Article 2(33) IFR.

## Prepaid card

- 1.9** A prepaid card works in a similar way to a debit card except that the money is taken from funds loaded onto the card in advance.
- 1.10** For the purposes of our market review, we use the IFR definition of a prepaid card. In the IFR, a prepaid card means a category of payment instrument on which electronic money, as defined in point 2 of Article 2 of Directive 2009/110/EC, is stored.<sup>5</sup>

## Consumer and commercial cards

- 1.11** For the purposes of our market review, we use definitions set out in the IFR:
- A consumer card means any card-based payment instrument issued to a consumer, which is defined in the IFR as a natural person who, in payment service contracts covered by the regulation, is acting for purposes other than the trade, business or profession of that person.<sup>6</sup>
  - A commercial card is defined in the IFR as any card-based payment instrument issued to undertakings or public sector entities or self-employed natural persons which is limited in use for business expenses where the payments made with such cards are charged directly to the account of the undertaking or public sector entity or self-employed natural person.<sup>7</sup>

## Card payment system

- 1.12** Card transactions can be categorised according to the card payment system involved. There are six card payment systems operating in the UK: American Express, Diners Club International (DCI), JCB International (JCB), Mastercard, UnionPay International (UPI) and Visa. We describe these card payments systems in paragraphs 1.21 to 1.61.

## Location

- 1.13** Card transactions can be categorised according to the location of the parties involved. Operators of card payment systems categorise transactions according to the location of the issuer relative to the merchant outlet. An issuer is a bank or organisation licensed by the operator to provide cards to cardholders (see paragraph 1.24). A merchant is a business that accepts card payments and an outlet is the location at which a card transaction is completed.<sup>8</sup>

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5 IFR Article 2(35).

6 IFR Article 2 (3).

7 IFR Article 2 (6).

8 The location of an outlet could be, for example, the location of a shop. For an e-commerce transaction, it is generally the principal place of business of the merchant.

**1.14** For Mastercard, there are three categories of card transaction:

- **Domestic transaction:** A card transaction where the outlet and issuer are located in the same country.
- **Intraregional transaction:** A card transaction where the outlet is located in a different country than the issuer, but in the same Mastercard region.
- **Interregional transaction:** A card transaction where the outlet is located in a different Mastercard region than the issuer.

**1.15** Visa uses three categories of card transaction:

- **Domestic transaction:** A card transaction in which the country where the merchant outlet is located and the card is issued are the same.
- **Intra-European transaction:** A card transaction in which the country where the merchant outlet is located is different to the country in which the card is issued and both countries are located in the Visa Europe region.
- **International transaction:** A card transaction in which the country where the merchant outlet is located is in the Visa Europe region and the country in which the card is issued is in a different Visa region.

**1.16** The IFR regulates transactions where the issuer and acquirer are located in the European Economic Area (EEA).<sup>9</sup> It categorises transactions according to the location of the issuer, acquirer and the point-of-sale<sup>10</sup> (that is, outlet). Under the IFR:

- a '**cross-border payment transaction**' means a card-based payment transaction where the issuer and the acquirer are located in different Member States or where the card-based payment instrument is issued by an issuer located in a Member State different from that of the point of sale<sup>11</sup>
- a '**domestic payment transaction**' means any card-based payment transaction which is not a cross-border payment transaction – that is, where the issuer, acquirer and point of sale are located in the same Member State<sup>12</sup>

## Channel

**1.17** Card transactions can be categorised according to the channel as follows:

- a **card-present transaction** is a transaction where the cardholder is present at the outlet and presents the card
- a **card-not-present transaction** is any transaction that is not a card-present transaction such as e-commerce transactions and mail order and telephone order (MOTO) transactions

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9 IFR Article 1(1).

10 See Article 2(2) IFR.

11 IFR Article 2(8).

12 IFR Article 2(9).

## Secure and non-secure transactions

- 1.18** Card transactions can be categorised as either secure or non-secure. The categorisation mainly depends on the way the cardholder authenticates themselves when making a payment. Secure transactions include:
- **Chip & PIN transactions:** The cardholder inserts the chip on their card into a point-of-sale (POS) terminal or card reader (see paragraph 1.62) and enters the PIN.
  - **3-D Secure transactions:** 3-D Secure is a messaging protocol developed by EMVCo<sup>13</sup> to enable consumers to authenticate themselves with their card issuer when making card-not-present transactions and protect merchants from exposure to fraud.
- 1.19** Contactless transactions, where the cardholder taps their contactless device (such as their card or mobile phone) over the POS terminal or card reader, are also generally considered secure. Depending on the contactless device, spending limits may apply for the transaction to be considered secure.
- 1.20** The categorisation of secure and non-secure transactions will be affected by the implementation of the Strong Customer Authentication (SCA) requirements in the second Payment Services Directive (PSD2). We describe these rules in paragraphs 1.321 to 1.324.

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13 EMVCo is a global payment standards body collectively owned by six operators of card payment systems.

# Card payment systems operating in the UK

- 1.21** Card payment systems enable people to make payments using cards. In this section, we outline how card payment systems work.
- 1.22** The operator of a card payment system needs to recruit cardholders (individuals or businesses) and merchants. It may choose to carry out these tasks itself or delegate them to other parties (called acquirers and issuers). This choice of approach gives rise to two types of card payment systems: 'four-party' systems and 'three-party' systems.

## Four-party card payment systems

- 1.23** There are five four-party card payment systems operating in the UK: DCI, JCB, Mastercard, UPI and Visa. Together, transactions involving Mastercard and Visa cards accounted for around 98% of all card payments at UK outlets in 2018, both by volume and value.<sup>14</sup>
- 1.24** There are at least five parties involved in four-party card payment systems:
- **Cardholders** – individuals or businesses that use cards to buy goods and services.
  - **Merchants** – businesses that accept payment by card.
  - **Operators** of card payment systems – organisations that license issuers and acquirers to recruit cardholders and merchants respectively.<sup>15</sup> 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.<sup>16</sup> Operators of card payment systems also provide processing services that manage the movement of funds between issuers and acquirers.<sup>17</sup>
  - **Acquirers** – banks or other organisations licensed by operators of card payment systems to recruit merchants to accept card payments. Acquirers provide card-acquiring services to merchants and play a key role in enabling card payments (as described in paragraphs 1.37 to 1.47).
  - **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.

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14 PSR analysis of data submitted by six operators of card payment systems.

15 In a four-party card payment system, the operator of the card payment system has no direct contractual relationship with cardholders or merchants.

16 Paragraphs 1.331 to 1.337 provides more information on scheme rules and Annex 5 considers scheme rules relating to collateral requirements.

17 Processing services provided by the operator of the card payment system can be procured by acquirers and issuers from other parties. We are not aware of any acquirers doing this in the UK.

**1.25** A card transaction may involve additional parties. An important example, for the purposes of our market review, is where a merchant buys card-acquiring services from a payment facilitator rather than directly from an acquirer.

**1.26** In the remainder of this section, we explain:

- how a card payment is made
- the main fees flowing between parties
- the role of acquirers
- the role of payment facilitators

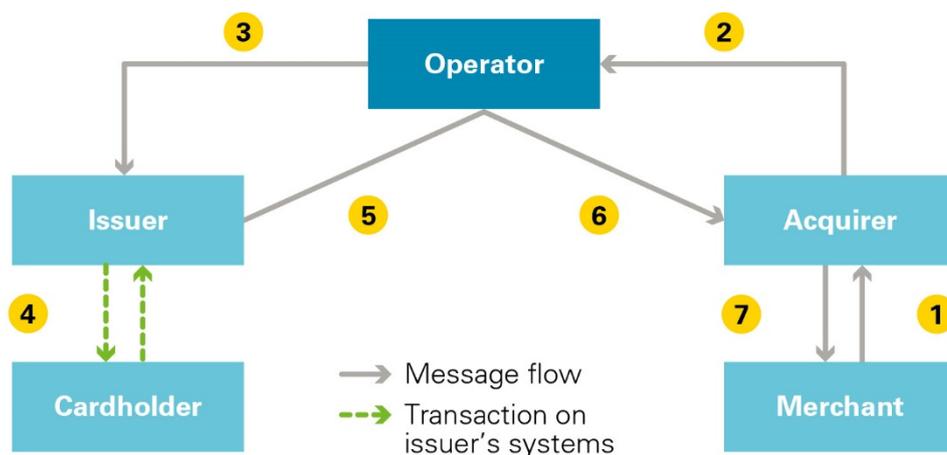
## How a card payment is made

**1.27** In this section, we provide an overview of how a card payment is made in a four-party card payment system when there are five parties involved: a cardholder, a merchant, an issuer, an acquirer and the operator of the card payment system.

**1.28** Generally, when a card is presented to pay for goods or services in a shop, the merchant's POS terminal captures the card details and sends them to its acquirer for authorisation. (In some cases, the transaction does not need to be authorised.) The acquirer then forwards the authorisation request to the cardholder's bank (the issuer) via the operator of the card payment system. The issuer decides whether to approve or decline the transaction including by checking that the cardholder has enough money in their account to make the payment and that the card has not been reported lost or stolen. If the transaction is authorised and once the merchant has received the issuer's response via the operator of the card payment system and the acquirer, the sale can proceed. Figure 1 provides a simplified representation of the message flows for an authorisation request.

**1.29** In some circumstances, the cardholder must authenticate themselves. For example, in a shop the cardholder might do this by inserting his or her card into a POS terminal and entering the PIN. The purpose of authentication is to ensure that the cardholder is the legitimate user of the card and has given their consent for the transfer of funds.

**Figure 1: Authorisation request in a four-party card payment system**



- 1 When the cardholder presents a card to pay for goods or services, the merchant sends an authorisation request to the acquirer.
- 2 Acquirer routes authorisation request to the operator of the card payment system.
- 3 The operator of the card payment system routes authorisation request to the issuer.
- 4 Issuer checks card account status (e.g. available balance, whether card is blocked, whether transaction is fraudulent).
- 5,6,7 Authorisation response is routed back to the merchant.

Diagram provides a simplified representation of an authorisation request in a four-party card payment system. In certain environments, authorisation can be carried out 'offline' meaning that the authorisation is performed at the POS terminal between the card and the POS terminal.

**1.30** Periodically throughout the day, the acquirer batches up card transactions received from its merchants and submits these to the operator of the card payment system. Later, the acquirer receives the funds from the issuer for the card payment (less of interchange fees and scheme fees – see paragraph 1.34) through processes called clearing and settlement that are facilitated by the operator of the card payment system.<sup>18</sup> The acquirer also credits the merchant's account and the issuer debits the cardholder's account. Figure 2 provides a simplified representation of clearing and settlement in a four-party card payment system. It also shows the flow of funds between the acquirer and the merchant, and the issuer and the cardholder.

**1.31** Generally, merchants receive the funds they are owed one, two or several days after the transaction takes place depending on various factors. A merchant may be settled net or gross:

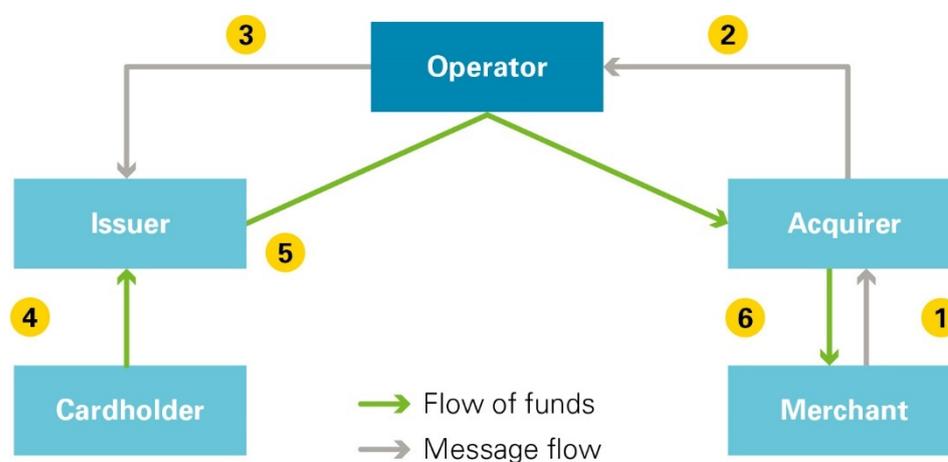
- with net settlement, the acquirer transfers the merchant the value of the purchase transactions it accepted less the merchant service charge (MSC), which is the total amount merchants pay to acquirers for card-acquiring services (see paragraph 1.34)
- with gross settlement, the acquirer transfers the merchant the full value of the purchase transactions it accepted and bills the merchant separately for the MSC

<sup>18</sup> Clearing is the exchanging of data on card transactions between issuers and acquirers to establish final positions for settlement. Settlement is the process for discharging obligations, claims and liabilities that arise between issuers and acquirers.

**1.32** The process described in paragraphs 1.28 to 1.31 is the same for an e-commerce transaction except that software called a payment gateway is used to capture and transmit the card details to the acquirer.

**1.33** An ‘on-us transaction’ is one where the acquirer and issuer are the same entity or from the same corporate group, and the transaction is not cleared and settled through the card payment system. Two large issuers in the UK have acquiring businesses: Barclays PLC (see paragraph 1.107) and Lloyds Bank plc (which part owns Lloyds Bank Cardnet and is a wholly owned subsidiary of Lloyds Banking Group – see paragraphs 1.113). However, on-us transactions are now rare in the UK: Barclays PLC does not have on-us transactions anymore following the implementation of structural reform<sup>19</sup> and on-us transactions account for a very low proportion (less than 1%) of Lloyds Bank Cardnet’s transactions at UK outlets.

**Figure 2: Clearing and settlement in a four-party card payment system**



- 1 Merchant submits a batch of card transactions to the acquirer.
- 2 Acquirer batches together all card transactions received from its merchants and submits them to the operator of the card payment system.
- 3 The operator of the card payment system routes card transactions to the appropriate issuer.
- 4 Issuer debits cardholder accounts.
- 5 Issuer pays acquirer settlement amount via the operator of the card payment system: total value of transactions, less any returned/refunded transactions, less interchange fee.
- 6 Acquirer pays merchant.

Diagram provides a simplified representation of clearing and settlement in a four-party card payment system.

<sup>19</sup> Certain UK banks were required to separate retail banking services from the rest of their businesses by 1 January 2019.

## Fees flowing between parties in a four-party card payment system

- 1.34** Figure 3 below shows the main flow of fees between parties in a four-party card payment system, including:
- **interchange fees**, which acquirers pay to issuers each time a card is used to buy goods or services
  - **scheme fees**, which acquirers and issuers pay to the operators of card payment systems for their services<sup>20</sup>
  - **MSC**, which is the total amount merchants pay to acquirers for card-acquiring services
  - **cardholder fees**, which cardholders may pay to the issuers

**1.35** The MSC comprises interchange fees, scheme fees and acquirer net revenue. Acquirer net revenue includes the costs the acquirer incurs (other than interchange fees and scheme fees) to provide card-acquiring services, plus the acquirer's margin.

- 1.36** Interchange fees and some scheme fees<sup>21</sup> vary depending on the characteristics of a transaction including:
- the card type (for example, whether a credit or debit card was used)
  - the card payment system (such as Mastercard or Visa)
  - the location (of the parties involved in the transaction)
  - the channel (for example, e-commerce or face-to-face)
  - the way the transaction is authenticated (secure or non-secure)

**Figure 3: Main fees flowing between parties in a four-party card payment system**

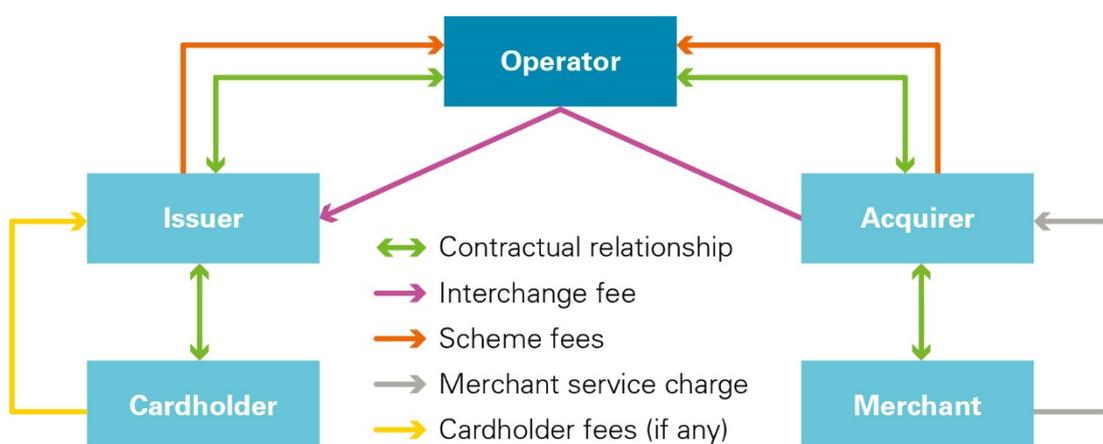


Diagram provides a simplified representation of a four-party card payment system.

<sup>20</sup> We use the term 'scheme fees' to refer to all fees acquirers pay to operators of card payment systems including fees paid for scheme services and fees paid for the processing services they provide.

<sup>21</sup> Some scheme fees are not directly attributable to transactions – see Annex 4.

## Role of acquirers

**1.37** Acquirers provide card-acquiring services to merchants. For the purposes of our market review, we define card-acquiring services as services to accept and process card payments on behalf of a merchant, resulting in a transfer of funds to the merchant. This comprises the following activities:

- onboarding the merchant to accept card transactions under one or more card payment systems
- underwriting the merchant – that is, taking the credit risk of merchant failure in respect of card payments
- supporting the merchant with the authentication, authorisation, clearing and settlement of card payments through the card payment system (see paragraphs 1.27 to 1.30)
- settling with the merchant – i.e. transferring it the funds for the card payments it accepts less any applicable fees (see paragraphs 1.31)
- facilitating the administration of chargebacks and refunds for the merchant
- monitoring the merchant’s compliance with scheme rules including the Payment Card Industry Data Security Standard (PCI DSS – see paragraph 1.77) and other standards
- terminating the relationship with the merchant for card-acquiring services

**1.38** Acquirers may also offer other products and services that help merchants accept card payments such as POS terminals (see paragraphs 1.62 and 1.63).

**1.39** In onboarding merchants, the acquirer assumes responsibility for the risks associated with granting them access to the card payment system. These risks include the credit risk that comes from being liable under scheme rules for disputes between cardholders and merchants. There is a range of circumstances in which a cardholder might contact their issuer to dispute a card payment. For example, this might happen where goods and services are not delivered or if a card payment appears fraudulent. If the issuer considers the cardholder has the right to dispute a card transaction under scheme rules, it will raise a chargeback.<sup>22</sup>

**1.40** The chargeback process gives rise to a credit risk for acquirers because an acquirer may not be able to recover the amount it must pay to the issuer if a chargeback is upheld (for example, if the merchant becomes insolvent or acts fraudulently).

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<sup>22</sup> A chargeback is different from a refund. The latter is a transaction initiated by the merchant as part of the normal course of business. A chargeback is initiated by the issuer where the cardholder has the right to dispute a transaction.

- 1.41** Credit risk also arises in other contexts because an acquirer may not be able to recover from merchants that become insolvent or were acting fraudulently:
- the amount it has paid to issuers for refunds initiated by the merchant
  - the amount it has paid in interchange fees and scheme fees for transactions it acquires for a merchant that is gross settled<sup>23</sup>
  - the amount of any fines issued by the operator of a card payment system for a merchant's failure to comply with scheme rules
- 1.42** Certain types of merchants carry a higher credit risk, such as deferred delivery merchants (those who typically accept payment for goods and services some time before they are provided, which includes furniture retailers and airlines) or merchants that operate in sectors that are more susceptible to fraud. The level of merchant credit risk will also vary from business to business depending on a range of factors including their financial position and trading history.
- 1.43** As well as credit risk, acquirers carry other risks<sup>24</sup> that come from providing card-acquiring services to specific merchants or sectors including:
- **Regulatory risk:** Acquirers must comply with statutory and regulatory obligations including anti-money laundering and terrorist financing requirements. Consequences for failure to comply include criminal or civil proceedings being brought against the acquirer, as well as regulatory and disciplinary action (and reputational damage). Certain types of merchants are more susceptible to criminal activities and hence providing them with card-acquiring services carries greater regulatory risk.
  - **Card payment system risk:** Being reliant on access to card payment systems, acquirers face risks arising from their relationships with the operators of these systems. For failure to comply with scheme rules, operators of card payment systems may apply financial penalties (which gives rise to a credit risk in certain circumstances – see paragraph 1.41) or limit, suspend or terminate an acquirer's participation in the card payment system. Operators of card payment systems may also place additional obligations on acquirers that serve merchants that represent a higher risk to their brand or the system.
  - **Reputational risk:** Certain types of merchants may give rise to higher reputational risk for acquirers, for example because they are more susceptible to criminal activities or because of ethical or moral sensitivities around the goods or services they sell.
- 1.44** Acquirers carry out due diligence on merchants as part of the onboarding process and on an ongoing basis to help them manage the credit risk and other risks they carry. For example, acquirers carry out know your customer and anti-money laundering checks. These checks help maintain the integrity and security of the card payment system and prevent financial crime. Acquirers also help merchants to reduce the likelihood of chargebacks and fraud.

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23 Acquirers are net settled (see paragraph 1.30) but may gross settle to the merchant (see paragraph 1.31). Merchants that are gross settled subsequently receive an invoice that recovers the interchange fees and scheme fees the acquirer paid plus its other costs and margin. The merchant may be unable or unwilling to pay the invoice if it has gone insolvent or was acting fraudulently.

24 Acquirers also face risks that are generic in that they apply to many other types of businesses and include process risk, people risk, information security risk and political risk, which we do not describe here.

- 1.45 As part of the onboarding process, acquirers will use, amongst other things, information from credit reference agencies, public information, merchant trading history, bank statements and other sources to assess new customers. Merchants deemed of greater risk may still be onboarded but only after enhanced due diligence or agreeing to measures that reduce the acquirer’s risk exposure (such as delayed settlement of funds for a merchant that carries a high credit risk). Acquirers may also decide – as a matter of policy – not to serve certain types of merchants.
- 1.46 Once onboarded, acquirers use combinations of machine learning, artificial intelligence and human review to manage the risks they carry. For example, acquirers monitor indicators that could suggest a merchant is at risk of insolvency or acting fraudulently including the number of chargebacks raised and refunds issued, and material changes in average transaction value.
- 1.47 Under scheme rules, acquirers may choose to outsource some activities to other parties. Wherever an acquirer outsources its activities, under scheme rules it retains responsibility and is liable for making sure that those it outsources to perform the activities in accordance these rules.

### Role of payment facilitators

- 1.48 A card payment may involve additional parties to the cardholder, merchant, issuer, acquirer and the operator of the card payment system. An important example, for the purposes of this report, is where a merchant buys card-acquiring services from a payment facilitator rather than directly from an acquirer.
- 1.49 As shown in Figure 4, payment facilitators are intermediaries between acquirers and merchants. Under scheme rules, acquirers can permit payment facilitators to recruit merchants on their behalf and contract with these merchants for card-acquiring services. Typically, when a merchant contracts with a payment facilitator for card-acquiring services, there is no direct contractual relationship between the merchant and the acquirer. There is also no direct contractual relationship between the payment facilitator and the operator of the card payment system.

**Figure 4: Payment facilitators in a four-party card payment system**

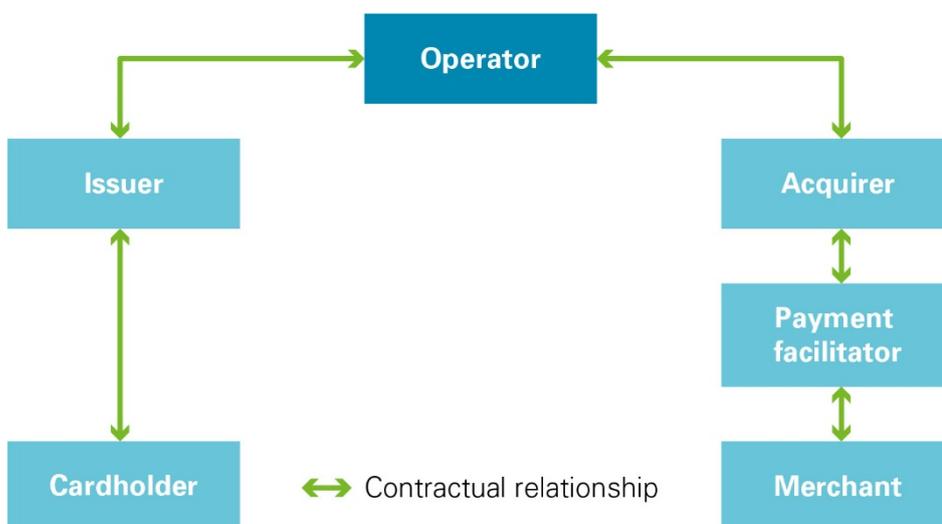


Diagram provides a simplified representation of a four-party card payment system.

- 1.50** The payment facilitator provides card-acquiring services to merchants, which includes onboarding merchants to accept card transactions and transferring them the money they are owed.
- 1.51** Payment facilitators are exposed to similar risks as acquirers including credit risk, regulatory risk and reputational risk from providing card-acquiring services to merchants. A payment facilitator is exposed to credit risk because, in the event a chargeback relating to one of its merchants is upheld, the acquirer will seek to recover the amount from the payment facilitator, which may not be able to do the same from the merchant if the merchant has become insolvent or was acting fraudulently.
- 1.52** The acquirer continues to play an important role in enabling card payments involving merchants recruited by payment facilitators. Where the merchant contracts with a payment facilitator, a card transaction works in a similar way to when a merchant contracts with an acquirer except that:
- The authorisation request is sent from the merchant to the payment facilitator, which forwards this to the acquirer. The acquirer then forwards the request to the issuer via the operator of the card payment system. When the acquirer receives the issuer's response, it forwards this to the payment facilitator, which forwards it to the merchant.
  - The payment facilitator aggregates card transactions for its merchants and submits these to the acquirer, which submits them to the operator of the card payment system for clearing and settlement.
  - When the acquirer receives the funds from the issuer for the card payment through the clearing and settlement process, it transfers the money to the payment facilitator which settles with the merchant.
- 1.53** The acquirer is also responsible for ensuring that the payment facilitator and the merchants it recruits comply with the scheme rules and remains ultimately liable for any chargebacks involving the payment facilitator's merchants.
- 1.54** Acquirers impose restrictions on the types and size of merchants that payment facilitators can contract with for card-acquiring services. These reflect laws and scheme rules that apply to acquirers (including scheme rules governing their interaction with payment facilitators), as well as acquirers own risk appetites. For example, acquirers may place restrictions on payment facilitators serving merchants they consider carry higher risk.
- 1.55** Scheme rules require that if the merchant's annual card turnover exceeds a specified amount, the acquirer must also contract with the merchant. This amount is \$1 million for Mastercard and Visa. We have been told that the limits are imposed to mitigate the risk of merchant default when, for example, a merchant is unable to deliver the goods or services purchased and is unable to provide a refund due to insolvency. We consider this requirement further in Annex 5.

## Three-party card payment systems

- 1.56** In four-party card payment systems like Mastercard and Visa, the operator of the system licenses third parties to issue cards and recruit merchants. In a three-party card payment system, the operator generally performs the issuing and acquiring functions itself.<sup>25</sup> American Express is the only three-party card payment system operating in the UK and is the only acquirer of transactions for UK merchants involving its cards.
- 1.57** Generally, when an American Express card is presented to pay for goods or services in shop, the merchant’s POS terminal captures the card details and transmits them to American Express for authorisation. American Express (in its capacity as an issuer) decides whether to approve or decline the transaction. (In some cases, the transaction does not need to be authorised.) American Express (in its capacity as an acquirer) then sends the response to the merchant and – if the transaction is authorised – the sale can proceed. The process is the same for an e-commerce transaction except that software called a payment gateway is used to capture and transmit the card details to American Express.
- 1.58** Periodically throughout the day, the merchant submits card transaction data to American Express. American Express (in its capacity as an acquirer) subsequently transfers to the merchant the money it is owed (less fees for its services, which American Express calls the ‘discount rate’).
- 1.59** Figure 4 shows certain fees flowing between the cardholder, the merchant and American Express. American Express (in its capacity as an acquirer) agrees with the merchant the discount rate. Importantly, except in certain circumstances<sup>26</sup>, there are no interchange fees or scheme fees.

**Figure 5: Some of the fees flowing between parties in the American Express card payment system**

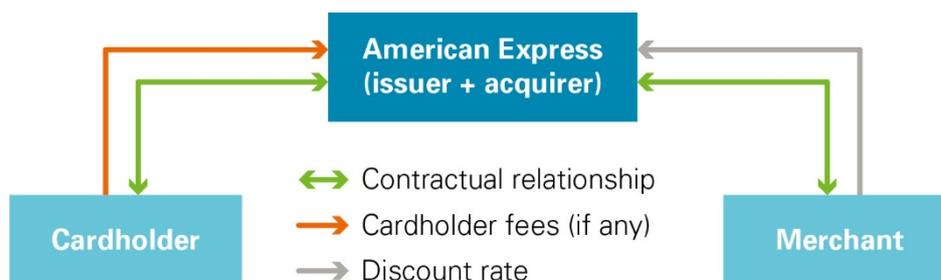


Diagram shows some of the fees flowing between parties in the American Express card payment system when it does not license other parties to act as issuers or acquirers.

25 Prior to the introduction of the IFR and PSD2, American Express licenced third parties to act as an issuer or acquirer in the EEA, while continuing to issue cards and acquire payments itself. American Express has discontinued these arrangements in Europe.

26 Namely where the operator of a three-party card payment system licenses other payment service providers for the issuance of card-based payment instruments or the acquiring of card-based payment transactions, or both, or issues card-based payment instruments with a co-branding partner or through an agent.

- 1.60** Acquirers for four-party card payment systems may assist merchants in accepting American Express cards by:
- **Referring merchants to American Express.** The acquirer refers the merchant to American Express and collects (and may verify) information necessary for due diligence. The contract for card-acquiring services is between American Express and the merchant.
  - **Providing the card acceptance products that the merchant needs to accept American Express cards.** American Express (in its capacity as an acquirer) does not offer card acceptance products to merchants. Merchants will need to obtain these products from another party, for example from their acquirer for Mastercard and Visa cards. Acquirers licensed by Mastercard and Visa can configure the POS terminals and payment gateways they provide to capture American Express card details at the POS and transmit these to American Express for authorisation.
  - **Batching up American Express card transaction data** and submitting this to American Express on the merchant's behalf.
- 1.61** American Express (in its capacity as an acquirer) acquires payment facilitators (also called 'master merchants') who, in turn, are allowed to enter separately into their own contracts with merchants (also called sponsored merchants) and aggregate card transactions. The payment facilitator contracts with American Express as a (master) merchant. There is no direct contract between American Express and the payment facilitators' merchants. Where the merchant contracts with a payment facilitator, a card transaction works in a similar way to when a merchant contracts with American Express (in its capacity as an acquirer) except that:
- the authorisation request is sent to the payment facilitator, which forwards this to American Express
  - the payment facilitator aggregates American Express card transaction data for its merchants and submits this to American Express
  - the payment facilitator receives the settlement funds from American Express and settles with its merchants in accordance with the contract it has with them

# Products merchants buy to accept card payments

- 1.62** To accept card payments, merchants need the following:
- **Card-acquiring services**, which can be bought from acquirers or payment facilitators. Paragraph 1.37 lists in more detail the activities involved in providing card-acquiring services.
  - **Hardware and software** to capture the card details at the POS and transmit these to the merchant's acquirer or payment facilitator. This includes card readers and POS terminals for card payments accepted face-to-face and payment gateways for e-commerce card payments. Card readers, POS terminals and payment gateways – which we refer to as card acceptance products – can be obtained from acquirers, payment facilitators or third parties and may or may not be integrated with the merchant's own systems.
  - A **bank account** to receive the funds for card payments from the acquirer or payment facilitator. Where an acquirer is part of a banking group, the merchant can obtain card-acquiring services and a bank account from the same firm.
- 1.63** Merchants also buy from acquirers and payment facilitators other goods and services, which we refer to as **value-added services**.
- 1.64** This section describes card acceptance products and some of the value-added services merchants can buy from acquirers and payment facilitators.

## Card acceptance products

### Merchants selling face-to-face

- 1.65** Merchants that accept card payments face-to-face need hardware to capture the card details. There are two options: POS terminals and card readers. They differ because POS terminals are standalone devices while card readers must be connected to an app on a smartphone or tablet to work.
- 1.66** There are three main types of POS terminal. Countertop POS terminals are fixed to the sales desk while portable POS terminals can be carried around the premises by staff. Both connect to the provider of card-acquiring services by linking to the merchant's fixed telephone line or broadband. Mobile POS terminals have an in-built SIM card and connect to the merchant's provider of card-acquiring services via a mobile telephone network.
- 1.67** Card readers connect via Bluetooth or cable to an app on the merchant's smartphone or tablet. The app then connects to the provider of card-acquiring services using Wi-Fi or the device's mobile phone signal.

- 1.68** Acquirers and others are developing new ways of capturing card details for card payments made face-to-face. For example, Fiserv (see paragraph 1.122) announced in February 2020 that it was piloting a new product in Poland that enables the merchant to capture card details using a smartphone or tablet without the need for additional hardware.

### Merchants selling online

- 1.69** Merchants that accept card payments via their own websites or mobile applications will need a payment gateway. In its most basic form, a payment gateway is software that captures the card details and translates them into a message that is sent to and understood by the acquirer's systems. A payment gateway can include a payments page, which is a webpage where the consumer enters their card details. Alternatively, a merchant may build its own payments page.
- 1.70** Merchants can also buy payment gateways for card payments accepted face-to-face. In simple terms, a payment gateway for card payments accepted face-to-face is software loaded on to a POS terminal that translates card details into a message that is sent to and understood by the acquirer's systems. Unless otherwise stated, where we refer to payment gateways we mean payment gateways that help merchants accept e-commerce payments.

### Merchant selling by telephone or mail order

- 1.71** Merchants can key in the card details to their POS terminal or card reader to accept card payments over the phone or by mail order.
- 1.72** Alternatively, a merchant may buy a virtual terminal, which is like a payment gateway. The merchant logs in to an online account and enters the customer's card details, which it has received via phone or mail order, to initiate the transaction.

### Integration of hardware and software

- 1.73** The hardware and software used to capture and transmit card details to the acquirer may be integrated to varying degrees with the merchant's systems.
- 1.74** For example, a merchant selling face-to-face may integrate a POS terminal with its Electronic Point of Sale (EPOS) system. An EPOS system is a combination of hardware and software that helps merchants selling face-to-face run their businesses by supporting, for example, inventory management, payroll and management information reporting. Payments functionality can be integrated with the EPOS system so that, for example, the value of the item being bought in a shop is automatically displayed on the POS terminal after being scanned or selected without the need for manual intervention.
- 1.75** If a merchant is selling online, some form of integration – for example by application programming interfaces (APIs)<sup>27</sup> – is required between the website and the payment gateway. Whether this is carried out by the merchant depends on how they are selling online.

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<sup>27</sup> An API is a set of routines, protocols and tools that specify how software components interact.

## Other products

- 1.76** Merchants may also buy other products from acquirers and payment facilitators, which may be offered through partnerships with third parties. In the report, we refer to these as 'value-added services'. These products include:
- services that help the merchant to comply with PCI DSS requirements
  - services that help merchants detect and prevent fraudulent transactions
  - dynamic currency conversion (DCC), which allows merchants to offer the cardholder the option to pay in their own currency at point of sale
  - reporting and analytical tools that provide merchants with detailed information and analysis on the card payments they accept
  - services that help merchants authenticate card payments in accordance with SCA requirements (see paragraphs 1.321 to 1.324)
  - services that help merchants accept non-card digital payments
  - business management services (such as EPOS systems)
  - cash advances, whereby cash is advanced to the merchant based on expected card transactions in return for a portion of future sales
- 1.77** PCI DSS is a set of standards designed to protect the security of card payments and reduce fraud. The standards are maintained by a council consisting of certain operators of card payment systems, with input from other parties such as acquirers and merchants. Scheme rules require that acquirers ensure their merchants comply with PCI DSS requirements.
- 1.78** An emerging trend in payments is the supply of omnichannel services. There is no single definition of omnichannel services, but broadly they can be defined as provision by a single firm of services integrating payments made via different channels (for example, e-commerce and face-to-face). Characteristics of omnichannel services may include:
- having a single contract with one provider (rather than having separate contracts for payments made via different channels with the same provider or with different providers)
  - consolidated reporting to give a single view of all payments the merchant accepts
  - consolidated billing and settlement – that is, the merchant receives one bill for all its transactions and all the money it is owed comes from a single source
  - supporting the merchant in implementing a seamless customer experience across different sales channels (for example, by using tokenisation<sup>28</sup> to allow the customer to buy online with one click or purchase a product online and then return it at a shop)

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28 In simple terms, tokenisation replaces the card details with a digital identifier known as a token.

# Characteristics of merchants and how they buy card-acquiring services

- 1.79** Card use has been growing strongly in recent years in part due to increasing levels of card acceptance among businesses particularly smaller businesses.<sup>29</sup> Surveys we've seen suggest that the majority of UK businesses currently accept card payments.<sup>30</sup>
- 1.80** Our market review uses two broad segments within the supply of card-acquiring services to structure our analysis and present our findings:
- **small and medium-sized merchants**, with annual card turnover up to £10 million.
  - **large merchants**, with annual card turnover over £10 million.
- 1.81** In this section, we describe the characteristics of merchants and how they buy card-acquiring services with reference to these segments (and some additional sub-segments within the two broad card turnover groups).
- 1.82** We draw on various sources including our survey of small and medium-sized merchants and responses we received to an information request we issued to large merchants (nearly all of whom were the largest merchants with an annual card turnover above £50 million).

## Merchant characteristics

- 1.83** A small number of merchants account for most transactions. As shown in Table 1, the largest merchants with annual card turnover above £50 million made up less than 0.1% of the merchant population but were responsible for 76% of the value of card transactions in 2018. Almost all merchants have an annual card turnover below £10 million and in 2018 they accounted for around 17% of the value of card transactions. Over 90% of merchants accepted fewer than £380,000 worth of card transactions in 2018.

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29 UK Finance, *UK Payment Markets 2020* (2020), Chart 1.1 and page 11.

30 A survey carried out by RFi Group for the UK Merchant Acquiring Council in 2019 found that 58% of UK businesses accepted payment by card, increasing to 63% as of H1 2020. A payments survey carried out by Savanta in 2018 found that 53% of UK businesses had received payment by card in the last six months. MarketVue Business Payments from Savanta, YE H2 2018 data, based on 5004 businesses with a turnover of £50,000-£25 million. Data weighted by region and turnover to be representative of businesses in G.B.

**Table 1: Merchant segments**

Merchant segment	Sub-segment (annual card turnover)	Proportion of merchants	Proportion of transactions (2018 volume)	Proportion of transactions (2018 value)
Small and medium-sized	Less than £380k	93.7%	8.1%	6.5%
	£380k – £1m	4.1%	3.3%	3.8%
	£1m – £10m	1.9%	5.3%	7.3%
Large	£10m – £50m	0.2%	4.8%	6.4%
	More than £50m	0.1%	78.6%	76.0%

Source: PSR analysis based on data provided by acquirers and payment facilitators on merchants served in April 2019 (or in one case, August 2019). Active merchants only. Figures may not sum to 100% due to rounding.

**1.84** Large merchants with annual card turnover between £10 million and £50 million made up around 0.2% of merchants and were responsible for approximately 6% of the value of card transactions in 2018. Many of these merchants are clustered at the lower end of this card turnover range; approximately 35% have an annual card turnover between £10 million and £15 million and a further 20% have an annual card turnover between £15 million and £20 million.<sup>31</sup>

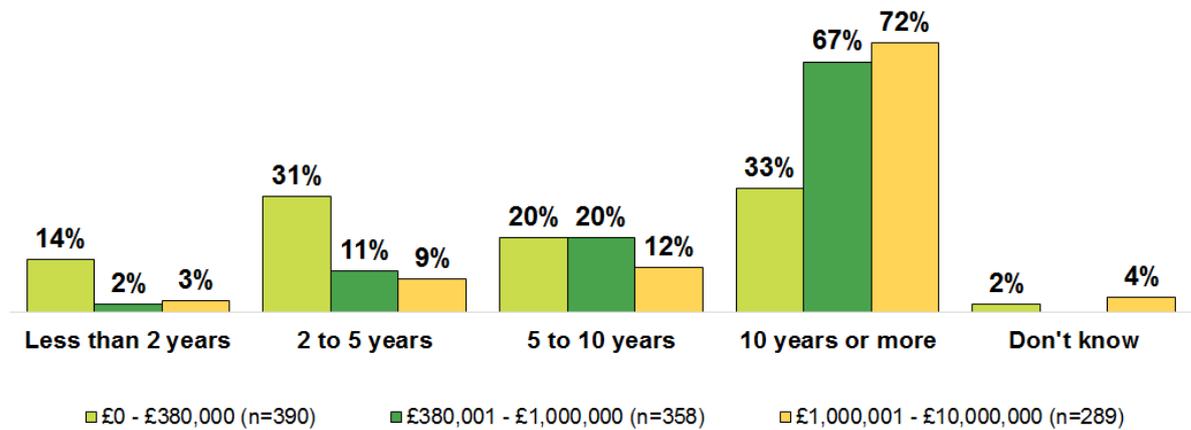
**1.85** Approximately 55% of the small and medium-sized merchants that we surveyed had accepted card payments for more than five years and 13% have been doing so for less than two years.<sup>32</sup> As shown in Figure 6, the length of time that merchants have accepted card payments increased with card turnover, which is consistent with the information we have about large merchants. Most of the largest merchants that responded to our information request had been accepting card payments for at least ten years and nearly three quarters of large merchants have been with their acquirer or payment facilitator for over five years.<sup>33</sup>

<sup>31</sup> PSR analysis of data provided by six acquirers and the largest payment facilitators.

<sup>32</sup> IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 57.

<sup>33</sup> PSR analysis of data provided by acquirers and payment facilitators.

**Figure 6: Length of time small and medium-sized merchants have been accepting card payments (n = 1,037)**

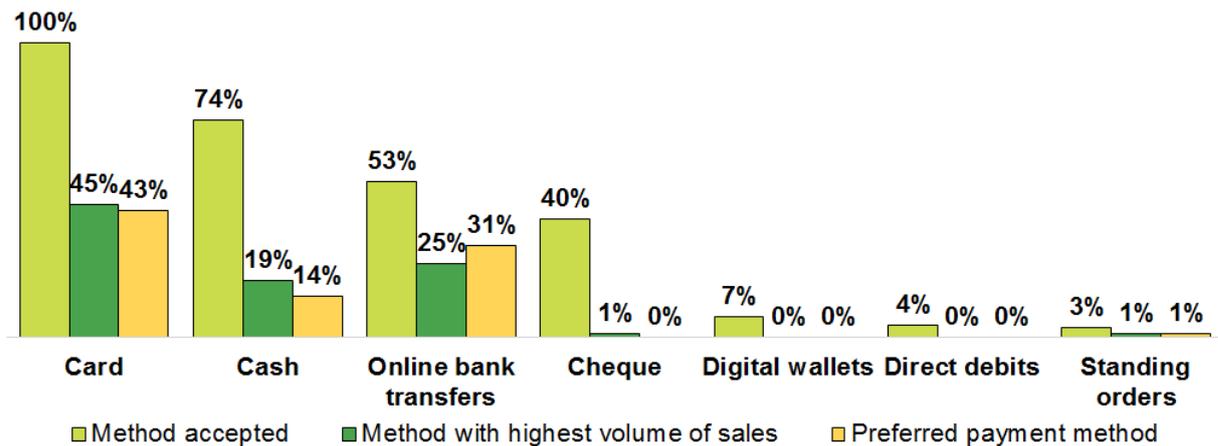


Source: IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 58.

**1.86**

Most small and medium-sized merchants also accept payment methods other than cards. As shown in Figure 7, 74% of survey participants accepted cash, 53% accepted online bank transfers and 40% accepted cheques.

**Figure 7: Payment methods accepted by small and medium-sized merchants (n = 1,037)**



Source: IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 42.

- 1.87** In some sectors, cards are the most frequently used payment method. In 2019, credit and debit cards accounted for 78%, 67% and 61% of spontaneous payments in the travel, retail and entertainment sectors respectively.<sup>34</sup> In other sectors, card payments are much less prevalent. Most consumers pay utility bills and make monthly mortgage repayments by direct debit.<sup>35</sup>
- 1.88** Merchants can accept card payments face-to-face, online, over the phone or by mail order. Most small and medium-sized merchants we surveyed accepted card payments in more than one operating environment and around a quarter only did so face-to-face.<sup>36</sup> Nearly all the largest merchants we collected information from said that they accepted card payments in more than one operating environment.
- 1.89** Merchants have two main ways to sell goods and services online:
- **Via their own website or mobile application.** A merchant may build a website or app in house or use an e-commerce platform such as Magento and Shopify. These platforms provide software that helps businesses to design and build a website. They also offer other services such as inventory management and marketing assistance. For more information on e-commerce platforms, see paragraph 1.153)
  - **Via an online marketplace.** Online marketplaces are websites or apps that bring together buyers and sellers. Examples include Amazon Marketplace, Etsy, Just Eat and Uber.
- 1.90** In many cases, the operators of online marketplaces enable buyers to pay sellers by card without leaving the website or app (including by contracting with acquirers or payment facilitators for card-acquiring services). Often, sellers (that is, merchants) may not be able to choose their own provider of card-acquiring services for transactions made on the online marketplace. Therefore, for the purposes of our market review, we consider the supply of card-acquiring services to online marketplaces but not individual sellers using those marketplaces (except insofar as those sellers may buy card-acquiring services from an acquirer or payment facilitator if selling via other channels such as their own website).

## How merchants buy card-acquiring services

### Who do merchants buy card-acquiring services from?

- 1.91** Merchants can buy card-acquiring services from acquirers or payment facilitators. In our survey of small and medium-sized merchants, 62% and 23% of participants, respectively, identified an acquirer and payment facilitator as their main provider of card-acquiring services.<sup>37</sup> The remainder identified a third party as their main provider of these services.<sup>38</sup>

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34 UK Finance, *UK Payment Markets 2020* (2020), page 24.

35 UK Finance, *UK Payment Markets 2020* (2020), page 12.

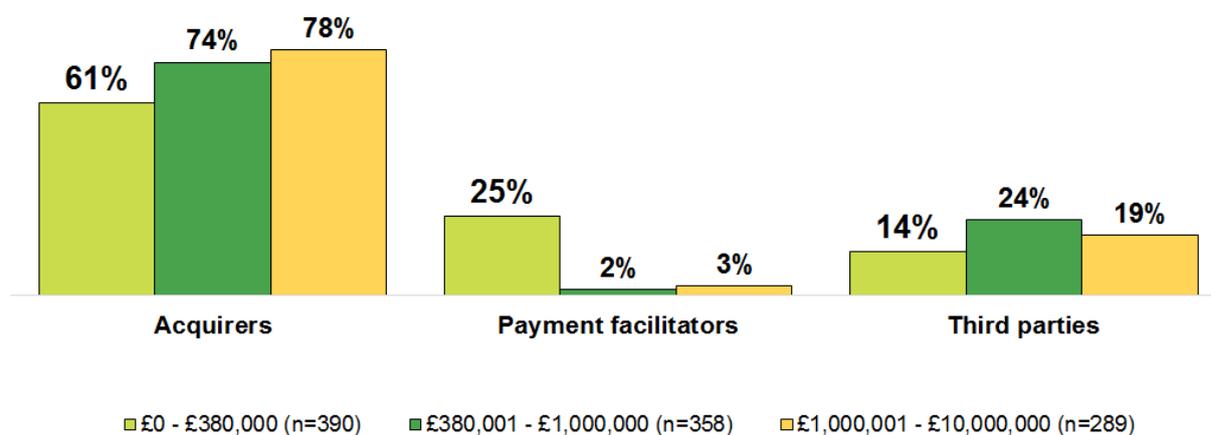
36 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 55.

37 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 10.

38 Some participants in our survey identified third parties – that is, firms that are not acquirers or payment facilitators – as their main provider of card-acquiring services. When describing the results of our survey, where we use the term ‘providers’ we mean the firm the merchant identified as its main provider of card-acquiring services.

**1.92** Our survey shows that merchants choosing a payment facilitator as their main provider are more likely to be the smallest merchants with annual card turnover below £380,000 and only accept card payments face-to-face. As shown in Figure 8, 25% of the smallest merchants said that a payment facilitator was their main provider of card-acquiring services, compared to around 2% of those with annual card turnover above £380,000. Around 40% of merchants that only accept card payments face-to-face said they were served by a payment facilitator, compared to approximately 10% who accept card payments in other operating environments (such as online only).<sup>39</sup>

**Figure 8: Type of provider of small and medium-sized merchants by card turnover (n = 1,037)**



Source: IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 64.

**1.93** Some participants in our survey identified third parties – that is, firms that are not acquirers or payment facilitators – as their main provider of card-acquiring services. Most of these third parties are ISOs, which sell card-acquiring services on behalf of an acquirer alongside card acceptance products and value-added services (for an explanation of these terms, see paragraphs 1.62 to 1.78). ISOs have a similar offering to most acquirers and commonly provide ongoing customer services to merchants (including in relation to card-acquiring services) after completing the sale. This may explain why some merchants identified ISOs as their main provider of card-acquiring services. We provide more information on ISOs in paragraphs 1.130 to 1.141.

**1.94** Large merchants typically buy card-acquiring services from acquirers (see Chapter 4 of our interim report). Most of the largest merchants we collected information from said that they have more than one acquirer for various reasons including:

- to enable them to benchmark the card-acquiring services they receive
- to improve their bargaining position with their providers, for example by playing off one provider against another

<sup>39</sup> IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 65.

- to improve resilience, because if one acquirer is unavailable due to planned downtime or an outage they can shift card transactions to another
- to obtain access to a greater variety of products and services (in addition to card-acquiring services) that may not be offered by a single provider

**1.95** Some (15%) small and medium-sized merchants that we surveyed said they had more than one provider of card-acquiring services. Over half said this is because they have different providers for different operating environments (for example, one for their shop and another for their website).<sup>40</sup>

### How merchants establish relationships with their provider

**1.96** Our survey finds that 46% of small and medium-sized merchants established their relationship with their main provider by approaching them directly. Many were also referred to the provider or approached.<sup>41</sup>

**1.97** A recent survey conducted by RFi Group broadly aligns with our findings. Merchants were asked how they discovered and researched the provider(s) they chose for 'merchant acquiring services'. 29% said they discovered and researched their provider via their website, 26% received a recommendation, 21% did their own research online and 20% heard by word of mouth.<sup>42</sup>

**1.98** Most of the largest merchants we collected information from used competitive tenders when selecting a provider. These merchants reported that running tenders helped them compare offerings and secure the best price. Some also said that they used specialist consultants, for example to help them run tenders.

### Other products and services merchants buy

**1.99** In addition to card-acquiring services, merchants can buy card acceptance products and value-added services from their provider (see paragraphs 1.62 to 1.78).

**1.100** In our survey, 84% of small and medium-sized merchants buy all the products they need to accept card payments from or via a single provider (that is, they one-stop-shop).<sup>43</sup> The most commonly cited reasons merchants gave for buying everything from one provider were that this is more cost effective and more convenient and because card-acquiring services and other products were sold together as part of a package.<sup>44</sup> Some merchants identified a third party as their provider, many of which are ISOs (see paragraph 1.93). Merchants that approach or are approached by an ISO can one-stop-shop because ISOs offer a package of goods and services that together enable a merchant to accept card payments (albeit they will refer the merchant to an acquirer for card-acquiring services and may refer them to a third-party POS terminal provider for a POS terminal).

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40 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 9.

41 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 13.

42 Merchants were allowed to provide more than one way of discovering and researching their provider(s). Survey carried out by RFi Group for the UK Merchant Acquiring Council in H2 2019

43 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 20.

44 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 20.

**1.101** Large merchants are more likely to buy card acceptance products and value-added services from third parties rather than their acquirer. Nearly all the largest merchants we gathered information from sourced POS terminals, payment gateways or value-added services from third parties. This may be changing – one acquirer told us that they are increasingly finding large merchants are seeking a single provider for card-acquiring services and card acceptance products for various reasons including to reduce complexity.

## Characteristics of providers that matter to merchants

**1.102** Our merchant survey asked small and medium-sized merchants what factors they considered when they search for providers – that is, assess their own needs, access information about providers and compare provider offerings.<sup>45</sup> Price of card-acquiring services was the most commonly cited factor. Other commonly cited factors were:

- the payment methods offered
- the price of other products
- the speed of settlement<sup>46</sup>

**1.103** In addition, 25% of merchants that considered switching but ultimately did not switch said that one reason was that their provider gave them a discount or better offer, which further underlines the importance of price to merchants.<sup>47</sup>

**1.104** Other surveys we've seen also find that price is an important consideration for merchants but not significantly more important than other factors. A recent survey conducted by RFi Group found that trust in the provider was the most commonly cited reason merchants that had switched in the last three years gave for choosing their provider. Speed of settlement and the ease of doing business with the provider were also important. The same survey found that high fees, settlement speed and speed of transaction processing were the main drivers of switching in the last three years.<sup>48</sup>

**1.105** We asked the largest merchants we collected information from what factors are most important when choosing their acquirer. Price, customer service and reporting were the most commonly cited considerations. Other factors considered included the range of payments methods offered and the speed of settlement.

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45 In the merchant survey, we used the term 'shop around'.

46 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slides 34, 36 and 38.

47 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 27.

48 Survey carried by RFi Group for the UK Merchant Acquiring Council in H2 2019.

# Acquirers and payment facilitators serving merchants

**1.106** A small number of providers account for 97% of card transactions acquired at UK outlets by volume (that is, number) and value of transactions.<sup>49</sup> We categorise these providers as follows and briefly introduce each below:

- The **five largest acquirers** (as measured by the volume and value of card transactions acquired in 2018) – Barclaycard, Elavon, Global Payments, Lloyds Cardnet and Worldpay.
- **Other acquirers** – Adyen, AIB Merchant Services, Chase Paymentech, EVO Payments, First Data and Stripe.
- The **largest payment facilitators** – PayPal (including iZettle), Square and SumUp.

## Five largest acquirers

### Barclaycard

**1.107** Barclaycard is a trading name of Barclays Bank PLC and Barclaycard International Payments Limited, both of which are ultimately owned by Barclays PLC (the holding company for the Barclays Group – a transatlantic consumer and wholesale bank headquartered in the UK that is listed on the London Stock Exchange). Barclays Bank PLC is authorised by the Prudential Regulation Authority (PRA) and regulated by the Financial Conduct Authority (FCA) and the PRA. Barclaycard International Payments Limited is regulated by the Central Bank of Ireland.

**1.108** Barclaycard offers card-acquiring services, POS terminals, card readers, payment gateways and value-added services to merchants. It serves merchants of all sizes, enabling them to accept card payments face-to-face, online, in app, over the phone or by mail order. Barclaycard is an acquirer for the following card payment systems operating in the UK: DCI, JCB, Mastercard, Visa and UPI. Barclaycard also facilitates the acceptance of payments using American Express.

### Elavon

**1.109** Elavon Merchant Services ('Elavon') is a trading name of Elavon Financial Services DAC (EFS), a wholly owned subsidiary of US Bancorp (a US bank listed on the New York Stock Exchange). EFS is regulated by the Central Bank of Ireland.

**1.110** Elavon offers card-acquiring services, POS terminals, card readers, payment gateways and value-added services. It serves merchants of all sizes, enabling them to accept card payments face-to-face, online, in app, over the phone and by mail order. Elavon is an acquirer for the following card payment systems operating in the UK: DCI, JCB,

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<sup>49</sup> PSR analysis of data provided by acquirers and operators of card payment systems.

Mastercard, Visa and UPI. Elavon also facilitates the acceptance of payments using American Express.

## Global Payments

- 1.111** GPUK LLP (trading as Global Payments) is a subsidiary of Global Payments Inc, which is a global provider of payments technology headquartered in the US and listed on the New York Stock Exchange. GPUK LLP is authorised and regulated by the FCA. It was originally created as a joint venture with HSBC in 2008. HSBC sold its stake to Global Payments Inc the following year.
- 1.112** Global Payments offers card-acquiring services, POS terminals, card readers, payment gateways and value-added services. It serves merchants of all sizes, enabling them to accept card transactions face-to-face, online, in app, over the phone and by mail order. Global Payments is an acquirer for the following card payment systems operating in the UK: DCI, JCB, Mastercard, Visa and UPI. Global Payments also facilitates the acceptance of payments using American Express.

## Lloyds Bank Cardnet

- 1.113** Lloyds Bank Cardnet is a joint venture between Fiserv (see paragraph 1.122) and Lloyds Bank plc (a wholly owned subsidiary of Lloyds Banking Group, a predominantly UK-focused provider of financial services including retail and commercial banking and general insurance that is headquartered in the UK and listed on the London Stock Exchange). Lloyds Bank plc is authorised by the PRA and regulated by the FCA and the PRA.
- 1.114** Lloyds Bank Cardnet offers card-acquiring services, POS terminals, a payment gateway and value-added services. Merchants that want a POS terminal are referred to third-party POS terminal providers (see paragraph 1.157) including First Data Global Leasing (FDGL) and Merchant Rentals. Lloyds Bank Cardnet serves merchants of all sizes and enables them to take card transactions face-to-face, online, in app, over the phone and by mail order. It is an acquirer for the following card payment systems operating in the UK: DCI, JCB, Mastercard, Visa and UPI. Lloyds Bank Cardnet also facilitates the acceptance of payments using American Express.

## Worldpay

- 1.115** Worldpay is a global provider of financial technology services specialising in merchant acquiring and payment card processing services. It is owned by Fidelity National Information Services, Inc (FIS), which is a global provider of technology services to merchants, banks and capital markets that is headquartered in the US and listed on the New York Stock Exchange. Worldpay was originally part of the Royal Bank of Scotland before being sold to two private equity firms in 2010 and then listed on the London Stock Exchange in 2015. It was subsequently acquired by Vantiv in 2018 and then Vantiv was in turn bought by FIS in 2019.
- 1.116** Worldpay provides card-acquiring services to UK merchants through Worldpay (UK) Limited (which is authorised and regulated by the FCA) and Worldpay B.V. (which is authorised and regulated by the central bank of the Netherlands – DNB). It also offers POS terminals, card readers, payment gateways and value-added services. Worldpay serves merchants of all sizes and enables them to accept card transactions face-to-face, online, in app, over the phone and by mail order. It is an acquirer for the following card

payment systems operating in the UK: DCI, JCB, Mastercard, Visa and UPI. Worldpay also facilitates the acceptance of payments using American Express.

## Other acquirers

### Adyen

- 1.117** Adyen N.V. (Adyen) is a global payments company headquartered in the Netherlands and listed on Euronext. It is authorised and regulated by the DNB. Adyen predominantly focuses on large enterprise merchants. It offers card-acquiring services, a payment gateway, POS terminals and value-added services. Adyen is an acquirer for the following card payment systems operating in the UK: DCI, JCB, Mastercard, Visa and UPI. Adyen also facilitates the acceptance of payments using American Express.

### AIB Merchant Services

- 1.118** AIB Merchant Services is a trading name of First Merchant Processing (Ireland) DAC, a joint venture between Allied Irish Banks PLC and Fiserv (see paragraph 1.122). Allied Irish Banks PLC is a financial services group operating predominantly in the Republic of Ireland and the UK that is headquartered in the Republic of Ireland and listed on the London Stock Exchange. AIB Merchant Services is regulated by the Central Bank of Ireland.
- 1.119** AIB Merchant Services offers card-acquiring services, POS terminals, a payment gateway and value-added services. Merchants that want a POS terminal are referred to FDGL. AIBMS serves merchants of all sizes and enables them to accept card transactions face-to-face-to-face, online, in app, over the phone and by mail order. AIBMS is an acquirer for the following card payment systems operating in the UK: DCI, Mastercard, Visa and UPI.

### Chase Paymentech

- 1.120** **Chase Paymentech Europe Limited** ('Chase Paymentech') is owned by J.P. Morgan Chase & Co, a global provider of financial services including retail and commercial banking that is headquartered in the US and listed on the New York Stock Exchange. Chase Paymentech is authorised and regulated by the Central Bank of Ireland and primarily acquires card-not-present transactions for large multi-national merchants; it also provides other services. It is an acquirer for the following card payment systems operating in the UK: JCB, Mastercard, Visa and UPI.

### EVO Payments

- 1.121** **EVO Payments International GmbH** ('EVO Payments') is a wholly owned subsidiary of EVO Payments Inc (a global acquirer and payments processor headquartered in the US and listed on the Nasdaq). EVO Payments is authorised and regulated by BaFin – the Federal Financial Supervisory Authority in Germany. EVO Payments predominantly serves small and medium-sized merchants and enables them to accept card transactions face-to-face, online, in app, over the phone and by mail order. It offers card-acquiring services, POS terminals, a payment gateway and value-added services. It is an acquirer for the following card payment systems operating in the UK: Mastercard, Visa and UPI. EVO Payments also facilitates the acceptance of payments using American Express.

## First Data

- 1.122 First Data Europe Limited** ('First Data') is owned by Fiserv, a global provider of financial services technology that is headquartered in the US and listed on the Nasdaq. First Data is authorised and regulated by the FCA. It began trading in 2013, at which time it acquired the acquiring business owned by Bank of Scotland (now part of Lloyds Banking Group).
- 1.123** First Data serves merchants of all sizes, enabling them to accept card payments face-to-face, online, in app, over the phone and by mail order. It offers card-acquiring services, POS terminals, card readers, payment gateways and value-added services. Merchants that want a POS terminal are referred to FDGL. First Data is an acquirer for DCI, Mastercard, Visa and UPI. It also facilitates the acceptance of payments using American Express.

## Stripe

- 1.124 Stripe Payments UK Ltd** ('Stripe') is an indirect wholly-owned subsidiary of Stripe Inc, a privately owned technology company that is headquartered in the US and provides software tools for businesses to accept payments and manage an online business. Stripe started providing card-acquiring services to UK merchants as a payment facilitator in 2013 before becoming an acquirer. It is an authorised Electronic Money Institution and regulated by the FCA. Stripe mainly serves merchants of all sizes selling online and in app. It offers card-acquiring services, a payment gateway and value-added services. Stripe is an acquirer for Mastercard and Visa. It also facilitates the acceptance of payments using American Express.

## Largest payment facilitators

### PayPal (including iZettle)

- 1.125** PayPal Europe (PayPal) is ultimately wholly owned by PayPal Holdings, Inc – a global technology platform and digital payments company that enables, among other things, digital and mobile payments on behalf of consumers and merchants. PayPal Holdings Inc is headquartered in the US and listed on the Nasdaq. PayPal Europe is authorised and regulated by the supervisory authority of the Luxembourg financial sector (CCSF). PayPal provides card-acquiring services, card acceptance products and value-added services to UK merchants of all sizes through four products: Braintree, PayPal Commerce Platform, PayPal Here and PayPal Pro. Braintree, PayPal Commerce Platform and PayPal Pro enable merchants to accept card payments online; PayPal Here enables merchants to accept card payment face-to-face. PayPal is registered as a payment facilitator for the following card payment systems operating in the UK: DCI, JCB, Mastercard, Visa and UPI, and facilitates the acceptance of payments using American Express. PayPal also offers a variety of other products in the UK including the PayPal digital wallet, PayPal Credit, Xoom and Hyperwallet.

- 1.126** In 2018, PayPal Holdings Inc acquired a payment facilitator called iZettle AB (iZettle). iZettle continues to operate as a separate brand and is authorised and regulated by the Swedish Financial Supervisory Authority. iZettle predominantly serves the smallest merchants selling face-to-face (though it also enables merchants to accept card-not-present transactions). It offers card-acquiring services, card readers and value-added services. iZettle is registered as a payment facilitator for the following card payment systems operating in the UK: DCI, JCB, Mastercard, Visa and UPI. iZettle also facilitates the acceptance of payments using American Express.

## Square

- 1.127** Squareup International Limited (Square) is wholly owned by Square, Inc – a US-headquartered technology company that is listed on the New York Stock Exchange and provides products and services to merchants to help them grow their businesses. Squareup Europe Limited – a subsidiary of Squareup International Limited – is authorised and regulated by the FCA. Square predominantly provides card-acquiring services (and card readers and value-added services) to the smallest merchants selling face-to-face, though it also serves merchants selling online. Square is a payment facilitator for the Mastercard and Visa card payment systems. Square also facilitates the acceptance of payments using American Express.

## SumUp

- 1.128** SumUp Holdings Luxembourg S.à.r.l (SumUp) is a privately owned holdings company that is headquartered in Luxembourg. SumUp Payments Limited – a subsidiary of SumUp – is authorised and regulated by the FCA. SumUp predominantly provides card-acquiring services (and card readers and value-added services) to the smallest merchants selling face-to-face, though it also serves merchants selling online. SumUp is a payment facilitator for the Mastercard, Visa, Diners, Discover, and UPI card payment systems. SumUp also facilitates the acceptance of payments using American Express.

# Third parties that help merchants accept card payments

**1.129** Merchants can buy card acceptance products, such as POS terminals, and value-added services from third parties. These third parties may also recommend or refer merchants to an acquirer or payment facilitator and hence can be an important entry point for merchants looking to buy card-acquiring services. In this section, we describe some of these third parties and how they help merchants accept card payments.

## ISOs

**1.130** ISOs sell card-acquiring services to merchants on behalf of one or several acquirers, alongside other card acceptance products and value-added services. There are over 60 ISOs operating in the UK<sup>50</sup>; Handepay, Paymentsense, RMS, takepayments (formerly Payzone) and UTP are five of the largest and together they had approximately 175,000 merchants at the end of 2018.<sup>51</sup> ISOs must be registered by acquirers with the operators of card payment systems.

**1.131** ISOs are agents of the acquirer that are tasked with procuring new merchant relationships in return for commission. ISOs refer merchants to acquirers for card-acquiring services; ISOs do not provide these services themselves. ISOs differ from other third parties that refer merchants to acquirers because in most cases they are permitted to agree with merchants the price they will pay for card-acquiring services. [3<] The acquirer has no direct involvement in the sales process, which is outsourced to the ISO. ISOs' discretion over pricing of card-acquiring services varies. [3<]

**1.132** Once a sale is agreed, ISOs help merchants to complete the acquirer's application form for card-acquiring services and submit this to the acquirer. The acquirer then carries out its usual onboarding process to decide whether to serve the merchant and has the option to reject the application.

**1.133** ISOs commonly provide customer services to merchants after they refer them to an acquirer. All the ISOs we collected information from said that merchants would typically contact them in the first instance with queries about card-acquiring services (and any other product they were sold by the ISO, such as POS terminals). The ISOs differ in how they handle queries about card-acquiring services: some automatically direct the merchant to their acquirer while others will seek to resolve the query themselves (including by liaising with the acquirer on behalf of the merchant).

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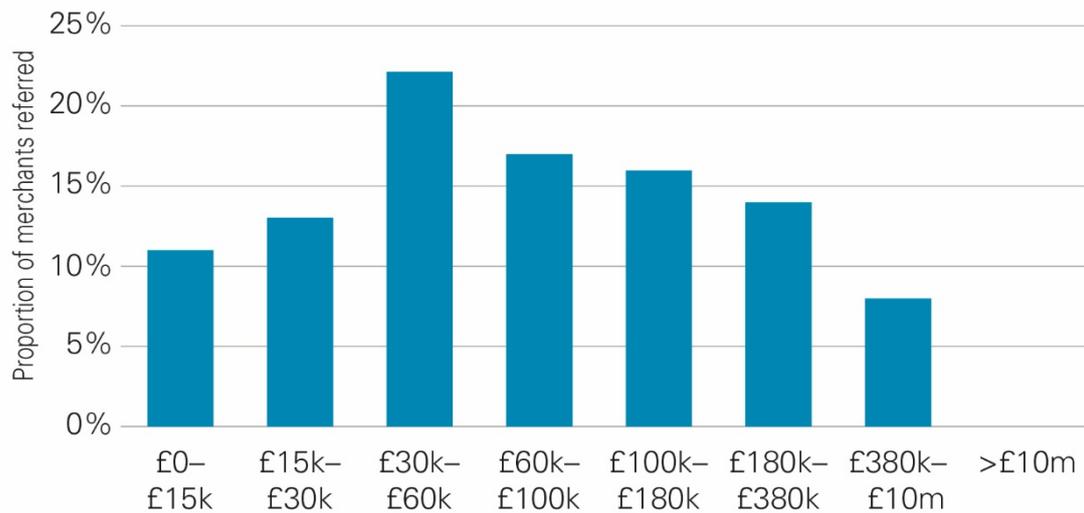
50 PSR analysis of data provided by acquirers on third parties that refer merchants.

51 PSR analysis of data provided by ISOs.

**1.134** ISOs predominantly refer merchants that sell face-to-face to acquirers. [36]

**1.135** As shown in Figure 9, nearly all the merchants ISOs refer to acquirers have an annual card turnover of up to £1 million. The ISOs we collected information from said they target small and medium-sized merchants.

**Figure 9: Annual card turnover in 2018 of merchants referred by ISOs to four of the five largest acquirers**



Source: PSR analysis of data provided by four acquirers.

**1.136** ISOs have large sales teams working to procure new merchant relationships. An important part of their customer acquisition strategies involves field sales or telesales agents cold calling merchants – that is, making unsolicited calls to merchants by phone or by visiting their place of business. ISOs also use other customer acquisition channels such as their own websites, price comparison websites and referrals from third parties such as ISVs.

**1.137** ISOs earn commission from referring merchants to acquirers. Commercial arrangements vary but generally the ISO receives the MSC (that is, the amount the merchant pays to the acquirer for card-acquiring services, which is agreed between the merchant and the ISO) less certain fees the acquirer charges the ISO (which can include interchange fees, scheme fees and processing fees). Generally, the majority of ISOs’ revenue comes from commission earned from referring merchants to acquirers for card-acquiring services: on average, the ISOs we collected information from obtained around 60% of their revenue in 2018 from this activity. Acquirers generally require or provide incentives for ISOs to generate a certain amount of revenue from referrals or refer a certain number of merchants.

- 1.138** POS terminals are another source of revenue for ISOs. Depending on the ISO, there are different commercial arrangements:
- Some merchants hire POS terminals from ISOs for a fixed monthly fee.
  - Some merchants pay for services or membership from the ISO for which they receive a POS terminal free of charge to use in conjunction with the ISO's other services.
  - Some merchants are referred by ISOs to a third-party POS terminal provider, which supplies the POS terminal(s) to the merchant. The ISO receives commission from the third-party POS terminal provider.
- 1.139** Acquirers often place restrictions on the types of merchants that ISOs can procure. For example, by prohibiting or placing conditions on ISO procurement of certain types of merchants that are considered high risk to serve.
- 1.140** In addition, acquirers typically include non-solicitation clauses in their agreements with ISOs that prevent ISOs from approaching merchants they have referred (and in some cases, any of the acquirer's customers) during the term of the agreement and sometimes for a period of 12 months after the end of the agreement. One ISO that works with more than one acquirer told us that non-solicitation clauses in acquirer contracts mean that in many cases ISOs do not want to contract with too many acquirers as this would limit the pool of merchants they could procure.
- 1.141** Some ISOs work with more than one acquirer, [§]. There were various reasons given for working with more than one acquirer including to create some competitive tension between acquirers. Differences in acquirers' risk appetites [§] and capabilities (some acquirers are better at serving certain sectors than others) were also cited as reasons. Other ISOs work with one acquirer only. [§]

## Other third parties

- 1.142** In this section, we describe some of the third parties – other than ISOs – that help merchants accept card payments.

### Banks

- 1.143** High-street banks that do not have their own acquiring business, such as HSBC and Santander, often have referral agreements in place with acquirers or payment facilitators. Most of the banks we spoke to have referral relationships, whereby customers of the bank that wish to accept card payments are referred to an acquirer or payment facilitator to discuss their card acceptance needs. All the banks we spoke to said that their customers are free to choose any provider of card-acquiring services that meets their needs.

### Comparison websites

- 1.144** These are websites (and apps) that allow merchants to compare or obtain quotes for card-acquiring services and card acceptance products from acquirers, ISOs and payment facilitators. Examples include Approved Index, Cardswitcher and Companeo.

- 1.145** Cardswitcher enables small and medium-sized merchants to compare prices of card-acquiring services. Merchants complete an online form and are presented with a list of quotes for card-acquiring services (and other products they might need, like POS terminals) from Cardswitcher's partners. The quotes presented are mainly from ISOs. The merchant can then choose to follow up on any of the quotes by asking to be contacted by one or more of the partners.
- 1.146** Other websites and apps such as Approved Index and Campaneo also enable merchants to obtain quotes for card-acquiring services but operate on a different model. Unlike Cardswitcher, these websites do not provide a list of quotes for card-acquiring services. Instead, the merchant completes an online form with details about its business and needs, which is sent to several of the website's partners (which include acquirers, payment facilitators and ISOs). The partners then follow up on these leads by contacting the merchant.

## Gateway providers

- 1.147** Many firms offer payment gateways including acquirers, payment facilitators and ISOs. Gateway providers are firms that specialise in providing this product but do not provide card-acquiring services. Gateway providers may offer a payment gateway for online payments as well as payments accepted face-to-face (sometimes alongside POS terminals that the merchant can buy or hire). Examples of gateway providers include CyberSource (owned by Visa) and Sage Pay (now owned by Elavon).
- 1.148** Gateway providers are involved with the processing of card transactions but – unlike acquirers and payment facilitators – do not settle with the merchant. The scope of services provided by gateway providers varies, but typically they will at a minimum facilitate card transactions by:
- forwarding the authorisation request from the merchant to the acquirer, which sends this to the cardholders' bank via the operator of the card payment system
  - receiving the issuers' response to the authorisation request from the acquirer and forwarding this to the merchant
  - batching up the merchant's card transactions and sending these to the acquirer, which submits these to the operator of the card payment system for clearing and settlement
- 1.149** Importantly, the merchant's acquirer (not the gateway provider) will transfer if the funds for the card payments it accepts.
- 1.150** Gateway providers may also offer additional goods and services such as:
- services that help merchants detect and prevent fraudulent transactions
  - DCC (see paragraph 1.76)
  - detailed reporting and analysis on the payments the merchant accepts
- 1.151** Gateway providers connect to multiple providers of card-acquiring services (mainly acquirers). Gateway providers typically have referral arrangements with acquirers.

## Independent software vendors (ISVs)

- 1.152** ISVs specialise in offering software (and in some cases, complimentary hardware) that helps merchants run their businesses. ISVs often have referral relationships with acquirers and payment facilitators.
- 1.153** For example, some ISVs specialise in software that helps merchants build a website and sell online such as Magento (owned by Adobe Inc), Shopify and Wix. Typically, e-commerce platforms have integrations with multiple acquirers and payment facilitators.<sup>52</sup> Some e-commerce platforms have referral arrangements with acquirers and payment facilitators they are integrated with. Some e-commerce platforms have a preferred provider that they promote to merchants.
- 1.154** Other ISVs specialise in offering EPOS systems to businesses selling face-to-face, such as EPOS Now and Vend. An EPOS system is a combination of hardware and software that helps brick-and-mortar merchants run their businesses by supporting, for example, inventory management, payroll and management information reporting. Payments functionality can be integrated with the EPOS system so that, for example, the value of the item being bought in a shop is automatically displayed on the POS terminal after being scanned. Some ISVs that provide EPOS systems have referral arrangements with acquirers, ISOs and payment facilitators.
- 1.155** Other ISVs provide accounting software, such as Sage and Xero. There are various ways such ISVs can integrate with providers of card-acquiring services. One form of integration allows information on card transactions to be automatically imported into the accounting application. Some ISVs providing accounting software have referral arrangements with providers of card-acquiring services.

## POS terminal manufacturers

- 1.156** POS terminal manufacturers sell POS terminals to acquirers, ISOs and other third parties, and in some cases directly to merchants. Ingenico and Verifone are examples of POS terminal manufacturers. Both also offer payment gateways, and other goods and services.

## Third-party POS terminal providers

- 1.157** Third-party POS terminal providers like First Data Global Leasing (owned by Fiserv – see paragraph 1.122) and Merchant Rentals supply POS terminals to merchants. They work with acquirers and ISOs, who receive commission for referring merchants that want a POS terminal to third-party POS terminal providers. The acquirer or ISO agrees with the merchant the monthly fee that the merchant will pay for hiring the POS terminal supplied by the third-party POS terminal provider and signs them up to a rental agreement. The agreement is between the third-party POS terminal provider (which owns the POS terminal) and the merchant.
- 1.158** [§<]

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<sup>52</sup> An e-commerce platform may also integrate with gateway providers. A merchant that chooses a gateway provider will also need to contract for card-acquiring services with an acquirer.

## Trade associations

- 1.159** Some trade associations such as the Federation of Small Businesses refer their members to acquirers.

# Pricing of card-acquiring services and other products

**1.160** In this section, we describe the pricing of card-acquiring services and certain other products by acquirers, payment facilitators and ISOs.

## Acquirer pricing of card-acquiring services and other products

**1.161** Most acquirers can provide card-acquiring services as a standalone product. They usually also offer a package of goods and services that together enable merchants to accept card payments. A typical basic offering for a merchant selling face-to-face would include:

- card-acquiring services
- one or more POS terminals, which the merchant hires
- services to enable the merchant to certify (and in some cases, assist) their compliance with PCI DSS requirements

**1.162** Some acquirers offer card readers as well as POS terminals.

**1.163** For merchants selling online that want to buy everything they need to accept card payments from an acquirer, the typical basic offering is the same as that for merchants selling face-to-face except that the acquirer provides a payment gateway rather than a POS terminal.

**1.164** Merchants can also buy other value-added services from their acquirer (see paragraph 1.76).

**1.165** Some acquirers may offer POS terminals, payment gateways, PCI DSS compliance services and other value-added services in partnership with third parties. For example, Lloyds Bank Cardnet (see paragraph 1.114) and AIB Merchant Services (see paragraph 1.119) refer merchants that want a POS terminal to third-party POS terminal providers.

**1.166** The remainder of this section describes the pricing of the main components of the acquirers' typical offering for merchants selling face-to-face and online.

### Pricing of card-acquiring services

**1.167** Acquirers tend to price card-acquiring services separately from card acceptance products and value-added services.

- 1.168** The MSC is the total amount the merchant pays for card-acquiring services to its acquirer. The MSC has three main parts:
- interchange fees, paid by the acquirer to the issuer
  - scheme fees, paid by the acquirer (and issuer) to the operators of card payment systems (such as Visa)
  - acquirer net revenue, which recovers the acquirer's other costs and margin
- 1.169** Merchants served by acquirers have one or more of the following pricing options for card-acquiring services:
- Standard pricing, whereby for any given transaction the acquirer does not automatically pass through at cost the interchange fee applicable to the transaction and the pricing option does not satisfy the criteria for IC+, IC++ or fixed pricing.<sup>53</sup>
  - Interchange fee plus (IC+) pricing, whereby for any given transaction the acquirer automatically passes on at cost the interchange fee applicable to that transaction.
  - Interchange fee plus plus (IC++) pricing, whereby for any given transaction the acquirer automatically passes on at cost the interchange fee and scheme fees<sup>54</sup> applicable to that transaction.
  - Fixed pricing, whereby the merchant pays a fixed, periodic fee for card-acquiring services (the amount of which does not depend on the volume or value of transactions it accepts or the characteristics of these transactions, within specified limits).

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53 Only where a pricing option passes through interchange fees at cost for all transactions will it be considered IC++ or IC+ pricing. (With IC++ pricing, scheme fees are also passed through at cost.) A pricing option that applies a per-transaction fee for card-acquiring services and passes through at cost the interchange fees applicable to some, but not all, transactions will satisfy the criteria for standard pricing.

54 The acquirer may also pass on at cost scheme fees that are not directly attributable to transactions.

**1.170** Table 2 below shows the pricing options of ten acquirers.

**Table 2: Acquirers' pricing options**

Acquirer	IC++	IC+	Standard	Fixed
Adyen <sup>55</sup>	✓	×	×	×
AIB Merchant Services <sup>56</sup>	✓	×	✓	×
Barclaycard	✓	×	✓	×
Lloyds Bank Cardnet	✓	✓	✓	×
Elavon	✓	×	✓	×
EVO Payments	✓	×	✓	✓
First Data	✓	✓	✓	×
Global Payments	✓	✓	✓	×
Stripe	✓	×	✓	×
Worldpay	✓	✓	✓	✓

Source: Information submitted by acquirers.

## Standard pricing – overview

**1.171** Over 95% of acquirers' merchants have standard pricing, which typically consists of:

- one or more 'headline rates' (typically several) that are applied to different types of purchase transactions (and sometimes refunds), and can take the form of an ad valorem fee, a pence-per-transaction fee or a combined ad valorem and pence-per-transaction fee
- one or more additional fees, which are mainly triggered by:
  - specific events such as chargebacks, refunds and PCI DSS non-compliance ('non-transactional additional fees'), and/or
  - specific types of purchase transactions (and sometimes refunds) such as e-commerce transactions ('transactional additional fees')

<sup>55</sup> Adyen has IC++ pricing for global card payment systems (where possible and applicable). For some payment methods Adyen has 'blended pricing' where permitted by the relevant network and regulations.

<sup>56</sup> There are circumstances in which AIB Merchant Services would apply standard pricing if requested by the merchant.

**1.172** Additional transactional fees are added to the relevant headline rates. For example, a merchant might pay a single headline rate of 1.2% for all debit card transactions plus an additional fee of 1% where such transactions involve debit cards issued outside the EU.

**1.173** Examples of non-transactional fees include the following:

- Administration fees, which are triggered when the acquirer makes certain changes to the merchant's account (for example, to update the merchant's details).
- Authorisation request fees, which are triggered when the merchant makes an authorisation request. Some acquirers have different fees depending on the authorisation method.
- Chargeback fees, which are triggered by a chargeback being raised against the merchant. Some acquirers always apply a fee when a chargeback is raised. Others charge only if the chargeback is upheld or if it exceeds a certain value.
- Integrity fees, which are triggered where an authorisation request does not meet certain conditions.
- Minimum monthly service charge (MMSC), which is triggered when the merchant's fees do not exceed a minimum amount in a month.
- PCI DSS non-compliance fees, which are triggered where the merchant does not certify their compliance.
- Refund fees, which are triggered when the merchant refunds a purchase. Some acquirers do not charge for refunds or gross charge (that is, they apply the relevant headline rate to purchase transactions plus refunds).
- Termination fees, which are triggered where the merchant terminates the card-acquiring services contract within six months.

**1.174** The MSC is the total amount the merchant pays the acquirer for card-acquiring services including any additional transactional and non-transactional fees.

**1.175** Most acquirers that have standard pricing do not publish their prices. Instead, the price they quote to a merchant is determined by the information that a sales agent collects about the merchant's characteristics during the sales process. Depending on the acquirer, the characteristics considered may include:

- the value of transactions the merchant accepts per year
- the merchant's average transaction value (ATV)
- the mix of card types the merchant accepts
- the merchant's operating environment(s)
- the merchant's industry
- the merchant's current price (if it is already accepting cards)

**1.176** Acquirers gather information from the merchant to enable them to provide a quote. Where a merchant is already accepting cards, a recent bill may be requested. If a merchant is new to cards, the industry they operate in can be used to forecast – for example – its likely ATV or the mix of card types it will accept. Sales agents may also draw on their own experience.

- 1.177** The structure of acquirers' standard pricing varies significantly because firms differ:
- in how they vary the headline rate according to the characteristics of a transaction
  - in how they express the headline rate(s)
  - in the additional transactional fees they have
  - in the additional non-transactional fees they have

**1.178** In the sections that follow, we describe the standard pricing options used by seven acquirers. We identify the headline rate where published.

## Barclays

**1.179** For merchants with annual turnover below [redacted]<sup>57</sup>, Barclays' 'blended tariff' has five 'price points':

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

**1.180** [redacted]

**1.181** [redacted]

**1.182** There are additional fees for the following types of purchase transaction:

- [redacted]
- [redacted]
- [redacted]

**1.183** The following non-transactional fees also apply if they are part of the pricing agreed with the merchant and if they are triggered:

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

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57 [redacted]

## Elavon

**1.184** Elavon's 'unblended tariff' has headline rates to accommodate the different Mastercard and Visa card types, as well as JCB, DCI and UPI cards.

**1.185** [REDACTED]

**1.186** [REDACTED]

**1.187** Elavon has standard additional non-transactional fees that can be apply when triggered for situations, such as chargebacks, PCI-DSS non-compliance, or late payments. The fees are:

- [REDACTED]

## EVO Payments

**1.188** EVO Payments 'tailor-made' tariff has one secure and one non-secure headline rate, split by Visa/Mastercard for each of the following types of purchase transactions:

- [REDACTED]

**1.189** [REDACTED]

**1.190** [X]

**1.191** There are no additional transactional fees. There are two additional non-transactional fees: [X]

## First Data

**1.192** First Data's 'general tariff' has one qualified headline rate and one non-qualified<sup>58</sup> headline rate for each of the following types of purchase transactions:

- [X]

**1.193** [X]

**1.194** [X]

**1.195** [X]

**1.196** The following non-transactional fees may apply if triggered:

- [X]

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58 What constitutes a qualified and non-qualified transaction is agreed between First Data and the merchant.

- [REDACTED]
- [REDACTED]
- [REDACTED]

## Global Payments

**1.197** Global Payments' 'Additional Transaction Fee (ATF) tariff'<sup>59</sup> has different headline rates for up to five transaction types involving EU-issued cards:

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

**1.198** [REDACTED]

**1.199** [REDACTED]

**1.200** There are additional transactional fees (called 'differential fees') for [REDACTED]. Scheme fees can either be included in the headline rate or broken out separately.

**1.201** The following non-transactional fees apply if triggered:

- [REDACTED]

**1.202** Global Payments also has another tariff that is the same as the ATF tariff except that there are no differential fees or scheme fees broken out separately from the headline rate.

## Lloyds Bank Cardnet

**1.203** Lloyds Bank Cardnet typically has seven different headline rates – one for each of the following types of purchase transaction involving EU-issued cards:

- [REDACTED]
- [REDACTED]
- [REDACTED]

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59 [REDACTED]

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

**1.204** [REDACTED]

**1.205** There are additional fees for the following types of purchase transaction:

- [REDACTED]
- [REDACTED]
- [REDACTED]

**1.206** The following non-transactional fees apply if triggered:

- [REDACTED]

## Stripe

**1.207** Stripe has a different headline rate for two types of purchase transactions involving Mastercard and Visa cards:

- EEA-issued cards (1.4% plus £0.20)
- Non-EEA issued cards (2.9% plus £0.20)

**1.208** Stripe's merchants also pay an additional fee for the administration of each chargeback incurred (which is reimbursed to the merchant if the disputed payment is found in their favour).

**1.209** For merchants with a card turnover above [REDACTED] per month, Stripe may offer a discount on the headline rates [REDACTED].

## Worldpay

**1.210** Worldpay's 'custom tariff' has [REDACTED] three different transaction types involving cards issued in the UK:

- [REDACTED]
- [REDACTED]
- [REDACTED]

**1.211** [X]

**1.212** There are additional fees for the following types of purchase transaction:

- [X]

**1.213** The following non-transactional fees may apply if triggered:

- [X]
- [X]
- [X]
- [X]
- [X]

**1.214** Worldpay's 'simplicity tariff' has a single headline rate of 1.5% for all purchase transactions involving Mastercard and Visa cards. This is subject to a fair usage policy, which includes transaction mix limits. The headline rate includes an annual subscription to SaferPayments, which is a product that helps merchants to achieve compliance with PCI DSS requirements. [X]

**1.215** The simplicity tariff is available to merchants with annual card turnover below [X] and commercial card/inter-regional transaction volumes below 25% of total card turnover.

**1.216** Two non-transactional fees apply if triggered:

- [X]
- [X]

**1.217** Worldpay's 'pay-as-you-go tariff' has a single headline rate of 2.5% for all transactions involving Mastercard and Visa cards. [X]

**1.218** The 'pay-as-you-go tariff' is available to merchants with annual card turnover below [X] and commercial card/inter-regional transaction volumes below 25% of total card turnover.

**1.219** The same additional fee of [X] applies for the following types of transaction:

- [X]
- [X]
- [X]

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

**1.220** The following non-transactional fees apply if triggered:

- [REDACTED]
- [REDACTED]
- [REDACTED]

### IC++ pricing

**1.221** Less than 5% of acquirers' merchants have IC++ pricing. Most acquirers told us that IC++ pricing is available to, or suitable for, large merchants.

**1.222** With IC++ pricing, the acquirer automatically passes on interchange fees and scheme fees at cost to the merchant. The remainder of the acquirer's costs plus margin are generally recovered through:

- a processing fee (also called a management fee) charged for each purchase transaction (and in some cases for refunds)
- one or more additional fees, which are usually triggered by specific events (see paragraph 1.172 for examples of these fees)

**1.223** The processing fee can take the form of an ad valorem fee, a pence-per-transaction fee or an ad valorem plus pence-per-transaction fee (depending on the acquirer and the merchant's preferences).

**1.224** [REDACTED], the same processing fee applies to all purchase transactions irrespective of the characteristics of a transaction because the costs to the acquirer that vary by transaction are interchange fees and scheme fees, both of which are passed on at cost.

### IC+ pricing

**1.225** A very small number of acquirers' merchants have IC+ pricing. With IC+ pricing, the acquirer automatically passes on interchange fees at cost to the merchant. The remainder of the acquirer's costs (including scheme fees) plus margin are generally recovered through:

- a processing fee (also called a management fee) charged for each purchase transaction (and in some cases for refunds)
- one or more additional fees, which are usually triggered by specific events (see paragraph 1.172 for examples of these fees)

**1.226** The processing fee can take the form of an ad valorem fee, a pence per transaction fee or an ad valorem plus pence-per-transaction fee (depending on the acquirer and the merchant's preferences).

**1.227** Unlike IC++ pricing, the processing fee can vary depending on the characteristics of a transaction (such as card type) because scheme fees – which are recovered through the processing fee – differ depending on transaction characteristics.

### Fixed pricing

**1.228** A very small number of acquirers' merchants have fixed pricing, whereby they pay a fixed, periodic fee for card-acquiring services (the amount of which does not depend on the volume or value of transactions they accept or the characteristics of these transactions, within specified limits). Two acquirers offer fixed pricing: EVO Payments and Worldpay.

**1.229** Worldpay's **fixed monthly tariff** has a fixed monthly fee that covers:

- card-acquiring services for all Mastercard and Visa card transactions as long as the merchant's transaction mix and turnover remains within a pre-agreed fair usage policy
- hire of a POS terminal or provision of a payment gateway
- SaferPayments (see paragraph 1.212)

**1.230** The fixed monthly tariff is available to merchants with annual card turnover below [£] and commercial card/inter-regional transaction volumes below 25% of total card turnover.

**1.231** The following non-transactional fees apply if triggered:

- [£]
- [£]

**1.232** EVO Payments **ready-made tariff** has a fixed monthly fee that covers:

- card-acquiring services for all Mastercard and Visa card transactions (up to a specified value)
- hire of a POS terminal

**1.233** EVO Payments makes fixed pricing available to customers with monthly card turnover up to [£].

**1.234** The following non-transactional fees apply if triggered:

- [£]
- [£]

## Pricing of card acceptance products and PCI DSS compliance services

- 1.235** The other components of an acquirer's typically offering are usually priced as follows:
- merchants hire POS terminals for a monthly fixed fee
  - payment gateways attract a fixed monthly fee (for a specified number of transactions), a fee for each transaction, or a fixed monthly fee plus a fee for each transaction
  - services to enable the merchant to certify (and in some cases, assist) their compliance with PCI DSS requirements attract a fixed monthly or yearly fee
- 1.236** The acquirer considers various factors in agreeing the price of POS terminal hire with the merchant, which may include the length of the hire agreement and the type of POS terminal.

## Payment facilitator pricing of card-acquiring services and other products

- 1.237** The largest payment facilitators – PayPal (through its iZettle brand and PayPal Here product), Square and SumUp – predominantly<sup>60</sup> provide card-acquiring services to merchants selling face-to-face (though PayPal has other products that it provides as a payment facilitator that are aimed at merchants selling online – see paragraph 1.238). They offer:
- card-acquiring services
  - a card reader
- 1.238** Unlike most acquirers, the largest payment facilitators do not offer a standalone product to help merchants comply with PCI DSS requirements. They cover PCI DSS compliance on behalf of their merchants<sup>61</sup>, or assist with this, as part of the overall fee for card-acquiring services.
- 1.239** While POS terminals are usually standalone devices, the card reader must be connected to an app on a smartphone or tablet to work. The apps offered by payment facilitators allow the merchant's smartphone or tablet to be used as a POS system. For example, the merchant can add products to an order at the checkout, track their inventory and access information on the transactions they accept. Payment facilitators usually do not charge the merchant to download the apps they provide. Payment facilitators also offer value-added services.

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60 One payment facilitator reported higher volumes of card-not-present transactions since the COVID crisis began.

61 In some cases, merchants may not need to self-certify.

- 1.240** PayPal (for the Braintree and PayPal Pro products) targets merchants that sell online. PayPal offering includes card-acquiring services and a payment gateway. PayPal (for the Braintree and PayPal Pro products) does not offer a stand-alone product to help merchants comply with PCI DSS requirements. PayPal assists its merchants with PCI compliance as part of the overall service although merchants may have their own obligations for PCI DSS compliance. PayPal's iZettle brand, Square and SumUp also enable merchants to accept payments online.
- 1.241** In the sections that follow, we describe the pricing of the main components of the payment facilitators' typical offering for merchants.

## Braintree

- 1.242** For the Braintree product, PayPal has a single headline rate of 1.9% plus £0.20 for transactions involving Mastercard and Visa issued in the EU. The headline rate includes a payment gateway.
- 1.243** There are two additional transactions fees:
- a fee of 1% for transactions involving cards issued outside the EU/EEA
  - a fee of 0.5% for transactions involving American Express cards
- 1.244** There are additional non-transactional fees for chargebacks and refunds.
- 1.245** Custom pricing (whereby the merchant receives a reduction on the headline rate) is available on request. Eligibility is determined based on various factors, [X]. Merchants using Braintree can also have IC+ pricing and IC++ pricing.

## iZettle

- 1.246** iZettle has three pricing plans: iZettle Go, iZettle Go Plus and iZettle Pro.
- 1.247** The iZettle Go pricing plan is aimed at merchants that accept card payments face-to-face. The merchant pays 1.75% for all card-present transactions. The merchant can also send an invoice to a customer that includes a link that routes the customer to a webpage to enter their card details. The charge for these card-not-present transactions is 2.5%.
- 1.248** All merchants receive a free app, which allows products to be added to an order at the checkout so that everything can be paid for in a single transaction. The app generates reports for the merchant (for example, on number of products sold) and can be used to track inventory (though it cannot be used to order additional products from suppliers).
- 1.249** For all pricing plans, card readers are bought outright for a discounted price, currently £29 plus VAT for the first device and £59 plus VAT for subsequent devices. A merchant can choose to buy card readers separately or as part of a bundle with other products such as an iPad or receipt printer.
- 1.250** With the iZettle Go Plus pricing plan, the merchant pays 1.75% for all card-present transactions and 2.5% for all card-not-present transactions. There is also an additional charge of £29 per month. Merchants with the iZettle Go Plus pricing plan have access to a tool called iZettle E-com, which allows them to create a website and sell online. A payment gateway is included. As with the iZettle Go pricing plan, a free app is included.

**1.251** The iZettle Pro pricing plan is aimed at restaurants, bars and cafes. It charges 1.25% for all card-present transactions. Merchants also pay £39 per month per iPad that the iZettle Pro cloud-based app is used on. This app is different to that offered with the iZettle Go and iZettle Go Plus pricing plans because it includes features designed for restaurants (such as table management and bill splitting).

**1.252** Custom pricing plans are available for some customers. [X]

## PayPal Here

**1.253** PayPal Here has a tiered pricing structure. Merchants pay one of four headline rates depending on their card turnover in the previous month for Chip and PIN and contactless transactions involving UK-issued Mastercard and Visa cards:

- 2.75% for merchants that have a card turnover of less than £1,500 per month
- 1.75% for merchants that have a card turnover between £1,500 and £6,000 per month
- 1.50% for merchants that have a card turnover between £6,000 and £15,000 per month
- 1% for merchants with over £15,000 per month

**1.254** Merchants must make a request to receive the lower headline rates.

**1.255** There are separate headline rates for:

- magnetic stripe and PAN key entry transactions involving UK-issued Mastercard and Visa cards (3.4% plus £0.20)
- American Express transactions (2.75%)

**1.256** There are additional transactional fees for transactions involving cards outside the UK that range from 0.5% to 2%

**1.257** There are additional non-transactional fees for chargebacks.

**1.258** Custom pricing (whereby the merchant receives a reduction on the headline rate) is available on request. Merchants using PayPal Here can also have IC+ pricing.

**1.259** Card readers are sold upfront for £45 plus VAT. Merchants receive a free app that provides reporting information on transaction activity and can help with inventory management.

## PayPal Pro

**1.260** PayPal Pro's standard tariff has a headline rate of 3.4% plus a fixed fee for transactions involving UK-issued Mastercard and Visa cards. The fixed fee is determined by the currency in which the transaction is carried out. Merchants also pay a fixed fee of £20 per month. The headline rate includes a payment gateway.

**1.261** The same additional transactional fees apply as for the PayPal Here product (see 1.254). There are additional non-transactional fees for chargebacks and uncaptured authorisations.

- 1.262** Custom pricing (whereby the merchant receives a reduction on the headline rate) is available on request. Merchants can also have IC+ pricing.

## Square

- 1.263** Square's standard tariff has two headline rates:

- 1.75% for card-present transactions
- 2.5% for card-not-present transactions

- 1.264** Merchants receive a free point-of-sale app. The app allows products to be added to an order at the checkout in a shop so that the total owed can be calculated. The app provides detailed analytics and reporting to help merchants understand and run their businesses. The merchant can add their inventory to the app and track what is being sold.

- 1.265** For card-not-present transactions, the headline rate includes a payment gateway.

- 1.266** The Square Reader costs £19 plus VAT. The Square Terminal costs £199 plus VAT. The Square Terminal does not need to be connected to a smartphone or tablet to operate.

- 1.267** Custom rates are available to some merchants [3<].

## SumUp

- 1.268** SumUp's standard tariff has three headline rates:

- 1.69% for card-present transactions
- 2.50% for card-not-present transactions
- 2.95% plus £0.25 for card-not-present transactions (with the virtual terminal only)

- 1.269** The standard pricing option comes with a free app. The app interfaces with the card reader. It operates like a cash register – that is, the merchant can add their product catalogue to it and select the products being bought at checkout. The app includes a dashboard that generates reports on card transactions accepted. Employee accounts can also be set up.

- 1.270** The headline rate for card-not-present transactions includes a payment gateway.

- 1.271** Four options exist for merchants for hardware: an Air card reader is £29 (or £19 when on offer); a 3G Card Reader is £99 (or £69 when on offer), SumUp Start hardware (which consists of an Air card reader, charging station and stand) is £139 and a 3G Card Reader with printer is £169 (or £139 when on offer). The 3G Card Reader does not need to be connected to a smartphone or tablet to operate.

- 1.272** Merchants that accept more than [3<].

## ISO pricing of card-acquiring services and other products

- 1.273** Like acquirers, ISOs offer a package of goods and services that together enable merchants to accept card payments. A typical offering would include:
- **Card-acquiring services.** As explained in paragraphs 1.130 and 1.131, ISOs refer merchants to acquirers for card-acquiring services. ISOs differ from other third parties that refer merchants to acquirers because in most cases they are permitted to agree with merchants the price they will pay for card-acquiring services.
  - **POS terminal(s).** An ISO may supply one or more POS terminals to a merchant or refer merchants that want a POS terminal to a third-party POS terminal provider.
- 1.274** ISOs may also offer payment gateways and value-added services such as services to help the merchant certify their compliance with PCI DSS requirements and loans.
- 1.275** In the sections that follow, we describe the pricing of the main components of the ISOs' typical offering for brick-and-mortar merchants (as ISOs predominantly refer merchants that sell face-to-face to acquirers – see paragraph 1.134).

### Pricing of card-acquiring services

- 1.276** Merchants referred by ISOs nearly always have standard pricing, which is like that typically offered by acquirers and consists of several headline rates and one or more additional fees triggered by specific types of purchase transactions and/or specific events (see paragraphs 1.171 and 1.172).
- 1.277** Like most acquirers, ISOs do not generally publish their prices. Instead, the price they quote to a merchant is determined by the information that a sales agent collects about the merchant's characteristics during the sales process (see 1.173 and 1.174).
- 1.278** The structure of ISOs' standard pricing varies. In the sections that follow, we describe the standard pricing options used by five ISOs.

### Handepay

- 1.279** Handepay refers merchants to [redacted]. Handepay has one secure and one non-secure headline rate for each of the following types of purchase transactions:
- [redacted]
  - [redacted]

- [X]

**1.280** [X]

**1.281** [X]

**1.282** There are additional non-transactional fees for [X].

## Paymentsense

**1.283** Paymentsense mainly refers merchants to [X]. Merchants referred to [X] typically pay a different headline rate for purchase transactions involving each of the following card types:

- [X]
- [X]
- [X]
- [X]
- [X]

**1.284** [X]

**1.285** There are additional transactional fees for the following types of purchase transactions:

- [X]

**1.286** Many of Paymentsense's merchants pay an [X] and the following non-transaction fees also apply if triggered:

- [X]
- [X]
- [X]
- [X]
- [X]
- [X]

## RMS

**1.287** [X] Merchants [X] typically pay a different headline rate for purchase transactions involving each of the following card types:

- [X]
- [X]
- [X]
- [X]
- [X]

**1.288** [X]

**1.289** [X]

**1.290** The following non-transactional fees also apply if triggered:

- [X]
- [X]
- [X]
- [X]

## Takepayments

**1.291** Takepayments mainly refers merchants to [X]. Merchants referred to [X] pay a different headline rate for a range of different types of purchase transactions including the following:

- [X]

- [REDACTED]
- [REDACTED]

**1.292** [REDACTED]

**1.293** There are additional transactional fees for the following types of purchase transaction:

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

**1.294** There are additional non-transactional fees that apply if triggered:

- [REDACTED]

## UTP

**1.295** UTP refers merchants to [REDACTED]. Merchants pay a different headline rate for up to 11 different types of purchase transactions:

- [REDACTED]

**1.296** [REDACTED]

**1.297** There are additional transactional fees for the following types of purchase transaction:

- [X]
- [X]
- [X]

**1.298** There are additional non-transactional fees that apply if triggered:

- [X]
- [X]
- [X]
- [X]
- [X]
- [X]

## Pricing of card acceptance products and PCI DSS compliance services

**1.299** Depending on the ISO, there are different commercial arrangements for supplying a POS terminal to the merchant:

- Some merchants hire POS terminals from ISOs for a fixed monthly fee.
- Some merchants pay for services or membership from the ISO for which they receive a POS terminal free of charge to use in conjunction with the ISO's other services.
- Some merchants are referred by ISOs to a third-party POS terminal provider, which supplies the POS terminal(s) to the merchant. The fixed monthly fee the merchant pays for the POS terminal is generally agreed between the merchant and the acquirer or ISO that makes the referral. The contract is between the merchant and the third-party POS terminal provider.

**1.300** ISOs predominantly refer merchants that sell face-to-face to acquirers (see paragraph 1.134) but if the merchant wants a payment gateway, it will typically pay a fixed monthly or yearly fee for a fixed number of transactions. Alternatively, a payment gateway may be supplied under a services or membership agreement (in the same way as a POS terminal – see paragraph 1.297).

**1.301** Some ISOs provide services to help the merchant meet PCI DSS requirements. Such services typically attract a monthly fixed fee.

# Regulatory framework, scheme rules and voluntary industry standards

**1.302** In this section, we provide an overview of the regulatory framework relevant to acquirers and payment facilitators. It also provides a brief introduction to scheme rules and voluntary industry standards.

## Regulatory framework

**1.303** Acquirers and payment facilitators are subject to various laws, regulations and other measures imposed by public bodies or regulators, including:

- payments legislation such as the IFR and PSD2
- anti-money laundering and related laws
- data protection and privacy laws

**1.304** This section describes the main pieces of legislation we refer to in our assessment: the IFR, PSD2 and the Consumer Credit Act 1974 (CCA), focusing on the provisions most relevant to our analysis.

**1.305** The UK left the EU on 31 January 2020. Under the UK-EU withdrawal agreement, EU law will continue to apply to the UK until the end of the transition period that ends on 31 December 2020. We refer to EU laws, regulations, rules and other measures where relevant.

## Interchange Fee Regulation

**1.306** The IFR took effect from April 2015 (although not all the provisions came into force at the same time) and was introduced following antitrust investigations by the European Commission into interchange fees. The main objectives of the IFR are to create a single market for card payments and promote competition.

**1.307** The IFR caps interchange fees on transactions involving consumer debit and credit cards issued in the EEA where the merchant's acquirer is located in the EEA. It requires that acquirers do not pay (and issuers do not receive) more than:

- 0.3% of the value of a consumer credit card transaction
- 0.2% of the value of a consumer debit card transaction

**1.308** The caps came into force on 9 December 2015. The caps do not apply to cards issued outside the EEA, to commercial cards or cards issued under a three-party card payment system (except in certain circumstances).

**1.309** The IFR also introduced several business rules. Most of these rules came into force on 9 June 2016. They include the following:

- Article 6, which prohibits any territorial restrictions within the EU and any requirement or obligation to obtain a country-specific licence or authorisation to operate on a cross-border basis or rules with an equivalent effect in licensing agreements or in payment card scheme rules for issuing payment cards or acquiring card-based payment transactions.
- Article 9(1), which requires that acquirers offer and charge MSCs<sup>62</sup> broken down for the various different categories<sup>63</sup> of payment cards (that is, prepaid cards, debit cards, credit cards and commercial cards) and different brands of payment cards (such as Mastercard and Visa) with different interchange fee levels unless the merchant in writing requests to be charged a 'blended' MSC.
- Article 9(2), which requires that acquirers' agreements with merchants specify the amount of each MSC, and show the applicable interchange fee and scheme fees separately for each category and brand of payment cards. Merchants can subsequently make a request in writing to receive different information.
- Article 12, which requires payment service providers (PSPs)<sup>64</sup> to provide (or make available) the following information to the merchant for each card-based payment transaction:
  - the reference enabling the payee to identify the card-based payment transaction
  - the amount of the payment transaction in the currency in which the payee's payment account is credited
  - the amount of any charges for the card-based payment transaction, indicating separately the MSC and the amount of the interchange fee<sup>65</sup>

**1.310** We are the lead competent authority for the IFR in the UK. We share competency with other public bodies including the FCA for certain business rules. We have a separate programme of work – outside this market review – to monitor and enforce compliance with the IFR.

**1.311** The European Commission recently published its report on the impact of the IFR.<sup>66</sup>

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62 For the purposes of our market review, we use the term MSC to refer to the total amount the merchant pays for card-acquiring services. However, the IFR defines an MSC as 'a fee paid by the payee to the acquirer in relation to card-based payment transactions'. As set out in our guidance on our approach to monitoring and enforcing the IFR, we consider that one-off or periodic fees are not part of the MSC. PSR, *Guidance on the PSR's approach as a competent authority for the EU Interchange Fee Regulation* (2016, updated 2020), paragraph 5.34.

63 In the market review, we use the term 'type of card'. This is similar to, but not the same as, the term 'category of card' used in the IFR, which refers to the following four types of card only: prepaid, debit, credit and commercial.

64 The legislation that established the PSR – the Financial Services (Banking Reform) Act 2013 – has a different definition of payment service provider to that used in the IFR and the PSRs 2017. In this document, when we use the term payment service provider (PSP) with reference to the IFR, we mean PSP as defined in the IFR and PSRs 2017.

65 This information can only be aggregated if the merchant has given prior and explicit consent to the acquirer.

66 European Commission, *Report on the application of Regulation (EU) 2015/751 on interchange fees for card-based payment transactions* (2020).

## Second Payment Services Directive

**1.312** PSD2 replaced PSD1 and came into force on 13 January 2016.

**1.313** The Payment Services Regulations 2017 (PSRs 2017) implement PSD2 in the UK.<sup>67</sup> Most of the provisions took effect from 13 January 2018. The PSRs 2017 apply, with certain exceptions, to everyone who provides payment services as a regular occupation or business activity in the UK (PSPs).<sup>68</sup> Acquiring of payment transactions is one of the services listed as a payment service in the PSRs 2017.

**1.314** The main objectives of PSD2 are to:

- contribute to a more integrated and efficient European payments market
- improve the level playing field for PSPs (including new players)
- make payments safer and more secure
- protect consumers

**1.315** In this section, we summarise the provisions in PSD2 relating to:

- authorisation and registration
- conduct of business requirements
- strong customer authentication (SCA)

**1.316** The FCA is the competent authority responsible for authorising and supervising payment and e-money institutions under the PSRs 2017 and the Electronic Money Regulations 2011 respectively. We are responsible for certain provisions that relate to payment systems, and information to be provided by independent ATM deployers.

### Authorisation and registration

**1.317** A UK business that provides regulated payment services must (unless it is exempt or benefits from an exclusion) be authorised by the FCA as a payment institution (PI) or registered as a small PI. The conditions that must be met to become an authorised PI include that the applicant:

- meets specified capital requirements
- has taken adequate measures to safeguard users' funds
- has governance arrangements, internal control mechanisms and risk management procedures that meet the conditions set out in the PSRs 2017

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<sup>67</sup> Acquirers and payment facilitators passporting in to the UK will be subject to legislation that implemented PSD2 in the country in which they are authorised.

<sup>68</sup> The legislation that established the PSR – the Financial Services (Banking Reform) Act 2013 – has a different definition of PSP to that used in the PSRs 2017. In this section, when we use the term PSP with reference to the PSD2, we mean PSP as defined in PSD2.

**1.318** If a business has an average turnover in payment transactions not exceeding €3 million per month, it can choose to be registered as a small PI. Registration is cheaper and simpler than authorisation, but small PIs are unable to provide payment services into other EEA member states or some other services permitted under the PSRs 2017.

**1.319** Some businesses are exempt from registration or authorisation under the PSRs 2017 including:

- banks (otherwise authorised by the FCA)
- building societies (otherwise authorised by the FCA)
- e-money institutions (authorised under the Electronic Money Regulations 2011 by the FCA)

## Conduct of business requirements

**1.320** Under the PSRs 2017, all PSPs (however authorised) must comply with the conduct of business requirements.

**1.321** Most relevant to our assessment are the following requirements to provide information to the customer<sup>69</sup> before and after the execution of a payment transaction where the transaction is carried out as part of an ongoing relationship under a framework contract<sup>70</sup>:

- Regulation 48. In good time before a framework contract is entered into (or immediately after the execution of the transaction if the contract has been concluded at the customer's request by means of distance communication), the PSP must provide the customer with certain information including:
  - details of the payment service to be provided
  - details of all charges payable by the customer to the PSP and, where applicable, a breakdown of them
  - information about the length of the contract and, where relevant, customer and PSP termination rights, and the terms under which the PSP can unilaterally vary the contract
- Regulation 50. For most changes to the framework contract, or the information that has to be disclosed before the framework contract is entered into, PSPs must provide notice of any proposed changes at least two months before they are due to take effect. The framework contract may provide for proposed changes to be made unilaterally by the PSP where the customer does not reject the proposed changes before they come into force; in this case, the customer has the right to terminate the contract without charge at any time before the proposed date of entry into force of the changes.

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69 There are also conduct of business requirements relating to the rights and obligations of both PSP and customer in relation to payment transactions.

70 A framework contract is a contract governing the future execution of individual and successive payment transactions (see Regulation 2 of the PSRs 2017 for the full definition). Information requirements differ depending on whether the transaction concerned is carried out as part of an ongoing relationship under a 'framework contract' or as a single payment transaction. We describe the requirements relating to the former scenario as these are most relevant to our assessment.

- Regulation 51. The framework contract may be terminated by the customer at any time, unless a period of notice (not exceeding one month) has been agreed. If the contract has been running for six months or more, no charge may be made for termination. Regular service charges for the running of the payment services may be charged, but any advance payments in respect of such service charges must be returned on a pro-rata basis. Any charge that is made for termination must reasonably correspond to the PSP's actual costs.
- Regulation 54. The PSP must provide payees with the following information on transactions:
  - a reference enabling the customer to identify the payment transaction and the payer and any information transferred with the payment transaction
  - the amount of the transaction in the currency of the payment account credited
  - the amount and, where applicable, breakdown of any transaction charges and/or interest payable in respect of the transaction
  - any exchange rate used by the payee's PSP and the amount of the payment transaction before it was applied the credit value date

**1.322** The obligations in Regulation 54 are complementary to the obligations in Article 12 IFR (see paragraph 1.307).

## Strong customer authentication

**1.323** PSD2 requires that a PSP must apply SCA in certain circumstances including for card payments (unless an exemption applies). SCA is intended to enhance the security of payments and limit fraud during the authentication process.

**1.324** Under the PSRs 2017, strong customer authentication means authentication based on the use of two or more independent elements (factors) from the following categories:

- something known only to the payment service user (knowledge)
- something held only by the payment service user (possession)
- something inherent to the payment service user (inherence)

**1.325** PSPs must comply with Regulatory Technical Standards (the SCA RTS) that provide detailed specifications for how the rules should be implemented.

**1.326** The rules on SCA took effect on 14 September 2019. However, the European Banking Authority accepted that more time would be needed to implement SCA for e-commerce transactions given the complexity of the requirements, a lack of preparedness and the potential for a significant impact on consumers. Subsequently, the FCA agreed an 18-month plan to implement SCA with the industry, with a further six months provided because of COVID-19. By 14 September 2021, the FCA expects all firms to have made the necessary changes and undertaken the required testing to apply SCA.

## Consumer Credit Act 1974 (as amended)

- 1.327** The CCA regulates consumer credit and hire agreements. The FCA is responsible for regulation of any firm or individual offering consumer credit, consumer hire or undertaking ancillary credit business.<sup>71</sup> The CCA applies in some cases to POS terminal hire contracts.
- 1.328** A regulated consumer hire agreement is an agreement for the hire of goods between the owner and an individual, which includes a sole trader or a small partnership (two or three partners which are not all incorporated) or an unincorporated body of persons (which are not all incorporated)<sup>72</sup>, for a period which is capable of subsisting for more than three months and is not a hire-purchase agreement (as defined in the CCA). If a consumer hire agreement does not fall within one of the exemptions to the CCA, it will be a regulated consumer hire agreement.
- 1.329** Where the CCA applies, firms with regulated consumer hire agreements are subject to obligations, including pre-contract disclosure, requirements on the form and content of agreements and the provision of copy documents. The CCA provides the regulated consumer hire agreement is unenforceable without a court order where relevant pre-contractual information has not been provided<sup>73</sup> or where the agreement has been improperly executed.<sup>74</sup>
- 1.330** Entry into regulated consumer hire agreements by way of business is a regulated activity which requires FCA authorisation.
- 1.331** Where the CCA applies, the merchant has a statutory right, subject to meeting certain conditions, to terminate the POS terminal hire contract without charge by giving notice (one month, if the merchant pays monthly) after the contract has run for 18 months.<sup>75</sup>
- 1.332** A term contained in a regulated consumer hire agreement is void if, and to the extent that, it is inconsistent with a provision for the protection of the hirer in the CCA.<sup>76</sup>
- 1.333** In addition to the CCA provisions noted above (these are illustrative and not exhaustive), there are also detailed conduct of business rules in the FCA Handbook applicable to firms in respect of consumer credit/hire and ancillary credit business.

## Scheme rules

- 1.334** In four-party card payment systems, acquirers must comply with scheme rules as a condition of their participation in those systems and are responsible for ensuring that their merchants, and the payment facilitators they work with, comply with these rules. Scheme rules govern much of the activity of acquirers and payment facilitators.<sup>77</sup>

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71 The FCA took over responsibility for regulating consumer credit on 1 April 2014 from the Office of Fair Trading (OFT). As part of the transfer of regulation, Parliament repealed some CCA provisions, and some of these were replaced by FCA rules.

72 'Individual' does not include companies or limited liability companies.

73 Section 55 of the CCA.

74 Section 65 of the CCA.

75 Section 101 of the CCA.

76 Section 173(1) of the CCA.

77 For the avoidance of doubt, this section describes scheme rules in general terms for illustrative purposes only and is not a comprehensive description of scheme rules.

- 1.335** Before entering into a licence agreement with an acquirer, the operator of a card payment system will undertake screening and assessment of a prospective acquirer to ensure they satisfy the operator's requirements. The screening process is designed to ensure that a prospective acquirer does not represent an undue risk to the security, safety or integrity of the card payment system.
- 1.336** If the application is approved by the card scheme operator, it will then sign a contract with the acquirer. The acquirer will need to undergo a process of testing and certification to ensure technical implementation is achieved so that it may successfully process transactions using the card payment system.
- 1.337** An acquirer must comply with scheme rules. Scheme rules typically require an acquirer, amongst other things, to:
- ensure consistent expression of the relevant brand and avoid any action that may result in harm to the brand
  - conduct appropriate due diligence when onboarding new merchants and refrain from recruiting merchants who deal with certain prohibited goods or services
  - provide merchants with the necessary equipment and services to accept card payments
  - process card transactions from authorisation through to settlement of funds
  - ensure merchants comply with scheme rules including by providing training and information and monitoring merchants' compliance
  - provide information required under scheme rules to the operator of the card payment system including details of third parties engaged by the acquirer
  - make payments required under scheme rules, such as scheme fees
- 1.338** Scheme rules set out the process for investigating and addressing a breach of the scheme rules and the consequences that may follow a confirmed breach. An acquirer found to have breached scheme rules may face financial or non-financial consequences. Operators of card payment systems may levy non-compliance fees against an acquirer and require the acquirer to indemnify them against any damages resulting from the acquirer's breach of its obligations under the scheme rules. Where a breach is sufficiently serious, the operator may place restrictions on or suspend an acquirer's participation in the card payment system. In the most serious cases, the operator may terminate an acquirer's license agreement, removing its ability to participate in the card payment system.
- 1.339** Operators of card payment systems permit acquirers to contract with payment facilitators to provide card-acquiring services to merchants. This is subject to certain conditions, such as a requirement that an acquirer have in place a written agreement with any payment facilitators it works with. Where an acquirer contracts with a payment facilitator, scheme rules provide that the acquirer is responsible for ensuring the payment facilitator and its merchants comply with scheme rules. An acquirer is responsible for any breaches of scheme rules on the part of a payment facilitator it contracts with and the payment facilitators' merchants, and may face financial or non-financial consequences stemming from the actions of a payment facilitator. Depending on the operator of the card payment system, the acquirer may be required to register with them details of payment facilitators they contract with and, in some cases, prior written consent may be necessary before entering into such agreements.

**1.340** In Annex 5, we describe and assess whether certain scheme rules may be a barrier to entry and expansion. The specific rules are described in that annex.

## Voluntary industry standards

**1.341** Acquirers and payment facilitators may also choose to follow voluntary industry standards such as:

- Standard 70, which defines messaging protocols for card payments between a card acceptor and an acquirer; it includes guidance on how card transactions should be processed, how merchants should interact with cardholders and receipt requirements (among other things) to meet the needs of the varying card payment systems and present a uniform cardholder experience
- the UK terminal approval scheme, which includes Common.SECC Common Criteria requirements for certifying POS terminals and card readers for security; and also accessibility and usability requirements for terminals for use in the UK in cooperation with the RNIB

# Alternatives to Mastercard and Visa

- 1.342** We considered if there are any payment methods that are effective substitutes for card payments (focusing on Mastercard and Visa cards), such that use of these payment methods exerts competitive constraints on card-acquiring services sold to merchants.
- 1.343** We examined in our merchant survey, whether merchants that accept Mastercard and Visa cards could instead accept other payment methods – for example, other cards such as American Express, or bank transfers.
- 1.344** We found that many merchants accept cards other than Mastercard-branded and Visa-branded cards. However, cards issued under other card payment systems, such as American Express, are unlikely to represent an effective substitute for merchants that accept Mastercard-branded and Visa-branded cards because:
- our survey shows that, generally, nearly all merchants accept Mastercard and Visa but they don't always accept other card brands<sup>78</sup>
  - together, Mastercard-branded and Visa-branded cards accounted for around 98% of all card payments at UK outlets in 2018, both by volume and value<sup>79</sup>
- 1.345** This indicates that merchants accept other cards in addition to, rather than instead of, Mastercard-branded and Visa-branded cards.
- 1.346** In our merchant survey, 96% of small and medium sized merchants reported that they accept at least one other payment method in addition to cards.<sup>80</sup>
- 1.347** Our focus on card-acquiring services in this review means that our survey only sought views from businesses that already accept card payments. The preferences of businesses that do not currently accept card payments are likely to be quite different from those that do. This does mean that care is needed in the interpretation of the results in relation to other payment types.
- 1.348** For the merchants in our survey, card payments were merchants' preferred payment method more than any other and also the payment method that accounted for the highest number of sales: 43% of participants reported that cards were their preferred payment method and for 45% of participants, card payments also accounted for the highest volume of sales.<sup>81</sup> This is consistent with many merchants needing to accept card payments to run their business (although the degree of substitutability between payment methods may vary for different types of merchants).

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78 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 43.

79 PSR analysis of based on data submitted by operators of card payment systems.

80 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 42.

81 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 42.

- 1.349** Our survey findings also suggest that the vast majority of small and medium-sized merchants do not wish, or are unable, to influence their customers into paying with another payment method (other than a Mastercard or Visa card). Only 7% of participants had taken steps to influence their customers in this way in the last year.<sup>82</sup> 91% of merchants had not taken steps to influence their customers into paying with a payment method other than Mastercard or Visa cards in the last year.<sup>83</sup>
- 1.350** We also asked merchants how they would respond to a hypothetical universal 10% increase in the cost of accepting Mastercard and Visa cards. 41% merchants stated they would continue accepting the cards but take steps to influence customers' choice of payment method (away from Mastercard-branded and Visa-branded cards); 28% stated they would continue to accept the cards and take no action; 22% stated they would stop accepting Mastercard and Visa cards altogether.<sup>84</sup>
- 1.351** We interpret merchants' reported responses to a hypothetical 10% increase in the cost of accepting Mastercard-branded and Visa-branded cards with caution because:
- a. The responses are not consistent with actual current merchant behaviour set out above, which found that around 90% do not take steps to influence their customers' choice of payment method and many merchants said card payments were their preferred choice of payment method.
  - b. Merchants want to accept the payment methods their customers want to pay with – so they will have a strong incentive to continue accepting card payments, which are the most frequently used payment method in the UK.
  - c. It is well recognised that care is needed in interpreting hypothetical questions of this type and that they need to be considered in the round with other evidence.<sup>85</sup> In this case, as discussed above, this would include how merchants are actually behaving currently. Hypothetical questions can also be difficult for individual responders to interpret and, for example, some of the results in para 1.348 above may arise from some merchants considering a 10% increase in the MSC rather than focusing on a 10% increase in the per-transaction fee.
- 1.352** In summary, we have not seen evidence that currently there are effective substitutes to Mastercard and Visa cards for merchants, which would exert a competitive constraint on the supply of card-acquiring services for these cards. There are a range of ongoing developments (including regulatory and technological developments) that may change the payment methods available to merchants but they have not made any significant impact to date in retail payments.

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82 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 44

83 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 46

84 IFF Research, *PSR Card-Acquiring Market Review: Merchant survey results*, slide 47

85 Office of Fair Trading, *Market definition: Understanding competition law* (2004), paragraph 3.7.

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