

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

Stakeholder input to the
terms of reference

October 2022

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1 Introduction

1.1 We received 16 responses to the consultation on the draft terms of reference (ToR) for the market review of UK-EEA consumer cross-border interchange fees from a variety of stakeholders.¹ In this paper, we summarise and respond to the feedback that we have received from these stakeholders on our proposed scope and approach.

1.2 Alongside the final ToR, we are publishing the non-confidential versions of the responses.² The remainder of this document is structured as follows:

- In **Chapter 2** we summarise the comments we received on the proposed scope described in the draft ToR. We then respond to these comments and confirm and finalise the scope of the market review.
- In **Chapter 3** we summarise the comments received on the proposed approach described in the draft ToR. We then respond to these comments and confirm and finalise the approach to the market review.
- In **Chapter 4** we summarise the comments received on any additional concerns that stakeholders had that are relevant to the review. We then respond to these comments.
- **Annex 1** lists those who responded.

1 MR22/2.1, [Market review of UK-EEA consumer cross-border interchange fees: An update and draft terms of reference](#) (June 2022)

2 www.psr.org.uk/publications/market-reviews/mr22-2-1-cross-border-interchange-fees-draft-terms-of-reference-feedback/

2 The scope of the market review

- 2.1** In our draft ToR, we proposed to focus on interchange fees for UK-EEA consumer cross-border card-not-present (CNP) transactions and cover both credit and debit cards. We further specified that outbound IFs will be prioritised – those paid by acquirers when an EEA-issued card is used to make a payment to a merchant located in the UK.

Respondents' views

Clarification of proposed scope

- 2.2** The majority of respondents that commented on the scope of the market review did not have objections to our proposal to review UK-EEA cross-border CNP IFs. One respondent said that increased IFs on the relevant transactions were likely to affect only a small subset of UK merchants' cost of acceptance.
- 2.3** Two respondents highlighted how the proposed scope prioritised outbound fees and agreed with this additional qualification. One of these respondents said that potential action should only target outbound fees since action involving merchants in other countries would pose additional complexities. The other respondent said the focus should be on the IFs that affect UK merchants. The majority of respondents who addressed the specification of inbound and outbound transactions did not comment on the prioritisation and agreed that the review should cover both.

Extending the review to three-party models

- 2.4** One respondent agreed with limiting the review to four-party card payment systems (Mastercard and Visa), and the associated cross-border IFs. This respondent said that the concerns outlined in this market review are not relevant to the activities of three-party schemes.
- 2.5** Conversely, one respondent recommended extending the scope to three-party card schemes. It noted that fees charged by three-party schemes are among the highest in the market and their exclusion would prevent us being able to properly investigate the competitive functioning of the market as a whole.

Widening the scope to other interchange fees

- 2.6** Several respondents requested that the scope be extended to cover IFs on transactions involving commercial cards. These can be significantly higher than comparable fees on consumer transactions, partly because they have not been capped under EU IFR, UK IFR or commitments made by the schemes. One respondent suggested that commercial card IFs could form a separate review in our wider work on card fees.
- 2.7** Some respondents proposed that we also review cross-border IFs for transactions between the UK and rest of the world (RoW) countries. Of these, a few highlighted that some of these fees were effectively capped when the UK was in the EU, since EU-RoW IFs were capped in the commitments made by Mastercard and Visa in 2019. The UK's withdrawal from the EU has meant that these commitments no longer apply, allowing for increases in IFs. One respondent suggested that inter-regional IFs are likely to represent a very small subset of the total cost of acceptance at most UK merchants. It felt that any price interventions on these would have less impact than alternative initiatives to boost broader competition in the UK retail payments market.
- 2.8** Two respondents proposed that the review be widened to consider the level and appropriateness of domestic IFs. One respondent referenced the ruling by the UK Supreme Court in June 2020 stating that multilateral IFs were anti-competitive.³ It pointed out how other countries have abolished domestic IFs because card issuers generate sufficient income from other sources and suggested they are no longer necessary in the UK's mature card payments market. The other respondent said it would be a missed opportunity in this review if we did not provide legal certainty over the level of interchange, particularly domestic, to ensure card schemes remain commercially sustainable and also provide clarity to emerging payment alternatives.

Widening the scope to broader competition issues potentially affecting card schemes

- 2.9** One respondent suggested that we include within our market review other potentially anti-competitive behaviours of the four-party card schemes, including issues that negatively impact innovation and fintech firms in the market. The respondent said that these behaviours and the ability to increase prices are derived from the market power of the schemes, meaning increases in IFs may further entrench their dominant position.

3 See Sainsbury's [2020] UKSC 24: <https://www.supremecourt.uk/cases/docs/uksc-2018-0154-judgment.pdf>

Our response

- 2.10** We will keep inbound and outbound UK-EEA IFs in scope, while prioritising outbound IFs. Our primary focus on outbound fees reflects the fact that these fees are paid to EEA issuers by UK acquirers (who may pass some or all of these costs on to UK merchants).
- 2.11** We do not consider three-party schemes to be relevant to the concerns we want to assess (that is, increases in IFs that were once capped by the EU IFR and now no longer are, either by the UK IFR or the EU IFR).
- 2.12** Including other IFs in the review, such as those for commercial card transactions, cross-border transactions between the UK and RoW countries, and domestic transactions, would represent a significant increase in scope. Addressing why a particular fee increase happened is a more targeted review and will allow us to reach a conclusion far more quickly than a wide-ranging review of many interchange fee issues.
- 2.13** In assessing other potential anti-competitive issues that might relate to four-party card schemes, we would note that as part of our assessment of the potential justifications for and impacts of the increases in UK-EEA cross-border card not present IFs, we will consider aspects related to competition, innovation and the interest of service users. More generally, however, as part of our ongoing horizon scanning activities, we monitor the competitive dynamics in the payment space on a regular basis. Any broader competition concerns may be picked up and assessed as part of these activities if appropriate.

Our decision on the scope of the market review

- 2.14** We will not be making any substantive changes to the ToR regarding its scope. We consider that the scope we consulted on is the right one and will allow us to move at pace. Other concerns can be assessed outside the market review as part of the other work we carry out within our organisation.

3 Our approach to the market review

- 3.1** In our draft ToR, we proposed to review the drivers and justifications for the increases in IFs following the UK's withdrawal from the EU. We will examine the reasons provided by Mastercard and Visa, including the considerations the schemes took into account when assessing the opportunity to increase IFs, as well as strategic, competition and regulatory aspects. We will evaluate the impact of increased IFs in the context of the advancement of our statutory duties in relation to competition, innovation and service users.

Respondents' views

The public consultation process

- 3.2** One respondent questioned whether a full public consultation on cross-border interchange was necessary. It cited legal evidence, including the UK Supreme Court's ruling in June 2020, that aspects of IFs have already been ruled as anti-competitive, and suggested that a full consultation was increasing costs for us and merchants. It further said that it was not clear if the removal of certain protections on IFs after the UK's withdrawal from the EU was deliberate, and therefore if a review process was required.

Timelines of review and interventions

- 3.3** One respondent asked for an indication of proposed timings for the market review, noting the fivefold increase in the IFs in a short period of time. It said that if timeframes are too lengthy, we should consider interim temporary interventions while the review is ongoing, to avoid harmful impacts on the retail industry.

Defining a relevant market

- 3.4** Three respondents noted that either the draft ToR does not specify a relevant market, or it does not indicate whether a relevant market will be defined as part of the market review.

Assessing the impact on the payments market

- 3.5** One respondent disputed whether the review should be based, in part, on the potential harm increased IFs could cause for consumers. The respondent mentioned that in the only interchange case to proceed to trial in the UK, pass-through from merchants to consumers was considered but not established. It felt the investigation of this review should not be founded on the impact on prices paid by consumers as there was not enough evidence on this topic.
- 3.6** One respondent said we should assess the impact of increased cross-border IFs on different merchant categories and sizes, arguing that larger merchants can decide which card and non-card payments to accept. The respondent recommended the review include an assessment of merchant service charges for online payments, particularly the pricing offered to small businesses.
- 3.7** Two respondents highlighted that IFs are an important source of revenue and cost recovery for issuers, even if they are a cost to acquirers. One respondent noted that issuing banks may face higher costs as a result of Brexit, which emphasises the need for cost recovery. The other stated that since IFs are paid to issuers and not to the scheme, the scheme would be objective when setting IF levels.

Consideration of our objectives

- 3.8** Two respondents said the review should be in accordance with our statutory objectives on competition, innovation and service users, and therefore it should look at the market from a broader perspective. One proposed the review should focus on end-user outcomes of payment systems, including safety, security and reliability, and the value derived from cross-border payments. It also said that the review should account for competitive constraints posed by different end-to-end payment solutions and the fast-moving nature of cross-border payments innovation.
- 3.9** One respondent said the increased IFs were contrary to UK competition law, as indicated by litigation within the UK. As a result, it argued that we must intervene in the payments market due to our statutory competition objective.
- 3.10** One respondent noted that even a small increase in IFs by Mastercard and Visa has a huge impact on smaller card schemes who do not have the same resources available for investments in innovation to ensure they can remain competitive. It argued that it is critical for us to clarify how the income from such fees is used, to ensure this is not simply further entrenching the dominant position of these schemes.

Use of merchant surveys

- 3.11** One respondent suggested that we undertake merchant surveys and market testing to build a sufficient evidence base for the market review.

Alternative payment methods

- 3.12** One respondent proposed that we conduct an assessment on the technical and commercial feasibility of alternative non-interchange-based payment methods for cross-border transactions. One example would be account-to-account payments.

Our response

- 3.13** We consider a market review the most appropriate mechanism to understand better the justifications provided by Mastercard and Visa for increasing UK-EEA cross-border CNP IFs. This includes establishing whether those justifications identify increases in relevant costs associated with these transactions since EU withdrawal. We will also assess the impact of these increases on competition, innovation and/or service users. This market review will complement the information we have gathered so far and will allow us to engage industry and wider stakeholders more effectively.
- 3.14** Regarding indicative timelines, these are listed in Annex 2 of the final ToR publication.⁴ On the points around interventions (including temporary interim measures), we will consider what actions, if any, to take if we identify a need to intervene.
- 3.15** In defining the relevant market, at this stage we propose to pursue our investigation under FSBRA and will assess the competitive constraints on UK-EEA IFs to help us understand the context for the fee increases.
- 3.16** We are engaging and will continue to engage with all relevant stakeholders, including merchants. We will consider potential impacts of the fees increases, if any, on service users, including merchants and consumers, along with the impacts they have on competition and innovation. We will consider different ways of doing this, including bilateral meetings, surveys and information requests.
- 3.17** We are seeking to understand Mastercard and Visa's potential justifications for increasing these IFs. This means that we may consider alternative payment methods as part of this review.

Our decision on our approach to the market review

- 3.18** We will not be making any substantive changes to the ToR regarding the approach of the review. We consider that the approach we consulted on is the right one and will allow us to understand the impact and rationale for the increased levels in IFs.

⁴ MR22/2.2, [Market review of UK-EEA consumer cross-border interchange fees: Final terms of reference](#) (October 2022)

4 Concerns to investigate

- 4.1** In our draft ToR, we set out our concerns regarding potential harm to competition, innovation and/or service users. We invited stakeholders' views on these concerns and asked whether there are other concerns we should be considering.

Respondents' views

Effect of subsidies and rebates

- 4.2** One respondent asked us to review the impact of market promotions and subsidies offered by Mastercard and Visa to certain merchants as a way of offsetting the impact of higher cross-border IFs.

Mitigation within cross-border acquiring rules

- 4.3** Two respondents highlighted how strategies to mitigate increased cross-border IFs are restricted by current scheme rules. These dictate that CP and CNP transactions depend on the location of merchants' physical stores and established entities respectively. One respondent stated that these scheme rules restrict their ability to convert cross-border transactions to domestic – for example, if a merchant's head office and the transaction point of sale are in the same location, but the card used is issued elsewhere. The other respondent noted how some merchants have raised concerns that these rules limit competition in the market for cross-border acquiring.

Assignment of CNP to in store transactions

- 4.4** One respondent drew attention to instances where transactions have been charged as CNP despite the customer being present in the store. It said this is increasingly occurring with the growth of mobile and digital transactions being used in store.

Loss of interchange fee refunds

- 4.5** One respondent pointed out that since October 2021 UK merchants no longer receive interchange fee refunds on refunded consumer transactions made between the UK and EEA with Visa consumer cards. It suggested that we include this issue in the scope and review whether UK-EEA transactions should be brought into line with pre-Brexit requirements.

Alleged prejudgement of harm

- 4.6** One respondent suggested that we appear to be pre-judging our analysis by referring to 'potential harm to competition, innovation or service users'. It said that we should identify what harm we have in mind and what evidence there is to already suggest that such harm is occurring – given the respondent is not aware of evidence of any such harm.

Implications of price intervention

- 4.7** One respondent expressed concerns around a potential price intervention, as this would create significant risks of unintended outcomes for consumers. It said that previous interventions to reduce IFs have primarily reduced acceptance costs for larger merchants, notably those on interchange plus pricing. However, the respondent said they have had much less impact on cost of acceptance for smaller merchants, and have been a contributing factor to the trend of reduced benefits or increased costs for consumers.
- 4.8** One respondent said that the review would need to include a detailed cost benefit analysis to understand the impact on consumers of any reduction to current IF levels. It also stated that reduced revenue from IFs will limit their ability to fund transitions to alternative non-interchange payment solutions.
- 4.9** One respondent proposed that instead of reducing IFs on a subset of cross-border transactions, we should focus on broader change in the market. Suggestions for other remedies included increasing transparency on fees, enabling switching for smaller merchants and supporting the development of non-card payment solutions.

Our response

- 4.10** Stakeholders have mentioned a number of ways in which the final impact of the IF increases could change, including subsidies, rebates and the relocation of transactions. As part of this review, we will consider whether and to what extent the impact of the IF increases can be mitigated. In particular, we will assess whether scheme rules around location of transactions could help mitigate the impact of the increases.
- 4.11** In relation to the potentially incorrect application of CNP status to transactions occurring in store, we consider this is something that could be reviewed outside the scope of this market review. This will allow us to prioritise this review, while being targeted and proportionate in our approach. For matters outside this market review, you can get in contact with us at contactus@psr.org.uk or write to us at:

Payment Systems Regulator
12 Endeavor Square
London E20 1JN

- 4.12** Regarding the discontinuation of IF refunds on Visa consumer cards for UK-EEA cross-border transactions, we will consider whether and to what extent changes in scheme rules since the UK's withdrawal from the EU raise additional concerns related to UK-EEA IFs.
- 4.13** There is no pre-judgement in describing concerns regarding potential harm to competition, innovation or service users. We consider it premature to discuss the potential implications of any regulatory interventions at this stage in the market review. We will look to understand the various impacts of changes to IFs on different service users at the appropriate stage in the process. This also applies to alternative remedies such as those relating to transparency or non-card payment solutions.

Annex 1

Respondents to the consultation

American Express

British Retail Consortium

British Airways

CMSPI

Coadec

Global Payments

Harcus Parker

HSBC

Innovate Finance

Lloyds Banking Group

Mastercard

Payments Association

Revolut

Tesco

UK Finance

Visa Europe

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