PSR Payment Systems Regulator

# Stakeholder roundtables on scheme and processing fees: Summary

*The following is a summary of points raised at a series of roundtables held by the PSR with issuers, acquirers, and merchants to discuss the draft Terms of Reference we published in June 2022, which sets out the scope and approach of our market review on scheme and processing fees. This paper summarises the views offered by participants in our roundtables. We do not consider the views given in these discussions and captured in this note as representative of all issuers, acquirers and merchants, but we do consider that they provide useful illustration and explanation of issues we are considering in our market review.*

*Representatives from the following organisations attended:*

| | | |
|---|---|---|
| **ABTA** | **Elavon** | **Monzo** |
| **Barclaycard** | **EVO Payments** | **Nationwide Building Society** |
| **Barclays** | **Fiserv** | **NatWest** |
| **Block Inc.** | **FIS** | **PayPal** |
| **British Independent Retail Association (BIRA)** | **Global Payments** | **SaltPay** |
| **British Retail Consortium (BRC)** | **HSBC UK** | **SumUp** |
| **Capital One** | **Lloyds Bank Cardnet** | **UK Finance** |
| **Confederation of British Industry (CBI)** | **Metro Bank** | |

# Background and definitions

**Question 1**

- Do you agree with our description of scheme and processing fees? If not, please explain:
  - how our description should be altered and whether there are alternative approaches to categorising Mastercard and Visa scheme and processing fees
  - why you think the description should be altered in this way.

## Trends since 2018

1. Our card acquiring market review found that scheme and processing fees paid by acquirers increased significantly between 2014 and 2018. As this analysis did not extend beyond 2018, we were interested to hear evidence about changes in scheme and processing fees since then and any potential drivers of such changes.

2. There was general agreement among acquirers and merchants that the trend of scheme fees increasing has continued since 2018. Issuers cautiously agreed with this, but said that they would confirm their position through written feedback.

3. Merchants and acquirers highlighted the shift to online transactions in recent years, in particular due to the Covid pandemic. However, the view of merchants and acquirers was that this did not help to explain the fee increases they had seen. One merchant suggested that a greater volume of transactions being made through card schemes should mean that fees would decrease, rather than increase. Another merchant acknowledged that there were valid reasons for some changes to card fees in response to changing transaction patterns in the UK, but that any fees associated with these changes had to be proportionate.

## Importance of innovation

4. One reason put forward for the recent increase in scheme fees is that it has led to increased innovation and quality of service.

5. Issuers agreed with this reasoning and thought that fees had brought with them an improvement in service, including Strong Customer Authentication (SCA).

6. However, merchants and acquirers disagreed with this analysis:

   - One acquirer felt that they were paying more to card schemes each year for the same service. They did not think that the innovations for which they are paying enhanced their service offering to customers.

   - The effectiveness of some innovations was also questioned by some merchants, including one merchant who stated that they hadn't seen a reduction in fraud since SCA was introduced.

- There was also a view from merchants that some merchants may confuse useful innovations developed by acquirers (e.g. with regards to POS terminals) with innovation from schemes.

**7.** Finally, there was a view from a merchant that there was scope for further innovation, such as removing card fees for card-based cashback transactions, in order to expand access to cash.

## Separation of scheme and processing fees

**8.** The general view of acquirers was that the separation of scheme and processing fees may be necessary for schemes, but that it was unnecessary from an acquirer perspective. Their reasoning was that both types of fees add to their cost base and must be recovered from customers (i.e. merchants).

**9.** One acquirer thought that all fees (other than interchange) should be combined into one category to avoid schemes finding a 'grey zone' for any new fees. There was a suggestion from an acquirer that the PSR should start with the broadest definition of fees as possible (this view was also expressed for looking at the payments made by card schemes to service users).

## Size of merchants

**10.** Both acquirers and merchants agreed that merchants of different sizes had been affected asymmetrically by the increases to scheme fees:

- Merchants noted that larger merchants would have greater capacity to analyse the card fee data that they receive from schemes. It was suggested that only large merchants that employ payment systems experts would have the capacity to engage in ongoing conversations with schemes and the technical expertise to analyse increases in fees and the reasons for that, such as repricing, new fees or changes in the volume of transactions. Smaller merchants, even if they also receive the same data, would not have the specialist capabilities required to analyse it.

- Merchants and acquirers both thought that larger merchants were in a better position to negotiate directly with schemes. However, it was suggested that only the very largest of merchants may be at a scale where there is a realistic threat to not accept fee increases by card schemes.

- Merchants said that it would be unusual for acquirers to go into great detail with smaller merchants about fee changes, due to issues with scalability. They said that acquirers would normally only maintain close relationships with larger merchants.

**11.** Both merchants and acquirers therefore expressed a view that our market review should take account of differences in negotiating position of small and large merchants.

## Communication with schemes

**12.** Merchants said that schemes were open to invitations to discuss fee increases, but that answers were often legalistic.

# Proposed scope

**Question 2**

- Do you agree with the proposed scope of the market review? If not, please explain:
    - how the proposed scope should be altered
    - why you think the proposed scope should be altered in this way.

## General

**13.** We propose that the scope of our market review cover all scheme and processing fees levied by Mastercard and Visa. We wanted to know if there were any fees on which we should focus our analysis.

**14.** Some of the fees identified by merchants as being of particular significance were early acquirer authorisation fees, SCA fees, refund fees, and Card Not Present (CNP) fees.

## Compliance fees

**15.** Compliance fees received significant interest at the merchant and acquirer roundtables:

- Many acquirers thought that some compliance fees were impossible to avoid in practice. They therefore felt that such fees should be considered a ‘grey area’ that formed part of the cost base to be recovered from merchants, who ultimately paid for it. One example that was cited by acquirers and merchants was 3D Secure (3DS), where acquirers were either billed for using a service (if they took up the service) or they would pay a penalty fee for not using it (if they did not take up the service).
- Several acquirers suggested that compliance fees were being used as part of a wider approach by schemes to increase their profitability.

**16.** The proportionality and process by which compliance fees were issued was also questioned by acquirers. One acquirer said that, until recently, non-compliance fees were only issued after acquirers had gone through a process with schemes to try and redress the situation. Under this process, acquirers would receive a letter notifying them of non-compliance and they would be given the opportunity to develop a resolution plan. If they failed to comply with this resolution plan, they would receive a fine. They suggested that this process had recently changed, with card schemes moving straight to issuing compliance fees as soon as non-compliance had been identified.

## Optional fees

**17.** There was some disagreement about the optionality of services from card schemes (and associated fees):

- One acquirer said that they did not take many additional services and that optional services were not a prerequisite for successful operation. However, another acquirer said that for some optional fees there was not a realistic alternative and that some of the fees for optional services were very high.

- A merchant said that fees were optional, but many were advantageous because of commissions (rebates and bundles) based on accepting as a new service.

### Difference between schemes

**18.** A merchant perceived that Visa was introducing a lot more new scheme and/or processing fees than Mastercard.

### Account-to-account as a potential constraint

**19.** One acquirer thought that the PSR should look at the potential for account-to-account payments through Open Banking becoming an alternative payment method, forming an additional competitive constraint on the card schemes and reducing barriers to entry. If card schemes were not the only option for merchants, then this may affect incentives on the acquiring side.

**20.** Issuers also thought that the PSR should consider whether to include new and innovative payment types as one of the constraints we are considering.

## Proposed approach

**Question 3**

- Do you agree with our proposed approach to the market review? If not, please explain:
  - how the proposed approach should be altered
  - why you think the proposed approach should be altered in this way.

**Question 4**

- Are there specific types of scheme and processing fees we should focus our work on? Perhaps because the scheme and processing fees represent a large percentage of total network fee revenues or because they have changed substantially?
- Are there specific types of scheme and processing fees we should not focus our work on? Perhaps because the fees represent a small percentage of total network fee revenues or because they have not changed substantially?
- In your response, please explain:
  - which scheme and processing fees we should or should not focus on
  - why you think we should focus on these scheme and processing fees

**Question 5**

- Do you have views on the potential factors that we propose to investigate?
- Are there other factors in relation to scheme and processing fees that we should be considering?

## Profitability

**21.** There was a general view from acquirers that our market review should look at profitability of the card schemes. One acquirer noted that, in their view, card schemes were by far the most profitable part of the card payment value chain.

**22.** However, a merchant thought that the review should also look at acquirer margin changes and how acquirer bundles and packages have changed since 2018. The merchant said that, since 2018, a series of changes had occurred in how acquirers bundle packages of services.

## Payments made to issuers by card schemes

**23.** An acquirer and merchant thought that increases to scheme fees had to be considered in the context of the Interchange Fee Regulation (IFR). In their view, the aim of the IFR was to solve inefficient cross-subsidisation as schemes would otherwise increase fees on acquirers to compete for issuers and it was important to understand if the increase in scheme fees and payments by card schemes to issuers could be circumventing Article 5 of the IFR.

**24.** Another acquirer thought that it would be important to analyse the potential consequences and impacts on how a scheme interacts with their customers if they have a strong relationship with an organisation on both the acquiring and issuing side.

## Complexity as a hidden cost

**25.** There was broad agreement amongst acquirers that a proliferation of new fees, repricing of existing fees and other technical adjustments had added significant complexity and reduced transparency of scheme fees. They described this complexity as a "hidden" additional cost.

- One acquirer stated that in a competitive environment they thought that the quantity and complexity of fees ought to decrease. In their view, the increased complexity observed with regards to Visa and Mastercard's scheme fees was therefore not a sign of a competitive market.
- The acquirer said that the level of transparency in the changes to scheme and processing fees was therefore adequate for acquirers, but not for merchants. However, there was a general view amongst acquirers that an additional non-financial cost of this complexity was the cost of communicating these changes to merchants. An acquirer noted that the schemes prohibit them from sharing the bulletins they receive from schemes with merchants. Finally, as part of the cost of communicating with merchants, acquirers may have to either renegotiate contracts or face attrition from customers. The perception amongst merchants wasn't that acquirers were indifferent to these increases, but that they were unable to push back against schemes.

- One acquirer noted that this complexity was exacerbated by the volatility of changes to the pricing, number and structure of fees, which created a lack of certainty over time. They said that in the past, scheme fees only changed once every 6 months, whereas now a variety of changes may happen without a regular schedule. Their view was that all changes to processing fees should be implemented once every 6 months and that scheme fees should change annually.