Payment
Systems
Regulator

Consultation paper

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

## Interim report

December 2023

MR22/2.6

We welcome your views on this consultation. If you would like to provide comments, please send these to us by **5 pm on 31 January 2024**.

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

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

We will consider your comments when preparing our response to this consultation.

We will make all non-confidential responses to this consultation available for public inspection.

We will not regard a standard confidentiality statement in an email message as a request for non-disclosure. If you want to claim commercial confidentiality over specific items in your response, you must identify those specific items which you claim to be commercially confidential. We may nonetheless be required to disclose all responses which include information marked as confidential in order to meet legal obligations, in particular if we are asked to disclose a confidential response under the Freedom of Information Act 2000. We will endeavour to consult you if we receive such a request. Any decision we make not to disclose a response can be reviewed by the Information Commissioner and the Information Rights Tribunal.

You can download this consultation paper from our website:
**www.psr.org.uk/mr22-2-6-cross-border-interchange-fees-interim-report/**

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# 1 Executive summary

## Introduction

**1.1** This report sets out our provisional findings on the cross-border interchange fees (IFs) market review. This review particularly focuses on Mastercard and Visa's recent increases in consumer cross-border IFs for card-not-present (CNP) transactions between the United Kingdom and the European Economic Area (UK-EEA).

**1.2** Effective competition supports good outcomes in payments markets, such as low prices, high service quality and continued innovation. However, for fees paid by UK acquirers to EEA issuers, we have provisionally found that we cannot rely on competition to be an effective constraint on Mastercard and Visa card schemes (card schemes) when they are setting UK-EEA consumer CNP outbound IFs (**outbound** IFs).[1]

**1.3** Taking the currently available evidence in the round, including that obtained from the comprehensive stakeholder engagement we have undertaken, we currently consider that Mastercard and Visa have raised UK-EEA consumer CNP outbound IFs higher than levels that would have been calculated if the most commonly established methodology to calculate the fee levels based on an appropriate comparator had been used. For the reasons set out in paragraph 1.14, including a provisional finding of ineffective competitive constraints on the acquiring side and an upward pricing pressure on the issuer side, we currently consider that markets are neither working well nor in the interests of all service users.

**1.4** Our current view is that intervention may be appropriate. To address the concerns we have identified, our current view is that an appropriate intervention may be to cap UK-EEA consumer CNP outbound IFs. Development and implementation of a lasting cap will likely take an extended period of time, and in the meantime the issues we have provisionally identified will likely continue. Therefore, our provisional thinking is that intervention would be appropriate in two stages:

- An initial time-limited cap. Our current view is that 0.2% for CNP consumer debit transactions and 0.3% for CNP consumer credit transactions – returning the fees to the levels that applied immediately prior to the increases – would be an acceptable interim cap. Other alternatives exist, both below the present IFs or at a lower level than 0.2/0.3%.
- Our current view is that a lasting cap could be set using either an updated merchant indifference test (MIT) or an alternative methodology.

**1.5** We are also proposing to close our review of fees paid by EEA acquirers to UK issuers (**inbound** IFs).[2] We are seeking feedback on these provisional conclusions and proposals.

1 The UK and EU Interchange Fee Regulation (UK IFR and EU IFR) defines two broad types of scheme: four-party card schemes and three-party card schemes. The PSR's IFR Guidance (September 2021) and Chapter 3 of this interim report provide further information on card schemes. In this interim report we use 'CNP outbound IFs' and 'outbound IFs' interchangeably to refer to UK-EEA consumer CNP outbound IFs.

2 In this interim report we use 'CNP inbound IFs' and 'inbound IFs' interchangeably to refer to UK-EEA consumer CNP inbound IFs.

# Context

**1.6** Cards are the most popular way for consumers to pay for goods and services in the UK and the EEA.[3] Nine in ten CNP payments at UK merchants where the card is issued in the EEA are based on Mastercard and Visa cards.[4]

**1.7** CNP transactions are completed online, by phone or by mail, so a card (be it physical or tokenised) is not present when the merchant is taking payment.[5]

**1.8** Every time a consumer initiates a card transaction, including a CNP transaction, with a Mastercard or Visa-branded card, the merchant acquirer pays an IF to a card issuer, typically a bank.[6]

**1.9** Until December 2020, the European Commission capped UK domestic IFs and cross-border IFs within the EEA (including between the UK and the EEA) at 0.2%/0.3% for debit and credit card transactions respectively, under the European Union's Interchange Fee Regulation 2015 (EU IFR).[7]

**1.10** Following the UK's withdrawal from the EU, the EU IFR caps on UK-EEA transactions no longer applied. Mastercard and Visa decided to reconsider their fees. This reconsideration resulted in the IFs for UK-EEA CNP transactions using consumer debit and credit cards increasing fivefold – from 0.2% and 0.3% to 1.15% and 1.5% respectively.

**1.11** In October 2022, we issued our final terms of reference for a market review on UK-EEA consumer cross-border IFs to understand:[8]

- the rationale for and impact of increases in cross-border IFs
- whether the increase in cross-border IFs is an indication that the markets are not working well for all service users
- what, if any, regulatory intervention is appropriate

# Key provisional findings

**1.12** Set out below are our key provisional findings and provisional view on the case for intervention for UK-EEA consumer CNP **outbound** IFs.[9]

- Evidence shows that Mastercard and Visa are likely to be subject to **ineffective competitive constraints on the acquiring side** and that there is a lack of effective competition in relation to the setting of outbound IFs which distorts the market

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3 Worldpay from FIS, Global Payments Report 2023, page 75.

4 PSR analysis based on 2022 data submitted by Mastercard, Visa, American Express and acquirers.

5 Tokenisation is the process of replacing a card's primary account number (PAN) – the 16-digit number on the plastic card – with a unique alternate card number, or 'token'. Tokens can be used for mobile point-of-sale transactions, in-app purchases or online purchases.

6 In this interim report, we typically use the term 'issuer', recognising that not all issuers are banks.

7 Regulation (EU) 2015 / 751 of the European Parliament and Counsel.

8 MR22/2.2, *Market review of UK-EEA consumer cross-border interchange fees - Final terms of reference* (October 2022).

9 In this interim report we use 'CNP outbound IFs' and 'outbound IFs' interchangeably to refer to UK-EEA consumer CNP outbound IFs.

against UK merchants and their customers. Both card schemes have a commercial incentive on the issuing side to increase IFs. Limited alternatives mean that UK merchants who engage in international trade with the EEA must take both Mastercard and Visa. It is either commercially or practically hard for UK merchants, who want to do business remotely, to decline or materially attempt to reduce volumes of payments over either Mastercard and Visa cards in response to the outbound IF increases. Mastercard and Visa-branded cards therefore appear to be must-take for merchants engaging in UK-EEA cross-border CNP transactions.

- IFs are paid in the first instance by acquirers and indirectly by the merchants they serve. **Acquirers pass on the outbound IF increases almost in their entirety to UK merchants.** We have provisionally found that only a few very large UK merchants were able to avoid some increases by relocating some or all of their transactions to the EEA. Relocating seems to be possible only for a limited number of very large merchants and merchants with significant cross-border operations. Evidence shows that relocation is not commercially viable for most UK merchants, especially for small and medium enterprises (SMEs). Even when a merchant relocates, this does not reduce the number of card transactions processed using Mastercard and Visa, so the card schemes suffer little or no detriment.
- Merchants unable to relocate in response to the IF increases must either absorb those additional costs or pass them on to consumers via higher prices. UK merchants have limited ability to steer cross-border consumers to payment methods that allow them to reduce Mastercard and Visa payment volumes. Alternative digital payment methods for CNP transactions are few and represent a weak alternative to Mastercard and Visa because they are less popular among consumers.
- We currently consider that this **lack of effective competitive constraints on the acquiring side combined with the commercial incentives on the issuing side to increase IFs for UK-EEA CNP transactions indicates** that, when it comes to outbound IFs, **prices are distorted across each side of the payment platforms to the detriment of UK acquirers and merchants. As far as we can currently see, having regard to our competition, service user and innovation objectives, the detriment that might flow from this distortion is not balanced by countervailing benefits elsewhere in the system.** We currently consider this combination of features is likely to put upward pressure on UK-EEA CNP IFs, and ultimately on retail prices, without adequate justification.
- We have considered several potential benefits *of* and reasons *for* increasing outbound IFs, but we have not seen any persuasive evidence to indicate that the increases were necessary or appropriate. Card schemes have said that the risk of fraud in CNP cross-border transactions is higher than in domestic and card-present (CP) transactions. We also understand from various public statements that IFs can be used towards the costs and risk associated with card issuing, including, but not limited to, the administrative costs of maintaining a card-issuing business, and fraud and bad debt costs**. However, we have identified no evidence to suggest the structure or level of IFs is linked to fraud risk and costs, or that it provides incentives for issuers to invest in fraud prevention. In addition, we have identified no evidence that IFs are actually used by issuers for this purpose. Instead, our current view is that the main reasons why the two schemes increased their fees are the issuer-side incentives they face and to ensure they remained on a level playing field with each other**. The evidence indicates that IFs represent income for issuers, and Mastercard and Visa compete for

the same issuers who then stimulate card use and generate income for the card schemes. Our current view is that fraud differentials for UK-EEA CNP transactions do not explain the change in IF levels for these transactions; there is no direct link between UK-EEA CNP transaction fraud levels and the new IF levels.

- Our current view is that the card schemes do not balance the costs and the interests of all service users when setting IF levels. There is no obvious constraint on how these prices are set which would lead them to consider the interest of users on the acquiring side. While issuers and card schemes may benefit from this revenue generation, we have identified **no clear corresponding benefit to merchants from the increases**.
- **We currently consider that, when they decided to increase** UK-EEA consumer CNP **outbound IFs, Mastercard and Visa did not ensure that the interests of all users were taken into account.** In particular, Mastercard and Visa adopted levels that had been set in another context and for different circumstances – that is, for cards issued in non-EEA countries and used at EEA (including the UK at the time) merchants. In doing so, we currently consider that Mastercard and Visa have adopted benchmarks that are not relevant to the UK-EEA context, and have, therefore, likely pushed UK-EEA CNP IFs to an unduly high level. The current levels also do not reflect the fact that the UK remains part of the Single Euro Payments Area (SEPA). SEPA is a European cross-border payment method that means that the transaction costs for credit and debit transfers between the UK and the EEA are lower than between non-SEPA countries and the EEA.
- Rather, it is unclear what other factor, or change in circumstances, apart from the political shift and deregulation of outbound IFs created by the UK's withdrawal from the EU, prompted the change in IF levels.
- Finally, we do not consider (and have not seen evidence) that the IF levels applicable before the increases carried any obvious risks, undermined or otherwise adversely affected the operations of either of the two payment systems in ways that caused detriment to service users, distorted competition or presented an impediment to innovation, relative to the increased IF levels. Specifically, to date, we have not seen any evidence to suggest that they presented an impediment to innovation, including in fraud prevention, where fraud levels on these transactions have been decreasing over time – for example, by constraining the amount of resources that EEA issuers could invest.
- **Our current view is that Mastercard and Visa have raised UK-EEA consumer CNP outbound IFs higher than levels that would have been calculated if the most commonly established methodology to calculate the fee levels based on an appropriate comparator had been used**. In addition, we are concerned that, if left unregulated, Mastercard and Visa may have an incentive to continue to raise outbound IFs while UK merchants cannot avoid or benefit from them.

**1.13** We are **concerned that the upward pricing pressure is evidence of a lack of effective competition, is not incentivising any additional innovation and is resulting in higher costs and prices for UK merchants, especially SMEs and their customers, to their detriment.** The evidence shows that the 2022 increase in outbound IFs amounted to approximately £150 million to £200 million extra paid that year by UK merchants and (to the extent this is passed on) to consumers. We have taken in the round the available evidence summarised above and described in this report. Our provisional view is that we cannot rely on competition to be an effective constraint on Mastercard and Visa setting outbound IFs. We provisionally conclude that at least part of the cost and price effects on UK merchants and their customers described in Chapter 6 are the result of the issues described in Chapters 4 and 5 where markets are not working well, nor are they in the interests of these service users, and that intervention may be appropriate.

**1.14** In addition, we are proposing to close our review of UK-EEA consumer CNP **inbound** IFs (see Chapter 8).

## Action we are considering

**1.15** We are considering potential remedies that could address or mitigate the issues we see in relation to UK-EEA consumer CNP outbound IFs. Any remedies are contingent on our final conclusions, and (following this consultation) our preferred remedies will be subject to further consultation.

**1.16** Our current thinking is that a price cap for UK-EEA consumer CNP outbound IFs may be appropriate. The MIT is an accepted methodology to calculate a figure that can be used as a proxy for a competitive IF. It involves assessing the costs to merchants of accepting one or more suitable alternative payment method(s) and using that data to calculate the price that would result from competition from an alternative payment method on a supplier with significant market power. While the MIT is not the only way to calculate IFs, it may be the most appropriate methodology in this context to apply to calculate a regulated maximum IF and deliver an appropriate outcome, that is, in line with our statutory objectives.

**1.17** Developing an appropriate and proportionate methodology that measures the costs for merchants when accepting cards in comparison to their costs when accepting alternative payment methods may take some time. In addition, with a few exceptions, information on merchant costs for accepting different payment methods is not generally available from public sources. Thus, to quantify the costs of payments for merchants, data needs to be collected which is also likely to take time. Establishing the appropriate approach to a MIT in this context, or considering and developing an alternative proportionate and appropriate methodology to conduct the MIT, will likely take considerable time. Therefore, we are provisionally considering a staged approach. That means, until we have developed the final methodology – and an appropriate new lasting cap based on it – we need to decide:

- whether interim caps are appropriate
- if so, what level those caps should be set at

**1.18** Given our provisional conclusion regarding the lack of effective competitive constraints on how UK-EEA consumer CNP outbound IF levels are set, the size of the increases (fivefold) and the magnitude of the fees being paid by UK acquirers and merchants, our current view is that it may be appropriate to apply an interim cap. We are mindful that any cap level set in the interim needs, on balance, to improve outcomes against our objectives, and apply for a time limited period, in the context that we are committed to a longer-term solution. Having considered the range of options available to us and the size of the potential detriment to service users, our current view is that it may be appropriate to apply, in the interim, a 0.2% cap for CNP consumer debit transactions and 0.3% for CNP consumer credit transactions.

## Next steps

**1.19** We are inviting comments on this interim report by **5 pm on 31 January 2024**. You can email your comments to **cardfees@psr.org.uk**.

**1.20** We plan to publish our final report and consult on any draft remedies in the first half of 2024.

# 2 Introduction

We are consulting on the provisional findings of our cross-border interchange fees (IF) market review. Our review considers Mastercard and Visa's increases to UK-EEA consumer cross-border interchange fees for credit and debit CNP transactions.

In this report, we present our provisional findings on why the outbound IF increases are unlikely to reflect the interest of all users of the Mastercard and Visa payment systems and why this may warrant regulatory intervention. We also outline potential measures to mitigate the service user detriment we are seeing.

**2.1** This is the interim report of our market review into cross-border IFs. Our payment systems objectives and regulatory principles have shaped our consideration of the issues explored in this review.

## The scope of our work

**2.2** Our aim is to:

- assess whether there are markets which are not working well for UK merchants and their consumers that could explain why Mastercard and Visa increased cross-border IFs for UK-EEA CNP transactions
- identify, if any, possible actions to remedy or mitigate any problems we may find

### Card payments

**2.3** Cards are the most popular non-cash method for people to make retail payments in Europe. They are also an increasingly popular way for domestic consumers to buy products and services. This increasing popularity is due to a combination of increasing digitisation, the growing use of contactless payments, mobile and online banking, and the lockdown restrictions imposed during the COVID-19 pandemic. Here are some relevant figures:

- Data from UK Finance shows that, in 2021, debit and credit cards accounted for 57% of total payment volumes in the UK. UK Finance predicts that cards will account for 61% of all payments in the UK by 2031.[10]
- Data from the British Retail Consortium (BRC) shows that in 2021, consumer credit and debit cards accounted for 90% of the total value of retail transactions in the UK, and 82% of the total number (volume) of retail transaction.[11]
- In 2022, Mastercard and Visa together accounted for around 99% of all UK debit and credit card payments, both by volume and value.[12]

10 UK Finance, *UK Payment Markets Summary 2022* (August 2022), pages 2 and 10.

11 British Retail Consortium (BRC)*, Media payment survey 2022*, pages 14 and 15.

12 UK Finance, *UK Payment Statistics 2022*, tab 8.1.

- Data from the European Central Bank (ECB) show that, in 2021, card payments accounted for 49% of the total number of non-cash transactions.[13]
- In 2022, in the Eurozone, card payments represented 51% of all online payments in terms of volumes and 47% in terms of values.[14]
- Many merchants, large and small, operate cross-border in the UK and EEA, and consumers demand cross-border payment solutions. Cards represent the most commonly used payment instrument for making UK-EEA online purchases. Mastercard and Visa are the cards most often used.

**2.4** In 2022, 3.6% of all card transactions at UK merchants were UK-EEA cross-border card transactions.[15] Of all UK-EEA cross-border card transactions in 2022, 70% were CNP.[16] Mastercard and Visa accounted for 90% of total volume and 79% of total value of all CNP transactions acquired by UK merchants where the card is issued in the EEA.[17]

**2.5** The role played by Mastercard and Visa in this space is important – given the vast majority of EEA-issued cards, including co-badged ones, are either from Mastercard or from Visa and cross-border acceptance of EEA co-badged cards relies entirely on these international card schemes.[18] In addition, EEA issuers, in particular banks, are increasingly issuing cards that only come from these two international card schemes.[19]

**2.6** The decline in the number of national card schemes in EEA countries (from 22 in 2013 to 17 in 2018) means that international card schemes are taking over the national markets as well as the European cross-border card market.[20]

## Issues this market review addresses

**2.7** In 2021 and 2022, since the removal of previously applicable caps, Mastercard and Visa have increased their IF levels for UK-EEA CNP transactions fivefold – from 0.2% to 1.15% for consumer debit and 0.3% to 1.5% for consumer credit cards.

**2.8** Several UK businesses have raised concerns with us about how the increases to outbound IFs have affected them. Every time a consumer uses an EEA-issued Mastercard or Visa debit or credit card for online transactions within the UK, an outbound IF is paid to the EEA issuer by the UK acquirer (the bank or other licenced payment service provider (PSP) that a merchant is contracted with to provide card-acquiring services). The acquirer may recover that cost as part of the merchant service charges (MSC) that it levies, so that IFs represent a cost to the merchant who accepted the card payment. In turn, a merchant may then pass part of this cost on to consumers.

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13 European Central Bank (ECB), *Payments statistics: 2021*.

14 ECB, *Study on the payment attitudes of consumers in the euro area* (2022) – Chart 9.

15 PSR analysis of data on transaction values submitted by acquirers through the s81 notice, and by Mastercard, Visa and American Express.

16 PSR analysis of data on transaction values submitted by acquirers through the s81 notice, and by Mastercard, Visa and American Express.

17 PSR analysis of data on transaction values submitted by acquirers through the s81 notice, and by Mastercard, Visa and American Express.

18 European Commission, *Study on the application of Interchange Fee Regulation* (2022), page 64.

19 ECB, *Card payments in Europe – current landscape and future prospects* (2019).

20 ECB, *Card payments in Europe – current landscape and future prospects* (2019).

**2.9** To inform our understanding of whether card payments are working well for UK merchants and, ultimately, for consumers, as part of our review we examined these specific issues:

- Key features relevant to understanding how the markets function. We have, for example, assessed the factors that may influence and constrain how Mastercard and Visa set cross-border IFs, including:
  - possible acquirers' and merchants' responses to an increase in outbound IFs
  - alternatives available to UK acquirers and merchants and whether Mastercard and Visa-branded cards have a must-take status for merchants.[21]
- The potential drivers of decisions by Mastercard and Visa to increase their fees. This includes competition, strategic and regulatory aspects.
- Information provided by Mastercard and Visa on the IF increases, including information provided to the Treasury Select Committee (TSC).[22]
- The potential effect of the increases in IFs for UK-EEA consumer debit and credit CNP transactions on competition, UK merchants and ultimately UK consumers.

**2.10** In line with our terms of reference, this review focuses on UK-EEA cross-border CNP IFs in the Mastercard and Visa card payment systems, as these are the IFs that increased materially recently. We are covering both debit and credit consumer cards.

**2.11** We have also focused our review on outbound IFs, which are fees paid by UK acquirers to EEA issuers.[23] Inbound IFs, which are paid by EEA acquirers to UK issuers, are currently subject to caps agreed between Mastercard and Visa and the European Commission.

## What we have done to date

**2.12** In November 2021, we announced our market review of card fees.

**2.13** In January 2022, we sent Mastercard and Visa initial information requests. These requests informed the draft terms of reference for our market review into UK-EEA cross-border IFs.

**2.14** In June 2022, we published our draft terms of reference.

**2.15** In July 2022, we held roundtables and consulted on our draft terms of reference with stakeholders, including:

- two large merchants
- five merchant representative bodies
- seven issuers

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21 A must-take card refers to a situation where merchants feel compelled to accept a given card even if it means incurring in higher acceptance costs, because they are concerned that turning down such a card would impair their ability to attract customers. See: Journal of the European Economic Association, *Must-take cards: merchant discounts and avoided costs*, Rochet, Jean-Charles and Jean Tirole (2011), Volume 9, Issue 3, pages 462-495.

22 Mastercard, *Letter to the Treasury Select Committee* (2 August 2022).
Visa, *Visa Response to Treasury Select Committee on Cross-border Interchange*.

23 MR22/2.2, *Market review of UK-EEA consumer cross-border interchange fees Final Terms of Reference* (October 2022), page 7, paragraph 2.3. In this interim report we use 'CNP outbound IFs' and 'outbound IFs' interchangeably to refer to UK-EEA consumer CNP outbound IFs; we use 'CNP inbound IFs' and 'inbound IFs' interchangeably to refer to UK-EEA consumer CNP inbound IFs.

- ten acquirers
- three card scheme operators

**2.16** In October 2022, following feedback on our draft terms of reference, we published our final terms of reference.

**2.17** In preparing this interim report, we have also engaged with stakeholders. This engagement took various forms, including information and document requests, voluntary questionnaires, roundtable discussions and bilateral meetings. Specifically, we engaged with:

- the card scheme operators, Mastercard and Visa
- American Express
- digital wallet providers
- a fintech company
- 13 issuers, who collectively account for over 90% of UK card transactions by value[24]
- three merchant representative bodies, who together cover thousands of independent and major UK retailers from a broad range of sectors, and eight large merchants
- 18 card acquirers, who collectively account for over 90% of UK card transactions by value[25]

**2.18** We have also considered responses to our December 2022 working paper on our initial thinking about how the UK-EEA cross-border IF increases affect UK service users, including SMEs. We published a summary of those stakeholder responses on 21 July 2023, alongside the non-confidential version of these responses.[26]

## Our powers

**2.19** We are conducting our market review using our powers under Part 5 of the Financial Services (Banking Reform) Act 2013 (FSBRA). We use market reviews to consider how well markets for payment systems, or services provided by payment systems, are working in line with our payment systems objectives.[27] These are to:

- promote effective competition in the market for payment systems, and markets for services provided by payment systems in the interests of those who use, or are likely to use, payments systems (the 'competition objective').
- promote the development of, and innovation in, payment systems in the interests of those who use, or are likely to use, services provided by payment systems, with a view to improving the quality, efficiency and economy of payment systems (the 'innovation objective').

24 PSR analysis. [✁]

25 PSR analysis. [✁]

26 MR22/2.5, *Cross-border interchange fees: stakeholder feedback to discussion of impacts working paper* (July 2023).

27 Financial Services (Banking Reform) Act 2013 (FSBRA), section 50 to 52.

- ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of those who use, or are likely to use, services provided by payment systems (the 'service user objective').

**2.20** We have considered whether the increases in cross-border IFs indicate that aspects of the markets are not working well by reference to our payment systems objectives.

**2.21** FSBRA gives us wide-ranging powers to take action, including the power to impose general and specific directions[28] and requirements[29], if we consider it appropriate following our review.

**2.22** Any decision to exercise these powers is informed by our regulatory principles and payment system objectives. FSBRA requires us to have regard to certain factors, including our regulatory principles[30], and in so far as is reasonably possible, to act in a way which advances one or more of our payment systems objectives[31] when deciding whether to impose a general direction. We will also have regard to our payment systems objectives and regulatory principles when deciding whether to impose specific directions or requirements in the context of a market review.

## Links to our strategy

**2.23** Our PSR Strategy states that, as a general principle, we will focus on whether our work is likely to deliver improved outcomes for end users, in the short or longer term. This is consistent with the approach other economic regulators use. It means we consider what effect our proposals may have on 'people and (non-payment) businesses' that need to make or receive payments.[32]

**2.24** In deciding whether to act, we will have regard to (among other things), maintaining the stability of, and confidence in, the UK financial system.[33] In addition, we consider our payment systems objectives and the regulatory principles in FSBRA.[34] We expect payment systems to be 'high quality, good value, efficient and cost-effective, while offering a reliable, secure and stable service'.[35]

### Strategic outcomes we are seeking

**2.25** Effective competition supports good outcomes in payments markets, such as low prices, high service quality and continued innovation. Our review and its proposals aim to reduce or prevent detriment to UK merchants (and to the extent of pass through, to consumers) who may face higher prices due to ineffective competition.

28 FSBRA section 54.
29 FSBRA section 55.
30 Namely, the importance of maintaining the stability of, and confidence in, the UK financial system, the importance of payment systems in relation to the performance of functions by the Bank of England in its capacity as monetary authority, and our regulatory principles in s. 53 FSBRA (s. 49 (3) FSBRA).
31 Our statutory payment system objectives are set out in sections. 50, 51 and 52 FSBRA.
32 *The PSR Strategy* (January 2022).
33 FSBRA section 49(3).
34 FSBRA section 53.
35 Objectives Guidance (March 2015), page 7, paragraph 6.2.

**2.26** We are mindful of the government's broader ambition for the UK to retain its international competitiveness. So, we want to see that UK merchants (particularly SMEs) have confidence in the payment systems they use and that those systems are efficient and commercially sustainable in the UK-EEA space and beyond.

**2.27** The PSR Strategy identifies the strategic outcomes we would like to see over the next four years and how our priorities help to meet them:[36]

**Outcomes**

| | | | |
|---|---|---|---|
| All users have access to payment services that meet their needs in terms of functions, quality, cost and other relevant factors | Users' interests are adequately protected when using payment systems so that they can use systems and services with confidence | Payment systems are designed and operated to enable effective competition in the provision of payment services | Payment systems are efficient and commercially sustainable |

**Priorities**

| | | | |
|---|---|---|---|
| Ensure users have continued access to the payment services they rely upon and support effective choice of alternative payment options | Ensure users are sufficiently protected when using the UK's payment systems, now and in the future | Promote competition in markets and protect users where that competition is not sufficient, including between payment systems within the UK and in the markets supported by them | Ensure the renewal and future governance of the UK's interbank payment systems supports innovation and competition in payments |

**2.28** This market review mainly concerns our priority of protecting users where competition between and within payment systems does not do so sufficiently (as outlined in the figure above).

## What we are seeking views on

**2.29** We are seeking feedback on our:

- analysis of, and provisional findings on, the factors that may influence and constrain how Mastercard and Visa set UK-EEA consumer outbound IFs
- analysis of, and provisional findings on, the reasons for the increases to debit and credit UK-EEA consumer outbound IFs

36 *The PSR Strategy* (January 2022), page 10.

- analysis of, and provisional findings on, what UK acquirers and merchants can do in response to these increases
- analysis of the effect of the increases and our articulation of why we provisionally consider we should intervene
- current view on potential remedies for outbound IFs
- provisional view that we should close the review on inbound IFs on the grounds of administrative priority

## Who this applies to

**2.30** The analysis and recommendations outlined in this interim report will be of particular relevance to:

- four-party card scheme operators
- card issuers
- card acquirers
- merchants

**2.31** Other stakeholders that may be interested in this report include:

- industry groups and trade bodies
- EEA-based card issuers
- firms based in Gibraltar, Jersey, Guernsey and the Isle of Man

## Equality and diversity considerations

**2.32** We have considered the equality and diversity issues that may arise from our current analysis, including the detriment we see and the remedies we are contemplating.

**2.33** We do not consider that our proposed remedies would negatively affect any of the groups with protected characteristics under the Equality Act 2010.

**2.34** We will continue to consider equality and diversity implications during the consultation period and as our thinking evolves. We will also revisit these considerations after we receive any relevant feedback.

## How to respond

**2.35** We invite comments on this interim report. Email your comments to **cardfees@psr.org.uk** by **5 pm on 31 January 2024**.

# 3 Background

This chapter provides an overview of:

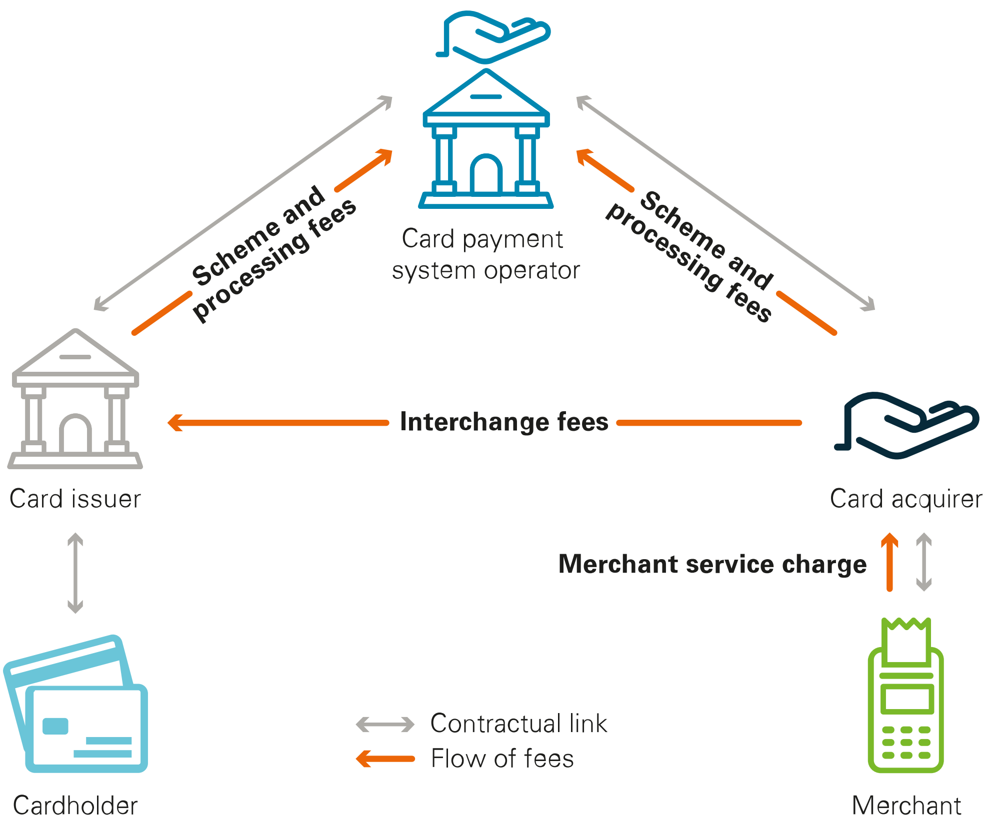
- the purpose of interchange fees, how four-party card schemes work and the distribution of revenues
- the regulation of interchange fees and changes to interchange fees that led to this review
- the wider context relevant to this review, including competition law enforcement and litigation in relation to Mastercard and Visa's historic interchange fees

## Four-party card schemes

### Simplified overview

3.1 Mastercard and Visa operate what are known as four-party card payment systems or four-party card schemes.

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



**3.2** Figure 1 sets out the main parties that make up the four-party model. These include the following groups:

- **Merchants**: organisations that accept card payments.
- **Acquirers**: banks or other organisations licensed by card payment system operators to process debit and credit card payments on behalf of merchants.
- **Card payment system operators (such as Mastercard and Visa)**: organisations that manage the 'scheme rules' on card payments and set the terms on which issuers, acquirers, merchants, cardholders and other parties participate in the card payment system.
- **Issuers**: banks or other organisations licensed by card payment system operators to provide cards to cardholders. The issuer pays an acquirer the money a merchant is owed for a transaction (retaining IFs) and debits a cardholder's account.

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

- **IFs**, which acquirers pay to issuers each time a card is used to buy goods or services;[37] these per-transaction fees are usually a percentage of the transaction value but can vary depending on transaction and IF type
- **scheme and processing fees (S&P fees)**, which are set by Mastercard and Visa
- **merchant service charge (MSC)**, which is the total amount merchants pay to acquirers for card-acquiring services; this comprises interchange fees, scheme and processing fees and acquirer net revenue
- **cardholder fees**, which cardholders may pay to the issuers

## Interchange fees

**3.4** IFs are transaction fees paid by acquirers, on behalf of their merchants, to issuing banks and other issuers. Interchange fees vary by:

- the card product (debit or credit) used for the transaction
- the transaction environment – CP or CNP
- category of card (consumer or commercial)
- the region the card is issued in
- the region where the transaction takes place

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

**3.5** Issuers can, should they choose to, use the derived income towards operation and maintenance costs for their internal payment processor, to increase security of transactions and towards any future development to make transactions faster, more convenient and secure.[38] We have also been told (by Visa, quoted below) that IFs are important to support innovation, including the development of new products and services.

**3.6** Mastercard and Visa set the default IF level (the multilateral IF) that merchant acquirers pay to issuers and, in turn, merchants pay through the MSC to their acquirers.[39] While issuers and acquirers can bilaterally negotiate lower IFs, this happens rarely.

**3.7** In their responses to the TSC, Mastercard and Visa said that IFs represent a mechanism to distribute cost of the payment services across the two sides of the card scheme.

**3.8** Mastercard said: 'Interchange is a small fee typically paid by card acquirers (the merchant/retailer's bank) to card issuers (cardholder's bank), to recognise the value delivered to merchants/retailers, governments and consumers by accepting electronic payments, the infrastructure required to make this possible and do so securely and the costs incurred in these respects'.[40]

**3.9** Visa said: 'Interchange supports [issuer's] ability to issue and manage cards and digital credentials. It enables those players to fortify security against bad actors trying to steal information or commit fraud; and it supports innovation, including the development of new products and services, making it easier for consumers to manage their financial lives safely and securely'.[41]

## Transaction and IF types

**3.10** Card transactions where an issuer, an acquirer and the merchant point of sale location (the merchant location) are in the same country are typically defined as domestic transactions.[42] The IFs for these transactions are called domestic IFs.

**3.11** Transactions where the card was issued in a different country to a merchant's location are typically referred to as cross-border transactions. These IFs are called cross-border IFs.

**3.12** For the purposes of this market review, we distinguish between two types of UK-EEA cross-border transactions and related IFs.

- **Outbound IFs:** IFs for transactions using non-UK-issued cards to make payments to merchants located in the UK. For UK-EEA transactions, these IFs relate to payments made with EEA-issued cards at UK merchants. These fees are paid to EEA issuers and represent a cost to UK merchants.

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38 *Market review of cross-border interchange fees: A discussion of the impact of the UK-EEA cross-border interchange fee increases* (December 2022), pages 7 and 16, paragraphs 2.7 and 3.27.

39 Mastercard sets its default IF according to its rules (see rule 8.3) and webpage. Visa sets its IFs according to information contained on its website (see: Frequently asked questions, What does it cost and how is this decided).

40 Mastercard, *Letter to the Treasury Select Committee* (2 August 2022), page 4.

41 Visa, *Visa Response to Treasury Select Committee on Cross-border Interchange*, page 1.

42 This is the UK Interchange Fee Regulation definition.

- **Inbound IFs:** IFs for transactions using UK-issued cards to make payments to merchants located outside the UK. For UK-EEA transactions, these IFs relate to payments made with UK-issued cards at EEA merchants. These fees are paid to UK issuers and represent a cost to EEA merchants.

## Pricing of card-acquiring services

**3.13** Card acquirers charge merchants for accepting credit and debit payment cards.

**3.14** As set out in our *CAMR Final Report*, acquirers tend to price card-acquiring services separately from card acceptance products and value-added services.[43] Merchants, depending on their size, have one or more of the following pricing options for card-acquiring services:[44]

- interchange fee plus (IC+) pricing, whereby for any given transaction an acquirer automatically passes through at cost the IF applicable to that transaction
- interchange fee plus plus (IC++) pricing, whereby for any given transaction an acquirer automatically passes through at the time of the transaction (at cost) the IF and other scheme fees applicable to that transaction[45]
- standard pricing, whereby for any given transaction an acquirer does not automatically pass through at cost the IF applicable to the transaction and the pricing option does not satisfy the criteria for IC+, IC++ or fixed pricing
- fixed pricing, whereby a 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

**3.15** By definition, in IC++ and IC+ pricing, acquirers automatically pass any IF charge on to merchants, so these are defined as 'pass-through' options. IC++ pricing is typically only for the largest merchants, with annual card turnover above £50 million.[46] More than 85% of merchants are on the standard pricing option.[47]

**3.16** Under the standard and fixed pricing options, acquirers do not automatically pass IFs on to merchants, but may choose to include the cost of IFs within the pricing arrangements. These pricing options are also known as 'blended' options because the individual cost components of the MSC (IFs, other scheme fees and acquirer margin) are often aggregated. However, periodic renegotiation of contracts may result in the acquirer passing on increasing fees.

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43 MR18/1.8, *Market review into the supply of card-acquiring services: final report*, page 31, paragraph 3.63.

44 MR18/1.8, *Market review into the supply of card-acquiring services: final report*, pages 31 -33, paragraphs 3.63 to 3.71, and Annex 1.

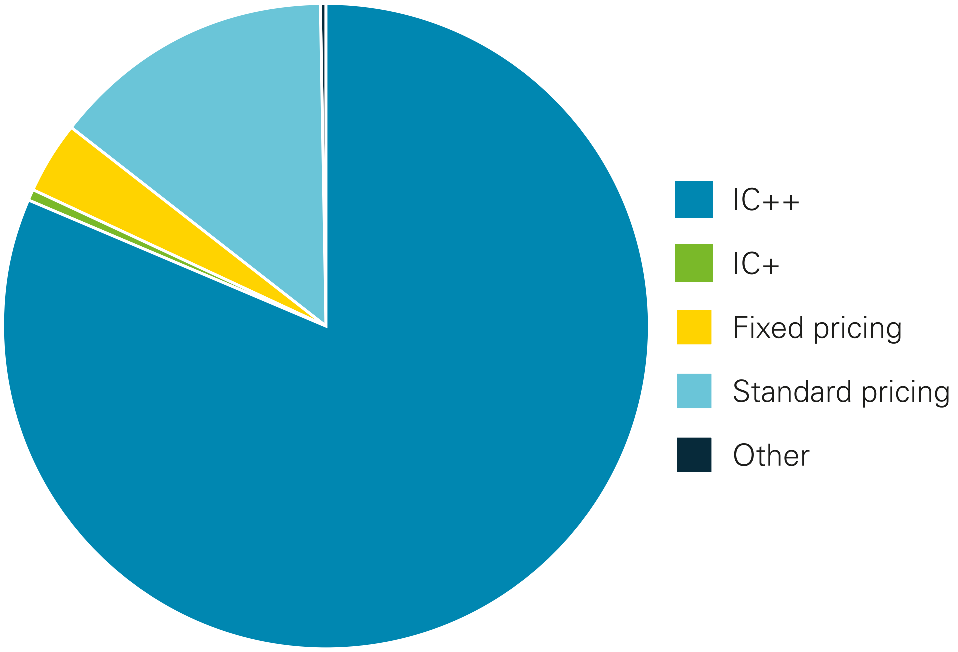
45 At the time of the transaction, the acquirer may also pass-through other card scheme and processing fees that are not directly attributable to transactions.

46 MR18/1.8, *Market review into the supply of card-acquiring services: final report*, page 10, paragraph 1.15.

47 MR18/1.8, *Market review into the supply of card-acquiring services: final report*, page 32, paragraph 3.64.

**3.17** Figure 2 breaks down UK-EEA CNP cross-border transactions at UK merchants in 2022 by pricing option. It shows that the majority (around 80%) of transactions, by value, were on pass-through pricing options (that is, IC++ and IC+). Standard and fixed pricing added up to about 20% of UK-EEA CNP cross-border transactions at UK merchants in 2022 by value.[48]

**Figure 2: Breakdown of UK-EEA CNP cross-border transactions by value at UK merchants in 2022 by pricing options**




Source: PSR analysis of data from acquirers

**3.18** We found in our *CAMR Final Report* that although IC++ pricing accounts for the largest proportion of transactions by value, the vast majority of merchants are not on IC++ contracts, with over 95% having standard pricing.[49] Merchants on IC++ pricing are typically the largest merchants, generally with an annual turnover above £50 million.[50]

## Issuers

**3.19** Issuers receive Mastercard and Visa's UK-EEA CNP IFs. We asked UK issuers how they have used the additional income derived from the UK-EEA cross-border IF increases. All UK issuers asked said that they do not consider individual sources of card revenue, such as UK-EEA IF revenue, in making their decisions on rewards for card holders or on investments (including in fraud prevention). They make decisions more holistically, at card portfolio level.

48 PSR analysis based on 2022 data [✂]

49 MR18/1.8, *Market review into the supply of card-acquiring services: final report*, page 32, paragraph 3.64.

50 MR18/1.8, *Market review into the supply of card-acquiring services: final report*, page 7, paragraph 1.15 and *CICC (1441-1444) – Judgment (CPO Applications) from 8 June 2023,* paragraph 86.

# Regulation of interchange fees

## UK Interchange Fee Regulation

**3.20** UK domestic IFs, for payments made at UK merchants using UK-issued cards, are regulated by the EU IFR as retained EU law.[51] The UK IF regulation (UK IFR) came into force on 31 December 2020.

**3.21** The UK IFR caps the level of IFs on domestic consumer debit and credit card transactions, at 0.2% and 0.3% of the value of the transaction respectively. The caps make no distinction between CP and CNP transactions.

**3.22** The PSR is the lead authority for monitoring and enforcing compliance with the UK IFR. The UK IFR does not regulate cross-border IFs for payments made at UK merchants using cards issued outside the UK.

## EU Interchange Fee Regulation

**3.23** Previously, the EU IF regulation (EU IFR) applied to the UK. The EU IFR came into force in 2015.[52] It set business rules for card payments and introduced price caps on the IF levels for domestic transactions and for transactions across the different countries in the EEA (intra-regional IFs). These caps fixed the maximum level of IF payable by merchants when accepting certain card payments.

**3.24** In putting the EU IFR in place, the European Commission aimed to address the problem of 'high and divergent' IFs in the EEA, while facilitating cross-border card payment services.[53] One concern was that high IFs were leading to higher final prices for goods and services at the expense of consumers. The price caps came into effect on 9 December 2015, and the majority of provisions relating to business rules were effective from 9 June 2016.

**3.25** While the UK was part of the EU, the EU IFR provisions applied caps for IFs on UK domestic and UK-EEA card transactions at the same levels as within the EEA: 0.2% of the value of consumer debit card transactions and 0.3% of the value of consumer credit card transactions. Since 31 December 2020, the UK IFR caps the level of domestic IFs within the UK.

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51 The EU IFR was retained and incorporated into UK Law by the European Union (Withdrawal) Act 2018 and 'onshored' by the Interchange Fee (amendment) (EU Exit) regulations 2019 (SI 2019/284), which amended provisions so that they operated effectively following the UK's withdrawal from the EU.

52 Official Journal of the European Union, Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions (Text with EEA relevance).

53 Official Journal of the European Union, Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions (Text with EEA relevance), paragraph 13.

## The 2019 European Commission Commitments

**3.26** In 2019, in response to the European Commission's competition law investigation into inter-regional IFs, Mastercard and Visa offered commitments to the European Commission to cap IFs on transactions involving non-EEA-issued cards and EEA merchants (the 2019 Commitments) which were accepted by the Commission.[54] Now the UK has withdrawn from the EU, the 2019 Commitments have been applied to UK-issued cards used at EEA merchants. We note that the European Commission subsequently took an alternative approach in *Mastercard/Nets*, defining 'EEA' to include the UK following its withdrawal from the EU.[55]

**3.27** As a result of the 2019 Commitments, UK-EEA inbound CP IFs are subject to caps of 0.2% and 0.3% for debit and credit cards respectively. UK-EEA inbound CNP IFs are subject to higher caps of 1.15% and 1.5% for debit and credit cards respectively. These commitments are due to expire in 2024.

**3.28** A key input to the setting of the levels in the 2019 Commitments was a merchant indifference test (MIT) on inter-regional transactions, both debit and credit and CP and CNP. The MIT used different payment alternatives as comparators for CP and CNP transactions:[56]

- For inter-regional CP transactions, the comparator was cash.
- For inter-regional CNP transactions, the comparator was bank transfers. These were non-SEPA bank transfers, since the relevant inter-regional transactions involved the EEA Contracting Parties (including the UK at the time) and other third parties that were outside the EEA and SEPA domestic payment systems.

**3.29** At the time, the UK was part of the EEA and SEPA. When the UK withdrew from the EU and the EEA, it stayed in SEPA. The SEPA region includes both EEA and non-EEA countries.[57] Non-EEA SEPA countries currently include Andorra, Monaco, San Marino, Switzerland and Vatican City State, alongside the UK. The European Payment Council (EPC) sets the participation criteria that countries need to meet to be deemed eligible for SEPA participation.[58]

**3.30** Currently there are no caps on IFs for UK-EEA CNP cross-border transactions using EEA-issued cards at UK merchants. The applicable caps for UK-EEA consumer CNP transactions are illustrated in Figure 3 and Table 1.

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54 European Commission, CASE AT.39398 – Visa MIF, VISA 2019 Commitments decision and 2019 Commitments; CASE AT.40049 – Mastercard II, Mastercard 2019 Commitments decision and 2019 Commitments.

55 European Commission, CASE M.9744 Mastercard / Nets, see definition used in the 2019 Commitments accepted by the European Commission, at page 40: 'EEA: the United Kingdom and those other countries participating in the European Economic Area as of the Effective Date'.

56 See, for example, European Commission, CASE AT.39398 – Visa MIF, VISA 2019 Commitments decision, recitals 79 to 84.

57 European Payments Council, EPC list of Countries in the SEPA Schemes' Geographical Scope (2 January 2023).

58 These criteria include relationship with the EU, criteria to ensure a level playing field with other SEPA Scheme participants, legal and regulatory criteria, Market and Operational criteria and additional criteria to preserve the integrity of the SEPA Schemes.

**Figure 3: Caps for UK and EEA consumer CNP transactions**

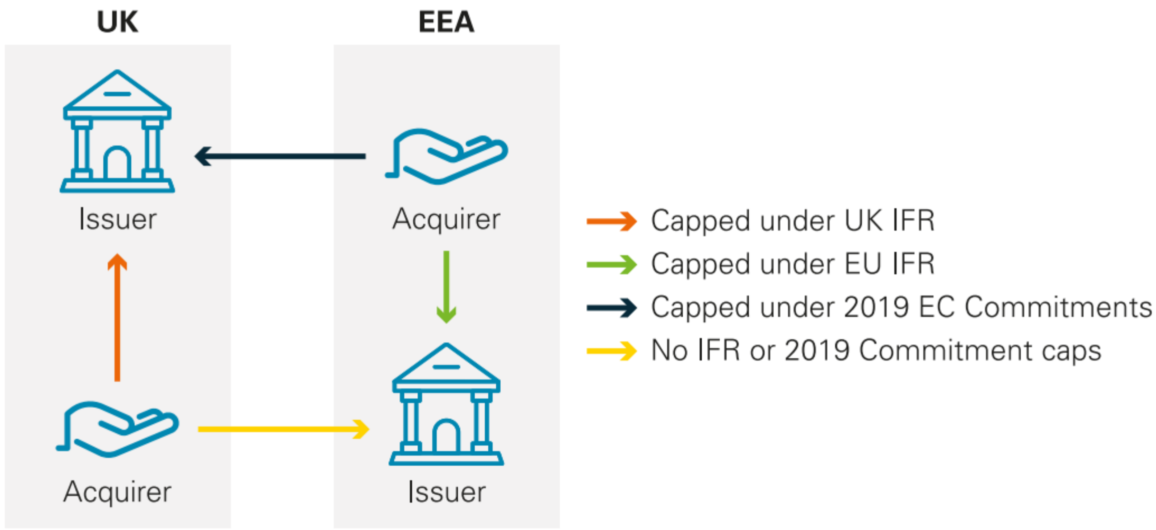


**Table 1: Caps for UK and EEA consumer CNP transactions**

| Regions | Location of issuer | Location of merchant | IF levels pre-the UK's withdrawal from the EU | IF levels now | Are they capped? |
|---|---|---|---|---|---|
| **UK domestic** | UK | UK | 0.2%/0.3% | 0.2%/0.3% | Yes (UK IFR) |
| **UK->EEA Inbound IF** | UK | EEA | 0.2%/0.3% | 1.15%/1.5% | Yes (2019 Commitments) |
| **EEA->UK Outbound IF** | EEA | UK | 0.2%/0.3% | 1.15%/1.5% | No |
| **EEA domestic** | EEA | EEA | 0.2%/0.3% | 0.2%/0.3% | Yes (EU IFR) |

## Merchant indifference test

**3.31** The MIT is an accepted methodology originally developed in economic literature and then further developed by the European Commission to set IF caps for cards.[59] It involves identifying a merchant's costs of accepting one or more suitable alternative payment method(s), for example, by surveying merchants to find out their costs of accepting one or more suitable alternative payment method(s) and using that data to calculate a figure that can be used as a proxy for a competitive IF level.

59 Rochet, Jean-Charles and Jean Tirole (2011) *Must-take cards: merchant discounts and avoided costs*, Journal of the European Economic Association , Volume 9, issue 3, pages 462-495.

**3.32** The EU IFR caps are based on this methodology as illustrated by the extract below: [60]

*"The caps in this Regulation are based on the so-called 'Merchant Indifference Test' developed in economic literature, which identifies the fee level a merchant would be willing to pay if the merchant were to compare the cost of the customer's use of a payment card with those of non-card (cash) payments (taking into account the fee for service paid to acquiring banks, i.e. the merchant service charge and the interchange fee). It thereby stimulates the use of efficient payment instruments through the promotion of those cards that provide higher transactional benefits, while at the same time preventing disproportionate merchant fees, which would impose hidden costs on other consumers…."*

**3.33** The 2019 European Commission Commitments are also based on an MIT calculation:[61]

*",,,taking into account the specificities of inter-regional transactions, the Commission conducted a market investigation requesting data from Visa, Mastercard, certain competitors and merchants. The MIT-compliant MIF caps were calculated by comparing the merchants' costs of accepting payments made by debit and credit cards to those of accepting payments made with alternative means of payment. The relevant alternative means of payment are composed of payment instruments which must not, and do not, include a MIF component."*

**3.34** For inter-regional CNP transactions, payment methods that were identified as plausible payment alternatives for the purposes of the MIT were: 'means of payments funded via bank transfers (which are outside the domestic payment systems of the EEA Contracting Parties and the Single European Payment Area, SEPA; "non SEPA bank transfers")'.

## Regulatory and legal scrutiny of interchange fees

**3.35** Payment cards in general, and IFs in particular, have received a considerable amount of regulatory attention. This interim report does not consider these prior regulatory findings in detail. However, we will refer to them as appropriate, particularly the 2019 Commitments which both Mastercard and Visa use to justify the increases in their UK-EEA CNP IFs. This past enforcement action, and related litigation, has taken place against a changing landscape, heralded most significantly by the 2015 introduction of the EU IFR, the adoption of the 2019 Commitments and the UK's subsequent withdrawal from the EU.

**3.36** We are acting in accordance with our regulatory framework, in particular our statutory objectives to promote competition, foster innovation and protect service users as outlined in Chapter 2. Although stemming from a different legal framework, certain antitrust cases provide relevant context for our review, principally the 2019 European Commission Commitment Decisions, the Supreme Court judgment in Mastercard v Sainsbury's (Sainsbury's SC) and the more recent Court of Appeal judgment in Dune v Visa (Dune CA).

**3.37** In considering these cases, we observe that it is established in EU and UK law that Mastercard's historic intra-EEA and domestic interchange fees infringed EU competition law. In 2007, the European Commission found that Mastercard IFs applicable within the European Economic Area (EEA MIFs) had been in breach of article 101(1) TFEU since 22 May 1992 and Mastercard had not provided sufficient proof that any of the first three

60 Official Journal of the European Union, Regulation (EU) 2015/751 of the European Parliament and of the council of 29 April 2015 on interchange fees for card-based payment transactions (Text with EEA relevance), at recital 20.

61 European Commission, CASE AT.39398 – Visa MIF, VISA 2019 Commitments decision (section 7.2.1, page 15); CASE AT.40049 – Mastercard II, Mastercard 2019 Commitments decision (section 7.2.1, page 14).

article 101(3) exemption criteria were met (Mastercard EC).[62] This decision was upheld by the General Court (Mastercard GC)[63] and by the Court of Justice of the European Union (Mastercard CJEU)[64] and has become final within the meaning of section 58A of the Competition Act 1998. Mastercard EC marked a shift from the previous exemption decision given to Visa in 2002. It establishes that Mastercard's historic intra-EEA IFs restricted competition, and that the card scheme had failed to demonstrate these IFs were justified, taking into account any efficiencies created.

**3.38** In Sainsbury's SC, the Supreme Court held that the 'essential factual basis' of Mastercard CJEU was mirrored in a series of actions relating to Mastercard and Visa's intra-EEA and domestic UK IFs until 2014, thus extending Mastercard EC to encompass these IFs.[65] The Supreme Court explained that:

*"93. In our judgment, the essential factual basis upon which the Court of Justice held that there was a restriction on competition is mirrored in these appeals. Those facts include that: (i) the MIF is determined by a collective agreement between undertakings; (ii) it has the effect of setting a minimum price floor for the MSC; (iii) the non-negotiable MIF element of the MSC is set by collective agreement rather than by competition; (iv) the counterfactual is no default MIF with settlement at par (that is, a prohibition on ex post pricing); (v) in the counterfactual there would ultimately be no bilaterally agreed interchange fees; and (vi) in the counterfactual the whole of the MSC would be determined by competition and the MSC would be lower."*

*"94. For all these reasons we conclude that Mastercard CJ is binding and that the Court of Appeal was correct so to hold."*

**3.39** The Supreme Court also explained that even if it were not bound by Mastercard CJ, it would have followed it and concluded that there was a restriction on competition in the consolidated appeals, because:

*"99. On the facts as found, the effect of the collective agreement to set the MIF is to fix a minimum price floor for the MSC. In the words of Mr Dryden, AAM's expert economist, it sets a "reservation price.*

*100. That minimum price is non-negotiable. It is immunised from competitive bargaining. Acquirers have no incentive to compete over that part of the price. It is a known common cost which acquirers know they can pass on in full and do so. Merchants have no ability to negotiate it down.*

62 European Commission, Commission Decision of 19 December 2007 (Case No COMP/34.579 Mastercard). No penalty was imposed as the decision had been notified to the European Commission. Mastercard appealed this decision to the General Court and in the meantime reduced its EEA IFs to zero.

63 MasterCard Inc v European Commission (Case T-111/08) [2012] 5 CMLR 5 (24 May 2012).

64 MasterCard Inc v European Commission (Case C-382/12 P) [2014] 5 CMLR 23 (11 September 2014).

65 Sainsbury's Supermarkets Limited v Mastercard Incorporated and others [2020] UKSC 24 (Sainsbury's SC); see also Sainsbury's Supermarkets Limited v Mastercard Incorporated and others [2018] EWCA Civ 1536 (Sainsbury's CA); and Sainsbury's Supermarkets Ltd v Mastercard Incorporated and others [2016] CAT 11 (Sainsbury's CAT).

The Supreme Court remitted to the CAT for further determination issues of fair share and quantum, however the cases subsequently entered into a confidential settlement agreement bringing the litigation to an end.

*101. Whilst it is correct that higher prices resulting from a MIF do not in themselves mean there is a restriction on competition, it is different where such higher prices result from a collective agreement and are non-negotiable.*

*102. Whilst it is also correct that settlement at par sets a floor, it is a floor which reflects the value of the transaction. Unlike the MIF, it involves no charge resulting from a collective agreement, still less a positive financial charge.*

*103. There is a clear contrast in terms of competition between the real world in which the MIF sets a minimum or reservation price for the MSC and the counterfactual world in which there is no MIF but settlement at par. In the former a significant portion of the MSC is immunised from competitive bargaining between acquirers and merchants owing to the collective agreement made. In the latter the whole of the MSC is open to competitive bargaining. In other words, instead of the MSC being to a large extent determined by a collective agreement it is fully determined by competition and is significantly lower."'*

**3.40** The extension of the Mastercard prohibition decision to the Visa scheme and domestic intra-EEA IFs underlines the extent to which the four-party scheme system operated by Mastercard and Visa is capable of operating contrary to competition law. This arises, as set out in the paragraphs above, because of the potential for a predetermined minimum IF to set a price floor which has the consequent effect of artificially increasing the MSC, by creating a driver for fees to increase. In the Sainsbury's cases, the counterfactual was determined to be where there was no IF, and the acquirer/issuer instead negotiated the fee, which might push it down.

**3.41** More recently, in Dune CA, the Court of Appeal upheld the CAT's determination that it could not extend Sainsbury's SC to deliver summary judgment in respect of domestic and intra-EEA IFs following the entry into effect of the IFR caps in 2015, or for inter-regional IFs in general. Summary judgment was granted in respect of those IFs (domestic and intra-EEA IFs prior to the introduction of the EU IFR) that were comparable to Sainsbury's SC. In so doing, both the CAT and the Court of Appeal determined that there were issues that required consideration at a full hearing before any such determination could be made.[66] These issues included the appropriate counterfactual and, in respect of inter-regional IFs, whether or not the fees are capable of having an 'appreciable effect' on competition.[67]

**3.42** A substantive trial of these and other issues will take place as part of the Umbrella Interchange Fee litigation, pursuant to the Umbrella Proceedings Order given in July 2022 by the CAT pursuant to Practice Direction 2/2022 (PD2/222).[68] PD2/22 sets out the procedural rules in place under which the designated 'Host Cases' (a large number of individual actions all claiming damages from Mastercard and/or Visa due to alleged breaches of competition law arising from interchange fees) are the subject of the Merchant Interchange Fee Umbrella Proceeding.

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66 Dune Group Limited and others v Visa and others [2022] EWCA Civ 1278 (Dune CA); Dune Group Limited and others v Mastercard and others [2022] CAT 14 (Dune CAT).

67 Dune CAT. See also Commercial and Inter-regional card claims v Mastercard and others [2023] CAT 38, referring to Dune at paragraphs 94-97.

68 Practice Direction 2/22 (2 June 2022).

**3.43** At present, it is envisaged that there will be hearings on the following issues:[69]

- Trial 1, to take place in the first quarter of 2024, to deal with liability issues in relation to UK and Irish domestic MIFs.
- Trial 2, to take place in October or November 2024, to deal with all issues relating to acquirer and merchant pass-on.
- Trial 3, to take place at a future unspecified date, to deal with all other issues including liability issues arising in relation to non-UK and non-Irish domestic MIFs.

**3.44** At the present time, therefore, there has been no judgment reached on whether or not the IFs for cross-border transactions subsequent to the introduction of the EU IFR are or were compatible with UK competition law.[70]

**3.45** As regards the 2019 Commitments, to the extent that the European Commission's market testing or analysis considered the position of the UK, it was: (i) as a member of the EEA, (ii) while the UK-EEA IFs were subject to the IFR, and (iii) as a country in which the IFs caps would apply. As a result of the drafting of those commitments, (iii) changed upon the UK's departure from the EU. In our view this does not, of itself, require, endorse or permit an increase in UK-EEA IFs.[71] Indeed, such an outcome is demonstrably counter to what the 2019 Commitments were intended to do, which was to 'significantly reduce (on average by around 40%) Mastercard and Visa's IFs for payments in the EEA with consumer cards elsewhere'.[72] In those circumstances, even if one accepts that the UK's withdrawal from the EU had the effect going forward of transforming UK-EEA IFs into inter-regional IFs (or a category of inter-regional IFs), it does not follow that the 2019 Commitments are the appropriate way for IFs to be determined for those transactions. As such, it is difficult to see how the 2019 Commitments could be determinative to the appropriateness of Mastercard and Visa's UK-EEA CNP IF increases.

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69 A hearing on pass on issues took place in May 2023. A detailed summary of the different trials is set out in the CAT's 2023 judgment in Case Nos: 1441-1444/7/7/22 Commercial and Interregional Card Claims I and II Ltd v Mastercard and Visa: Collective Proceedings Order (CPO) applications [2023] CAT 38, see paragraphs 20-25. The CPO applications were refused; in a subsequent order of 4 September 2023 sets out a timetable for filing revised applications by 15 December 2023, with a CPO certification hearing in April 2024.

70 It is possible that the proceedings currently before the CAT may ultimately settle and/or be subject to further appeals.

71 A fundamental point common to the EU IFR and the 2019 Commitments is that the IF caps set maximum levels but do not preclude IFs being set at a lower level or not set at all.

72 European Commission, Press release: *Antitrust: Commission accepts commitments by Mastercard and Visa to cut inter-regional interchange fees* (29 April 2019).

**3.46** Table 2 below summarises the different regulatory and legal precedents, and the IF levels considered.

**Table 2: Summary of regulatory and legal precedents**

| Regulatory decision / action and judgments | Interchange fee level | Outcome |
|---|---|---|
| **Visa (2002)**[73] | Intra-EEA debit: €0.28 maximum<br>Intra-EEA credit: 0.7% maximum<br>Transparency obligations; differential IFs for CP and CNP transactions | Commitments accepted by the European Commission (2002 to 2007) |
| **Mastercard – OFT (2005)**[74]<br>**Mastercard – CAT (2006)**[75] | UK domestic credit/charge cards (0.9% to 1.5%) | Notified agreement declared incompatible with UK/EU competition law<br>Decision subsequently withdrawn on appeal |
| **Mastercard I (2007)**[76]<br>**Judgments: Mastercard GC,**[77] **CJ**[78] | Intra-EEA debit: 0.4% of the transaction value increased by €0.05 and 1.05% increased by €0.05<br>Intra-EEA credit: between 0.8% and 1.2% | Prohibition[79]<br>Upheld by the General Court and Court of Justice |
| **Visa debit (2010)**[80] | The decision: i) required Visa to reduce its weighted average EEA debit MIF to 0.2%; ii) recorded the allegation that the MIFs had both the object and effect of restricting competition; and iii) without making a finding on liability, and subject to compliance with the decision, held that the Commission would not take further action against Visa in relation to its EEA debit MIFs | Commitments accepted (2010 to 2015) |

73 2002/914/EC: Commission decision of 24 July 2002 (Case No COMP/29.373 – Visa International – Multilateral Interchange Fee) (Text with EEA relevance) (notified under document number C(2002) 2698). The IFs related to Visa's EU region, which at the time included the EU Member States as well as Iceland, Liechtenstein, Norway, Turkey, Israel, Cyprus, Malta, and Switzerland (see paragraph 5).

74 CA98/05/05, Decision and Press release (includes links to annexes to the decision).

75 Mastercard v OFT case page, see, in particular, Mastercard v OFT [2006] CAT 14.

76 Commission decision of 19 December 2007 (Case No COMP/34.579 Mastercard).

77 MasterCard Inc v European Commission (Case T-111/08) [2012] 5 CMLR 5 (24 May 2012).

78 MasterCard Inc v European Commission (Case C-382/12 P) [2014] 5 CMLR 23 (11 September 2014).

79 See paragraph 3.37. The European Commission found that the Mastercard EEA IFs applicable since 22 May 1992 had been in breach of Article 101(1), and Mastercard had not proved to the requisite standard that any of the first three Article 101(3) exemption criteria were met.

80 Case No COMP/39.398 – Visa Europe – Debit IFs, Commitments and Commitments decision (September 2010).

| Regulatory decision / action and judgments | Interchange fee level | Outcome |
|---|---|---|
| **Visa credit (2014)**[81] | 0.3% (weighted average intra-EEA credit MIF), no increase to domestic credit MIFs and within two years intra-EEA credit MIF to apply | Commitments accepted (2014 to 2019); superseded by the EU IFR |
| **EU IFR (2015)**<br><br>**See paragraph 3.23 above** | 0.2%/0.3% (domestic and intra-EEA) | – |
| **Cross-border acquiring (Mastercard)**[82] | NA. Prior to the entry into force of the EU IFR, Mastercard's rules obliged acquiring banks to apply the interchange fees of the country where the retailer was located, preventing retailers in high-interchange fee countries from benefiting from lower interchange fees offered by an acquiring bank located in another Member State | Mastercard fined €570 million (reduced by 10% for settlement)<br><br>The infringement ended when Mastercard amended its rules in view of the entry into force of the EU IFR |
| **2019 Commitments Decisions**<br><br>**See paragraph 3.26 above** | The decisions: i) required each of Mastercard and Visa to reduce their inter-regional MIFs to 0.2%/0.3% (for CP debit and credit transactions) and 1.15%/1.5% (for CNP debit and credit transactions); ii) recorded the allegation that the MIFs had both the object and effect of restricting competition; and iii) made no finding on liability | 2019 Commitments accepted, bringing to an end the European Commission's investigations in relation to Mastercard's and Visa's consumer credit and debit IFs (2019 to date) |
| **Sainsbury's SC**<br><br>**See paragraph 3.38 above** | Intra-EEA and UK domestic | *Mastercard CJ* extended to the Visa scheme and to UK domestic IFs (pre-IFR) |
| **UK IFR**<br><br>**See paragraph 3.21 above** | UK domestic, 0.2%/0.3% (consumer debit/credit) | – |
| **Dune**<br><br>**See paragraph 3.41 above** | Intra-EEA and UK domestic pre-IFR<br><br>Intra-EEA and UK domestic post-IFR, inter-regional, commercial, Italian domestic IFs | Summary judgment granted, relying on *Sainsbury's SC*<br><br>*Mastercard I* and *Sainsbury's SC* distinguished; summary judgment denied – substantive hearing as part of the Umbrella Proceedings |

81 European Commission, Case No COMP/39.398 – Visa Europe – Credit IFs, Commitments and Commitments decision (February 2014). The Commitments also related to cross-border acquiring; see section 6.

82 European Commission, Case AT.40049 – MasterCard II (22 January 2019) (Prohibition decision).

| Regulatory decision / action and judgments | Interchange fee level | Outcome |
|---|---|---|
| **Merricks Collective Proceedings**[83] | UK consumer IFs (Mastercard only) | Hearing to take place in 2024 |
| **Merchant Interchange Fee Umbrella Proceedings**[84] | EEA, domestic, inter-regional | Hearing to take place in 2024 |
| **Commercial and Inter-regional Card Claims (Collective Proceedings Order application)**[85] | EEA, domestic, inter-regional | CPO applications denied<br>Order requiring revised applications to be filed by 15 December 2023, with a further certification hearing to take place in April 2024 |

## Increases in UK-EEA consumer CNP IFs

3.47 After 2021, shortly after the removal of previous caps, Mastercard and Visa decided to increase IFs for consumer debit and credit CNP transactions from 0.2% and 0.3% to 1.15% and 1.5%, respectively.

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

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

3.49 For CP transactions using consumer debit and credit cards, inbound and outbound UK-EEA IFs have remained capped under Mastercard and Visa's 2019 Commitments at 0.2% and 0.3%, respectively.

83 Case 1266/7/7/16 Walter Hugh Merricks CBE v Mastercard Incorporated and others. The parties in the Merricks Collective Proceedings have not to date been included in the Umbrella Proceedings, but were ordered to participate in a hearing with the Umbrella Proceedings parties about the issue of pass on methodology, which took place in May 2023.

84 Case 1517/11/7/22. Over 90 separate claims are part of the Umbrella Proceedings.

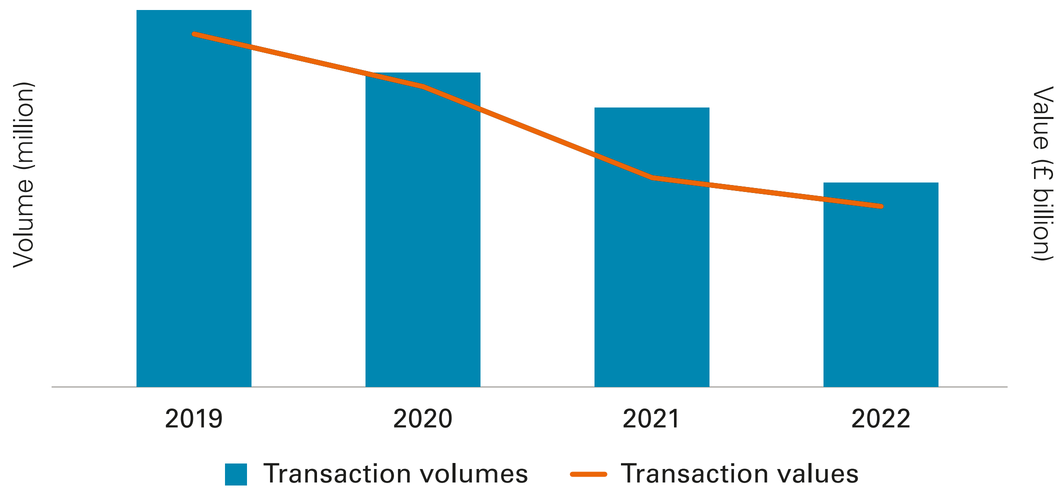
85 Case 1441/7/7/22.

## Quantification of the increases

**3.50** We have gathered data from Mastercard and Visa to calculate the scale of their increases in UK-EEA CNP cross-border IFs. The data covers the period 2019 to 2022.

**3.51** Figure 4 shows CNP transaction volumes and values for 2019 to 2022 where the card used is issued in the EEA and the merchant is located in the UK.

**Figure 4: EEA cards used at UK merchants, transaction volumes and values 2019 to 2022**




Source: PSR analysis of data from Mastercard and Visa.

Note: The figures for transaction volumes and values take account of any relocation that has already happened (see Chapter 4); we have removed numerical values from the axis to avoid disclosing potentially sensitive information.

**3.52** Figure 4 shows a relatively stable decline between 2019 and 2022 in both volumes and values of approximately 46% and 49%, respectively.[86]

**3.53** Despite the decline in transaction volumes and values across the period, Figure 5 shows a different pattern for the corresponding IFs.[87] Visa increased the level of its outbound IFs in October 2021, and Mastercard did the same in April 2022. The blue bars in Figure 5 for 2019 and 2020 show the actual values of IFs for transactions in those years. The blue bars for 2021 and 2022 show what IFs would have been if the previous levels of 0.2% and 0.3% for debit and credit cards, respectively, had still applied, with transaction volumes and values at their actual levels. The orange bars for 2021 and 2022 show the total values of IFs in addition to what they would have been with the previous levels. Adding together the blue and orange bars therefore shows the actual total values for those two years. Our internal data analysis shows no substantial evidence of merchants switching between Mastercard and Visa acquiring services over the same period.[88]

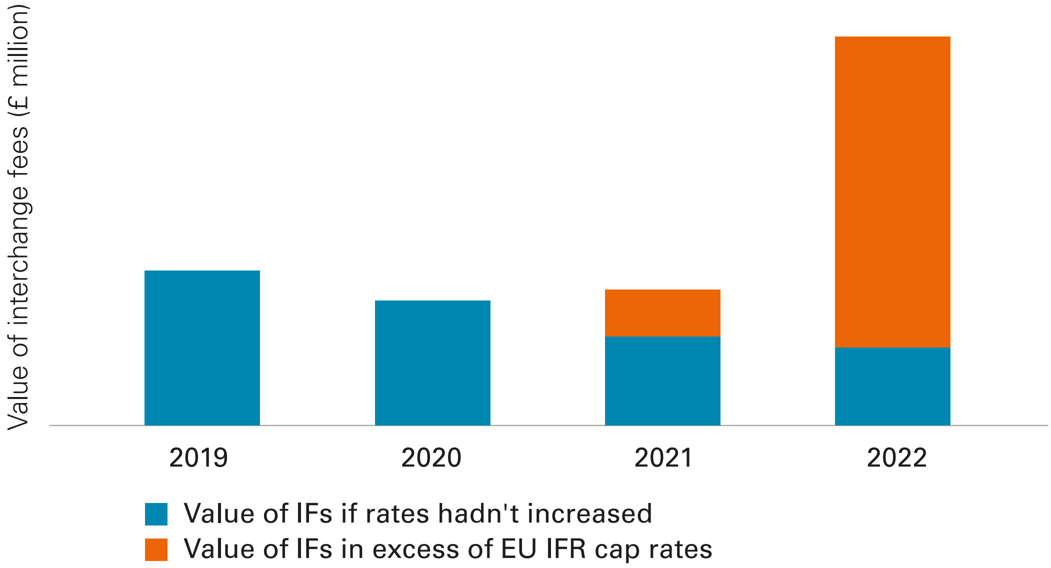
86 PSR analysis of data on transaction values submitted by acquirers through the s81 notice, and by Mastercard and Visa.

87 The decline is mainly due to merchant relocation in response to EU withdrawal-related issues, including where they recognise their payments. Merchant relocation following the UK's withdrawal from the EU is explained in more detail in Chapter 4.

88 PSR analysis of data submitted by acquirers under the s81 notice, and by card schemes.

**3.54** Figure 5 shows that the total value of UK-EEA outbound IFs increased by approximately 151.2% over the period 2019 to 2022.

**Figure 5: Outbound IFs 2019 to 2022**




Source: PSR analysis of data from Mastercard and Visa.

Note: The figures for outbound CNP IFs take account of any relocation that has already happened (see below); we have removed numerical values from the axis to avoid disclosing potentially sensitive information.

**3.55** Figure 5 shows a substantial increase in IFs of approximately £150 million to £200 million in 2022.

**3.56** For the value of IFs if levels had not increased, we based our estimates on the realised transaction values produced after the card schemes increased the UK-EEA levels. We cannot know the actual value and volumes of transactions that would have taken place without these increases. They may have been higher, assuming that their reduction was to some extent attributable to the introduction of higher IFs, which may have caused a reduction in sales and/or merchants taking mitigating action to combat the increases –for example, setting up entities in the EEA to make UK-EEA cross-border transactions EEA domestic and vice versa. However, as mentioned by some stakeholders, other factors, in addition to the IF changes, may have led merchants to relocating and may have contributed to this fall in volumes and values.[89] For example, the UK's withdrawal from the EU, the Covid pandemic and the conflict in Ukraine are likely to have affected trade flows between the UK and EEA.[90]

**3.57** The 2022 range of approximately £150 million to £200 million represents the annual effect in terms of additional costs incurred by UK acquirers and merchants as a consequence of the increases.

89 MR22/2.4, [Market review of UK-EEA cross-border interchange fees: stakeholder submissions on discussions of impacts working paper] (18 July 2023), page 36.

90 House of Commons Library, Research Briefing, [Statistics on UK-EU trade] (11 May 2023).

## Questions for stakeholders

### Question 1

- Do you have any views on how we have described the facts and considerations we have identified in Chapter 3? Do you think there are any other factors we should consider as context and background to our market review?

# 4 Competitive constraints

Four-party card schemes like Mastercard and Visa are two-sided networks, serving users on both sides of the payment system they operate: issuers and cardholders on one side (the issuing side), and acquirers and merchants on the other side (the acquiring side). The competitive conditions on each side of the network influence the card schemes' decisions on IF levels.

In this chapter we focus on the acquiring side and consider the extent to which Mastercard and Visa are subject to effective competitive constraints when setting outbound IFs for UK-EEA card-not-present (CNP) payments. It includes an assessment of the extent to which UK acquirers and merchants can respond to increases in UK-EEA CNP IFs to mitigate their impact.

## Introduction

**4.1** Many merchants, large and small, operate cross-border between the UK and the EEA. For remote transactions between these two jurisdictions (for example, in internet shopping and in payments by phone or mail), merchants and their consumers need reliable and convenient cross-border payment methods.

**4.2** As outlined in Chapter 2, Mastercard and Visa currently play significant roles in retail payments in the UK, in the EEA, and across the two.

**4.3** In this chapter we first consider the ways in which acquirers could respond to an increase in UK-EEA outbound IFs and we assess whether their responses are likely to provide an effective competitive constraint on IF levels.

**4.4** Secondly, as IFs form part of the MSC paid by merchants to their acquirers, we consider the ways in which merchants could respond to an increase in UK-EEA outbound IFs and we assess whether their responses are likely to provide an effective competitive constraint on IF levels.

**4.5** Effective competition supports good outcomes in payments markets, such as low prices, high service quality and continued innovation.

## Ability of acquirers to constrain any increases

**4.6** IFs are directly charged to acquirers, so our analysis of competitive constraints on UK-EEA outbound IFs begins with them and their potential responses.

**4.7** Our analysis of UK acquirer data for 2022 shows that the financial impact of an IF increase on acquirers is notably limited because most of these fees are passed on to merchants. Around 80% of transactions by value are on automatic 'pass-through' pricing options (see Chapter 3).[91]

**4.8** The remaining transactions by value (20%) are charged according to blended rate contracts (see Chapter 3). Pass-through rates for these are also high because acquirers tend to pass on IF increases as part of their annual or other regular pricing reviews. As a result, approximately 95% of all the outbound IF increases were passed on to UK merchants either immediately or at some point in 2022 (see Chapter 3). Only 5% of these increases were 'absorbed' by a small number of UK acquirers.[92]

**4.9** Complete (or almost complete) and rapid pass-through to merchants means that an increase in IFs has very little direct financial effect on acquirers. Changes in merchant behaviour could affect acquirers by reducing transaction volumes, but (as we examine later) this potential change is very constrained.

**4.10** Changes in IFs affect all the acquirers that pay them. Increases in outbound IFs on UK-EEA CNP transactions do not provide an opportunity for one UK acquirer to undercut the others, as the increases affect all these acquirers similarly. This generalised impact at acquirer level supports the tendency for IF increases to be passed on to merchants.

**4.11** Acquirers have a strong incentive to continue to provide acquiring services for both Mastercard and Visa because ceasing to provide either service would entail significant business losses. Hence, acquirers are unlikely to leave a card scheme in response to an increase in its outbound IFs. Fear of business losses means that acquirers will continue to provide acquiring services even where there are fee increases. Such an outcome reflects the must-take status of the Mastercard and Visa cards to merchants (see later in this chapter).

**4.12** With the exception of [✂], all UK acquirers who have responded to our information request, which represent over 90% of transaction values acquired in the UK, have confirmed that they provide acquiring services for both Mastercard and Visa.

### What Mastercard and Visa told us

**4.13** Visa stated that it does 'not control how acquirers (and other participants in the payments value chain) ultimately price their services to merchants, or the specific level of interchange payable by merchants for each individual Visa transaction, and that Visa does not have full visibility of the merchant pricing models that acquirers use'.[93]

**4.14** Similarly, Mastercard stated that ultimately 'it is acquirers, rather than Mastercard which determine the exact fees paid by merchants'.[94]

91 PSR analysis of UK acquirer data for 2022.

92 PSR analysis of UK acquirer data for 2022.

93 Visa response to PSR questions dated 12 January 2022. [✂]

94 Mastercard response to PSR questions dated 5 August 2022. [✂]

**4.15** We asked Mastercard and Visa to explain and provide supporting evidence of the factors that constrain their ability to increase UK-EEA IFs and how these factors affected their decisions to increase these fees.[95] We reviewed the internal documents provided by the card schemes also with a view to understanding whether and how potential acquirer responses to outbound IF increases were taken into account.

**4.16** Internal documents from Mastercard focused on [✁].[96]

**4.17** Internal documents from Visa also mention [✁].[97]

**4.18** In Mastercard's response to us and in its internal documents [✁]. In Visa's response to us and in its internal documents [✁].

### What UK acquirers told us

**4.19** The UK acquirers that we asked confirmed that all UK merchants who accept payments, including from the EEA, accept both Mastercard and Visa branded cards.[98] None knew of UK merchants who accept one card brand but not the other.[99] Some acquirers explained that this is because UK and EEA consumers expect merchants to accept Mastercard- and Visa-branded cards by default.[100] Correspondingly, virtually all acquirers offer acquiring services for both card brands, thus providing a comprehensive service to merchants.

**4.20** Acquirers confirmed they have to offer acquiring services for both Mastercard and Visa because otherwise they would lose potential customers (that is, merchants) or would fail to acquire them.[101] In practice, acquirers cannot decline to offer either Mastercard or Visa in response to a fee increase, given their must-take status.

**4.21** Many UK acquirers also said they could do little to respond to Mastercard's and Visa's increases in UK-EEA CNP IFs.[102] Some said this is because, in practice, they cannot negotiate on the level of IFs.[103] These acquirers also said they have no option but to accept increases in IFs, and that they largely passed these increases on to merchants.[104]

### Our provisional view

**4.22** Mastercard and Visa set the default IF level that merchant acquirers pay to issuers. The card schemes do not control how acquirers charge merchants. However, given that the IF is a 'per transaction' cost affecting all acquirers in the same way, it will typically be passed on to the acquirers' customers (that is, their merchants). Hence, an increase in IFs translates into an increase in prices paid by merchants, regardless of whether this is intended by the card schemes. In any event, we provisionally find that the two schemes

95 Mastercard and Visa response to PSR questions dated 12 January 2022. [✁]
96 Mastercard response to PSR questions dated 12 January 2022. [✁]
97 Visa response to PSR questions dated 12 January 2022. [✁]
98 Stakeholder responses to PSR information requests dated 11 January 2023. [✁]
99 Stakeholder responses to PSR information requests dated 11 January 2023. [✁]
100 Stakeholder responses to PSR information requests dated 11 January 2023. [✁]
101 Stakeholder responses to PSR information requests dated 11 January 2023. [✁]
102 Stakeholder responses to PSR information requests dated 11 January 2023. [✁]
103 More information on how four-party card schemes work is provided in Chapter 2.
104 Stakeholder responses to PSR information requests dated 11 January 2023. [✁]

envisaged that some level of pass-through from acquirers to merchants was anticipated or at least possible.

**4.23** The increases in UK-EEA CNP IFs apply similarly to all acquirers, who pass most of these increases on to merchants. For the large segment of the market who are on IC++ pricing contracts, the increases are automatically passed on to merchants. Under other contract types, acquirers pass most of the IF increases on to merchants at some point. Acquirers also confirmed to us that they passed on the increases to merchants because there was nothing else they could do to respond.

**4.24** This means that the increases have left the acquirers on a level playing field and have had a very limited effect on their margins. This is consistent with the fact that we have not seen evidence of a possible reaction from acquirers to the increase in outbound IFs [✂].

**4.25** Considering this, and the importance to acquirers of offering merchants a comprehensive card acceptance service, including both Mastercard and Visa (given their must-take status), we provisionally find that UK acquirers have made little response to increases in outbound IFs (beyond passing these on to merchants).

**4.26** Accordingly, our provisional view is that UK acquirers' responses do not provide an effective competitive constraint on increases in UK-EEA outbound IFs.

## Potential constraints from merchant responses

**4.27** Since acquirers pass on IFs almost entirely to merchants, we now consider merchants' possible responses to increases in UK-EEA outbound IFs and whether these might provide an effective competitive constraint on increases in UK-EEA CNP IFs.

**4.28** In principle, a merchant might respond to higher UK-EEA outbound IFs for a card scheme by:

- limiting card acceptance (for example, by declining or restricting acceptance of the card brand)
- continuing to accept the card but finding other ways to reduce their exposure to UK-EEA CNP transactions and the associated IFs

**4.29** If merchants' responses were sufficiently strong, they would reduce the volumes of UK-EEA CNP transactions sufficiently to undermine the profitability of the increase in UK-EEA outbound IFs, thus providing an effective competitive constraint on those fees.

**4.30** The following sub-sections consider merchants' potential responses in terms of:

- declining to accept the card brand or limiting its acceptance
- reducing the volumes of transactions that incur UK-EEA outbound IFs

### Declining or limiting card acceptance to avoid the increases

**4.31** We have considered whether declining or limiting card acceptance may be deployed to avoid the increases. A merchant's decision to accept a particular card brand and product (such as Visa consumer debit) is based on the full 'basket' of transaction types that can be received via the card – for example, domestic and cross-border, both CP and CNP. UK-EEA CNP transactions are just one of these types, and for most UK merchants they represent only a small proportion of transactions using a card brand and category. For example, out of all Visa consumer debit card transactions at all UK merchants, online payments from EEA-issued Visa cards were only [✂] % by volume and [✂] % by value in 2021.[105, 106]

**4.32** Mastercard's and Visa's scheme rules prevent a merchant from choosing or declining transactions (whether CP or CNP) on the basis of the card issuer's location. The Honour All Cards (HAC) rule states that merchants who accept Mastercard and Visa consumer debit or credit cards domestically cannot refuse to accept these cards in a cross-border context.[107] A merchant can choose to accept only consumer credit or debit/pre-paid cards. It can also choose not to accept commercial products. Where a merchant chooses to accept a product, that merchant must accept all instances of that product.

**4.33** This means that a UK merchant cannot accept domestic transactions with domestic IFs but refuse those from EEA-issued cards of the same brand with the higher cross-border IFs. With regard to issuer location, the HAC rule makes accepting a card brand an all-or-nothing decision, at least at a product level.

**4.34** In the UK, almost 90% of all retail sales are card-based (see paragraph 2.3). There is no national card scheme, and Mastercard and Visa account for around 99% of all card transactions.[108]

**4.35** Of all card transactions at UK merchants, 3.6% were UK-EEA cross-border, and only 2.5% of the total were CNP UK-EEA cross-border (the transactions that generate outbound IFs).[109]

**4.36** To estimate the potential impact of the increase in UK-EEA CNP outbound IFs on the average UK merchant, we considered an illustrative example using a starting assumption that IFs represent 60% of the MSC they must pay their acquirer on a UK-EEA transaction.[110] We also made an assumption that, before the recent increase in IFs, MSCs on UK-EEA CNP transactions were similar to the average MSC merchants have to pay across other card transactions. This indicates that, for such a merchant, a fivefold increase in UK-EEA CNP IFs implies an increase in the overall MSC of around 5%.[111]

**4.37** Owing to the significant market presence of both Mastercard and Visa, we consider that declining either Mastercard or Visa would have a major effect on a merchant's business. In such a scenario, customers denied their preferred payment card might buy instead from an alternative merchant who continues to accept it. Indeed, it is the fear of losing

105 PSR analyses of data submitted by Mastercard and Visa, and of data from UK Finance.

106 This considers the share of Visa cross-border transactions (CP and CNP) over total Visa transactions in the UK. If we consider CNP only, the percentages drop slightly to [✂]% (volume) and [✂]% (value).

107 The HAC rule states that if a merchant accepts one of a card scheme's products it should then accept all of the card scheme's cards that fall under that product category. For example, if a merchant accepts a Mastercard credit card, it should accept all Mastercard credit cards. This rule appears to be at a product level. See *Mastercard rules* (13 December 2022), Rule 5.11.1; *Visa core rules and Visa product and service rules* (15 April 2023), Rule 1.5.4.2.

108 BRC, *Payments survey 2022*, page 12. These are both in person (CP) and remote (CNP) transactions. See Tab 8.1 of *UK Payment Statistics 2022*.

109 PSR internal analysis of data submitted by acquirers, Mastercard, Visa and American Express as part of the s81 notice (2023).

110 The assumption that IFs represent around 60% of the average MSC is based on our card-acquiring market review. See MR18/1.8, *Market review into the supply of card-acquiring services: final report: annex 3: financial review* (November 2021), page 6.

111 For every £100 in MSC, the increase in UK-EEA CNP IFs affects around £1.20 of this (60% of around 2% of all transactions that are of this type, assuming similar average MSCs on these as other transactions). Following a fivefold increase in UK-EEA CNP IFs, this element becomes around £6, giving a total of £104.80, an increase of 4.8%.

customers that results in merchants typically accepting cards even when these are more costly to them than alternative payment methods – a situation often referred to as the must-take status of the Mastercard and Visa card schemes.[112]

**4.38** The HAC rule also prevents merchants from refusing cards on the basis of an issuer's location, but refusing to accept the card brand as a whole would mean losing significant volumes of sales for domestic transactions of all types and not just for CNP transactions using EEA-issued cards. This makes it highly unlikely that UK merchants would stop accepting either Mastercard or Visa branded cards in response to an increase in UK-EEA outbound IFs even if alternatives to these cards were readily available (something that we discuss later). It also shows that Mastercard and Visa do not compete with one another in providing services to merchants and that both have must-take status.

**4.39** For some UK merchants (such as those operating in the travel industry), UK-EEA CNP transactions may represent a much higher percentage of total transactions. A fivefold increase in IFs will, therefore, have a greater effect on the MSCs these merchants pay. If they changed their behaviour on card acceptance, that could represent a constraint on UK-EEA CNP IFs. We observe, however, that:

a. While the greater impact of the fee increase might give this small group of merchants more incentive to respond, in practice, given the must-take status of these cards, they are unlikely to be able to decline or limit the acceptance of these cards. We note, for example, that all merchants that responded to our review said that they accept all Mastercard- and Visa-branded cards and they have not considered changing their acceptance of (that is, declining) any of these cards in the last five years.[113]

b. While an individual merchant with very large volumes of UK-EEA trade might exercise some pressure over the card schemes to get a better deal, that does not constrain UK-EEA outbound IFs as a whole. Amazon, for example, told its customers in November 2021 that it would stop accepting payments made with UK-issued Visa credit cards from 19 January 2022, blaming its decision on the 'high fees Visa charges for processing credit card transactions'.[114] However, on 17 January 2022, it was reported that there had been an '11th hour reprieve', and that Amazon had 'started sending affected customers emails telling them they would be able to continue to use their Visa credit cards to pay for items, and for Amazon Prime'.[115] It was subsequently reported in the Financial Times that 'Amazon had reached a global truce' with Visa.[116]

112 See also Chapter 2.

113 Stakeholder responses to PSR information requests dated 11 January 2023 and 18 July 2023. [✂]

114 *Guardian*, Amazon to stop accepting UK-issued Visa credit cards (17 November 2021).

115 *Guardian*, UK Amazon users can continue using Visa credit cards after dispute is settled (17 January 2022).

116 *Financial Times*, Amazon reaches 'global' truce with Visa on credit card fees (17 February 2022).

### Our provisional view

**4.40** From the above, it is apparent that, given the must-take status of Mastercard and Visa, very few, if any, UK merchants can be expected to respond to an increase in UK-EEA outbound IFs by declining the card brand as a whole. Accordingly, changes in card acceptance do not provide a mechanism whereby profitability of the increase in IFs could be undermined. Thus, our provisional view is that the potential for a merchant to decline the card brand or limit its acceptance does not provide an effective competitive constraint on UK-EEA outbound IFs.

## Reducing volumes on which outbound IFs are levied

**4.41** We have considered whether, while continuing to accept Mastercard- and Visa-branded cards, UK merchants may be able to reduce their exposure to UK-EEA outbound IFs by taking steps that lower their volumes of the relevant transactions on which these fees are payable.

**4.42** In principle, there are three ways to do this, which we discuss below:

- cross-border acquiring
- merchant relocation
- steering consumers towards alternative payment methods

## Cross-border acquiring

**4.43** In cross-border acquiring, an acquirer in one country processes transactions for a merchant located in a different country. If this were possible, a UK merchant would contract with an EEA-based acquirer who would process its UK-EEA CNP transactions in the EEA instead of in the UK. If such a transaction was then treated as a domestic or intra-regional EEA transaction, it would fall under the EU IFR and incur an IF of 0.2% or 0.3% (for debit or credit, respectively), rather than 1.15% or 1.5% (for debit or credit, respectively) as a UK-EEA CNP transaction.

**4.44** However, the EU IFR sets the criteria for merchant location, including for e-commerce, and it is likely that an EEA acquirer would need to obtain FCA authorisation to offer services to UK merchants, and acquirers must generally accept transactions from a merchant located within the acquirer's country of domicile.[117] Broadly, when a firm provides regulated payment services in the UK, as a regular occupation or business activity, and neither the firm nor their services fall within an exclusion or exemption, the firm must be authorised or registered by the FCA. It is a merchant acquirer's responsibility to consider whether their activities fall within the FCA's regulatory perimeter based on their specific circumstances, including where each part of their activity takes place. A firm that fails to do so risks committing a criminal offence under regulation 138 of the Payment Services Regulations 2017.

117 European Parliament and European Council, Regulation (EU) 2015/751 of the European Parliament and of the Council, section 29.

### What UK acquirers and merchants told us

**4.45** A UK-based acquirer [✂] stated that cross-border acquiring is restricted under card schemes' cross-border acquiring rules. Currently, rules establish that regions are assigned based on the presence of that merchant in a given geographical area, and not based on the acquirer's or the payment processor's location. For CNP transactions, rules state that a merchant must have an entity established in the given country, thus making it inaccessible for most small businesses. This restriction limits competition between cross-border acquirers, who could offer a transaction routing service to merchants to minimise their acceptance costs if the region was based on the acquirer's location. Therefore, acquirers are widely prevented from mitigating this rise in fees.[118]

**4.46** The BRC stated that no existing regulation prevents merchants from routing their transactions through their different acquirers in different countries, but card scheme rules negate the importance of acquirer location. It also said that if a merchant has an acquirer in another country, there is an argument to be made that it would make sense for a merchant to be able to route any transactions made with cards from that country through their acquirer in the corresponding country, and therefore be charged as a domestic transaction.[119]

### Our provisional view

**4.47** Cross-border acquiring is currently not an option for UK merchants engaging in e-commerce with the EEA, so UK merchants can't use it to mitigate the increase in UK-EEA CNP IFs. We provisionally conclude that cross-border acquiring provides no effective competitive constraint on increases in UK-EEA outbound IFs.

## Merchant relocation

**4.48** We have considered whether UK merchants could avoid or mitigate the increase in UK-EEA outbound IFs by relocating part or all of the relevant transactions to an EEA country where they meet the requirements to do so and where the lower intra-EEA IFs would apply.

**4.49** Under the card scheme rules, which levy IFs according to the location of a merchant, merchants can relocate their transactions by changing the geographic locations where they accept payments.[120] For example, a UK-located merchant selling online to consumers in France (a transaction that would generate an outbound IF) could establish a presence in the EEA and use an EEA-based acquirer to process these transactions. What would previously have been a UK-EEA cross-border transaction would then become an EEA domestic transaction, subject to the lower IFs capped under the EU IFR.

**4.50** For the (lower) EU IFR caps to apply, the card must be issued within the EEA and the merchant's acquirer must be located there, too.[121]

118 Stakeholder response to PSR information request dated 11 January 2023 [✂]

119 BRC response to PSR information request dated 11 January 2023. [✂]

120 Mastercard sets its default IFs according to its rules (see rule 8.3) and webpage. Visa sets its IFs according to information contained on its website (see 'Frequently asked questions, What does it cost and how is this decided').

121 European Parliament and European Council, Regulation (EU) 2015/751 of the European Parliament and of the Council, section 29.

### What Mastercard and Visa told us

**4.51** Mastercard provided internal documents showing that [✂] could result from the outbound IF increases. [✂].[122]

**4.52** Visa provided internal documents showing that [✂] could result from the outbound IF increases. [✂][123]

**4.53** We asked Mastercard about merchant relocation and how it would alter the impact of the increases in UK-EEA CNP IFs.[124]

**4.54** Mastercard explained that, in the context of IFs, 'localisation' (meaning relocation) is when a merchant changes its location to convert a cross-border transaction into a domestic transaction. It provided the following example:

- [✂] sells certain products to consumers using UK-issued cards ('UK consumers') through an entity based in the EEA. This is a UK-EEA cross-border transaction which would be subject to the increases in inbound IFs.
- If [✂] decides to sell those same products to UK consumers through an entity based in the UK, the transaction becomes a UK domestic transaction, no longer subject to cross-border IFs.[125]

**4.55** Mastercard stated there may be other online merchants who might decide to 'localise' and serve consumers through an entity based in the same domestic market as their consumers, in order to avoid paying cross-border IFs.[126]

**4.56** Mastercard also said that there are many reasons, other than IFs differentials, why a merchant may consider changing its location for some transactions. These include tax optimisation, corporate restructuring, risk management (for example, to have higher issuer approval rates) and reducing currency conversion risks.[127]

**4.57** Mastercard explained that, while it requires merchants to provide accurate location information, it does not know enough about their underlying behaviour to predict when and why they may localise. There is also [✂]. In addition, Mastercard submitted that localisation does not mean that all transactions are either cross-border or domestic (localised). Rather, it can be seen as a partial movement of some transactions over time.

**4.58** Mastercard said that a significant number of merchants accept transactions in both the EEA and UK. It said that this means they have entities in both locations and hence could easily relocate some of their CNP cross-border transactions to domestic ones, if that met their commercial aims.[128]

122 Mastercard, [✂]
123 Visa, [✂]
124 Mastercard response to PSR questions dated 5 August 2022. [✂]
125 Mastercard response to PSR questions dated 5 August 2022. [✂]
126 Mastercard response to PSR questions dated 5 August 2022. [✂]
127 Mastercard response to PSR questions dated 5 August 2022. [✂]
128 Mastercard response to PSR questions dated 5 August 2022. [✂]

**4.59** Mastercard provided internal documents that suggest that [✂].[129]

**4.60** We asked Mastercard to provide the names of the merchants that have relocated part or all of their CNP UK-EEA transaction volumes. Mastercard's analysis shows that the merchants that it believes may have relocated their transactions are very large merchants, such as [✂].[130]

**4.61** Visa similarly explained that a merchant with a principal place of business in the EEA and multiple other locations across Europe (including in the UK) could configure its operations to shift transaction volume across locations. For example (under certain criteria), a merchant can shift some volume to its UK location, so fewer transactions are subject to the higher UK-EEA IFs (and more transactions are subject to the lower UK domestic IFs).[131]

**4.62** Visa also said that, because of the UK's withdrawal from the EU, many large e-commerce merchants wanted to ensure they had both UK- and EEA-based operations. As these merchants made this shift, many consumer transactions that were previously cross-border became localised. Visa said that if this trend were to continue, the proportion of transactions impacted by the increases in question would fall.[132]

**4.63** Internal documents from Visa also show that it [✂].[133] [✂]:

- [✂].
- [✂].

### What UK acquirers and merchants told us

**4.64** We asked UK acquirers and merchants whether:

- merchants can relocate their UK-EEA CNP cross-border transactions to UK domestic or EEA domestic
- acquirers may enable or facilitate relocation
- merchants have already relocated any transactions[134]

**4.65** Some large e-commerce merchants (for example, [✂]) told us that they relocated at least some of their operations following the UK's withdrawal from the EU.[135] This meant that they avoided at least some of the UK-EEA outbound IF increases.

**4.66** Acquirers confirmed that some of their larger merchants have relocated.[136] However, some said that, on average, the number of merchants that actually relocated was small, due to the considerable costs involved.[137]

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129 Mastercard response to PSR questions dated 12 January 2022. [✂]
130 Mastercard response to PSR questions dated 5 August 2022. [✂]
131 Visa response to PSR questions dated 5 August 2022. [✂]
132 Visa, *Visa response to Treasury Select Committee on Cross-border Interchange*, page 5.
133 Visa response to PSR questions dated 5 August 2022. [✂]
134 PSR merchant questionnaire and PSR acquirer questionnaire. [✂]
135 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
136 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
137 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

**4.67** Acquirers and merchants explained that relocation from the UK to the EEA (and vice versa) appears to only be an option for:

- the biggest merchants who already have a presence in both jurisdictions
- merchants who do not have a presence in both jurisdictions but have a significant proportion of cross-border transactions[138]
- large merchants operating in specific sectors, such as e-commerce platforms, online booking services, online entertainment and fintech

**4.68** Acquirers and merchants confirmed that a merchant can relocate some cross-border transactions to turn them into domestic transactions only if it has a legal entity where it wishes to relocate them. They said that card scheme rules stipulate this entity must be the one that is actually responsible for the sales of goods or services for the jurisdiction.[139]

**4.69** Acquirers and merchants also said that, for most merchants, the financial and logistical burden of setting up a new legal entity precludes doing so.[140]

### Our provisional views

**4.70** The available evidence indicates that relocation has helped, and may continue to help, a few large merchants avoid or at least mitigate outbound IF increases. However, the available evidence also shows that relocating is likely to be a possibility only for very large merchants, and that it is not a possibility for UK SMEs (because it is not economically viable for their businesses). As a result, SMEs are effectively unable to avoid any of the outbound IF increases. This is consistent with our finding at paragraph 3.57 that in 2022 an extra £150 million to £200 million was paid by UK acquirers and in turn by UK merchants due to the increases in outbound IFs.

**4.71** Merchants who can relocate (typically the large merchants) can reduce the volume of cross-border transactions for a given card, reducing their exposure to increased cross-border IFs. However, relocation does not change the total number of card transactions for the card schemes involving those merchants. Only in some unlikely scenarios, such as where merchants relocate in full, may there be some small losses for card schemes associated with relocation and related to lower scheme and processing fees. Overall, we provisionally find that the card schemes suffer little or no detriment from such relocation.

**4.72** Considering the above, our provisional view is that merchant relocation does not provide an effective competitive constraint on increases in UK-EEA outbound IFs.

## Consumer steering towards alternative payment methods

**4.73** We have considered whether merchants may be able to mitigate the impact of increases in IFs for UK-EEA CNP transactions by encouraging cross-border consumers to use alternative payment methods that cost them less, for example by:

- introducing card surcharges or offering discounts or bonuses for using an alternative payment method

138 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
139 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
140 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

- providing information on the fees facing a merchant
- asking the consumer to choose a different payment method
- presenting website payment options in a way that nudges consumers to use an alternative payment method (for example, by making these methods more prominent)

**4.74** The ability of a UK merchant to use any of these strategies depends on whether alternative payment methods are available and acceptable to consumers as well as themselves. To reduce UK-EEA outbound IFs, EEA consumers must be able to use the alternatives for their remote purchases and the UK merchant must be able to accept them. Then, because it is the consumer who chooses the payment method from the options a merchant will accept, a merchant will need to 'steer' (that is, nudge) consumers to choose a payment method that it prefers.

**4.75** For a UK merchant wanting to reduce its exposure to outbound IF increases, there are two key questions:

- What alternative payment methods are available to an EEA consumer who wants to pay a UK merchant remotely?
- What are the likely costs and risks of trying to steer potential consumers to use an alternative payment method instead of a Mastercard- or Visa-branded card – in particular, the risk of losing the transaction altogether?

**4.76** Answers to both these questions will ultimately determine merchants' ability to mitigate the impact of the increases in outbound IFs through consumer steering.

**4.77** As outlined in Chapter 2, cards are the leading payment method in both the UK and EEA for e-commerce transactions. This includes both domestic card transactions and international card transactions. Some EEA countries have national card schemes alongside the international ones, namely Mastercard and Visa. However, cardholders can use such domestic card schemes only to make domestic payments in their own respective EEA countries. A cross-border transaction can be made only if the domestic card is co-badged with either Mastercard or Visa. Most EEA domestic cards are co-badged in this way.[141] As a result, EEA domestic card schemes do not represent an alternative to Mastercard and Visa for EEA consumers and UK merchants that want to accept cross-border payments.

**4.78** Cross-border payments can take place not only via a 'plastic' card transaction, but also via other kinds of remote payment solutions, such as digital wallet (or e-wallet) payments and buy-now-pay-later (BNPL) solutions.[142] Merchants in the EEA increasingly accept BNPL tools, and digital wallets are increasingly accepted for international trade.

**4.79** [✂] are examples of a 'pass-through' payment services, which act as a proxy for an international card payment.

141 Dr H. Godschalk, Infographic co-badging of national card schemes in the EU (9 November 2021).

142 Buy-now-pay-later solutions imply that a third party pays a merchant for products and services on behalf of a consumer, and then collects the payment from the consumer. This is typically in a small number of monthly instalments.

**4.80** We were told [✂] that, for cross-border transactions, if EEA domestic cards attempt a cross-border transaction and are co-badged with an international scheme, the transaction will flow through the international schemes network. If they are not co-badged with an international scheme, the services do not work because their underlying domestic schemes do not offer that capability.[143, 144, 145]

**4.81** A digital wallet provider [✂] also confirmed that it is a pass-through digital wallet. It does not offer payment processing services to merchants. Broadly, its digital wallet shares the retail customers' card details with the relevant merchant and their payment processor, who in turn processes the payment transaction.[146]

**4.82** A digital wallet provider [✂] offers different funding sources, including card payments and bank transfers. In 2022, nearly [✂]% of all EEA consumer transactions at UK merchants via this provider's digital wallet were card based [✂]. In addition, the digital wallet provider said that [✂].[147, 148]

**4.83** We were told [✂] that the cross-border nature of a transaction can be dependent on the billing address (country) of the consumer and the merchant location. In addition, it is possible, albeit rare, for a consumer residing in the UK to make a purchase at a UK merchant that is settled with a cross-border payment (such as a Visa/Mastercard transaction or a direct bank transfer from a bank in another country).[149]

**4.84** Online bank transfers and other third-party payment solutions that rely on the same bank payment rails (that is, interbank infrastructure) can also be used for remote payments. In these cases, consumers can make a purchase by transferring funds to a merchant's account from their bank account. Other third-party solutions that rely on the same bank rails are becoming increasingly popular in some EEA countries (for example, iDEAL in the Netherlands and Blik in Poland). However, they are rarely available outside of their respective domestic borders.

### What Mastercard and Visa told us

**4.85** In response to questions about their reasons for deciding to increase the IFs for UK-EEA CNP transactions, Mastercard and Visa made several references to alternative payment methods.[150]

**4.86** Mastercard explained that, whenever setting IFs, it considers various factors, including the cost of alternative payment methods.[151] It stated that alternative cards, such as American Express, and digital wallets, such as PayPal, are important for cross-border transactions.[152]

**4.87** Mastercard also stated that the European Commission, in evaluating the levels that informed the 2019 Commitments, considered a range of different service providers relevant to cross-

143 Stakeholder response to PSR information request dated 20 July 2023. [✂]
144 Stakeholder response to PSR information request dated 20 July 2023. [✂]
145 Stakeholder response to PSR information request dated 20 July 2023. [✂]
146 Stakeholder response to PSR information request dated 7 August 2023. [✂]
147 Stakeholder response to PSR information request dated 20 July 2023. [✂]
148 [✂]
149 Stakeholder response to PSR information request dated 20 July 2023. [✂]
150 Mastercard response to PSR questions dated 5 August 2022. [✂]
151 Mastercard response to PSR questions dated 5 August 2022. [✂]
152 Mastercard response to PSR questions dated 5 August 2022 and 16 March 2023. [✂]

border transactions, including between the EEA and the rest of the world. This included three-party card payment schemes, other means of payments that can be funded by bank transfers, such as e-wallets (digital wallets), e-payments or bank transfer payments.[153]

**4.88** Visa explained in its response that, when setting IFs, it takes account of [✂].[154]

**4.89** We asked both Mastercard and Visa to explain, with supporting evidence, the factors that constrain their ability to increase UK-EEA cross-border IFs and how those factors are considered in their relevant price-setting decisions.[155]

**4.90** Mastercard stated that the range of specific alternatives will depend on the country in which the customer is based. It also said that alternatives, such as three-party cards, are generally more prominent in cross-border transactions.[156]

**4.91** Mastercard stated: 'On the merchant side, the cross-border EEA interchange fees apply to a much smaller proportion of overall transactions than domestic interchange fees, and merchants are able to apply surcharges when these cards are accepted.'[157]

**4.92** Visa told us that its decisions on IFs are taken in the context of the competitive environment within which it operates. It also understands that merchants, particularly thos operating in CNP environments, have options to complete e-commerce transactions and that these will be selected if they are preferred.[158]

**4.93** However, a 2019 report produced for Visa [✂]. The report said that [✂]. The report also said [✂]. In addition, the report said [✂].[159] Visa told us that [✂].[160]

### What UK acquirers and merchants told us

**4.94** We asked UK acquirers and merchants (and their representative bodies) about the extent of the competition that Mastercard and Visa face from other international card schemes and non-card payment options, specifically for UK-EEA cross-border CNP transactions.[161]

**4.95** Merchants and acquirers both mentioned the following alternative payment options to Mastercard and Visa that can be used for UK-EEA cross-border transactions: [162, 163]

- American Express and Diners Club cards
- Apple Pay, Google Pay and PayPal

153 Ultimately an estimate of the cost of bank transfer payments informed the CNP IF levels that the European Commission used to determine the interchange caps that were part of the 2019 Commitments.

154 Visa response to PSR questions dated 5 August 2022. [✂]

155 Mastercard and Visa responses to PSR questions dated 12 January 2022. [✂]

156 Mastercard response to PSR questions dated 12 January 2022. [✂]

157 Mastercard response to PSR questions dated 12 January 2022. [✂]

158 Visa response to PSR questions dated 12 January 2022. [✂]

159 [✂]

160 Visa response to PSR questions dated 17 August 2023. [✂]

161 PSR merchant questionnaire and PSR acquirer questionnaire [✂]

162 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

163 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

- bank transfers and third-party solutions that rely on the same bank rails[164]
- BNPL solutions (such as Klarna)

**4.96** However, some stakeholders said that Apple Pay and Google Pay are proxy payment services for card payments – that is, they simply store card details and pass them to a merchant and its payment processor.[165] So, for cross-border transactions, they simply rely on international card schemes and, in particular, on Mastercard and Visa cards. As such, they cannot be considered real alternative payment options to Mastercard and Visa cross-border CNP payments – at least not in a sense that is different from other international card options.

**4.97** Acquirers and merchants also said that third-party solutions that rely on bank rails available in some EEA countries (such as iDEAL in the Netherlands and Blik in Poland) are generally not available in the UK, and that it would be too costly and not economically viable for merchants to adopt each of these.[166]

**4.98** We asked merchants if they steer consumers away from cards for UK-EEA transactions by encouraging them directly or indirectly to pay using alternative methods (despite the limited number available).

**4.99** All the merchants that responded to the questionnaire told us that they do not steer their consumers towards a specific payment method.[167] Rather, they let the consumers choose their preferred payment method. A merchant representative body, the BRC, stated that, in its view, steering techniques other than surcharging (such as asking the consumer to pay with a different payment method) may have limited effectiveness, as consumers typically have a preferred payment method for different reasons (for example, budgeting or rewards) and will use it despite encouragement to do otherwise.[168]

**4.100** We also asked acquirers and merchants:

- whether merchants can differentiate between CNP consumers that use EEA-issued cards rather than UK-issued cards [169]
- if so, whether merchants can or do apply a surcharge based on the jurisdiction where the card was issued for transactions that use EEA-issued cards[170]

**4.101** One acquirer explained that while, in principle, merchants can recognise and surcharge cards issued in another jurisdiction, doing so creates undesirable frictions in the consumer experience and can lead to abandonment of the transaction.[171] Other acquirers said they

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164 SEPA bank transfers, which allow consumers to send and receive cross-border payments in euros. SEPA bank transfers work the same way as domestic bank transfers as long as both countries are part of SEPA. Trustly, which uses Open Banking to offer consumers the ability to pay directly from their bank account without a debit or credit card. See https://www.trustly.com/cross-border-payments/what-are-open-banking-payments

165 Stakeholder response to PSR information request dated 11 January 2023. [✂]

166 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

167 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

168 BRC response to PSR information requests dated 11 January 2023. [✂]

169 PSR acquirer questionnaire. [✂]

170 PSR merchant questionnaire. [✂]

171 Stakeholder response to PSR information request dated 11 January 2023 [✂]

are not aware of any such practice.[172] Overall, no acquirer we spoke to said it is easy or common to surcharge based on the location of the issuer.[173]

**4.102** We also asked UK acquirers if they know of, or have facilitated, any actions other than relocation that the merchants they serve have taken (or plan to take) to avoid or mitigate higher UK-EEA cross-border CNP IFs. This question received no responses.

**4.103** Finally, we asked acquirers and merchants if they must accept any particular cards or alternative payment methods, including for UK-EEA remote transactions, or risk losing a significant number of consumers and transactions.[174]

**4.104** The UK acquirers and one merchant representative body, the BRC, that responded said that UK merchants must be able to accept Mastercard- and Visa-branded cards for remote transactions, including with EEA consumers. They said there are no merchants that accept only one of the two. This is because consumers expect merchants to accept Mastercard- and Visa-branded cards by default.[175] One respondent stated that Mastercard and Visa are 'a bare minimum setup for most merchants interacting with our platform', and 'not offering Visa or Mastercard would entail critical and existential losses' for them and most likely for any payment processing provider.[176]

**4.105** Some respondents said they also accept other payment methods, but Mastercard and Visa are the payment methods that consumers most commonly use and must be accepted to avoid 'conversion losses'. Other payment methods are much less commonly used and in some cases are offered mainly to expand consumer choice, but consumers are less aware of them or less likely to use them.[177]

### Our provisional views

**4.106** The availability of alternative payment methods depends on the location of both the consumer initiating the payment and the merchant receiving it. Our provisional view is that, in the UK-EEA context, UK merchants who want to engage in retail e-commerce with the EEA and EEA consumers who want to make purchases at UK merchants must take both Mastercard and Visa. In addition, UK merchants who engage in international trade with the EEA have few alternative payment methods besides Mastercard and Visa. These are:

- SEPA bank credit transfers and and third-party solutions that rely on the same bank rails
- other international card schemes (such as American Express and Diners Club)
- PayPal payments (to the extent that these are funded via a bank transfer and not via a Mastercard or Visa card).

**4.107** Digital wallets such as Apple Pay and Google Pay are also popular payment solutions. However, they are currently proxy payment services for cards, including in the cross-border space for international cards. So they can't be considered real alternatives to

172 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
173 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
174 PSR merchant questionnaire and PSR acquirer questionnaire. [✂]
175 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
176 Stakeholder response to PSR information request dated 11 January 2023. [✂]
177 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

Mastercard and Visa for UK-EEA cross-border CNP payments – at least not in a sense different from other international card options.

**4.108** PayPal is also often based on Mastercard and Visa card rails and funding, and [✂].[178] In 2022, EEA online retail payments to UK merchants made either with PayPal methods that are not based on international cards, or with international cards other than Mastercard and Visa, accounted for [✂]% of total volumes and [✂]% of total values.[179] In addition, [✂]. So PayPal represents a weak alternative to Mastercard and Visa.

**4.109** Klarna does not currently represent an alternative to Mastercard and Visa because, for cross-border transactions, it only facilitates card-based transactions.

**4.110** There are other third-party solutions for e-commerce, such as iDEAL and Blik, that rely on bank rails. But these are national offerings. iDEAL offers limited cross-border transactions services, facilitating SEPA payments from consumers in the Netherlands using SEPA Credit Transfer.[180] Blik is still confined to its domestic borders and does not offer a cross-border payment service. So, these third-party solutions do not represent strong alternative payment methods for UK merchants who want to engage in international trade across the EEA.

**4.111** The number of alternatives to Mastercard and Visa for UK-EEA CNP transactions is limited, given that some existing payment solutions, such as digital wallets, are also based on Mastercard and Visa payment rails. Currently, the only available alternatives for these transactions are other international cards (such as American Express and Diners Club), PayPal (to the extent that transactions are not based on Mastercard and Visa), SEPA bank transfers, and third-party solutions that rely on the same bank rails.

**4.112** In light of the evidence described above, our provisional view is that UK merchants who engage in international trade with the EEA must take both Mastercard and Visa. Mastercard- and Visa-branded cards, therefore, appear to be 'must-take' for merchants engaging in UK-EEA cross-border CNP transactions. There are very few alternatives to Mastercard and Visa for merchants who engage (or want to engage) in international trade with the EEA, and those that do represent an alternative offer only a very limited constraint on Mastercard and Visa. Such an outcome reinforces the must-take status of Mastercard and Visa.

**4.113** Turning to how merchants might steer consumers' choice of payment method, surcharging[181] is legal for UK-EEA transactions (unlike domestic transactions). Regulation 6A(1) of the Consumer Rights (Payment Surcharges) Regulations 2012 lays out a ban on surcharging by a payee to a payer for using a particular payment method.[182] Regulation 6B specifies that such a ban only applies when both the payer and payee are located in the UK.[183] Regulation 6A(2) states that the payee must not charge a fee that exceeds the cost it incurs for using that specific payment method.[184] But surcharging for UK-EEA transactions is likely to create consumer journey frictions, which may discourage merchants from

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178 Stakeholder response to PSR information request dated 20 July [✂]

179 PSR analysis [✂] and [✂]

180 See information available at: https://www.ideal.nl/en/ideal-information/

181 Surcharging is when a merchant adds an additional cost to a transaction depending on the payment method.

182 Consumer Rights (Payment Surcharges) Regulations 2012 (SI 2012/3110), section 6A, paragraph 1. See also: Department for Business, Energy and Industrial Strategy, *Guidance on the Consumer Rights (Payment Surcharges) Regulations* (June 2018), page 7, paragraphs 7.1 to 7.3.

183 Consumer Rights (Payment Surcharges) Regulations 2012 (SI 2012/3110), section 6B, paragraphs 1 to 3.

*184* Consumer Rights (Payment Surcharges) Regulations 2012 (SI 2012/3110), section 6A, paragraph 2.

introducing it. Merchants we have engaged with said that they do not typically surcharge.[185] UK merchants may also find themselves at a competitive disadvantage compared to EEA merchants selling the same products or services to those consumers.

**4.114** Finally, while merchants could use some behavioural steering of consumers towards a specific payment method, this typically involves some costs – for example, in designing the consumer interface. While a few merchants who are particularly impacted by the increase in UK-EEA outbound IFs may have some incentive to do this, it is unlikely that most UK merchants would be financially motivated to engage in such measures because the relevant transactions represent a very small share of all card transactions.

**4.115** Given the above, our provisional view is that consumer steering is unlikely to represent an effective competitive constraint on UK-EEA outbound IFs at this time.

## Provisional conclusions

**4.116** In this chapter we assessed the effectiveness of competitive constraints on Mastercard and Visa on the acquiring side and whether these constrain the level of UK-EEA outbound IFs that the two card schemes can set. As IFs are paid in the first instance by acquirers and indirectly by the merchants they serve, we considered possible responses of acquirers and merchants to an increase in UK-EEA outbound IFs.

**4.117** Our provisional view is that UK acquirers are passing on fee increases almost entirely to UK merchants, so any increases have very little direct financial effect on UK acquirers. In addition, despite the increases, acquirers have a strong incentive to continue to provide acquiring services for both Mastercard and Visa, given their must-take status.

**4.118** In light of the above, our provisional view is that UK acquirers' responses do not provide an effective competitive constraint on increases in UK-EEA outbound IFs.

**4.119** We have also provisionally found that merchants can't decline to accept either Mastercard or Visa as this would have a major effect on their businesses. If consumers find they can't use their preferred payment card, a material number of customers may respond by purchasing from a merchant that accepts the card. This confirms the must-take status of Mastercard and Visa.

**4.120** The HAC rule also prevents merchants from selectively declining a card brand and product (such as Visa consumer credit) because of the issuer's location. A merchant can only refuse to accept all cards for a given brand and product and hence for all transactions, not only cross-border but also domestic. Doing so would risk the loss of significant volumes of sales, making it highly unlikely that UK merchants would stop accepting Mastercard- or Visa-branded cards in response to an increase in UK-EEA outbound IFs.

**4.121** In addition, many merchants – especially SMEs – can't resort to cross-border acquiring practices or merchant relocation to reduce their exposure to increased UK-EEA outbound IFs. Relocating appears to be possible for only a limited number of very large merchants and merchants with significant cross-border operations. Even when a merchant relocates, this does not reduce the number of card transactions processed using Mastercard and Visa (given their must-take status), so the card schemes suffer little or no detriment.

185 Stakeholder response to PSR questions dated 11 January 2023. [✂]

This means that SMEs, who can't typically relocate because it is not economically viable for them to do so, are effectively unable to avoid any of the IF increases.

**4.122** We have also considered whether merchants could try, while continuing to accept Mastercard- and Visa-branded cards for UK-EEA CNP transactions, to steer their customers towards cheaper alternatives to mitigate the impact of the increases. We found, however, that merchants have limited ability to steer cross-border consumers to payment methods that allow them to reduce Mastercard and Visa payment volumes. Alternative payment methods available are few and they represent a weak alternative to Mastercard and Visa also because they are less popular among consumers – noting that it is customers who decide which of a merchant's payment options to use (and that Mastercard and Visa have must-take status). Accordingly, even where merchants may prefer to accept other payment methods, this does not necessarily or sufficiently constrain Mastercard and Visa. Our provisional view is that merchants must take Mastercard and Visa cards for fear of losing customers, and this means that merchants must accept paying the increased IFs.

**4.123** Finally, steering consumers towards a specific payment method typically involves some costs for merchants. So, it is unappealing to the majority of UK merchants for whom the relevant UK-EEA cross-border transactions represent a very small share of all card transactions.

**4.124** Our provisional view is that UK merchants' responses do not provide an effective competitive constraint on increases in UK-EEA outbound IFs.

**4.125** Overall, based on the evidence set out in this chapter, we provisionally conclude:

- There is a lack of effective competition on the acquiring side in relation to the setting of outbound IFs for UK-EEA CNP transactions.[186]
- There are no factors that effectively offset the effects of the lack of effective competition elsewhere in the system.

## Questions for stakeholders

### Question 2

- Do you have any views on our analysis and provisional finding that the Mastercard and Visa card schemes are subject to ineffective competitive constraints on the acquiring side when setting UK-EEA outbound IFs?

### Question 3

- Do you agree with our analysis and provisional finding that merchants' responses do not provide an effective competitive constraint on Mastercard and Visa in setting UK-EEA outbound IFs?

### Question 4

- Do you have any views on our analysis and provisional finding that cross-border acquiring is not currently possible and does not, therefore, provide an effective competitive constraint on increases in UK-EEA outbound IFs?

186 Effective competition supports good outcomes in payments markets, such as low prices, high service quality and continued innovation.

### Question 5

- Do you agree with our analysis and provisional finding that merchant relocation does not provide an effective competitive constraint on increases in UK-EEA outbound IFs? Does your view differ depending on the size of the merchant?

### Question 6

- Do you agree with our analysis and provisional finding that there are few alternative payment methods to Mastercard and Visa for UK merchants who engage in (or want to engage in) international trade with the EEA? And, where alternatives are present, they do not provide an effective constraint on Mastercard and Visa?

### Question 7

- Do you think there are any other competitive constraints on Mastercard and Visa in setting UK-EEA outbound IFs we have not yet considered, but should consider? If yes, please describe those constraints and their effect on Mastercard's and Visa's ability to set UK-EEA outbound IFs.

# 5 Stated rationale for the increases

This chapter summarises what Mastercard and Visa told us about their reasons for and considerations in deciding to increase outbound IFs to the current levels, when we asked about those. Where applicable, it also presents what third parties have told us in relation to possible reasons and considerations. The chapter also outlines our provisional assessment of that information.

We group the card schemes' responses into four themes and present their reasons and considerations in this order:

- issuer costs, in particular those attached to card payment fraud
- alternative payment methods and the cost to merchants of accepting them instead of Mastercard and Visa cards
- competitive interactions between the two card schemes on the issuer side
- other practical considerations.

## Introduction

5.1 As part of this review, we asked Mastercard and Visa to explain and justify their increases to UK-EEA CNP IFs. We requested access to internal documents and information to help us understand their respective positions. We also asked questions to third parties (UK acquirers, merchants and issuers) to better understand the key issues.

5.2 In the sections that follow, we summarise:

- what Mastercard and Visa told us
- what we have identified in Mastercard's and Visa's internal documents
- what third parties told us, where applicable
- our provisional views.

## What Mastercard and Visa told us

5.3 In summary, Mastercard and Visa explained that when deciding to increase the UK-EEA CNP inbound and outbound IFs, they considered:

- **Fraud levels and related issuer costs:** Mastercard said higher IF levels were justified because they better reflect the cost that issuers incur due to the higher fraud levels seen in CNP cross-border transactions. Visa said that cross-border e-commerce payments present a higher risk of fraud and may require issuers to invest further in risk and fraud detection systems. IFs help to support issuers with costs and risk associated with card issuing, including fraud. Visa said IFs [✁].

- **Cost to merchants of alternative payment methods:** Mastercard told us that they considered the cost of alternative payment methods when setting IFs for UK-EEA CNP cross-border transactions. Visa indicated that it had considered [✁].
- **Methodology underpinning the 0.2%/0.3% capping of CNP cross-border IFs:** Mastercard stated that the previous caps were not fit for purpose for all transactions in general, including for UK-EEA outbound IFs. It said that neither the underlying comparator (cash) nor the evidence underpinning the 0.2%/0.3% capping of cross-border IFs is appropriate in relation to any CNP IFs, including UK-EEA IFs. Visa stated that the approach used to set the 0.2%/0.3% IFR caps is not fit for purpose for all transactions in general, including for UK-EEA outbound IFs. It said that the underlying approach, which focused solely on cash as the only comparator, and [✁] are not appropriate for assessing any CNP IFs, including UK-EEA IFs today.
- **The 2019 Commitments and the UK's withdrawal from the EEA:** Mastercard said that after the UK's withdrawal from the EU, there was no objectively justifiable reason for **not** increasing inbound IFs up to the existing European Commission 2019 caps for transactions between the EEA and the rest of the world (RoW). Visa explained that [✁].
- **Competitive dynamics on the issuing side:** Mastercard said it felt compelled to increase its fees to remain attractive to EEA issuers following Visa's announcement that it would raise outbound IFs.
- **Practical benefits of aligning IFs for EEA cards at UK merchants with other IF levels:** Mastercard said that aligning outbound IFs with IFs for non-EEA cards transacting with UK merchants provides greater simplicity for UK acquirers and their merchants. Visa said that [✁].
- **Merchant-related considerations:** Visa said that it considered [✁].[187]

**5.4** We set out more detail on each of these below.

## Fraud levels and related issuer costs

**5.5** Like any other payment, a card payment carries a level of risk for fraudulent activity. While banks and financial institutions implement measures to protect cardholders, the evolving nature of fraudulent techniques and the presence of sophisticated fraudsters ensures the risk cannot be eradicated. Issuing banks may incur costs when dealing with fraud disputes and payment defaults – including operational costs, fees and financial losses.

187 Visa response to PSR questions dated 12 January 2022. [✁]

**5.6** Mastercard told us that its IFs for UK-EEA CNP transactions better reflected the higher issuer transaction costs that characterise UK-EEA CNP transactions, particularly those related to fraud disputes and payment defaults.[188]

**5.7** Mastercard explained that 'cross-border transactions have greater levels of fraud for issuers and are of higher value to merchants'.[189] It further stated that transaction costs (including as regards fraud and payment defaults) are one of the factors that Mastercard takes into account whenever setting IF rates.[190] Mastercard told us that it 'always held the view that the prevailing rates were too low and had fallen below costs over time (particularly given those related to cross-border CNP transactions), since the Interchange Fee Regulation used a benchmark based only on cash (and even then only a limited range of cash costs)'.[191] In other words, even before the UK's withdrawal from the EU, the previous rates for UK-EEA CNP transactions, and (implicitly, by extension) for other intra-EEA CNP transactions, failed to reflect the higher costs that CNP cross-border transactions generate for issuing banks.

**5.8** In the internal documents that were shown to senior decision makers at Mastercard and that were subsequently provided to us, specific fraud levels are not mentioned to justify increasing UK-EEA CNP IFs. Mastercard told us that fraud was a relevant factor when developing options involving higher fees. However, the evidence we saw indicated that the main concern and consideration was [✂].

**5.9** Mastercard was not able to provide us with specific information on the costs incurred by issuers due to fraudulent UK-EEA CNP transactions.

**5.10** When asked, Mastercard explained that it [✂] when setting the revised IF rates on EEA-UK CNP transactions and said that 'the rates which we set were based on the levels which had been set/accepted by the European Commission at the end of its long-running investigation. But that investigation did consider fraud as part of the reason for setting interchange at the rate which it did.'[192]

**5.11** Mastercard also explained that it 'does not have direct information on the specific costs of fraud and payment default, as these costs are primarily met by issuers. However, as noted in our previous response, these are factors that inform Mastercard's commercial judgment with respect to appropriate interchange fee levels. In particular, Mastercard is aware that the risk of fraud is elevated in the case of card not present and cross-border transactions, a payment specific factor that supports the differential interchange rates applied to CNP cross-border transactions in the UK and EEA.'[193]

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188 'Fraud disputes' are disputes when cardholders' accounts are debited for transactions they did not authorise. These usually occur when an individual's card details have been compromised and someone who has gained access performs unauthorised transactions, or when a fraudulent merchant is processing questionable transactions through to the consumer's account. They can also arise when a consumer disputes a transaction they made. This could be for several reasons, such as goods not received, goods not as described/damaged, cardholder charged incorrect amount, or processing errors. Mastercard Rules or Chargeback Guide, 'Cardholder dispute chargeback', page 46, and 'Fraud related chargebacks', page 76. 'Payment default' refers to situations when a consumer misses a payment or payments on a credit agreement they have entered.

189 Mastercard response to PSR questions dated 5 August 2022. [✂]

190 Mastercard response to PSR questions dated 5 August 2022. [✂]

191 Mastercard response to PSR questions dated 5 August 2022. [✂]

192 Mastercard response to PSR questions dated 30 June 2023. [✂]

193 Mastercard response to PSR questions dated 16 March 2023. [✂]

**5.12** Mastercard subsequently provided the following fraud-level data.[194]

**5.13** Table 3 illustrates the fraud levels, measured in basis points, reported by Mastercard for the period 2020 to 2022. It includes: i) the levels of fraud for UK domestic and intra-EEA cross-border CNP transactions (UK cards at UK merchants; EEA cards at EEA merchants); ii) the levels of fraud for UK cards used at EEA merchants and for UK cards used at non-EEA merchants; and iii) the levels of fraud for EEA cards used at UK merchants and for EEA cards used at non-EEA merchants.

**5.14** The table indicates that domestic transactions within the UK and domestic and cross-border transactions within the EEA are subject to fraud less often than cross-border transactions between the UK and the EEA and with non-EEA countries. Specifically, for cross-border transactions, transactions that take place between the UK and the EEA appear less subject to fraud than transactions involving non-UK and non-EEA countries. The table also indicates that fraud levels declined between 2020 and 2022 for both domestic and UK-EEA CNP transactions.

**Table 3: Fraud levels 2020 to 2022 reported by Mastercard (in basis points)**

**CNP transactions**

| Year | UK card at UK merchants | UK card at EEA merchants | UK card at non-EEA merchants |
|---|---|---|---|
| 2020 | [✁] | [✁] | [✁] |
| 2021 | [✁] | [✁] | [✁] |
| 2022 | [✁] | [✁] | [✁] |

**CNP transactions**

| Year | EEA card at EEA merchants | EEA card at UK merchants | EEA card at non-EEA merchants |
|---|---|---|---|
| 2020 | [✁] | [✁] | [✁] |
| 2021 | [✁] | [✁] | [✁] |
| 2022 | [✁] | [✁] | [✁] |

194 Mastercard response to PSR questions dated 6 July 2023. [✁]

**5.15** Visa told us that [✂].[195] We note that in its submission to the Treasury Select Committee, Visa stated that 'Cross border, ecommerce transactions have unique characteristics, including higher risk of fraud and the need for greater vigilance and investment by issuers to ensure their security and efficiency.'[196]

**5.16** Visa also explained that 'cross-border payments involve different patterns of spend, which may require issuers to invest further in: (i) risk and fraud detection systems to ensure that they strike the right balance between the risk of fraud and the inconvenience of card declines; and (ii) consumer service, to handle and resolve fraud complaints'.[197]

**5.17** Visa also said that 'interchange fees received by card-issuing entities help to support them with the costs and risk associated with card issuing, including, but not limited to, the administrative costs of maintaining a card issuing business, and fraud and bad debt costs. [✂].'[198]

**5.18** Visa also told us that [✂].'[199]

**5.19** In addition, Visa said that its decision to revise its interchange structure was [✂]'. It considered that, [✂].[200]

**5.20** We asked Visa to provide any existing documents relating to information that it had considered and/or any analysis it had used/carried out in support of the above statements and in particular that 'Cross-border, ecommerce transactions have unique characteristics, including higher risk of fraud'. [✂]. Visa explained that [✂].[201]

**5.21** Visa said it does not have visibility of the costs incurred by issuers due to fraudulent UK-EEA CNP transactions.

**5.22** Visa shared with us a report from the European Central Bank (ECB) that presents fraud rates for different types of transactions (for example, CP versus CNP) and in different areas (that is, domestic versus cross-border). The report contains information showing that cross-border CNP transactions are more prone to fraud but does not include anything specific to UK-EEA CNP transactions and does not provide any assessment of the cost impact of this.[202]

**5.23** The report explains that in 2019: 'domestic transactions accounted for 89% of the value of all card transactions, but only 35% of fraudulent transactions. Cross-border transactions within SEPA represented 9% of all card transactions in terms of value, but 51% of reported fraud. Although only 2% of all transactions were acquired outside SEPA, they accounted for 14% of fraud.'[203]

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195 Visa response to PSR questions dated 5 August 2022. [✂]
196 https://committees.parliament.uk/publications/28459/documents/171158/default/
197 Visa response to PSR questions dated 5 August 2022. [✂]
198 Visa response to PSR questions dated 5 August 2022. [✂]
199 Visa response to PSR questions dated 5 August 2022. [✂]
200 Visa response to PSR questions dated 5 August 2022. [✂]
201 Visa response to PSR questions dated 5 August 2022. [✂]
202 ECB, *Seventh report on card fraud* (October 2021).
203 ECB, *Seventh report on card fraud* (October 2021), page 3.

**5.24** We also asked Visa to provide fraud-level information, specifically for UK domestic and UK-EEA cross-border transactions (both CP and CNP). Visa said that it did not have such information readily available as this [✂]. Visa stated that sourcing the information required time, and, as such, it was not able to share that information with us in the initial timeframe. Subsequently, Visa provided data on fraud levels, and a note that outlined the role of interchange in managing transaction risk and described the provided data.[204] Data were provided in basis points (bps).[205, 206]

- Table 4 shows fraud levels, measured in basis points, reported by Visa for the period 2020 to 2022. Separately, for CP and CNP transactions, it includes: i) the level of fraud for UK domestic transactions (UK cards used at UK merchants; ii) the level of fraud for EEA cards used at UK merchants; and iii) the level of fraud for UK cards used at EEA merchants.
- Table 4 also shows that [✂]. In addition, it shows that [✂].

**Table 4: Fraud levels 2020 to 2022 reported by Visa (in basis points)**

**CNP transactions**

| Year | UK card at UK merchant | EEA card at UK merchant | UK card at EEA merchant |
|---|---|---|---|
| 2020 | [✂] | [✂] | [✂] |
| 2021 | [✂] | [✂] | [✂] |
| 2022 | [✂] | [✂] | [✂] |

**CP transactions**

| Year | UK card at UK merchant | EEA card at UK merchant | UK card at EEA merchant |
|---|---|---|---|
| 2020 | [✂] | [✂] | [✂] |
| 2021 | [✂] | [✂] | [✂] |
| 2022 | [✂] | [✂] | [✂] |

204 [✂]

205 Fraud levels are calculated by dividing the total value of fraud transactions in a given period of time by the corresponding value of total sales in the same period of time. Note that 100 bps = 1%.

206 Data for 2020 fraud levels refers only to Q3 and Q4 of 2020.

### What third parties told us

**5.25** We asked thirteen UK issuers, which collectively account for over 90% of UK card transactions by value, for information and opinions on operational costs, including any changes to these, following the UK's withdrawal from the EU when comparing UK-EEA cross-border CNP transactions with UK or EEA domestic transactions.[207]

**5.26** Most issuers we contacted told us they had not experienced any changes in operational costs after the UK's withdrawal from the EU.[208] Some issuers told us that fraud rates for CNP cross-border transactions are higher than CP domestic transactions, and this has an impact on the costs of transactions. A few issuers said that UK-EEA cross-border CNP transactions incur higher costs in scheme and processing fees and foreign exchange fees, which are charged by, and represent revenue for, the card schemes.[209]

**5.27** Regarding Visa's statement that [✂], we asked several UK acquirers and merchants whether they:

- have experienced any positive impact in terms of fraud levels for UK-EEA CNP transactions following the increases
- know if the increases were used for investments in fraud prevention
- have experienced a reduced number of rejected UK-EEA cross-border CNP transactions.[210]

**5.28** Acquirers and merchants said that they have seen no visible change in fraud prevention for UK-EEA CNP transactions following the increases in UK-EEA CNP IFs. Some also stated that fraud is already addressed via other funded mechanisms.[211]

**5.29** We also asked UK issuers how they use the additional income derived from the UK-EEA cross-border CNP IF increases and, in particular, if they re-invested it to increase security and anti-fraud measures.[212] Those who responded confirmed that they do not purposely re-invest this additional income to set up new anti-fraud measures or improve existing ones.[213] We have no reason to believe that EEA issuers take a different approach. However, most respondents said it is difficult for them to keep track of this particular revenue and to keep it separate from other sources: each issuer combines its income streams and bases investment on the overall availability of resources.[214]

207 PSR analysis. [✂]
208 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
209 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
210 PSR merchant questionnaire and PSR acquirer questionnaire. [✂]
211 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
212 PSR issuer questionnaire. [✂]
213 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
214 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

### Our provisional view

**5.30** Card schemes have said that the risk of fraud in CNP cross-border transactions is higher than in domestic and CP transactions. We also understand from various public statements that IFs can be used towards the costs and risk associated with card issuing, including, but not limited to, the administrative costs of maintaining a card issuing business, and fraud and bad debt costs**.** However, we see no evidence that the structure of IFs is linked to fraud risk and costs, or that it provides incentives for issuers to invest in fraud prevention.

**5.31** We haven't seen any contemporaneous evidence that card schemes' decision makers considered fraud differentials for UK-EEA CNP transactions when deciding to change IF levels on these transactions. Nor have we seen any direct link between (or calculations relating to) UK-EEA CNP transaction fraud levels and the new IF levels. We asked Mastercard and Visa for fraud-specific information they had considered when deciding to increase the fees but they could not produce it.

**5.32** We understand that the IF caps relating to transactions where RoW cards are used at EEA merchants set out in the 2019 Commitment decisions took into account fraud costs associated with alternative payment methods to cards.[215] However, it is unclear how the fraud costs taken into account in the 2019 Commitments process compare with the fraud rates for card transactions between various countries and regions set out above.

**5.33** We also note that the transactions relevant to the 2019 Commitments (CNP transactions between EEA merchants and consumers from non-EEA countries) are not the same as those relevant to UK-EEA outbound IFs (which are CNP transactions between UK merchants and consumers holding EEA-issued cards). In addition, the UK was part of the EEA at the time and so was not among those non-EEA countries. Mastercard's and Visa's decisions to raise UK-EEA outbound IFs to the same level as the IFs governed by the 2019 Commitments suggests that Mastercard and Visa may consider that fraud levels considered when setting the 2019 Commitments for the types of transactions governed by those commitments are comparable to fraud levels for UK-EEA CNP transactions. However, there is little reason to assume that fraud levels for the types of transactions governed by the 2109 Commitments and UK-EEA transactions are the same.

**5.34** While we have not seen the fraud data underpinning the 2019 Commitments levels and therefore cannot draw a direct comparison with that for UK-EEA CNP transactions provided by Mastercard and Visa in the tables above, the data made available to us by Mastercard is suggestive of higher fraud rates for transactions involving countries outside the EEA and the UK (that is, non-SEPA countries) than for transactions between the UK and EEA member states. If this is the case, the allowance made for fraud costs in the 2019 Commitments is likely to overstate that which would be reached from an analysis of fraud affecting the transactions relevant to UK-EEA outbound IFs. Similarly, the ECB data referred to by Visa also suggest that, in relative terms, when non-SEPA countries are involved, fraud levels appear to be higher than for transactions happening within SEPA.

215 European Commission, CASE AT.39398 – Visa MIF, Visa 2019 Commitments decision, recital 78; European Commission, CASE AT.40049 – Mastercard II, Mastercard 2019 Commitments decision, April 2019, recital 77.

**5.35** We recognise that if issuers want to, they can use part or all of their revenue from IFs to cover costs and risks associated with card issuing, including investments to mitigate fraud. However, we have seen no persuasive evidence that shows that individual issuers' fraud prevention investments are directly related to the IF revenue they receive. Indeed, we have identified no evidence to suggest the structure or level of IFs is linked to fraud costs or that it provides incentives to invest in fraud prevention.

**5.36** Moreover, Mastercard and Visa do not appear to have considered data or other evidence of such a relationship in their decision to increase UK-EEA outbound IFs. Our view on this was confirmed by statements from UK issuers that they do not track the cost of fraud specifically for UK-EEA outbound CNP transactions and have not invested the additional revenue from the higher IF levels to improve fraud prevention for these or other transactions.[216] Accordingly, our provisional view is that there is no direct link between the IF levels set by the schemes for UK-EEA transactions and the fraud levels characterising these transactions.

**5.37** We also note that Mastercard's fraud levels for UK-EEA CNP transactions were declining even before the higher IFs were introduced (see Table 3). This suggests that improvements in its fraud prevention were not hindered by the previous, lower IF levels.

## Cost to merchants of alternative payment methods

**5.38** Mastercard explained to us in its response that the cost to merchants of relevant alternative payment methods is an important factor it considers when setting IFs for UK-EEA CNP transactions, 'not least because it is an indication of the value of card payments to merchants'.[217]

**5.39** Mastercard explained that it 'always held the view that the prevailing rates were too low and had fallen below costs over time (particularly given these related to cross-border CNP transactions), since the Interchange Fee Regulation used a benchmark based only on cash (and even then only a limited range of cash costs)'.[218]

**5.40** It appears that Mastercard's view is that the merchants would face higher costs for alternative payment services, especially for costs relating to accepting cross-border CNP transactions.[219]

**5.41** For inbound IFs, Mastercard explained that it applied the IF rates contained in the 2019 Commitments in relation to inter-regional transactions 'which had been accepted based on a consideration of the alternative transaction methods available for those transactions, recognising cash was not such an alternative for card not present transactions'.[220]

**5.42** In terms of alternatives, Mastercard stated that the European Commission investigation that concluded with the 2019 Commitments had considered three-party schemes, cash, bank credit transfers and e-money transfers as alternative measures, 'with the European Commission placing more weight on the latter options in determining the interchange fee levels which should apply'.[221] However, in another response, it stated that 'an estimate of

216 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]
217 Mastercard response to PSR questions dated 5 August 2022. [✂]
218 Mastercard response to PSR questions dated 5 August 2022. [✂]
219 [✂]
220 Mastercard response to PSR questions dated 12 January 2022. [✂]
221 Mastercard response to PSR questions dated 5 August 2022. [✂]

the cost of bank transfer payments ultimately informed the card not present rates the European Commission used to determine the interchange caps that were part of those Commitments'.[222, 223]

**5.43** Mastercard also told us that some of the main alternatives for cross-border transactions are:

- cash
- alternative cards, such as American Express
- PayPal[224]

**5.44** Internal documents from Mastercard [✁]. Mastercard told us that the documents specific to the decision taken at the time when developing options involving higher fees include an implicit understanding by Mastercard and its senior team that the regulated rates of 0.2%/0.3% did not represent a level that would ensure efficient outcomes, particularly for CNP transactions, given the alternatives merchants would turn to instead of cards.

**5.45** Visa said that the previous IF levels were established by the European Commission based on an assessment of the costs of processing CP payments versus cash payments. Hence, there was no consideration of e-commerce environments because cash is not a 'comparator' for CNP transactions, which take place in different environments. It added that it considered [✁].[225]

**5.46** Visa also said that it [✁].[226]

**5.47** In addition, Visa said that [✁].[227]

**5.48** For example, one of the internal governance documents that Visa shared with us states that [✁]. The document also states, [✁].[228]

**5.49** We asked Visa for details [✁] of alternative payment methods.[229] In response, Visa said that [✁].[230]

**5.50** Visa, however, further stated that 'CNP payments have a multitude of alternative options, including Amex, PayPal, China Union Pay, AliPay and bank transfers'.[231]

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222 Mastercard response to PSR questions dated 12 January 2022 and 16 March 2023. [✁]
223 European Commission, CASE AT.40049 Mastercard II, Mastercard 2019 Commitments Decision, April 2019, recitals 78 and 85.
224 Mastercard response to PSR questions dated 12 January 2022. [✁]
225 Visa response to PSR questions dated 5 August 2022. [✁]
226 Visa response to PSR questions dated 5 August 2022. [✁]
227 Visa response to PSR questions dated 5 August 2022. [✁]
228 Visa, [✁]
229 Visa response to PSR questions dated 5 August 2022. [✁]
230 Visa response to PSR questions dated 5 August 2022. [✁]
231 Visa response to PSR questions and Visa dated 12 January 2022. [✁]

**5.51** Internal governance documents from Visa, produced at the time of its decision in relation to proposed changes to IFs, show that when deciding to increase the IF for UK-EEA CNP transactions, it considered [✁].[232, 233]

**5.52** We then asked Visa to provide any contemporaneous documents that support these statements.[234] Visa stated that, when making these statements (and considerations), it [✁].[235] [✁], Visa also said that there was publicly available information [✁]. For example, it stated:

- Account-to-account and/or digital wallet solutions, such as PayPal, cost UK merchants/acquirers between approximately between 2.49% and 4.19% per transaction
- For American Express, merchants are charged 3.95%, on average, for global transactions, plus a fixed fee
- For Klarna, a BNPL provider, a typical fee is between 2.60% and 2.99%, plus a fixed fee

### Our provisional view

**5.53** Where IFs need to be set by a regulator, they can be set based on the cost to merchants of accepting other payment methods. This is one approach and it is also the approach that sits behind the MIT – a test that has been used by the European Commission to cap specific IF levels set by Mastercard and Visa (EU IFR and the 2019 Commitments). The evidence we have seen gives no specific information that the card schemes used the costs of other payment methods in the UK-EEA context in setting the new IF levels; as such, it appears they did not use a MIT or appropriate alternative to calculate these levels. The schemes set out a qualitative argument about alternative payment methods but did not provide any quantitative analysis as to how these costs related to the actual fee increases.

**5.54** Collectively, Mastercard and Visa directly or indirectly mentioned the following payments as alternatives:

- PayPal
- three-party card payment schemes (such as American Express)
- cash
- other means of payment that can be funded by bank transfers, such as e-wallets, e-payments or bank transfer payments

**5.55** A digital wallet ([✁]) heavily relies on Mastercard and Visa rails both in the UK and in the EEA. We set out its scale first in the UK, second in the EEA, and then cross-border. In 2022, [✁] % of this digital wallet's total UK domestic transactions by value were card based, and Mastercard and Visa alone accounted for [✁] % of its total UK domestic transactions (that is, just [✁] % of its total UK domestic transactions by value were made using alternative card schemes).[236] Within the EEA, [✁] % of this digital wallet's transactions by value were card based, and [✁] % of total transactions were made with a Visa- or Mastercard-branded card.

232 Visa response to PSR questions dated 12 January 2022. [✁]
233 Visa response to PSR questions dated 12 January 2022. [✁]
234 Visa response to PSR questions dated 5 August 2022. [✁]
235 Visa response to PSR questions dated 5 August 2022. [✁]
236 PSR internal analysis of data submitted by a digital wallet [✁] as part of the s81 notice. [✁]

In terms of cross-border payments, [✁] % of transactions, by value, made by EEA consumers at UK merchants using this digital wallet were card based, with [✁] % made using Visa- or Mastercard-branded cards (that is, just [✁] % of these transactions by value were made using alternative card schemes).[237] The cost of its services to merchants will incorporate Mastercard or Visa IFs (and scheme and processing fees), including for UK-EEA CNP transactions. So, this digital wallet's payment services do not represent a suitable alternative for benchmarking the card schemes' pricing.

**5.56** We understand that cash was mentioned by Mastercard only as a relevant alternative in the context of CP, not CNP, transactions.[238]

**5.57** We have not seen any evidence that Mastercard or Visa considered the cost of relevant or appropriate alternatives, such as bank transfer payments and the other payment methods that bank transfers can fund, such as e-wallets. As Mastercard also stated, the European Commission relied on an estimate of the cost of non-SEPA bank transfer payments when it evaluated the levels informing the 2019 Commitments.[239] In the UK-EEA context, SEPA bank transfers would be the relevant alternative to consider. Despite this, we have not seen any specific assessment or consideration from Mastercard or Visa on the costs of this alternative.

**5.58** We also note that for the 2019 Commitments made by both Mastercard and Visa, the relevant comparator for CNP cross-border transactions was (non-SEPA) bank transfers.[240] PayPal and American Express were not included as comparators.

**5.59** Our provisional view is that the current levels have been set seemingly arbitrarily and free from competitive constraints, representing a failure on the part of the card schemes to consider what might be an appropriate methodology or benchmark for UK-EEA CNP IFs.

## Methodological issues raised

**5.60** Both Mastercard and Visa explained that one of their reasons for increasing their UK-EEA CNP IFs was methodological flaws in a study commissioned by the European Commission in 2015 (the European Commission study).[241] They considered that these flaws made the study unsuitable as the basis to set IF levels for UK-EEA CNP transactions.

237 PSR internal analysis of data submitted by a digital wallet [✁] as part of the s81 notice. [✁]

238 Mastercard, Letter to the Treasury Select Committee (2 August 2022), page 7.

239 European Commission, CASE AT.40049 – Mastercard II, Mastercard 2019 Commitments decision (April 2019), recitals 78 and 85.

240 European Commission, CASE AT. 40049 – Mastercard II, Mastercard 2019 Commitments decision (April 2019), recital 79(b) and European Commission, CASE AT.39398 – Visa MIF, VISA 2019 Commitments decision (April 2019), recital 80(b).

241 European Commission, *Survey on merchants' costs of processing cash and card payments: final results* (March 2015).

**5.61** As mentioned in paragraph 5.7, Mastercard told us that in its view the 0.2%/0.3% IF levels were too low and had fallen below costs over time, particularly for cross-border CNP transactions. Mastercard also told us that this was because the European Commission study[242], which underpinned the IFR caps, used a benchmark based only on cash and even then included only a limited range of cash costs.[243]

**5.62** Mastercard provided two 2016 presentations from the consultancy [✂][244] providing 'further details on Mastercard's view on the limitations of the assessment underpinning the imposed IFR rates'.[245]

**5.63** In particular, one of the two 2016 documents included a number of criticisms of the European Commission study in general and in relation to the applicability of its findings to the costs incurred by EEA merchants for accepting payments from outside the EEA. The document mentioned:

- **The non-suitability of cash as a comparator:** In an inter-regional context, due to the high proportion of credit and online transactions, cash may not, even in principle, be a suitable alternative, while other alternatives to four-party card payments exist. The analysis from the consultancy [✂] adjusted the European Commission study estimates by considering American Express and PayPal among the relevant comparators – that is, it was not based solely on cash and did not include bank transfers.
- **Limited and non-representative merchant sample:** The number of merchants that responded to the merchant survey was too low and the sample turnover was dominated by large merchants in the retail sector, which is a poor representation of the 'average merchant' for the purposes of a MIT. The analysis from the consultancy [✂] adjusted the European Commission study estimates by considering a merchant size that in its view was likely to be a better estimate of the overall average MIT MSC than an estimate based on the merchant size considered by the European Commission.
- **Self-selection and reporting bias:** Participation depended on whether the MIT was likely to be in the merchant's 'best interest' – that is, whether it perceived cost of cards was high relative to cash, leading to low MIT IF estimates by construction. In addition, merchants in the sample would have had an incentive to provide responses in line with the desired final result. Questions that require an element of judgement are likely to be particularly susceptible to such biases.
- **Cost of processing payments:** The European Commission study focused too much on the short term and did not sufficiently consider long-term scenarios where fixed costs become variable. The analysis from the consultancy [✂] adjusted the European Commission study estimates by using econometric techniques to give more prominence to the longer run and the related absence of fixed costs.

**5.64** Visa told us that its decision to increase the level of UK-EEA consumer cross-border IFs was taken as [✂].[246]

242 European Commission, *Survey on merchants' costs of processing cash and card payments: final results* (March 2015).
243 Mastercard response to PSR questions dated 5 August 2022. [✂]
244 [✂]
245 Mastercard response to PSR questions dated 5 August 2022. [✂]
246 Visa response to PSR questions dated 5 August 2022. [✂]

**5.65** Visa explained that: 'A clear difference between a CP transaction and a CNP transaction is that cash is not a "comparator" for CNP transactions, which take place in different environments. This is important because the pre-existing interchange levels of 20/30bps (mandated by the EU IFR) were established by the European Commission on the basis of a single methodology which used surveys conducted in 2012/2013 across 10 different Member States. These surveys focused only on analysing merchants' costs of processing CP card payments versus cash payments in order to support the European Commission's view of an appropriately harmonised level of EEA-wide interchange at that time. There was no consideration of ecommerce environments, and for this reason alone, levels of 20/30bps would not be appropriate for CNP transactions, particularly in light of the substantial growth in the proportion of CNP transactions since that time.'[247]

**5.66** Specifically, on 'the nature of the underlying analysis that established the rates of 20/30bps', Visa told us that 'The European Commission established interchange caps of 0.2%/0.3% in the EU IFR on the basis of the so-called "Merchant Indifference Test" (MIT), based on which the European Commission sought to equate merchants' costs of accepting card payments only with those of accepting cash.' The analysis mentioned by Visa is the one included in the 'European Commission Survey on merchants' costs of processing cash and card payments' (that is, the European Commission study).[248]

**5.67** Visa said that, in its view, the European Commission study contained a number of methodological flaws that make it inappropriate to be used as a basis for supporting UK-EEA cross-border interchange at a level of 0.2%/0.3% today.[249] In particular, Visa stated that the European Commission study:

- Did not specifically analyse EEA cross-border transactions; Visa stated that [✂].'[250]
- [✂] Visa stated that [✂].' [251]
- Did not include any analysis of CNP transactions; Visa stated that [✂].'[252]
- Focused exclusively on cash as the only comparator to card payments; Visa stated that [✂].' Visa added that [✂]. As such, [✂].' [253]

**5.68** Internal governance documents from Visa also address this issue. For example, in one of its internal governance documents, Visa stated that 'The current consumer EEA interchange rates (0.20% Debit and 0.30% Credit) were based on a domestic cost of cash study. The study did not take account of the fact that domestic cash is not a comparator for cross-border CNP transactions (as recognised in the different rates for CNP transactions agreed with the Commission in the European Commission Commitments).' In the same document, it also stated: 'We have consistently argued, and we believe, it has been demonstrated, that [✂] and [✂].'[254]

247 Visa response to PSR questions dated 5 August 2022. [✂]

248 European Commission, [Survey on merchants' costs of processing cash and card payments: final results]() (March 2015).

249 Visa letter to the PSR dated 14 October 2022. [✂]

250 Visa, [✂]

251 Visa, [✂]

252 Visa, [✂]

253 Visa, [✂]

254 Visa, [✂]

**5.69** Visa has provided evidence consistent with it holding the view that the 20/30 bps levels at which interchange was capped were inappropriate, including:[255]

- [✁]
- [✁]
- Finally, [✁].[256] [✁].

### Our provisional view

**5.70** We recognise that, prior to the UK's withdrawal from the EU, caps on IF levels for UK-EEA transactions were set using cash as the comparator payment method, and that cash is primarily a comparator for CP transactions.

**5.71** This argument would hold also for all CNP transactions between EEA countries, and not just for UK-EEA CNP transactions. Intra-EEA CNP transactions are still capped at 0.2%/0.3% under EU IFR; however, we do not see any sign of these fees being too low – that is, having negative implications for merchants and consumers. Fraud levels, for example, are declining for both CP and CNP cross-border transactions capped at 0.2%/0.3%, such as intra-EEA transactions and UK-EEA transactions (before the caps were increased).[257]

**5.72** We currently consider that, by increasing the outbound IFs for CNP transactions to levels included in the 2019 Commitments, the parties have adopted a benchmark that is not suitable – that is, they have replaced one not-relevant comparator (cash) with another not-relevant comparator (non-SEPA bank transfers). This means that the IFs have been raised higher than the level that would likely have been obtained from a commonly established methodology based on appropriate comparators. The additional evidence provided by the parties in this context includes methodological assumptions that are not necessarily appropriate for this market review. This is discussed in more detail below. We also note the European Commission is likely to have considered studies commissioned by the card schemes when making its decisions and there is a reasonable expectation that there is a sound rationale for why it produced studies and set the IF cap levels as it did.

**5.73** [✁]. The European Commission has instead considered the MIT, given the merchants' need to accept cards even when they cost them more than alternative payment methods, for fear of losing customers (see Chapter 4). Given both the age and the purpose for which [✁], we do not consider them or their results to be relevant, both in general and in the context of this market review.

**5.74** The [✁][258] and [✁].[259] Visa told us that [✁]. One of Visa's main criticisms of the European Commission study of 2015 (*Survey on merchants' costs of processing cash and card payments*) is that cash as a comparator to card payments is inappropriate for CNP transactions.

**5.75** [✁] We note that as part of the 2019 Commitments decision, the European Commission took 'into account that in inter-regional transactions there are the following main groups of payment service providers: four-party card payment schemes; three-party card payment

255 Visa, response to PSR questions dated 12 January 2022. [✁]

256 [✁]

257 ECB, [Card fraud in Europe declines significantly]() (May 2023). See also Mastercard's data in Table 3.

258 [✁]

259 [✁]

schemes; other means of payments that can be funded by bank transfers, such as e-wallets (digital wallets), e-payments or bank transfer payments'. On the basis of the information it collected, the European Commission identified a distinct comparator for inter-regional CNP transactions. The European Commission said that: 'For inter-regional CNP transactions cash could not be considered a valid alternative. Other alternatives, that are means of payments funded via bank transfers (which are outside the domestic payment systems of the EEA Contracting Parties and the Single European Payment Area, SEPA; "nonSEPA bank transfers")' were identified as plausible payment alternatives for the purposes of the MIT.[260]

**5.76** Similarly, the analysis that the consultancy [✂] produced for Mastercard is now over six years old and relies heavily on comparators such as American Express and PayPal, and did not consider bank transfers. Mastercard told us that the consultancy's [✂] analysis identified alternative comparators as being more relevant than 'naked' bank transfers for that case, and therefore used these in the MIT.[261]

**5.77** We note the card schemes' argument that cash, which represented the only comparator utilised in the European Commission study of 2015, may be less relevant and potentially inappropriate as a comparator to cards in the CNP cross-border context. However, in adopting the benchmarks underpinning the 2019 Commitments for EEA-RoW transactions and their corresponding IF levels for UK-EEA transactions, we provisionally conclude that Mastercard and Visa appear not to have considered likely differences that characterise UK-EEA transactions compared to RoW-EEA transactions, including: i) that the UK is part of SEPA but the RoW-EEA caps used non-SEPA bank transfers as a comparator; ii) even if we agreed fraud levels were relevant, the fraud levels could be lower for UK-EEA transactions than RoW-EEA transactions. Both of these elements are likely to represent lower costs to UK merchants of accepting payments in a SEPA context compared to a non-SEPA one.[262]

**5.78** On the evidence and reasoning provided, we are not persuaded that the card schemes' methodologies and the information in their submissions to us form a sound basis for the current UK-EEA CNP IF levels.

## The 2019 Commitments and the UK's withdrawal from the EEA

**5.79** Mastercard explained to us that, for inbound IFs, it applied the IF levels contained in the 2019 Commitments in relation to EEA-RoW interregional transactions 'which had been accepted based on a consideration of alternative transaction methods available for those transactions'.[263]

**5.80** In Mastercard's view, following the UK's departure from the EU, aligning the IFs for transactions at EEA merchants using UK-issued cards with the IFs that apply to transactions at EEA merchants using (other) non-EEA-issued cards was a logical approach. In this regard, it stated that 'as the UK was now outside of the EEA, there was no

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260 European Commission, CASE AT.39398 – Visa MIF, [VISA 2019 Commitments decision (April 2019), recital 80]; European Commission, [Antitrust: Commission accepts commitments by Mastercard and Visa to cut inter-regional interchange fees] (April 2019). More details on the MIT applied by the European Commision in the context of the inter-regional CNP transactions can be found at footnote 45 and recitals 81 to 86 of the Commitments decision.

261 Mastercard defined a 'naked' bank transfer as '*An interbank payment from a consumer account to a merchant account using the relevant inter-bank system. 'Naked' refers to the use of such transfers outside the context of a broader scheme or payment service that provides additional security or functionality to the sender or receiver of the payment*'. [✂]

262 PSR analysis based on our online analysis of the top six banks in the UK. [✂]

263 Mastercard response to PSR questions dated 12 January 2022. [✂]

objectively justifiable reason to apply different rates to UK-issued cards compared with any other non-EEA issued cards (for transactions at EEA merchants)', and 'it is likely that questions would have been raised by UK issuers had that change not been made'.[264, 265]

**5.81** Mastercard internal documents show that the levels in the 2019 Commitments [✂].[266] These rates were seen as [✂] while potential 'new' lower rates (that is, above 0.2%/0.3% [✂]) were [✂]. The same internal documents also show that [✂].[267] Mastercard subsequently told us that [✂].'[268]

**5.82** Contrary to the purpose of setting IFs, for the purpose of setting scheme and processing (S&P) fees relevant to UK-EEA CNP transactions, Mastercard considered the UK's SEPA membership as a reason not to change these S&P fees.[269] This was because, as per their internal documents, [✂].[270]

**5.83** Even before it became known that [✂], Mastercard [✂] Internal documents from 2017 show that Mastercard's UK team suggested that Mastercard [✂].[271] The same approach could have been applied for UK-EEA IFs. Our provisional view is that the fact that both the UK and the EEA are part of SEPA is a reason for not raising outbound IFs to levels that have been defined for transactions where cards are issued in non-SEPA countries.

**5.84** Indeed, internal documents on UK-EEA pricing considerations stated that [✂]. This was because [✂]. The same internal documents also stated that [✂]. However, Mastercard identified that one of the main challenges to doing so was [✂].[272]

**5.85** Visa said that its changes reflected the fact that the previous IFs were determined on the basis of the UK being subject to the EU IFR. It explained that now that the UK is no longer a member of the EEA, it (Visa) had moved 'to an interchange structure that represents levels that are consistent with cross border transactions'. It also told us that the previous IF rates for UK-EEA CNP transactions [✂].[273]

**5.86** Visa also explained that 'as a global organisation, it is necessary to have a global interchange structure that reflects the geopolitical and trading status of the countries we operate within and between. [✂].[274]

264 Mastercard response to PSR questions dated 12 January 2022 and 5 August 2022. [✂] See also Mastercard, *Mastercard response to TSC* (August 2022), page 7.

265 As mentioned in Chapter 3, IFs related to transactions involving RoW cards at UK merchants are capped by the 2019 Commitments.

266 Mastercard, [✂]

267 Mastercard, [✂]

268 Mastercard, [✂]

269 Mastercard, [✂]

270 Mastercard, [✂]

271 Mastercard, [✂]

272 Mastercard, [✂]

273 Visa response to PSR questions dated 12 January 2022 [✂]

274 Visa response to PSR questions dated 5 August 2022 [✂]

**5.87** Visa stated in its submissions to us that [✂]. Those submissions included an overview of the card scheme's considerations when Visa decided to change IFs at the time, as well as the documents that relate to those decisions.[275]

**Our provisional view**

**5.88** The 2019 Commitments were based on a merchant indifference test (MIT) (see Chapter 3) that used non-SEPA bank transfers as a comparator for CNP transactions. Although the UK is no longer part of the EU, it is part of SEPA (see Chapter 3). So, the evidence used to set the IFs in the 2019 Commitments is not relevant to UK-EEA transactions.

**5.89** While increasing IFs to the levels permitted by the 2019 Commitments may be commercially justified for Mastercard and Visa, it is not necessarily in the interests of UK merchants and their consumers. Our provisional view is that the fact that both the UK and the EEA are part of SEPA is a reason for not raising outbound IFs to levels that have been defined for transactions where cards are issued in non-SEPA countries. There is no technical reason for the UK to be treated any differently from its fellow SEPA member countries.

**5.90** Visa also stated that [✂].[276] [✂].

**5.91** However, even following the UK's withdrawal from the EU, the UK's trading status with the EEA remains more similar and closer to the EEA than to many RoW countries. The new fee structures, however, consider that the trading status of the UK is the same as that of any other RoW country, which is not the case.

**5.92** In our assessment of the evidence and reasoning provided to us by the card schemes, we are not persuaded that the UK's withdrawal from the EU represents a sound basis for concluding that higher IF levels are appropriate.

## Competitive dynamics on the issuing side

**5.93** In its letter to the TSC, Mastercard said that: 'to remain competitive and continue to offer benefits of electronic payments to consumers, Mastercard must be able to attract issuing and acquiring banks to the scheme. Interchange fees at the right level allow this by ensuring the costs of issuing and acceptance are properly and fairly balanced in the system. The rates Mastercard offers must be comparable with its competitors, otherwise its cards will simply not be issued.'[277]

**5.94** Mastercard explained to us that they are a two-sided platform facing 'the commercial imperative to attract, and keep on board, both types of users' (for example, cardholders and merchants).[278] In this regard cardholders are customers of the issuers and are on the issuing side of the platform as compared to merchants who are on the acquiring side. Mastercard further explained that: 'in competing with other payment platforms, [it] faces the challenge of keeping issuers and acquirers participating in the platform, and keeping sufficient consumers and merchants using the platform where it is available to them.'[279]

275 Visa response to PSR questions dated 5 August 2022 [✂]
276 Visa response to PSR questions dated 5 August 2022 [✂]
277 Mastercard, *Mastercard response to TSC* (August 2022), page 6.
278 Mastercard response to PSR questions dated 12 January 2022 [✂]
279 Mastercard response to PSR questions dated 12 January 2022 [✂]

**5.95** It explained this means that card schemes that rely on IFs 'are competitively constrained both from increasing and decreasing these fees too far from the commercial optimum, given the risk of business being lost to any rival platforms or payment services with a more competitive pricing structure'.[280]

**5.96** Mastercard stated that 'in the absence (or in advance) of any potential alternative regulatory benchmark which applied specifically to the UK, Mastercard decided to apply the same IFs as those contained in the 2019 Commitments in relation to RoW-EEA transactions.' It did so 'with an awareness of the competitive considerations related to rival payment services who also provide cross border transactions.'[281]

**5.97** Mastercard also said that in March 2021 Visa announced it was increasing its inbound and outbound IFs to the maximum set by the 2019 European Commission Commitments. Mastercard explained [✂]. It continued: [✂].[282]

**5.98** Mastercard then told us that in view of this [✂] and 'in the absence of any alternative regulatory benchmark which applied specifically to outbound IFs, it revisited its position on these [outbound] rates and decided to increase also these to the levels allowed by the 2019 Commitments.'[283]

**5.99** From Mastercard's internal documents it is clear that its main concern, when deciding what to do with UK-EEA CNP IFs following the UK's withdrawal from the EU, was the [✂]. For example, one document, which considers competitive dynamics, shows that [✂]. However, the same document also shows that [✂].[284]

**5.100** Internal documents from Mastercard show that the [✂].[285] Mastercard then stated that: 'any commercial advantage would be short-lived' (because Visa was likely to match the rates). Likewise, any commercial disadvantage if Visa raised the rates a few months before Mastercard was likely to be short-term. However, Mastercard was also very concerned about a long term/permanent commercial disadvantage if Visa's interchange rates remained at a higher level that was better aligned with the level required to ensure the success of a four-party scheme.[286]

**5.101** Internal Mastercard documents also show that [✂]. In internal documents it produced [✂].[287, 288]

**5.102** In addition, internal Mastercard documents show that, [✂].

**5.103** In its response to us, [✂].

**5.104** Visa did not mention this as a reason for increasing the fees, [✂].

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280 Mastercard response to PSR questions dated 12 January 2022 [✂]
281 Mastercard response to PSR questions dated 12 January 2022 [✂]
282 Mastercard response to PSR questions dated 5 August 2022 [✂]
283 Mastercard response to PSR questions dated 5 August 2022 [✂]
284 Mastercard, [✂]
285 Mastercard, [✂]
286 Mastercard, [✂]
287 Mastercard, [✂]
288 Mastercard, [✂]

**5.105** We saw evidence in internal documents that Visa considered it a relevant factor that, [✂]. In particular, in internal documents, Visa noted that [✂]. It also noted that [✂].[289] In addition, Visa's documents noted that [✂] and that [✂].

**Our provisional view**

**5.106** We currently consider that an increase in IFs may increase (or at least maintain) the attractiveness of cards to card issuers. In light of the available evidence, we currently consider that Mastercard and Visa wanting to remain attractive to issuers (particularly to EEA issuers for outbound IFs) is a reason why the card schemes raised their outbound IFs after the UK's withdrawal from the EU.

**5.107** Visa announced it was increasing its outbound IFs level and Mastercard followed suit (see Chapter 3) to match the uplift [✂]. This was despite Mastercard's statement that, as a two-sided platform, it has a commercial imperative to attract, and keep on board, both types of users: in this case their only concern was issuers and not the users on the acquiring side, such as merchants. While Visa's response to us did not explicitly mention the need to remain competitive, [✂].

**5.108** We therefore provisionally conclude that schemes have a commercial incentive on the issuing side to raise IFs.

## Merchant-related considerations

**5.109** Visa explained to us that [✂].[290]

**5.110** We asked Visa to explain how higher IFs enable merchants to make better-informed decisions about their payment options. Visa said that [✂]. Visa also said [✂].[291]

**5.111** We asked Visa to provide any existing documents (including presentations and reports either prepared internally or by third parties relating to information that they considered, or analysis that they carried out), that support the statement that [✂].[292]

**Our provisional view**

**5.112** We have not seen any evidence indicating how an increase in IFs could benefit merchants, and we do not currently consider that the higher fees help merchants make better-informed choices.

**5.113** We are also unaware of any allocative inefficiencies that historical regulatory intervention may have created. Visa (and Mastercard) are widely used in both the UK and the EEA and their use has increased over time despite regulatory interventions.

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289 Visa, [✂]

290 Visa response to PSR questions dated 12 January 2022 [✂]

291 Visa response to PSR questions dated 5 August 2022 [✂]

292 Visa response to PSR questions dated 5 August 2022 [✂]

## Mastercard and Visa's statements on the value of their card propositions

**5.114** Mastercard and Visa have both told us the value their card-scheme networks bring to different participants – issuers, cardholders and merchants.

**5.115** Visa states that its mission is to be the best way to pay and be paid, everywhere.[293] It explains that IFs are an integral feature of four-party card schemes and that it does not earn revenue from them.[294] Instead, Visa provides a value transfer from acquirers, playing an essential role in balancing the costs and incentives of issuers, cardholders, merchants and acquirers. Taking each in turn:

- **Issuers:** Visa states that IFs help issuers to offer many of the banking services that are typically free to UK cardholders, including the ability to use a card online and across borders, while enjoying the protections and security they expect. Visa also considers that IFs help enable competition, incentivising issuers to provide innovative products and services.
- **Cardholders:** Visa states that cardholders benefit from services such as a convenient yet secure checkout experience, which challenges bad actors without creating unnecessary frustrations for legitimate customers.
- **Merchants:** Visa states that merchants benefit from increased sales, due to cardholders being able to buy from them safely and reliably, including online and across borders.[295] They also benefit from the protections and security of the transaction and authorisation checks.

**5.116** We have not seen in internal documents, contemporaneous to the setting of the higher IF levels, any evidence supporting the above representations.

**5.117** Mastercard states that merchants benefit strongly from the ability to accept CNP transactions from cardholders in other countries. It is confident that the UK-EEA CNP rates implemented ensure that both merchants and cardholders in the UK and the EEA share in the benefits that arise from the scheme and its activities.[296] Mastercard states that the value it brings to users includes improved payment efficiency, increased security and stability, innovative payment products, and – for merchants – reduced barriers to entry, increased sales and expansion of the consumer base. Mastercard states that:

- Its technology and expertise make payments safe, simple and smart.
- Its security systems continuously protect the Mastercard network and the transactions and data that cross it against fraud and cybercrime. New products and services that help protect users include SCA, tokenisation, biometrics, machine-learning and the latest EMV chip card security.
- It guarantees the settlement of Mastercard transactions between its principal issuers and acquirers. It explains that this helps enable global acceptance of Mastercard-

293 Visa response to PSR questions dated 12 January 2022 [✂]
294 Visa response to PSR questions dated 5 August 2022 [✂]
295 Visa response to PSR questions dated 5 August 2022 [✂]
296 Mastercard response to PSR questions dated 5 August 2022 [✂]

branded cards by providing acquirers and merchants with a recourse in the event that a cardholder fails to settle.

- It transforms new ideas and emerging technology into attractive, scalable services – for example, contactless payments.
- Merchants and cardholders both benefit from higher-value transactions thanks to direct access to current accounts and credit lines. Merchants therefore directly benefit from the higher profit margins linked to more and higher-value transactions.

**5.118** We have not seen in internal documents, contemporaneous to the setting of the higher IF levels, any evidence supporting the above representations.

### Our provisional view

**5.119** Though the card schemes have said that IFs provide a value transfer from acquirers and are essential in balancing the costs and incentives of issuers, cardholders, merchants and acquirers, we have not seen any evidence that they sought to 'balance' the costs to and incentives of issuers, cardholders, merchants and acquirers in deciding to increase outbound IF fees.

**5.120** While the card-scheme networks may aim to bring value to different participants, we have not seen any evidence identifying a benefit to UK merchants that would explain the increases in UK-EEA CNP IFs. For example, we have seen no evidence of any particular innovation to account for IF increases – such as improved fraud prevention, quality, efficiency or economy of the card payments systems benefiting UK merchants. This suggests that the card schemes have been able to extract the value from the increase in UK-EEA CNP IFs to the benefit of issuers with no comparable increase in value to other participants.

## Practical benefits of aligning IFs for EEA cards at UK merchants with other IF levels

**5.121** Mastercard told us that in the absence of regulatory certainty or guidance and in light of potentially conflicting priorities of issuers and acquirers in the UK and the EEA, it was seeking an approach that fairly balanced the interests of all parties within its ecosystem. It explained that consistency and predictability was a key consideration. It therefore considered alignment/reciprocity was an objective, non-discriminatory and logical basis for IF rates that could readily be understood [✂] by any participant.[297]

**5.122** Mastercard considered that aligning IF rates for transactions at EEA merchants on UK-issued cards with the rates for transactions on (other) non-EEA-issued cards was a logical approach, following the UK's departure from the EU.[298]

**5.123** We asked whether and how these benefits had been measured and compared to the additional cost imposed on merchants by the outbound IF increases. Mastercard explained that: 'as the benefit being referred to is not a direct financial benefit to issuers or Mastercard, it is not possible to weigh it against any costs to merchants. As explained,

297 Mastercard response to PSR questions dated 5 August 2022 [✂]

298 Mastercard response to PSR questions dated 5 August 2022 [✂]

it is the benefit of consistency and objectivity at the scheme level overall, which therefore accrues to acquirers/merchants as much as to issuers'.[299]

**5.124** We have not seen specific mention of any positive benefits to merchants from alignment with non-EEA-to-UK IFs in Mastercard's internal documents.

**5.125** Visa stated in its response to our questions that the new outbound IF levels meant that, from a UK merchant perspective, all incoming transactions (from non-UK consumer cards such as the USA, Australia or France) would have the same interchange rates applied.

**5.126** Visa told the TSC that these changes harmonised the interchange levels for non-UK consumer cards being used online with UK merchants. For example, irrespective of whether a consumer debit card is issued in the USA, Australia or France, a UK merchant will pay the same level of interchange on a cross-border e-commerce purchase.[300]

**5.127** Visa explained that: 'a simpler interchange structure [✁].'[301]

**5.128** Visa also explained that this is consistent with 'Visa's 2013 antitrust commitments with the European Commission in which, at the European Commission's request, Visa committed to reducing the number of different interchange levels by at least 25% to aid transparency and comparison between rates.'[302]

**5.129** We asked Visa to provide us with any contemporaneous documents it had considered showing the alleged simplicity benefits. Visa told us [✁].[303]

### Our provisional view

**5.130** While Mastercard refers to the benefit of consistency and predictability in applying the same IF levels in relation to both inbound and outbound UK-EEA IFs, we note that Mastercard initially decided not to adopt this approach. This suggests that, at least initially, Mastercard did not consider reciprocity to be a particularly strong consideration. Its suggestion that there was no direct financial benefit to issuers of this benefit was not one we found convincing.

**5.131** It is also not clear to us how raising IFs would generate 'consistency' and/or 'predictability'. We consider that leaving inbound and outbound IF levels at the levels they were before the UK's withdrawal from the EU would have achieved a higher degree of 'consistency' and 'predictability' at no extra cost to merchants, and that those existing levels were capable of being readily understood by participants.

**5.132** Harmonising the interchange structure for non-UK consumer cards used online with UK merchants was mentioned as one of the elements that Visa considered when deciding to increase UK-EEA CNP IFs. However, it is unclear to us how any alleged benefits from such a claimed simpler structure for merchants would outweigh the detriment imposed on the same merchants by the increased IFs they would face. We have seen no evidence that merchants were seeking 'a simpler interchange structure'. Nor have we seen any evidence that merchants have welcomed the 'simpler interchange structure', notwithstanding the increased IFs that accompanied it. Indeed, the evidence we have received from merchants

299 Mastercard response to PSR questions dated 5 August 2022 [✁]
300 Visa, Visa Response to Treasury Select Committee on Cross-border Interchange.
301 Visa response to PSR questions dated 5 August 2022 [✁]
302 Visa response to PSR questions dated 5 August 2022 [✁]
303 Visa response to PSR questions dated 5 August 2022 [✁]

has been that these extra costs are not welcomed and did not provide any benefits to them. In addition, by keeping the levels as they were before, the existing relatively simple interchange structure could have continued, but at no cost for merchants.

**5.133** Therefore, our current view is that the increase in fees was not justified by reference to the benefits put forward by Visa or Mastercard.

## Provisional conclusions

**5.134** As part of our assessment of the reasons put forward as to why Mastercard and Visa have increased UK-EEA outbound IFs, we have provisionally concluded that the two card schemes have strong commercial incentives, on the issuing side, to increase such fees.

**5.135** We have considered several potential benefits of and reasons for increasing outbound IFs but, as illustrated in this chapter, we have not seen any persuasive evidence to indicate that the increases were necessary or appropriate. This suggests that the card schemes have been able to extract the value from the increase in UK-EEA outbound IFs to the benefit of issuers with no comparable increase in value for other participants.

### Fraud levels

**5.136** Card schemes have said that the risk of fraud in CNP cross-border transactions is higher than in domestic and CP transactions. We also understand from various public statements that IFs can be used towards the costs and risks associated with card issuing, including, but not limited to, the administrative costs of maintaining a card-issuing business, and fraud and bad debt costs. Card schemes have also told us that the previous levels were not appropriate in relation to any CNP transactions, and that the UK's withdrawal from the EU provided them an opportunity to address their concerns.

**5.137** However, we have identified no evidence to suggest the structure or level of IFs is linked to fraud risks and costs, or that it provides incentives for issuers to invest in fraud prevention. In addition, we have identified no evidence that IFs are used by issuers for this purpose. Even assuming a direct link between fraud levels and IFs, we haven't seen any contemporaneous evidence that – when deciding to change IF levels on these transactions – the schemes' decision-makers considered fraud differentials for EEA-UK CNP transactions or calculations relating to UK-EEA CNP transaction fraud levels and the new IFs levels.

**5.138** Instead, our current view is that the main reasons why the two schemes increased their fees are the issuer-side incentives they face and to ensure they remained on a level playing field with each other.

**5.139** The evidence indicates that IFs represent income for issuers, and Mastercard and Visa compete for the same issuers who then stimulate card use and generate income for the card schemes. Our current view is that fraud differentials for UK-EEA CNP transactions do not explain the change in IF levels; there is no direct link between UK-EEA CNP transaction fraud levels and the new IF levels.

**5.140** Finally, we do not consider (and have not seen evidence) that the IF levels applicable before the increases carried any obvious risks, or undermined or otherwise adversely affected the operations of either of the two payment systems in ways that caused detriment to service users, distorted competition or presented an impediment to innovation, relative to the increased IF levels. Specifically, to date, we have not seen any evidence to suggest that they presented an impediment to innovation including in fraud prevention – where fraud levels on these transactions have been decreasing over time – for example, by constraining the amount of resources that EEA issuers could invest.

### Cost of alternative payment methods and methodological concerns with prior levels set

**5.141** We recognise that IFs, especially in Europe, are typically capped by relevant authorities on the basis of the cost to merchants of accepting alternative payment methods. Both card schemes indicated that the previous caps were not fit for purpose especially for UK-EEA outbound IFs, considering that these were based on cash as a comparator and due to other **methodological concerns** that they have expressed to us, in relation to the previous cap levels.

**5.142** We have found limited evidence that the schemes considered alternative payments and costs specifically for the purpose of setting UK-EEA outbound fees. The evidence we have seen gives no specific information that the card schemes used the costs of alternative payment methods in setting the new IF levels. They do not appear to have used a MIT or appropriate alternative to calculate these levels. The schemes set out a qualitative argument about alternative payment methods but did not provide any quantitative analysis of how these costs related to the actual fee increases. The evidence indicates that their considerations were based on implicit understanding and institutional knowledge about these issues. Where they have provided some documents, these are not necessarily relevant to the changes in scope.

**5.143** Both card schemes later provided submissions on alternatives, all typically more expensive to merchants, that would justify the increases based on an approach that looks at the cost of acceptance for merchants. In addition, both card schemes made references to the fact that by adopting the 2019 Commitments they have implicitly considered alternative payment methods suitable for cross-border CNP transactions. However, we have not seen evidence pertaining to alternative payment methods and cost information specific to UK-EEA CNP transactions.

**5.144** While we note that the previous levels were set based on the cost of cash payments to merchants and that cash is primarily a comparator for CP transactions, we are not persuaded that the card schemes' approach to setting UK-EEA CNP IFs and the information in their submissions form a sound basis for the current IF levels. The evidence we have seen gives no specific information that the card schemes analysed and used the costs of alternative payment methods in setting the new IF levels, or that they considered whether the cost of such an alternative payment method would be a reasonable proxy for a competitive price level. If they had done so, it may have helped ensure the new IF levels were set at more appropriate levels.

**5.145** Ultimately, by adopting the levels included in the 2019 Commitments for UK-EEA CNP IFs the card schemes have indirectly adopted levels that are based on bank transfers. However, the 2019 Commitments relied on an estimate of the cost of non-SEPA bank transfer payments. These bank transfers are not relevant in the UK-EEA context where SEPA bank transfers would be the relevant alternative to consider. Despite this, we have not seen any specific assessment or consideration from Mastercard or Visa on the costs of this alternative. We are therefore not persuaded that the current IF levels are appropriate.

**5.146** For the same reason, that is, the fact that the 2019 Commitments applied to a different and wider geographical scope, we do not currently consider that the new levels can be simply justified based on the **UK's withdrawal from the EU**. We are not aware of any operational changes related to card payments between the UK and the EEA. Considering that the UK continues to be part of SEPA, while other RoW countries are not, we are not persuaded that the levels established for RoW and non-SEPA countries are appropriate for UK-EEA transactions and outbound IFs.

**5.147** Therefore, we currently consider that Mastercard and Visa adopted levels that had been set in another context and for different circumstances, that is for cards issued in non-EEA (and non-UK at the time) countries and used at EEA (including the UK at the time) merchants. In doing so, we currently consider that Mastercard and Visa have adopted benchmarks that are not relevant to the UK-EEA context, and have, therefore, likely pushed UK-EEA CNP IFs to an unduly high level. The current levels also do not reflect the fact that the UK remains part of SEPA.[304]

### Benefits to merchants and benefits to issuers

**5.148** We considered whether **practical benefits to merchants** related to the alignment of UK-EEA outbound IFs with other international IF levels could be a reason for the increase in UK-EEA outbound IFs. We have considered whether there may be practical benefits for merchants including the possibility that the IF increases could help merchants to make better-informed choices on payment options. We have found no evidence to suggest that the alignment and increase of IFs generated any benefits to UK merchants, and certainly not to an extent that offsets the five-fold increase in the fees that they now must pay following these decisions.

**5.149** **It is our current view that the main reasons why the two schemes increased their fees are the issuer-side incentives they face and to ensure they remained on a level playing field with each other**, noting both schemes compete for the same issuers for card issuance. Visa's announcement to raise outbound IFs created a commercial imperative for Mastercard to increase its fees for outbound IFs, to remain attractive to EEA issuers.

**5.150** It is unclear what other factor, or change in circumstances, apart from the political shift and deregulation of outbound IFs created by the UK's withdrawal from the EU, could have prompted the change in IF levels.

**5.151** As explained in Chapter 4, we provisionally find that the lack of effective competitive constraints on the acquiring side means that both schemes could set higher outbound IFs for UK-EEA CNP transactions.

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304 Prior to the SEPA regulation, cross-border credit transfers and direct debits often took a long time to be completed and incurred significant interbank fees. The SEPA regulation effectively created a new class of SCT and SDD payments, completed in a guaranteed time with no deductions from the amounts transferred and much lower transaction fees for cross-border transactions. For example, all six UK major banks do not charge their customers for initiating or receiving SEPA payments. Some of these, however, apply a charge for non-SEPA payments. This improves the efficiency of financial transactions and allows all merchants, including UK merchants and SMEs, to receive payments from SEPA countries on a similar basis to their domestic payments. It follows that the cost to UK merchants of accepting payments from EEA consumers cannot be as high as the cost they incur for accepting payments from consumers in non-SEPA countries. If a benchmark were to be used that was more relevant to UK-EEA transactions, and in particular that reflected the fact that the UK continues to be part of SEPA, we currently consider that it is likely that a lower level of IFs would have resulted.

**5.152** We currently consider that Mastercard and Visa have both focused predominantly on issuer-side commercial considerations. Our current view is that the card schemes do not balance the costs and the interests of all service users when setting IF levels. There is no obvious constraint on how these prices are set that would lead them to consider the interest of users on the acquiring side. While issuers and card schemes may benefit from this revenue generation, we have identified no clear corresponding benefit to merchants from the increases.

**5.153** We, therefore, provisionally conclude that the card schemes were motivated by the upward pressure on UK-EEA CNP IFs arising from their commercial relationships with issuers, which was unconstrained by the acquirer/merchant side of the market. In the next chapter, we explain how this could adversely affect UK merchants and their consumers.

## Questions for stakeholders

**Question 8**

- Based on the analysis outlined in Chapter 5, do you have any views on our reasoning and provisional conclusion that fraud differentials do not justify or explain the increases in UK-EEA outbound IFs?

**Question 9**

- Do you have any views on our analysis and provisional conclusions that both Mastercard and Visa's methodologies for setting outbound IFs appear to have failed to consider that:
  a. the UK is part of SEPA
  b. even if fraud levels were a relevant consideration in setting the IFs, the appropriate fraud levels for UK-EEA transactions could be lower than those for RoW-EEA transactions?

**Question 10**

- Do you have any views about our analysis and provisionl conclusions that it was Mastercard and Visa's desire to remain attractive to issuers (particularly EEA issuers for outbound IFs) that was the main reason why they raised their outbound IFs following the UK's withdrawal from the EU?

**Question 11**

- Do you have any views on, can you point to, or can you provide any evidence that might illustrate any practical benefits that may have accrued to UK merchants because of the increases in UK-EEA CNP IFs (and their alignment with non-EEA-to-UK IFs)?

# 6 Impact of the increases

This chapter sets out our current view on the effect of the increase in outbound interchange fees on UK merchants and – to the extent that those fees are passed through – on their customers.

## Introduction

**6.1** It is our current view that the lack of effective competitive constraints we have provisionally identified on the acquiring side (Chapter 4), combined with the commercial incentives on the issuing side to increase IFs (Chapter 5), creates a distortion in the setting of outbound IFs leading to adverse outcomes for UK merchants and their consumers. We currently consider that the effect of upward pressure on UK-EEA outbound IFs ultimately, as we explain in this chapter, feeds in to retail prices. To date, we have identified no countervailing benefits elsewhere in the system. As discussed in this chapter, we also have not found evidence that lower IFs would be detrimental to innovation or that higher IFs have stimulated innovation.

**6.2** In the rest of the chapter, we:

- consider the extent to which the outbound IF increases have affected UK merchants
- illustrate how merchants' customers are likely to be affected by the increases in outbound IFs

### The extent to which UK merchants have been affected by the outbound IF increases

**6.3** Increases in outbound IFs represent an additional cost for UK merchants serving consumers who use EEA-issued cards, which are reflected in higher merchant service charges (MSCs) (see Chapter 4, paragraphs 4.36 - 4.39). As an increased cost to merchants, this may also result in higher consumer prices. As identified in Chapter 4, we currently consider that these increases are enabled by a lack of effective competition on the acquiring side and, in the absence of countervailing benefits elsewhere in the system (for example on the issuing side of the payment platforms), we have provisionally concluded that these lead to worse outcomes for those using payment systems: UK merchants and, ultimately, their customers.

**6.4** To the extent that higher UK-EEA outbound IFs are passed through to consumers, we currently consider that the effects are unlikely to be limited to those consumers who use the cards that generate the higher IFs (that is, EEA consumers, in the case of outbound IFs). Considering them in their commercial context, in our view it is likely that higher card costs will be reflected, to some degree, in prices for all consumers, including those using UK-issued cards and those who do not pay with a card at all.

**6.5** The ultimate impact on merchants and their customers depends on the pass-through rates from acquirers to merchants and from merchants to consumers.

**6.6** We set out our provisional view on the extent to which acquirers and merchants can pass on these fee increases in the sections that follow.

## Pass-through of fee increases from acquirers to UK merchants

**6.7** As explained in Chapter 3, following the increases in UK-EEA CNP IFs by Mastercard and Visa, our provisional conclusion is that UK acquirers paid additional outbound IFs of approximately £150 million to £200 million in 2022 – and, going forward, with the current outbound IF levels they are very likely to pay a similar amount on an annual basis.

**6.8** Impacts on merchants depend on the degree of pass-through of these higher IF costs from their acquirers. As discussed in Chapter 3, Figure 2, in 2022 around 80% of UK-EEA CNP cross-border transaction values were with UK merchants on IC++ or IC+ pricing tariffs, both of which entail automatic pass-through of IFs to merchants, including the full extent of any changes in IFs. We estimate that this means that:

- Approximately 80% of the value of the 'additional' IFs will have been automatically passed through from acquirers to UK merchants.
- The remaining 20% of the value of the 'additional' IFs is associated with merchants on Fixed or Standard pricing tariffs. Whether acquirers pass through these charges to the merchants or internalise them is dependent on each acquirer's approach to pricing. This is discussed below.

**6.9** Based on data provided by our representative sample of UK acquirers, we estimate that around 75% of the 'additional' IFs associated with merchants on Fixed or Standard pricing tariffs have been passed through by their acquirers to merchants over the 12 to 18 months following the increases.[305] As a consequence:

- Overall, approximately 95% of the value of all the 'additional' outbound IFs was passed through to UK merchants over the last year.
- The remaining IF increases were absorbed by a small number of acquirers – these mainly related to merchants on Fixed pricing.[306]

**6.10** Given the above, and assuming the volume and value of Mastercard and Visa CNP transactions at UK merchants does not change, we currently consider that UK merchants are paying an additional £150 million to £200 million per year.

### Large merchants and SMEs

**6.11** As described in Chapter 4, while a small number of large merchants have relocated their UK-EEA sales to an EEA-based subsidiary and, in doing so, mitigated the impact of the increase in UK-EEA outbound IFs, the vast majority of UK merchants, particularly SMEs, have been unable to do this. Hence, they have not been able to avoid the cost increases and have felt the full force of these.

305 Many [✂] acquirers who did not immediately pass through the higher IF charges [✂] have told us they have now done so in the 12 to 18 months following the increases, as part of their repricing exercises. Some have explained that to do so they reclassified UK-EEA cross-border transactions from being treated as domestic to being treated as international transactions. This meant that they could pass through the higher charges to merchants automatically, as the MSCs these acquirers charge for international transactions are higher than for domestic transactions.

306 Stakeholder responses to PSR information requests dated 11 January 2023. [✂]

### What industry is telling us

**6.12** To date, we have received feedback on the impact of the IF increases from seven large merchants and some merchant representative bodies accounting for important proportions of UK-EEA retail CNP transactions.

**6.13** Feedback from the large merchants on the IF increases was mixed:

- Some [✁] told us that they have not been affected by the IF increases, either due to their ability to process UK and EEA transactions via a corresponding domestic entity to avoid cross-border IFs (that is, through relocation) or because most of their transactions were domestic.[307]
- Others [✁] told us that their costs had risen due to IF increases, and that their ability to mitigate those increases was limited.[308]
- One merchant told us that it has been negatively affected by the increase in interchange fees, but has not yet taken any remedial action. It is currently evaluating different options, including relocation, since its acquirers allow this.[309]

**6.14** We received several representations from merchant representative bodies on the effects of these IF increases on merchants of all sizes.

**6.15** The British Retail Consortium (BRC) said that 'to merchants, these [IF increases] are simply increased costs without any corresponding value delivered. It appears to be Visa and Mastercard taking advantage of a regulatory loophole…'.[310]

**6.16** The Startup Coalition (formerly Coadec) similarly stated that it had heard 'extensively through our ecosystem members … that the current state of the Card market means that merchants often have little to no choice but to accept cards, regardless of the rate of cross-border interchange [fees]'.[311]

**6.17** The above comments from merchant representatives align with our provisional view (discussed in Chapter 4) that not all merchants with cross-border operations have been affected to the same extent by the IF increases. While larger merchants appear to have an ability to react to IF increases by relocating, SMEs are particularly disadvantaged since, in practice, relocation is not a viable option for them.

## Pass-through of fee increases from UK merchants to consumers

**6.18** As outlined earlier, we have estimated that the annual cost of increased UK-EEA outbound IFs on UK acquirers and merchants is £150 million to £200 million. The evidence described above indicates that the vast majority of these increases were passed on by acquirers to UK merchants. This section considers pass-through from UK merchants to consumers in the UK and the EEA.

307 Stakeholder responses to PSR information requests dated 11 January 2023. [✁]
308 Stakeholder responses to PSR information requests dated 11 January 2023. [✁]
309 Stakeholder response to PSR information request dated 11 January 2023. [✁
310 BRC response to PSR information request dated 11 January 2023. [✁]
311 The Startup Coalition response to PSR working paper dated 15 December 2022 [✁]

**6.19** Economic theory and empirical evidence from several studies suggest that, over time, merchant cost changes will be passed through, at least to some extent, to consumer prices.[312] The extent to which such additional costs can be passed through to consumers depends on a range of factors that characterise the affected industries and firms. These include intensity of competition, elasticity of demand, slope of marginal cost curve and whether the cost changes are industry-wide or affect only some firms. Empirical evidence also suggests that there may be significant differences in the degree of cost pass-through between firms in the same industry, even when the cost change is industry-wide.[313]

**6.20** Given the differences in cost pass-through rates between industries and even between firms within the same industry, arriving at an overall estimate of the proportion of the additional £150 million to £200 million paid by merchants following the increase in outbound UK-EEA IFs that has been passed through to consumers would involve significant work, which we do not consider would materially influence the overall conclusion. In our view, the full amount is unlikely to be passed through to consumers under typical market conditions.[314] We expect that the adverse effect will be to some material extent shared between UK merchants (in the form of reduced margins) and also part of it may be passed on to their consumers in the form of higher retail prices.

**6.21** In the cross-border setting, where the increases in UK-EEA outbound IFs may be passed on by merchants, the question arises as to what proportion of these increases is borne by UK as opposed to EEA consumers. Since the increase in outbound IFs arises from EEA-issued cards, which are generally held by EEA rather than UK consumers, it might be assumed that any resulting increase in consumer prices would mostly affect EEA rather than UK consumers. However, such an outcome would require prices to be tailored to specific groups of consumers based on the location of their card issuer, or (as a proxy) of the consumer. As we have discussed in Chapter 4, this approach is not always feasible or desirable for a merchant.

**6.22** The most direct way of targeting the pass-through of higher UK-EEA outbound IFs at those consumers who generate it would be to levy a surcharge on EEA-issued consumer cards. However, as outlined in Chapter 4, merchants do not widely impose surcharges on consumers based on the country where their card is issued.

**6.23** Alternatively, some merchants set different retail prices for consumers in the UK and those in EEA countries, an approach known as territorial pricing. This may be achieved by, for example, using separate websites each aimed at consumers in a different country or region. A merchant that engages in territorial pricing could choose to reflect the increase in UK-EEA outbound IFs in its pricing to EEA consumers only, while leaving its UK pricing unchanged.

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312 For a literature review, see RBB Economics, *Cost pass-through: theory, measurement, and potential policy implications, A Report prepared for the Office of Fair Trading* (February 2014).

313 RBB Economics, *Cost pass-through: theory, measurement, and potential policy implications, A Report prepared for the Office of Fair Trading* (February 2014), page 6 and Chapter 8.

314 RBB Economics, *Cost pass-through: theory, measurement, and potential policy implications, A Report prepared for the Office of Fair Trading* (February 2014), footnote 18 and sections 4, 6 and 7.

6.24 However, territorial pricing is not a feasible or desirable practice for all merchants. For it to be feasible there must be barriers preventing large numbers of consumers in the country facing the higher price from purchasing at the lower price intended for the other territory, otherwise such arbitrage would undermine the price differential and ultimately eliminate it. Territorial pricing also incurs additional costs for the merchant, such as creating and maintaining separate websites and taking measures to direct customers to the appropriate website for their location. Merchants may conclude that attempting to differentiate their pricing between the UK and the EEA is not worthwhile and instead set a common, uniform price across the region.

6.25 For merchants that set a common price across the UK and the EEA, pass-through of higher UK-EEA outbound IFs affects their UK customers as well as those in the EEA. As with pass-through rates themselves, arriving at an overall estimate of the proportion of this that is borne by UK consumers – as opposed to those in the EEA – is not necessary or proportionate, as our provisional findings are not dependent on this. However, in our view, it is implausible that the entire burden of any pass-through of higher UK-EEA outbound IFs will fall on EEA consumers alone. Accordingly, we currently consider that there are very likely to be some material impacts on UK consumers too, as well as impacts on UK merchants.

## Our concerns

6.26 We are currently concerned that UK merchants, especially SMEs, and potentially some of their UK customers, are adversely impacted as a result of these additional costs. The evidence shows (see Chapter 3) that the increase in outbound IFs in 2022 amounted to approximately £150 million to £200 million extra paid by UK merchants that year and, to the extent this is passed through, their customers.

### Questions for stakeholders

**Question 12**

- Do you have any views on our assessment of the impact of the fee increases on UK acquirers and merchants?

# 7 Our provisional conclusions

This chapter explains why the evidence we have seen to date leads us to provisionally conclude that aspects of the markets are not working well in the interests of all service users, and therefore that intervention may be appropriate.

## Introduction

**7.1** In this chapter, we set out:

- our overall concerns, including drawing on previous chapters of this interim report
- our provisional conclusions on whether the markets are working well in the interests of service users, and whether intervention may be appropriate

## Our provisional conclusions

**7.2** Effective competition supports good outcomes in payments markets, such as low prices, high service quality and continued innovation.

**7.3** In Chapter 4, we provisionally concluded that the evidence shows that Mastercard and Visa are likely to be subject to ineffective competitive constraints on the acquiring side in the setting of outbound IFs, which distorts the market against UK merchants and their customers. Both card schemes have a commercial incentive on the issuing side to increase outbound IFs. We are concerned that this lack of effective competition has resulted in outcomes that are not in the interests of all service users, particularly UK merchants.

**7.4** Also in Chapter 4, we provisionally concluded that limited alternatives mean that UK merchants who engage in international trade with the EEA must take both Mastercard and Visa. It is either commercially or practically hard for UK merchants who want to do business remotely to decline or materially attempt to reduce volumes of payments with Mastercard or Visa cards in response to the IF increases. Mastercard and Visa-branded cards, therefore, appear to be ‘must-take’ for merchants engaging in UK-EEA cross-border CNP transactions.

**7.5** In Chapter 5 we considered several potential benefits of and reasons for increasing outbound IFs, as put to us by the schemes, but we provisionally concluded that we have not seen any persuasive evidence to indicate that the increases in outbound IF levels by each of Mastercard and Visa were necessary or appropriate. We currently consider that Mastercard and Visa have both focused predominantly on issuer-side commercial considerations. Our current view is that the card schemes do not balance the costs and the interests of all service users when setting IF levels. There is no obvious constraint on how these prices are set that would lead the schemes to consider the interest of users on the acquiring side. While issuers and card schemes may benefit from this revenue generation, we have identified no clear corresponding benefit to merchants from the increases. On the contrary, we provisionally concluded that both Mastercard and Visa focused predominantly on issuer-side commercial considerations and because of that were both incentivised to increase IFs for UK-EEA CNP transactions.

**7.6** Our current view is that the lack of effective competitive constraints on the acquiring side, combined with the commercial incentives on the issuing side to increase IFs for UK-EEA CNP transactions, indicates that, when it comes to outbound IFs, prices are distorted across each side of the payment platforms to the detriment of UK acquirers and merchants. Our current view is that, having regard to our competition, service-user and innovation objectives, the detriment that might flow from this distortion is not balanced by countervailing benefits elsewhere in the system. We currently consider that this combination of features is likely to put upward pressure on UK-EEA CNP IFs, and ultimately on retail prices, without adequate justification.

**7.7** As we provisionally concluded in Chapter 5, we currently consider that, when deciding to increase outbound IFs, Mastercard and Visa did not ensure that the interests of all users were taken into account. In particular, Mastercard and Visa adopted levels that had been set in another context and for different circumstances: for cards issued in non-EEA (and non-UK at the time) countries such as the USA or Japan and used at EEA (including the UK at the time) merchants. In doing so, our current view is that Mastercard and Visa have adopted benchmarks that are not relevant to the UK-EEA context, and have, therefore, likely pushed UK-EEA CNP IFs to an unduly high level.

**7.8** In addition, as set out in Chapter 5, Mastercard and Visa's decisions to raise UK-EEA outbound IFs to the same level as the IFs governed by the 2019 Commitments suggests that they may consider that the fraud levels considered when setting the 2019 Commitments for the types of transactions governed by those commitments are comparable to fraud levels for UK-EEA CNP transactions. However, there is little reason to assume that fraud levels for the types of transactions governed by the 2019 Commitments and for UK-EEA transactions are the same. Rather, we provisionally consider that the allowance made for fraud costs in the 2019 Commitments is likely to overstate that which would be reached from an analysis of fraud affecting the transactions relevant to UK-EEA outbound IFs.

**7.9** As explained in Chapter 5, we have not seen any contemporaneous evidence that the schemes' decision-makers considered fraud differentials for EEA-UK CNP transactions when deciding to change IF levels on these transactions. Nor have we seen any direct link between (or calculations relating to) UK-EEA CNP transaction fraud levels and the new IF levels. Accordingly, our provisional view is that there is no direct link between the IF levels set by the schemes for UK-EEA transactions and the fraud levels associated with these transactions. Rather, it is unclear what other factor, apart from a political shift (the UK's withdrawal from the EU), prompted the schemes to choose to raise outbound IFs to their current levels. Beyond this political shift, nothing else has changed to affect these levels.

**7.10** Finally, we do not currently consider (and have not seen evidence suggesting) that the IF levels applicable before the increases carried any obvious risks, undermined or otherwise adversely affected the operations of either of the two payment systems in ways that caused detriment to service users, distorted competition or presented an impediment to innovation. Specifically, to date, we have not seen any evidence to suggest that they presented an impediment to innovation, including in fraud prevention – where fraud levels on these transactions have been decreasing over time – for example, by constraining the amount of resources that EEA issuers could invest.

**7.11** As explained in Chapter 6, we expect that the adverse effect of the increase in UK-EEA outbound IFs will be to some material extent shared between UK merchants (in the form of reduced margins) and also part of it may be passed on to their consumers in the form of higher retail prices.

**7.12** We are concerned that the upward pricing pressure referred to in paragraph 7.5 is evidence of a lack of effective competition, is not incentivising any additional innovation, and is resulting in higher costs and prices for UK merchants, especially SMEs, and their customers, to their detriment. In particular, in relation to innovation we have seen no evidence of any particular innovation to account for IF increases – such as improved fraud prevention, quality, efficiency or economy of the card payments systems that benefit UK merchants.

**7.13** In light of the above, we provisionally conclude that at least part of the cost and price effects on UK merchants and their customers described in Chapter 6 are the result of the issues described in Chapters 4 and 5 and that these aspects of the markets are not working well, nor are they in the interests of these service users. In addition, we are concerned that, if left unregulated, Mastercard and Visa may have an incentive to continue to raise outbound IFs while UK merchants cannot avoid or benefit from them.

**7.14** We provisionally conclude (see Chapters 4 and 6) that only a few very large UK merchants were able to avoid the increases by relocating some or all of their transactions to the EEA. Evidence shows that relocation is not commercially viable for most UK merchants, especially for SMEs. We note this may indicate that SMEs may be particularly adversely impacted by the increases in outbound IF levels.

**7.15** We have considered the above in light of our statutory objectives under FSBRA. As set out in Chapter 2, we have a statutory objective to ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of those who are likely to use services provided by payment systems (our 'service user' objective) and to promote effective competition and innovation in the interests of those users (our 'competition' and 'innovation' objectives respectively). For the most part these objectives are mutually supportive.

**7.16** Having regard to each of our statutory objectives, and in light of our provisional conclusions set out in this chapter and the wider interim report, we provisionally conclude that:

- Mastercard and Visa are likely to be subject to ineffective competitive constraints on the acquiring side and that there is a lack of effective competition in relation to the setting of outbound IFs which distorts the market against UK merchants (and to the extent of pass through, their customers) and this has resulted in detriment to these service users.
- Aspects of the Mastercard and Visa card schemes are not being operated and/or developed in a way that takes account of the interests of all service-users, in particular UK merchants and (to the extent of pass through) their customers, and that this has resulted in detriment to these service users.
- We have seen no evidence of any particular innovation to account for IF increases – such as improved fraud prevention, quality, efficiency or economy of the card payments systems that benefited UK merchants.

**7.17** As set out in Chapter 2, as part of our service-user objective, among other things, we expect payment systems to provide good value and be cost-effective.[315] Having regard to our provisional findings set out in this chapter and the wider interim report, we do not consider that the increased IF levels represent good value or that they are cost-effective from the perspective of UK merchants or their customers. In particular, we note our provisional conclusion that the additional cost resulting from the IF increases has likely impacted UK merchants (through reduced margins) and has likely been passed through, at least to some extent, in higher prices to their customers. In 2022, the increase in outbound IFs amounted to approximately £150 million to £200 million paid by UK merchants and their consumers.

**7.18** In addition, as detailed in Chapter 2, we will have regard to the regulatory principles in FSBRA, including the desirability of sustainable growth in the economy of the UK in the medium or long term.[316] We note in particular our provisional conclusion that UK acquirers and merchants may face higher costs and prices due to lack of effective competition.[317] We provisionally conclude that the issues we have identified, in particular the pricing outcomes, are not conducive to the broader principle of sustainable growth in the economy of the UK in the medium or long term. This is particularly so at a time of sustained general price increases and rising cost of living.

**7.19** Overall, taking our provisional conclusions separately and together, we provisionally conclude the market is not working well. In Chapter 9 we consider possible remedies that may be appropriate ways to address or mitigate the issues we have identified. These are exploratory at this stage and would be contingent on final conclusions on the matters set out above, following this consultation.

315 *Objectives Guidance* (March 2015), paragraph 6.2.

316 FSBRA, section 53.

317 See paragraph 7.14.

# 8 Inbound interchange fees

This chapter considers the fees paid by EEA acquirers to UK issuers (inbound interchange fees) and the reason why we are proposing to cease considering these fees as part of our review.

## Introduction

**8.1** Up to now this document has primarily considered outbound IFs that apply to transactions involving UK merchants and EEA-issued cards. This chapter, however, turns to the inbound IFs that apply to CNP transactions involving UK-issued cards and EEA merchants. In exploring this issue, we consider:

- what our terms of reference required us to consider
- what our analysis identified
- our proposed approach to inbound IFs

**8.2** We are also seeking stakeholders' views on our proposed way forward.

## What we said in our terms of reference

**8.3** In the terms of reference for this review we said that we wanted to understand the effect that increases in outbound and inbound IFs may have on UK services users. We were concerned that IFs represent a cost to merchants for accepting card payments and that merchants may pass them on (at least in part) to some or all of their consumers.

**8.4** The terms of reference also said that this review would prioritise outbound IFs.

## What our analysis identified

**8.5** As outlined in Chapter 3, Mastercard and Visa agreed to the 2019 Commitments which were accepted by the European Commission.[318] These commitments continue to apply to UK-issued cards used at EEA merchants.

**8.6** As a result, UK-EEA CP transactions involving UK-issued cards and EEA merchants (inbound CP IFs) are subject to caps of 0.2% and 0.3% for debit and credit cards respectively, while the equivalent CNP transactions are subject to higher caps of 1.15% and 1.5%.

**8.7** The level of IFs set by Mastercard and Visa for UK-EEA CNP transactions correspond to the levels for inter-regional commitments accepted by the European Commission as part of the 2019 Commitments.

318 European Commission, CASE AT.39398 – Visa IF, VISA 2019 Commitments decision (April 2019); European Commission, CASE AT.40049 – Mastercard II, Mastercard 2019 Commitments decision (April 2019).

**8.8** The 2019 Commitments expire in 2024.

## Our proposed approach

**8.9** According to our Administrative Prioritisation Framework (APF) we need to use our resources in the most efficient and effective way to further our statutory objectives, functions and duties, in accordance with section 53(a) of FSBRA. This means that we need to make decisions regarding, for example, which investigations we open and continue, and how we respond to applications and complaints, subject to any specific legal duties we might have.[319]

**8.10** In making these decisions, we will initially consider the degree to which taking action provides us with an opportunity to advance one or more of our statutory objectives, functions and duties, as we are unlikely to pursue an action that does not clearly do this.[320] As outlined in Chapter 2, our statutory objectives[321] are to:

- promote effective competition in the market for payment systems and markets for services provided by payment systems in the interests of those who use, or are likely to use, services provided by payments systems (the 'competition objective').[322]
- promote the development of, and innovation in, payment systems in the interests of those who use, or are likely to use, services provided by payment systems, with a view to improving the quality, efficiency and economy of payment systems (the 'innovation objective').
- ensure that payment systems are operated and developed in a way that takes account of, and promotes the interests of those who use, or are likely to use, services provided by payment systems (the 'service user objective')

**8.11** For any proposed action we will then weigh up the impact and strategic importance of taking action with respect to the advancement of our statutory objectives, functions and duties, against the associated risks and resource implications. In other words, we will decide whether taking action would be consistent with our administrative priorities.[323]

**8.12** We have considered the commitments that are currently in place (see Chapter 3) and the extent to which progressing with the review would meet the APF requirements. In particular, we have considered the resource and cost implications (as well as the practicalities) of gathering new information from EEA merchants. We provisionally conclude that to progress with this aspect of the review would be:

- an inefficient use of our resources
- inconsistent with our administrative priorities

319 Administrative Priority Framework (March 2015), page 1.
320 Administrative Priority Framework (March 2015), page 1.
321 FSBRA, sections 50 – 52.
322 FSBRA, section 50(3) states that, in considering the effectiveness of competition in a market, we may have regard, amongst other things, to the needs of different persons who use, or may use, services provided by payment systems.
323 Administrative Priority Framework (March 2015), page 1.

**8.13** We therefore propose to close our review of inbound IFs on the grounds of administrative priority. We would, of course, welcome stakeholders' views on this preliminary position.

## Questions for stakeholders

### Question 13

- Do you have any views on our proposal to close our review of inbound IFs on the grounds of administrative priority?

# 9 Potential remedies and next steps

This chapter outlines the potential action we are considering may be appropriate for addressing or mitigating the issues we have identified for UK-EEA consumer CNP outbound IFs, contingent on our final conclusions.

## Introduction

9.1 Our provisional conclusion is that markets are neither working well nor working in the interests of all service users. Contingent on our final conclusions, we currently consider that it may be appropriate for us to intervene.

9.2 We are concerned that UK merchants, and especially SME merchants, are subject to ineffectively constrained outbound IFs that are likely unduly high.

9.3 We are considering what action we could take to improve outcomes for UK merchants and consumers.

9.4 We are seeking feedback on our evaluation of the potential remedies for outbound IFs set out in this chapter, including the potential application of a price cap. In particular, for the potential application of a price cap, we are seeking feedback on, for each of the options listed:

- practical consequences
- implementation considerations
- costs and benefits

9.5 We expect to carry out further detailed work on the design of potential remedies, and we may still decide not to take any action. **We intend to consult further on potential remedies in the first half of 2024.**

## Potential remedies for outbound IFs

9.6 Having regard to our statutory objectives and regulatory principles (see Chapter 2) and in light of the concerns detailed in this report, we have considered a range of potential remedies for outbound IFs at a high level, looking at how they could address the issues we have provisionally identified.

9.7 In this chapter we outline:

- action we are provisionally considering
- action we have considered but do not currently consider we should explore further

**9.8** We have wide-ranging powers to intervene in respect of payment systems if we consider it is appropriate to do so. These include the power to:

- direct participants in payment systems to take, or not take, specified actions (section 54 of FSBRA)
- require operators of payment systems to change rules governing the operation of payment systems in a specified way (section 55 of FSBRA)

**9.9** Our FSBRA powers would enable us to implement any of the potential remedies we discuss in this chapter.

**9.10** Any remedy we impose must be proportionate. This principle is underscored by the regulatory principles we have regard to when considering whether to exercise our powers under FSBRA.[324] For each potential remedy we have indicated factors that, in our current view:

- are particularly pertinent to assessing its proportionality
- have informed our preliminary view of its overall appropriateness

**9.11** For UK-EEA consumer CNP outbound IFs, we are considering three mechanisms to address the concerns we have identified:

- boosting competition
- encouraging steering
- regulation

**9.12** When considering potential remedies we have had regard to (among other things) maintaining the stability of, and confidence in, the UK financial system.

## Boosting competition

**9.13** We have considered in principle whether we could do more to boost competition in alternative payment methods for UK-EEA remote transactions.

**9.14** We have provisionally found that there are very few alternative methods to pay for these transactions (see Chapter 4). In time, alternative methods may boost competition in this context, such as SEPA instant payments for intra-EEA transactions and transactions with SEPA countries.[325] We cannot reliably predict when these would be widely available or how widely merchants might adopt them. At this time, we have limited ability to accelerate the availability or use of alternative cross-border payments and we do not expect there to be sufficient growth in this area to alleviate our provisional concerns. We are not aware of any action we could take that would sufficiently accelerate their availability and uptake to alleviate our provisional concerns.

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324 FSBRA, section 53(b) provides that: *'the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction'.*

325 European Commission, See Article 5a COM (2022) 546: *Proposal for a regulation of the European Parliament and of the Council amending Regulations (EU) No 260/2012 and (EU) 2021/1230 as regards instant credit transfers in euro*, (2022).

**9.15** Innovation in payments could also, over time, provide ways for UK merchants to reduce their IFs. For example, Stripe, a payment facilitator, offers a service to reduce merchants' IFs by using an acquirer in the region where the consumer is located.[326] However, merchants must have a location that supports the sale of local goods or services in that region. We have provisionally concluded that setting up an additional business location or relocation is not possible for most UK merchants, especially SMEs (see Chapter 4).

**9.16** Competition may produce desirable effects requiring less regulatory intervention in the longer term (whether from other international card schemes, instant SEPA or third-party solutions using bank transfers).[327] However, this is currently uncertain and could take many years to become sufficiently established, and we have not seen evidence to suggest it is likely to be sufficiently effective to mitigate the detriment we are provisionally seeing. Therefore, we are concerned that the lack of effective competitive constraints will have implications for the foreseeable future. Because of the limited number of alternative payment methods, it follows that we do not consider that information transparency on IF levels or costs, or encouraging merchants or customers to consider payment methods based on these costs, would work at the moment .

**9.17** Therefore, our current view is that:

- any action we could take to boost competition is unlikely to address our concerns effectively
- competition will not achieve the outcomes we want to see on a timescale that would remove the need for other action

## Encouraging steering

**9.18** Merchants may 'steer' their customers to choose a payment method that is advantageous for the merchant. We have considered at a principles level the implications of encouraging merchants to:

- provide a benefit or disadvantage for choosing a payment option
- use behavioural or visual cues to encourage customers to choose a particular payment option

**9.19** Merchants are legally permitted to steer their customers for UK-EEA cross-border transactions. In fact, the UK IFR prohibits restrictions on steering in agreements between the acquirers and card schemes. [328] However, in the context of UK-EEA consumer CNP payments, merchants cannot steer their customers away from cards unless they have acceptable alternative payment options.

326 Stripe, *A guide to managing network costs*.

327 Effective competition supports good outcomes in payments markets, such as low prices, high service quality and continued innovation.

328 UK IFR, article 11.

### Surcharging

**9.20** We have considered whether encouraging UK merchants to introduce different forms of steering for EEA-issued cards (such as surcharging based on card-BIN number) would mitigate the detriment we are seeing. We are primarily considering methods based on financial benefits, although other means such as loyalty points or discounts for non-card payments could have a similar effect.

**9.21** As provisionally found in Chapter 4, merchants fear that surcharges for CNP transactions could dissuade consumers from shopping with them and drive them elsewhere. A recent study on surcharges in Australia and parts of America also indicates that many retailers fear that surcharges will dissuade customers from continuing with a transaction.[329] In the UK-EEA context, our view is that surcharges could also impede merchants' ability to compete with EEA-based merchants.

**9.22** In theory, surcharges for EEA card transactions could encourage consumers to consider the different costs of alternative payment methods. However, we have provisionally concluded that there are currently very limited alternative methods to pay for UK-EEA consumer CNP transactions (see Chapter 4).

**9.23** Surcharging could also impose disproportionate costs on UK merchants. They would have to be able to identify the issuing location of every card used to make a retail CNP payment. To do this, they would have to implement an in-house solution or use a third-party service provider.

**9.24** Surcharging would particularly affect merchants that cannot relocate to mitigate the outbound IF increases, especially UK SMEs. We also note that although IFs increased almost two years ago, and merchants have had the option to surcharge since then, they have not applied a surcharge.

**9.25** Therefore, our current view is that steering in the form of surcharging will not address the issues we currently see. It would also be likely to have additional negative effects.

### Other forms of steering

**9.26** We also considered whether we could encourage UK merchants to introduce other forms of steering. This could include:

- nudging customers towards cheaper payment methods through user-interface design
- ordering the list of accepted payment methods
- reducing the friction for customers when they select the non-card-payment method rather than the card-payment method

**9.27** In theory, if EEA payers had wider access to alternative payment methods, UK merchants could use other ways to steer consumers towards payment methods beneficial to them (for example, methods that avoid higher IFs or processing costs). Encouraging UK merchant steering could theoretically let UK merchants avoid higher IFs. However, we have provisionally found that there are currently limited alternative ways to pay for UK-EEA consumer CNP transactions (see Chapter 4) that would allow merchants to do so.

329 The Economist, *The old bank/card model is still entrenched in the rich world* (May 2023).

**9.28** We also note that merchants have been able to steer for almost two years but have not been widely doing so (see Chapter 4), therefore it is not addressing the detriment we are seeing.

**9.29** Therefore, our current view is that other forms of steering will not be effective in addressing the issues we are seeing.

## Regulation

**9.30** We have considered two areas of potential regulatory intervention:

- requiring changes to card scheme rules to permit cross-border acquiring
- setting a price cap

### Changes to card scheme rules

**9.31** Some third parties suggested we consider changes to card scheme rules.[330] They did not specify which rules or what type of changes to scheme rules might be helpful.

**9.32** We considered whether we could change card scheme rules to:

- permit cross-border acquiring
- classify transactions as domestic or cross-border based on acquirer location rather than merchant location

**9.33** In theory, this could enable UK merchants to partner with EEA acquirers and their UK-EEA transactions to be classed as domestic EEA transactions.

**9.34** Mastercard and Visa set the criteria for merchant location in their rule guides and the card schemes' classifications of transactions as either domestic (including EEA intra-regional) or cross-border is linked to merchant location. [331] The EU IFR also sets criteria for merchant and acquirer location for the intra-EEA caps to apply.

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330 Stakeholder response to PSR questions dated 11 January 2023. [✂]

331 For example, rule 5.5 (merchant location) in the Mastercard Rules (June 2023) states that merchants and acquirers must satisfy the following criteria:

- the merchant conducts business locally
- the merchant holds a permit to operate locally
- the merchant complies with local tax laws and regulations
- the merchant is subject to local consumer laws and courts

Similarly, rule 1.5.1.2 of Visa Core Rules and Visa Product and Service Rules (October 2023) says that an acquirer must assign the country of the merchant's principal place of business as their location.

**9.35** Card schemes may also require the merchants to disclose their physical location so that relevant parties can:

- determine whether the transaction is domestic or cross-border[332]
- dispute the location assigned by the acquirer and determine the 'correct' location[333]

**9.36** Our current view is that it is unclear how such a potential remedy might be implemented in line with existing regulation.

**9.37** Even if this potential remedy could be implemented, our current view is that it would put the onus on, and add costs to, UK merchants who would either need to use an EEA acquirer for all of their transactions including UK domestic transactions, or adopt a second acquirer only for EEA retail CNP transactions.

**9.38** It is unclear whether EEA acquirers would see the benefits of this additional business as being worth the cost to them. It is likely that an EEA acquirer would need to be authorised by the FCA and it is unclear whether changes to scheme rules would suffice to enable cross-border acquiring.

**9.39** Given the processing of UK-EEA transactions would likely occur in another jurisdiction under such a potential remedy, it is unlikely that we would be able to effectively monitor its effectiveness.

**9.40** Our current view, therefore, is that these kinds of changes to card scheme rules will not be effective in addressing the issues we are seeing. Other potential remedies are likely to be less complex to implement and less likely to place significant burdens on merchants.

### Setting a price cap

**9.41** We have considered in principle whether a price-control remedy may be appropriate – in particular, capping the level of UK-EEA consumer CNP outbound IFs currently set by Mastercard and Visa. We have also considered what this might look like in practice. In addition, we have identified and considered potential timing issues, and how we might address them in the best interests of all service users.

**9.42** We recognise that a price cap would not address the underlying cause of the detriment we have provisionally identified. However, we currently consider that restricting the maximum level of outbound IFs would likely be effective in mitigating:

- the adverse impacts of the lack of effective competition, coupled with the upward pricing pressure from the commercial relationship between issuers and the card payment schemes
- the likelihood that prices are unduly high
- the risk that prices may increase further for UK merchants

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332 Mastercard (Transaction Processing Rules, June 2023) defines 'Domestic/Intra-country Transaction' as being when a transaction occurs at a merchant with a card issued in the same country (page 380). 'Cross-border transactions' are transactions where the merchant is located in a different country from the country where the card was issued (page 373).

Visa (Visa Core Rules and Visa Product and Service Rules, October 2023) defines 'Domestic Transaction' as when the card is issued from the same county as where the merchant is located (page 861).

333 Refer to footnote 330.

**9.43** This type of remedy could continue for as long as it is appropriate to address the detriment we have provisionally identified to service users.

**9.44** We have considered the appropriate process and basis for determining the level of any price cap. Our current thinking is that, in the long term, a cap could be based on a merchant indifference test (MIT) (see Chapter 3) designed to be appropriate for outbound IFs.[334] We are open to views on other approaches.

**9.45** We shared our invitation to tender (ITT) for a MIT with the card schemes on 24 May 2023. They raised concerns, including that any envisaged MIT would take considerable time to develop including through consultation with them (see later in this chapter). We have considered their initial representations and our current thinking is that it is likely to take some time to develop an appropriate methodology (MIT or other), to conduct the work to generate and interpret the results based on that methodology, and to design and implement any resulting price cap. We currently estimate this process could take up to 18 months.

**9.46** We have considered whether it is appropriate to seek to take steps to address the detriment to service users we are provisionally seeing in the short to medium term, or rather to wait until we complete the above work first. The current increased levels of outbound IFs have been in place since October 2021 for Visa and since April 2022 for Mastercard. We expect the detriment we have provisionally identified to continue without intervention and, for the reasons set out above, our current view is that other remedy approaches will not be effective in addressing the detriment we are seeing. In this context, we currently consider it appropriate to consider steps to address the service user detriment we have provisionally identified in the short to medium term as well as the longer term. As development and implementation of a lasting cap will likely take an extended period of time, and the issues we have provisionally identified will likely continue, we have considered whether a two-stage remedy would be appropriate.

**9.47** On this basis, our provisional thinking is that intervention would be appropriate in two stages:

- **Stage 1** would likely involve setting an interim cap on outbound IFs to be implemented in the short term. This stage would apply until we developed and applied the methodology for an enduring solution or until any detriment we provisionally see no longer applied (whichever happens first).
- **Stage 2** would likely involve development and implementation of a lasting cap on outbound IFs, as far as such a remedy would still be required. Such an enduring remedy would likely be based on a methodology (MIT or alternative) that we would have consulted on. This second-stage remedy would replace the interim cap set up in the first stage. It could be in place for a fixed period, for an enduring period with a review mechanism, or until the detriment we have provisionally identified no longer applied.

**9.48** Below we consider both of these stages and the various options for each.

334 Indeed, a MIT methodology was used by the European Commission to set the level of caps for IFs in the 2015 EU Interchange Fee Regulation. It was also the methodology used to determine the caps in the 2019 Commitments decisions for each of Mastercard and Visa for RoW-EEA transactions (see Chapter 3).

## Stage 1 – setting an interim cap

9.49 Regarding a potential interim cap, we have weighed up a range of options that we consider could be implemented relatively quickly:

a. not applying a cap in the interim
b. capping outbound IF levels at the levels the card schemes currently use (1.15% and 1.5%)
c. capping them at the levels that applied when the UK was in the EU (0.2% and 0.3%)
d. applying a cap above or below 0.2% and 0.3% but not at the current level
e. applying a cap at zero (or otherwise removing IFs)

9.50 We have considered each option and we set out our preliminary views below. We are also open to hearing views on potential alternative proposals for an interim cap.

### Not applying a cap in the interim

9.51 We have considered whether it would be appropriate not to impose any cap on outbound IFs in the interim.

9.52 As set out in Chapter 7, we have provisionally concluded that Mastercard and Visa are likely to be subject to ineffective competitive constraints on the acquiring side and that there is a lack of effective competition in relation to the setting of outbound IFs. Not applying a cap will not address these concerns in the interim, including offering no protection from further increases. We consider that allowing the card schemes to continue to apply the current IF levels, and not preventing further increases, would be detrimental to UK merchants and (to the extent of pass through) their customers. We currently consider that even in the short to medium term, the continued and unfettered use of such levels will likely result in poor outcomes that would not align with our payment system objectives.

9.53 Our current view is that the no-cap option will not address or mitigate the issues we have identified. However, we recognise that a no cap option would mean that no costs or burdens would be placed on the payment systems or issuers during the development of an enduring approach. We also recognise that this option would offer no protection from distorted pricing or from the upward pricing pressure we see in the commercial relationships between the card schemes and the issuers, the impact of which would continue to fall on UK merchants and (to the extent pass through occurs) their customers.

9.54 Taking into account the needs of all relevant service users in the round, and having regard to the duration for which the higher fees have been charged to date, our current view is that setting no cap is not an appropriate option.

### Setting a cap at current levels

9.55 Capping outbound IF levels at current levels would prevent them from increasing and further impacting UK merchants and their customers.

9.56 In Chapter 5 we outlined our provisional findings including that Mastercard and Visa have not reflected the fact that the UK remains part of SEPA in the current IF levels. Given this, our current thinking is that current outbound IFs are likely higher than any appropriate MIT would find, and are therefore unlikely to reflect the interests of all service users. While capping at current levels would prevent a worsening of that situation, it would not address our core concern that UK merchants and (to the extent of pass through) their consumers would be likely to continue to pay unduly high fees.

**9.57** Our current view is that this option would only mitigate one aspect of the issues we have provisionally identified (the risk of further increases in outbound IFs) and will not address or mitigate the core issue; that UK merchants are likely paying outbound IFs that are unduly high.

**9.58** We recognise that capping at current levels would place no costs or burden on the card schemes or issuers while we developed an enduring approach. But it would also offer no relief for UK merchants from distorted pricing or the effects of the upward pricing pressure we have identified from the commercial relationships between the card schemes and the issuers, the impact of which would continue to fall on UK merchants and their customers.

**9.59** Taking into account the needs of all relevant users in the round and having regard to the duration for which the higher fees have been charged to date, our current view is that capping prices at the current levels is not an appropriate option.

### Setting a cap at 0.2%/0.3%

**9.60** This option would implement a return to the levels that applied before the card schemes increased their outbound IF levels, with an interim price cap based on those levels. This remedy would address, on a temporary basis, the issues we have provisionally identified in this interim report insofar as such a price cap would reverse the increase in fees and restore the conditions that prevailed before the price regulation was lifted.

**9.61** We are mindful that this remedy would require a return to levels that were based on a MIT methodology that used cash as the alternative payment method. We note the schemes' argument that this approach is not necessarily appropriate for CNP transactions. We also note that these levels were set some time ago, and that the European Commission is considering next steps with respect to the levels offered in the 2019 Commitments, which expire in 2024. While those previous levels may not be those ultimately determined for an enduring remedy, we see good arguments to return to the IF levels that applied before the card schemes increased their outbound IF levels on a temporary basis. We also see good arguments as to why this would be an appropriate interim response to alleviate the burden falling on UK merchants of incurring the costs of the current IF levels, while we develop the methodology to determine an enduring cap.

**9.62** For our assessment, it is particularly significant that:

- the UK continues to be a member of SEPA
- outbound transactions continue to be between two SEPA members
- if 0.2%/0.3% applies for transactions between EEA SEPA members, it could equally be deemed appropriate for transactions between two SEPA members only one of which is in the EEA

**9.63** Furthermore, the EU IFR still uses these IF levels as caps for intra-EEA CNP debit and credit transactions. We currently consider that these are justifiable levels because they were the IFR levels for intra-EEA transactions while the UK was still part of the EEA. Other than a political shift (the UK's withdrawal from the EU), nothing else of substance appears to have changed. A cap at this level also reflects a return to the pricing levels prior to the market conduct that gave rise to our provisional concerns.

**9.64** We remain open at this stage to a potential remedy allowing an interim price cap to remain aligned with the intra-EEA price caps, should the current levels change to a higher level.

**9.65** We also note that in an open letter addressed to the European Commission, the Treasury and us, key stakeholders (including the BRC and EDPIA) have indicated to us that 0.2%/0.3% would be an acceptable level (time-limited or lasting) for outbound IFs pending a fuller consideration of an enduring solution to setting these fees.[335]

**9.66** We have considered how both card schemes and issuers operated within the EEA at these pre-existing levels. As explained in Chapter 5, we do not consider (and have not seen any evidence to suggest) that the IF levels applicable before the increases carried any obvious risks, undermined or otherwise adversely affected the operations of either of the two payment systems in ways that caused detriment to service users, distorted competition or presented an impediment to innovation. Specifically, to date, we have not seen any evidence to suggest that they presented an impediment to innovation (including, for example, in fraud prevention) by leaving EEA issuers short of investment funds. Accordingly, we have no current basis to consider that reducing outbound IFs to this level as an interim remedy would jeopardise or otherwise adversely affect, the operations of either of the two payment systems in ways that would cause detriment to service users, distort competition or present an impediment to innovation. Rather, since we have not seen evidence to suggest the raised fees were linked to increased costs or improved quality, we currently consider the payment systems would likely continue to operate more or less the same as they did before and have done since the increases.

**9.67** Similarly, the European Commission's review of the effectiveness of the IFR, final report published in June 2020, found no link between the resulting drop in IF revenue for issuers and a decline in what issuers offer to cardholders.[336]

**9.68** To better understand various points that third parties made to us, we requested information on how the increased outbound IFs may have benefited those who use card services and on whether the increased income from IFs has resulted in investments to reduce fraud. We have seen no evidence from stakeholders to suggest that the application of our preferred option will damage innovation in payment systems in the interests of those who use them or are likely to use them. By contrast, feedback from several stakeholders (see Chapter 5) suggests there has been no material increase in innovation (including in fraud prevention) following the recent IF increases.

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335 See the open letter from BRC, COADEC, EDPIA and Euro Commerce, and the stakeholder letter to the PSR dated 4 August 2023.

336 European Commission, *Report on the application of Regulation (EU) 2015/751 on interchange fees for cardbased payment transactions*, page 8 (29 June 2020).

**9.69** We recognise that the most immediate impact of this remedy would be primarily felt by EEA issuers and there is a possibility that the final enduring price cap may be higher than this interim cap. However, this must be assessed in the round, including its benefit for other participants in the system, and the different purposes each stage of the remedy serves. Further, although Mastercard and Visa have made representations to the effect that the 0.2%/0.3% levels are too low, our current view is that we are not persuaded by the reasons given so far by each of the card schemes to support this contention. In particular:

- There is little reason to assume that fraud levels for the types of transactions governed by the 2019 Commitments (CNP transactions between EEA merchants and consumers from non-EEA countries while the UK was part of the EEA) and CNP transactions between UK merchants and consumers holding EEA-issued cards are the same. Rather, the allowance made for fraud costs in the 2019 Commitments is likely to overstate that which would be reached from an analysis of fraud affecting the transactions relevant to UK-EEA outbound IFs.
- The [✂] to support its view that the 0.2% /0.3% levels are too low do not specifically relate to outbound IFs.

**9.70** Until a more lasting and refined remedy is in place, reintroducing the pre-existing levels would reduce the cost burden from the current, likely unduly high IFs for UK merchants and (to the extent of pass-through) their customers. We consider this particularly desirable at a time of sustained general price increases and rising cost of living.

**9.71** In considering whether this interim remedy is proportionate, we have taken into account:

- the provisional concerns this interim report identifies, including the size of the potential detriment to service users
- the reasons we currently see in support of the remedy
- its likely net effect relative to the entire period, from price rise up to the implementation of an enduring price cap

**9.72** We currently consider that while we develop an appropriate enduring remedy, shifting costs away from UK merchants and returning the fees to the levels applied immediately prior to the increase would represent a proportionate interim outcome. We also currently consider that the cost imposed is proportionate to the general benefits expected to result.

**9.73** Therefore, on balance, our current view favours a return to the pre-existing outbound IF levels in the short to medium term as an interim remedy. Our current view is that this would set outbound IFs at an acceptable level for that period and would be in the interests of those who use, or are likely to use, the card schemes. In reaching this preliminary view, we have had regard to the adverse effects that we have provisionally identified and to the differing needs and interests of various service users, in line with our statutory objectives. Also, we have not seen any evidence to suggest that the imposition of this interim remedy would adversely affect the stability of, or confidence in, the UK's financial system.

### Setting a cap above or below 0.2%/0.3% but not at the current level

**9.74** In light of the above and of our provisional findings in Chapter 7, on balance our current view is that it would be more appropriate to impose a lower level of IFs than current levels, in the context of an interim remedy, which would seek to mitigate or remedy the concerns we have provisionally identified.

**9.75** We consider that such an approach would better reflect our statutory objectives. We have considered a number of possible options within this framework. In reaching this view, we recognise that a cost would be placed on either the card payment schemes or the issuers, to the benefit of UK merchants as a whole.

**9.76** We also recognise the theoretical risk that UK merchants and their customers could benefit from an interim cap that is ultimately found to be lower than whatever enduring cap we may devise following a MIT (or alternative methodology). However, UK acquirers and merchants will have suffered likely unduly high fees for at least two years by the time any interim remedy might be implemented. If we put the enduring remedy in place in the timescales envisaged, EEA issuers will have received average fees significantly in excess of the level in place before the fee rises. Other than potentially for a cap that was below the 0.2%/0.3% levels previously set, relative to that same ultimate benchmark, we consider that it is highly unlikely that any differential would fully offset the higher income received by EEA issuers as a whole between the initial raising of the fees and any final enduring price cap.

**9.77** While no clear alternative figure to 0.2%/0.3% or compelling rationale for such a figure has been presented to us to date, we remain open to reasoned representations regarding an appropriate alternative to 0.2%/0.3% as an interim remedy. We note that for an interim remedy to be effective, it should not involve further complex analysis that significantly delays defining the cap.

### Applying a cap at zero (or otherwise removing IFs)

**9.78** We have considered capping the fees at zero or otherwise removing IFs. In the short term, this lower level of cap may also serve to re-balance UK merchants for the overall effect of the total relevant period, from the initial increase in fees to the implementation of an enduring remedy.

**9.79** There are some arguments to suggest that it is no longer necessary to incentivise card issuance in the domestic context and by extension the UK-EEA context, and that IFs have moved from incentivising a cheaper payment method to entrenching a potentially costlier one. Domestic schemes in some countries do not apply IFs and there is a case to be made that IF levels reinforce issuers' commitment to card payment systems. Such reinforcement could be to the detriment of other potentially more innovative payment methods such as Open Banking-enabled account-to-account (A2A) payments. IFs were introduced to stimulate adoption of cards, which had benefits compared to cash, but the need to do this may have reduced over time. In the UK, cards are used more than cash (see Chapter 2) and are considered a commoditised offering for account holders.

**9.80** However, we do not consider that applying a zero cap is necessarily appropriate at this time, particularly as an interim remedy. Our current view is that this would go beyond what is necessary or proportionate for an interim step. It might also have wider implications than the scope of this particular review, particularly as a short-term step prior to more detailed analysis that would inform such a position.

**9.81** While we have considered this option at a preliminary level, we consider it would likely take a significant amount of time to investigate such a significant potential reform. However, we will continue to consider a zero cap as a potential option in the longer term, including perhaps as part of our broader reform agenda.

### Our views on an interim cap remedy

**9.82** We have carefully considered the factors outlined in this chapter, mindful of the need to put any interim remedy in place quickly. In our current view, capping CNP IFs at the previous levels for outbound transactions (0.2% for debit cards and 0.3% for credit cards) would be an acceptable interim cap.

**9.83** We recognise that further refinement and consideration of this option will be necessary (as alternative options exist, both below the present IFs or at a lower level than 0.2%/0.3%). We also note the contents of the [✂] 2023 MIT IF assessment (see below). Given our preliminary views regarding the substance of this report (set out below), we provisionally consider that it does not include any new persuasive evidence that would cause us to change our current view that 0.2%/0.3% would be an acceptable level for an interim cap.

**9.84** We consider that this first step in a two-stage remedy would need careful consideration in terms of the following core components, as well as more granular detail:

- **Duration:** An interim remedy would need to be in place for long enough to enable us to develop an enduring remedy. But stakeholders are likely to benefit from a degree of certainty in the milestones. This may entail an interim stage of up to 18 months, with a potential review clause for exceptional circumstances, or to ensure it is not prematurely 'timed-out'.
- **Transition measures:** Implementing such an interim remedy may be feasible within 3-6 months. We wish to understand whether there are any unavoidable impediments to this.
- **Circumvention:** It would be important that a cap be effective, including by preventing the card schemes from immediately applying the same charge in a displaced or recategorised form.

**9.85** We welcome feedback on this option (as well as other options laid out in this chapter), including initial views on the likely effectiveness, costs, consequences and practicality of this as an interim remedy. Should we decide that this option is appropriate we will look to consider these issues in more detail.

## Stage 2 – setting an enduring cap or other long-term remedy

**9.86** For a stage-two remedy, we considered a range of options that we considered could be effective in the longer term, including not setting a cap at all. We considered the following options:

a. not applying a cap
b. applying a cap at zero (or otherwise removing IFs)
c. applying a cap at 0.2%/0.3% or a level otherwise set by the EU for intra-EEA CNP transactions
d. capping outbound IF levels at a level to be determined by an MIT or alternative methodology.

**9.87** With respect to option (a) of not applying any cap, this could be as a matter of policy. With respect to option (b) this could be because further analysis, such as a MIT, concludes that zero is the appropriate level. However, the same issues as discussed above in relation to a potential interim remedy apply to the consideration of a longer-term remedy. Our current view is that this option will not address or mitigate the issues we provisionally identify in the longer term (which we currently consider will likely continue to persist), so is not appropriate.

**9.88** It is possible that the MIT or further analysis may indicate that the appropriate levels should be around zero. We also refer to the arguments outlined in paragraph 9.80 that IFs may be less justified than they once were. However, to date, we have not received strong support for this form of potential remedy from respondents to our market review. We currently consider that, since our analysis focuses on the fee increases, rather than the caps set by the European Commission in the EU IFR, and focuses on only one type of fee, this remedy may have broader implications and go further than is necessary to address or mitigate the scope of the detriment we have provisionally identified. We recognise that further work will be needed to establish the overall long-term effects on the payments system of such a remedy – and the economic basis for it. Any such analysis would consider potential costs incurred by EEA issuers in supporting well-functioning, secure, efficient and competitive card-based payment transactions. At this stage, we consider this option is unlikely to be proportionate or appropriate, and it would probably be more appropriate to consider this option in a broader context. However, further evidence may alter this position, especially as part of the significant piece of analysis envisaged for stage two of our suggested approach to remedy.

**9.89** In relation to option (c), applying the outbound IFs caps of 0.2%/0.3% or at a level set by the EU, we are conscious of the effects of the UK's withdrawal from the EU, and of the impact of a review, if any, of the EU IFR, including that the fees under consideration in this market review would be out of scope of that exercise, and the methodologies applied are unlikely to be ideal. Therefore, while we remain open to representations from the parties on the relative importance of international pricing divergence or convergence, and the appropriate classification of the UK as part of SEPA, rather than RoW, we consider it unlikely that an enduring cap, set by reference to 0.2%/0.3% or to a future level for EEA-RoW transactions, is likely to be effective or appropriate.

**9.90** Lastly, we considered the option of capping outbound IF levels at a level to be determined by an MIT or alternative in the longer term to mitigate the detriment we have provisionally identified. Our considerations are set out below.

### Setting a cap at a level to be determined by a MIT or alternative methodology

**9.91** Under this option, we have considered setting an enduring cap based on a methodology that we would consult upon, such as a MIT or alternative (see also Chapter 3).

**9.92** In May 2023, we had an emerging view that there may need to be an enduring remedy based on such a methodology. We were mindful of some of the concerns and potential issues that any methodology might raise (see below). To help this, we published an invitation to tender (ITT) for external consultants to support us in developing a MIT focused on outbound IFs. As we currently consider a two-stage remedy could be appropriate, we anticipate that work on the MIT methodology would start as soon as is practicable. We would continue to develop this workstream after our final decision and first remedy decision, and it would inform our decisions on the second stage of any remedy. We have now commissioned the successful ITT bidder, Grant Thornton, to commence preparatory work towards developing a methodology that we would be able to consult on, subject to our final decision.

**9.93** We outline our proposed next steps in more detail later in this chapter and we will provide timeline updates in due course.

**What the card schemes told us about our proposed MIT study**

**9.94** We shared our ITT for a MIT with Mastercard and Visa on 24 May 2023. The ITT sets out an initial high-level summary of how we anticipate approaching an MIT study should we seek to undertake such work. Mastercard and Visa gave us preliminary comments orally and in writing both following the sharing of the ITT and more generally in relation to MIT studies, which are summarised below.[337]

**9.95** Prior to sharing the ITT with Visa, Visa said that the European Commission's MIT study, which led to the 0.2%/0.3% capping of cross-border interchange fees in the EU IFR, contained a number of serious methodological flaws. It said the study:

- [✁]
- did not specifically cover EEA cross-border and/or CNP transactions
- only focused on cash as an alternative payment method to cards
- [✁]

Visa also said [✁][338]

**9.96** Visa said that our proposed MIT study set out in the ITT [✁].[339]

**9.97** Visa said that the approach of our proposed MIT in the ITT [✁].Visa considered that we [✁]. Additionally, it considered that [✁]. Furthermore, Visa told us that [✁].[340] In addition, [✁].'[341]

**9.98** Visa said that our proposed MIT study should consider [✁]. Visa states that [✁].[342]

**9.99** Visa said that 'there is a real (actual and perceived) risk that [✁]. Visa also said that [✁] and that there would be [✁]. Secondly, Visa said that [✁].[343]

**9.100** Visa added that, [✁].[344]

**9.101** Visa said that any 'application' of our proposed MIT study [✁]:

a. [✁]
b. [✁]
c. [✁].

337 In addition, Visa recently shared with us [✁].
338 Visa letter to the PSR dated 14 October 2022. [✁]
339 Visa, [✁]
340 Visa, [✁]
341 Visa, [✁]
342 Visa, [✁]
343 Visa, [✁]
344 Visa, [✁]

**9.102** As noted in paragraph 5.62, Mastercard provided[345] an analysis conducted by a consultancy [✂][346] that raised several criticisms against the study carried out by the European Commission in 2015, and against the applicability of the European Commission's findings to cross-border CNP transactions.[347] The consultancy [✂] said that the European Commission study was not 'suitable for conducting an economic assessment [of the] inter-regional interchange'.[348]

**9.103** The consultancy study highlighted that cash is not suitable to be a comparator in a MIT study that covers interregional transactions 'due to the high proportion of credit and online transactions where cash may not, even in principle, be a suitable alternative, while other alternatives to four-party card payments exist'.[349] The consultancy [✂] mentions three-party schemes (such as American Express) and digital wallets (such as PayPal) as potential alternatives to Mastercard and Visa, and states that such alternative methods are more expensive for merchants to accept than four-party card schemes. The analysis run by the consultancy [✂] in response to the European Commission study did include such payment methods as comparators, while reducing the role of cash. The consultancy's [✂] study, however, did not include bank transfers as comparators. Mastercard told us that bank transfers are included in the consultancy's [✂] analysis to the extent that they are part of another payment service.

**9.104** Additionally, the consultancy [✂] stated that the European Commission study 'does not take into account the credit functionality of credit cards, which allows consumers to make the purchase without the required funds'.[350] Hence, cash 'is not a substitute for all credit card transactions'.[351] The consultancy [✂] also said that CNP transactions 'are particularly important in an inter-regional context, since they represent a higher proportion of trade compared with domestic transactions'.[352]

**9.105** The consultancy [✂] document stated that the sample of merchants who replied to the European Commission investigation was too small, and that the sample turnover was 'dominated by large merchants in the retail sector, which is a poor representation of the "average merchant" for the purpose of the MIT'.[353] In their alternative study, the consultancy [✂] used a larger sample of merchants, and, as opposed to the one used by the European Commission, only half of it consisted of retailers. Additionally, larger merchants were excluded.

**9.106** The consultancy [✂] said that the European Commission study was affected by severe self-selection and reporting bias. Merchant participation 'depended on whether the MIT was likely to be in the merchant's "best interest" (that is, whether it perceived cost of

345 Mastercard response to PSR questions dated 5 August 2022. [✂]
346 Mastercard response to PSR questions dated 5 August 2022. [✂]
347 European Commission, [Survey on merchants' costs of processing cash and card payments, Final results, March 2015] (March 2015).
348 Mastercard response to PSR questions dated 5 August 2022. [✂]
349 Mastercard response to PSR questions dated 5 August 2022. [✂]
350 Mastercard response to PSR questions dated 5 August 2022. [✂]
351 Mastercard response to PSR questions dated 5 August 2022. [✂]
352 Mastercard response to PSR questions dated 5 August 2022. [✂]
353 Mastercard response to PSR questions dated 5 August 2022. [✂]

cards was high relative to cash)'[354], thus leading to 'low MIT IF estimates by construction'. In addition to this, 'merchants in sample would have had an incentive to provide responses in line with desired final result'[355], that is lower IFs. Furthermore, the consultancy [✂] said that the European Commission, in its study, had included 'merchants that […] were considering or pursuing litigation against MasterCard at the time of the survey, presenting a potential conflict of interest'.[356] The consultancy [✂] also said that those merchants 'had a significant and possibly majority share of turnover in the Commission's study'[357] and were 'subject to a more severe reporting bias than merchants in general'.[358]

**9.107** The consultancy [✂] also said that the European Commission study focused too much on the short term and did not sufficiently consider long-term scenarios where fixed costs become variable. The consultancy [✂] study adjusted the European Commission's estimates by using econometric techniques to give more prominence to the longer run and the related absence of fixed costs. Thus, in the consultancy's [✂] opinion, its study provided a better quantification of merchants' costs and of the appropriate interchange fee. Additionally, the consultancy [✂] said that the cost classification 'depends on merchants' judgment of which types of costs to include as variable costs'[359] and that, in the European Commission study, there was 'evidence of inconsistency between merchants and even within different responses of the same merchant'.[360]

### What third parties told us about our proposed MIT study

**9.108** In July 2023, we disclosed our intention to undertake an MIT study to a third party. In August 2023, we received written feedback from the third party where it expressed high-level recommendations and concerns, as well as its own views regarding the proposed MIT, which are summarised below.

**9.109** The third party [✂] said that the MIT is a contextual regulatory tool that cannot mitigate the anti-competitive nature of multilateral IFs. The European Commission's goal for its MIT study was to encourage the use of cards in markets that are less digitalised than the UK, by reducing the cost of card acceptance for merchants. The third party [✂] said that, in their view, the Supreme Court[361] also confirmed that the 2019 caps were set in order to improve the functioning of the internal market and reduce transaction costs, rather than to address specific issues under EU competition law.[362]

**9.110** The third party [✂] said that it considered the MIT study unnecessary and not an appropriate way to reverse the 'hike' in cross-border interchange fees. It said that CNP transactions (especially online sales) inevitably involve card payments or payment methods that work on card rails (for example, PayPal). In this context, merchants cannot reasonably encourage consumers to use alternative payment methods. Therefore, if cross-border

354 Mastercard response to PSR questions dated 5 August 2022. [✂]
355 Mastercard response to PSR questions dated 5 August 2022. [✂]
356 Mastercard response to PSR questions dated 5 August 2022. [✂]
357 Mastercard response to PSR questions dated 5 August 2022. [✂]
358 Mastercard response to PSR questions dated 5 August 2022. [✂]
359 Mastercard response to PSR questions dated 5 August 2022. [✂]
360 Mastercard response to PSR questions dated 5 August 2022. [✂]
361 Supreme Court in Sainsbury's v Visa and Mastercard (2020), UKSC 24.
362 Stakeholder letter to the PSR dated 4 August 2023. [✂]

transactions are almost exclusively card-based, it is unreasonable to consider a level of IFs at which a merchant could consider two payment methods to be on par.[363]

**9.111** The third party [✁] said that there is no viable comparator to do a MIT test with. The tourist test requires comparing cards to another universally accessible payment method that carries no MIF and is more expensive or less efficient than cards. Cash cannot be used as a comparator for CNP transactions, given their nature. In this context, there is no payment method that is as universally accepted as cards in the UK and, even if the PSR were to consider account-to-account payments as a future-facing alternative, those methods are considerably cheaper than cards so would not work for the tourist test.[364]

**9.112** The third party [✁] stated that the current levels of IFs set by Mastercard and Visa are too high compared to what the competitive levels should be and that they are incompatible with FSBRA regulation. The third party [✁] said that this increase was an abuse of a dominant position rather than being justified by a change in market conditions. Additionally, it stated that card schemes did not 'derive[~~d~~] their UK-EEA cross border interchange fees through "a fair and transparent methodology", nor presented such a methodology to the PSR for review as envisioned by Parliament when enacting FSBRA'.[365]

**9.113** The third party [✁] said the lowering of IFs to the levels seen before the UK's withdrawal from the EU would be the most appropriate course of action, unless new market analyses or internal investigations by us deemed an increase necessary – that is, unless there is a specific reasoning behind the difference in nature of transactions pre- and post- the UK's withdrawal from the EU that requires such an increase.

### The [✁] 2023 MIT IF study

**9.114** Shortly prior to this publication, Visa asked us to consider a study entitled *Applying the Merchant Indifference Test to Visa's EEA to UK CNP transactions (the [✁] 2023 MIT IF assessment)*. This study was commissioned by Visa from an economic consultancy ([✁]). The study assesses Visa's EEA>UK CNP MIFs *[UK-EEA consumer CNP outbound IFs]* against the MIT – 'a benchmark that has long been used by the European Commission for assessing the appropriateness of multilateral IF levels, including to underpin the interchange caps in the IFR and in the 2019 European Commission Commitments Decision'.[366]

**9.115** At a high level, the [✁] 2023 MIT IF assessment involved:[367]

a. [✁]

b. [✁]

c. [✁]

d. [✁]

e. [✁]

363 Stakeholder letter to the PSR dated 4 August 2023. [✁]
364 Stakeholder letter to the PSR dated 4 August 2023. [✁]
365 Stakeholder letter to the PSR dated 4 August 2023. [✁]
366 [✁]
367 [✁]

**9.116** Each of the consultant's steps are considered below.

a. [✁]

**9.117** [✁].[368]

b. [✁]

**9.118** [✁].[369] [✁].[370]

c. [✁]

**9.119** [✁].[371] [✁].[372]

d. & e.[✁]

**9.120** [✁]

**Table 55:** [✁][373]

[✁]

[✁]

**Table 6: [✁]** [374]

[✁]

[✁]

[✁]

**9.121** [✁].[375]

### Our provisional view

**9.122** Given how late into the review process the [✁] 2023 MIT IF assessment was provided to us by Visa, we have had very limited time to review it. As a result, we intend to fully consider the 2023 MIT IF assessment alongside any other representations that Visa may wish to make during the consultation period of our interim report. At this late stage, however, we provisionally make the following observations.

368 [✁]
369 [✁]
370 [✁]
371 [✁]
372 [✁]
372 [✁]
373 [✁]
374 [✁]
375 [✁]

**[✂]**

**9.123** [✂].[376] [✂].[377]

**[✂]**

**9.124** [✂].

**9.125** [✂].

**9.126** [✂].

**9.127** [✂].[378] [✂].[379]

**9.128** [✂].

**[✂]**

**9.129** [✂]

**[✂]**

**9.130** [✂]

### Our current views on an enduring price cap remedy

**9.131** We currently consider that a MIT for UK-EEA CNP outbound consumer transactions could provide an acceptable proxy that we can use to set a regulated maximum fee level as an enduring remedy. However, as noted above, developing and implementing an appropriate methodology for a lasting cap will take an extended period of time. At this stage, we do not agree with all of the representations outlined above. For example, while previous models may not be appropriate in this specific context, we consider that adjustments could be made that rectify or mitigate these issues. We also consider that the degree to which a piece of work may reasonably influence a regulatory conclusion will depend on:

- its reliability, including the possibility of stress-testing the importance of relevant variables, taken together with other relevant considerations
- the degree to which it is determinative or contributory

376 Visa, [✂]

377 Visa, [✂]

378 An important feature of any comparator for the purposes of the MIT is that it should not contain an IF element. This avoids spurious effects related to the fact that the current cost to merchants of potential comparators may be impacted by the IF levels of Visa (and Mastercard) cards. This is also explained at paragraphs 77 and 80 of the Visa 2019 Commitments decision and at paragraph 75 of the European Commission's 2017 Cost of Cash and Cards study.

379 European Commission, CASE AT.39398 – Visa MIF, VISA 2019 Commitments decision and 2019 Commitments, recitals 77 and 80. A similar approach was followed as regards Mastercard's commitments for inter-regional MIFs – see CASE AT.40049 – Mastercard II, Mastercard 2019 Commitments decision and 2019 Commitments.

**9.132** As such, we consider that, where appropriate, we can use analysis and evidence as indicators to reasonably inform our ultimate assessment even when they carry a degree of uncertainty or imprecision.

**9.133** As for the representations set out above regarding the potential use of a MIT, our initial overall view is that we do not consider that any of the concerns raised are insurmountable, nor do we consider they should limit the potential use of an MIT or alternative methodology to set an enduring price cap. Specifically:

- Should we decide to proceed with an MIT or alternative approach, we would propose to apply robust Quality Assurance processes, to mitigate the risk of using biased or unreliable data. We consider that this is standard practice for quantitative projects and was, for example, successfully applied in the MITs for the 2015 EU IFR.[380]
- We consider that an MIT that compares card scheme transactions against one alternative payment method, even if it is the cheapest available alternative, could be a reasonable approach and would not necessarily fail to reflect the relevant set of costs and benefits. We consider that such an approach would be consistent with the 2019 Commitments, where means of payments funded via (non-SEPA) bank transfers were used as a comparator notwithstanding that other payment methods were available.
- Our current view is that a MIT that focuses on CNP transactions only (and does not consider CP transactions) would be reasonable. It is unclear to us why CP transactions should be included when this review focuses on EEA-UK CNP transaction IFs.

**9.134** We currently consider that an enduring price cap remedy which is based on an MIT or alternative approach would likely result in a proportionate outcome in the longer term. Further, our current view is that the cost imposed is likely to be proportionate to the general benefits expected to result. In considering whether this approach (that is, an enduring price-cap remedy which is based on an MIT or alternative approach) is likely to be proportionate, we have taken into account:

1. the provisional concerns that this interim report identifies
2. the reasons we currently see that point to a remedy of this nature being appropriate

In our view, the fact that UK-EEA outbound transactions may only account for a limited percentage of all UK merchant consumer transactions does not necessarily mean that a remedy of this nature would be disproportionate, particularly given the service-user detriment we have provisionally identified. Also, we have not seen any evidence to suggest that the imposition of an enduring remedy of this nature would adversely affect the stability of, or confidence in, the UK's financial system.

380 The European Commission's 2019 Commitments decision also did not consider this issue as insurmountable.

**9.135** Nevertheless, having carefully considered the issues raised at this stage regarding the potential use of an MIT or alternative approach, we recognise the degree of debate remaining on what appropriate methodology or analytical approach would be appropriate, including the detail underpinning that conceptual approach. Stakeholders will have an opportunity to comment on any approach (MIT or alternative) that is proposed as well as any proposed enduring price-cap remedy. Any such approach, once settled, would require evidence-gathering and the results would need to be carefully interpreted. Our current view is that conducting a MIT (after consultation on its details) is the approach most likely to lead to an appropriate maximum cap level for the longer term, in the context of this review. We currently consider that (subject to consultation), in the absence of an approach or framework that stakeholders can broadly agree is appropriate as a starting point, a work programme to address the concerns set out above would enable an effective, appropriate and proportionate longer-term outcome, should this ultimately be deemed necessary.

## Our current view on potential remedies

**9.136** Overall, at this preliminary stage, our preferred package of remedies is that:

1. We impose an interim price cap remedy, returning UK-EEA consumer CNP outbound IFs to 0.2%/0.3% for debit and credit cards respectively. We consider this interim measure may be appropriate given the lack of effective competitive constraints on how outbound IF levels are set, the size of the increases (five-fold), and the magnitude of the fees being paid by UK acquirers and merchants. We also consider that such an approach would better reflect our statutory objectives. This stage of the remedy would apply until such time as the methodology for an enduring solution had been developed and applied or until the adverse effects we have provisionally identified no longer apply, whichever occurs first.
2. On a longer-term basis, recognising that development and implementation of a lasting cap will take an extended period of time, we would set an enduring cap for UK-EEA consumer CNP outbound IFs, to the extent that such a remedy is still required. Such an enduring remedy would be based on a consulted-upon methodology (MIT or alternative). This remedy would replace the interim cap set by the first stage of our remedy.

**9.137** The purpose of this remedy package would be to address the specific issues and further the statutory objectives as set out in this document, and we do not consider the effect would be to alter the degree to which a person may obtain or maintain access to, or participation in, a payment system.

**9.138** We expect to carry out further detailed work to consider the most effective way to design and implement any potential remedies, including their proportionality, and we welcome views on our preferred package of remedies or alternative options, including the relative benefits, costs and potential ramifications.

**9.139** In the event that we were to take action to implement our preferred remedy package we would consider our most appropriate tool to do so, potentially giving one or more directions or imposing a requirement in relation to outbound IFs under FSBRA.

**9.140** Our current view is that we may use FSBRA general or specific directions to give effect to this potential remedy package under section 54 or 55 FSBRA. We refer to the judgment in the Notemachine[381] judicial review, which includes an application for review on the grounds relating to the interpretation of section 108 of FSBRA. We consider this intervention would be consistent with the rulings of that judgment insofar as the purpose of this remedy would not engage section 108 of FSBRA. We also consider that issuing a direction under these provisions to establish a fee cap is consistent with the legal framework and the principles of public law.[382] We are considering the scope and application of these powers in the context of this market review.

## Questions for stakeholders

### Question 14

- Do you agree that the initiatives we considered to boost competition for CNP IFs discussed in Chapter 9 are unlikely to achieve the outcomes we would want to see in a timescale that removes the need for regulatory intervention?

### Question 15

- Do you agree that the initiatives we considered to encourage cross-border surcharging or other forms of steering for UK-EEA transactions discussed in Chapter 9 are unlikely to remove the need for regulatory intervention on UK-EEA outbound IFs?

### Question 16

- Do you agree that the potential amendments to card-scheme rules considered in Chapter 9 would be unlikely to address the concerns we have identified? Are there alternative amendments to card-scheme rules that we should consider? If so, please outline what those amendments are.

### Question 17

- Do you agree with our current view that an interim remedy may be required and that capping CNP IFs at the previous levels for outbound transactions (0.2% for debit cards and 0.3% for credit cards) may be an appropriate interim remedy?

### Question 18

- Do you have any views on whether a merchant indifference test (MIT) for UK-EEA outbound consumer transactions could be a useful mechanism to help set a regulated maximum fee level as an enduring remedy (subject to consultation on its details)? Is there an alternative methodology we should consider?

381 Case No: CO/2015/2021, Neutral Citation Number: [2023] EWHC 2522 (Admin).

382 We can impose general or specific directions pursuant to the Payment Systems Regulations 2017, Regulation 125.

**Question 19**

a. What are the potential benefits, costs, challenges and/or unintended consequences that may arise from our interim proposal to cap UK-EEA outbound interchange fees, including on fraud levels and innovation? We would be particularly interested in your views as to whether those differ between market participants, including between large and small merchants. Please provide your reasoning and any estimates (if available).

b. What, if any, implementation costs will be incurred from these?

c. Are there any other costs that may be incurred by market participants?

**Question 20**

- On the assumption that our preferred remedy is taken forward, do you have views on whether the costs (implementation or other) incurred by various market participants, including issuers, acquirers and merchants, would be likely to be greater than the costs they would typically incur when a change in fees is announced? In other words, will the costs associated with implementing our preferred remedy be captured (or absorbed) through 'business as usual' activity?

**Question 21**

- Are there other remedies we should consider either on an interim or long-term basis?

**Question 22**

- Is there anything else we have not considered and you think we should consider?

## Next steps

**9.141** We welcome feedback on our provisional findings and our current views on potential remedies including our preferred remedies. Please send us your comments by **5 pm on 31 January 2024.**

**9.142** You can email us at cardfees@psr.og.uk or write to us at:

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

**9.143** We will consider the feedback and aim to publish a Final Report in Q1 2024. All steps after our Final Report are contingent upon our findings in our Final Report.

## Timeline

**9.144** The table below sets out the indicative timeline for our work on cross-border interchange fees.

**9.145** This is an ambitious and challenging timetable, as it is dependent on timely and constructive engagement from Mastercard, Visa and other stakeholders. If we make significant changes to this timetable, we will publish a revised version on our website.

| Phase | Activity | Timing |
|---|---|---|
| **Final Report** | Publish Final Report | Q1 2024 |
| **Remedies** | Consultation on remedies package<br>• Stage 1 remedy<br>• Principle of Stage 2 remedy<br>• MIT or alternative methodology | Q1/Q2 2024 |
| | Consultation on legal instrument for Stage 1 remedy | Q1/Q2 2024 |
| | Decision<br>• Remedies package and Stage 1 remedy<br>• Methodology to determine Stage 2 remedy (MIT or alternative methodology) | <br>Q2 2024<br>Q3 2024 |
| **Stage 1 remedy** | Legal instrument made for Stage 1 remedy | Q2 2024 |
| | Stage 1 remedy in place (subject to implementation timeframes) | Q3/Q4 2024 |
| **Stage 2 remedy** | Consultation on detail of Stage 2 remedy | Q2 2025 |
| | Consultation on legal instrument for Stage 2 remedy | Q2 2025 |
| | Decision Stage 2 remedy | 2025/2026 |
| | Legal instrument made for Stage 2 remedy | 2025/2026 |
| | Stage 2 remedy in place (subject to implementation timeframes) | 2026 |

# Annex 1
# Questions in this paper

1.1 This report sets out our provisional findings, and the potential remedies we could be focusing on in the next phase of work. We welcome stakeholder feedback on the following questions:

**Question 1**

- Do you have any views on how we have described the facts and considerations we have identified in Chapter 3? Do you think there are any other factors we should consider as context and background to our market review?

**Question 2**

- Do you have any views on our analysis and provisional finding that the Mastercard and Visa card schemes are subject to ineffective competitive constraints on the acquiring side when setting UK-EEA outbound IFs?

**Question 3**

- Do you agree with our analysis and provisional finding that merchants' responses do not provide an effective competitive constraint on Mastercard and Visa in setting UK-EEA outbound IFs?

**Question 4**

- Do you have any views on our analysis and provisional finding that cross-border acquiring is not currently possible and does not, therefore, provide an effective competitive constraint on increases in UK-EEA outbound IFs?

**Question 5**

- Do you agree with our analysis and provisional finding that merchant relocation does not provide an effective competitive constraint on increases in UK-EEA outbound IFs? Does your view differ depending on the size of the merchant?

**Question 6**

- Do you agree with our analysis and provisional finding that there are few alternative payment methods to Mastercard and Visa for UK merchants who engage in (or want to engage in) international trade with the EEA? And, where alternatives are present, they do not provide an effective constraint on Mastercard and Visa?

**Question 7**

- Do you think there are any other competitive constraints on Mastercard and Visa in setting UK-EEA outbound IFs we have not yet considered, but should consider? If yes, please describe those constraints and their effect on Mastercard's and Visa's ability to set UK-EEA outbound IFs.

### Question 8

- Based on the analysis outlined in Chapter 5, do you have any views on our reasoning and provisional conclusion that fraud differentials do not justify or explain the increases in UK-EEA outbound IFs?

### Question 9

- Do you have any views on our analysis and provisional conclusions that both Mastercard and Visa's methodologies for setting outbound IFs appear to have failed to consider that:
  a. the UK is part of SEPA
  b. even if fraud levels were a relevant consideration in setting the IFs, the appropriate fraud levels for UK-EEA transactions could be lower than those for RoW-EEA transactions?

### Question 10

- Do you have any views about our analysis and provisionl conclusions that it was Mastercard and Visa's desire to remain attractive to issuers (particularly EEA issuers for outbound IFs) that was the main reason why they raised their outbound IFs following the UK's withdrawal from the EU?

### Question 11

- Do you have any views on, can you point to, or can you provide any evidence that might illustrate any practical benefits that may have accrued to UK merchants because of the increases in UK-EEA CNP IFs (and their alignment with non-EEA-to-UK IFs)?

### Question 12

- Do you have any views on our assessment of the impact of the fee increases on UK acquirers and merchants?

### Question 13

- Do you have any views on our proposal to close our review of inbound IFs on the grounds of administrative priority?

### Question 14

- Do you agree that the initiatives we considered to boost competition for CNP IFs discussed in Chapter 9 are unlikely to achieve the outcomes we would want to see in a timescale that removes the need for regulatory intervention?

### Question 15

- Do you agree that the initiatives we considered to encourage cross-border surcharging or other forms of steering for UK-EEA transactions discussed in Chapter 9 are unlikely to remove the need for regulatory intervention on UK-EEA outbound IFs?

### Question 16

- Do you agree that the potential amendments to card-scheme rules considered in Chapter 9 would be unlikely to address the concerns we have identified? Are there alternative amendments to card-scheme rules that we should consider? If so, please outline what those amendments are.

### Question 17

- Do you agree with our current view that an interim remedy may be required and that capping CNP IFs at the previous levels for outbound transactions (0.2% for debit cards and 0.3% for credit cards) may be an appropriate interim remedy?

### Question 18

- Do you have any views on whether a merchant indifference test (MIT) for UK-EEA outbound consumer transactions could be a useful mechanism to help set a regulated maximum fee level as an enduring remedy (subject to consultation on its details)? Is there an alternative methodology we should consider?

### Question 19

a. What are the potential benefits, costs, challenges and/or unintended consequences that may arise from our interim proposal to cap UK-EEA outbound interchange fees, including on fraud levels and innovation? We would be particularly interested in your views as to whether those differ between market participants, including between large and small merchants. Please provide your reasoning and any estimates (if available).
b. What, if any, implementation costs will be incurred from these?
c. Are there any other costs that may be incurred by market participants?

### Question 20

- On the assumption that our preferred remedy is taken forward, do you have views on whether the costs (implementation or other) incurred by various market participants, including issuers, acquirers and merchants, would likely be greater than the costs they would typically incur when a change in fees is announced? In other words, will the costs associated with implementing our preferred remedy be captured (or absorbed) through 'business as usual' activity?

### Question 21

- Are there other remedies we should consider either on an interim or long-term basis?

### Question 22

- Is there anything else we have not considered and you think we should consider?

1.2 Comments can be sent by email to **cardfees@psr.org.uk**. We are asking for your feedback **by 5 pm on 31 January 2024**.

# Annex 2
# Summary of stakeholder feedback

## Merchants' incentives to limit card acceptance

### What merchants told us

**2.1** We asked merchants if there are any cards or alternative payment methods that they have to accept for their card-not-present (CNP) transactions, including UK-EEA transactions, in order not to lose a significant number of customers and/or transactions.[383]

**2.2** The respondents to our information notices and questionnaires confirmed that UK merchants who want to do business remotely with the EEA must be able to accept Mastercard- and Visa-branded cards, and they cannot reasonably decline any of these cards (individually or in combination) in response to the recent interchange fee (IF) increases. Merchant respondents also confirmed, as indicated in publicly available information, that none of them accept only one of the Mastercard or Visa card schemes.

**2.3** Besides Mastercard and Visa, respondents mentioned other payment methods that to a greater or lesser extent are also important to them. In what follows, we have redacted references to specific payment methods other than Mastercard and Visa in order to prevent the possible identification of specific respondents through the payment methods they refer to.

**2.4** Below, we set out summaries of responses we received from the British Retail Consortium (BRC) and seven merchants.

**2.5** The BRC said that it is unaware of any major merchant in the UK that does not accept Mastercard and Visa credit and debit cards. Apart from the 2021 action by Amazon, when the company briefly indicated it would stop accepting Visa credit cards, the BRC was not aware of any other member that has changed (or attempted to change) its acceptance of Visa- or Mastercard-branded cards.[384]

**2.6** A merchant [✁] said that it has to continue accepting credit and debit cards because it is optimised for subscription billing compared to other payment methods. It said that, currently, a majority of its customers choose to pay with credit and debit cards – mostly Mastercard and Visa, but also [✁].[385]

383 PSR information request dated 11 January 2023 [✁]
384 BRC response to PSR information request dated 11 January 2023 [✁]
385 Stakeholder response to PSR information request dated 11 January 2023 [✁]

**2.7** A merchant [✂] said it accepts [✂].[386] The merchant said it considers all its currently offered forms of payment in the UK as essential for its business. Furthermore, the merchant reported that Mastercard and Visa are its customers' most preferred cards.[387]

**2.8** A merchant [✂] said that, due to its specific line of business, its customers prefer to use traditional bank transfers (especially for high amounts) instead of cards. The merchant also said that Mastercard and Visa cards are the second most popular payment method for its customers[388], and that Visa- and Mastercard-branded cards don't have strong competitors among other card brands or alternative payment methods.[389]

**2.9** A merchant [✂] confirmed that it accepts all Mastercard- and Visa-branded cards, but also credit cards from other schemes (for example, [✂]). The merchant also partnered with [✂]. The merchant did not specify if there is a payment method it must accept not to lose sizeable revenues, but it stated that it continuously evaluates the payment methods it accepts from customers based on consumer preference, service quality and the costs incurred to accept such payments.[390]

**2.10** A merchant [✂] said that it has to accept credit and debit cards (issued in both the UK and the EEA), as they are the most frequently used payment method for [✂].[391] Additionally, it said it accepts payments through [✂], and that it has recently introduced open banking solutions.[392] For UK-EEA cross-border transactions, cards and [✂] are currently supported.[393]

**2.11** A merchant [✂] said that it offers Visa, Mastercard and [✂] and a selection of alternative payment methods, such as [✂].[394] The merchant also explained that each available payment method has been added to the website after an assessment of consumer behaviour in the relevant market. Therefore, removing any of the payment options would have a detrimental impact on its business. However, because Mastercard and Visa account for the largest proportion of transactions, removing such payment methods would entail a significant loss of transaction value.[395]

**2.12** A merchant [✂] said that it accepts cards belonging to any scheme because, currently, cards are its customers' most preferred payment method. The merchant also said that it accepts payments through alternative payment methods (such as [✂]), to provide its customers with further payment options, though this is primarily in the EEA.[396]

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386 Stakeholder response to PSR information request dated 11 January 2023 [✂]
387 Stakeholder response to PSR information request dated 11 January 2023 [✂]
388 Stakeholder response to PSR information request dated 11 January 2023 [✂]
389 Stakeholder response to PSR information request dated 11 January 2023 [✂]
390 Stakeholder response to PSR information request dated 11 January 2023 [✂]
391 Stakeholder response to PSR information request dated 11 January 2023 [✂]
392 Stakeholder response to PSR information request dated 11 January 2023 [✂]
393 Stakeholder response to PSR information request dated 11 January 2023 [✂]
394 Stakeholder response to PSR information request dated 11 January 2023 [✂]
395 Stakeholder response to PSR information request dated 11 January 2023 [✂]
396 Stakeholder response to PSR information request dated 11 January 2023 [✂]

## What acquirers told us

**2.13** We asked UK acquirers what cards or alternative payment methods they offer, including for UK-EEA transactions, and, among these, which payment methods they have to offer acquiring services for because, otherwise, they would lose or fail to acquire potential customers (that is, merchants demanding specific acquiring services).[397]

**2.14** All responding acquirers confirmed that all their merchant customers accept both Mastercard and Visa.[398]

**2.15** Below, we set out summaries of responses received from fifteen acquirers.

**2.16** An acquirer [✂] said that its card-acquiring services enable its merchant customers to accept payments from both Mastercard and Visa cards. All its merchant customers are automatically given the ability to accept card payments from both schemes. It does not support its merchant customers accepting cards from one scheme but not the other, as there is no merchant demand for this (that is, merchants want to accept both Mastercard and Visa cards).[399]

**2.17** An acquirer [✂] said that Mastercard and Visa are the main processing payment methods required by all its merchants. Other card schemes (for example, [✂]) and payment methods (for example, [✂]) are not a hard requirement for merchants.[400]

**2.18** An acquirer [✂] said that Mastercard and Visa card payment methods are the main acquiring products it offers to potential customers. The acquirer also said that, currently, every online shop uses them as payment methods, therefore, if the acquirer cannot offer such card payments, it would lose clients.[401]

**2.19** An acquirer [✂] said that it offers card-acquiring services for both Mastercard and Visa, as all its customers require both schemes.[402]

**2.20** An acquirer [✂] told us that merchants typically request both Mastercard and Visa services to be able to transact with their customers. Additionally, the acquirer stated that Visa, Mastercard and customary local payment options constitute the baseline payment services for most merchants. The acquirer also believes that not offering Visa or Mastercard options would entail significant losses, most likely for any payment processing provider to merchants.[403]

**2.21** An acquirer [✂] said it provides card-acquiring services for both Mastercard and Visa, as all the merchants it works with require access to both schemes.[404] The acquirer said that providing card-acquiring services is necessary for the success of its business, since it is the primary method of payment used by the majority of merchants and consumers in the UK.[405]

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397 PSR information request dated 11 January 2023. [✂]
398 Stakeholder responses to PSR information requests dated 11 January 2023 [✂]
399 Stakeholder response to PSR information request dated 11 January 2023 [✂]
400 Stakeholder response to PSR information request dated 11 January 2023 [✂]
401 Stakeholder response to PSR information request dated 11 January 2023 [✂]
402 Stakeholder response to PSR information request dated 11 January 2023 [✂]
403 Stakeholder response to PSR information request dated 11 January 2023 [✂]
404 Stakeholder response to PSR information request dated 11 January 2023 [✂]
405 Stakeholder response to PSR information request dated 11 January 2023 [✂]

**2.22** An acquirer [✂] said that Mastercard and Visa are payment options that must be offered to merchants. The acquirer said that it also offers merchants alternative card brands and payment types. However, in practice, these are commonly ancillary payment methods for merchants who still primarily accept Mastercard and Visa, since consumer usage of these alternative methods is limited to specific consumer segments of countries.[406]

**2.23** An acquirer [✂] said that it must offer Mastercard and Visa as payment methods to its merchants, for both card-present (CP) and card-not-present (CNP) transactions, and for both domestic and cross-border transactions. It believes that merchants want to ensure that both Mastercard and Visa are available payment forms for their own customers, in order to satisfy customer demand.[407] The acquirer said that Mastercard and Visa are the most commonly accepted card payment methods, and if merchants are not able to offer these to their customers, they may lose business themselves.[408]

**2.24** An acquirer [✂] said that its customers require Mastercard and Visa, given the high volume of Mastercard- and Visa-branded cards issued in the market. It also stated that if it were to stop offering such services, it would lose customers.[409]

**2.25** An acquirer [✂] said that it considers it essential to provide merchants with access to all possible payment types, with Mastercard and Visa being the most preferred.[410] Mastercard and Visa still dominate the market in the UK. While there is some new competition and barriers have been reduced, merchants still consider both of these card schemes to be the 'must-have' (that is, must-take) payment options, and there are still considerable barriers to entry within this area of the market.[411]

**2.26** An acquirer [✂] said that it offers card-acquiring services for both Mastercard and Visa, as all the merchants they work with require access to both schemes. No acquiring is done in the UK by the acquirer for alternative card and non-card payment schemes.[412] The acquirer said it classifies Mastercard and Visa as 'must-have' (that is, must-take) cards: any merchant who would use just one of the two schemes will not be able to compete on the market.[413]

**2.27** An acquirer [✂] said that it would lose a significant amount of its business if it stopped offering acquiring services for Mastercard and Visa.[414]

**2.28** An acquirer [✂] said that Mastercard, Visa and [✂] represent the payment options that merchants need to offer to their clients to remain competitive in the market.[415]

**2.29** An acquirer [✂] said that it would lose a significant amount of its business if it stopped offering acquiring services for Mastercard and Visa.[416]

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406 Stakeholder response to PSR information request dated 11 January 2023 [✂]
407 Stakeholder response to PSR information request dated 11 January 2023 [✂]
408 Stakeholder response to PSR information request dated 11 January 2023 [✂]
409 Stakeholder response to PSR information request dated 11 January 2023 [✂]
410 Stakeholder response to PSR information request dated 11 January 2023 [✂]
411 Stakeholder response to PSR information request dated 11 January 2023 [✂]
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414 Stakeholder response to PSR information request dated 11 January 2023 [✂]
415 Stakeholder response to PSR information request dated 11 January 2023 [✂]
416 Stakeholder response to PSR information request dated 11 January 2023 [✂]

**2.30** An acquirer [✂] said that it would not be able to attract or retain customers or be a viable business if it did not offer card-acquiring services for both Mastercard and Visa, since most consumers use one of these as a primary method of card payment.[417] In addition, the acquirer said that no merchant would reject cards from either Visa or Mastercard, as this would negatively impact on their sales, and that it provides card-acquiring services to all of its merchants for both Mastercard and Visa. Mastercard and Visa are a ‘must’ in terms of card acceptance from a merchant’s perspective.[418]

## Potential alternatives to Mastercard and Visa are very limited in general and more so for UK-EEA e-commerce

### What merchants told us

**2.31** We asked UK merchants and the BRC questions about alternative payment methods, other than Visa- and Mastercard-branded cards and cash, that they offer to their customers.[419]

**2.32** We also asked UK merchants and the BRC about the extent of the competition that Mastercard and Visa face from other international card schemes and non-card payment options, both in general terms and specifically for UK-EEA cross-border CNP transactions.[420]

**2.33** Below, we set out summaries of the responses we received from the BRC and eight merchants. Many respondents, when describing alternatives to cards, referred to digital wallets supported by payment cards.

**2.34** The BRC and merchants mentioned the following alternative payment options to Mastercard and Visa payment cards that can be used for UK-EEA CNP cross-border transactions:[421]

- other card schemes (including American Express, JCB and Diners Club)
- PayPal
- account-to-account payments
- ‘buy-now-pay-later (BNPL)

**2.35** The BRC told us that its *Payments survey* shows that 90% of UK retail spending was made on cards in 2021, and that Mastercard and Visa face very limited competition from other card networks. The BRC also stated that alternative payment methods face a barrier to entry due to IFs and, therefore, there is little competition for the two major card schemes.[422]

417 Stakeholder response to PSR information request dated 11 January 2023 [✂]
418 Stakeholder response to PSR information request dated 11 January 2023 [✂]
419 PSR information request dated 11 January 2023. [✂]
420 PSR information request dated 11 January 2023. [✂]
421 BRC response to PSR information request dated 11 January 2023 [✂]
422 BRC response to PSR information request dated 11 January 2023 [✂]

**2.36** A merchant [✂] said it offers its customers the possibility to pay [✂].[423] However, it said that cards continue to be the most preferred method for its customers.[424]

**2.37** A merchant [✂] said it offers the option to use [✂] (which are still card based). However, the merchant said [✂].[425]

**2.38** A merchant [✂] told us that it currently accepts other credit schemes, such as [✂], and that it [✂].[426] The merchant also stated that it has not enabled account-to-account payments as these are not popular among UK-based consumers, and they are cumbersome to implement in a cross-border environment.[427] Additionally, the merchant told us that it is not aware of any potential payment method that could act as a true alternative to Mastercard and Visa.[428]

**2.39** A merchant [✂] stated that customers prefer to use traditional bank transfers (especially for high amounts), due to the nature of its business. However, Mastercard and Visa still play a pivotal role in the merchant's CNP transactions. The merchant considered that Mastercard and Visa do not have strong competitors among other card brands and alternative payment methods.[429] Nonetheless, the merchant stated that open banking solutions might be potential competitors, but significant improvements to the customer experience must be implemented to make these solutions viable and usable by a significant number of customers.[430]

**2.40** A merchant [✂] said that it accepts [✂] in the EEA, and digital wallets, such as [✂], in both the UK and the EEA. However, it said that digital wallets are merely proxy payment methods for Mastercard and Visa (and other schemes), since they act as a 'container' for these card schemes.[431] The merchant said that it is evaluating the possibility of introducing open banking application programming interfaces (APIs) and working with a BNPL provider to launch in the UK.[432]

**2.41** A merchant [✂] said that Mastercard and Visa are clearly the dominant card schemes in the UK and the EEA. While it provides customers with other payment methods and card schemes, the merchant does not believe that the leading position of either Visa or Mastercard is under threat.[433]

**2.42** A merchant [✂] said that it supports card payments, account-to-account payments [✂], and that it has recently introduced open banking payments.[434] The merchant also stated that, since July 2022, [✂]. Therefore, it believes that open banking now represents the

423 Stakeholder response to PSR information request dated 11 January 2023 [✂]
424 Stakeholder response to PSR information request dated 11 January 2023 [✂]
425 Stakeholder response to PSR information request dated 11 January 2023 [✂]
426 Stakeholder response to PSR information request dated 11 January 2023 [✂]
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433 Stakeholder response to PSR information request dated 11 January 2023 [✂]
434 Stakeholder response to PSR information request dated 11 January 2023 [✂]

most meaningful alternative to Mastercard and Visa for CNP payments.[435] The merchant said that bank-rail-based account-to-account solutions are available in some European countries but not in the UK, and that importing these would require too much effort from merchants, considering the limited market share they would bring.[436]

**2.43** A merchant [✁] said it currently accepts [✁], as well as Mastercard and Visa cards.[437] It is also [✁].[438] The merchant said that, currently, card payments [✁] used by consumers in the UK and the EEA.[439] However, the merchant said it would be willing to support any payment method preferred by its customers.[440]

## What acquirers told us

**2.44** We asked UK acquirers questions about alternative payment methods, other than Visa- and Mastercard-branded cards and cash, that they offer to their customers.[441]

**2.45** We also asked UK acquirers about the extent of the competition that Mastercard and Visa face from other international card schemes and non-card payment options, both in general terms and specifically for UK-EEA cross-border CNP transactions.[442]

**2.46** Below, we set out summaries of the responses we received from seventeen acquirers. Many respondents mentioned American Express. They also mentioned other payment solutions, but stated that these rely on traditional schemes (for example, Mastercard and Visa). Acquirers told us that there are payment solutions that do not rely on Mastercard and Visa (for example, account-to-account and open banking solutions), but many of these are yet to become widespread.

**2.47** An acquirer [✁] told us that they provide acquiring services for other card schemes and alternative payment providers, including [✁] for UK-EEA e-commerce transactions. However, relevant transaction volumes are minimal compared to corresponding Mastercard and Visa transaction volumes.[443] The acquirer explained its view that [✁].[444]

**2.48** An acquirer [✁] said that it offers other payment methods, including [✁], alongside Mastercard and Visa, although the reported volumes for these non-Mastercard and non-Visa payment methods are negligible. It also said that [✁].[445]

**2.49** An acquirer [✁] said that there are currently no scaled-up, viable alternatives to Mastercard and Visa in the UK.[446] Acquiring services for alternative payment methods are also provided, but mostly in mainland Europe (for example, the Netherlands and Poland),

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435 Stakeholder response to PSR information request dated 11 January 2023 [✁]
436 Stakeholder response to PSR information request dated 11 January 2023 [✁]
437 Stakeholder response to PSR information request dated 18 July 2023 [✁]
438 Stakeholder response to PSR information request dated 18 July 2023 [✁]
439 Stakeholder response to PSR information request dated 18 July 2023 [✁]
440 Stakeholder response to PSR information request dated 18 July2023 [✁]
441 Stakeholder response to PSR information request dated 18 July2023 [✁]
442 PSR information request dated 11 January 2023. [✁]
443 Stakeholder response to PSR information request dated 11 January 2023 [✁]
444 Stakeholder response to PSR information request dated 11 January 2023 [✁]
445 Stakeholder response to PSR information request dated 11 January 2023 [✁]
446 Stakeholder response to PSR information request dated 11 January 2023 [✁]

where the acquirer stated that these systems accounted for more than 50% of e-commerce-related transactions in 2021.[447]

**2.50** An acquirer [✂] did not mention any other payment options that it offers to its customers for UK-EEA CNP transactions in addition to Mastercard and Visa. The acquirer said that some merchants had asked it to provide acquiring services for other card schemes, [✂], due to the nature of the merchants and whether they have customers from countries in which these brands are prevalent.[448] The acquirer [✂] also said that, in the UK, Klarna is widely accepted. In the EU, with the exception of SEPA bank transfers, alternative payment methods tend to be localised in a specific country and, because of their highly localised nature, such alternatives tend to be focused on domestic processing and are not comparable to global networks such as Mastercard and Visa.[449]

**2.51** An acquirer [✂] said that, in addition to the main card schemes, it offers acquiring services for another card scheme [✂]. However, transaction levels for these cards are negligible.[450] The acquirer said that it has also seen the emergence of account-to-account payments, mainly aimed for high-value, low-volume transactions, but it is currently not offering any other services.[451]

**2.52** An acquirer [✂] said that it provides a variety of different card and non-card alternatives to Mastercard and Visa to merchants in the UK. However, it stated that, in contrast with the United States and EEA countries, the UK is dependent on card payment methods for e-commerce transactions. It reported that, in December 2022, non-card payments accounted for only [✂] of its UK payment processing volume.[452]

**2.53** An acquirer [✂] said that it offers [✂] for UK-EEA CNP transactions in addition to Mastercard and Visa, but the volumes and values of its alternative card transactions are negligible in comparison to its Mastercard and Visa transactions.[453] The acquirer said that cards are still, and are expected to remain, the most popular payment type for online purchases. In the last few years, it has witnessed the establishment and fast growth of payments processed via Apple, Amazon and Google. These alternative methods are still card-based, but the acquirer said that, in the future, they could potentially move away from card rails to for other payment rails, such as bank transfers. Finally, the acquirer said that BNPL methods have also been growing strongly in the last few years, and that bank transfers are also becoming more popular.[454]

**2.54** An acquirer [✂] said that Mastercard and Visa face little if no competition stemming from alternative card systems or non-card payment methods. Most of the non-card systems, such as PayPal, rely on Visa's and Mastercard's rails nonetheless, and are therefore subject to any increase in fees by the card schemes. For example, when Mastercard and

447 Stakeholder response to PSR information request dated 11 January 2023 [✂]
448 Stakeholder response to PSR information request dated 11 January 2023 [✂]
449 Stakeholder response to PSR information request dated 11 January 2023 [✂]
450 Stakeholder response to PSR information request dated 11 January 2023 [✂]
451 Stakeholder response to PSR information request dated 11 January 2023 [✂]
452 Stakeholder response to PSR information request dated 11 January 2023 [✂]
453 Stakeholder response to PSR information request dated 11 January 2023 [✂]
454 Stakeholder response to PSR information request dated 11 January 2023 [✂]

Visa increased their IFs following the UK's withdrawal from the EU, PayPal also increased its cost for UK businesses – from 0.5% to 1.29% of the transaction value.[455] [456]

**2.55** An acquirer [✂] said that it supports merchant card transactions through Visa, Mastercard, [✂]. It also supports Direct Debit services for merchants ([✂]). Additionally, merchants have been able to process alternative payments through a [✂]. However, it also stated that currently the volumes processed via smaller schemes and alternatives it supports are immaterial compared to Mastercard and Visa's transaction volumes.[457] The acquirer said that Mastercard and Visa currently account for the vast majority of transactions processed by it.[458]

**2.56** An acquirer [✂] said that it offers non-card options as alternatives to Mastercard and Visa, and that it has implemented open banking solutions.[459]

**2.57** An acquirer [✂] said that, in addition to Mastercard and Visa, it offers merchants alternative payment options, such as [✂] and open banking solutions by [✂].[460] The acquirer also said that Mastercard and Visa transaction methods are very popular in the UK, accounting for more than [✂]% of the market share. Furthermore, it said that the introduction of contactless transactions, and of [✂] transactions in CP environments, has led to significant growth of card payments in the CNP segment. The acquirer said e-wallets (that is, digital wallets), such as [✂], were the second most popular payment method it offers. These digital wallets account for approximately [✂]% of the market share, but they require users to link their Visa or Mastercard card to use them. However, the acquirer said that none of the aforementioned alternative payment methods could constitute an alternative to card payments in terms of usability and prevalence.[461]

**2.58** An acquirer [✂] said that it offers [✂] as alternatives for e-commerce transactions, though volumes for these alternatives are limited in comparison to its Mastercard and Visa transactions.[462] It stated that, since the introduction of Payment Services Directive 2, several open banking (payment initiators) providers have entered the payment market, and the services they offer enable customers to easily make bank transfers to merchants at the checkout. It noted that these providers could potentially become competitors for Mastercard and Visa in the future. It stated that bank transfers currently account for [✂]% of e-commerce payments in Europe and are expected to grow by a further [✂]% by 2026. However, it also reported that bank transfer payment methods are limited to domestic schemes in Europe.[463]

**2.59** The same acquirer [✂] further explained that several open banking APIs have been rolled out since 2018, allowing customers with any bank account to pay merchants across the EU. It said that the instant banking payment infrastructure across Europe and the UK is an

455 Stakeholder response to PSR information request dated 11 January 2023 [✂]
456 Institute of Chartered Accountants in England and Wales, Rising Payment Costs and How to Mitigate Them (October 2022)
457 Stakeholder response to PSR information request dated 11 January 2023 [✂]
458 Stakeholder response to PSR information request dated 11 January 2023 [✂]
459 Stakeholder response to PSR information request dated 11 January 2023 [✂]
460 Stakeholder response to PSR information request dated 11 January 2023 [✂]
461 Stakeholder response to PSR information request dated 11 January 2023 [✂]
462 Stakeholder response to PSR information request dated 11 January 2023 [✂]
463 Stakeholder response to PSR information request dated 11 January 2023 [✂]

attractive option for merchants and consumers. The merchant benefits from immediate funding, as opposed to next-day settlement, and lower costs compared to credit and debit cards, despite regulatory changes to drive down IFs. In addition, payments by bank transfer do not pose a risk of chargeback for merchants. However, the acquirer said that there are drawbacks for merchants due to the current acceptance footprint and the quality of the payment experience not yet being consistent across Europe. This is expected to change in the future due to increased regulation in this space. The success of open banking will be based upon consumer adoption, ease of use and how it has been implemented, which will determine whether it will become a viable alternative to Mastercard and Visa, and digital wallets (for example, [✂]).[464]

**2.60** An acquirer [✂] said it primarily offers acquiring services for Mastercard and Visa, but it also provides services for both card and non-card payment systems. Despite recognising the growing importance of account-to-account systems, it does not consider that such methods could realistically rise to the level of the traditional card schemes.[465]

**2.61** An acquirer [✂] said that it does not offer any acquiring services for alternative providers to Mastercard and Visa.[466]

**2.62** An acquirer [✂] said that it offers acquiring services or support for alternative card schemes (for example, [✂]) and non-traditional payment methods (for example, account-to-account). It stated that it provides a large selection of acquiring services, so all the requirements of individual merchants are taken into account.[467] The acquirer said it considers Mastercard and Visa to be must-have cards because they dominate the market for electronic online payments in the UK. In the acquirer's view, although the use of alternative payment methods is more widespread now, consumer adoption has not yet sufficiently matured to enable a true reduction in Mastercard's and Visa's dominance.[468]

**2.63** An acquirer [✂] said that it offers acquiring services for account-to-account and open banking payment methods.[469] The acquirer does not currently offer acquiring services for [✂].[470] The acquirer said that traditional card schemes have been affected by the competition stemming from alternatives in recent years. However, many of these new payment methods (for example, Apple Pay) directly rely on traditional schemes. Account-to-account and open banking systems are alternatives that bypass card schemes, but their diffusion is still limited. The acquirer said that it expects new payment alternatives that connect merchants and customers directly (avoiding scheme networks) to become more competitive in the electronic payment landscape in the near future.[471]

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464 Stakeholder response to PSR information request dated 11 January 2023 [✂]
465 Stakeholder response to PSR information request dated 11 January 2023 [✂]
466 Stakeholder response to PSR information request dated 11 January 2023 [✂]
467 Stakeholder response to PSR information request dated 11 January 2023 [✂]
468 Stakeholder response to PSR information request dated 11 January 2023 [✂]
469 Stakeholder response to PSR information request dated 11 January 2023 [✂]
470 Stakeholder response to PSR information request dated 11 January 2023 [✂]
471 Stakeholder response to PSR information request dated 11 January 2023 [✂]

**2.64** An acquirer [✁] said that it offers [✁] as an additional payment option for UK-EEA CNP transactions.[472] The acquirer also said that, aside from Mastercard and Visa, many merchants may want to offer alternative payment schemes, so that their customers have a range of payment options. It also explained that merchants' appetite for these additional schemes may depend on their target customer base/transaction mix: for example, merchants may see a lot of traffic from China, in which case they could be interested in offering UPI as a payment option. This merchant-led (and ultimately cardholder-led) demand for alternative payment schemes then filters upwards to the acquirer's offering. [473]

## Consumer steering towards alternative payment methods

**2.65** Merchants may be able to mitigate the impact of the increases in IFs for UK-EEA transactions by persuading the relevant customers to move away from paying by Mastercard- and Visa-branded cards and towards payment methods that are less costly for them (steering). Potential ways in which a merchant may be able to steer cross-border customers include:

- introducing card surcharges or offering discounts/bonuses for using an alternative payment method
- providing information on the fees facing the merchant
- asking the customer to choose a different payment method
- influencing customer choice through presentation of payment options on the user interface (for example, salience)

### What merchants told us

**2.66** We asked merchants if they steer consumers away from cards by encouraging them directly or indirectly to pay with alternatives.[474] We also asked them if they are able to differentiate between CNP customers that use EEA-issued cards and those that use UK-issued cards, and, if so, whether they are able to price differently (that is, surcharge) for transactions that use EEA-issued cards rather than UK-issued cards.[475]

**2.67** The eight merchants who responded to our questionnaire typically do not steer consumers towards a specific or an alternative payment method.[476]

**2.68** The BRC said that certain types of low-level steering, such as encouraging customers to use a store's own gift cards or loyalty points, are commonplace. It also stated that its members have often seen that steering techniques have limited effectiveness, as customers typically have a preferred payment method for different reasons (for example, budgeting, rewards) and will use it despite any steering.[477]

472 Stakeholder response to PSR information request dated 11 January 2023 [✁]
473 Stakeholder response to PSR information request dated 11 January 2023 [✁]
474 PSR merchant questionnaire. [✁]
475 PSR merchant questionnaire. [✁]
476 Stakeholder responses to PSR information requests dated 11 January 2023 [✁]
477 BRC response to PSR information request dated 11 January 2023 [✁]

**2.69** A merchant [✂] said that its customers are able to choose different payment methods and to set their preferred payment choice in their personal profiles. Additionally, the merchant said that it has [✂].[478]

**2.70** A merchant [✂] said that its customers are free to pay with any payment method of their choice. It said that it generally does not steer customers towards a certain payment method, but it continues to evaluate different design options to recommend certain payment methods that provide the best payment experience for its customers. It said that it never imposes surcharges or provides monetary incentives for using a certain payment method.[479]

**2.71** A merchant [✂] said that it does not steer customers towards specific payment methods as part of their booking path or payment process, and it allows customers to choose between different payment options. However, occasionally it facilitates promotions by certain payment providers in co-branded advertising campaigns. For instance, it may highlight if a payment provider is offering a discount to customers who use that provider's payment method.[480]

**2.72** A merchant [✂] said that it explicitly rules out any steering towards payment methods that are alternatives to credit and debit cards. Additionally, on its website, the merchant does not encourage customers to use a particular type of card (for example, debit rather than credit) or a particular card scheme (for example, Mastercard rather than Visa).[481]

**2.73** A merchant [✂] said that it does not incentivise its users to use any specific card or payment method.[482] However, it said that it tries to nudge users to cheaper methods (for example, [✂]) with minimal intervention/friction. Additionally, it applies a surcharge to certain payment methods to recover some of the extra costs and explore potential impact on churn.[483]

**2.74** A merchant [✂] said that it does not steer customers towards any specific type of payment method or card scheme.[484]

**2.75** A merchant [✂] told us that it might encourage the use of certain payment methods based on consumer benefit, lower card fees and other commercial and operational factors that vary over time.[485]

**2.76** A merchant [✂] said that it does not steer consumers towards any particular payment method, but instead offers its customers the choice to pay with their most preferred payment method(s). [✂].[486]

478 Stakeholder response to PSR information request dated 11 January 2023 [✂]
479 Stakeholder response to PSR information request dated 11 January 2023 [✂]
480 Stakeholder response to PSR information request dated 11 January 2023 [✂]
481 Stakeholder response to PSR information request dated 11 January 2023 [✂]
482 Stakeholder response to PSR information request dated 11 January 2023 [✂]
483 Stakeholder response to PSR information request dated 11 January 2023 [✂]
484 Stakeholder response to PSR information request dated 11 January 2023 [✂]
485 Stakeholder response to PSR information request dated 11 January 2023 [✂]
486 Stakeholder response to PSR information request dated 18 July 2023 [✂]

# Mitigating actions, other than steering and relocation

## What acquirers told us

**2.77** Similarly, we asked UK acquirers whether they have facilitated or are aware of any mitigating actions in addition to or beyond relocation (discussed in the following section) that merchants they serve have taken, are taking, or plan to take, with the purpose of reducing the impact of the higher UK-EEA cross-border CNP IFs. We also asked acquirers about their merchants' ability to surcharge depending on the jurisdiction where the card is issued.[487]

**2.78** Responses suggest that their merchants did not take any other action in response to the increases in IFs, beyond relocation.[488] Below we set out responses we received from sixteen acquirers.

**2.79** An acquirer [✂] said that no mitigating action, besides relocation, has been undertaken by its merchants to mitigate the impact of higher IFs. It said all its merchants, regardless of size or industry, were already reviewing their structures as a result of the UK's withdrawal from the EU.[489]

**2.80** An acquirer [✂] did not mention any other mitigating actions in addition to or beyond relocation.[490] It said merchants may consider surcharging, e.g., increasing transaction charges for all cards or just for those that sit outside the domestic consumer card space.[491]

**2.81** An acquirer [✂] said that no action, besides relocation, has been undertaken by its merchants to mitigate the impact of higher IFs. It noted all sizes of its merchants were already reviewing their structures as a result of the UK's withdrawal from the EU but, while some merchants reviewed their legal entity structure in light of cross-border implications, it knew of no cases where changes were specific to the fee changes.[492]

**2.82** An acquirer [✂] said that it was not aware of any action, besides relocation, taken by its merchants to mitigate the impact of the increased IFs.[493]

**2.83** An acquirer [✂] said that it was considering expanding its set of available payment options to help its merchants mitigate the impact of IF increases.[494] The acquirer said that merchants can sign up to bank-based or other alternative payment solutions (e.g. [✂]) that would avoid these higher costs, although the acceptance level of such options is low due to market penetration as it is driven by consumer choice.[495] Its merchants had taken no

487 PSR merchant questionnaire. [✂]
488 Stakeholder responses to PSR information requests dated 11 January 2023 [✂]
489 Stakeholder response to PSR information request dated 11 January 2023 [✂]
490 Stakeholder response to PSR information request dated 11 January 2023 [✂]
491 Stakeholder response to PSR information request dated 11 January 2023 [✂]
492 Stakeholder response to PSR information request dated 11 January 2023 [✂
493 Stakeholder response to PSR information request dated 11 January 2023 [✂]
494 Stakeholder response to PSR information request dated 11 January 2023 [✂]
495 Stakeholder response to PSR information request dated 11 January 2023 [✂]

further mitigating actions besides accepting alternative payment methods and relocating.[496]

**2.84** An acquirer [✁] said it raised its concerns with Mastercard and Visa regarding the potential impact the increased fees could have on its merchants.[497] No other mitigating action has been undertaken by the acquirer. But the acquirer is able, through another part of its corporate structure, to acquire transactions for merchants who have relocated.[498]

**2.85** An acquirer [✁] said it was unaware of any action, besides relocation, taken by its merchants to mitigate the impact of the increased IFs.[499]

**2.86** An acquirer [✁] said that some of its merchants are reconsidering their payment offering and exploring the adoption of alternative payment methods to (among other factors) reduce their costs.[500]

**2.87** An acquirer [✁] said it has not taken any action on behalf of its merchants to mitigate the increase in IFs.[501] Additionally, the acquirer said it has not observed any of its merchants taking any mitigating action on their own. Its view is that there are (potentially) four channels, other than relocation, through which the merchants can avoid or reduce the impact of higher fees: negotiate lower fees with scheme owners and/or acquirers, stop accepting UK-EEA cross-border CNP transactions altogether, accept alternative payment methods instead of or other than cards for cross-border CNP transactions, or price-differentiate and charge an additional cost for EEA-issued cards.[502]

**2.88** An acquirer [✁] stated that some of its merchants are considering the possibility of accepting (additional) alternative payment methods (e.g. account-to-account) to cope with the increased fees and avoid relocation.[503]

**2.89** An acquirer [✁] said that no action, besides relocation, has been taken by its merchants to mitigate the impact of higher IFs.[504]

**2.90** An acquirer [✁] said that none of its merchants have taken any mitigating action, since it does not have significant transaction volumes with the EEA.[505]

**2.91** An acquirer [✁] said it has not observed any material actions, besides relocation, taken by its merchants to mitigate the impact of the increased IFs.[506]

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496 Stakeholder response to PSR information request dated 11 January 2023 [✁]
497 Stakeholder response to PSR information request dated 11 January 2023 [✁]
498 Stakeholder response to PSR information request dated 11 January 2023 [✁]
499 Stakeholder response to PSR information request dated 11 January 2023 [✁]
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503 Stakeholder response to PSR information request dated 11 January 2023 [✁]
504 Stakeholder response to PSR information request dated 11 January 2023 [✁]
505 Stakeholder response to PSR information request dated 11 January 2023 [✁]
506 Stakeholder response to PSR information request dated 11 January 2023 [✁]

**2.92** An acquirer [✂] said that it was not able to take any actions for or on behalf of its merchants to reduce the impacts of the higher IF rates on UK-EEA cross-border CNP transactions.[507]

**2.93** An acquirer [✂] said it can offer merchants who satisfy both UK and EEA onboarding requirements the ability to set up accounts with the acquirer's different UK and EEA entities to benefit from domestic acquiring and lower IFs. The acquirer said that larger merchants with a significant processing volume who have the time, resources, and skills necessary to navigate the complexity of establishing themselves in a new country are generally the merchants who have considered this option. The acquirer said it has not taken any other mitigating actions beyond helping to facilitate relocation of a merchant's UK-EEA cross-border transactions.[508]

## Merchant relocation

**2.94** UK merchants can avoid or mitigate the increase in IFs by relocating part or all of the relevant transactions to an EEA country so that lower intra-EEA IFs apply. 'Merchant relocation' refers to the decisions of merchants with operations in multiple jurisdictions, including on both sides of the UK-EEA border, to (among other things) shift the acceptance of their transaction volumes across jurisdictions.[509]

**2.95** We asked UK acquirers and merchants about their ability to relocate their UK-EEA cross-border CNP transactions to UK domestic or EEA domestic,[510] whether their acquirer(s) may enable or facilitate this practice, and whether they already have relocated (part of) their aforementioned transactions.[511]

**2.96** Respondents told us that some (larger) merchants have relocated their operations and as such avoided some or most of the cross-border IF increases, but the vast majority of merchants have not.[512]

### What merchants told us

**2.97** A merchant [✂] said it has relocated all its cross-border transactions in response to the higher IFs so that they are all now classified as either UK domestic or EEA domestic. To put this strategy in place, the merchant had to endure temporary processing costs, since part of its transaction volume was retained as cross-border initially, and there were engineering costs to create new re-routing solutions.[513]

**2.98** A merchant [✂] said that scheme rules that govern merchant location limit the possibility of merchants relocating to reduce the impact of the higher cross-border interchange fees.[514]

507 Stakeholder response to PSR information request dated 11 January 2023 [✂]

508 Stakeholder response to PSR information request dated 11 January 2023 [✂]

509 See Chapter 4 of this interim report. As noted by several stakeholders, merchants may have relocated for reasons separate or additional to IF increases – for example, they may have relocated due to higher trade friction following the UK's withdrawal from the EU, such as new VAT and tax rules and additional administrative requirements associated with managing imports/exports.

510 A UK (EEA) domestic transaction is a transaction where the card used is issued in the UK (EEA).

511 PSR merchant questionnaire. [✂]

512 Stakeholder responses to PSR information requests dated 11 January 2023 and 18 July 2023 [✂]

513 Stakeholder response to PSR information request dated 11 January 2023 [✂]

514 Stakeholder response to PSR information request dated 11 January 2023 [✂]

**2.99** A merchant [✁] said that, following the rise in cross-border IFs, it created a new legal entity in the UK to handle transactions for UK-based customers. For such transactions, the domestic rate is paid. At the same time, the EEA-based entity processes the transactions of EEA-based customers. The merchant said that relocating UK-based activities to the UK helped it reduce its operational costs, including by minimising IFs, and rule out the possibility of passing on these costs to the customers. However, the establishment of the new legal entity involved a considerable amount of time and resources.[515]

**2.100** A merchant [✁] said it has put no relocation plans in place since the increase of cross-border CNP IFs.[516]

**2.101** A merchant [✁] said that, due to the UK's decision to leave the EU, it was required to establish a European-regulated entity to provide regulated payment services to EEA customers. Following the UK's exit from the EU, the UK-based entity of the merchant lost its passporting rights in the EEA and, hence, its ability to process payments for EEA-based customers. A new legal entity within the EEA had to be created in order to ensure the continuation of the merchant's business in the EEA. This decision was taken before the new IFs on cross-border CNP transactions came into existence, therefore no significant losses were experienced by the merchant due to the rise in IFs. The merchant explained that cross-border IFs are avoided by an in-house routing function that optimises transactions between the EEA-based entity and the UK-based one. Following the establishment of the EEA-based entity, the merchant said it is able to process EEA-based transactions as domestic instead of as UK-EEA cross-border CNP transactions. Over the last two years, the merchant said it has processed as domestic in the UK a total of $[✁] million worth of transactions for UK-issued cards denominated in euro.[517]

**2.102** A merchant [✁] said it is evaluating different options to mitigate the impact of the higher IFs, including relocation.[518]

**2.103** A merchant [✁] said it has not yet considered the possibility of relocation.[519]

## What acquirers told us

**2.104** An acquirer [✁] said that none of its merchants relocated, since it does not have significant transaction volumes with the EEA.[520]

**2.105** An acquirer [✁] said that its UK acquiring business can only acquire transactions for merchants where the contracting entity is UK-incorporated, plus in any outlets that that merchant may have in the EEA. Another part of its corporate structure can acquire transactions for merchants where the contracting entity is EEA-incorporated (plus in any outlets that that merchant may have in the UK).[521]

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515 Stakeholder response to PSR information request dated 11 January 2023 [✁]
516 Stakeholder response to PSR information request dated 11 January 2023 [✁]
517 Stakeholder response to PSR information request dated 11 January 2023 [✁]
518 Stakeholder response to PSR information request dated 18 July 2023 [✁]
519 Stakeholder response to PSR information request dated 11 January 2023 [✁]
520 Stakeholder response to PSR information request dated 11 January 2023 [✁]
521 Stakeholder response to PSR information request dated 11 January 2023 [✁]

**2.106** An acquirer [✁] said that it facilitates relocation if the merchants establish (or have already established) an entity in one of the European countries in which passporting permissions are maintained and where merchants meet the requirements. Some merchants reviewed their legal entity structures to do so, following the increase in cross-border IFs or the UK's exit from the EU.[522]

**2.107** An acquirer [✁] said that it facilitates relocation if the merchants establish (or have already established) an entity in which it is licenced to operate. Some merchants decided to do so.[523]

**2.108** An acquirer [✁] said it can advise its merchants on how to reduce their fees and optimise transaction management, if they have previously established entities in both the EU and the UK, in conformity with the existing regulations. The acquirer said that some of its merchants have multiple locations across the two jurisdictions, but did not provide any data.[524]

**2.109** An acquirer [✁] stated that some of its larger merchants have relocated their business either in the UK or the EEA to mitigate the impact of higher cross-border IFs. However, the number of merchants who could relocate is insignificant. Smaller merchants cannot relocate due to the high operational costs of doing so.[525]

**2.110** An acquirer [✁] said it provides support for its merchants who decide to relocate (part of) their transaction volumes to the UK or the EEA, provided they have a local entity in the relevant jurisdiction. This way, merchants can treat former cross-border transactions as domestic.[526]

**2.111** An acquirer [✁] stated that [✁] (representing less than 5% of merchants that use its acquiring services) relocated its transactions from the EEA to the UK to avoid higher cross-border IFs.[527]

**2.112** An acquirer [✁] said it was not aware of any mitigating action taken by its merchants.[528]

**2.113** An acquirer [✁] said it has not observed any relocation. Additionally, it does not offer any support to merchants who want to relocate in the EEA because it is not licenced to operate in that market.[529]

**2.114** An acquirer [✁] said that no merchant that uses them as an acquirer has relocated (part of) its transaction volume to a different jurisdiction. It said it does not provide any advice to merchants in this regard.[530]

522 Stakeholder response to PSR information request dated 11 January 2023 [✁]
523 Stakeholder response to PSR information request dated 11 January 2023 [✁]
524 Stakeholder response to PSR information request dated 11 January 2023 [✁]
525 Stakeholder response to PSR information request dated 11 January 2023 [✁]
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527 Stakeholder response to PSR information request dated 11 January 2023 [✁]
528 Stakeholder response to PSR information request dated 11 January 2023 [✁]
529 Stakeholder response to PSR information request dated 11 January 2023 [✁]
530 Stakeholder response to PSR information request dated 11 January 2023 [✁]

**2.115** An acquirer [✁] said that larger merchants have been able to relocate (part of) their transactions by establishing a new entity in the UK or the EEA (depending on their original location). The acquirer also said that it allows its merchants to operate with two entities provided that they conform to the relevant card scheme's requirements.[531]

**2.116** An acquirer [✁] said that some of its merchants have sought to reconsider their business models and geographic locations with a view to minimising the effect of the changes in cross-border IFs. Larger merchants, who have a significant processing volume, and have the time, resources and skill to navigate the complexity of establishing themselves in a new country, have considered this option.[532]

**2.117** An acquirer [✁] said that a limited number of its clients have relocated business to other regions to limit the impact of increased fees. The reason this is limited is because it [✁]. It has, however, become apparent that when looking for new business some major merchants have set up this way to benefit from some of the cost savings.[533]

**2.118** An acquirer [✁] said it did not observe any relocation, but it assumes that some of its larger merchants will have opened entities in both the UK and the EEA to mitigate the impact of increased cross-border IFs.[534]

**2.119** An acquirer [✁] said that some of its merchants look to optimise their transactional flows, which may include relocating their relevant payment location for some of their transaction flows. However, due to the sizeable relocation costs, this option is more feasible for larger merchants than for small and medium businesses.[535]

**2.120** An acquirer [✁] ruled out the possibility of any of its merchants relocating (part of) their transactions as a consequence of the increased fees, since they are too small to afford such an expensive move. It said that scheme rules state that merchants need to establish an entity in the jurisdiction they want to operate before they can transfer their transactions there.[536]

**2.121** An acquirer [✁] said that some of its merchants have relocated permanently to the EEA or have established EEA or UK subsidiaries to operate in the relevant jurisdiction and avoid cross-border IFs. This is the case for fintech companies who use this acquirer and who operate in both the UK and the EEA.[537]

531 Stakeholder response to PSR information request dated 11 January 2023 [✁]
532 Stakeholder response to PSR information request dated 11 January 2023 [✁]
533 Stakeholder response to PSR information request dated 11 January 2023 [✁]
534 Stakeholder response to PSR information request dated 11 January 2023 [✁]
535 Stakeholder response to PSR information request dated 11 January 2023 [✁]
536 Stakeholder response to PSR information request dated 11 January 2023 [✁]
537 Stakeholder response to PSR information request dated 11 January 2023 [✁]

# Additional interchange income and fraud prevention

**2.122** We asked UK issuers questions about fraud. More specifically, we asked issuers if their operational costs, concerning UK-EEA cross-border CNP transactions, have increased since the UK's exit from the EU.[538] Additionally, we asked issuers how they use the additional income derived from the increase in IFs for UK-EEA cross-border CNP transactions.[539]

**2.123** We set out below responses from ten issuers. Issuers told us that their operational costs associated with UK-EEA cross-border CNP transactions have not increased since the UK's exit from the EU. Most respondents told us they do not know if the additional income was purposely reinvested to set up new anti-fraud measures or improve existing ones as it is difficult for them to keep track of this particular revenue.

**2.124** An issuer [✂] said its operational costs have not changed since the UK's withdrawal from the EU, and/or specifically for CNP transactions. It could not comment on what part of the income stemming from increased IFs has been reinvested for anti-fraud purposes.[540]

**2.125** An issuer [✂] said that it does not believe that there are significant cost differences between UK-EEA CNP transactions and domestic transactions. It additionally noted that its operational costs have not changed following the UK's withdrawal from the EU.[541] The issuer further said it has not made any product changes for cardholders directly as a result of the increased revenue and that it cannot directly attribute any of the new products and features it has launched since 2021 to a particular revenue line. However, none of the new products and features it listed in its reply were directly connected to increases in fraud prevention.[542]

**2.126** An issuer [✂] said that it has not experienced an increase in operational cost for CNP transactions due to the UK's withdrawal from the EU. It said that investment and consumer proposition decisions (including matters relating to fraud and reward) are made holistically and are not based solely on one element of the card profit and loss account, and that IF income is assessed in the same way as other portfolio revenue and costs. The issuer said that it is not possible for them to definitively track the use of the additional income derived from the UK-EEA cross-border CNP IF increases.[543]

**2.127** An issuer [✂] said it sees international CNP transactions as carrying substantially greater risk and operational overhead, even with strong customer authentication. However, it did not mention specific investment in fraud prevention with the funds raised through the increase in IFs. It instead said that any additional income would have been used to enhance the platform to enable more issuers into the market, to provide greater competition and consumer benefit.[544]

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538 PSR merchant questionnaire. [✂]

539 PSR merchant questionnaire. [✂]

540 Stakeholder response to PSR information request dated 11 January 2023 [✂]

541 Stakeholder response to PSR information request dated 11 January 2023 [✂]

542 Stakeholder response to PSR information request dated 11 January 2023 [✂]

543 Stakeholder response to PSR information request dated 11 January 2023 [✂]

544 Stakeholder response to PSR information request dated 11 January 2023 [✂]

**2.128** An issuer [✁] said in its response that it does not experience any difference in terms of internal costs between domestic transactions and UK-EEA cross border CNP transactions, and that its operational costs for CNP transactions have not changed since the UK's withdrawal from the EU. It said that it does not invest the additional income from the increased IFs for a specific purpose, but looks at its total income level as a whole to make such decisions. It also said that it has invested additional resources over the past few years in preventing fraud.[545]

**2.129** An issuer [✁] said that it cannot accurately quantify the additional costs of cross-border transactions as distinct from domestic transactions, although it has good reasons to believe that they are higher in general. It also said that additional income from increased IFs is pooled together and it is difficult for it to allocate that revenue based on specific consumer or transaction types. The issuer also said that it has been heavily investing in improving fraud outcomes for its consumers, and this includes EEA-UK transactions. The issuer said that some debit-card issuers saw a marked increase in fraud attacks from March 2022 onwards as the industry adopted Strong Customer Authentication and fraudsters adapted to circumvent it. Continued investment in fraud alerts and anti-fraud architecture, including adding further authentication controls, were necessary to address these attacks.[546]

**2.130** An issuer [✁] said its internal financial crime team has not seen any noticeable higher rates of fraud on EEA CNP transactions versus domestic. It said that while inter-regional (outside EU) fraud rates are higher, this does not apply to EEA CNP transactions. As such, it does not expect EEA CNP transactions to make higher usage of fraud analysis tools versus its domestic equivalents on a per-transaction basis. Additionally, the issuer said that its share of non-domestic transactions is very low. It did, however, incur other operational costs.[547] The issuer said that the estimated increase in income of £[✁] from increased EEA CNP IF rates had not been directly taken and reinvested to reduce fraud or reward consumers with extra benefits. However, it also said that, since IFs were first capped in 2015, costs have continued to increase on card transactions, which is negatively affecting the economics of card spending for issuers.[548]

**2.131** An issuer [✁] said its operational costs have not changed since the UK's withdrawal from the EU. It said that it does not maintain data at the level of detail to be able to discern a change in costs following the UK's withdrawal from the EU but that, at the margin, it may be the case that fraud costs of these cross-border CNP transactions are different from the fraud costs of other transactions. It also said that it does not account for interchange income at the level of granularity that would allow it to associate pricing decisions with changes in IFs. The issuer told us that it had not made specific pricing changes in response to the increase in cross-border IFs. Rather than seeing the additional income derived from increased cross-border IFs as entirely a benefit, the issuer said it was concerned that the increase in cross-border fees could reduce the competitiveness of its credit-card products, if the effect was to reduce the acceptance of its [✁] payment cards on account of the increased IFs payable by merchants.[549]

545 Stakeholder response to PSR information request dated 11 January 2023 [✁]
546 Stakeholder response to PSR information request dated 11 January 2023 [✁]
547 Stakeholder response to PSR information request dated 11 January 2023 [✁]
548 Stakeholder response to PSR information request dated 11 January 2023 [✁]
549 Stakeholder response to PSR information request dated 11 January 2023 [✁]

**2.132** An issuer [✂] said it is not aware of any cost differences between CP and CNP transactions, as generally it does not specifically attribute operational and cost differences to types of transactional activity. Moreover, it said that no additional income derived from the UK-EEA cross-border CNP IF increases was utilised specifically to reduce fraud or the number of rejected UK-EEA CNP transactions.[550]

**2.133** An issuer [✂] said that cross-border CNP transactions are generally associated with higher cost(s) in the form of scheme fees, foreign exchange settlement fees and foreign exchange fees. It additionally told us that it is likely that cross-border CNP transactions are perceived as more 'risky' and as a result there is more friction in the form of fraud checks and higher 3D Secure challenge rates. Such friction, the issuer explained, introduces higher operational and infrastructure costs such as consumer-support cost, service quality maintenance cost (e.g. to ensure high card acceptance for such transactions) and higher cloud application costs.[551] It went on to state that additional overall income derived from increased fees allows it to justify further strategic investments to improve a successful product that contributes meaningfully to company profitability. It said that the majority of its card portfolio benefits from any strategic improvements and investments in its systems, operations, and teams, rather than just a subset of its portfolio such as UK-EEA cross-border transactions. To that effect, the issuer said it has [✂]. Their role extends to working [✂]. The issuer did not have a breakdown of what proportion of the additional income has been used for the initiatives described.[552]

**2.134** An issuer [✂] said in its response that it is potentially more exposed to frauds after the UK's withdrawal from the EU, and that it requires additional income to invest in further fraud-protection mechanisms.[553]

550 Stakeholder response to PSR information request dated 11 January 2023 [✂]
551 Stakeholder response to PSR information request dated 11 January 2023 [✂]
552 Stakeholder response to PSR information request dated 11 January 2023 [✂]
553 Stakeholder response to PSR information request dated 11 January 2023 [✂]

# Annex 3
# Glossary

| Term | Definition for the purpose of this document |
|---|---|
| **Acquirer** | A bank or other licensed payment service provider that contracts with one or more merchants to provide card-acquiring services for card payment systems. |
| **Blending pricing** | Pricing offered by acquirers to merchants for card-acquiring services, whereby for any given transaction the acquirer does not automatically pass through at cost the interchange fee applicable to the transaction. |
| **BNPL** | Buy now, pay later. |
| **Brexit** | The withdrawal of the United Kingdom from the European Union. The transition period following the UK's withdrawal from the EU ended on 31 December 2020. |
| **Card-acquiring services** | Services to accept and process card transactions on behalf of a merchant, resulting in a transfer of funds to the merchant. |
| **Cardholder** | A person who is issued a payment card and authorised to use that payment card. |
| **Card-not-present/CNP transaction** | A transaction that is completed online, by phone or by mail, so a card (be it physical or tokenised) is not present when the merchant is taking payment. |
| **Card payment system** | A payment system that enables a holder of a payment card to make a payment. |
| **Card payment system operator** | Organisations that manage the 'scheme rules' on card payments and set the terms on which issuers, acquirers, merchants, cardholders and other parties participate in the card payment system. |
| **Card-present/CP transaction** | A card transaction in which the cardholder is present at the outlet and presents the payment card. |
| **Card schemes** | Operators of card payment systems (such as Mastercard and Visa). These are organisations that license issuers and acquirers to recruit cardholders and merchants, respectively. They manage the 'scheme rules' that govern how card payments are made and set the basis on which issuers, acquirers, merchants, cardholders and other parties participate in the card payment system. |

| Term | Definition for the purpose of this document |
|---|---|
| **Card transaction** | A transaction carried out under a card payment system that results in the transfer of funds between a cardholder and a merchant. This includes purchase transactions, refunds and transactions related to the chargeback process. |
| **CAT** | The Competition Appeal Tribunal. |
| **Court of Appeal/CA** | The Court of Appeal of England and Wales. |
| **Court of Justice/CJEU/CJ** | The Court of Justice of the European Union. |
| **Credit card** | A card whose holder has been granted a revolving line of credit. It enables the holder to make purchases and/or withdraw cash up to a prearranged ceiling; the credit granted can be settled in full by the end of a specified period or can be settled in part, with the balance taken as extended credit. Interest may be charged on the transaction amounts from the date of each transaction or on the outstanding balance where it has not been settled in full. |
| **Cross-border transactions** | Card transactions where the issuer and the acquirer are located in different countries or where the card was issued by an issuer located in a different country from that of the point-of-sale location (the merchant location). |
| **Debit card** | A card enabling the holder to have their purchases directly charged to funds in their account. |
| **Digital wallet** | An application on an electronic device that stores payment details, which allows the holder to securely make payments without the physical card. |
| **EC** | The European Commission. |
| **EEA** | The European Economic Area. |
| **EEA acquirer** | An acquirer who provides services to EEA merchants. |
| **EEA cardholder** | A cardholder whose card is provided by an EEA issuer. |
| **EEA merchant** | A merchant with at least one EEA outlet. |
| **ECB** | The European Central Bank. |
| **EU** | The European Union. |
| **EU IFR** | The EU Interchange Fee Regulation 2015, Regulation (EU) 2015 / 751 of the European Parliament and Counsel. |
| **FSBRA** | The Financial Services (Banking Reform) Act 2013. |

| Term | Definition for the purpose of this document |
|---|---|
| **Fraud disputes** | Disputes where cardholders' accounts are debited for transactions they did not authorise. These usually occur when an individual's card details have been compromised and someone who has gained access performs unauthorised transactions, or when a fraudulent merchant is processing questionable transactions through to the consumer's account. They can also arise when a consumer disputes a transaction they made. This could be for several reasons such as that the goods were not received, goods were not as described or damaged, the cardholder was charged an incorrect amount, or processing errors. |
| **General Court/GC** | The General Court of the European Union. |
| **Honour All Cards/HAC rule** | Mastercard and Visa's scheme rules that prevent a merchant from choosing or declining transactions on the basis of a card issuer's location. |
| **IC++ pricing** | Pricing offered by acquirers to merchants for card-acquiring services, whereby for any given transaction the acquirer automatically passes on at cost the interchange fee and scheme fees applicable to the transaction. |
| **Inbound interchange fees (Inbound IFs)** | IFs for transactions using UK-issued cards to make payments to merchants located outside the UK. For UK-EEA transactions, these IFs relate to payments made with UK-issued cards at EEA merchants. These fees are paid to UK issuers and represent a cost to EEA merchants.<br>Note: In the interim report we use 'CNP inbound IFs' and 'inbound IFs' interchangeably to refer to UK-EEA consumer CNP inbound IFs. |
| **Interchange fee/IF** | A fee that acquirers pay to issuers each time a card is used to buy goods or services. This is a per-transaction fee and is usually levied as a percentage of the transaction value. The IF charged can vary depending on transaction and IF type. |
| **Issuer** | Banks or other organisations licensed by card payment system operators to provide cards to cardholders. The issuer pays an acquirer the money a merchant is owed for the transaction (retaining IFs) and debits a cardholder's account. |
| **Merchant** | An organisation that accepts card payments. |
| **MIF** | Multilateral interchange fee. |
| **MIT** | Merchant indifference test. |
| **MSC** | Merchant service charge. |
| **Nudging** | A form of behavioural steering. |

| Term | Definition for the purpose of this document |
|---|---|
| **Outbound interchange fees (Outbound IFs)** | IFs for transactions using non-UK-issued cards to make payments to merchants located in the UK. For UK-EEA transactions, these IFs relate to payments made with EEA-issued cards at UK merchants. These fees are paid to EEA issuers and represent a cost to UK merchants.<br>Note: In the interim report we use 'CNP outbound IFs' and 'outbound IFs' interchangeably to refer to UK-EEA consumer CNP outbound IFs. |
| **Payment system** | A system that is operated by one or more persons in the course of business for the purpose of enabling persons to make transfers of funds. |
| **Payment default** | A situation where a consumer misses a payment or payments on a credit agreement they have entered into. |
| **Processing fees** | All fees paid to a card scheme operator by customers for the processing of card transactions (the authorisation, clearing and settlement of purchase transactions) that arise as a result of them being party to any card transactions involving one or both of:<br>• payments to (or from) a UK merchant<br>• payments from (or to) a UK cardholder |
| **Retail transaction** | A transaction between a consumer and a merchant. |
| **RoW** | Rest of the world |
| **Scheme fees** | All fees paid to a card scheme operator that arise as a result of customers being party to any card transactions involving one or both of:<br>• payments to (or from) a UK merchant<br>• payments from (or to) a UK cardholder<br>This includes fees that are directly attributable to a card transaction as well as fees that are not directly attributable to a card transaction but are paid as a condition of participation in the payment scheme.<br>This does not include fees directly attributable to card transactions at non-UK outlets, unless a UK cardholder was involved.<br>This does not include processing fees and international fees. |
| **Scheme rules** | All rules, policies, procedures, regulations and standards that relate to the operation and administration of a card payment system (whether published or not). |
| **SEPA** | The Single European Payment Area. |
| **Supreme Court** | The Supreme Court of the United Kingdom. |

| Term | Definition for the purpose of this document |
|---|---|
| **UK** | The United Kingdom, |
| **TFEU** | Treaty on the Functioning of the European Union. |
| **Tokenisation** | The process of replacing a card's primary account number (PAN) – the 16-digit number on the plastic card – with a unique alternate card number, or 'token'. Tokens can be used for mobile point-of-sale transactions, in-app purchases or online purchases. |
| **UK acquirer** | An acquirer who provides services to UK merchants. |
| **UK cardholder** | A cardholder whose card is provided by an UK issuer. |
| **UK IFR** | The EU Interchange Fee Regulation 2015 as retained and incorporated into UK law by the European Union (Withdrawal) Act 2018 and as amended by The Interchange Fee (Amendment) (EU Exit) Regulations 2019 (SI 2019/284). |
| **UK merchant** | A merchant with at least one UK outlet. |
| **2019 Commitments** | Commitments offered by each of Mastercard and Visa and accepted by the European Commission to cap IFs on transactions involving cards issued outside the EEA and merchants in the EEA. |

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