Payment Systems Regulator

Market review of UK-EEA cross-border interchange fees

Stakeholder submissions to interim report consultation

December 2024

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

American Express

American Express response to the PSR's Interim Report on cross border interchange fees market review

[redacted]

American Express (Amex) welcomes the opportunity to comment on the PSR's interim report and is supportive of initiatives to promote competition in the payment sector.

As the PSR is aware, American Express competes with Visa and Mastercard both as a three-party card scheme alternative to the dominant card schemes and, since 2019, as a payment initiation service provider (PISP) by offering our Pay with Bank transfer (PwBt) product. American Express therefore plays an important role in bringing competition, innovation, and increased consumer choice.

As an integrated payments service provider, American Express is both the issuer and acquirer of American Express transactions in the UK. It competes to provide card issuing services and to secure merchant acceptance of those cards. Unlike the dominant card schemes, American Express does not compete based on ubiquity. It must instead prove its value to both consumers and merchants based on a highly differentiated, value-generating business model. American Express' model also does not involve four party interbank arrangements and interchange fees involved in the Visa and Mastercard schemes.

As American Express operates a different model to Visa and Mastercard, it is not in a position to respond to each of the detailed questions that the PSR has asked with respect to its interim findings. We are nonetheless keen to offer assistance as an interested third party and therefore set out below a few observations on the PSR's interim findings from our perspective as a small, innovative three-party scheme competitor to Visa and Mastercard.

- **The 'must take' nature of Visa and Mastercard.** We note that the PSR does not consider competitive alternatives to be a sufficient constraint on Visa and Mastercard given their incumbent scale. [redacted].

- **Initiatives to encourage cross-border card-not-present (CNP) surcharging or other forms of steering by UK merchants**. We support the PSR's interim view not to pursue initiatives to encourage cross-border surcharging or other forms of steering as a response the increase in UK-EEA Visa and Mastercard outbound interchange fees that the PSR is concerned with and welcome a more targeted and proportionate approach. As the PSR has identified, encouraging such surcharging and steering initiatives would likely introduce its own challenges by creating friction in the consumer journey, adding costs for merchants, and potentially placing UK merchants at a competitive disadvantage to EEA merchants. American Express believes that surcharging and steering lead to poor consumer outcomes. Given that the UK Government has clearly recognised the benefits of prohibiting surcharging consumer cards in the UK,[1] it would be contradictory to encourage the introduction of surcharging by UK merchants for cross-border transactions.

[1] Para 2.12 HM Treasury Payments Landscape Review Call for Evidence, July 2020.

- **Requiring changes to Visa and Mastercard card scheme rules to permit cross-border acquiring or classify transactions as domestic or cross-border based on acquirer location rather than merchant location.** We agree with the PSR's view that it is unclear how such a remedy could be implemented in line with existing regulation. Should the PSR consider pursuing such a remedy, particularly if the basis on which transactions are classified as domestic or cross-border is changed, it would be important to carefully consider the potential for broader unintended consequences that could arise from such changes, including additional cost and complexity for merchants and other industry participants.

- **The imposition of price caps.** It is important that regulatory intervention is proportionate. American Express believes that price regulation should only be implemented in exceptional circumstances, where there is a clear market failure that can not be remedied in a less burdensome way and only where strictly necessary as a last resort. If imposed, it is critical that caps are tailored appropriately to avoid unintended consequences and harm to competition. In the context of this market review, it is clear that the PSR's concerns relate specifically to price increases introduced by Visa and Mastercard with respect to their cross-border interchange fee model. Accordingly, should the PSR decide to introduce price caps, American Express urges the PSR to ensure that its directions are clearly proportionately targeted and limited in scope with respect to Visa and Mastercard's cross-border interchange fees.

- **Cost of alternative payment methods.** The interim report indicates that Visa has nonsensically suggested American Express global discount rates are a relevant point of comparison for UK-EEA cross-border interchange fees. We are not aware of how Visa has calculated the rate that it refers to. However, as general observations:
  [redacted]

- **The merchant indifference test as a mechanism for setting price caps.**
  - The merchant indifference test has inherent limitations in both design and application. If nonetheless the merchant indifference test is used, careful consideration must be given to ensure it is correctly formulated and applied to take into account the full range of benefits that merchants receive from the use of payment cards (i.e. they should not be limited to direct transactional benefits only) and the full costs of comparators. We would caution that there are also challenges to obtaining reliable data, as merchants may not have a full understanding of the costs and benefits associated with payment methods. [redacted]

[redacted] so the PSR is right to think carefully and consult upon its methodology for the merchant indifference test should it choose to use this.

British Retail Consortium

BRC response to PSR interim review on cross-border interchange fees

ABOUT THE BRC

The BRC's purpose is to make a positive difference to the retail industry and the customers it serves, today and in the future.

Retail is an exciting, dynamic and diverse industry which is going through a period of profound change. Technology is transforming how people shop; costs are increasing; and growth in consumer spending is slow.

The BRC is committed to ensuring the industry thrives through this period of transformation. We tell the story of retail, work with our members to drive positive change and use our expertise and influence to create an economic and policy environment that enables retail businesses to thrive and consumers to benefit. Our membership comprises over 5,000 businesses delivering £180bn of retail sales and employing over one and half million employees.

Overview

The BRC welcomes the PSR's consultations on the market reviews of card fees. The PSR's earlier Market Review on the supply of card acquiring services involved a thorough study that confirmed the BRC's own findings that the benefits of legislation to reduce card fees have not been passed on to most retailers, and that the fees levied by the card schemes have been increasing aggressively for several years.

Response to the working paper

The BRC and its members are relieved to see that the PSR has finally recognised the anti-competitive environment that exists in the payments ecosystem. Merchants are losing out by funding the entire ecosystem with fees that constantly rise, often with no explanation or reasoning. Merchants are held by a must-take status of the card schemes, unable to negotiate or refuse when fee changes occur, and this imbalance of power is being abused.

We agree that the card schemes have not considered the interests of all parties when setting fees, and that there is no clear corresponding benefit to merchants from the increases.

We would also reiterate that these actions and concerns are not only relevant to how cross-border interchange fees have been set, but are also relevant to how scheme and processing fees are consistently set too, without any regard to the interests of merchants.

We welcome a cap being reintroduced but have several comments on the way this cap is reintroduced, so as to even the playing field, undo the damage, and avoid lengthy, and costly, legal battles.

1. Reimbursement

We fully agree with the interim review that the five-fold increase in cross-border interchange fees has been unfairly calculated and we stand firm that a regulatory loophole has been exploited.

As you outline in your paper, there have been numerous court cases over the years relating to interchange fees, where merchants have consistently challenged the legality of these fees and won, resulting in years of trying to reclaim overpayments. These reimbursement battles are costing the industry hundreds of thousands of pounds.

Given that your paper clearly outlines that these fees should not have been increased at the level they have been, we strongly recommend that the PSR considers how merchants will be reimbursed for the overpayment of fees since the unnecessary and unjust hike in 2021, and builds this into the intervention.

2. Approach to cap

The interim report asks for views on whether the cap should be set at the same levels they were at before the UK left the EU (ie. 0.2% for debit and 0.3% for credit), or whether they should be subject to a merchant indifference test (MIT).

Our recommendation is that the fees are set at 0 until the overpayment has been fully repaid.

Following this we recommend the caps are set at a consistent rate, possibly lower than the existing caps in the IFR. Our reasoning for this is simple; the IFR set a 'cap' (ie. a highest rate, with rates under that recommended if relevant for the market) which was based on an average across all EU member states. Interchange fees were introduced to encourage card usage, and so an average across member states considered differing maturities of card markets came out at 0.2 and 0.3. The UK, as we all know, is a very mature card market. Given that these are caps, we would therefore expect to see the card schemes setting their rates for a UK market below this. We have, however, seen the opposite, with any chance to increase them jumped at, and the caps effectively becoming a 'set rate' rather than a cap.

Further, following the introduction of Strong Customer Authentication (SCA), we don't see a big difference in risk profile of credit and debit card transactions, or card-present vs card-not-present, and as such we see no reason for a difference in the cap applied. The introduction of SCA took this out of the merchants' hands, they are just processing a card with SCA as payment guarantee and the issuer handles the cardholder's financial position.

We recommend, following a period of 0 to level out reimbursement, that the caps are then set to 0.2% for all card transactions, or an MIT is conducted, using Open Banking as a cost comparator.

3. Outbound vs inbound

We also recommend that these interventions be applied to both inbound and outbound interchange fees, as the '2019 Commitments' that currently cap inbound UK-EEA transactions are due to expire in November 2024. Further, the 2019 Commitments use an MIT for card-not-present (CNP) transactions that is based on bank transfers; these are not a good comparator for retail payments. As above, Open Banking should be the cost comparator and as such, the caps set for UK-EEA inbound CNP transactions within the Commitments are far too high.

There is no reason inbound transactions should not be subjected to the same level of caps.

Further, many British retailers have operations in the EU and it would therefore be in the interest of protecting UK businesses.

For consistency, we recommend all interchange fees be capped at 0.2% across all UK & EEA transactions, following the period of 0 to level out reimbursement of the overpayments.

4. Implementation period

Whilst this is not discussed in your interim report, we would like to take the opportunity to highlight that this intervention should not require a long implementation period. Any ongoing fee changes should be reversed immediately to stop any and all overpayments made by merchants to card schemes. We recommend one month would be plenty of time for the card schemes to adjust the fees on their systems, and ensures the ongoing harm is minimised.

Conclusion

The BRC is very supportive of the PSR's work and the findings in this paper. As per the points above, we are supportive of a cap on cross-border interchange fees but see a few critical adjustments that need to be made:

- Merchants need to be reimbursed for the harm that has been caused by the overpayments made since the regulatory loophole was exploited and the fivefold increase came into effect.
- The level of cap needs to be seriously considered. Whilst it may be easy to revert to the levels set in the IFR, it is a great opportunity to assess whether these are accurate for the UK market and make changes.
- Inbound UK-EEA transactions should also be considered and within scope, as the '2019 Commitments' are due to expire in 2024.
- We do not see any need for debit and credit to be set at different levels.
- We therefore recommend that all UK-EEA interchange fees be set at 0.2%, after a period of 0 to level out reimbursement of overpayments.
- The PSR should then consider how these findings are indicative that further action is needed to assess interchange fees more widely, including work on commercial card interchange fees.

Collison Group

[redacted],

I am writing regarding the PSR's proposed cap on cross-border (card not present) interchange fees.

I represent The Collinson Group: a family-run British company and global business operating in the international travel benefits, consumer rewards, and airport services sectors, with over 400 million consumers. Our company is concerned that the proposed PSR reforms may pose several serious risks to the tourism industry, as highlighted below, and I would like to request a meeting to discuss these issues in greater detail with the PSR.

Detrimental impact on the tourism sector

The UK's tourism and aviation sectors amount to £237 billion of UK GDP. We believe the reforms could have negative implications for the industry, as detailed below:

- **Reduction in travel spending:** In the US, debit card rewards essentially disappeared overnight after IF caps were enacted. If the same happens to UK credit cards, rewards that consumers take for granted, such as points on spending and help saving for holiday trips, could be gone for good. According to US airline research, 63% of all frequent flier points issued in 2022 were generated by credit card, not travel, and so we would expect to see a significant fall in rewards-based travel – hurting both consumers and the broader economy.

Threat to consumers

We believe the proposals could also pose further threats to consumers:

- **Exacerbates barriers to finance:** Card issuers argue that interchange fees help them afford additional safeguards for fraud prevention. It is unclear how the PSR reforms would ensure these protections remain. Moreover, without the additional budget, issuers are likely to take other measures, such as reducing access to credit to those with limited current credit history. Such a development would impact pensioners or those on fixed incomes, young adults and first-time credit seekers, and under-banked communities.
- **Reduced rewards for loyal customers:** If interchange fees are reduced, co-branded cards may need to scale back rewards to customers for using their credit cards. This isn't just big international airlines and banks: it will impact British consumers' ability to access cashback on petrol, groceries, and other expenses, or save up points for a family holiday.

Lack of industry consultation

The travel industry seems to have been neglected in the consultation processes for the new interchange fee regulation, including the 2022/23 PSR consultations. The most recent consultation, closing on January 31 of this year, did not include a representative from the tourism sector. As outlined above, the tourism and rewards sectors rely significantly on interchange fees, and so the sectors' inclusion in this would have been valuable.

Thank you for taking the time to read my letter. I would welcome the opportunity to meet with you to discuss these issues, our concerns, and potential solutions to the proposed reforms in further detail and I look forward to your response in due course.

Yours sincerely,

COLLINSON

Elavon

Hello,

Thank you for providing us with the interim report for your market review into cross-border interchange fees, including your proposed approach to remedies which will benefit all participants of the card payment market.

We would like to provide the following feedback on the interim report:

On top of card not present transactions, card present should be also in the scope. Moreover the proposal does not mention cardholders outside of EEA.

Interchange rates when the cardholder is outside of EEA are currently set to:

- Card Present:
  - Debit 0.2%
  - Credit 0.3%
- Card Not Present
  - Debit 1.15%
  - Credit 1.50%

and they have legacy commitments set in 2019 that will expire in October 2024.

Therefore the full proposal could be (changes to the original proposal highlighted in yellow):

- An initial time-limited cap of 0.2% for UK non-domestic consumer debit transactions and 0.3% for consumer credit transactions (where the transactions are made online[1] at UK businesses)
- An initial time-limited cap of 0.2% for UK non-domestic consumer debit transactions and 0.3% for consumer credit transactions (where the transactions are made card present at UK businesses)
- A lasting cap on these interchange fees in the future, once further analysis has been carried out to establish an appropriate level.

If you have any questions, please do not hesitate to contact me.

Thanks

usbank Elavon A U.S. Bancorp Company

EuroCommerce

Dear sir/madam,

Thank you for allowing stakeholders to submit views on the above report. EuroCommerce represents retailers and wholesalers in Europe and has been and still is quite vocal on the topic of payments. See www.eurocommerce.eu/payments for our position on the various payment topics.

We would like to express our support for an intervention by you. Visa and Mastercard have immediately exploited the fact that the UK left the EU to raise their interchange fees, although materially nothing changed in payments between the EEA and the UK.

However, we think the proposed **time-limited cap is insufficient** for the following reasons:

1. 0,2% for debit and 0,3% for credit **does not make sense**. If anything, credit should be lower than debit, because merchants have to bear the risk of chargebacks.
2. With **SCA correctly applied to a transaction**, the liability (except gross negligence or fraud by the merchant) shifts to the issuer. Therefore, there is no logical reason, why CNP should be more expensive than CP, or credit more than debit, or commercial more than consumer, or interregional more than domestic.
3. **Percentage-based fees are unfair**, because as the transaction amount increases, so does the fee. However, the effort and risk of the payment ecosystem to move 1 SCA-ed pound or 1000 pounds is the same. We strongly advocate a 'fee-per-transaction' model, that would finally **allow merchants to benefit from economies of scale**, be it in volume or value of transactions. If it can be done in Open Banking, then why not in card-based transactions as well.

Your view to set a lasting cap via an updated **Merchant Indifference Test** is not going to be helpful. Whilst it might give a **snapshot of comparing current popular** payment methods, it says little to nothing about the near future. CBDCs are not too far away and the increased popularity and availability of Instant Payments (Open Banking) at the check-out both lead to a paradigm shift that will not be reflected in any MIT soon.

Lastly, we strongly urge you to not close your review on **inbound IFs**. As many of our EEA-based members want to serve UK cardholders, it is imperative that they have the same conditions as UK merchants serving EEA cardholders. We will inform DG COMP from our side as we're sure you are and will be in contact with them as well. Creating this level playing field will pave the way to renew the 'commitments' later this year and extend them to CP transactions.

In summary, based on our above reasoning, we would advocate you set a low pence-per-transaction fee as an IF-cap for all EEA-UK transactions, both in- and outbound and for both CP and CNP.

We welcome your feedback and remain available for any questions or comments. Many thanks.

Best regards,

EuroCommerce
Retail & Wholesale

European Banking Federation

Dear Madam/Sir,

The European Banking Federation (EBF) would like to thank you for the opportunity to react to the interim report in relation to the Market review of UK-EEA cross-border interchange fees published by the Payment Systems Regulator in December 2023.

In principle, we do not support that interchange fees for cross-border transactions are aligned to the ones that apply to domestic transactions. Not only there are differences in terms of legal treatment between domestic and international (i.e. between EU and non-EU countries) transactions but there is also a higher risk of fraud from international transactions.

However, if the decision for a cap is to be taken, it should be symmetric, that is, the same cap should apply for UK-issued cards to be charged from EEA countries.

We thank you for considering our comment.

With kind regards,

European Banking Federation

Avenue des Arts 56, B-1000 Brussels, Belgium
European Transparency Register - ID number 4722660838-23
www.ebf.eu @EBFeu Disclaimer

European Banking Federation and Payments Europe (joint letter)

1 August 2024

To Tulip Saddiq, Economic Secretary to His Majesty's Treasury, and Aidine Walsh, Chair of the Payment Services Regulator

Cc John Berrigan, Director-General for Financial Stability, Financial Services and Capital Markets Union, and Olivier Guersent, Director-General for Competition, European Commission

Subject: Cross-border interchange fees

Dear Minister,
Dear Chair,

On behalf of the European banking and card-based payments industry we wanted to raise serious concerns about the potential price cap that the UK is considering to impose on EU banks and payment companies specifically.

We are aware the UK regulator is considering proposing an 'interim' 20/30 bps inter-regional interchange price cap on all EEA to UK card-not-present transactions (CNP).

While we appreciate the rationale for taking action to boost competition and innovation in payments domestically, and cross border, we see the proposed measure as potentially discriminatory, a risk to the integrity of national payments and retail banking markets in the EU and counterproductive as it will limit the ability for new innovative solutions to scale-up and grow. It will also negatively impact EU consumers by creating pressure for EU issuers to reduce services or introduce new fees (e.g. account fees, FX fees, etc).

For example:

- The costs incurred by EU issuers for enabling such transactions often can exceed 20/30 bps (including mandatory costs they must pay to third parties, and core costs on servicing consumers and providing consumer protections). Costs have increased since 2015 and are higher than for domestic transactions. As the cap being applied would likely be below many issuers' costs for such transactions, EU issuers will lose money on each transaction. The cap will not increase competition or boost innovation, but mainly benefit a few large UK online merchants.
- The 2015 Interchange Fee Regulation's (IFR) approach to setting the same interchange for card-present (CP) and card-not-present (CNP) transactions is out of date and superseded by the 2019 'Commitments' approach of setting a higher rate for CNP, reflecting the obviously

higher fraud costs of those transactions[1]. By setting the same interchange level for CP and CNP transactions, the PSR would be adopting an outdated approach.

- We understand the UK plans to implement this cap just on EEA issuers. UK issuers and those based in the US or other markets will not be subject to such a price cap for their cross-border transactions. This will put existing EU payments companies at a disadvantage, but importantly also undermine the ability for new card-based FinTechs based in the EU to start up or scale.
- While we respect any regulator's right to act to address concerns in the market, the process being followed is particularly concerning. For example, the UK regulator plans to apply this 20/30 bps 'interim' cap' while it conducts an 18-month study to decide if a cap is even needed and what level would be appropriate.

Given the potential negative impact on EU issuers, we would appreciate confirmation from the UK authorities that (i) the UK will properly consult EU Member States and do an impact assessment before taking such a material step and (ii) EU issuers will not be subject to any cap that unfairly disadvantages them (e.g. cap below costs, discriminatory between EU issuers and international issuers, etc).

We thank you for considering our observations and request, and we remain at your disposal to elaborate further on our views.

With kind regards,

[redacted]

European Banking Federation

[redacted]

Payments Europe

About EBF
The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from across Europe. The federation is committed to a thriving European economy that is underpinned by a stable, secure, and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere.
www.ebf.eu @EBFeu

About Payments Europe
Payments Europe is the voice of the card-based payment industry in Europe. Our mission is to promote a better understanding of the complexity of card-based payments and the inherent value it brings to society. We support a vibrant, innovative, and competitive European payments market, that is based on a balanced regulatory framework and that puts consumers and consumer protection at the heart of everything. Payments Europe's members are card issuers, card acquirers, card schemes and other businesses that offer card-based payment solutions in Europe.
www.paymentseurope.eu

[1] On 5 July, the Commission took note of the extension of the 2019 Commitments until November 2029.

European Digital Payments Industry Alliance

EDPIA
The European Digital Payments Industry Alliance

EDPIA's Response to the PSR's UK-EEA cross-border interchange fees Interim Report

January 2024

The European Digital Payments Industry Alliance (EDPIA) welcomes the Payment Systems Regulator's (PSR) Interim Report on the Market Review of UK-EEA Consumer-Cross Border Interchange Fees.

As outlined in our joint letter sent to the PSR in June 2023, EDPIA believes that there should be prompt action taken against this unjustified hike by the dominant international card schemes. Below we outline our views on the PSR's findings, on the necessary next steps, and on how the PSR should leverage this investigation to take further bold action to improve the payments landscape for end-users.

EDPIA views on the provisional findings

We fully support and would like to reiterate the following findings reached by the PSR in the Interim Report:

- The international card schemes are not subject to effective competitive constraints in the setting of interchange fees (both direct and indirect) and have an incentive to increase them in order to retain and attract issuing business, at the detriment of merchants and their customers.
- Acquirers and merchants lack a viable alternative to accepting the dominant card schemes. As a result, they are unable to mitigate the cost of this increase and place competitive pressure on the networks. This is especially true for small businesses, who cannot resort any payment optimisation mechanisms.
- Acquirers, merchants, and consumers receive no countervailing benefits that can compensate for the increases. This is because the structure and level of the IFs are neither linked to any fraud risk nor any innovation objective. The increases are a result of the pressure on the two schemes to increase IFs as they compete for issuing volume, without regard to the interest of other users.
- There is no material change in the nature of the UK-EEA transactions in question that justifies the increases. This is strengthened by the fact the UK has remained a part of the Single European Payments Area (SEPA) which indicates a continued regulatory and technological alignment between the two jurisdictions.

Furthermore, EDPIA would like to emphasise that the findings above apply to all Multilateral Interchange Fees. As outlined in previous competition reviews and cases listed by the PSR, MIFs are inherently subject to an upward pricing pressure due to the asymmetrical bargaining structure of this two-sided market. This is especially relevant in a market such as the UK where cards are universally utilised and have been the dominant payment method for retail payments for over 5 years.

Finally, EDPIA would add that any increase in such fees can hamper the development of any alternative payment methods, such as Account-to-Account. Given the PSR's focus on supporting the development of Account-to-Account payments, the PSR should include this important finding in its final report.

EDPIA views on proposed remedies package

EDPIA strongly supports the imposition of an interim remedy as part of the investigation and agrees placing an interim cap at the previous levels is the minimum action required. Furthermore, the PSR should also impose strict anti-circumvention rules to protect against increases on other direct and indirect interchange fees used to compensate issuers for this reduction.

Moreover, in establishing a long-term remedy, the PSR should not simply replicate previous tests, but ensure it takes an approach that is appropriate for the UK market and the specific facts of this review.

For example, it is well established that the transactions in question are 'always card' transactions, meaning there is no alternative payment method which merchants could steer consumers towards if they wish to avoid the increase in fees. In the interim report, the PSR confirms this lack reasonable alternative to the dominant schemes for these transactions.

The findings of the PSR confirm the relevant MIF is set solely to attract more issuing volume, and that the issuers and acquirers in question does not indicate that there was any countervailing benefit as a result of the MIF. The PSR should leverage these important findings and make a principled decision over the necessity of a MIF for this class of transactions.

EDPIA views on broader action the PSR should take

Finally, while EDPIA recognises the terms of reference for this investigation, we would like to emphasise the importance of leveraging the PSR's findings and consider wider policy action. It is important to underline that while a positive conclusion of the current investigation will bring benefits to end-users, it only captures a fraction of all card transactions, all of which are subject to the same competitive problems.

EDPIA calls on the PSR to ensure that the findings made in this investigation are also leveraged in its ongoing review into card scheme and processing fees.

About EDPIA

The European Digital Payments Industry Alliance (EDPIA) represents the interests of European independent Payment Services Providers. Its purpose is to contribute to EU policy debates that define the business environment for electronic payments, and to strengthen the visibility and understanding of the European payments industry amongst policy makers and society as a whole. EDPIA's broader objective is to support the EU's objective to create a Digital Single Market, fueled by digital payments. It is in favour of a strong, stable and properly enforced European regulatory framework that enables intense competition between transparent and market-based solutions, allowing them to compete for the trust of their European and global clients.

Federation of Small Businesses

Federation of Small Businesses

Sent via email: cardfees@psr.org.uk

2 February 2024

Dear Sir/Madam,

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

FSB welcomes the opportunity to provide a response to the above consultation.

FSB is a non-profit making, grassroots and non-party political business organisation that represents members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

FSB supports the findings of the PSR that the fees charged by debit and credit card providers to UK businesses which accept payments from within the EEA are too high. Whilst the fees are borne by the payment service providers, they in turn pass the hike in fees onto small businesses who use their services. FSB is a member of the Axe the Card Tax coalition, the 2023 report found similar findings, in which the cost of using card payments has risen significantly for small businesses, up 13% since 2014 and for scheme and processing fees, they have risen up to 600% over this same period.

Small businesses have profoundly felt the hike in interchange card fees since Brexit. Coupled with impact of the pandemic, high inflation and now high interest rates, small businesses margins are further eroded by unjustified high interchange card fees. Small businesses have limited options in the card market and limited alternative technologies to undertake card transactions. It is imperative that the PSR regulate the card market to ensure that small businesses can engage in cross-transaction trade without unfair payment fees.

FSB supports the PSR proposal to introduce a price cap aimed at protecting UK businesses from overpaying on interchange fees. We believe that the initial time-limited cap proposed of 0.2% for EEA consumer debit transactions and 0.3% for consumer credit transaction is appropriate and a step in the right direction. Given the sheer and growing volumes of card transactions occurring and the steps UK is taking to increase trade with the EU, we recommend that PSR consider a lower cap going forward to facilitate trade. The 0.2% and 0.3% figures align with the current EU caps, however, the UK has a rate of near 90% card penetration and will be at the same cap level as EU countries that are cash-dependent, such as Italy, Croatia and Hungary which have less than 40% of transactions taking place by card[1]. Going forward, FSB recommends the PSR to consider in their review, a rate that is more reflective of the high uptake in card-transactions in the UK.

To ensure that the interchange fees savings are passed onto small businesses, the PSR should ensure that interchange fees are not replaced by unregulated fees or unfairly increased in other jurisdictions by card schemes. FSB suggest that the PSR include a recommendation to undertake a future review

[1] European Central Bank, Student on the payment attitudes of consumers in the euro ara, 2022, https://www.ecb.europa.eu/stats/ecb_surveys/space/html/index.en.html

the UK to rest-of-world interchange fees. Under commitments made by Visa and Mastercard to the EU, merchants in the European Economic Area (EEA)fsch benefited from reductions in cross-border interchange fees between the EEA and ROW. The UK's withdrawal from the EU has also meant a failure to secure the continued reductions in UK-ROW interchange fees. The UK has developing trade relations with other countries and it is imperative that small businesses are not disadvantaged for these transactions if they have large consumer bases elsewhere.

FSB also encourages the PSR include a recommendation to undertake a future review on commercial card interchange fees which are unregulated in the UK (and the EU). Commercial card interchange fee rates are generally much greater than consumer cards, totalling up to 2.5%. Such interchange fees impose a substantial cost on retailers, especially those with a high share of commercial card transactions, such as wholesale and travel sector small businesses.

Yours sincerely,

[redacted]
Federation of Small Businesses

For further information please contact:

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Aidene Walsh
Chair of the PSR Board
Payment System Regulator
London E20 1JN
UK

Delivered by email to: PSRChairandMDOffice@psr.org.uk

19 July 2024

Dear Ms. Walsh,

I am writing to you on behalf of the Financial Services Ireland Group (FSI) to express our deep concerns regarding the recent proposal by the UK Payment Systems Regulator (PSR) concerning inter-regional interchange fees. As the trade association representing the totality of the financial services industry in Ireland—banking, (re)insurance, asset management, funds, payments, and more—we believe it is crucial to bring to your attention the potential negative implications the PSR's actions may have on competitiveness and market dynamics.

We are aware that the UK regulator is considering proposing an 'interim' 20/30 bps inter-regional interchange price cap on all EEA to UK card not present transactions.

While we understand the rationale for taking action to boost competition and innovation in payments both domestically and cross-border, we see the proposed measure as potentially discriminatory, a risk to the integrity of national payments and retail banking markets in the EU, and counterproductive as it will limit the ability for new innovative solutions to compete with cards in this corridor.

For example:

- The costs for such transactions for EU issuers often can exceed 20 bps. Consequently, as the cap being applied would likely be below many issuers' costs for such transactions, EU issuers will lose money on each transaction.
- The UK, we understand, plans to implement this cap just on EEA issuers—UK issuers and those based in the US or other markets will not be subject to such a price cap for their cross-border transactions into the UK. This will put existing EU payments companies at a disadvantage, but importantly, also undermine the ability for new card-based fintechs to emerge in the EU.
- Additionally, as this cap will not apply to certain players (e.g., Amex), we are concerned the UK's move will distort the market in EU Member States (already 21% of EEA to UK CNP transactions are by non-Visa/Mastercard schemes).
- While we respect any regulator's right to act to address concerns in the market, the process being followed is particularly concerning. For example, the UK regulator plans to apply this 20 bps 'interim cap' while it conducts an 18-month study to decide if a cap is even needed and what level would be appropriate.

Given the potential very negative impact on EU issuers, we would appreciate confirmation from the UK authorities that (i) the UK will properly consult EU Member States before taking such a material step, and (ii) EU issuers will not be subject to any cap that unfairly disadvantages them (e.g., cap below costs, discriminatory between EU Issuers and international issuers, etc.)

Thank you for your attention to this critical matter.

Sincerely,

[redacted] [redacted]

[redacted]
[redacted]@ibec.ie

CC:

Tulip Siddiq:est@hmtreasury.gov.uk

John Berrigan: John.Berrigan@ec.europa.eu

Olivier Guersent: Olivier.Guersent@ec.europa.eu

French Bank Federation

Dear Chair,

[redacted] We were alerted by our members and we are quite concerned about an upcoming decision you may take in September to implement a provisional cap of 20 basis points on the inter-regional interchange fee only for EU issuers and on cardless transactions. I understand that meanwhile the PSR is conducting a 18-month study to decide whether a cap is actually necessary.

[redacted]

We believe that it will have a significant impact on European banks and their customers, and notably for those who have free cards. One of our british member told us that it's 125,000 customers who will become unprofitable and whose costs will increase, and 5 million customers will be affected as the costs will be passed to them.

The costs for issuers of these transactions generally exceed 20 basis points (for example, among all the fees we have to pay to one of the international card systems, one of these fees exceeds it only 55 basis points). Therefore, this decision represents substantial losses for European issuers since the cap would be lower than costs and this will have an impact on European customers.

Furthermore, I understand that the PSR would only apply this cap to EEA issuers. UK issuers and those based in the US or other markets will not be subject to such a cap for their cross-border transactions. If the goal is to give back money to British consumers (which will not be the case according to us), why not applying this cap to the other issuers?

Furthermore, as this cap will not apply to certain players (e.g. Amex), we fear that your decision will distort the market in EU member states (already 21% of EU transactions EEA to UK are via non-Visa/Mastercard systems).

I'm looking forward to discussing with you or someone in your team.

Best regards,

FÉDÉRATION BANCAIRE FRANÇAISE

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Site internet FBF | Site extranet FBF | Site d'information grand public |

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HM Revenue & Customs

Good Afternoon,

Feedback regarding this Interim Report and proposal:

Whist the vast majority to card payments to HMRC are from Customers are “UK-domestic”, I welcome the PSR proposal to introduce an interchange price cap for Mastercard or Visa debit or credit cards issued in the EEA. This would bring a reduction in Interchange fees charged by our acquirer (as passthrough), thus bringing card processing charges down.

I note below specific responses to the Qs

Question No.	Question	Answer
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?	The information is comprehensive and set out clearly into relevant topics supported by tables and infographics. There are no other factors for consideration that spring to mind.
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?	Agree with these views on your analysis and provisional finding.
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?	Yes.
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?	Agree with these views on your analysis and provisional finding.
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?	Agree with these views on your analysis and provisional finding.
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?	No comment
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	No

	effect on Mastercard's and Visa's ability to set UK-EEA outbound IFs.	
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?	Agree with these views on your reasoning and provisional conclusion.
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?	Agree with these views on your analysis and provisional conclusion.
10	Do you have any views about our analysis and provisional 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?	No comment
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)?	No.
12	Do you have any views on our assessment of the impact of the fee increases on UK acquirers and merchants?	The assessment appears to be based on sound rationale and is therefore robust.
13	Do you have any views on our proposal to close our review of inbound IFs on the grounds of administrative priority?	Agree, as it is our understanding that these fees are paid by EEA acquirers to UK issuers and therefore would not affect us.
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?	Agree
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?	Agree

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.	Agree
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?	Yes.
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?	No comment
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?	No specific comments in response to A-C, however whilst the majority of our card payments are UK Domestic, we do receive INTRA (EEA) card payments so would see a reduction in processing fees.
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?	It would be a consideration, however not able to comment on how acquirers and merchants would be impacted for implementation costs.
21	Are there other remedies we should consider either on an interim or long-term basis?	Not aware
22	Is there anything else we have not considered and you think we should consider?	No

Kind Regards

[redacted]

[redacted]

HMRC Payments

[redacted]

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Glasgow

Email: [redacted]@hmrc.gov.uk

Phone: [redacted] Mobile [redacted]

JP Morgan Chase Bank NA - London Branch (JPMCB) and Chase Paymentech Europe Limited (CPEL)

Re: Market review into cross-border interchange fees - interim report publication

Dear Team

Following on the below, J.P. Morgan ("the Firm") appreciates the opportunity to submit its responses to the Payment Systems Regulator ("PSR") questions related to the market review of UK-EEA consumer cross-border interchange fees ("market review").

Upon review of the published market review the Firm found the factors included for analysis exhaustive and associated reasoning to be sound and well considered.

The Firm would like to highlight the following points for consideration by the PSR as the market review stage 1 remedy transitions into implementation phase:

- To assist with a seamless implementation, the industry should be provided with a minimum of 6 months' notice before enforcement of the change;
- Peak transactional periods (e.g. November and December) should be considered in planning and excluded from implementation.

The Firm looks forward to continued engagement in upcoming consultations as the proposed remedies progress.

Kind regards

[redacted]

[redacted] | [redacted] | EMEA Conduct, Compliance & Operational Risk (CCOR) - Regulatory Management | **J.P. Morgan** | [redacted] | 25 Bank Street, Canary Wharf, London E14 5JP | [redacted]@jpmchase.com | [redacted]

Lithuanian Banking Association

Dear Ms. Saddiq,

I am writing on behalf of card issuers to express serious concerns regarding the potential introduction of a price cap on EU banks and payment companies, a measure that, as we understand, may not apply to UK, US, or other international counterparts.

We have been made aware that the UK regulator is considering a proposal for an 'interim' price cap of 20/30 basis points on all card-not-present transactions from the EEA to the UK. While the intentions to foster competition and innovation in both domestic and cross-border payments are acknowledged, we believe that this measure may inadvertently discriminate against EU issuers, compromise the integrity of the EU's national payments and retail banking markets, and hinder the development of innovative payment solutions. Moreover, such a cap could negatively affect EU consumers, potentially forcing issuers to curtail services or introduce new fees (such as account fees, foreign exchange fees, etc.).

For example:

- The costs incurred by EU issuers for enabling such transactions often can exceed 20/30 bps (including mandatory costs they must pay to third parties, and core costs on servicing consumers and providing consumer protections). Costs have increased since 2015, and are higher than for domestic transactions. As the cap being applied would likely be below many issuers' costs for such transactions, EU issuers will lose money on each transaction. The cap will not increase competition or boost innovation, simply shift costs from a few large UK online merchants to EU consumers.
- The UK we understand plans to implement this cap just on EEA issuers - UK issuers and those based in the US or other markets will not be subject to such a price cap for their cross border transactions. This will put existing EU payments companies at a disadvantage, but importantly also undermine the ability for new card based fintechs based in the EU to start up or scale.
- Additionally, as this cap will not apply to certain players (e.g. 3 Party Schemes) we're concerned the UK's move will distort the market in EU Member States (already 21% of EEA to UK CNP transactions are by non-Visa / Mastercard schemes).
- We do not see this intervention as proportionate or effective, and are concerned it will in fact reduce competition. Most UK merchants will see no benefit (notably small merchants). By artificially reducing the cost of cross border transactions by the largest payment schemes, it will undermine the ability for new alternatives to succeed (e.g. solutions based on Open Banking).
- While we respect any regulator's right to act to address concerns in the market, the process being followed is particularly concerning. For example, the UK regulator plans to apply this 20/30bps 'interim cap' while it conducts an 18 month study to decide if a cap is even needed and what level would be appropriate.

Given the potential very negative impact on EU issuers, we would appreciate confirmation from the UK authorities that (i) the UK will properly consult EU Member States and do an impact assessment before taking such a material step and (ii) EU issuers will not be subject to any cap that unfairly disadvantages them (e.g. cap below costs, discriminatory between EU Issuers and Intl issuers, etc).

Thank you for your attention to this matter.

Kind regards,

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Lithuanian Banking Association

Paperless

www.lba.lt

Lloyds Banking Group

LLOYDS BANKING GROUP PLC

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

31 January 2024

This response contains confidential information. The information contained in this response is provided to the PSR in relation to the market review of UK-EEA consumer cross-border interchange fees. Publication or disclosure to any other person of such information would harm the legitimate business interests of Lloyds Banking Group (LBG). Accordingly, no such information should be published or disclosed to any third party without giving LBG the opportunity to redact such information.

Executive Summary

Lloyds Banking Group (LBG) welcomes the opportunity to respond to the Payment Systems Regulator's (PSR) consultation paper on the Market Review of UK-EEA consumer cross-border interchange fees. This area has been the subject of regulatory and legal scrutiny for many years, and one on which there remains considerable uncertainty for stakeholders. The review is therefore an opportunity for the PSR to resolve some of these issues and to provide the clarity and certainty to support competition, innovation, and investment. We are concerned that the PSR's interim findings and proposed remedy in relation to outbound cross-border interchange fees do not achieve this.

As stated in our previous submissions, we would be happy to work collaboratively with the PSR through the reviews that are being carried out to help with its understanding of how the markets operate in practice, and to provide constructive views on the outputs of the PSR's assessment and consideration of any remedies. LBG has no role in setting of interchange fees. However, our position as one of the largest banks in the UK brings insight into the perspectives of a number of different groups who may be affected by the outcome of this review, including consumers, issuers, acquirers and merchants.

We note that the PSR has closed its investigation into inbound cross-border interchange fees, which we support.

Interchange fees are a crucial component of payment services providers' revenue which enables these providers to offer a range of payment methods to consumers, innovate for the benefit of consumers and merchants and protect consumers against the risk of poor outcomes.

Interchange promotes a strong, competitive and efficient global electronic payments system for consumers, merchants and society. Against a background of free-if-in-credit banking, it serves as a critical tool to balance the benefits and costs of card payments, ensures each participant pays their fair share of the costs associated with processing and protecting payment card transactions, and therefore supports the sustainability of payment providers.

The current commercial model in cards payments balances incentives in the market and encourages inter-platform competition and innovations in the payments industry. This has benefitted consumers and merchants by increasing choice, quality of payment product services and improving prices. Future innovation will continue to create value by improving the quality of services, methods of payment protection, efficiency and convenience of the payment process. Banks have historically played, and will continue to play, an important role in supporting investment in innovative solutions in the industry. For further benefits to be realised, banks need to be correctly incentivised to continue to invest and, as such, there is no rational argument that supports zero or near-zero price for card scheme interchange received by Issuers. Further detail of the benefits of interchange are outlined as follows:

1. **Income for Issuers to support the global network** – provides revenue that supports the issuing of cards, authorisations, processing and settling payments, maintenance of and investment in resilient infrastructure, as well as providing important support to customers – particularly in moments that matter - through branch, telephony and banking apps; as well as other staff costs relating to authorisations, queries, disputes, and other customer enquiries related to payments.
2. **Incentive for Issuers to participate in the global network** - encouraging active participation in the card market, to expand the customer base and compete with other providers through innovation, and develop the ecosystem through collaboration on fraud,

cyber security, standards, effective dispute resolution – all of which benefits customers and merchants.

3. **Investment in the global network** – encourages firms to invest in safe, secure and resilient infrastructure to help ensure a trusted and resilient network, as well as to offer and participate in new ecosystem technology (e.g. tokenisation), and facilitate the offering of rewards programmes for merchants keen to boost card spending/ consumer purchases, which in turn financially benefits consumers.
4. **Risk mitigation for the global network** – interchange fees contribute to the covering risks associated with the card transactions, which can include fraud and credit risk. This helps to manage potential losses and impairments which may not be incurred without participation in the card networks. Further, it enables firms to offer and support dispute resolution services to customers which benefits consumers and helps merchants to defend valid transactions.
5. **Competition and innovation in the global network** – interchange supports the wide acceptance of cards by issuers around the world, including new market entrants and FinTechs. This creates a virtuous cycle of pro-competitive behaviour to improve the product for the benefit of consumers and merchants.
6. **Participation in the Payment Ecosystem** – interchange fees facilitate Bank Issuer participation in the broader ecosystem. By issuing cards that are widely accepted, banks contribute to the growth and efficiency of electronic payments and adapt to evolving preferences and needs of consumers, as witnessed the Covid19 pandemic.

It is important to also highlight how interchange benefits merchants. A merchant will consider costs and benefits to itself only as a part of its profit maximising strategy. As such, it will view the cost of payment acceptance holistically as part of the options that are available and with a view to the additional transactions they can attract by offering cards – removing interchange may remove choice if firms choose not to participate. Merchants also benefit strongly from increased sales by facilitating online payments which creates a significantly wider customer prospect base both domestically and internationally, and can save merchants valuable costs to support a storefront if fully digital. lower costs than what would be incurred through accepting a different payment method, e.g. cash (having an online rather than a physical presence), three-party model costs, BNPL; access to credit provided by issuers which can increase sales as well as the benefits from the fraud checks which limit merchant losses .

As indicated above, **banks provide a range of services that are vital to the operation of card payments (fraud, disputes etc) and many other services which are beneficial to consumers and merchants**. Without an appropriate interchange fee, the potential consequences could be (i) providers do not fully cover their costs, creating economic inefficiency; (ii) card functionality is reduced (eg payments not permitted in certain sectors/geographies (ii) there is reduced incentive to invest and innovate in payments, and / or (iii) cost recovery via other means – eg from customers, such as domestic usage fees which begin to diminish free banking and underpin the role of digital payments for both merchants and customers.

In our review of the PSR's interim report, we do not believe that it fully takes account of this context. Whilst the PSR references some domestic schemes in other countries do not use an interchange model, this comparison is misplaced because it fails to take account essential differences between countries including the free-if-in-credit banking model in the UK. **We agree with the PSR that it is not necessary, proportionate or appropriate to consider setting interchange at zero.** We note that the PSR states that it has 'identified no evidence to suggest the structure or level of interchange fees is linked to fraud risk and costs, or that it provides incentives for issuers to invest in fraud prevention' while also concluding that it has 'identified no evidence that interchange fees (IFs) are actually used by issuers for this purpose'. However, these generalised statements are not well founded on the evidence presented by the PSR. The PSR appears to have only surveyed 10 issuers, but the evidence from these issuers indicates that, generally speaking, the revenues from interchange fees go into a pot that will inform rewards (e.g., cashback on cards) and investment decisions including on fraud. Just because this cannot be readily tracked due to the pooling of resources, this does not mean that it should be so dismissed by the PSR.

Overall, we believe the PSR's proposed remedies package fails to deliver the right outcomes for the cards ecosystem.

Whilst initially beneficial for merchants, we believe a reduction in interchange could lead to worse outcomes for merchants and consumers in the longer run. In an extreme scenario, it could make the business models of issuers operating with narrow margins or limited product sets no longer sustainable, leading to less choice and/or competition, and therefore undermining personal current account economics, which are the cornerstones of fintech business models. Even before that, firms may channel their finite resources towards investment and innovation in areas of their business where they are still allowed to make a sustainable return. This could lead to a lower volume of cross-border payments, harming merchants to a greater degree than any gain from lower interchange.

We believe the following points must be carefully considered by the PSR as part of any next steps.

We believe the PSR should focus on arriving at a lasting interchange fee level as a priority to prevent additional market disruption.

To the extent that the PSR pursues a remedy, we welcome the PSR's acknowledgement that it should give thought to the most appropriate tool. We consider that the PSR should be seeking a legally certain regulated price, rather than a price cap, implemented as a legal requirement. The price should take account of both consumer and merchant benefits, as well as costs and a reasonable return for issuers.

The reason a cap would be the wrong tool is borne out by the experience with the Interchange Fee Regulation. The Interchange Fee Regulation set caps on interchange fees at a level that regulators considered would provide benefits for merchants and consumers and did not call into question the operation of international card schemes and payment service providers. Although this Regulation said on its face that it would "provide legal certainty", that has failed to transpire in the UK. As an international outlier, the UK courts have been dealing with unprecedented levels of litigation querying whether compliance with regulation could still fall foul of competition law – a question that will take years for the courts to resolve (if ever). This undermines conditions for investment, participation and growth; could lead to erosion of consumer and merchant benefits; and damage the UK's international competitiveness.

Reducing the interchange fee on an interim basis presupposes the outcome of any cost study.

The cost study may in fact find that lower interchange fee levels do not allow for proper cost recovery and a reasonable return to ensure a sustainable commercial model for cards. Indeed, the PSR itself notes that "there is a possibility that the final enduring price cap may be higher than this interim price cap". If that were the case, the PSR's actions could possibly create additional disruption and costs for the industry: changing the fee only to change it again relatively soon afterwards. We would encourage the PSR to expedite the process of determining a lasting price, rather than needing to move twice.

Timescales will play a significant role in ensuring that any measure ultimately implemented by the PSR, is properly assessed and prioritised according to conflicting regulatory activities.

If an interim cap (or price) were to be introduced, then our acquiring business would ideally need 8-12 months to fully implement any merchant pricing changes. Technology change would be required for our pass-through pricing structures (IC+ and IC++) as interchange is embedded in the platforms and any change would need to go through our semi-annual platform change releases (currently April and October, planning required at least 2 months in advance). For our fixed price and blended merchants, we would need to evaluate the cost implication in the context of our overall pricing strategy. [redacted]

We do not believe the Merchant Indifference Test (MIT) is the most appropriate method and instead believe the PSR should determine price with consideration of firms' fair and reasonable costs.

We do not believe that using a Merchant Indifference Test as proxy for determining interchange fee levels is the right approach.

The intention of the MIT is to identify a price at which merchants are indifferent between accepting card payments and accepting an alternative payment option (which has historically been cash), taking into account the costs faced by merchants for each payment option and the benefits received by cardholders. However, there are two key issues with the application of the MIT for cross-border payments:

- First, it is not clear that cash (or any other payment option) is an appropriate comparator for cross-border payments today. This reflects that the use of cash has declined over time, and that for some payments (in particular CNP transactions) it may not be a viable alternative at all.
- Second, the differences between countries make setting a single rate difficult. With respect to the outbound IFs that are the subject of the PSR's proposed remedy, the differences in cardholder benefits across countries mean that it is likely to be challenging to identify an interchange rate at which merchants are indifferent between card payments and an alternative.

We ask the PSR to consider alternative options which may better achieve the PSR's aims. Chiefly, we suggest that the PSR explores setting interchange fee levels with direct reference to the costs incurred by issuers in providing card payments, and an appropriate return.

Finally, we are concerned that the short timescales for issuing the final report may not allow sufficient time to comprehensively review responses and would encourage the **PSR to take the time to reach conclusions and remedies that are fit for purpose for all market participants**.

We welcome further discussion with the PSR on the report and the substance of the issues that it will address.

Mastercard

Mastercard response to the PSR '*Market review of UK-EEA consumer cross-border interchange fees Interim report*' MR22/2.6

14 FEBRUARY 204

Executive Summary

This Executive Summary summarises the key points made in Mastercard's response to the PSR's Interim Report (the "Report"). In particular, that:

- it is critical that the Report's findings underpinning its proposed interim remedy are supported by the evidence, which is currently not the case;
- if a MIT is intended to help understand the optimal level of IFs for these transactions, it should satisfy a number of important conditions;
- by attaching insufficient weight to constraints from the acquiring side of the market, the Report has overlooked the variety of choices which consumers have and important competitive constraints facing Mastercard; and
- the PSR does not have the requisite powers under FSBRA to impose a price-cap remedy, whether as an interim or longer-term remedy.

Proposed Interim Remedy

Mastercard disagrees with the findings underlying the Report's proposal for the interim remedy, namely 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*" and

- 20/30 may be an "*acceptable*" or "*justifiable*" level.

Mastercard considers that it is critical for the Report's findings to be supported by evidence, which is currently lacking:

- The 20/30 levels were set in 2015 (based on data gathered in 2012-13) and have not been updated since then to reflect changes in the payments landscape, particularly the growth of cross-border online payments which have higher associated costs of fraud. Indeed, online payments were not considered at all in determining these rates. The Commission justified this on the basis that online card payments accounted for a small proportion of the total card value in the European Union. This is not true today, and certainly not for the UK: the current proportion for the UK is more than double that historical EU proportion by number and more than triple by value.

- The 20/30 levels were based on an MIT methodology that used cash as the alternative payment method. Cash is clearly not an alternative payment method to CNP transactions. In a CNP context, cardholders are more likely to switch to alternative online retail payment methods and three-party schemes such as Amex. This makes these historic 2015 rates inappropriate in the CNP context.

- The Report mistakenly looks for changes as a result of, or since, Brexit that may justify the increase in rates. While Brexit provided the legal ability to increase rates, the justification for the increase pre-dates Brexit: reflecting the substantial changes that have occurred since the 20/30 levels were set, namely the growth of cross-border online payments and the pressing need to consider alternative payment methods other than cash, and the understanding that the 20/30 levels were always an underestimate of the appropriate IFs for these transactions.

- Contrary to the Report's finding, Mastercard believes strongly that fraud differentials do justify and explain the increases in UK-EEA outbound IFs. As acknowledged in the Report itself, the fraud levels recorded in EEA-UK transactions are significantly higher than the levels in the intra-EEA transactions covered by the 2015 rates. Indeed, the fraud levels in EEA-UK CNP transactions are much more aligned to the fraud levels in the EEA-non EEA channel covered by the 2019 Commitments. The EEA-non EEA IF levels of 115/150 set by the 2019 Commitments are therefore a better indicator than intra-EEA rates of the IFs that would appropriately reflect the costs that issuers face for CNP transactions (including fraud costs) on the EEA-UK channel.

- The fact that the PSR has not been able to identify individual issuers' fraud prevention investments that are directly related to the IF revenue they receive is not persuasive given that evidence from EEA issuer was not requested or analysed. Furthermore, since Mastercard's increase in IFs for EEA to UK outbound transactions only occurred in April 2022 and, ever since, the PSR's market review has caused considerable uncertainty as to the future stability of that revenue stream to issuers, it would be unreasonable to expect to see specific issuer investments linked to the increases, let alone significant changes in fraud levels brought about by those investments.

- The Report seems to suggest that fraud levels and more generally cost studies may not even be relevant to inform the level of interchange fee. This view appears to be inconsistent with the PSR's work on the pricing principles for Open Banking-based products, where the PSR has proposed a cost-based approach (including fraud prevention and reimbursement as relevant cost items) for setting bilaterally and multilaterally agreed fees.

- The Report's approach is similarly misplaced in attaching disproportionate weight to the UK's continuing membership of SEPA post-Brexit, as regards comparators to be used for the MIT study. The Report seems to consider SEPA credit transfers (i.e. without an overlay service or retail payment product) as the relevant comparator for Mastercard and Visa transactions. However, given the limited consumer convenience and protection provided by them, SEPA credit transfers unsurprisingly account for a negligible proportion of cross-border transactions between UK merchants and EEA consumers. It is therefore inappropriate to use SEPA transactions as a relevant comparator for a MIT study. That is not to say that the EEA-UK corridor is not otherwise unique in ways which the MIT study should consider.

In conclusion, the Report's findings underpinning its proposed interim remedy are unsupported by the evidence. Mastercard is concerned that these unsupported findings should not prejudge the outcome, and potentially prejudice the objective implementation, of the MIT study that the PSR envisages.

The role of a MIT in helping to establish a remedy

Mastercard welcomes the PSR's proposal to undertake a merchant indifference test (MIT) study for transactions on EEA-issued consumer cards at UK merchants in order to help understand the optimal level of Ifs for these transactions. Its usefulness depends however on the satisfaction of the following important conditions:

- The MIT should identify the appropriate average transaction, in terms of EEA cardholders and UK merchant type, across all CNP transactions from the EEA into the UK.

- The MIT should identify the appropriate set of comparators for CNP transactions from EEA cardholders to UK merchants including alternative online payments and three-party schemes that would be available to a large proportion of CNP transactions.

- The MIT should include an accurate reflection of cost to the average UK merchant of accepting payments for each of the payments methods considered.

- Finally, the MIT should be based on an appropriate weighting for the costs of all alternative payment methods and not solely on the costs of the cheapest alternative.

The Report seems to consider SEPA credit transfers as the relevant comparator for Mastercard and VISA transactions for the EEA-UK channel. However, this is inconsistent with the preferences of both merchants and consumers as well as the PSR's own views in the context of its work on Open Banking. The PSR has repeatedly emphasised the importance of convenience and consumer protection for the development of successful Open Banking retail payment products. The MIT study should consider the unique feature of the EEA-UK corridor, but that does not mean that SEPA credit transfers are a relevant (let alone the only relevant) comparator for those purposes.

That said, the MIT can be a conservative method, resulting in fee levels that are lower than optimal, in that it may fail to account for merchant or consumer benefits. Alternatively, a benefits-cost balancing method could be applied in full (measuring all costs and revenues on the acquiring and issuing side) or approximated by the heads of costs incurred by issuers that benefit merchants but do not generate direct revenues for issuers (processing costs, payment guarantee, fraud, buyer protection and interest-free period).

Any study conducted to assess the optimal level of IFs needs to be objective and evidenced based. Mastercard is concerned that the Report's unsupported findings that 115/150 appears to be too high and that 20/30 levels appear to be "justifiable" or "acceptable" should not distort the outcome of the MIT study.

Mastercard looks forward to engaging with the PSR to ensure that the MIT study is conducted robustly, objectively and based on all available evidence.

Competitive constraints

Mastercard does not agree that the Mastercard scheme is subject to ineffective competitive constraints on the acquiring side when setting IFs.

- Mastercard must balance the competitive pressures from both the issuing and acquiring sides when setting interchange fees, as well as supporting activities (such as those relating to security or convenience) that benefit all users of the system.

- The Report's omission to consider the alternative payment methods available to *EEA consumers*, who are the relevant consumers for this EEA-UK transaction corridor rather than UK consumers, is a clear flaw in the Report's approach and evidence base.

  - There is a variety of alternative payment methods in the cross-border CNP space, accounting for a large proportion of transactions particularly online, to which cardholders can switch. As the PSR acknowledges in its report, these include digital wallets, such as PayPal, Revolut Pay and Skrill, American Express, China Union Pay and BNPL, as well as credit-transfer based payment methods such as Trustly. In particular in the EEA, a very large proportion of PayPal payments (65%) are funded by credit transfers or direct debits (and domestic cards). In some countries, the proportion is even higher (e.g. 80–85% in Germany).
  - In various countries in the EEA, consumers are very used to paying for online purchases by non-card payment methods. Indeed, we observe that payment methods are shifting from cards towards alternative payments in recent years. Research by WorldPay shows that in 2022, alternative payment methods were the most popular e-commerce payment method in 9 out of the 12 EEA countries featured in its report.
  - The Report seems to overlook the fact that many merchants in the UK with EEA customers already accept alternative payment methods such as PayPal and have the option to accept

domestic payment methods such as Giropay, Sofort and Cartes Bancaires. Some merchants in the UK indeed already accept domestic EEA payment methods.

- In addition to considering many of the relevant payment methods which are already operating in this space as comparators, the Report attaches insufficient weight to the fact that the payments landscape is ever evolving and fails to acknowledge that payment services may start domestically before expanding internationally. It is the credible threat of entry and expansion which leads to relevant competitive constraints, even if the market shares of entrants are small.

- As a result of these alternative payment methods and multi-homing by cardholders, merchants are able to exert competitive pressure by:-

  - **Steering:** UK merchants can choose to nudge consumers towards alternative methods of payment for cross border CNP (such as PayPal), for example by selecting default methods or asking consumers to pay with the merchants' preferred payment method. The PSR suggests costs in redesigning a webpage's interface are a barrier but does not provide any evidence. The cost of making changes to a website to steer consumers is likely to be small.
  - Threatening to **refuse to accept** certain card payment methods if IFs were hypothetically to be raised materially above their optimal levels. This is especially the case as a substantial proportion of payments in this specific channel are PayPal transactions that are not funded by Mastercard and Visa. The growth of alternative payment methods means that cardholders would have other ways to transact.

- Finally, the Report argues that acquirers place little competitive constraint on fees as most of these fees are passed on to merchants. As explained in more detail below, this is unsupported by evidence and we believe that the Report underestimates the IFs absorbed by acquirers and payment facilitators. This is likely to have led it to underestimate the degree of competitive pressure exerted by the acquiring side as a whole.

In conclusion, by attaching insufficient weight to constraints from the acquiring side of the market for cross border EEA-UK CNP transactions, the Report has overlooked important competitive constraints facing Mastercard. Mastercard has worked with the PSR during the market reviews to help it understand the functioning of the market and the role of alternative payments and looks forward to continued engagement with the PSR on these issues.

PSR's Powers

Contrary to the view expressed in the Report, the PSR does not have the power to impose a price cap remedy on interchange fees (or scheme and processing fees) under FSBRA:

- Based on the well-established principle of statutory construction that general statutory provisions cannot override specific provisions, neither ss. 54 nor 55 of FSBRA provide a power to cap the fees or charges which are caught by s. 57 of FSBRA.

- That conclusion follows from the natural reading of the words used in those sections, the Explanatory Notes to the legislation, the specific power in s. 57, and the different appellate regimes applicable to the exercise of powers under ss. 54 and 55 on the one hand and s. 57 on the other (with the latter providing for a full merits review and the former only allowing challenge on judicial review principles at most by virtue of ss. 77 and 79).

- Interchange fees (and indeed scheme and processing fees) fall within the scope of s. 57 of FSBRA. The PSR's powers under s.57 are not however exercisable in these circumstances.

As a result, FSBRA does not provide a power to cap interchange fees (or indeed scheme and processing fees) as a remedy following a market review. Mastercard believes that any attempt by the PSR to exercise this power would not survive judicial scrutiny.

Response to consultation questions

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?***

At paragraph 3.37, the PSR mischaracterises UK law when it observes that "*it is established in […] UK law that Mastercard's historic [sic] intra-EEA and domestic IFs infringed EU competition law*." As paragraphs 3.38 and 3.39 go on to describe, Sainsbury's SC only determined that UK MIFs restricted competition but did not consider whether an exemption may be available and therefore whether there was an infringement.

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?***

Mastercard does not agree that the Mastercard and Visa schemes are subject to ineffective competitive constraints on the acquiring side when setting fees.

As we explain in response to Question 10, there is a variety of factors which Mastercard takes into account when setting IFs, which includes factors on both sides of the market, and these forces influence fees in both directions. On one hand, on the issuing side of the market competition with Visa for issuers can apply upward pressure on IFs. On the other hand, the response from the acquiring side of the market, including acquirers and merchants can apply downward pressure. Mastercard must balance these competitive pressures when setting interchange fees, as well as supporting activities (such as those relating to security or convenience) that benefit all users of the system.

UK merchants can steer EEA cardholders to use alternative payment methods to pay for cross border CNP transactions, and alternative payment methods are becoming increasingly commonplace in the cross-border CNP context. As we have explained in previous responses, as the payment landscape evolves, the variety of alternative payment methods is also growing (see our answer to Question 6 for more detail). The growing use of alternative payment methods for cross border CNP transactions increasingly enables merchants to choose which payment methods they accept and steer consumers towards, and therefore creates competitive constraints on the acquiring side in respect of both acquirers and merchants (further discussed in Question 3 below).

It is also possible for UK merchants (without having to set up a local presence in the EEA) to accept domestic payment methods such Cartes Bancaires and Giropay which are popular in some EEA countries. The Report appears to overlook that these payment methods are available to UK merchants. Some UK merchants have indeed started accepting such domestic payment methods; we discuss this in response to Question 6.

The Report also argues that acquirers place little competitive constraint on fees as most of these fees are passed on to merchants,[1] a position which conflicts with the PSR's earlier findings that little of the savings resulting from the Interchange Fee Regulation (IFR) were passed on to small and medium-sized merchants.[2]

We address the Report's analysis in Question 12 below. The Report's underestimation of the IFs absorbed by acquirers and payment facilitators may have led it to underestimate the degree of competitive pressure exerted by the acquiring side as a whole. By failing appropriately to consider constraints from acquirers, and by failing to conduct detailed analysis of alternative payment methods in the correct geographical area, the Report has underestimated the constraints facing Mastercard.

We therefore disagree with the PSR's conclusion that there are ineffective competitive constraints on the acquiring side.

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?

Mastercard also does not agree with the Report's provisional finding that merchants' responses do not provide an effective competitive constraint on Mastercard and Visa in setting UK-EEA outbound IFs. In the event that IFs were raised too high, we consider that merchants would exert competitive pressure on IFs through the following:

- **Steering**: UK merchants can choose to nudge consumers towards alternative methods of payment for cross border CNP transactions, if they prefer to accept these methods of payment; and
- **Non-acceptance:** in more extreme cases where rates are set materially above optimal levels, declining to accept either Visa, Mastercard or both.

Steering and non-acceptance are discussed in turn below.

Steering

Steering refers to sellers' ability to exploit behavioural biases by nudging consumers towards certain methods of payment, for example by selecting default methods or asking consumers to pay with their

[1] PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 4.117.
[2] PSR (2021), 'Market review into card-acquiring services', November, para 1.15.

preferred payment method. The Report has noted that steering is unlikely to impose an effective constraint on IFs in CNP transactions, as steering consumers may require the merchant to incur costs in redesigning a webpage's interface. The Report does not provide any evidence for this. Steering consumers on a website does not require substantial changes and making some changes to a website is unlikely to be costly; online retailers make changes to their website on a very frequent basis. Therefore, we consider that the cost of making changes to a web interface to steer consumers would not be a barrier to merchants, if they felt the cross border CNP interchange fee increases were significant enough to justify any action being taken.

As we have explained, there are an increasing number of alternative payment methods available to merchants in the EEA cross-border CNP space which act as an alternative to cards. In addition, cardholders generally multi-home, namely hold more than one method of payment. These factors provide the option for merchants to seek to steer consumers between these different payment methods for EEA cross-border CNP transactions.

Non-acceptance

The number of alternative payment methods amongst EEA households (discussed above) potentially enables merchants to refuse to accept some payment methods, as they know that cardholders are likely to have alternative methods of payment.

The Report implies that it does not consider that non-acceptance of cards places an effective constraint on IFs. It states that it does not consider that merchants have the option of choosing not to accept cards, on the basis that a large majority of merchants currently accept both Mastercard and Visa.[3] We disagree with the Report's logic here, as the Report has only found this to hold when IFs have been raised to their current levels, which, as we have argued in previous responses, is likely to be around their optimal level. It does not follow that, if IFs were hypothetically to be raised materially above their optimal levels, that merchants would still choose to accept Mastercard and Visa card payments given the variety of alternative payment methods available.

Indeed, if fees for a particular method of payment are too high, merchants may choose not to accept this method of payment. The fact that a substantial proportion of payments in this specific channel are PayPal transactions that are not funded by international cards or are funded by international cards which are not Mastercard or Visa, provides suitable alternatives for merchants to threaten to reduce acceptance of cards. [4] EEA cardholders would also have a number of other options, such as GoCardless, American Express and China Union Pay, amongst other alternatives, to complete the transactions at UK merchants (see our response to Question 6 for further discussion of alternative payment methods). This indicates that it may

[3] PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 4.112. See Confidential Annex.
[4] PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 4.108.

be feasible for merchants to refuse to accept Visa and Mastercard if IFs were raised materially above optimal levels.

For the reasons above, merchants' responses provide an effective competitive constraint on Mastercard and Visa in setting UK-EEA outbound IFs.

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?***

Mastercard agrees that there are limitations to cross-border acquiring in the UK. However, this is a function of FCA regulations[5] rather than the rules of any card scheme (including Mastercard). The FCA requires that an acquirer must be authorised in the UK in order to operate in the UK and be able to acquire UK merchants. A core feature of that authorisation is that the acquirer is located in the UK. Nothing in Mastercard rules does or can influence the FCA prohibition on UK merchants being acquired by non-UK based acquirers.

Cross-border acquiring is just one of many potential competitive constraints on the level of IFs and even in the absence of cross-border acquiring Mastercard would still face multiple constraints when setting IFs (as discussed further in response to Question 2).

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?***

As the Report describes, a merchant may have a number of reasons for relocating, including the opportunity to reduce the total cross-border IFs it pays (with an offsetting increase in domestic interchange fees). For example, if the UK 'branch' of a merchant (in the CNP context, this would often be an online sales portal) is relocated to the EEA, the merchant would then pay intra-EEA/domestic IFs for transactions from EEA issued cards. Other factors which may influence these decisions include tax optimisation and corporate restructuring.

Mastercard does not try (and indeed has no ability) to influence merchants decision as to where to locate their business. Such decisions are driven by a multitude of factors of which Mastercard has no insight or knowledge. Mastercard does not therefore view relocation as the 'answer' to merchants as how to reduce

[5] Specifically regulation 138 of the 2017 Payment Services Regulations requires that a person may not provide a payment service in the UK, or purport to do so, unless it meets specific criteria. See Gov.UK, 'The Payment Services Regulations 2017', accessible here https://www.legislation.gov.uk/uksi/2017/752/regulation/138/made, last accessed 7 February 2024.

interchange costs. But we observe that the independent choice of some merchants to adopt that approach does exert competitive constraints on how Mastercard sets interchange fees.

Mastercard aims to set IFs properly to balance the cost and benefits of the card network across both sides of the market and to support the provision of services by issuers that benefit the network as a whole (including merchants). It is correct that localisation does not directly alter this set of core principles. There is a range of factors which informs the optimal rate of IFs and a key aspect of this decision is the alternative choices that all four parties have and how IFs incentivise their use of cards. In the case of CNP cross-border transactions, localisation is one of the options which may be available at least to some merchants to reduce the IFs they pay and hence relocation is taken into account in Mastercard's balancing exercise when setting the optimal rate. Merchants' ability and incentives to relocate some of their transactions are particularly strong for CNP transactions, where the location of the 'branch' does not need to provide customer service, but simply needs to process the transaction.

Firstly, the Report argues that relocation does not have a substantive effect on IFs, based on the fact that, following the UK's departure from the EU, Mastercard and Visa were able to increase IFs on these transactions.[6] However, this fact does not provide sufficient evidence that relocation provides no constraint since, UK-EEA consumer IFs were previously set below their optimal level[7], and specifically at the same level as domestic interchange fees (at 0.2% for debit transactions and 0.3% for credit transactions). The evidence suggests that, at the optimal level, UK-EEA IFs would be set at a higher rate than domestic IFs, based on the MIT approach and also the incremental fraud and other costs associated with these transactions (as discussed in response to Questions 8 and 9). If UK-EEA fees were to be increased above the optimal level, this may incentivise some merchants to relocate, which would result in these merchants paying domestic IFs instead of cross-border IFs.

Secondly, the PSR argues that relocation is unlikely to provide an effective competitive constraint on IFs because only a small number of merchants have the ability to relocate.[8] However, even if only a few merchants can relocate, evidence suggests that the merchants who have the ability to relocate are large.[9] Mastercard's analysis indicates that [redacted]

[6] See PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 4.71.
[7] By equilibrium level, we refer to the optimal rate of interchange which maximises the joint benefits of all parties. See also our answer for Question 8 for a discussion of the reasons we consider that IFs were previously set below their equilibrium level.
[8] See PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 4.70.
[9] Mastercard provided analysis indicating that several e-commerce giants appear to have relocated some of their operations since Brexit. See our response to the PSR's second information request.

This is supported by evidence from acquirers and merchants contained in the Report.[10] If large merchants were to relocate, this would cause a step-change to issuer revenues from CNP cross-border IFs which could have a wider effect on schemes.

In conclusion, the interchange fee is, and always has been, only one factor which could influence merchants' potential decisions to relocate. Nevertheless, were IFs to be set at a level that was materially too high, the transaction volumes that would be affected by relocation would be taken into account by schemes when setting the optimal fee.

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?***

The Report does not appear yet to develop and apply a relevant framework for analysing the competitive constraints in the retail payment market and may misinterpret the evidence received from acquirers and merchants. Perhaps most importantly, the Report appears to inform its view based on its understanding of the market in the UK rather than the experience and actual behaviour of households based in the EEA, which are the relevant consumers for this EEA-UK transaction corridor and who are very used to paying by alternative payment methods. Not considering the alternative payment methods available to EEA consumers, rather than UK consumers, is a significant oversight in the Report's approach and evidence base.

The Report asks whether we "*agree with our [PSR] 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?*". The framing of this question appears to be misplaced for assessing the competitive constraints in a market for payment services. Instead, the question should be whether alternative payment methods exist, and whether merchants and consumers can use these alternatives. As we go on to explain below, the answer is yes – there are alternative payment methods available to use for merchants and consumers. Even if there are only one or two alternative payment methods, this can be sufficient to impose competitive constraints in a market with network effects.

In its analysis of alternative payment methods and responses from acquirers and merchants, the Report seems to focus very much on the market shares of alternative payment methods. There are various statements from merchants and acquirers confirming that there are alternative payment methods but that the market shares of these payment methods are relatively small: "*While it provides customers with other*

[10] See PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, paras 4.65-4.66.

payment methods and card schemes, the merchant does not believe that the leading position of either Visa or Mastercard is under threat". However, in dynamic markets characterised by competing networks, market shares are unlikely to be a reliable measure of the extent of competition.

Alternative payment methods

Based on Mastercard's understanding of the market and the summary of the responses from acquirers and merchants (contained in Annex 2 of the Report), we observe the following:

- **Firstly, there are alternative payment methods available for cross-border (EEA-UK) CNP transactions**. As the Report acknowledges, payment methods which act as alternatives to Visa and Mastercard in this space include digital wallets, such as PayPal, Revolut Pay and Skrill, card payment methods such as American Express, China Union Pay and BNPL, as well as credit-transfer based payment methods such as Trustly. In particular in the EEA, a very large proportion of PayPal payments (65%) are funded by credit transfers or direct debits (and domestic cards). In some countries, such as Germany as many as 80–85% of PayPal transactions are funded by direct debits and credit transfers.[11]

  The Report also states that credit-transfer based payment methods "*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*." This is not correct. Both domestic card products such as Cartes Bancaires and domestic credit-transfer based payment methods such as iDEAL and Giropay can be used by merchants in the UK (without merchants having to set up a local presence) to accept payments by customers in EEA countries. Payment facilitators such as Stripe offer these payment methods to merchants in the UK.[12]

- **Secondly, many merchants in the UK who take payments from EEA customers already accept alternative payment methods such as PayPal and have the option to accept domestic payment methods such as Giropay, Sofort and Cartes Bancaires.** The Report does not refer to UK merchants being able to accept EEA domestic payment methods. Some merchants in the UK indeed already accept domestic EEA payment methods. These include Matches Fashion, a global luxury e-commerce platform, shipping to over 200 countries, which accepts American Express, Paypal, Alipay and Cartes Bancaires and Joseph Ltd, a British-based luxury fashion brand, which accepts UnionPay, Apple Pay, PayPal, Amex, Alipay, JCB as well as domestic payment methods Giropay, iDeal and Sofort. There are many merchants that accept alternative payment methods. These

[11] See IT Finanzmagazin (2018), 'Die girocard ist vermutlich zu spät – Interview mit Hugo Godschalk, PaySys Consultancy', 19 September.
[12] We note that the PSR refers to Stripe and Stripe's website that explains the option of using a local acquirer but then mentions that " 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". The PSR does not mention that the very same website of Stripe that the PSR refers to also explains that Stripe also makes domestic payment methods available to merchants in the UK and that for the acceptance of such payment methods no local presence is required.

include DAZN, a British over-the-top sports streaming and entertainment platform, which accepts PayPal; Sofa.com, a UK-based company founded in 2006 whose primary business is selling sofas, sofabeds, chairs and beds online, which accepts American Express, pre-paid cards and PayPal; and, Heelys, a Shoe brand, and British Museum accept PayPal.

- **Thirdly, consumers in the EEA are very used to paying by alternative payment methods.** Indeed, we observe that payment methods are shifting from cards towards alternative payments in recent years. Research by WorldPay shows that in 2022, alternative payment methods were the most popular e-commerce payment method in 9 out of the 12 EEA countries featured in its report.[13] PayPal is a popular payment method in various EEA countries for example with a market share of 45% in Germany.[14]

  In addition to overlooking the full range of payment methods which are already operating in this space, the Report attaches insufficient weight to the fact that the payments landscape is ever evolving, and fails to acknowledge that payment services may start domestically before expanding internationally. The threat of expansion of these services provides a competitive constraint to Mastercard.

The wording of the question, alongside the presentation of evidence from acquirers and merchants,[15] may indicate that the PSR has misunderstood the competitive constraints faced by Mastercard.

Despite entry and expansion of alternative payment methods being observed in the UK landscape, it is important to note that the economic characteristics of payment systems mean that widespread entry and expansion of new payment providers is not required in order for Mastercard to be competitively constrained. It is the credible threat of entry which leads to relevant competitive constraints, even if the market shares of entrants are small. In this market, competition is supported by the prospect of tipping points. In particular, where one payment method offers substantial mutual advantages to merchants and customers when compared to rival payment methods, widespread multi-homing can be expected to facilitate rapid switching to that payment method. By attaching insufficient weight to this factor and instead focusing on market share, the Report has not captured a key competitive dynamic of the market, as it applies to Mastercard. Indeed, focusing on (potential changes in) market share is unlikely to provide an accurate understanding of the degree of competition which Mastercard faces and is likely to overlook the underlying competitive dynamics in the market.

[13] Worldpay 2023 'GPR 2023: the global payments report', 8th edition. EEA countries in the sample are Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Poland, Spain and Sweden.
[14] Deutsche Bundesbank (2022), 'Payment behaviour in Germany in 2021', July, pp 2.
[15] As set out in Annex 2 of its interim report.

Mastercard has worked with the PSR during the market reviews to help it understand the functioning of the market and the role of alternative payments, and looks forward to continued engagement with the PSR on this.

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?***

We refer responses to Questions 2-6. Mastercard is subject to several competitive constraints when setting the optimal IF level. As the PSR acknowledges, there is some upward pressure on IFs as Visa and Mastercard compete for customers on the issuing side. However, schemes must retain customers on the acquiring side, and merchants may also switch between payment methods, leading to downward pressure on IFs from this side of the market. Therefore, Mastercard has incentives to balance the interests of both sides of the market in order to facilitate card payments. Looking at prices and revenues only on one side of the market would not appropriately capture the dynamics in the payment market.

We therefore consider that Mastercard faces multiple effective constraints when setting IF levels.

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?***

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?***

Relevance of the UK's continuing membership of SEPA

The Report argues that the current IF levels "*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*."

The UK has indeed remained part of SEPA and this means that consumers in the EEA can use SEPA transfers to transfer money to households and corporates in the UK. SEPA sets standards for credit transfers and direct debits and this means, for example, that transactions between two SEPA transactions are typically faster than transfers between a SEPA and a non-SEPA country.

We note that SEPA credit transfers come with very limited consumer convenience and protection. For example, the consumer needs to initiate a credit transfer by manually entering the transaction amount, account number and other relevant details of the merchant thereby running the risk of making mistakes. SEPA transfers also come with very limited protection in relation to the payment itself and no protection in relation to the delivery or the condition of the product or service purchased. It is therefore not surprising that SEPA credit transfers are rarely used for retail payments by households in the EEA to merchants in the UK.

In sum, the Report seems to consider SEPA credit transfers (i.e. without an overlay service or retail payment product) as the relevant comparator for Mastercard and VISA transactions. Mastercard disagrees. This is inconsistent with the preferences of both merchants and consumers as well as the PSR's own views in the context of its work on Open Banking. The PSR has repeatedly emphasised the importance of convenience and consumer protection for the development of successful Open Banking retail payment products. The fact that SEPA transactions are hardly used by consumers for EEA-UK CNP transactions means that the UK's continuing membership of SEPA is of no relevance to the cost of relevant comparators in applying an MIT.

But that is not to say that there are not features of the EEA-UK corridor which make it unique and which should be considered as part of a well-designed MIT study. Indeed, Mastercard agrees that it is important that the methodology used takes account of all such factors, as well as the specific comparator payment methods which enable EEA consumers to make purchases from UK merchants (which may not be offered by other non-UK, rest of the world merchants to EEA merchants). However, SEPA credit transfers are not such a payment method, even though they result from the fact that the UK remains within SEPA.

Relevance of fraud costs for the setting of IFs

Mastercard believes strongly that fraud differentials do justify and explain the increases in UK-EEA outbound IFs. The Report seems to suggest that fraud levels and more generally cost studies may not even be relevant to inform the level of interchange fee. Conducting a cost study is a well-established approach to inform the level of interchange fees and has repeatedly been used by various competition authorities. Furthermore, the Report's view is also entirely inconsistent with the PSR's work on the pricing principles for Open Banking-based products. For example, in its recent Consultation Paper on 'Expanding variable recurring payments', the PSR has proposed a cost-based approach for setting bilaterally and multilaterally agreed fees; it explicitly refers to dispute resolution, fraud prevention and fraud reimbursement as relevant cost items.

As reported in Table 3 of the Report, fraud levels reported by Mastercard between 2020 and 2022 are higher for cross-border transactions than for domestic transactions, for both EEA-UK and for EEA-non-EEA transactions.[16] Mastercard considers fraud levels (among other types of transaction costs incurred by issuers) as one of the factors contributing to the setting of IF rates. As Mastercard does not have direct information on all of the specific fraud costs incurred by issuers, Mastercard could not explicitly consider specific fraud levels when setting the EEA-UK CNP rates. However, Mastercard's knowledge of the higher fraud levels for cross-border CNP transactions informed its decision to set a higher level for the EEA-UK CNP rates than for the UK domestic rates. For example, as shown in Table 3 of the PSR's interim report, fraud levels on Mastercard CNP transactions involving EEA cards at UK merchants in 2020, 2021 and 2022 were [redacted] basis points respectively, compared to [redacted] for Mastercard CNP transactions involving EEA cards at non-EEA merchants and just [redacted] for Mastercard CNP transactions involving EEA cards at EEA merchants during the same years.

Levels of the EEA-UK CNP rates were then set in line with the 2019 Commitment Decisions (where the Commission took into account fraud levels, among other costs).[17] As illustrated by Table 3 of the Report, the fraud levels recorded in EEA-UK transactions are significantly higher than the levels in intra-EEA transactions. Indeed, the fraud levels in the EEA-UK CNP transactions are much more aligned to the fraud levels in the EEA-Rest of the World channel, that would have been relevant for the 2019 Commitments.

As such, Mastercard believes that the IFs set by the 2019 Commitments are a better indicator of the IFs that would appropriately reflect the costs that issuers face for CNP transactions (including fraud costs) on the EEA-UK channel than intra-EEA rates.

The Report also argues that it has seen "*no persuasive evidence that shows that individual issuers' fraud prevention investments are directly related to the IF revenue they receive*".[18] We disagree with this conclusion and we believe that the PSR should request or receive the requisite information from EEA issuers to support this; in fact, only UK issuers were asked two narrow questions on the additional interchange income and fraud prevention.

Firstly, the PSR asked issuers whether their operational costs, concerning UK-EEA cross-border CNP transactions, have increased since the UK's exit from the EU.[19] This question however does not distinguish the effect of Brexit from other changes that would have happened at the same time. Furthermore, a number of issuers did mention that it is likely that cross-border CNP transactions would be perceived to be more risky or more exposed to fraud.[20]

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[16] Similar results also apply when considering UK-EEA and UK-non-EEA transactions: both types have higher fraud levels than UK domestic transactions.
[17] 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.
[18] See PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 5.35.
[19] See PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 2.122, Annex 2.
[20] See PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 2.133-2.134, Annex 2.

Secondly, the PSR asked issuers how they use the additional income derived from the increase in IFs for UK-EEA cross-border CNP transactions.[21] However, some issuers did mention that additional resources were invested or would be invested in further fraud-protection mechanisms.[22]

An analysis of the effect of higher IFs on fraud levels would also need to consider the counterfactual fraud levels and fraud investments that would have taken place absent the higher IFs, and appropriately account for any other change that may have had an impact on fraud levels at the same time. Any consideration of issuer investments should, moreover, include not only fraud mitigation but also fraud prevention measures.

Significantly, it is also worth noting that Mastercard only increased its IFs for EEA to UK consumer CNP transactions in April 2022. Therefore, it is too early to be able to detect significant changes in issuers investment decisions and even more so to detect significant changes in the level of fraud that could be associated with these investments. As discussed further below, the uncertainty over the future levels of IFs triggered by announcement of the PSR's market review and therefore security of future IF income streams are also likely to have had an impact on the issuers' decisions on investments.

10. ***Do you have any views about our analysis and provisional 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?***

When setting IF levels, Mastercard takes into account several competitive constraints, which exert both upward and downward pressure on rates.

Mastercard competes with Visa for customers on the issuing side and competitive pressure from Visa was therefore one of the reasons that prompted Mastercard to review its rates, to ensure that it was not competitively disadvantaged by continuing to apply the artificially low intra-EEA CNP rates, which Mastercard has consistently maintained are set below the optimal level.

However, competitive pressure from Visa is not the only consideration which Mastercard takes into account when setting IF levels. Mastercard considers the interests of all parties in the payments ecosystem and not issuers alone, and selects the optimal rate that would benefit all parties (including merchants). Competition between issuers is intense, and if IFs were to be lowered, issuers would have to make up the revenue shortfall from elsewhere, such as through reduced services, worse FX rates or the introduction of transaction fees, which would affect merchants either directly or indirectly through discouraging sales (or diverting them to online merchants based elsewhere to whom such charges may not apply). It could also

[21] See PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 2.122, Annex 2.
[22] See PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 2.128 and 2.134, Annex 2.

drive consumers to alternative, competing payment methods such as three-party cards or BNPL that are likely to be more expensive for merchants to accept.

Issuers also carry out a wide range of activities to prevent fraud and enhance service. These are direct benefits that accrue to merchants and are supported by IFs. Issuers are liable for the cost of fraud and both pay for and implement services which reduce the incidence of fraud or handle fraud once it has occurred. This is particularly relevant in the context of the CNP space, in which 79% of card fraud occurs.[23] However, schemes do not have detailed understanding of the costs underpinning the full range of activities benefitting merchants which are carried out by issuers and in order to gain more insight into this, the PSR should seek additional input from issuers directly, especially the EEA issuers affected.

Therefore, merchants benefit both directly and indirectly from an optimally set IF, as these revenues allow issuers to continue to deliver card payments and to invest in services which make them more attractive to cardholders, through improvements in payment convenience and reductions in fraud. This in turn encourages cardholders to continue to use cards, rather than alternative payment methods, which leads to incremental sales and/or reduced costs for merchants.

Additionally, the increase in IFs between the UK and EEA benefits all players in the ecosystem, as it provides consistency and stability by aligning with interregional IFs for CNP transactions. Maintaining consistency and stability within the scheme is important for all players in the ecosystem, including merchants who benefit from transparent and stable MSC costs. When the UK was part of the EU, both CP and CNP IFs were regulated at 0.2% for debit and 0.3% for credit transactions. When the UK left the EU, this was no longer the case. Given that the UK has left this regulatory environment, it is more consistent for these fees to align with interregional CNP IFs than to continue to align with intra-EEA IFs based on a regulation informed by old data on physical transactions. Certainly, Mastercard is aware of no reasoning in the IFR or the evidence underlying it, that would justify these transactions being aligned to domestic/card-present transactions in the EEA, rather than other cross border CNP transactions in the UK.

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?***

As we have indicated in our response to Question 10, Mastercard sets IFs to balance the incentives and interests of all parties within the scheme, including merchants. Merchants benefit from IFs directly through issuer investments, for example to tackle fraud, which subsequently reduce costs for merchants (for example, through reducing fraud handling costs). Merchants also benefit from issuer investments which lead to improved payer convenience, buyer protection and provision of credit. In addition, merchants

[23] UK Finance (2021), 'Fraud - the facts 2021: The definitive overview of payment industry fraud', p. 21.

benefit indirectly by an appropriate level of IF, which enable issuers to continue to support card payments, and to invest in services which make them more attractive to cardholders, leading to incremental sales and/or reduced costs for merchants.

Such a relationship between IF revenues and issuer services is clearly evidenced when looking at the full portfolio of services offered by issuers. For example, a study conducted for the European Commission indicates that the aftermath of the Interchange Fee Regulation (IFR) saw a drop-off in benefits for cardholders, including an increase in average cardholder fees for credit cards.[24] This is an example of an impact which could drive an indirect reduction in benefits for merchants, by affecting consumer incentives as to whether to use credit cards or an alternative payment method (such as American Express).

Further, IFs revenue overall enables issuers to improve service provision such that cardholders are incentivised to use cards. Were issuer revenues to reduce, including as result of a reduction in IF revenue, it would be reasonable to expect a consequent reduction in both investment by and risk appetite of issuers.

For the reasons outlined above, it is not possible to identify specific benefits to merchants accruing shortly after IF have been increased. This does not mean, however, that increases in IFs will not benefit merchants over the longer term, both directly and indirectly.

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

Due to the limited amount of relevant data accessible to Mastercard's advisors, it has not been possible to verify that the Report's calculations of the proportion and value of pass-on to merchants are correctly calculated, given the Report's methodology. Our detailed assessment of the Report's analysis is set out in the Confidential Annex.

In any event, we consider that this methodology for the calculations is not robust in estimating the degree of pass-on in particular for blended contracts. We have several concerns with the Report's methodology, and consequently with its conclusions on pass-through and the impact of the IF increases on merchants.

- The Report's analysis is heavily reliant on qualitative statements from acquirers which do not allow it to accurately assess the degree to which IFs are passed on to merchants. For example, where one acquirer has not provided sufficient information to determine the degree to which it passes on IFs to merchants, the Report has made an assumption as to the percentage of IFs that are passed on to merchants, but has not explained why this figure has been selected. To conduct a robust analysis

[24] Ernst and Young and Copenhagen Economics (2020), 'Study on the application of the Interchange Fee Regulation: Final Report', 4 August, p.131.

of the degree to which IFs are passed on, the PSR should conduct a quantitative analysis. Not doing so means that the estimate of the proportion of IFs passed on is unsupported by any proper evidence.

- All the relevant economic dynamics cannot be properly captured or tested based on such qualitative statements. For example, an acquirer may have adjusted their headline prices to make allowance for the change in interchange rates, and therefore concluded that the change has been passed on. However, whether such changes achieve full pass-on in practice will depend, *inter alia*, on the extent to which an acquirer has accurately forecasted its own transaction mix, the extent to which merchants have negotiated discounts or other modifications to their acquiring contracts and the extent to which the fee change has prompted merchants to switch to other acquirers offering lower service charges. Such effects are important and can only be captured in a quantitative analysis which is missing from the Report. The responses by acquirers therefore reflect a subjective and partial view of acquirers' pass-on intentions, not a robust measure of how much pass-on was actually achieved. As a matter of principle, this is particularly important where a methodology is based on the views of parties which may have an interest in the outcome of the exercise.

- The lack of a robust estimate for merchants on blended contracts is relevant because 95% of merchants are on blended contracts, as set out in the PSR's CAMR Final Report.[25] Therefore the Report's headline figure overlooks the fact that the vast majority of UK merchants (especially small and medium size) are on blended contracts and do not necessarily experience high pass on. As we have explained in the paragraphs above, the degree of pass-on to these merchants cannot be estimated using the qualitative information and methodology which the Report has adopted.

- By assessing the degree to which IFs are passed on by acquirers, rather than the degree to which IFs are passed on to merchants, the Report overlooks the important impact of players which sit between acquirers and merchants, such as payment facilitators. Payment facilitators play an increasingly important role in onboarding smaller merchants and sitting between these merchants and acquirers. Data from the PSR suggests that over 80% of new merchants onboarded in the UK in 2018 were onboarded by the largest payment facilitators and Stripe.[26] The Report does not take account of these players in its analysis, and overlooks the fact that payment facilitators and other intermediaries absorb some of the IF increases which are passed on by acquirers, so the increases do not all accrue to merchants. It is important to take account of this significant development in the payments landscape, in order to avoid substantially overestimating the degree of pass-on to merchants.

[25] MR18/1.8, *Market review into the supply of card-acquiring services: final report*, page 32, paragraph 3.64
[26] PSR (2021), 'Market review into card acquiring services', November, Figure 7.

- While it has collected data from a proportion of acquirers in its analysis, it is important to note that not all acquirers provided data to the PSR. Specifically, it is possible that the acquirers which did not provide data share certain characteristics, which means that provisional findings about the market are not robust. For example, this may mean that the PSR has not considered medium and smaller acquirers and new entrants, which may have a higher proportion of merchant customers on blended contracts. These acquirers may have to pass on less of the IF increases in order to attract customers. As such we consider that, by relying on data from a subsection of the market, a significant bias has been introduced in the estimate of the degree of pass-on to merchants.

For the reasons outlined above, we consider that the Report's estimated proportion of IFs passed on to merchants was not calculated using an appropriate methodology and, as such, is unlikely to be accurate or robust. We consider that the overall pass-through to merchants, and in particular to small merchants on blended contracts, is likely to be lower than the Report estimates, and therefore that the value of IFs passed on to merchants in 2022 is likely to be lower than the Report's estimate suggests.

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?

As explained below, Mastercard does not believe that the PSR has the requisite powers under FSBRA to impose a price-cap remedy, whether as an interim or longer-term remedy. Accordingly, the legal basis for the proposed interim remedy is incorrect and cannot be regarded as appropriate for that reason. The following more detailed comments should be read subject to that overriding point.

The assumption underlying the PSR's proposal for its interim remedy 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*"[27] or that 20/30 may be an "*acceptable*"[28] or "*justifiable*"[29] level. There is however no evidence to support such an assumption:

- The 20/30 levels were set in 2015 (based on data gathered earlier, in 2012 and 2013) and have not been updated since then to reflect changes in the payments landscape, particularly the growth of cross-border CNP payments which have higher associated costs of fraud. Indeed, CNP payments were not considered at all in determining these 20/30 rates. The Commission justified this at the time on the basis that "*Only a minority of the merchants that have face-to-face transactions do*

[27] Paragraph 1.12, final bullet. See also para 9.56: "our current thinking is that current outbound IFs are likely higher than any appropriate MIT would find".
[28] Paragraphs 9.73 and 9.83
[29] Paragraph 9.63

have an online activity as well" and that "*in 2012, online card payments accounted for only 5.6% of the total volume of card transactions and 9.3% of the total card value in the European Union.*"[30] Neither is likely to be true today, and certainly not for the UK; based on UK Finance data, the CNP proportion for the UK for the period September 2022 to August 2023 is 34% by value and 14% by number. [31]

- The 20/30 levels were based on an MIT methodology that used cash as the alternative payment method, which makes these rates inappropriate in the CNP context. Cash is not an alternative payment method to CNP transactions. This MIT did not consider the basket of payment methods to which cardholders would most likely switch in a CNP context, which may comprise online retail payment methods and three-party schemes such as American Express.

- The statement that "*Other than a political shift (the UK's withdrawal from the EU), nothing else of substance appears to have changed*", does not take into account the time that has elapsed and the very substantial changes that have occurred since the 20/30 levels were set (based on data that are now over 10 years old). These include the growth of cross-border CNP payments and the pressing need to consider alternative payment methods other than cash. The UK's withdrawal from the EU is relevant only insofar as it provided Mastercard with the legal ability to increase interchange levels a) to reflect these substantial changes that took place since the 20/30 levels were originally set in 2015 and b) because the 20/30 levels were always an underestimate of the appropriate IFs for these transactions. Looking for increases in costs since Brexit or because of Brexit, as the Report appears to do, is therefore not the correct approach.

- The Report refers to a very limited number of stakeholders (including the BRC and EDPIA) who support the proposition of 20/30 rates and these stakeholders predominantly reflect the views of those with an inevitable interest in paying lower fees. Their views should not therefore be regarded as an objective assessment of what level of fees is "*acceptable*".

- Although the Report states that it has not seen evidence to suggest that IFs at 20/30 previously presented an impediment to innovation (e.g. in fraud prevention) by leaving EEA issuers short of investment funds, the PSR does not appear to have sought evidence from EEA issuers as to fraud levels or the impact on innovation of any change in such IFs. This is notwithstanding the fact that the Report explicitly recognises that "*the most immediate impact of this remedy would be primarily felt by EEA issuers*".

[30] European Commission, Directorate-General for Competition, *Survey on merchants' costs of processing cash and card payments – Final results, March 2015*, Publications Office, 2015, footnote 41 and 42.
[31] https://www.ukfinance.org.uk/system/files/2023-12/Card%20Spending%20Update%20-%20September%202023.pdF

- Similarly, the Report appears to have no evidence to justify its assertion 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. Indeed, as explained in response to Questions 8 and 9 above, the IFs set by the 2019 Commitments are a better indicator of the IFs that would appropriately reflect the costs that issuers face for CNP transactions (including fraud costs) on the EEA-UK channel than intra-EEA rates.[32]

Accordingly, not having yet conducted its proposed MIT or any alternative methodology, the Report does not have any basis for suggesting that current rates are "*too high*" or that rates at 20/30 are likely to be "*acceptable*" or "*justifiable*". Indeed, Mastercard is concerned that these unsupported findings do not prejudge the outcome, and potentially prejudice the objective implementation, of the MIT study that the PSR envisages.

In light of Mastercard's firm view that the PSR does not have the legal power to impose the proposed interim remedy, Mastercard has not commented on the specific modalities of the proposed remedy described in the Report. Mastercard encourages, however, the PSR to seek the views of EEA issuers, and other relevant stakeholders, as to the costs, disruption and lack of certainty caused by reducing IFs to 20/30 levels for an interim period followed by a further change in rates in 2-3 years' time (which we discuss further in response to Question 19).

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?***

Mastercard does not believe that the PSR has the requisite powers under FSBRA to impose a price-cap remedy, whether as an interim or longer-term remedy. Accordingly, the legal basis for any longer-term remedy is incorrect, regardless of the methodology used to inform any such remedy. The following more detailed comments on the methodology should be read subject to that overriding point.

Nevertheless, Mastercard agrees that a merchant indifference test (MIT) for UK-EEA outbound consumer transactions would be a useful mechanism to help understand the optimal level of IFs for some transactions. For that reason, Mastercard welcomes an MIT study. When calculated correctly, the resulting IF from an MIT test is such that the average merchant would be indifferent between accepting a card and accepting other payment means, hence maximising benefits for both merchants and consumers.

[32] See more generally the response to Questions 8 and 9 above.

However, measuring the right level of interchange based on the MIT is far from straightforward. The MIT requires information on the cost to the average merchant of accepting card payments for the relevant channel and compares this to the cost of accepting the payment methods to which cardholders in the EEA would be most likely to switch, if faced with higher costs of completing a CNP transaction with a UK merchant using a Mastercard (or Visa) card. An appropriate methodology should consider a number of factors.

- First, the MIT should identify the appropriate average transaction in terms of EEA cardholders and UK merchant type, across all CNP transactions from the EEA into the UK.

- Secondly, the MIT should identify the appropriate set of comparators for CNP transactions from EEA cardholders to UK merchants. This would need to incorporate a number of payments (such as e-wallets, three-part schemes, BNPL and other payment alternatives) that would be available to a large fraction of CNP transactions.

- Thirdly, the MIT should include an accurate reflection of cost to the average UK merchant of accepting payments for each of the payments methods considered. The analysis of costs should also appropriately consider the classifications of variable and fixed costs adopting a long-term view, if the resulting IF is meant to be inform the rates that would be applied in a potential enduring remedy.

- Finally, an appropriate MIT should not be based solely on the costs of the cheapest alternative. To the contrary, appropriate weighting for the costs of all alternative payment methods should be applied, reflecting the future time period for which any remedy is meant to be in place.

In addition, we note that the MIT can be a conservative method, in that it may fail to account for merchant benefits. As such, according to good practice any remedy should be informed by a range of different established methodologies that can determine the optimal interchange rate, including calculations based on a benefit-cost balancing method. The benefits-cost balancing method could be applied in full (measuring all costs and revenues on the acquiring and issuing side) or approximated by the heads of costs incurred by issuers that benefit merchants but do not generate direct revenues for issuers (processing costs, payment guarantee, fraud and interest-free period).

Any study conducted to assess the optimal level of IFs needs to be independent and evidenced based. Mastercard is concerned that the Report, by making unsupported statements that 115/150 appears to be too high and that 20/30 levels appear to be "*justifiable*" or "*acceptable*", should not prejudge the outcome, and potentially prejudice the objective implementation, of the MIT study. Mastercard is similarly concerned that the Report's focus on SEPA and overlooking payment methods widely used by EEA consumers may prejudice the outcome of the MIT.

Mastercard looks forward to engaging with the PSR to ensure that the MIT study is conducted robustly, objectively and based on all available evidence.

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 IFs, 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?

Mastercard does not believe that the PSR has the requisite powers under FSBRA to impose a price-cap remedy, whether as an interim or longer-term remedy. Accordingly, the legal basis for the proposed interim remedy is incorrect. The following comments on the costs and consequences of any such interim remedy should be read subject to that overriding point.

As discussed above, Mastercard challenges the Report's assumption that the current rates are "*too high*" or that rates at 20/30 are "*likely*" to be "*appropriate*". Mastercard believes that the current rates are necessary to promote the efficient use of the card network and to enable and incentivise issuers to invest and innovate to counter increased levels of fraud associated with cross-border CNP transactions (see Mastercard's comments on chapter 5 of the Report). There is a material risk that any interim remedy substantially reducing current rates for UK-EEA CNP transactions will reduce issuer incentives to innovate and invest to combat fraud. This would mean that fraud levels would continue to increase (or at least would not reduce by as much as they would otherwise have done) to the detriment of the market as a whole. Mastercard also suggests that any comments on the appropriateness of the current rates can only be made after the completion of an MIT assessment.

It should be noted that the uncertainty as to issuers' future revenue streams, created by the PSR's announcement of its market review on 21 June 2022 (and arguably even earlier following the press release issued by the Treasury Select Committee on 13 January 2022 regarding increased interchange fees and the PSR's statement of 17 November 2021 in which it announced "*an additional phase of work*" in relation to card fees), will have already reduced issuer incentives to invest. Yet more uncertainty created by the proposed interim remedy, with a view to revising the rates yet again in 2-3 years' time once the PSR's longer term remedy is in place, is likely to compound further the existing uncertainty, with commensurate risks to issuers' incentives to innovate and invest. This will in turn impact on fraud levels.

Even if rates are subsequently increased, e.g. returning them to current levels or higher, following a properly conducted MIT study (in accordance with the conditions set out in response to Question 18 and free of any bias), any investments in fraud prevention that are then optimally incentivised will take time to implement and to feed through into fraud levels. The PSR should not therefore assume that the market risks attached to its proposed interim remedy are insignificant. Indeed, the adverse consequences of rates that are too low for an interim period may have longer-lasting consequences for market participants in terms of reduced investment and higher fraud levels, than rates that are too high for the same period.

Mastercard encourages the PSR to seek evidence from EEA issuers directly affected by the PSR's interim remedy proposals, including in particular the impact of uncertainty as to future revenue streams on their incentives to invest.

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*****?**

Any changes to fee structures or levels require system implementation changes by all market participants, which in turn involve both costs and time. Although fee changes are business as usual activity, each one will impose an additional, incremental cost. More importantly, participants need time to be able to schedule the technical work to make the changes and acquirers need to be able to implement the new fee levels for their merchant customers, particularly where contractual changes are required. For that reason, Mastercard typically gives 6-9 months' notice of any fee changes[33]. Mastercard is mindful that acquirers previously provided feedback to the PSR that insufficient time to make system and fee changes can cause them difficulties.

[33] Mastercard gave 7 months' notice and 10 months' notice when it previously altered the EEA-UK CNP interchange rates

The PSR's powers to impose a price cap remedy

We note the statement in the Interim Report that the PSR's FSBRA powers under sections 54 and 55 "*would enable us to implement any of the potential remedies*" discussed in chapter 9, including the proposed interim and longer-term price caps[34]. The Report expresses its current view that "*we may use FSBRA general or specific directions to give effect to this potential remedy package under section 54 or 55 FSBRA*"[35]. Mastercard does not believe that the PSR has the requisite powers under FSBRA to impose a price-cap remedy, whether by general or specific directions and whether as an interim or longer-term remedy.

More particularly, based on the well-established principle of statutory construction that general statutory provisions cannot override specific provisions, neither ss. 54 nor 55 of FSBRA provide a power to cap the fees or charges which are caught by s. 57 of FSBRA. That conclusion follows from the natural reading of the words used in those sections, the Explanatory Notes to the legislation, the specific power in s. 57, and the different appellate regimes applicable to the exercise of powers under ss. 54 and 55 on the one hand and s. 57 on the other (with the latter providing for a full merits review and the former only allowing challenge on judicial review principles at most by virtue of ss. 77 and 79). Any other conclusion would enable the PSR to avoid the specific constraints on the exercise of the fee varying power in s.57 and the need for a full merits review attached to the exercise of powers under that section.

It is clear that interchange fees (and indeed scheme and processing fees) fall within the scope of s. 57 of FSBRA[36]. This reasoning would apply as much to domestic transactions as to cross-border transactions as there is nothing limiting the s. 57 power to the former. However, the PSR's powers under s.57 can only be exercised in specific circumstances that are not applicable here. As a result, FSBRA does not provide a power to cap IFs (or indeed scheme and processing fees) as a remedy following a market review.

Mastercard believes that any attempt by the PSR to exercise this power may well not therefore survive judicial scrutiny.

[34] PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 4.114, paragraphs 9.8 and 9.9
[35] PSR (2023), 'Consultation paper: Market review of UK-EEA consumer cross-border interchange fees, interim report', December, para 4.114, paragraph 9.140
[36] As fees payable under either (a) *any agreement made between the operator of a regulated payment system and a payment service provider* or (b) *any agreement concerning fees or charges payable in connection with (i) participation in a regulated payment system, or (ii) the use of services provided by a regulated payment system*.

Members of European Parliament (Joint Letter)

Dear Minister, Dear Chair,

We, the undersigned Members of the European Parliament, are writing to express our concerns regarding the impact of an inter-regional interchange price cap that the UK is considering imposing on the EU payments industry.

We understand that the UK Payments System Regulator is proposing an interim cap on the EEA to UK card-not-present transactions, a cap which may fall below the actual costs incurred by EEA payment providers for such transactions.

We are concerned that this would not only place European companies at a distinct disadvantage to competitors outside of the EEA, but would also negatively affect European consumers, who may face higher charges for ordinary transactions or even disruption in services. We are particularly worried about the impact on the provision of low cost accounts and cross-border payment services to European consumers, and the ability for European FinTechs who are trying to compete with the international card schemes to grow.

While we appreciate the shared ambition to ensure a competitive and fair market for both merchants and consumers in our respective jurisdictions, from a European perspective, we are concerned that such proposals of an inter-regional cap on interchange fees would do so at the expense of European businesses, and ultimately, European consumers - particularly in the absence of wider consultation with EU Member States, EU Commission, and EU issuers, and economic assessment to justify such a measure.

We strongly believe that both the EU and the UK are committed to strengthening our post-Brexit relationships. However, unilateral actions like this risk undermining those commitments. We would note that if the EU decided to retaliate in a similar fashion, UK payment companies and UK consumers would suffer the same negative consequences as those facing their EU counterparts.

We are ready and willing to act as partners on this matter, and we would urge you to conduct a thorough assessment of the proposed measures and their impact on the market before proceeding, including formally consult with EU Member States and the EU Commission, and EEA issuers. It is critical to avoid the unintended consequences of creating a situation in which European consumers are burdened with additional costs when making online payments in the UK.

With kind regards,

Ralf Seekatz
Member of the European Parliament
EPP, Germany

Stephen Nikola Bartulica
Member of the European Parliament
ECR, Croatia

Isabel Benjumea Benjumea

Member of the European Parliament
EPP, Spain

Regina Doherty
Member of the European Parliament
EPP, Ireland

Billy Kelleher
Member of the European Parliament
Renew, Ireland

Kinga Kollar
Member of the European Parliament
EPP, Hungary

Stéphanie Yon-Courtin
Member of the European Parliament
Renew, France

Payments Europe

PAYMENTS EUROPE

RESPONSE TO THE PSR MARKET REVIEW OF UK-EEA CONSUMER CROSS-BORDER INTERCHANGE FEES

Dear Mr./Ms.,

I am writing you on behalf of Payments Europe, the association of card-based payment solutions providers. Payments Europe members are active in Europe and the UK, representing card issuers, card acquirers, and card schemes. Our mission is to promote the value that card-based payments bring to the economy and society. We strive for a vibrant, competitive, safe, and consumer-centric payments market, supported by a balanced regulatory framework.

Payments Europe took note of the interim report of the UK Payment Systems Regulator (PSR) Market review of UK-EEA consumer cross-border interchange fees. Payments Europe would like to take this opportunity to provide our comments on the proposed price caps. We are open to further engaging with the UK PSR and other stakeholders to inform your work and to ensure any review of card fees is based on evidence from the whole spectrum of stakeholders, including the cards industry.

Generally, interchange provides the economics that underpin the key elements of an efficient electronic payment ecosystem. These include acceptance, innovation, security, fraud protection, and guaranteed payments to merchants. Hence, the interchange is crucial for a healthy acquiring ecosystem capable of driving acceptance among new merchants. As such, it should be high enough for new players to be incentivised to enter the space and low enough that merchants are encouraged to adopt digital payments.

More specifically, we believe that:

- Interchange fees should not be viewed simply as a cost to an acquirer/merchant which, therefore, needs to be managed or regulated to the lowest possible level. Interchange is about balancing the interests of all participants in the ecosystem. They have a clear purpose and value in allowing issuers to deliver services on behalf of cardholders, which in turn benefits merchants by encouraging usage/driving sales. The alternative may be that no sale is made or that more expensive alternatives are used, e.g., 3-party cards or BNPL.
- The European 20/30 rates were set nearly 10 years ago for domestic (and intra) transactions within the EU. They are not, and never were, the appropriate benchmark to use for cross-border transactions beyond the EU.
- The Interchange Fee Regulation's (IFR) approach to setting the same interchange for card-present (CP) and card-not-present (CNP) transactions is out of date and superseded by the 2019 Commitments approach of setting a higher rate for CNP, reflecting the obviously higher fraud costs of those transactions. By setting the same interchange level for CN and CNP transactions, the PSR would be adopting the old approach for the future.
- The Payments Europe Members confirm and emphasise that the 20/30 rates are not sufficient to cover issuer costs (particularly fraud costs) of cross-border CNP transactions and can assist you further to support this point.
- Following the previous point, 20/30 does not incentivise issuer investment in promoting the use of card payments.
- The PSR seemed to be concerned about the cost to UK merchants, not taking into account the importance of interchange received by EU issuers. If the European Commission chose to reciprocate and apply the same 20/30 rates in reverse, it would severely impact the interchange revenues of UK issuers, which would reduce their ability to invest on behalf of UK merchants.

Private Individual 1

Dear PSR team,

I find your Market review of UK-EEA cross-border interchange fees, interim report from December 2023 insightful. It is a valuable source of information.

It has to be acknowledged that regulating interchange fees is a daunting task. In the past I explored this field by examining different country interventions in intechange fee setting and investigating the reform effects: [redacted]

It will be interesting to watch how you deal with the matter. I keep my fingers crossed for the right decisions!

Kind regards,
[redacted]

Private Individual 2

Dear PSR

I would like to draw your attention to how shortsighted regulating interchange fee regulation is as a singular element within the workings of the 4 party (really 5) party model:

1/ Cardholders eg Me
2/ Issuers eg Barclaycard
3/ Networks eg Mastercard
4/ Acquirers eg WorldPay
5/ Merchants eg Tesco

When I buy £100 of groceries in Tesco using my Mastercard branded credit card issued by Barclaycard, WorldPay process the transaction on Tesco's behalf, and the transaction is routed via Mastercard to Barclaycard to Authorise the payment. Clearing and Settlement happens later. As a result:

A/ Tesco get £100 less the merchant fees paid to WorldPay.
B/ WorldPay pay interchange to Barclaycard (as set by Mastercard). WorldPay also pay Scheme Fees as an acquirer to Mastercard (set by Mastercard as the network).
C/ Barclaycard also pay Scheme Fees as an issuer to Mastercard (set by Mastercard as the network).
D/ I pay Barclaycard £100 for my purchase, plus applicable interest and fees for usage of my card.

Your thinking that:

Less Interchange paid by Acquirers to Issuers means lower costs for Merchants, means lower prices for Cardholders

is simply WRONG for two reasons:

I. The Networks can adapt their rules, Scheme Fees and rebates in response to interchange regulation - #SchemeFees paid by Acquirers can go up, and #SchemeFees (less any rebates) paid by Issuers can go down, so the economic balance between Issuers, Acquirers and Networks can be equalised if regulating interchange alone.

II. Merchants keep any potential saving, so consumers don't necessarily get lower prices.

Any interchange regulation that doesn't take into account the totality of the economics of the 5 party model - and in particular the Scheme Fees set by the Networks and paid by (and rebates offered to) Issuers and Acquirers - will be fundamentally flawed and utterly ineffective in the long run.

Best regards,

[redacted]

Private Individual 3

Dear [redacted], Chris Hemsley and Aidene Walsh (cc'd parties FYI and potential response)

[redacted]

Please may I thank the PSR for raising the public interest issue of Visa/Mastercard Cross-Border Interchange Fees being at an unduly high level; https://www.psr.org.uk/news-and-updates/latest-news/news/psr-provisionally-proposes-to-cap-cross-border-interchange-fees-on-credit-and-debit-cards-to-protect-uk-businesses/ ; 'The PSR has set out its provisional concerns that Mastercard and Visa have likely raised these fees to an unduly high level, at the expense of UK businesses. Last year alone, the PSR estimates that UK businesses paid an extra £150-200 million due to the fee increases.' (Source Credit; PSR).

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Yours Sincerely

[redacted]

Revolut

Revolut

PSR Working Paper on Consumer Cross-border Interchange
Revolut Comments - February 2024

EXECUTIVE SUMMARY

We appreciate the opportunity to provide comments on the interim report. Revolut operates as an issuer, acquirer and merchant and strongly supports the objective of boosting competition and innovation in cross-border payments. Unfortunately, we are concerned that the PSR's set of proposed interventions will not deliver on this objective.

We do support the PSR's decision to close the investigation into imposing potential caps on cross-border interchange related to UK → EEA card transactions. We believe the closure of the investigation is justified as (i) costs for such transactions are clearly higher than for domestic transactions, (ii) Visa and Mastercard market share in EU Member States (MS) varies significantly, reducing the rationale for an intervention, (iii) capping UK →EEA cross-border interchange would have negligible impacts on the total cost of acceptance for most EEA merchants and (iv) any intervention would simply reduce revenue for UK issuers and their customers, without creating any potential benefits for merchants.

However we remain deeply concerned about the PSR's proposed interventions on EEA → UK card transactions. We are concerned the PSR's proposals are disproportionate, potentially discriminatory and set a concerning precedent. We also believe they would be ineffective. We would encourage the PSR to instead prioritize actions to enable the growth of alternatives to card based payments in the UK (e.g. leveraging open banking).

- **Disproportionate**:
    - **The 20/30bps cap will force EEA issuers to operate EEA to UK CNP transactions at a loss, fundamentally undermining EU payment providers' economics and viability.** The PSR has received data which shows issuers such as Revolut can incur costs in excess of 20 bps for some EEA to UK debit card not present consumer transactions. Direct costs can in fact be [redacted], not merely 'in excess' by a small margin. Estimates for 2023 indicate our core transaction costs for EEA to UK CNP spending are in a range from [redacted], and this excludes general costs we face per user (e.g. servicing costs, operational costs, marketing, etc)[1]. We are likely one of the most efficient providers of cross border payment services. It is a significant concern that EEA issuers like Revolut will be forced to enable cross border transactions at a loss (i.e. where costs are >20bps, but an interim cap is applied at 20bps) for a period of time. This will particularly impact issuers who are predominantly focused on cross border payments, and will likely reduce the viability of current and future EU-based FinTechs offering card-based cross border payment functionality. Our own analysis indicates more than [redacted] customers of Revolut will become unprofitable for us [redacted]. Given other EEA issuers will likely have similar impacts, the PSR's

actions will likely lead to negative real world impacts on millions of EU consumers - whilst doing nothing to boost competition or innovation in cross border payments, or in reducing costs for the vast majority of UK merchants.

  - **The PSR appears to be choosing to implement a 20/30bps cap using a series of assumptions, before conducting the needed economic and competition impact analysis.** The PSR's decision to implement an interim cap appears to pre-judge the results of their upcoming study, assuming already that (i) a cap is justified and (ii) the cap will be lower than 115/150bps, (iii) the potential loss of revenue due to the interim 20/30bps cap will be offset by issuers' presumed 'excess' revenue over the last two years. The latter point is particularly of concern, since it does not take into account issuers with significant growth over that period [redacted] or the negative impact on new entrants to the payments market who will likely lose money on every EEA→UK transaction from day one (significantly undermining their viability).
  - **The IFR's 20/30bps is not an appropriate benchmark as (i) it was designed using data from a general merchant indifference test on EEA transactions not specifically on UK→EEA CNP transactions and (ii) costs on issuers have changed significantly since 2015.** On point (ii) we are particularly concerned that the PSR has not considered the increased costs issuers face for both domestic and international transactions since the IFR was introduced despite clear evidence being provided to it (for example [redacted] have added costs for issuers which are a significant portion of interchange revenue). The PSR has not provided analysis of these increased costs, or any rationale as to why these costs have not been taken into account when choosing to set a 20/30bps cap.
  - **Taking action to cap issuers' revenue while taking no action to address their costs is unjustified.** We strongly encourage the PSR to complete its scheme fee review before taking action on cross-border interchange.[redacted] The artificial reduction in EEA issuer's revenue before the completion of the scheme fee review will harm new entrants and reduce competition and investment in innovation in cross-border payments in the EEA. Given the important role payment firms have played in creating broader competition in the UK and EEA retail banking industry, the effect this will have on investment sentiment into the sector must also be assessed. No analysis of this impact has been provided by the PSR, and as far as we are aware there has been very limited consultation with EU MS, EU Issuers or EU/UK investors.

- **Discrimination and creation of an unlevel playing field**:
  - **This proposed cap will distort competition and put EEA issuers at a disadvantage versus (i) peers in other markets like the US or China (who will continue to earn 115/150bps from cross-border transactions into the UK) and (ii) competitors [redacted] who will be exempt yet can hold significant market share in cross-border transactions.** The PSR's data indicates that already non-Visa/Mastercard schemes hold 21% market share in value for CNP EEA to UK transactions. Capping only a portion of the market could have serious implications for competition in EEA markets for payments and broader retail banking services. In addition, the likely shift by consumers to these un-capped alternatives, many of which may be priced higher, may significantly reduce any potential cost reductions for UK merchants.
  - **The PSR's action may trigger retaliatory action by the EEA hurting UK issuers and**

UK consumers, or provide a justification for other jurisdictions to apply discriminatory price caps only on UK issuers. The introduction of the PSR's proposed interim cap, before conducting a robust study to justify such action, increases the risk that due process will not be followed by other countries, not just in this specific area of inter-regional interchange but more broadly. UK issuers face protectionist restrictions in trying to enter new markets, and the PSR's actions in this area heighten the risk of continued unilateral actions which will undermine the UK's vision of developing global champions in technology and finance.

- **Ineffective**:
  - **A cap on EEA→UK CNP cross-border transactions will have a negligible impact on the cost of acceptance of card based payments by merchants in the UK.** As the PSR data indicated, in 2022 only 3.6% of all UK merchant card transactions were from EEA issued cards, and only 70% of these were CNP. It is unclear from the PSR's interim report, but this may include both commercial and consumer spending, meaning an even smaller sub-set will be actually impacted by the proposed action on consumer CNP interchange rates. Even if the costs of these transactions were zero, this would not create any material change in total cost of acceptance by UK merchants.
  - **Small UK merchants would see no benefits, and the PSR recognises that large merchants are already well placed to adopt alternative payment options.** The PSR's data showed that 95% of merchants are on standard pricing. The small remainder of merchants on IC+/++ pricing are recognised by the PSR as generally being the largest merchants (annual turnover over £50M), and so while they can account for a high % of the value of EEA-UK CNP transactions, they are also the best placed to mitigate the costs associated with these transactions if needed. Therefore we would particularly challenge the assumptions made in section 4.36 on the impact on average merchants. We believe, the vast majority of merchants on standard pricing models will see no benefit in the reduced interchange rates proposed under the interim cap, and consequently, reduction in prices for consumers is unlikely.
  - **The PSR recognises that the interim cap will 'not address the underlying cause of the detriment' they have identified.** In the UK, small merchants pay double to accept card payments vs large merchants (<£380K turnover merchants costs >180bps, >1M-10M turnover merchants approximately 90bps, >£50M turnover merchants approximately 40 bps)[1]. In turn, we would urge the PSR to focus its efforts on assisting those smaller merchants by boosting competition in the domestic market, through Open Banking solutions and alternative payment methods like [redacted].

The PSR's statutory objectives include the requirement to promote effective competition in the markets and to promote the development and use of innovation in payment systems. We believe that the decisions made are not in line with these objectives.

HM Treasury's Future of Payments Review ('Review') explored the payments market in the UK and outlined a number of recommendations around how to improve the competitiveness of the UK's payment systems and future-proof it to ensure it remains a globally competitive sector. It is notable that the Review did not highlight interchange fees as a concern, both for issuers, merchants or consumers. Indeed it highlighted the following: "Although there is some evidence that card costs

[1] P52, Final Report, PSR Card Acquiring Market Review, 2021

to merchants have increased, we did not see data which indicates that costs are out of line with relevant international comparators".

The payments market is evolving rapidly. Stablecoin regulation is incoming, Open Banking is becoming more popular (particularly with the advent of Variable Recurring Payments, which we use ourselves as a merchant) and FPS remains an option. We would strongly recommend that instead of adopting an approach of capping fees which will have a negligible impact on most UK merchants' cost of acceptance, whilst creating dangerous and potentially discriminatory impacts for EEA issuers and EU consumers, the PSR focuses resources in enabling new competitive cross border solutions to be more strongly supported.

SECTION 2: DETAILED RESPONSES

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?

See Executive summary.

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?

Visa and Mastercard already face competition for cross border transactions, with the PSR's own data indicating as of 2022 that alternative card payment methods already hold reasonable market share in EEA to UK CNP transactions (10% volume, 21% value). We believe the competitive constraints on Visa and Mastercard will continue to increase, with more alternatives to card payments being offered. Short term, increased competition is already visible through products such as [redacted] and other alternatives based on instant payments / digital wallets emerging onto the market. Bain (2023)[32] considers that card-heavy, high-interchange markets should actually "propel growth in alternative payments, causing card growth to slow". Pix in Brazil and India's UPI are two examples of alternative payment solutions that continue to grow at a rapid pace. Medium term, we believe both stablecoins and potentially CBDCs will offer new low cost solutions. The acquiring market in the UK remains very competitive, and the PSR's existing interventions under the acquiring market review will likely further increase choice for merchants.

We do not believe the PSR has demonstrated a lack of competition specifically in CNP EEA to UK transactions, or that that competition is creating negative outcomes at a level which has a material impact for UK merchants or consumers. We believe a fuller analysis is needed to determine (i) the trend (as volume and value market share may be evolving rapidly given recent technological developments), (ii) the pricing and availability of these alternative payment methods (to determine if the charge to merchants is below, above or at par with the current Visa and Mastercard solutions) and (iii) how many of the merchants are directly exposed to changes in CNP EEA to UK interchange rates (i.e. are on Interchange + / ++ pricing models as opposed to blended models).

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?

[2] https://www.bain.com/insights/consumer-to-business-payments-a-strong-growth-outlook/

We do not agree with the PSR's analysis, we refer to our answer in the Executive Summary and in Question 2 for further details. We strongly encourage the PSR to conduct trials, such as enabling surcharging for certain merchants on certain transactions or supporting small merchants in adopting alternative payment methods, before ruling all such alternative interventions as ineffective. We would particularly stress the fact that merchants already have alternatives for cross border payments, and that the largest merchants already have the power to choose to use them and promote them to end users.

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?

We believe the UK acquiring market in general remains highly competitive, with new entrants (such as [redacted]) entering the market and continued pricing pressure driving lower costs and the creation of innovative new solutions. This is particularly true for the EEA to UK CNP market. Merchants have the choice today to accept alternative payment methods to Visa and Mastercard which by itself provides a competitive constraint [redacted].

For cross border acquiring specifically, while FCA authorisation would be needed to offer acquiring services in the UK, this is not a material barrier for new entrants, and in fact many significant EU acquirers also offer services in the UK. This requirement is also something UK and EU regulators could address if needed (e.g. by offering passporting for EEA or UK regulated acquirers). Similarly if the PSR feels scheme rules are preventing competition in acquiring, a more proportionate response than capping inter-regional interchange would be to address such issues by directly engaging the schemes. In both areas the UK Government, PSR and FCA have tools to implement more proportionate remedies.

We believe that the larger merchants, who are the ones who are most likely to benefit from the PSR taking further action on cross border acquiring, already have the resources and capabilities to set up an additional merchant location in the UK or EEA (as relevant) to benefit from lower costs of acceptance and reduce cross-border interchange fees (See our response to Question 5 for more detail.)

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?

We do not agree with the PSR's assessment. Large merchants with significant amounts of EEA-UK CNP, who are often on IC +/++ pricing models and so can be directly impacted by changes in IF, have the competence and incentive to relocate for that portion of their volumes when it makes economic sense for them to do so. Smaller merchants, who likely do not have such competence, are generally less directly impacted as often will be on blended pricing models where EEA cards are charged at the same amount as UK issued cards for CNP transactions. The PSR's Interim report recognises this. An in depth study to look at the costs and benefits for UK merchants to implement such solutions, and trends over the last 2-3 years, should be undertaken before adopting such a material intervention as an 'interim cap' as proposed by the PSR.

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?

We do not agree with the PSR's analysis and provisional finding, as per our answers to Questions 2 and 4. We would highlight our own Revolut Pay solutions as one example which exists, and enables merchants to accept EEA to UK transactions via Revolut Pay without dependency on Visa or Mastercard rails. As Open Banking, stablecoin and other digital wallet solutions gain traction we expect competition to increase [redacted]. There are already a number of initiatives being explored globally (e.g. Google UPI partnership, G20 FSB Roadmap, etc)

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.

We believe there are a number of competitive constraints on Mastercard and Visa. We would refer to a number of our responses in the Executive Summary, Question 2, 4 and 6. One area not explored yet by the PSR is the changing dynamics of EU payments, notably initiatives such as the European Payments Initiative. [redacted]

We also would recommend the PSR engages directly with EU issuers and EU Member States at scale to understand the potential impacts on them from these changes. While the PSR has engaged a large number of UK issuers, the primary impact from the PSR's proposed decisions will be the EU issuers.

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?

Fraud is just one component of cost which issuers can face. Revolut's fraud and chargeback costs are higher for UK→EEA transactions than domestic transactions [redacted]

Such fraud and chargeback costs would justify a higher inter-regional interchange rate being applied, but fraud is clearly not the only cost issuers can face for CNP transactions. As referenced in other sections of our response, issuers can face a range of other fees including [redacted] Revolut's costs for such transactions are in excess of [redacted]. We would also note that the 20bps applied to domestic EEA CNP transactions pre-dated new fees being introduced, such as [redacted] and therefore may not be the correct benchmark to use. This underlines why it is a major concern for the PSR to apply an interim cap at 20bps before a full study has been conducted.

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:

- the UK is part of SEPA
  - 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?

We cannot comment on the methodologies Visa and Mastercard have used in setting outbound IFs, however (i) we do not believe the fact the UK is a part of SEPA to be a material factor impacting the costs EEA issuers face when enabling EEA to UK transactions, (iii) even if SEPA were a factor there is no rationale for it to be so significant as to justify an 82% lower interchange cost for EEA→UK vs RoW→UK. As noted above in response to Question 8, fraud is not the only cost issuers face and so we disagree with the assumptions being used that it is the main factor in determining whether a higher inter-regional interchange rate is justified. [redacted] Again, were the PSR to conduct a proper study, which also captured full market data on EEA→UK CNP fraud vs RoW→UK CNP fraud they would be able to make more data based conclusions. Depending on consultation responses from just a small number of industry participants is not sufficient for deciding on such a material intervention.

Question 10: Do you have any views about our analysis and provisional 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?

We cannot comment on Visa and Mastercard's motivations for the changes they took on cross-border interchange. However, we do not agree with the analysis provided by the PSR. (1) We believe the alignment of EEA to UK cross-border interchange rates with those applied on RoW to UK transactions is justified and better reflects the real world costs issuers face to enable such transactions. [redacted]

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)?

We disagree with the premise of this question. UK merchants were already receiving the benefits of having a payment method that non-UK consumers could use to make purchases with very high reliability, low fraud and low abandonment. When it comes to credit transactions, these transactions are also often being enabled with a credit risk falling on the issuer. These benefits for merchants clearly outweighed the costs, [redacted]

[redacted] As referenced in our Executive Summary, there are a number of increases in costs issuers have faced since 2015 and the original 20/30bps cap was not designed specially for EEA→UK CNP transactions. A study would be needed to draw clear conclusions, and simply implementing an interim cap based on assumptions is not justified.

Question 12: Do you have any views on our assessment of the impact of the fee increases on UK acquirers and merchants?

We believe the PSR must further assess two areas to better reflect the true impact of its potential interventions, that we believe will have a negligible impact on cost for UK merchants.

First, as referenced in the Executive Summary, using the PSR's own data, the impact of cross-border interchange has a negligible impact on the vast majority of UK merchants. Only the largest merchants in some specific channels will have seen an impact. EEA to UK CNP transactions make up only 2.5% of all card transactions for UK merchants. As 95% of UK merchants are on standard pricing, a very small percentage on IC+/++ pricing will be exposed. The PSR has recognised these are generally the largest merchants with a turnover in excess of £50M a year, who also have the best tools to offer alternative payment methods or otherwise mitigate the impact.

Second, as the PSR data also shows, 21% of EEA to UK CNP transactions already take place on alternatives to Visa and Mastercard. The PSR would need to further explore the impact on merchants if the interventions push consumers to adopt these alternatives - some of which may be priced higher than the current IC+ pricing for EEA to UK transactions (e.g. [redacted]). [redacted]

Again, these are complex markets and the potential impact requires more data collection and study than the PSR has so far conducted.

Question 13: Do you have any views on our proposal to close our review of inbound IFs on the grounds of administrative priority?

We agree with the decision to end the investigation into the application of cross-border interchange caps for UK to EEA transactions. While the PSR has justified this on the basis of administrative priority, we believe this decision is fully justified by the facts that (i) costs for such transactions are clearly higher than for domestic transactions, (ii) Visa and Mastercard market share in EU Member States varies significantly reducing the rationale for an intervention, (iii) capping cross-border interchange would have negligible impacts on the total cost of acceptance for most merchants and (iv) any intervention would simply reduce revenue for UK issuers and their customers, without creating any potential benefits for UK merchants.

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?

No, we disagree. As described in our Executive Summary, and in answer to question 2, 4 and 6, we believe that the PSR can deliver the outcomes it wants in a more proportionate manner by focusing actions on enabling alternatives to card based payments to emerge. Revolut's own solution Revolut Pay enables cross border transactions not on Visa and Mastercard rails. UK merchants can sign up for it today. There are other solutions emerging onto the market. The PSR could invest in efforts to accelerate awareness and adoption of such products, and support development of other solutions based on Open Banking or stablecoins.

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?

No, we disagree. As described in an answer to Question 6 we see some of these alternative interventions as viable and would recommend the PSR properly explores pilots in these areas before adopting such a material intervention in the market as an interim price cap.

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.

Card scheme rules and fees can have a material impact on the costs for EEA→UK CNP transactions. The PSR appears to have identified some relevant factors in the Interim Report, but much of the PSR's work under the Scheme Fee review is relevant here. We would recommend that the PSR aligns the implementation schedule for both reviews given how interlinked they are. This would reinforce the rationale for the PSR to take the time to properly conduct the planned 18 month study rather than implementing an interim price cap (i) before having adequate data to justify it and (ii) before taking potential action on issuers costs as well as their revenues.

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?

We strongly disagree with the proposed remedy. We refer to the extensive points listed in our Executive Summary.

Revolut considers that the introduction of the remedy will have the following impact:

- **EEA Issuers** are likely to need to increase fees to cover the costs of payments made at UK merchants. This may take the form of a bank-led charge, passed on to consumers, for general banking or payment services. Some EEA Issuers may choose to cut services or offboard certain customers. [redacted]
  - In this example, EU consumers will be clearly worse off. If the EU or other jurisdictions were to retaliate following the PSR's decision, this detriment would also be experienced by UK consumers.
- **UK Merchants** are unlikely to decrease their charges as a result of decreased costs for processing cross-border card transactions. The transactions in question make up only 2.5% of all merchant transactions. 95% of merchants on standard pricing will see no impact. Only the largest merchants will see a minor impact. There is no evidence from previous interchange interventions that merchants pass on price savings to consumers. Also, given alternatives such as American Express will be uncapped and be able to offer increased services to EEA consumers it is likely some volume will shift to these alternatives

which can be more expensive for these larger merchants - which will certainly negate any benefits, and may in fact lead to increased costs.

    ○ In this example, small merchants and UK consumers are not benefitting. Only the largest UK merchants with an exposure to EEA CNP spend may benefit, but then marginally.

- **Acquirers** will likely maintain Merchant Service Charges in bundled pricing models at the same level. This could lead to increased revenues for the acquirer, but again at a negligible level given the small % of transactions being impacted.
    ○ No UK merchant or consumer benefits.
- **Card Schemes** will see no significant changes to their global revenues. [redacted] Lowering the economics for cross border payments for issuers would likely reduce the viability of alternative schemes emerging (e.g. EPI would not prioritize enabling cross border EEA→UK transactions at 20/30bps). No UK merchant or consumer benefit. No increase in competition or innovation.

At a net level, it is Revolut's view that the introduction of the proposed remedy would have unintended consequences, with further costs being passed to EEA consumers as a result of this change, with minor margin benefits simply "banked" by the largest merchants, and no increase in competition to card schemes from alternative means of payment.

[redacted] At a net level, it is Revolut's belief that no intervention or a single intervention (rather than a two stage approach) is likely to lead to a better long-term outcome for end users.

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?

We believe, at a bare minimum, the actual costs incurred by issuers must be taken into account when calculating a fair interchange fee for specific transaction types. We also believe simply suppressing interchange to a level where issuers only cover their direct costs is not appropriate, and in fact only serves to shift the cost of running a global card based payments ecosystem from merchants to consumers.

We do not have specific comments at this time on the appropriateness of using a merchant indifference test or alternative methodologies. We would need to see detailed proposals before we could provide a view.

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?

Please see detailed comments provided in our Executive Summary.

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?

We view these changes from the perspective as an issuer, acquirer and a merchant. We expect to incur a number of costs when managing any change from a price cap being applied on inter-regional interchange. These costs will be magnified if such a cap is applied on just a portion of cross border transactions. Costs will come from a range of areas including legal, operational and technology services. Costs will also be magnified by the uncertainty from implementing an 'interim cap', whilst also having to plan for further material changes following an 18 month period (linked to the full study on inter-regional interchange and the scheme fee review). We would strongly encourage the PSR to only implement one set of changes covering both inter-regional interchange and scheme fees. Ideally this would be coordinated with the EU's own review of its regulation in this area. The PSR's current plan would require us to manage three sets of changes over a short period, with substantial uncertainty on final outcomes, which would at least triple the costs for implementation. The costs we face though are likely a small fraction of what other smaller payments focused fintechs may suffer.

Question 21: Are there other remedies we should consider either on an interim or long-term basis?

Revolut believes that the most effective remedy would be to improve competition [redacted]. The PSR would also be able to have a much more meaningful impact on UK merchants' cost of acceptance for payments by focusing on reducing costs for domestic transactions - notably for small merchants. The ROI for such initiatives would be much better, and should therefore be an administrative priority for the PSR.

Question 22: Is there anything else we have not considered and you think we should consider?

We would reiterate that the proposed interventions, particularly the interim price cap on EEA→UK CNP transactions, are disproportionate, discriminatory and will be ineffective at reducing the cost of acceptance for UK merchants.

UK consumers will see no benefit. Only a small number of the UK's largest merchants may benefit, and even then the real world impact will be negligible (given EEA→UK CNP transactions account for only 2.5% of all transactions and it is likely some may shift to higher cost alternatives such as Amex). 95% of UK merchants will see no benefit - and will continue to pay double what large merchants pay to accept card payments. EEA issuers and consumers will clearly be worse off. [redacted] If the EU were to retaliate, hundreds of thousands of UK consumers would likely also be negatively impacted.

The PSR's action to only apply price caps on a portion of the market (exempting players that already represent 21% of transactions by value) may distort competition in a number of major EU Member States in a material manner. In addition, EU issuers and any new payments focused fintechs will be at a serious disadvantage against global peers with less exposure to EEA→UK CNP transactions.

Most concerningly, the PSR's action appears to not consider the fact that data clearly shows EEA→UK CNP transactions cost issuers more than domestic transactions, these costs are well in excess of [redacted] for debit transactions, and costs overall for enabling CNP transactions have increased since 2015 [redacted]. Applying a price cap below issuers costs sets an incredibly concerning precedent, particularly when done before a full study on the economic and competition impacts has been undertaken.

We would urge the PSR to properly consult with EU Member States and the EU Commission before considering such a material intervention, and at a bare minimum for the PSR to (i) ensure no EEA issuer is forced to enable EEA→UK transactions below cost and (ii) that before any action or interim cap is implemented a full study will be completed to assess all the potential impacts.

Romanian Asociation of Banks

TO: **PAYMENT SYSTEMS REGULATOR (PSR)**
Attn: Mrs. Aidene Walsh, Chair of the PSR Board

Subject: the PSR interim report for its market review into cross-border interchange fees

Dear Mrs. Aidene Walsh,

The Romanian Association of Banks (RAB), as a professional association representing the Romanian banking community, would like to submit to your attention this letter on behalf of the banking sector of Romania to raise our concerns regarding the potential local impact of an 'interim' interchange price cap on European Economic Area (EEA) - UK card-not-present transactions, that UK is considering proposing.

While we understand the intention to address local concern on the UK market, we strongly believe that such a cap could put pressure on both Romanian issuers and Romanian consumers.

Considering the potential negative impact on the Romanian issuers, we hereby kindly request your view and guidance on the matter described above as well as your confirmation that Romanian issuers will not be subject to a cap that would risk undermining the level playing field. We do think that a consultation with all EU Member States before taking any decision would be useful when assessing the impact of implementing such a cap.

Allow us to thank you in advance for your attention and considerations,

Sincerely yours,

ROMANIAN ASSOCIATION OF BANKS

asociația română a băncilor

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Startup Coalition

STARTUP
C✱ALITION

www.startupcoalition.io

Market review of UK-EEA consumer cross-border interchange fees
Startup Coalition response

About the Startup Coalition:

Startup Coalition (formerly Coadec) is the policy voice of tech startups and scaleups in the UK. Since 2010, Coadec has worked to engage on behalf of tech startups in public policy debates in the UK across a range of priority issues for startups including access to finance, immigration and skills, and technology regulation.

Startup Coalition is part of the Axe the Card Tax campaign, a coalition of trade bodies representing 240,000 businesses across the UK campaigning for measures to support payments innovation.[1] The coalition is calling for actions to promote competition in the payments sector, to reduce the costs of accepting payments, and to ensure there is a level playing field that enables the UK's burgeoning Fintech sector to compete with incumbents.

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?

Startup Coalition agrees with the facts and considerations of the PSR within Chapter 3.

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?

Startup Coalition agrees with the PSR's analysis and provisional findings that there are ineffective competitive constraints on the acquiring side when setting 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?

Startup Coalition agrees with the PSR's analysis and findings on the inability for merchants to provide an adequate competitive constraint on Mastercard and Visa on their 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?

N/A

STARTUP COALITION

<u>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?</u>

The PSR is correct in its analysis of relocation when it states that this is an option only available for the largest, well-resourced merchants and is unavailable for a large number of UK based SMEs.

It is important to note that the largest, well-resourced merchants already have significant advantages when it comes to the total cost of accepting card payments due to their ability to negotiate both scheme and processing fees as well card acquirer fees. This drives down the cost of accepting cards for the largest merchants while leaving the UKs important SMEs to pay large fees in the form of an effective card tax.

<u>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?</u>

Startup Coalition agrees with the provisional findings that there are few alternative payment methods to Mastercard and Visa.

We also believe this issue extends beyond international trade with the EEA and that there is a lack of alternative payment methods within the UK too. This has allowed other fees, such as scheme and processing fees, to also see significant rises.

The negotiation issue for the total cost of accepting cards is worsened in a duopolistic market. With Visa and Mastercard dominating over 99% of the payments market and setting both the scheme and processing fees as well as the interchange fees.

<u>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</u>

No, Startup Coalition does not think there are other competitive constraints on Mastercard or Visa in setting outbound IFs.

In fact Startup Coalition believes there are additional anti-competitive measures within the market that act as barriers to competition and have caused fees to rise.

Competition in payment card markets and other similar "*multi-sided markets*" is characterised by what the European Commission has called "*reverse competition*", namely, where Mastercard and Visa actually compete with each to <u>increase</u> the level of interchange fees, in order to attract and/or retain card issuers and cardholders, namely:

> "***IFs are subject to reverse competition*** *meaning that competition between card schemes to attract card issuers (banks) leads to ever higher interchange fees (and consequently, MSCs). IFs are basically revenues offered to banks by card schemes in exchange for issuing their cards rather than the cards of the competitors. Therefore, an increase in MIFs offered by one card scheme leads banks to issue the cards of this particular scheme.*"[1]

> "*In the context of card payments, reverse competition means that card schemes compete with each other by offering higher MIF revenues to banks that issue their cards. This results in higher fees for card payments in general, which are passed on merchants and, ultimately, consumers (rather than lower fees which would be the case under normal competition). As a result there is a welfare loss for merchants and consumers and a restricted market entry for new players, as ever increasing levels of MIFs are considered as a minimum threshold by banks that issue cards.*"[2]

The Commission provided multiple case studies (and analysis) of such reverse competition.

Accordingly,in our view Mastercard and Visa's dramatic increases in their UK-EEA consumer cross-border interchange fees is an unambiguous example of such reverse competition.

Such reverse competition of course does not vindicate Mastercard and Visa interchange fee increases. On the contrary, it shows why such price increases are likely to harm consumers and competition, are also likely to be unlawful.[3]

Further, companies demonstrating large network effects and global scale economies, such as Visa and Mastercard, will almost certainly not operate in competitive markets. This itself is the prime reason for *economic regulation* of such industries, as well also new regulation of digital markets, including the UK Digital Markets Unit (**DMU**) and EU Digital Markets Act (**DMA**), Such regulation is in recognition of the substantial network effects, global scale economies, and associated absence of competitive constraints and high profitability in such sectors.

<u>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?</u>

No comment

<u>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?</u>

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[1] European Commission Staff Working Document: Impact Assessment accompanying the Commission's proposal for the EU Interchange Fee Regulation, SWD(2013) 288 final (**IFR Impact Assessment**), Volume 1/2, page 19.
[2] IFR Impact Assessment, Volume 1/2, page 86.
[3] I.e. both merchants and end-consumers.

As demonstrated by the PSR the UK has remained a sustained membership to the Single European Payments Area (SEPA), both regions continue to have strong economic, regulatory, and technological links. Through conversations that we have had with members of the Axe the Card Tax Coalition, we believe that the risk and cost of UK-EEA transactions are not materially different post-Brexit, let alone different enough to justify a fivefold increase in outbound IFs.

Further, aligning the fees, as is proposed, would complement the recently signed Memorandum of Understanding between the UK and the EU establishing a framework for structured regulatory cooperation in the area of financial services.

Question 10 • Do you have any views about our analysis and provisional 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?

Yes, as stated in a previous question Visa and Mastercard experience 'reverse competition' when setting their fees. This allows them to remain attractive to issuers and means they compete, often, to raise fees.

The card schemes compete with each other to increase the level of interchange fees, in order to attract and/or retain card issuers and their cardholders, leading "to ever higher interchange fees (and consequently, MSCs). Interchange fees are revenues offered to banks by card schemes in exchange for issuing their cards rather than the cards of the competitors. Therefore, an increase in MIFs offered by one card scheme leads banks to issue the cards of this particular scheme." This was also acknowledged in the IFR Impact Assessment.[4]

This perverse incentive to increase interchange fee is also reproduced when the card schemes set scheme and processing fees. Given they want to win more business and have more transactions running through their network, they can raise scheme and processing fees paid by acquirers and merchants, offsetting fees paid by issuers to the schemes. These incentives, which come in many forms, could be seen as an indirect form of interchange fees. They help explain the continuous increases we have seen in scheme and processing fees despite the IFR attempting to prevent this type of circumvention. Ultimately, both direct and indirect interchange fees represent a wealth transfer from merchants, and small businesses in particular, to issuing banks.

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)?

[4] European Commission, European Commission Staff Working Document: Impact Assessment accompanying Volume 12, 2013

No, we do not believe that there is evidence that the increase to fees has led to any practical benefit for UK merchants. This is primarily due to the fact that the fee increases were not linked to an increase in service or security. Instead as stated above the fee rises occurred due to opportunism, and 'reverse competition' in a duopolistic market.

This is particularly pernicious during a cost of doing business crisis, where merchants are facing significant price rises across their supply chain, alongside fees to accept card payments.

Question 12 • Do you have any views on our assessment of the impact of the fee increases on UK acquirers and merchants?

The paper stated that the PSR is currently concerned that UK merchants, especially SMEs, and potentially some of their UK customers, are adversely impacted as a result of these additional costs. We fully agree with this analysis and would like to reiterate our initial statement to the PSR that we have heard extensively through our ecosystem and through the Axe the Card Tax Coalition that many merchants face no choice but to accept these fee rises and it has had a considerable impact on their businesses.

When discussing the impact that the fee increases have had on UK acquirers and merchants the PSR states that:

> *"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."*

While we agree that the overall cost to the consumer should not impact the conclusions of the cross-border interchange fees interim report, this analysis may, however, prove valuable for some of the additional work happening around payments. Notably, the pass on costs to consumers could provide significant additional insight both into the PSR's ongoing work around scheme and processing fees and might be additionally useful for the work on the National Payments Vision.

Question 13 • Do you have any views on our proposal to close our review of inbound IFs on the grounds of administrative priority?

No comment

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?

As we stated in a previous answer, the anti-competitive nature of Visa and Mastercard means that there is no effective way to boost competition for CNP IFs within the current market. While this highlights the need to review this market on a wider scale it also means that direct regulator action is required to reduce the fees that have risen.

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?

Yes, Startup Coalition agrees that most SMEs would not be able to introduce surcharging. There would be a significant risk to SMEs introducing surcharging to their customers, with many customers likely to move to other businesses that absorbed the costs of the fee rises.

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.

No comment.

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?

The Startup Coalition agrees that an interim remedy cap is required for outbound transactions in order to cap the fee rises that we have seen in the market. Furthermore, the PSR should also double down on strict anti-circumvention rules to protect against increases on other direct and indirect interchange fees used to compensate issuers for this reduction.

We believe that there may be evidence to suggest that the interim remedy cap should be set at a lower level than the 0.2% for debit cards and 0.3% for credit cards as a means to remediate the fees that many businesses have already paid on these fees. This would allow some remedy for the market while a more permanent cap is found. We look forward to further contributing to the parallel investigation on Scheme and Processing fees to this end.

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?

No comment.

STARTUP COALITION

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?

No comment.

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?

No comment.

Question 21 • Are there other remedies we should consider either on an interim or long-term basis?

No comment.

Question 22 • Is there anything else we have not considered and you think we should consider?

No comment.

Tesco Group

Market review of UK-EEA consumer cross-border interchange fees: interim report.

- About Tesco: Tesco is the UK's largest retailer and accounts for one in every £11 spent in UK retail (including fuel). [redacted] Our online grocery services also process a significant number of card-not-present transactions to meet consumer demands. Tesco Group in the UK includes Tesco Bank, the One Stop convenience store chain and Booker wholesaler, amongst other divisions. Tesco is also operational in ROI and central European markets.

Executive Summary

- Cross-border interchange fees have risen from 0.2% to 1.15% for debit card and 0.3% to 1.5% for credit card transactions. This level of increase cannot be justified via added services for merchants or broader market trends.
- These increased fees have cost Tesco millions since 2021 and ultimately led to higher consumer prices. These fees are unavoidable for all UK merchants who engage in international trade.
- The PSR should adopt a two-stage approach to caps on UK-EEA cross-border interchange fees. First, both inbound and outbound fees should be capped at a level which enables the full recovery of overpayments incurred since 2021. Second, permanent caps should be introduced at a rate no higher than the existing caps for domestic interchange fees.
- The level of permanent interchange fee caps should be reviewed before implementation, to consider whether the 0.2% and 0.3% rates still reflect the changing cost base of debit and credit card transactions.
- Cross-border interchange fee caps should be introduced alongside caps for commercial cards and scheme fees. This would protect merchant and consumer outcomes.

Q1) 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?

- One factor to consider is how the payments market reacted to the Interchange Fee Regulation (IFR). Interchange fees increased significantly prior to the IFR taking effect, whilst scheme fees have increased since and non-capped commercial card fees have continued to rise. The PSR's measures on cross-border fees should avoid repeating these unintended consequences, by capping scheme fees and bringing commercial cards into scope.

[redacted] The increase in card payments as a proportion of transactions emphasises the impact of higher costs for this payment method. [redacted]

Q2) 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?

- We agree with this assessment. For Tesco, alongside the broader merchant community, the costs of processing card payments are rising significantly, [redacted] The card schemes effectively operate as two parallel monopolies as merchants cannot realistically influence the acceptance or otherwise of the two dominant schemes. This also means Visa and Mastercard do not compete against each other for merchant custom.

Q3) 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?

- We agree. [redacted] Account-to-account services, led by open banking, have the potential to provide competition to the card schemes in the future. However, this will be a long-term process and so requires the development of open banking to be pursued in parallel with regulatory measures on scheme fees and cross-border interchange fees.

Q4) 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?

Q5) 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?

- Whilst cross-border acquiring may be possible for some merchants within some industries, it is not a feasible replacement for local acquiring for the vast majority of merchants. The complexities involved requires significant in-house payments expertise for a merchant to instigate cross-border acquiring, whilst the setup does not support businesses with a physical site presence.

Q6) 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?

- We agree with this assessment. We do not anticipate that open banking will emerge as a viable alternative to card payments over the next five years, without interventions which address the following three core issues.

    1) Not possible: Existing regulations do not allow customer-not-present A2A payments. This includes grocery delivery where the final amount may vary from when the customer authorises payment (e.g. due to substitutions, weighted goods when).
    2) Not practical: The average transaction time with a card is 6 seconds, compared to 10-30 seconds with open banking. This difference in transaction speed is driven by requirements within the PSD2 regulation and Open Banking Standards for customers to be redirected to online or mobile banking to authenticate each transaction. This presents operational and customer experience challenges.
    3) Not economical: A2A payment fees are charged per transaction, unlike card fees which are predominantly ad valorem. This fixed cost model makes A2A payments prohibitively expensive for businesses with low value, high volume transactions. This reduces the economic incentive for retailers, including Tesco, to invest in A2A acceptance.

Q7) 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?

- A cap is the most effective way of achieving fair cross-border interchange fees, however this will not prevent the card schemes 'clawing back' reduced revenue via scheme fees and other bilateral deals with card issuers. Given the behaviour seen post the 2015 IFR, scheme fees should also be capped.

- Scheme fees are an issue for merchants of all sizes. We understand it is not feasible for most merchants to assess or interpret their costs for processing card payments, due to the opacity and complexity of Visa and Mastercard charging structures. Some charges are per transaction, some charged monthly, some quarterly, and some have a minimum floor. This is not a sign of a functioning market. Across the retail sector, these fees have increased by 28% alone from 2020 to 2021, while total Merchant Service Charges (MSCs) increased by 12%[1].

- Overall, the increasing cost of processing card payments, led by scheme fees, mean the total cost of card payments is now higher than when regulation capped interchange fees in 2015. The BRC finds the cost of collection is 0.41% for credit cards, 0.27% for debit cards and 0.16% for cash payments[2]. We acknowledge the PSR's existing conclusions that 'a substantial proportion of these increases are not explained by changes in the volume, value or mix of transactions'[3]. This is despite Article 5 of the same regulations prohibiting the circumvention of regulatory caps on interchange fees, including via scheme fees[4].

Q8) 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?

- With the increased rollout of SCA across the EEA, and the costs already levied on merchants for processing transactions via SCA, we do not believe that fraud differentials are sufficient to justify a five-fold interchange fee increase.

Q9) 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:

Q9a) the UK is part of SEPA

Q9b) 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?

- As per Q8, we do not believe that there is any conclusive evidence of higher fraud levels for UK-EEA transactions, particularly considering the increase of SCA within these transaction types.

Q10) Do you have any views about our analysis and provisional 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?

- We agree with this assessment, given previous observations about how the IFR preceded increased fees elsewhere.

Q11) 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)?

- No.

Q14) 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?

- We agree (please see Q6). It is also possible that solutions, such as open banking or bank transfers, could adopt a similar interchange model in the future if not regulated.

Q15) 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?

- We agree. Surcharging customers based on their location would unfairly penalise customers and would not amount to fair outcomes from the payments market.

Q16) 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.

- We agree. Any card scheme rule changes to cross-border processing would not negate the many operational and financial complexities and challenges involved.

Q17) 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?

Q21) Are there other remedies we should consider either on an interim or long-term basis?

- We agree, subject to consideration of a further initial reduction in an interim period to account and allow recovery for merchant costs from the extended overcharge since 2021. This initial reduction before permanent caps are implemented should be applied to both inbound and outbound interchange fees. Bank transfers are used as the cost comparator for retail payments, which has led to caps for UK-EEA inbound CNP transactions being set too high. We believe open banking should form the cost comparator.

Q22) Is there anything else we have not considered and you think we should consider?

- The findings from the PSR's Market Review on cross-border interchange fees should be used to inform the parallel market review into scheme fees and other strategic activities. For example, the interim report highlights the higher costs associated with uncapped commercial cards.

- We would support commercial cards being brought into the scope of the IFR for domestic and cross-border transactions. [redacted] This increase alone is estimated to cost [redacted] with no associated business benefit, but with a downstream impact onto customers via our small business wholesale partners. Interchange fees for commercial cards are much higher than consumer cards. This penalises firms predominantly operating in B2B markets.

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[1] payment-survey-2022_final.pdf (brc.org.uk)
[2] payment-survey-2022_final.pdf (brc.org.uk)
[3] PSR MR22/1.1 Market review of card scheme and processing fees update and draft terms of reference
[4] 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) (legislation.gov.uk)

Teya

UK-EEA cross-border interchange fees

Interim report

Teya response

31.01.2023

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Chapter 3: Background

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?

[redacted]

Structure of four-party card schemes

The PSR has correctly noted the important players in the card value chain, as well as the commercial model around them. Four-party card schemes are an example of a two-sided network: merchants and their payment service providers (PSPs) i.e., acquirers on one side, and cardholders and their PSPs i.e., issuers on the other side. In the middle are card payment system operators, in this case, Visa and Mastercard, who manage their respective scheme rulebooks – including the setting of different fees – and provide the infrastructure for the authorisation and clearing of transactions by facilitating communications between issuers and acquirers.

Similar to other networks, there are two types of fees: retail and wholesale. On the cardholder or payer side, the wholesale fees are the issuer scheme and processing fees, and the retail fees are the cardholder fees paid to issuers. On the merchant or payee side, the wholesale fees are the acquirer scheme and processing fees, and the retail fee is the merchant service charge paid to the acquirer. However, beyond these, the interchange fee (IF) is a unique attribute of four-party card schemes as they are paid by one side of the market to another i.e., by acquirers to issuers, on a per transaction basis. As rightly noted by the PSR, IFs vary along various factors, namely the type of card, transaction environment (card-present or card-not-present – CP and CNP), category of card, the region where the card is issued, and the region where the transaction occurs.[1] These fees are set multilaterally by the schemes, rather than through competitive bargaining between issuers and acquirers, and therefore can be referred to as multilateral IFs (MIFs).

The PSR notes Visa and Mastercard's rationale for this unique fee, which cannot be attributed as a wholesale or retail fee for either side of the market, as the need to compensate issuers for the costs

[1] Particularly with respect to the region factors: card schemes determine the region based on where the merchant is based (i.e., where the transaction occurs) as opposed to where the acquirer is based (this means that cross-border acquiring is restricted under the scheme rules).

to issue and manage cards. In particular, the schemes indicate fraud management costs for issuers as the reason for such fees. [redacted]

Types of IFs

Among the MIFs that were increased by Visa and Mastercard in 2021 following the post-Brexit regulatory gap between the EEA and the UK, the PSR makes a distinction between outbound IFs (where IFs are paid to EU issuers by UK merchants) and inbound IFs (where IFs are paid to UK issuers by EU merchants). While this will be discussed further below in the Chapter 8 discussion on administrative priorities, Teya believes that the present distinction is largely artificial. In other words, although the PSR has rightly noted that inbound IFs are regulated under the commitments made by Visa and Mastercard to the European Commission on inter-regional transactions, ultimately the increase in UK-EEA MIFs following Brexit included these fees and outbound IFs simultaneously. Therefore, considering that the PSR regulates Visa and Mastercard as regulated operators of payment systems (RPSOs) under the Financial Services (Banking Reform) Act 2013 (FSBRA), [redacted]

Price of Card-Acquiring Services

The PSR accurately notes the most prevalent pricing practices by acquirers in the industry, which include interchange plus (IC+ - interchange passed down at cost), interchange plus plus (IC++ - interchange and scheme fees passed down at cost), and blended rate (set pricing per transaction accounting for the transaction mix of the merchant). As found in the PSR's Card-Acquiring Market Review final report, IC++ is restricted to the largest merchants, with the overwhelming majority of SMEs being on blended pricing.

Regulation of MIFs

Prior to Brexit coming into effect on 31 December 2020, all four-party consumer card transactions within the European Economic Area (EEA) and the UK were subject to the Interchange Fee Regulation (IFR) caps of 0.2% and 0.3% for debit and credit cards respectively. These caps have been in force since 9 June 2016. However, the PSR is correct in finding that following the exit of the UK from the EEA, Visa and Mastercard concluded that the two jurisdictions were no longer the same region. As a result of this, the two schemes re-classified transactions made between the UK and EEA as *inter*-regional as opposed to previously *intra*-regional. Accordingly, there was a resulting regulatory gap: these previously regulated transactions were no longer capped. Therefore, Visa and Mastercard decided to raise the MIFs associated with such transactions, regardless of the direction of the flow of funds, to 1.15% for debit and 1.5% for credit card transactions.

The reason that the international card schemes opted for these figures is because they are in line with the commitments they made to the European Commission following the *Mastercard/Nets* proceedings in 2019. These competition proceedings involved Commission scrutiny of the MIFs paid by EEA merchants to non-EEA issuers i.e., outbound inter-regional IFs (EEA-RoW). The PSR appropriately considers that the Commission in such proceedings included the UK as part of the EEA, as this was before Brexit formally came into force. Subsequently, Visa and Mastercard opted to enter into commitments to keep EEA-RoW outbound inter-regional IFs to the amount of 1.15% and 1.5%. After Brexit, the UK was classified as RoW, and the schemes adhered to the cap in the commitments to increase IFs to the aforementioned figures. However, the PSR importantly notes that the UK-EEA (UK-RoW) fees remain uncapped by the commitments. [redacted]

Teya also welcomes the PSR's decision to consider the UK's membership of the Single Euro Payments Area (SEPA). Despite the UK's withdrawal from the EEA, it remains in SEPA and is therefore able to benefit from the standardised payment arrangements for account-to-account payments with EEA countries. [redacted]

Merchant indifference test

The merchant indifference test (MIT) is the methodology used by the European Commission to arrive at the current level of the caps stipulated in the EU and UK IFR of 0.2% and 0.3% for credit and debit respectively. The evolution and eventual adoption of the MIT can be considered with the evolution of case law on European Commission proceedings against MIFs. The first decision of the Commission in respect of IFs was in 2002 – the Visa International negative clearance decision, where the Commission found MIFs to create a restriction of competition among Visa issuers and acquirers.[2] As a result of this initial ruling, Visa pre-empted Commission enforcement by proposing a methodology based on issuers' costs to determine the maximum level of the intra-EEA MIF. The Commission accordingly allowed the exemption, and the methodology led to IFs of 0.28% and 0.7% for intra-EEA debit and credit card cross-border IFs respectively.

However, following the Mastercard Infringement proceedings by the Commission in 2007,[3] it abandoned the issuer cost methodology. Accordingly, following discussions between Mastercard

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[2] Commission Decision 2002/914/EC – *Visa International – Multilateral Interchange Fee* (24 July 2002).
[3] Commission Decision 2009/C 264/04 on Case COMP 34.759 – *Mastercard* (19 December 2007).

and the Commission in 2008, the Commission requested the scheme to propose commitments based on the MIT. The MITs led to a commitment from Mastercard to the tune of the current caps, which were subsequently also proposed by Visa in 2010, and eventually enshrined into regulation in 2015 through the IFR.

The reason the Commission abandoned the issuer cost methodology is linked to the rationale it identified for the level of MIFs set by Visa and Mastercard. According to the Commission, the issuer cost methodology assumes that MIFs are charged by issuers in exchange for a benefit that they provide to merchants, with the 'payment guarantee' being cited most commonly by international card schemes. [redacted]

[redacted]

[redacted]

In other words, based on the leading academic literature on MIFs, Visa and Mastercard cards are 'must-take' as acquirers and merchants must accept these cards due to the fear of losing the business of consumers, whose banks can choose to issue their cards with either Visa or Mastercard. As a result, 'must-take' cards are defined as cards that merchants will continue to accept despite the marginal benefits from a transaction being lower than the marginal costs. [redacted]

While issuing banks single home (i.e., choose between either Visa or Mastercard to issue their cards), acquirers must multi home (i.e., accept both Visa and Mastercard). [redacted]

[redacted]

[4] Ibid., paras 704-705.

[redacted]

The MIT was a direct consequence of the above analysis on must-take cards. As merchants accept cards in cases where the marginal costs of acceptance exceed the marginal transactional benefits they get from accepting cards as opposed to alternative forms of payments, the MIT should cap MIFs at the level where merchants become indifferent between accepting cards in comparison to cash (for a non-repeat customer). The decision to use the MIT, which relied on a comparable payment instrument as a benchmark out of design, was a public policy decision based on the perceived inefficiency of the comparable payment instrument itself – cash. This is mentioned in the IFR recital:

> *"The 0.2% and 0.3% caps…are based on the so-called 'Merchant Indifference Test'…It thereby stimulates the use of efficient payment instruments through a promotion of those cards that provide higher transactional benefits, while at the same time prevent disproportionate merchant fees, which would impose hidden costs on consumers…"*[5]

To elaborate, the Commission perceived the issue with interchange fees as being that consumers must face hidden costs. In the absence of surcharging, merchants will pass on the costs of accepting cards – which due to MIFs were higher than those of cash – to *all* customers, including those who pay with cash. As a result, setting IFs at a level equivalent for merchants to the costs of accepting cash would result in consumers facing equivalent costs across the board, while bringing the lower societal costs that card payments present. Simply put, the MIT was to be used to set the MIFs at a level where card usage is maximised i.e., by finding the optimum balance between preventing merchant reluctance to accept cards while providing issuers sufficient incentives to issue cards (and therefore cardholders to use cards). [redacted]

General analysis of all MIFs

[redacted]

[5] Interchange Fee Regulation (2015), recital 20.
[6] In 2021, 90% of all retail turnover came from cards as per the British Retail Consortium's Payment Survey.

Chapter 4: Competitive Constraints

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?

[redacted]

[redacted]

[redacted]

[redacted] Therefore, while the type of pricing (i.e., IC++, IC+, blended) may determine to a small extent how acquirers are able to mitigate the increased cost burden from the 400-475% increase in UK-EEA CNP MIFs, their ability to set a competitive retail price (MSC) for their merchant is constrained.

[redacted]

[redacted]

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?

The PSR rightly considers that there are three ways that merchants can respond to constrain a rise in IFs: declining or limiting card acceptance, merchant relocation, and consumer steering.

Declining or limiting card acceptance

As mentioned above, the must-take nature of Visa and Mastercard means that merchants must accept both brands. Therefore, declining card acceptance is not a viable method, particularly in an online cross-border setting such as in UK-EEA CNP transactions, [redacted]

[redacted] Teya also agrees with the PSR noting here that while mega merchants such as Amazon may individually place competitive pressure on IFs or SFs by threatening to stop accepting cards, in return they are only able to constrain their cost burden. The vast majority of merchants, particularly the smallest businesses, remain subject to increasing IFs and SFs.

Merchant relocation

As considered above, the card scheme rules prevent cross-border acquiring, therefore making merchant relocation the only means by which merchants could restrain the rise in IF costs by reclassifying transactions as intra-regional as opposed to UK-EEA inter-regional. To elaborate, this can only be facilitated if the merchant is geographically situated within the same region. In a CNP context, this involves creating entities in the UK or EEA respectively to render such transactions intra-regional and thus apply the previous IF levels of 0.2% and 0.3%. This approach is only viable for large enterprises and SMEs are unable to relocate their businesses. Therefore, the PSR rightly finds that merchant relocation is not a viable means for merchants to constrain the increases in IFs.

Consumer steering

The only means through which a merchant can steer a consumer away from card transactions is through nudging them using UI/UX features. This is because although merchants are legally allowed to recognise cards issued in another jurisdiction and accordingly surcharge them, this is not a viable option. [redacted]

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?

Teya agrees with the PSR's analysis that cross-border acquiring is not currently possible. This is because card scheme rules require the classification of a transaction based on the location of a merchant rather than the acquirer. [redacted]

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?

As stated above, merchant relocation does not provide an effective competitive constraint as only the largest enterprise businesses are able to do so. SMEs, who comprise the majority of the businesses affected by Visa and Mastercard's decision to increase IFs, do not have the monetary, time, or skills resources to create entities in other jurisdictions and facilitate the selling of goods through that new entity.

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?

[redacted]

[redacted] Examples include digital wallets and the majority of buy-now-pay-later (BNPL) transactions.

[redacted]

[redacted] This is because current industry practice is not to surcharge customers, and therefore this creates inertia preventing merchants from being the first to begin surcharging such transactions following Brexit.

[redacted]

[redacted]

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.

[redacted]

Chapter 5: Stated Rationale for Increases

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?

[redacted]

[redacted]

[redacted]

[7] https://www.gov.uk/government/publications/uk-eu-memorandum-of-understanding-on-financial-services-cooperation/uk-eu-memorandum-of-understanding-on-financial-services-cooperation.

[redacted]

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?***

[redacted]

[redacted]

[redacted] This is because, as mentioned above, UK and EEA regulations (particularly on consumer protection) have not diverged significantly post-Brexit, UK and EEA regulators regularly cooperate in light of Memorandums of Understanding signed between the two governments, and the banks of both regions adhere to similar payment rules due to them being part of SEPA.

Question 10

Do you have any views about our analysis and provisional 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?

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[8] The schemes have agreed to do so following the 2002 *Visa Exemption* decision by the European Commission.

[redacted]

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)?

[redacted]

[redacted]

Chapter 6: Impact of the Increases

Question 12

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

[redacted]

[9] See, for instance, this blogpost highlighting the disconnect between collateral taken by the schemes from issuers and the degree of the settlement risk that collateral is aimed to cover.

[redacted]

Chapter 8: Inbound Interchange Fees

Question 13

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

EEA-UK Inbound IFs

[redacted]

[redacted]

UK-RoW Outbound IFs

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted]

[10] By indirect IFs, we refer to circumvention of the IFR caps through rises in scheme and processing fees on the acquiring side, which are used to fund discounts, rebates, and incentive payments to issuers of values that are greater than their scheme fee costs.
[11] https://www.ecb.europa.eu/stats/ecb_surveys/space/html/ecb.spacereport202212~783ffdf46e.en.html.

Chapter 9: Potential Remedies and Next Steps

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?

[redacted] It is important to highlight that both merchants and their acquirers are the players in the value chain with the biggest incentive to implement strategies that seek to reduce their cost of acceptance, given the vast majority of players cannot negotiate fees with the schemes. Therefore, the lack of any proven methods to do so absent regulatory measures is further proof that there is a continuous need for direct regulatory intervention into this problem.

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?

Yes, as discussed in previous contributions, Teya does not believe that surcharging or steering can help mitigate this or any increase in the wholesale cost of acceptance (i.e., interchange and scheme fees) and has not seen any evidence of these practices being systematically utilised to reduce the cost of acceptance. This is especially true for small businesses which have fewer resources to dedicate towards payment optimisation strategies and a more subject to the business stealing effect and the risk of cart abandonment.

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.

[redacted]

[redacted]

[redacted]

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?

[redacted]

[redacted]

[12] https://committees.parliament.uk/committee/158/treasury-committee/news/172852/visa-and-mastercard-respond-to-treasury-committee-on-card-fee-increases/#:~:text=The%20Treasury%20Committee%20today%20publishes,increases%20in%20card%20transaction%20fees.&text=In%20October%202021%2C%20Visa%20and,European%20consumers%20to%20UK%20businesses.

[redacted]

[redacted]

[redacted]

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?

[redacted]

[13] Sainsbury's [2020] reporting on the European Commission's views at paragraph 137.
[14] Sainsbury's [2020] at para 137

[redacted]

> [redacted]

[redacted]

> *The EC issued several SOs against Visa International (in 2009, 2013 and 2017) and one SO against Mastercard (in 2015). The main allegations are as follows. First, Visa International and Mastercard, despite their respective IPOs, remain associations of undertakings as the two conditions mentioned in the Court of Justice of the European Union (CJEU) 2014 Mastercard judgment were met, i.e. (1) issuers and acquirer retained important decision-making powers in respect of essential aspects of the operation of the scheme; and (2) the existence of a commonality of interest between the scheme and issuers/acquirers on the issue of IF (read: a commonality of interest in a 'high' default IF).*
>
> *Second, the interregional IF 'amount to horizontal price-fixing [...] Such price fixing is by its very nature harmful to competition and reveals in itself a sufficient degree of harm to competition to be considered a restriction of competition "by object".'69 The Visa and Mastercard inbound interregional IF are not objectively necessary to the operation of the Visa and Mastercard schemes.*
>
> *Third, The Visa and Mastercard inbound interregional IF did not meet the conditions for an exemption. Visa International and Mastercard both offered commitments to the EC. Both schemes proposed to reduce the default IF applicable to inbound interregional transactions. The EC accepted the commitments and made them binding in two decisions dated 29 April 2019.*

---

[15] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX%3A32015R0751

[redacted]

[redacted]

[redacted]

> *The MIT, which is also known as "the tourist test", is an economic methodology developed by Professors Rochet and Tirole, initially in a paper published in 2008. It embodies the notion that there is a level of MIF which, when included in the MSCs paid by merchants, equalises the cost to merchants of accepting a scheme card with the cost of their accepting other methods of payment such as cash. If the MIT is set at that level, a merchant would be indifferent as to whether a one-off customer (such as a tourist) chooses to pay with cash or card, so long as he does not choose to shop elsewhere. If, however, it is set at a higher level, while a merchant could in principle be better off by refusing to accept scheme cards because other forms of payment would be cheaper, in reality, if he did so, he would probably lose sales to rivals who did accept them ("the business-stealing effect"). There are "must-take cards" that merchants cannot turn down. The MIT seeks to put an upper limit on MIFs so that the schemes are not able to exploit their market power over merchants in this way (Rochet and Tirole, Must-Take Cards: Merchant Discounts and Avoided Costs, (2011) Journal of the European Economic Association 9(3): 462 at 463)*

[redacted]

[redacted] [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

"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."

[redacted]

[redacted]

[redacted]

"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."

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

> *"Transactional benefits of card payments need to be measured relative to another means of payment. At least as far as face-to-face payments are concerned, cash appears to be a natural comparator as it is legal tender and it is the most used alternative to cards (it makes up the largest proportion of non-card retail payments). Furthermore, cash has no MIF attached to its use – an important criterion when selecting a comparator for cards in the context of the MIT, to avoid endogeneity problems."*[17]

[redacted]

[16] https://competition-policy.ec.europa.eu/system/files/2021-01/visa_mastercard_commission_observation2_en.pdf
[17] https://ec.europa.eu/competition/sectors/financial_services/dgcomp_final_report_en.pdf

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Question 19

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).

a. ***What, if any, implementation costs will be incurred from these?***

b. *Are there any other costs that may be incurred by market participants?*

Benefits

Beyond a reduction in the cost of acceptance for merchants, and small businesses in particular, Teya sees two additional benefits to an interim cap: (1) more competition between acquirers and (2) a lower competitive distortion against alternative payment methods such as account-to-account. The first benefit would emerge from acquirers swiftly adjusting the cost of acceptance and being able to provide a lower overall price to merchants in order to win sales, leading others to the same. The second benefit, as outlined multiple times in the answers above, would emerge from issuers receiving less revenue from their card transactions and thus being more willing to consider alternative payment methods to offer to consumers, since they are less concerned it would cannibalise their card transactions.

[redacted]

Costs

Teya does not expect an interim cap to impose any material costs on market players or merchants. PSPs offering unblended pricing models will start to immediately pass down the savings from the interim cap, similar to how they pass down any negative or positive change in fees. PSPs offering blended prices will likely be quick to change the MIF in their estimation models, in order to unlock savings for merchants in an effort to both retain and attract customers, given other players are likely to do the same. Furthermore, since the PSR's analysis found issuers did not utilise the additional interchange revenue for any particular purpose, there is no cost associated with a reduction in interchange.

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?

As explained above, Teya believes that the preferred remedy would not impose any additional cost to market participants compared to any typical change in fees. The change would be implemented precisely like any other change in the cost of acceptance estimations of Acquirers.

Question 21

Are there other remedies we should consider either on an interim or long-term basis?

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[18]Guidance on the PSR's approach to monitoring and ensuring compliance with the Interchange Fee Regulation https://www.psr.org.uk/media/y4qhglmn/ifr-guidance-annex-1-sept-2021-clean.pdf Glossary, page 88

[redacted]

- [redacted]
- [redacted]

[redacted]

[redacted]

[redacted]

Question 22

Is there anything else we have not considered and you think we should consider?

[redacted]

[19] Ibid.
[20] Ibid.

UK Finance

UK FINANCE

PSR Cross Border Interchange Fees Interim Report - Consultation Response

Date: 14.02.2024

Address: The Payment Systems Regulator, 12 Endeavour Square, London E20 1JN

Sent to: cardfees@psr.org.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

Executive Summary

Issuers:

- Generally do not support an interim cap – there is in an insufficient body of evidence or a demonstrated urgent and material need to do so
- The approach in the Interim Report draws wide conclusions from a slim body of evidence – even stating the purpose of interchange is to incentivise issuers to sign up to one four party scheme or the other - that conclusion is not accepted
- Merchant costs are important, but the Interim Report focusses on those costs alone, too readily dismissing the value of cards to the UK economy as a whole, to merchants and to consumers
- The approach should bear in mind the Future of Payments Report which states the cards work well and that the UK has one of the leading card propositions globally – it also recognises that sustainable commercials are required for open banking (as does JROC) and this principle should apply to the cards industry too
- Any future study on pricing (such as a merchant indifference test) needs to take into account merchant cost, but also the other success factors embedded in the card proposition to merchants and consumers

Merchant Acquirers:

- Are more supportive of reduced costs
- Are concerned about the practical implementation on their core platforms and how much notice they will have to execute

1. Introduction

We welcome the Payment Systems Regulator's (PSR) review of cross border card interchange fees and its interim report (the “Interim Report”). We acknowledge the complexity of this issue, especially given the varying perspectives arising from different business models and roles within, or outside, the four-party arrangement.

This response first considers views from the issuer community. Acquirer views are represented in section 10 below.

2. Context

2.1 It is worthwhile recalling a broader context, before considering the issues raised in the Interim Report.

2.2 The legal position post-Brexit led to the removal of the Interchange Fee Regulation (IFR) 0.2% cap for debit card and 0.3% cap for credit card transactions for transactions between the EEA and the UK. In the absence of any applicable cap, Mastercard and Visa changed their multilateral default rates to the rates set out in the EU Commitments[1]. It is worth noting that the EU Commission concluded that these caps ensure costs for retailers accepting inter-regional consumer card payments did not exceed those of alternative methods, such as cash or e-wallets. These commitments expire in late 2024.

2.3 The focus of the cross-border interchange consultation is on interchange fees payable to EEA issuers by UK acquirers, while the review of interchange fees payable to UK issuers by EEA acquirers has been stopped. We believe that the reduced scope means that the consultation now covers only a few per cent of all UK card transactions processed by UK acquirers.

2.4 The Interim Report finds that the increase in cross border interchange fees post Brexit did not correspond with any increased issuer risks, costs, or added value. The Interim Report also notes that the PSR did not see any evidence of any difference in the risk and costs to issuers between domestic and cross border transactions.

2.5 The Interim Report's approach is based on the economic theory of pass-through, suggesting that reductions in merchant acquirer input costs should ultimately benefit consumers (to the extent this is passed on by acquirers to merchants).

2.6 The Interim Report sets out proposals to reintroduce the IFR caps to transactions between UK merchants/acquirers and EEA consumers/issuers as an interim measure and to conduct a further study to set a long term cap for those transactions, using a merchant indifference test (MIT).

2.7 Joe Garner's Future of Payments Review Report was published in November 2023[2]. It called for a National Payments Vision and recognised merchant costs as an issue but placed greater emphasis on the lack of viable alternatives to card payments. It recommended the development of open banking with necessary consumer protection and commercial arrangements for all participants. The Review noted the efficiency of card systems in serving both merchant and consumer needs and that they work well.

2.8 Developments in the field of open banking may provide some useful context. In June 2023, the Joint Regulatory Oversight Committee (JROC) published its Principles for Commercial Frameworks for Premium APIs[3] (the "JROC Principles"). To some degree some of those principles are relevant to any payments system, including cards. The relevant principles set out that fees and charges should:

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[1] Antitrust: Commission accepts commitments by Mastercard and Visa to cut inter-regional interchange fees (europa.eu),

[2] https://assets.publishing.service.gov.uk/media/6557a1eb046ed400148b9b50/Future_of_Payments_Review_report.pdf

[3] https://www.fca.org.uk/publication/corporate/jroc-principles-commercial-frameworks-premium-apis.pdf

• broadly reflect relevant long-run costs (Principle 1)
• incentivise investment and innovation (Principle 2)
• incentivise take-up of open banking by consumers and businesses and use of network effects (Principle 3)

These principles support the general concept that costs, innovation and investment need to be funded within the system. In open banking, the solution is to provide income for sending banks through a premium API charging model. In cards, issuers invest and incur costs (such as claims, service, security, fraud, digital wallets, card specific platform and innovation – these are all card related, not general banking overhead and are "relevant" long-run costs (Principle 1 above)). We do not think there is any good reason why the concepts applicable to open banking should not apply to the cards system.

2.9 The PSR is also consulting on its proposals to accelerate open banking in the field of variable recurring payments[4]. On the basis that account banks do not have relevant costs, the initial approach requires banks to facilitate the services without earning income for enabling account access.

Response to Consultation

3. Issuer concern : Legal certainty

A matter of current concern for many UK issuers is the legal risk that even at a prescribed cap, the interchange concept and rates are susceptible to legal challenge based on an alleged breach of competition law. This situation risks clogging up the UK competition and appeal courts for years and leaving issuers and schemes with potential long-term liabilities, which in turn cast unnecessary doubt over long term commercial returns and investments. Whatever the outcome of this consultation may finally be, issuers wish any cap to be legally certain and immune from further competition law challenge. This applies to domestic and cross border interchange. It is acknowledged that such an approach may be beyond the powers of the PSR and engagement with HM Treasury will be required to achieve certainty through legislation.

4. EEA Context

4.1 The EU Commitments cover cross border interchange receivable by "Rest of World" issuers outside the EEA, payable by acquirers within the EEA. The European Commission accepted the commitments made by Visa and Mastercard in 2019: "*The Commission concluded that, with the proposed inter-regional MIFs caps, the cost for retailers of accepting inter-regional consumer card payments does not exceed the cost of accepting alternative means for such payments, such as cash for Card Present Transactions and e-wallets (digital wallets) funded via bank transfers for Card Not Present Transactions*".

4.2 Post Brexit, the IFR regulation no longer applied to UK-EEA cross border card transactions. The Interim Report finds that the EU Commitments' cross border interchange rates were not an appropriate comparable to use for setting UK-EEA cross border interchange. The rationale is that the UK's continued access to the European SEPA payment scheme, differentiates the UK-EEA relationship from the EEA-Rest of World (non UK) relationship, in the context of inter-regional card payments and alternatives.

4.3 However, the Interim Report notes that SEPA payments for EEA consumer / UK merchant cross border payments are not a viable alternative to cards. We therefore question whether the inter-regional differentiation between the EEA and the Rest of World, based on SEPA

[4] CP23/12 VRP Expanding variable recurring payments: call for views (psr.org.uk)

access, is justifiable. Further, there is some merit in the argument that in the absence of any direct UK legislation or coordination with the EU, the rates set by the four party card schemes were as close to being legally certain than any other option, including maintaining at domestic rates (which as we note above are subject to legal uncertainty).

5. Proxy for a bigger issue?

5.1 The Interim Report concludes that post Brexit there is no evidence of a direct correlation between cross border interchange income and how that income was used to invest in fraud risk mitigation or improve services. The conclusion is based upon an assumption that the IFR rates were set by the EU at the appropriate level for intra EEA cross border card payments.

5.2 The approach overlooks the likelihood that in the context of cross border UK-EEA transactions, issuers operate at a loss at the old IFR rates. The Interim Report also finds a lack of difference between the domestic and cross border contexts. However, there is insufficient exploration of the costs issuers incur in cross border transactions as compared to domestic transactions – for example, UK issuers contend that UK-EEA cross border transactional costs, fraud costs and the cost of handling non fraud disputes are all higher.

5.3 The approach overlooks that in some years there will be heavy investment when new features, authentication/fraud tools or propositions are rolled out and in other years the investment may be less. The Interim Report too narrowly expects that interchange income must be traced through to in-year line-by-line spend. In the context of the value issuers bring and the costs they incur in providing cross border payments and comparing UK domestic and UK-EEA rates, more focus is needed on the baseline differential (rather than merely the post Brexit differential) between UK domestic transactions and UK cross border transactions.

5.4 All the above factors and assumptions lead to a generalised and unsubstantiated conclusion about the purpose of interchange (not just cross border) – namely to incentivise issuers to sign up to one four party card scheme or the other. Industry strongly rejects this assertion.

6. The Broader Policy Context.

6.1 Regulatory intervention should be made in the broader context of where the UK payments industry is today and where it needs to be in the future. In particular, the UK is preparing to launch a National Payments Vision as recommended by the Future of Payments Report. Recommendation 7 of that report states that policy makers need to "…*prioritise agreement of a commercial model for Open Banking so that there is scope to invest in both infrastructure and consumer protection. Without sustainable financials, it is hard to see that Open Banking can thrive over the long term*". The JROC Principles are caste along similar lines. The Future of Payments Report and the JROC Principles clearly identify the need for commercial arrangements to pay for the end-to-end proposition of a payment type. However, when looking at cards alone, the approach in the Interim Report, completely overlooks the propositional features present in cards that need to be built in open banking to compete with cards (e.g. customer protections). It is difficult to understand why zero interchange is mooted for cards, but commercials are proposed for open banking.

6.3 The approach in the Interim Report is stated to be on the basis of the PSR's statutory objectives (which include competition, service user and innovation objectives). Having overlooked baseline value and true costs, the focus becomes one of competition (by way of merchant cost) at the expense of service and innovation. Competition and payment policy should be promoting competition of payment types based on the end-to-end proposition for all users. A more balanced approach would of course include merchant cost, but also take into account the costs and investments incurred by all industry participants that develop value for both merchants and consumers alike, including speed, security, fraud protection, resilience, consumer experience and consumer recourse.

6.4 A more consistent policy approach is needed, that recognises that the value and proposition of any payment type requires commercials for all PSPs that cover costs and pay for innovation and investment.

7. Lack of Merchant Choice and Cost

7.1 The Interim Report notes that for merchants, cards are "must take" because alternatives either do not exist or are too expensive. Both statements can be challenged, for example e-wallets funded by e-money are widely available to consumers and businesses. Cards can represent a cheaper option that alternative payment methods and it seems odd that the Interim Report rules them out as an alternative option because they may be more expensive. E-wallet providers may actually challenge that they are more expensive.

7.2 Some industry participants have put forward the view that the best way to deliver competition and give merchants choice is to pursue the approach set out in the Future of Payments Report and encourage alternative payment types by building propositions that can compete with cards. Some point out there is little evidence base in the Interim Report for the assumption that reduced merchant acquirer input costs (interchange) automatically leads to lower prices for consumers. A merchant cost approach to competition, founded on zero or below cost issuer / sending bank commercials could be counter-productive. It risks harm to the future innovation and safety of the UK payments industry as a whole, leaving it behind our international competitors and failing to realise its potential to power economic growth.

8. The Merchant Indifference Test (MIT) – "MIT +"?

8.1 The Interim Report notes that the MIT methodology is accepted as the best way to determine interchange. However, its application needs to be nuanced. Merchants are indifferent to many of the benefits that consumers enjoy from cards. Arguably, under competition law cases before the courts, the four party card schemes are being assessed against the value to merchants alone and cannot bring value to consumers into the argument. The PSR on the other hand has service user objectives that include value but industry is circumspect as to whether value is being considered sufficiently (and what that value costs).

8.2 When constructing the approach to the study, alternative payment types and their costs to merchants will be considered. The problem though is comparing "apples and apples". The cards "apple" offers a superior proposition (e.g. payment and fraud protection) to other options. We submit that the value elements to merchants and the consumers (largely paid for by the merchants) should be taken into account (e.g. a SEPA payment with no consumer protection is not the same as a card or other payment that carries consumer protection). Where one payment type has additional features over others, those features should be included in the framework for determining regulatory pricing or caps. The historic MIT approach did not consider issuers' costs. Issuers' costs include specific card industry elements such as Apple Pay, but there are significant other costs directly related to issuing cards that are not general banking overhead costs (such as card platform costs, card fraud prevention technologies, customer servicing and handling claims, amongst others). Placing caps potentially below the aggregate of those uncapped input costs is not going to increase competition in the issuing sector, nor support further development in innovation or fraud protection.

8.3 The future study should take into account some of the pricing principles set out by JROC and the commercial principles set out in the Future of Payments Report. Payments incur costs and require investments to deliver the broader value to all users. The costs to issuers and the benefits to consumers and merchants must be taken into account, in addition to merchant costs, when considering the future level of interchange. The future methodology should therefore be “MIT +”.

9. Interim Cap

Issuers have expressed strong opinions that an interim cap is inappropriate. It would be somewhat unprecedented to impose a regulatory price cap, in the absence of a full body of evidence and impact assessment demonstrating a need for it, or what that price should be. Whilst the cross border rates did increase, the Interim Report does not assess the current levels. In any event, interchange remains a small proportion of a merchant’s total input costs (as compared to other input costs like energy, staff, raw materials etc). Imposing a temporary price cap, in the absence of an urgent and materially significant costs shock to merchants is also inappropriate. There is the potential that a temporary cap imposed in such circumstances will create a dangerous precedent in the UK more widely. The issuers point to the likelihood that a temporary cap sets expectations as to where a final cap will land and could be materially prejudicial.

10. Acquirer perspectives

10.1 The response comments above come from an issuer perspective. The following section is a merchant acquirer only view.

10.2 Acquirers are more supportive than issuers of reducing cross border interchange, as they argue that will ultimately benefit merchants. However, several acquirers have told us that implementing a new regime will require significant operational changes and is more than a mere “switch”. For some that may involve creating a new “region” in their systems. For example, the current UK-EEA flow of card transactions in both directions would be treated as a single region. Imposing a cap on one way traffic which differs to traffic the other way, means that an acquirer will need to split the existing region into two. The change would impact interchange ++ and blended pricing and is a portfolio and platform issue. This development work is significant and depending on an acquirer’s current configuration could take over 12 months. Those acquirers that created the new region when the new cross border rates were introduced will need to unwind that programme and start again. Those that did not build a new region in their systems (and thereby may have absorbed the increases in interchange) may need to initiate a new programme on their platforms.

10.3 Further, leaving aside the core platform change issue, repricing merchants is extremely complex and requires considerable analysis, in part related to the Consumer Duty. Portfolio repricing has to be planned and scheduled and usually occurs at periodic intervals.

10.4 Therefore acquirers request a reasonable period of notice before any new interchange caps are applied so that they can consider and execute any pricing and platform changes required.

10.5 Some acquirers told us that merchants want some certainty as to their future costs. Some also would rather implement any change once, not twice. Some would rather the old IFR cap became permanent as soon as possible, but this leaves open the legal and evidential basis for doing so. Other acquirers would rather wait until a full study is completed and are therefore not supportive of the two-step interim-then-final cap approach.

10.6 Acquirers accept that they generally pass on interchange onto merchants although they point out that interchange is only one of the factors that impact their final pricing to merchants.

10.7 Acquirers look forward to engaging on the costs study to make sure all relevant factors are considered, including the costs to them for making platform changes, costs and fair value for merchants but also ensuring all PSPs have sufficient economics to invest in innovation and value for payment service users.

If you have any questions relating to this response, please contact the below at [redacted]@ukfinance.org.uk.

[redacted]

END

Visa

VISA'S RESPONSE TO THE PSR'S CROSS-BORDER INTERCHANGE MARKET REVIEW INTERIM REPORT OF 13 DECEMBER 2023

1. Executive Summary

1.1 Visa welcomes the opportunity to respond to the PSR's interim report (***IR***) on the interchange fees (***IFs***) applicable to Visa (and Mastercard) consumer debit and credit 'Card Not Present' (***CNP***) transactions between UK merchants and EEA cardholders (***XB CNP Transactions/IFs***).[1]

1.2 In line with the PSR's statutory objectives,[2] Visa believes in well-evidenced regulation that promotes the best interests <u>of all users</u> – i.e., merchants, cardholders, issuers and acquirers. Given this, and Visa's delivery of a valuable payment system that enables millions of transactions to take place every day between UK merchants and EEA cardholders/issuers, Visa has serious concerns with the proposals set out in the IR.

1.3 In particular, despite the PSR's market review having been ongoing for almost two years, the IR makes clear that the PSR has not yet conducted the analysis that it itself says is necessary for assessing Visa's XB CNP IFs.[3] Nonetheless, the IR proposes to short-circuit the principles of good regulation by assuming that Visa's XB CNP IFs are "*likely to be unduly high*"[4] and, on that basis, suggests that it should intervene in an unprecedented manner by itself setting the IFs applicable to Visa's (and Mastercard's) XB CNP Transactions – both on an interim basis *before conducting any analysis*, and then again on an enduring basis.

1.4 Such an approach is legally and economically unsustainable. As explained in:[5]

(a) **Section 2 below**, <u>the IR contains no evidence of Visa's XB CNP IFs being "*unduly high*"</u>. Rather, it confirms the PSR has still not devised "*an appropriate and proportionate methodology*" for any such assessment, that doing so will "*likely take considerable time*" that may involve another "*18 months*",[6] and that any such assessment should be based on a comparison against only merchants' cost of accepting SEPA bank transfers - despite SEPA bank transfers being barely (if ever) used by UK merchants and EEA cardholders for

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1 CNP transactions are those where a cardholder is not physically present at the merchant's point of sale. The majority of CNP transactions comprise digital transactions that take place, for example, over the internet. Other CNP transactions captured by the PSR's review include transactions administered over the phone.

2 See sections 50-52 of the Financial Services (Banking Reform) Act 2013 (***FSBRA***) in which:

a. the competition objective as set out in section 50 FSBRA requires the PSR to "*promote effective competition […] in the interests of those who use, or are likely to use*" Visa's payment system, including by having regard to "*the needs of different persons*", "*the ease*" with which they may use Visa, and "*the ease*" with which they may "*change*" to using another payment alternative;

b. the innovation objective as set out in section 51 FSBRA requires the PSR to "*promote the development of, and innovation in, payment systems*" for all users, with a focus on improving the "*quality, efficiency and economy*" of payment systems; and

c. the service user objective as set out in section 52 FSBRA requires the PSR to ensure "*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*" them.

3 IR, para. 1.16.

4 IR, paras. 1.12, 9.70.

5 To the extent this response does not comment on any part of the IR, this should not be understood as Visa's agreement with those parts of the IR.

6 IR, paras. 1.17 and 9.45.

XB CNP Transactions and therefore an irrelevant consideration for the purposes of the PSR's market review;[7]

(b) **Section 3 below**, the IR contains no evidence for why IFs of 0.2%/0.3% are more appropriate for XB CNP Transactions than Visa's current levels. The IR also ignores that all of the available evidence makes clear that this is not the case. This includes Visa's submission of an expert economist-led 2023 Merchant Indifference Test (***MIT***) assessment, endorsed by the co-creator of the MIT Professor Jean Charles Rochet, which finds XB CNP IF levels of up to [2.50-2.90%] – i.e., significantly higher than Visa's current XB CNP IFs of 1.15%/1.50%;

(c) **Section 4 below**, sections 54 and 55 FSBRA do not confer any power upon the PSR to impose the interim 0.2%/0.3% XB CNP IFs and enduring XB CNP IFs it has proposed. The IR admits itself to not yet having conducted the necessary analysis as to the appropriate powers and expresses doubt about having any legal basis for these proposals, as reflected in its proposal to consult specifically on its "*legal instrument*";[8] and

(d) **Section 5 below**, the IR's unprecedented proposals, in particular its proposed interim cap, do not reflect due process and risk distorting competition and benefits for UK merchants. Visa informed the PSR about its proposed XB CNP IFs three years ago. Despite this, and the market review itself now being two years in and still without any analysis or consultation with even a single EEA issuer/consumer, it is clear that such a significant 'interim' change lacks any evidence or urgency, and is therefore not justified.[9]

1.5 Visa is also concerned that the IR fails to reflect that IFs applicable to XB EEA to UK 'Face-to-Face' (***F2F***) transactions and UK domestic transactions have not changed, and remain at 0.2%/0.3%. On that basis, and following the UK's departure from the EU, Visa took a carefully balanced decision to revise its EEA to UK XB CNP IFs in line with:

(a) the IF levels that it had agreed to apply for UK to EEA XB CNP transactions with the European Commission (***EC***) (the ***EC's 2019 Visa Commitments Decision***) following an extensive competition law investigation;

(b) the PSR having expressly acknowledged the changed status of UK/EEA transactions by referring to them in its post-Brexit statement as transactions now involving "*third countries (for example, the USA or Australia), including the UK*", and by making clear that such transactions would be "*subject to interchange fee caps set out in the commitments made by Visa and Mastercard to the European Commission in 2019*" and that "*the PSR does not monitor or have any role with respect to them*";[10] and

(c) the harmonised EU Single Market Interchange Fee Regulation (***EU IFR***) ceasing to apply to the UK, coupled with the UK Government expressly deciding against retaining the EU IFR caps for anything other than UK domestic transactions in the 'UK onshored IFR'.[11] Again,

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7 IR, paras. 5.57, 5.89 and 5.145.

8 IR, paras. 9.140 and 9.145.

9 PSR Powers and Procedures Guidance, para. 4.43: "*We may use our FSBRA powers to take urgent action, including the use of interim measures, where appropriate… to … address a negative impact that has already occurred.*"

10 See the PSR's IFR and Brexit statement available at: https://www.psr.org.uk/our-work/card-payments/the-ifr-and-brexit/. Visa welcomes the PSR's proposal to close its review into Visa's IFs for consumer CNP transactions between UK cardholders and EEA merchants (see IR, para. 8.13).

11 UK's Interchange Fee (Amendment) (EU Exit) Regulations 2019 (the ***UK IFR***).

the PSR stated at the time that "*consumer cross-border card payments between the UK and EU (or any other third country), where either the acquirer or issuer is based outside the UK's jurisdiction, are no longer subject to the interchange fee caps established under either the UK IFR or EU IFR*".[12]

1.6 By adopting this approach, Visa has ensured that its XB CNP IFs reflect the consistent and significant body of expert economic evidence that shows that the continued application of the 0.2%/0.3% EU IFR caps would be unjustified and inappropriate for these transactions today. Visa has also ensured that:

(a) UK merchants continue to benefit from Visa participating in a level competitive playing field, particularly in circumstances where IFs comprise issuer (and not Visa) revenue, and the consequence of cardholders turning to popular non-four-party card scheme alternative payment methods (such as American Express, PayPal and Klarna) is that UK merchants would pay significantly *more*, and not less, than the cost of accepting a Visa card;

(b) the UK payments ecosystem is currently thriving in a way that is consistent with the statutory objectives underpinning this market review. In particular, merchants and consumers can and do change between different payment alternatives with "*ease*", and benefit from "*quality and efficiency*" and continued "*innovation in payment systems*";[13] and

(c) Visa XB CNP IFs, which apply to less than 2% of UK merchant transactions, give rise to an impact of less than 1 pence per UK merchant transaction. Indeed, given the limited IF changes that have been introduced by Visa, 98%+ of UK merchant transactions have seen no impact whatsoever.

1.7 Visa supports proportionate,[14] outcomes-focused regulation that is grounded in current and relevant evidence, and which seeks to promote the future growth and competitiveness of the UK economy. That, however, is not the approach of the IR, which does not provide any justification for its expansive and unprecedented conclusions and proposals, fails to give due consideration and weight to key bodies of evidence, does not stand to further the PSR's statutory objectives, and fails to recognise the vital role of Visa's payment system in supporting the stability and resilience of UK payments – and its benefits for UK merchants and the UK economy more generally.[15]

1.8 Visa continues to welcome regulatory engagement which furthers these outcomes, as Visa has done through the period of this market review.

2. THE IR CONTAINS NO EVIDENCE OF VISA'S XB CNP IFS BEING "UNDULY HIGH" AND CONFIRMS THE PSR HAS NOT YET IN FACT UNDERTAKEN ANY SUCH ASSESSMENT

2.1 The IR contains no evidence of Visa's XB CNP IFs being "*unduly high*". To the contrary, the IR states that the PSR does not yet have "*an appropriate and proportionate methodology that*

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12 See the PSR's IFR and Brexit statement.

13 See sections 50-52 FSBRA, in particular the competition, innovation and service user objectives.

14 See section 53(b) FSBRA, as also referenced in the IR at para. 2.22.

15 Visa notes that it is designated as a Recognised Payment System (subject to supervision by the Bank of England) and as a Regulated Payment System (subject to supervision by the PSR) in the UK due to its systemic importance for the stability of the UK's financial system and economy. See https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision.

measures the costs for merchants when accepting cards in comparison to their costs when accepting alternative payment methods", with such an assessment being necessary to "*deliver an appropriate outcome… in line with* [the PSR's] *statutory* objectives". The IR notes that establishing an "*appropriate approach… will likely take considerable time*", and that "*to generate and interpret the results based on that methodology [once developed], and to design and implement any resulting price cap... could take up to 18 months*".[16]

2.2 The IR is therefore clear that the PSR has not yet assessed whether Visa's XB CNP IFs are in fact "*unduly high*". Instead, the IR's proposals are based on a theoretical and pre-judged assumption that Visa's XB CNP IFs are "***likely to be***" unduly high.[17]

2.3 Such an approach does not accord with any principle of good regulation. It also gives rise to serious concerns given that, in order to substantiate this central assumption, the IR has relied on the following series of further theoretical assumptions:

- **A flawed assumption that Visa's XB CNP IFs should be assessed against only the cost of SEPA bank transfers**[18] – even though SEPA bank transfers are rarely (if ever) used for XB CNP Transactions, and the PSR has not, in any event, conducted any such analysis;
- **A flawed assumption that it would be appropriate for the PSR to dismiss all payment alternatives that are actually used for XB CNP Transactions**[19] – particularly three-party card schemes such as American Express, digital wallets such as PayPal and 'Buy Now Pay Later' (***BNPL***) providers such as Klarna; and
- **A flawed assumption that Visa's XB CNP IFs have benefitted Visa and have directly harmed UK merchants/SMEs** even though: (i) IFs are not retained by Visa and comprise issuer (and not Visa) revenue; (ii) XB CNP Transactions comprise less than 2% of UK merchant transactions, for which Visa's XB CNP IFs have had an impact of less than 1 pence per UK merchant transaction; and (iii) UK SME merchants are typically subject to 'blended' IF contracts which mean that, irrespective of the level at which Visa sets XB CNP IFs, such merchants will not typically see a one-for-one 'pass on' of every individual IF change (be they IF increases or decreases), to the extent there is any pass-on.[20]

2.4 Visa provides further detail in relation to each of these points below.

The IR wrongly assumes that Visa's XB CNP IFs should only be assessed against one single payment alternative, and for that payment alternative to comprise SEPA bank transfers

2.5 The IR asserts that Visa's XB CNP IFs are "*likely to be unduly high*" based on the UK continuing to be a member of SEPA and, on this basis, assumes that SEPA bank transfers are "*the relevant alternative*" against which Visa's XB CNP IFs should be assessed.[21]

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16 IR, paras. 1.16, 1.17, 9.45.

17 IR, paras. 1.12, 9.70.

18 IR, para. 5.145.

19 IR, paras. 4.111 – 4.112.

20 IR, para. 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*". See also para. 6.8 and the PSR's market review into the supply of card-acquiring services: Final report, November 2021, para. 4.90.

21 IR, paras. 5.57, 5.89 and 5.145.

2.6 Setting aside that the IR does not, in any event, undertake this assessment, this underlying assumption is fundamentally flawed because SEPA bank transfers are rarely (if ever) used for XB CNP Transactions. This is unsurprising given:

(a) **The nature of XB CNP Transactions** – which typically comprise travel (e.g. transport, hotel, tourism) and other discretionary transactions. For such transactions, EEA consumers are significantly more likely to use alternative payment methods such as American Express, PayPal and Klarna rather than a SEPA bank transfer (particularly if they require credit functionality which a SEPA bank transfer does not offer);

(b) **SEPA bank transfers do not feature in any leading payment industry reports** regarding EEA consumers' payment preferences for online transactions.[22] This includes Worldpay's 2023 Global Payments Report (***Global Payments Report 2023***) which does not list SEPA bank transfers as a 'popular alternative payment method' in any European country, but instead lists for example PayPal, Klarna, Apple Pay and Google Wallet, alongside popular card brands such as American Express and domestic card schemes;[23]

(c) **Given the lack of consumer demand, very few UK merchants accept SEPA bank transfers** – even when looking at large merchants such as Airbnb, Booking.com, Expedia, Ryanair, British Airways, Uber, ASOS, Harrods, John Lewis and Selfridges, which are most likely to benefit from significant volumes of XB CNP Transactions, none list SEPA bank transfers as an available payment option.

This is consistent with the merchant feedback received by the PSR in which[✂][24] and in which two such merchants stated 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*" ([✂]),[25] and that account-to-account payments have not been enabled because "*they are cumbersome to implement in a cross-border environment*" ([✂]).[26] Such considerations are likely to be more acute for smaller merchants, particularly as SEPA bank transfers are Euro-denominated and so UK merchants must either have a Euro bank account (which many smaller merchants will not have), or pay costly currency conversion fees to receive payments in GBP; and

(d) **SEPA bank transfers involve significant added friction compared with Visa and other popular payment methods** – which, particularly in an online and cross border context, consumers and merchants are more likely to be conscious of. These considerations include, for example: (i) the time, inconvenience, information sharing and error risks

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22 See, in particular Paysafe, 'Lost in Translation: Consumer Payment Trends 2023'. Accessible at: https://www.paysafe.com/en/lost-in-transaction-2023-download/. This report captures research conducted in April 2023 with 14,500 consumers from around the world, including the UK, Germany, Austria, Italy and Bulgaria; PaymentsEurope, 'The Evolution of the European Payments Market: From Cash to Digital, What Do Europeans Want?' (2021). Accessible at: https://www.paymentseurope.eu/wp-content/uploads/2021/11/The-Evolution-of-the-European-Payments-Market_Payments-Europe_Spread.pdf. Report based on survey completed by 3,223 consumers living in France (544), Germany (539), Italy (530), Spain (540), Sweden (538) and Poland (532) and by 680 merchants working in retail both online and offline (France (109), Germany (110), Italy (110), Spain (110), Sweden (106) and Poland (103).

23 Worldpay, "Global Payments Report 2023", May 2023. https://www.fisglobal.com/en/global-payments-report.

24 [✂]

25 IR, Annex 2 para. 2.42.

26 IR, Annex 2 para. 2.38.

associated with needing to manually enter a merchant's transaction details from a personal consumer bank account; (ii) the lack of reassurance associated with not receiving any immediate merchant order confirmation; (iii) the lack of consumer payment protection guarantees, with SEPA payments typically being irrevocable once processed, and (iv) the potential for additional consumer fees of up to €12.00 per transaction for Instant Credit Transfers.[27] See **Table *1*** below for further details.

Table 1 – Examples of key security and cost differences between Visa and SEPA payments

Feature	Visa card payments	SEPA payments
Transaction security	Visa card payments include significant in-built fraud protection. This contributes to a significantly lower average value of fraud incidents on Visa card payments cards – i.e., £178 for CNP transactions.[28]	SEPA bank transfers include no in-built fraud protection, for example if a recipient refuses to return funds that may have been transferred to them in error or fraudulently. This contributes to a significantly higher average value of fraud incidents for interbank payments – where UK Faster Payments for example have an average fraud incident value of £572.[29]
Transaction reimbursement	Visa cardholders benefit from strong payment protection guarantees. This contributes to a much higher proportion of funds lost to transaction fraud being returned to cardholders – i.e., 98%.[30]	SEPA bank transfers do not provide consumers with any comparable recourse for fraudulent transactions. This contributes to a much lower proportion of funds lost to transaction fraud being returned – for the current operation of UK Faster Payments, for example, this proportion is 57%.[31]
Cost	Visa cardholders do not tend to be charged any fees for domestic and cross-border transactions.	While one working day transfers carry no charge, SEPA Instant Credit Transfers (which may be particularly relevant to e.g., travel and accommodation XB CNP Transactions)

27 TrueLayer. 'Introduction to Payment Schemes'. https://docs.truelayer.com/docs/introduction-to-payment-schemes. See also: AIB (Ireland), 'SEPA Payments and International Payments', https://aib.ie/international-sepa-payments-explained; Deutsche Bank (Germany), 'Echtzeit-Überweisung', https://www.deutsche-bank.de/pk/konto-und-karte/bankgeschaefte-erledigen/echtzeit-ueberweisung.html; Frankfurther Volksbank (Germany), 'Echtzeit-Überweisung: Geld in Sekundenschnelle überweisen', https://www.frankfurter-volksbank.de/so-funktionierts/echtzeit-ueberweisung.html; BNP Paribas (France), 'Les virements instantanés, https://mabanque.bnpparibas/fr/gerer/cartes-moyens-paiement/moyens-paiement/virements-instantanes.

28 UK Finance 2023 Annual Fraud Report, pp. 14-15.

29 Total fraud value from UK Finance 2023 Annual Fraud Report, pp. 56. https://www.ukfinance.org.uk/policy-and-guidance/reports-and-publications/annual-fraud-report-2023
Volume data from UK Payments Markets 2022, pp. 33. https://www.ukfinance.org.uk/policy-and-guidance/reports-and-publications/uk-payment-markets-2022 Figures for 'Spontaneous Payments' only.

30 UK Finance 2023 Annual Fraud Report, p. 13.

31 UK Finance 2023 Annual Fraud Report, p. 53. We have used total 'purchase scan' fraud value and repatriated fraud value.

Feature	Visa card payments	SEPA payments
		involve charges to consumers of up to €12.00 per transaction.

Statistics based on the UK Finance Annual Fraud Report 2023 and UK Payments Markets 2022.

2.7 Against this background, Visa is not aware of any regulatory IF analysis having ever been undertaken on the basis of a comparison against only the cost of bank transfers (let alone SEPA bank transfers). This includes the analysis undertaken by the EC when establishing the EEA-wide IF caps set out in the IFR, and (contrary to what the IR claims) when agreeing the IF levels set out in its 2019 Visa Commitments Decision. Rather, the EC's 2019 Visa Commitments Decision considered the costs of a wide variety of commonly used alternative payment methods, including "*four-party card payment schemes; 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*",[32] including specifically American Express and PayPal.[33]

2.8 Visa also notes that the IR contradicts its own reliance on SEPA bank transfers being an important – or indeed "*the relevant*"[34] – payment alternative for XB CNP Transactions given its own dismissal of popular EEA account-to-account (***A2A***) payment providers such as iDEAL (which facilitates bank transfers based on underlying SEPA infrastructure) and Blik on the basis that they "*are national offerings*" where "*iDEAL offers limited cross-border transactions services*" and "*Blik is still confined to its domestic borders and does not offer a cross-border payment service*".[35]

The IR wrongly assumes that it would be appropriate for the PSR to dismiss all payment alternatives actually used by EEA consumers and UK merchants for XB CNP Transactions

2.9 In focusing on Visa's so-called 'must take' status, the IR assumes that it is appropriate to ignore *all* of the payment alternatives that are used by EEA consumers when transacting with UK merchants – even though all of these payment alternatives are used for XB CNP Transactions to a *significantly greater* extent than SEPA bank transfers.

2.10 As the PSR is aware, there is nothing unlawful about consumers and merchants valuing the quality and competitiveness of Visa's global payment system. Indeed, it is precisely these benefits that the PSR should be reflecting upon in order to discharge its statutory competition, innovation and service user objective duties as set out in sections 50-52 FSBRA. However, rather than doing so, the IR asserts that there are only a limited number of CNP payment alternatives available,[36] and that a SEPA bank transfer is "*the relevant*" payment alternative. On that basis, the IR considers it appropriate to dismiss all of the payment alternatives that are available – and used – for XB CNP Transactions. Such an approach is unjustified for a forward-looking and robust regulatory IF assessment. It is also deeply flawed as:

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32 Bank transfers and payment methods *funded* by bank transfers can be distinguished from each other. For example, bank transfers involve a direct payment from a consumer's bank account to the merchant's account. For payment methods such as digital wallets like PayPal and BNPL, the consumer pays the merchant directly with these payment options but can use a bank transfer or card to pay the digital wallet or BNPL provider.

33 EC's 2019 Visa Commitments Decision, para. 79.

34 IR, paras. 5.57, 5.89 and 5.145.

35 IR, para. 4.110.

36 IR, paras. 4.98, 4.106, 4,112.

(a) **It dismisses commonly used three-party card schemes such as American Express**

The IR dismisses commonly used three-party card schemes such as American Express without reason.[37] That approach is, however, contradicted by the PSR's own analysis which indicates that such other card schemes represent approximately 21% of the value of XB CNP Transactions.[38] It is also contradicted by the strong adoption of three-party card schemes in both the UK and EEA, including by UK merchants and EEA consumers. American Express is, for example, now accepted by approximately half of all UK card-accepting merchants,[39] and there were 18.4 million American Express cards issued in Europe in 2019.[40]

(b) **It dismisses commonly used digital wallets such as PayPal**

The IR dismisses commonly used digital wallets such as PayPal on the basis that such transactions may be funded by Visa and Mastercard cards and therefore include an IF component.[41] That is however incorrect as it fails to recognise that "staged" wallets such as PayPal and Amazon Pay enable consumers to choose a number of different funding mechanisms other than Visa and Mastercard including, in particular, three-party card schemes such as American Express as well as bank transfers that do not involve the use of any payment card.[42] This has been confirmed by [✁].[43]

More broadly, digital wallets like PayPal have become increasingly important payment methods for e-commerce transactions in Europe and the UK. According to the Global Payments Report 2023,[44] digital wallets are the most commonly used e-commerce payment instrument in Europe, with a 2022 e-commerce market share of 29% that exceeded the share of credit cards and debit cards respectively. A survey conducted by PayPal also found that between 26-46% of surveyed consumers across Ireland, Germany, Italy, France, Spain, Greece and Belgium listed PayPal as their preferred payment method when shopping online.[45] Another PayPal survey also found that 75% of surveyed UK

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37 IR, para. 4.112. In particular, despite listing other international card schemes such as American Express and Diners Club as alternative payment methods for XB CNP Transactions at para. 4.106, the IR does not set out why it considers that these present only a weak alternative to Visa and Mastercard (as concluded in para. 4.112) whereas it sets out some, albeit unevidenced and erroneous, reasoning with respect to other payment alternatives.

38 IR, para. 2.4.

39 Digital & Card Payments Yearbooks, "European Region, UK, Statistical Yearbook 2021/2022", page 69. "*American Express and Diners Club cards are accepted at around 750,000 outlets and 305,000 outlets in the UK respectively […]*". This represents around half of the card-accepting merchant population in the case of American Express (there are around 1.58 million card accepting outlets in the UK (Table 9)).

40 Digital & Card Payments Yearbooks, "European Yearbook Statistical Report 2020-2021", Table 4.1.6.

41 IR, paras. 4.107, 4.108, 4.111 and 5.55.

42 A PayPal transaction can be funded using: (a) a consumer's existing pre-funded PayPal balance, (b) a direct bank transfer from a linked account, (c) PayPal Credit, (d) a card payment, or (e) an eCheque.

43 [✁]

44 Global Payments Report 2023, p.75.

45 'PayPal e-Commerce Index: Europe'. PayPal, November 2022. https://www.paypalobjects.com/marketing/web/shared/enterprise/campaigns/ecommerce-index/UK/PayPal_eCommerce_Index_2022_EU_EN_Master_Final.pdf.

businesses stated that they offered PayPal as a payment option (compared, for example, to 78% that offered the option of paying by debit card).[46]

(c) **It ignores the rapid growth of BNPL providers such as Klarna**

Like digital wallet payments, BNPL payments can also be funded by a variety of different mechanisms, including three party card schemes such as American Express and bank transfers. With respect to Klarna specifically, the range of funding mechanisms available depends upon the location of the consumer, with consumers in several EEA countries including Belgium, the Netherlands and Germany able to repay Klarna via, for example, bank transfer.[47] The IR is accordingly incorrect when it states that "*Klarna does not currently represent an alternative to Mastercard and Visa because, for cross-border transactions, it only facilitates card-based transactions*".[48]

More generally, and again similar to digital wallet payments, BNPL providers are becoming increasingly important payment alternatives for consumers in both the EEA and the UK. BNPL providers are already well-established in the EEA, with a 2022 European e-commerce market share of 10%, and are predicted to grow further with BNPL global e-commerce transaction value projected to grow at 16% compound annual growth rate from 2022-2026.[49] Klarna has more than 100 million users across Europe,[50] and is accepted by more than 25,000 UK merchants.[51] Klarna has grown rapidly over the past few years, and since 2020 has launched in 11 European markets.[52] It is identified in the Global Payments Report 2023 as a popular payment method in, for example, Belgium, Denmark, Finland, Germany, Ireland, the Netherlands, Norway, Poland, Sweden, and the UK.[53] As of 2022, BNPL also accounted for 8% of UK domestic e-commerce transaction value.[54]

(d) **It ignores important stakeholder feedback**

The IR's proposals – and their application of, in particular, the PSR's statutory competition objective[55] – fail to reflect that merchants consulted by the PSR ([✁])[56] specifically identified other card schemes (namely American Express and Diners Club), PayPal and BNPL providers as alternative payment methods to Visa and Mastercard.[57] They also fail

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46 'PayPal eCommerce Index 2022 Deep Dive: The UK'. PayPal, November 2022. https://www.paypalobjects.com/marketing/web/shared/enterprise/campaigns/ecommerce-index/UK/PayPal_eCommerce_Index_2022_Deep_Dive_UK.pdf.

47 Klarna's 'Pay in 30' can be re-paid using Bancontact in Belgium and the Netherlands and using instant transfer in Germany. See Klarna's regional websites for further details: https://www.klarna.com/be/, https://www.klarna.com/nl/ and https://www.klarna.com/de/jetzt-kaufen-spaeter-bezahlen/.

48 IR, para 4.109. [✁]

49 Global Payments Report 2023, p. 21.

50 'Europe Turns Pink: Klarna Announces Huge Growth in Key European Markets'. https://www.klarna.com/international/press/europe-turns-pink-klarna-announces-huge-growth-in-key-european-markets/.

51 'Why Klarna Is a Long Term Growth Partner for Retailers – Klarna UK'. https://www.klarna.com/uk/blog/why-klarna-is-a-long-term-growth-partner-for-retailers/.

52 'Europe Turns Pink: Klarna Announces Huge Growth in Key European Markets'.

53 Global Payments Report 2023, pp. 87-115.

54 Global Payments Report 2023, p. 115.

55 Section 50 FSBRA.

56 IR, footnote 162.

57 IR, para. 4.95 and Annex 2 para. 2.34.

to reflect that such feedback expressly confirms the importance of these alternative payment methods to their business,[58] including:

(i) "*[a] merchant ([✂]) that said it accepts [✂] and considers all the forms of payment it offers in the UK as essential for its business*";[59]

(ii) another 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*";[60] and

(iii) similarly, another merchant noted that "*it offers Visa, Mastercard and* [✂] *and a selection of alternative payment methods, such as* [✂]", explaining that "*each available payment method has been added to [its] 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*".[61]

(e) **It also ignores that all these commonly used alternative payment methods are significantly more expensive for UK merchants to accept than a Visa card**

The IR wrongly asserts that payment alternatives to Visa and Mastercard are less costly for UK merchants to accept than a Visa (or Mastercard) card.[62] This is incorrect. While confidential information relating to the fees charged by these payment alternatives to UK merchants is not known to Visa, publicly available information indicates that the cost to UK merchants of accepting transactions from EEA consumers using, e.g., a three-party card scheme such as American Express is approximately 3.95%,[63] PayPal is 4.19% together with an additional fixed fee of £0.20-0.40 per transaction,[64] and Klarna (based on an average fee) is 2.68% together with an additional fixed fee of £0.37 per transaction.[65]

2.11 Finally, and as it did in relation to SEPA bank transfers, Visa notes that the IR contradicts its dismissal of these payment alternatives by stating that "*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*".[66] The IR also finds that non-card funded [✂] and payments with [✂] – even when excluding [✂] account for [✂] of the total value of EEA to UK CNP transactions.[67] This is likely to be [✂] when taking into account [✂] such as [✂]. All of the evidence available to the PSR therefore shows that [✂] XB CNP Transactions are already taking place using payment methods other than Visa or Mastercard - findings which cannot justifiably be ignored.

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58 IR, Annex 2 para. 2.3.

59 IR, Annex 2 para. 2.7.

60 IR, Annex 2 para. 2.9.

61 IR, Annex 2 para. 2.11.

62 See for example IR, paras. 4.37, 4.73, 4.122, 9.79.

63 Adyen, Pricing. https://www.adyen.com/pricing.

64 PayPal, 'Merchant Fees - Seller Fees | PayPal UK'. https://www.paypal.com/uk/webapps/mpp/merchant-fees.

65 Klarna's fee depends on the consumer country. See https://www.adyen.com/en_GB/payment-methods/klarna.

66 IR, para. 4.78.

67 IR, para. 4.108.

The IR wrongly assumes that Visa's XB CNP IFs have benefitted Visa and directly harmed UK merchants/SMEs

2.12 As explained in paragraph 2.3 above, IFs are not payable to Visa, nor do they comprise 'Visa revenue'. Rather, IFs form part of the merchant service charge that merchants pay to acquirers (and eventually to issuers) in circumstances where although the IF applicable to the underlying transaction corridor is set by Visa, whether and how IFs are reflected in an acquirer's 'merchant service charge' is determined by the acquirer and will depend on a merchant's and acquirer's contractual relationship with one another. Such contractual relationships can include: (a) typically in the case of larger merchants – 'interchange++ contracts' that apply granular IF breakdowns reflecting the specific IF level set by Visa for the transaction corridor to which a transaction relates; versus (b) typically in the case of smaller merchants – 'blended contracts' that apply simplified and aggregated merchant service charges, that will not automatically vary according to the specific IF level set by Visa for the transaction corridor to which a transaction relates.[68]

2.13 Against this background, the IR wrongly assumes that Visa's XB CNP IFs have directly harmed UK merchants/SMEs and/or that any change (particularly the reductions proposed by the IR) is passed on by acquirers "*almost in their entirety*" to UK merchants – particularly to SMEs.[69] This can be understood, for example, from the fact that:

(a) **Visa XB CNP Transactions comprise less than 2% of UK merchant transactions, and give rise to a less than 1 pence per UK merchant transaction impact –** in fact, 98%+ of UK merchant transactions have not been impacted by Visa's XB CNP IFs, particularly as IFs for Visa EEA to UK XB F2F transactions remain at 0.2%/0.3%, as do the IFs applicable to all UK domestic transactions (as is required by the UK IFR).

(b) **80% of XB CNP Transactions by value involve UK merchants on unblended 'interchange++' acquirer contracts**[70] - in relation to which the PSR has previously found that such contracts typically relate to large merchants with over £50 million in annual card turnover.[71] Since Brexit, such large merchants have typically organised their operations in a way that enables their transactions to be located in the EEA and which, as a result, do not involve the application of Visa's XB CNP IFs.[72] This is confirmed by acquirer and merchant feedback received by the PSR which notes that relocation is 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; [and] large merchants operating in specific sectors, such as e-commerce platforms, online booking services, online entertainment and fintech*".[73] Such feedback

68 IR, para. 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*". See also para. 6.8 and the PSR's market review into the supply of card-acquiring services: Final report, November 2021, para. 4.90.

69 IR, para. 1.12.

70 IR, para. 3.17.

71 PSR, Market review into the supply of card-acquiring services: Final report, November 2021, para. 1.15.

72 Merchant relocation is a business decision which takes into account a wide range of factors including tax optimisation, corporate restructuring, regulation, among others. Visa understands that many merchants with significant cross-border transactions relocated their operations in order to ensure that they had both UK and EEA-based operations following the UK's exit from the European Union.

73 IR, para. 4.67.

also notes that merchants had been reviewing their corporate organisational structures as a result of Brexit,[74] with [✂][75] [✂] all, for example, having confirmed that they [✂].[76]

(c) **The remaining 20% of XB CNP Transactions involve merchants on 'blended contracts', with decisions relating to the level and timing of any such pass on (whether with regards to an IF increase or decrease) being fully at the acquirer's discretion.**[77] Visa notes that the PSR's claim that 75% of XB CNP IF increases have been 'passed on' to UK merchants on blended contracts is not based on any quantitative analysis of acquirer data.[78] Instead, the IR relies entirely on [✂][79] from which the PSR has made a number of "additional pass-on" assumptions that likely over-estimate the impact of Visa's revised XB CNP IFs. For example, [✂] notes that it [✂] This statement does not however confirm that [✂].[80]

(d) **The PSR's separate and recent card-acquiring market review has itself made clear that changes to IFs are unlikely to be passed on to merchants on blended contracts**. In particular, the PSR found in that review (based on a quantitative analysis of acquirer data) that merchants that were not on 'interchange++ contracts', namely "*small and medium-sized merchants, and merchants with annual card turnover between £10 million and £50 million*", saw little, if any, reduction in their merchant service charges payable to acquirers after the introduction of, for example, the EU IFR IF caps indicating that they received "*little or no pass-through of the IFR savings*".[81]

2.14 Taken together, it is clear that the IR contains no evidence or analysis that Visa's XB CNP IFs are in fact, or even "*likely*" to be, "*unduly high*", with the PSR itself making clear that the necessary analysis still remains to be undertaken.[82]

3. THE IR ALSO CONTAINS NO EVIDENCE FOR WHY IFS OF 0.2%/0.3% WOULD BE MORE APPROPRIATE THAN VISA'S CURRENT XB CNP IFS, AND IGNORES THE SIGNIFICANT BODY OF ECONOMIC EVIDENCE THAT SHOWS THIS TO BE UNTRUE

3.1 The IR fails to engage with the significant volume of detailed expert economic evidence provided by Visa to the PSR which shows why IFs of 0.2%/0.3% have never been – and are certainly no longer – appropriate for XB CNP Transactions, as well as why they are not more appropriate or more justified than Visa's current XB CNP IFs.

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74 See, e.g. IR Annex 2 paras. 2.79 and 2.81.

75 In particular, we note that [✂] had already decided to relocate its operations in response to Brexit and that an in-house routing function optimises transactions between its EEA-based and UK-based entity such that it is able to process EEA-based transactions as EEA transactions. See IR, Annex 2 para. 2.101.

76 IR, para. 6.13.

77 IR, para. 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*". See also para. 6.8.

78 See, for example, IR para 6.9 which notes that the PSR "*estimate[d] that around 75% of the 'additional' IFs associated with merchants on Fixed or Standard pricing tariffs have been passed through by acquirers to merchants*" (emphasis added). In contrast, the PSR noted in its Final Report in the card-acquiring market review that it had, for example, "*calculate[ed] the direct effect of the IFR caps on the interchange fees for capped transactions*" (para 5.31) and calculated "*average interchange fees and average MSCs before and after the IFR caps came into force by merchant type*" (see para 5.20 and Table 2).

79 [✂]

80 [✂]

81 PSR, Market review into the supply of card-acquiring services: Final report, November 2021, para. 4.90.

82 IR, paras. 1.17 and 9.45.

3.2 Despite not having even formulated a methodology for analysis, the IR states that the PSR should seek to compel Visa to apply interim IFs of 0.2%/0.3% while it undertakes the necessary analysis, in place of Visa's current and plainly *better justified* interchange levels. The IR asserts this simply on the basis that these were the IF caps that applied when the UK was a member of the EEA and which Visa was therefore required to apply under the *then applicable* EU IFR and, perhaps more confusingly, because the UK continues to be a member of the SEPA.[83]

3.3 In making these suggestions, the IR ignores:

(a) **The flaws in the historic economic studies underpinning the EU IFR caps which mean that such caps are not more appropriate for XB CNP Transactions than Visa's current XB CNP IFs** – such studies did not even consider, for example, CNP or cross-border transactions, but instead were based on an assessment of only F2F and domestic transactions and, even then, against only a cash comparator that has no relevance to CNP transactions;

(b) **The multiple expert economic studies submitted by Visa which – both from a merchant and issuer cost perspective – support XB CNP IFs that far exceed 0.2%/0.3%** – such studies include Visa's 2017 MIT study that went on to underpin the establishment of different IF levels for CNP versus F2F transactions as enshrined in the EC's 2019 Visa Commitments Decision, with such IF levels being those that Visa now applies to its UK to EEA XB CNP and F2F transactions, and to the EEA to UK XB CNP (and F2F) Transactions that are the subject of this market review; and

(c) **Visa's 2023 MIT assessment prepared specifically in the context of this market review, including with the full endorsement of the co-creator of the MIT, Professor Jean-Charles Rochet** – this assessment is based on up-to-date transaction and payment comparator data. It unambiguously confirms that, even when applying several conservative adjustments (e.g., to account for potential SEPA bank transfer payments) Visa's current XB CNP IFs do not exceed any MIT 'benchmark' and (in line with the PSR's own focus on the MIT) are therefore fully justified and not "*unduly high*".

3.4 Visa provides further detail in relation to each of these points below.

The IR ignores that the EC's EU IFR caps are based on historic economic studies that do not justify replacing Visa's current XB CNP IFs with the EU IFR caps

3.5 The IR states that "*there is a reasonable expectation that there is a sound rationale for why [the EC] produced studies and set the [IFR] cap levels as it did*".[84] However, such an assertion does not attempt to analyse whether such studies provide any sound rationale for applying the EU IFR caps to Visa's XB CNP Transactions today, nor does it take into account the submissions made by Visa which show this not to be the case. In particular, regarding the:

(a) **Early 2000s central bank studies relied upon by the EC**

These were published by the central banks of Belgium, the Netherlands and Sweden, and were used by the EC to support the EU IFR caps.[85] However, not only were these studies

83 IR, paras. 9.62 and 9.63.

84 IR, para. 5.72.

85 See the EC's Proposal for the IFR, 2013/0265(COD), 24.7.2013, p. 16, which refers to the 0.2% and 0.3% caps as having been "*calculated on the basis of [the MIT], using data gathered by four national central banks".*

compiled almost 20 years ago,[86] they also did not focus on the merchant sectors most relevant for cross-border transactions. These studies instead focused on the cost of a cash-based alternative, which is not relevant for CNP or the vast majority of cross-border transactions as is recognised in the IR[87] and by the EC.[88]

(b) **EC's 2015 Cost of Cash Study**

Despite the EC relying on this study to further support the EU IFR IF caps, this too provides no basis for establishing any current or forward-looking XB CNP IFs. In particular, the study included no assessment of XB CNP Transactions, and instead focused on:

(i) F2F transactions, with the EC itself acknowledging that a separate analysis would be needed to assess CNP transactions involving, for example, an altogether different sampling of merchants and payment options;[89]

(ii) cash as the only relevant payment comparator which, of course, has no relevance to CNP transactions, and on this basis did not consider all relevant CNP alternative payment methods available in the EEA and the UK such as American Express, PayPal and Klarna;

(iii) domestic transactions within ten EU Member States, and on domestically-focused merchant sectors such as supermarkets which are not representative of typical XB CNP Transactions.[90] No meaningful consideration was given to EEA cross-border transactions, and no specific consideration was given to XB CNP Transactions; and

(iv) historic data derived from studies carried out between 2012 and 2013, i.e., more than 10 years ago. Such data does not account for the changes that have occurred in the payments landscape in recent years, including the *significant* growth in CNP transactions[91] and the increase in the availability and adoption of alternative payment methods such as digital wallets and BNPL providers by consumers, and therefore also by merchants.

The IR ignores the expert economic studies submitted by Visa which – both from a merchant and issuer cost perspective – support XB CNP IFs that far exceed 0.2%/0.3%

3.6 Visa has, over the course of the past two decades, commissioned several IF-focused expert economic studies. Irrespective of the economic methodology utilised – i.e., whether from an

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86 EC, Survey on merchants' costs of processing cash and card payments: Final results, March 2015 (***EC Cost of Cash Study***), para. 33. The studies are: Banque Nationale de Belgique, 'Couts, Avantages et Inconvenients des Differents Moyens de Paiement', 2005; De Nederlandsche Bank, 'Betalen Kost Geld', March 2004, and EIM, 'Het toonbankbetalingsverkeer in Nederland', 2007; and Bergman, M, Guibourg, G, and Segendorf, B, 'The Costs of Paying – Private and Social Costs of Cash and Card Payments', Riksbank Research Paper Series No 112, 2007.

87 IR, para. 5.72.

88 EC's 2019 Visa Commitments Decision, para. 80(b).

89 EC Cost of Cash Study, para. 104.

90 EC Cost of Cash Study, para. 137.

91 European e-commerce revenue has grown from EUR 312 billion in 2012 to EUR 899 billion in 2022. See https://ecommerce-europe.eu/press-item/european-e-commerce-to-reach-e-312-billion-in-2012-19-growth/#:~:text=European%20online%20revenue%20of%20goods,%2C%20a%20growth%20of%2018.1%25 and https://ecommerce-europe.eu/wp-content/uploads/2023/11/European-Ecommerce-Report-2023-Light-Version.pdf.

issuer or merchant cost perspective – these studies have consistently supported XB CNP IFs that far exceed 0.2%/0.3%.[92] In particular:

(a) **Two economic studies (the 2011 [✂] Report and the 2012 [✂] Report) found that:** even if Visa were to deliberately apply a narrow EC-led methodology (i.e., based only on cash as a comparator), when corrected to account for key methodological and data flaws (e.g., to include additional European countries and retail sectors), MIT-based IFs for EEA cross-border transactions far exceed 0.2%/0.3% - specifically [1.40% - 1.80%] for debit card transactions and [1.50% - 1.70%] for credit card transactions;

(b) **Similarly, the study prepared by [✂] in 2017 found that:** when adjusting the EC's 2015 Cost of Cash Study to account for cross-border and CNP transactions, the resulting MIT-based IFs were significantly above 2% for inter-regional CNP debit and credit card transactions. [✂] adjustments were made to reflect merchant sectors relevant to cross-border transactions, and non-cash-based payment alternatives relevant to XB CNP transactions such as other card schemes (e.g., American Express) and digital wallets (e.g. PayPal); and

(c) **Assessments submitted by Visa of intra-EEA transactions based on issuer cost-based methodologies:** these have also supported XB CNP IFs that again far exceed 0.2%/0.3%.

The IR critically ignores Visa's 2023 MIT assessment which unambiguously demonstrates that Visa's current XB CNP IFs do not exceed any MIT 'benchmark' and are therefore fully justified

3.7 Visa has submitted an independent expert economic MIT assessment of its current XB CNP IFs by [✂]. This assessment is based on up-to-date Visa transaction data and focuses specifically on XB CNP Transactions (the [✂] ***Report***). It has further been reviewed and endorsed by the co-creator of the MIT, Professor Jean-Charles Rochet, and confirms that Visa's current XB CNP IFs do not exceed any MIT 'benchmark' and are therefore fully justified and in no way inappropriate or "*unduly high*".

3.8 Specifically, and contrary to the IR's claims,[93] the [✂] Report has assessed Visa's XB CNP IFs against current and commonly used alternative payment methods that do not involve any Visa (or Mastercard) IFs,[94] including three-party card schemes such as American Express, non-card funded digital wallets that include PayPal, BNPL providers such as Klarna, and A2A payment solutions that include – on a conservative basis – SEPA bank transfers.

3.9 [✂] compared the cost for UK merchants to accept these alternative payment methods against the total cost for UK merchants of accepting payments using a Visa card. In fact, the report conservatively overstates the cost to UK merchants of accepting a Visa card transaction by at least

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92 The IR cannot simply dismiss these reports without any consideration simply on the basis that the issuer cost-based studies are historical and are not based on a MIT assessment (IR, para. 5.73), and the [✂] Reports rely on cash as a comparator and/or do not relate specifically to XB CNP Transactions (IR, paras. 5.74, 5.75 and 9.69).

93 IR, paras. 9.123-9.130.

94 While BNPL transactions can be funded by card: (a) the debt re-payment occurs as a separate and delayed transaction (i.e. over a series of instalments not exceeding a 12-month period), and (b) the debt re-payment is between the BNPL provider and consumer, and will be considered as a domestic or EEA intra-regional payment transaction and is therefore not affected by Visa's XB CNP IFs. [✂]

[✁] to account for any potentially overstated cost estimates for alternative payment methods.[95] On this basis, the report found that:

(a) the MIT 'benchmark' for XB CNP Transactions is [2.70-2.90%] and [2.50-2.70%] for debit and credit card transactions respectively; and

(b) even when applying conservative sensitivity adjustments to "stress test" these results (for example by focusing disproportionately on A2A payment instruments which involve the lowest merchant fees of any payment method), the relevant MIT 'benchmark' is still far higher than Visa's current XB CNP IFs, i.e., [2.00-2.20%] for both debit and credit card transactions.

3.10 On this basis, and contrary to the claims in the IR, the [✁] Report is entirely consistent with the "*spirit of the MIT*".[96] The IR is also incorrect in asserting that the PSR "*ha[s] not seen evidence pertaining to alternative payment methods and cost information specific to UK-EEA CNP transactions*".[97]

3.11 Taken together, and notwithstanding that the UK is no longer part of the EU Single Market and therefore no longer required to apply the EU IFR caps of 0.2%/0.3%, these studies make very clear that there is no basis for replacing Visa's current XB CNP IFs with the EU IFR caps.

4. THE IR'S FEE SETTING PROPOSALS HAVE NO LEGAL BASIS, PARTICULARLY FOR FEES THAT COMPRISE THE INCOME OF LARGE NUMBERS OF NON-UK INTERNATIONAL ISSUERS

4.1 The IR suggests the adoption of expansive remedies that would involve the PSR effectively setting the fees/income of international issuers via: (a) first, interim XB CNP IF caps that would require Visa to replace its current XB CNP IFs with caps of 0.2%/0.3% that are clearly unsupported by any available evidence (***Interim IF Caps***);[98] and (b) longer-term XB CNP IF caps based on a MIT (or other such) study (***Enduring IF Caps***),[99] (together, the ***Proposed IF Caps***).

4.2 The IR states that its current view is that the PSR "*may*" give effect to its Proposed IF caps by issuing general or specific directions under sections 54 or 55 of FSBRA (the ***s.54/55 powers***).[100] At the same time, the PSR expresses doubts about its legal powers in this regard – and relies not only on a judgment that provides no support for this suggestion,[101] but notes also that it is still

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95 [✁] Report, para. 120.

96 IR, para. 9.126.

97 IR, para. 5.143.

98 IR, para. 9.82.

99 IR, para. 9.47.

100 IR, para. 9.140.

101 IR, para. 9.140 relies on the High Court's recent decision in *NoteMachine UK Limited v PSR* [2023] EWHC 2522 (Admin) as a basis for ascribing itself fee setting powers under sections 54 and 55 FSBRA. However, the *NoteMachine* case concerns the interpretation of section 108 FSBRA and the circumstances in which section 108 precludes the PSR from exercising powers that would otherwise be available to it under sections 54-58 of FSRBA. Nothing in the Court's judgment provides any support for the proposition that section 54 or 55 FSBRA can be construed as empowering the PSR to impose the Proposed IF Caps. Nor does the IR explain how this case supports the PSR's view that it could use its s.54/55 powers to "give effect" to the Proposed IF Caps. Equally, the fact (referred to in the IR at footnote 382) that the PSR has the power to impose directions under Regulation 125 of the Payment Services Regulations 2017 (***PS Regulations 2017***) is not relevant to whether the PSR has the power to set fees using its s.54/55 powers. In particular, the PSR could only use the power under Regulation 125 to remedy or prevent a failure to comply with a "qualifying requirement" (as defined in the PS Regulations 2017).

"*considering the scope and application of these powers in the context of this market review*", and that it plans to consult specifically on its "*legal instrument*" before its conclusion.[102]

4.3 Visa considers that the PSR is right not only to express these doubts, but that it is clear that sections 54 and 55 FSBRA **do not** empower the PSR to set fees/charges – far less to determine fees/charges that comprise the income of large numbers of non-UK international issuers, as is being proposed.

Sections 54 and 55 FSBRA do not confer fee setting powers on the PSR

4.4 As is clear from the text of the provisions,[103] section 54 is concerned with the operation of payment systems, and section 55 concerns rules for the operation of payment systems. Neither confer any power on the PSR to set fees or charges, or to impose its Proposed IF Caps. Neither in fact refer to fees or charges.

4.5 Were there to be any doubt about this (which there is not), it is confirmed by the separate provision made in section 57 to set fees or charges, with the Explanatory Notes to FSBRA further making clear that it is only section 57 which confers on the PSR a power to set fees in certain circumstances:[104]

> "*235. Sections 54 to 58 set out the regulatory powers of the Payment Systems Regulator. The Payment Systems Regulator has the following powers: <u>to give directions to participants in regulated payment systems (section 54); to impose certain requirements on the operator of a regulated payment system concerning the rules of the system (section 55)</u>; to order the provision of access to a regulated payment system (section 56); <u>to vary the fees and charges payable under, and other terms and conditions of, an agreement concerning access to a regulated payment system (section 57)</u>; and to require the disposal of an interest in the operator of a regulated payment system (section 58).*"

4.6 Section 57 is the only power in Part 5 of FSBRA which confers on the PSR a power with respect to fees or charges. It is also only decisions under section 57 that are subject to a full-merits appeal, i.e., where the Competition and Markets Authority (***CMA***) can intervene on wide-ranging grounds and substitute its own decision for that of the PSR.[105] This reflects the fact that such a decision (impinging on pricing/income freedom) is a particularly intrusive form of regulatory intervention, and one which Parliament considered should be subject to a higher level of scrutiny by way of a full-merits appeal to a specialist body. It also mirrors the position in other sectors, where regulatory price-setting similarly attracts a full-merits appeal to the CMA,[106] and where the

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102 IR, para. 9.145.

103 Specifically:

a. Section 54(2)(a) refers to a direction to "*require or prohibit the taking of <u>specified action</u> in relation to the system*".
b. Section 54(2)(b) allows the PSR to give directions to "*<u>set standards</u> to be met in relation to the system*".
c. Section 55(1)(a) states that the PSR may require the operator of a regulated payment system "*<u>to establish</u> rules for the operation of the system*".
d. Sections 55(1)(b) to (d) similarly refer to a change of rules for the operation of the system.

104 For the avoidance of doubt, Visa also does not consider that section 57 of FSBRA could provide a legal basis for the measures proposed in the IR, and notes that the PSR has also not sought to rely on section 57 of FSBRA in the IR.

105 Sections 76(6), 76(7) and 79 of FSBRA.

106 Examples of other sectors where appeals are made to the CMA include:

a. Aviation: Civil Aviation Act 2012.
b. Energy: Electricity Act 1989 and Gas Act 1986.
c. Water: Water Industry Act 1991.

drafting of the relevant provisions of FSBRA have evidently drawn upon the wording of legislation in other sectors.[107] By contrast, decisions under sections 54 and 55 are limited to challenge by way of judicial review (***JR***) before the Competition Appeal Tribunal (***CAT***) or the Administrative Court.[108] In a JR, the court is confined to considering whether the decision was lawful, rational, or procedurally fair, rather than stepping into the shoes of the primary decision-maker to retake the decision. Further, it is a well-established principle of statutory construction that general provisions in a statute do not override specific provisions, especially if this would allow constraints on the exercise of the specific power (such as appeal rights) to be circumvented.[109]

The legislative history of FSBRA further reinforces that sections 54 and 55 do not confer fee setting powers on the PSR

4.7 The legislative history of FSBRA confirms the statutory wording, namely that sections 54 and 55 were never intended to confer powers in respect of fees and charges.

4.8 Taking for example HM Treasury's (***HMT***) response to the 2013 "*Opening up UK Payments*" consultation (the ***2013 HMT Consultation Response***), that dealt specifically with the PSR's proposed powers.[110] HMT noted that the PSR would be given powers that would include "*powers to give directions to operators, infrastructure providers, indirect access providers and other participants*" (now set out in section 54), and "*powers over requirements regarding system rules*"(now set out in section 55).

4.9 It also specified that the PSR would be granted a separate and distinct "*power to amend commercial agreements governing service levels, access prices and other fees*", which was said to include "*a power to exercise ex-ante price setting*" – i.e., a very clearly delineated power to amend commercial agreements with respect to fees and charges, now set out in section 57.

4.10 The 2013 HMT Consultation Response further emphasised the relevance of the distinction between the different forms of appeal available in respect of the different regulatory powers, and specifically confirmed that the PSR's price-setting decisions would be scrutinised by way of a full-merits appeal before the CMA:

> *"2.102 Decisions to impose requirements concerning system rules and to give directions will be subject to appeal to the CAT, to a judicial review standard rather than full merits-based appeal.*

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107 By way of example, the grounds of appeal that can be advanced in an appeal against a section 57 decision (see section 79(5) of FSBRA) are materially identical to those that can be advanced in an appeal against a price control decision by Ofgem (see section 11E(4) of the Electricity Act 1989 and section 23D(4) of the Gas Act 1986).

108 A person who is affected by a decision to give a specific direction or impose a specifically-imposed requirement has a statutory right of appeal to the CAT, which must apply JR principles: sections 76(1), 76(3)-(4) and 77(4) of FSBRA. By contrast, a general direction or generally-imposed requirement cannot be appealed to the CAT and would need to be challenged by way of JR in the Administrative Court.

109 See Bennion, Bailey and Norbury on Statutory Interpretation (8th edition, 2020) at Section 21.4, citing *R v Liverpool City Council ex p Baby Products Association* (2000) 2 LGLR 689 where Lord Bingham CJ stated: "*A power conferred in very general terms plainly cannot be relied on to defeat the intention of clear and particular statutory provisions.*"

110 HMT, Opening up UK Payments: response to consultation, October 2013 (paras 2.80 and 2.82). https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/249085/PU1563_Opening_up_UK_payments_Government_response.pdf.

> *2.103 <u>For actions and decisions taken under the specific regulatory powers, appeals will be made to the CMA, and the level of scrutiny will be a full merits review. This will include the exercise of price-setting</u>, access-ordering and divestment powers by the Regulator".*

4.11 Given the legislative intention to ensure a full-merits appeal acts as an appropriate safeguard against the potential inappropriate exercise of an intrusive price-setting power, it would clearly be inappropriate for the PSR to be able to circumvent that deliberate safeguard by seeking to use its powers under section 54 or 55 to set or cap fees. Parliament plainly did not intend to provide a full-merits appeal as a safeguard against the specific price-setting power in section 57 while, at the same time, conferring a much wider price-setting power under sections 54 or 55 with no such safeguard in place.

4.12 It is also striking that, as far as Visa is aware, at no point in the last 10+ years since the enactment of FSBRA to the publication of the IR has the PSR suggested in any published guidance that it has the power to impose/cap fees or charges under sections 54 or 55 – including the PSR's Powers and Procedure Guidance. Nor was it mentioned in the final terms of reference for this market review. Given the breadth and impact of a price regulating power, and the legislative context set out above, the PSR would be expected to set out clear guidance on how such a purported power would be exercised.

4.13 Similarly, prior to the publication of the IR, the PSR has also never purported to use sections 54 or 55 to set or cap fees, and none of the general or specific directions that the PSR has issued to date set or determine the level of fees or charges payable.

The proposed use of any fee-setting power in the context of fees that do not comprise Visa prices/revenues but rather the income of large numbers of international issuers is all the more unfounded

4.14 Visa is not aware of the use of regulatory powers to impose a cap on cross-border IFs in any jurisdiction without the consent of the relevant payment scheme operator.[111] In both the UK and the EU, neither the UK Government nor the European Union has enacted legislation in respect of IFs that have non-domestic/non-single market extra-territorial application.

4.15 Further, the IR's Proposed IF Caps have the perverse effect of expanding the scope of the UK IFR in circumstances where the UK Government has only recently made clear that its application should be limited to UK domestic transactions. Such an approach would, in effect, bypass the transparent and consultative legislative process required to amend the UK IFR in order to expand its scope to cover international cross-border transactions.

4.16 Such an approach would also contradict the guidance received by Visa from HMT which has also made clear that: [✂].[112]

4.17 For the reasons set out above, Visa believes that any use by the PSR of its s.54/55 powers to impose its Proposed IF Caps would be <u>*ultra vires*</u> and Visa reserves its rights in relation to any such exercise of these powers accordingly.

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111 Indeed, even in Costa Rica where cross-border IF regulation exists, the use of these powers is currently under appeal.

112 [✂]

5. THE REMEDIES PROPOSED IN THE IR HAVE NO LEGAL OR EVIDENTIAL BASIS, DO NOT REFLECT THE PSR'S STATUTORY OBJECTIVES, AND RISK DESTABILISING THE VALUE OBTAINED BY USERS ON BOTH SIDES OF VISA'S PAYMENT SYSTEM (PARTICULARLY IN THE LONGER TERM)

5.1 As explained in **Sections 2, 3 and 4** above, the IR's proposed remedies, and in particular its proposal to require Visa to replace its current IFs with interim caps of 0.2%/0.3%, is not supported by any due process. It is not supported by any analysis, evidence, or legal basis – and in fact *contradicts* the evidence on the PSR's file that makes the inappropriateness of these levels plain. The IR's proposals are all the more concerning given:

(a) **The IR admits to not having conducted the analysis necessary for analysing Visa's XB CNP IFs and, with no such methodology even in place, needing ~18 months to do so**[113] – this reason alone makes clear that there is no basis for seeking to impose any interim XB CNP IF caps. However, when coupled with the further *significant* evidential and legal shortcomings explained in **Sections 2, 3** and **4** above, [✂], and that proceeding on this basis would be plainly *unlawful and improper*;

(b) **The PSR has repeatedly been made aware by Visa, including by the co-creator of the MIT Professor Jean-Charles Rochet, that even its proposed approach for establishing any Enduring IF Caps is deeply flawed** – particularly the PSR's insistence on undertaking a 'MIT' assessment of Visa's XB CNP IFs based on a comparison of only the cost of a SEPA bank transfer rather than conducting a proper MIT assessment that includes the payment alternatives actually – and commonly – used by EEA cardholders when transacting with UK merchants;[114] and

(c) **In light of Visa's designation as a Recognised and Regulated Payment System due to its systemic importance for the stability of the UK's financial system and economy, the risk that not undertaking the necessary analysis properly and completely creates in the potential destabilisation of Visa's payment system and the PSR's objectives,** including by disrupting the careful balance that exists between the costs and incentives of merchants/acquirers on the one hand and cardholders/issuers on the other, particularly in the longer term. Indeed, the IR also overlooks that any "temporary" interim measures would in themselves take at least six months to be implemented, and even then risk creating serious disruption to the payment ecosystem at large.

5.2 Visa provides further detail in relation to each of these points below.

The IR's proposed Interim IF Caps

First, the PSR lacks any legal or evidential basis for adopting any such caps.

5.3 The IR states that evidence is required to determine the correct level of XB CNP IFs.[115] However, as explained in **Sections 2** and **3** above, in proposing Interim IF Caps of 0.2%/0.3%, the IR proposes that Visa implements XB CNP IFs that were established more than 10 years ago based on data relating to neither cross-border nor CNP transactions.

5.4 Even more concerning than this, however, is the fact that as also explained in **Sections 2, 3** and **4** above, the IR makes this proposal despite: (a) the PSR not yet having undertaken any analysis of Visa's current XB CNP IFs and stating that it would need up to 18 months to do so; (b) the PSR not

113 IR, para. 9.45.
114 IR, paras. 9.133, 5.57 and 5.145.
115 See, e.g., IR, para 1.16.

being empowered under sections 54 or 55 FSBRA to impose any fee/income caps, far less for large numbers of international issuers and on an urgent interim basis; and (c) the PSR having adduced no evidence to demonstrate that XB CNP IFs of 0.2%/0.3% would be *more appropriate* than Visa's current XB CNP IFs, and with all of the available evidence making the opposite clear.

5.5 Such an approach also contradicts the PSR's own previously articulated position as set out in oral testimony to the Treasury Select Committee (the ***TSC***) which made clear that any interim action would "*still require evidence*" including a "*careful analysis of whether there are issues*".[116]

5.6 Such an approach also contrasts with, for example, other examples of "market studies" such as CMA market studies in which the CMA does not have the power to impose interim measures. Notably, the Government also consulted on and dismissed the proposal to introduce such a power in the context of in-depth CMA market investigations, noting that respondents to the consultation warned of an increased risk of "*inaccurate or premature interventions*" and "*unjustifiable over-enforcement if the imposition of remedies was based on the CMA's early-stage concerns*".[117] This same risk arises here.

Second, the caps fail to satisfy any urgency requirement

5.7 At its core, the IR proposes to impose Interim IF Caps in order to "*address the detriment to service users we are provisionally seeing in the short to medium term*",[118] and as a "*short-term step prior to more detailed analysis*".[119]

5.8 However, as the PSR's Powers and Procedures Guidance makes clear, interim measures should be used only to take "*urgent action*" and to "*address a negative impact that has already occurred*" (of which, as explained in **Section 2** above, there is no evidence).[120] Clearly the PSR's guidance does not endorse the imposition of urgent interim action in order to give the PSR more time to conduct an analysis that it has already had two years to undertake, and to respond to changes about which it was transparently made aware of almost three years ago.

Third, the caps would, in any event, take acquirers at least six months to implement and, even then with no guarantee that any such changes would be 'passed on' to UK merchants

5.9 Consistent with previous IF changes (including in Visa's previous commitments decisions with the EC), Visa understands that at least six months would be required to implement the technical changes involved in reflecting any IF changes in Visa's, acquirers' and issuers' systems.[121]

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116 When providing oral evidence to the TSC on 25 May 2022, Chris Hemsley, when asked if the PSR was considering reinstating the pre-Brexit cap on IFs as an interim measure, responded "*Taking that sort of step in itself, as you would expect, would likely be contested and so* ***would need to be as a result of careful analysis*** *of whether there are issues. That in itself would take some time.* ***The sort of action that I referred to in that letter, even those earlier interventions, would still require evidence*** *and would still take some time to put in place*."

117 Reforming Competition and Consumer Policy, Government Response to Consultation, paras. 1.43, 1.44 and 1.47.

118 IR, para. 9.46.

119 IR, para. 9.80.

120 PSR Powers and Procedures Guidance, para. 4.43.

121 This six-month period following announcement of any changes is required to allow acquirers to properly adjust their systems and contracts, and to enable issuers to adjust their spending (including on innovation and fraud prevention) to take into account reduced IFs. In order to allow customers sufficient time to make the necessary technical changes, Visa seeks to limit major changes to twice a year (via Business

5.10 Such an approach stands to cause significant cost and disruption to the global payments ecosystems operated by Visa (and Mastercard) – particularly in circumstances where the PSR also proposes to implement further IF changes by way of Enduring IF Caps relatively soon thereafter, and where (for the reasons explained in **Section 2** above) there is no evidence that Visa's current XB CNP IFs have directly and incrementally been passed on to UK merchants by acquirers, or that any reduction in IFs (particularly if only on a temporary basis) would be passed on to UK merchants. Contrary to the PSR's service user objective, such an outcome is unlikely to be in the best interests of Visa's users.

Finally, the PSR has failed to consider the impact of the Interim IF Caps on EEA issuers/cardholders

5.11 Visa notes that the PSR has not sought feedback from any EEA issuers or consumers despite them representing a significant proportion of Visa's "service users".[122] In doing so, the PSR adopts a narrow and one-sided assessment that considers the impact of Visa's XB CNP IFs only on merchants and acquirers, and not on all of Visa's users.[123] This one-sided approach is inconsistent with the PSR's statutory objective of promoting competition and innovation in a way that works in the best interests of *<u>all users</u>* of Visa's payment system, and statements previously made by the PSR. Indeed, the PSR's Strategy page leads by stating that "*it's the PSR's job to ensure that the systems underpinning them work well for everyone*".[124] Similarly, Natalie Timan (PSR) recently noted in a speech that to understand the future of payments, the PSR would look to "*identify and work with all stakeholders […]*"[125] and Chris Hemsley (PSR) explained in a letter to Rt Hon Mel Stride MP that "[a]*s the UK's regulator of payment systems, we [the PSR] want there to be effective competition in the market, sufficient choice and payment systems that <u>work well for everyone</u>*".[126]

5.12 Notably, the PSR's proposal in relation to the Interim IF Caps does not address the implications, particularly for non-UK issuers, of the Enduring IF Caps being set at, or above, Visa's current XB CNP IFs (as all of the available evidence indicates they should).[127] Instead, the IR suggests that even if the Interim IF Cap is lower than the Enduring IF Cap, it would be mitigated by the fact that non-UK issuers would already have received unduly high IF revenue before the Interim IF Cap is put in place.[128] In taking this approach, the PSR appears to have already determined, without

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Enhancement releases in April and October) with a six-month notification period built into the release schedule, including a one-month test window in which customers can test their coding prior to implementation. A similar six-month implementation period was applied both to the EC's 2019 Visa Commitments and the IF changes announced by Visa for UK to EEA and EEA to UK transactions in March 2021 and applied in October 2021.

122 For example, IR, paras. 3.19 ("*we asked <u>UK</u> issuers how they have used the additional income derived from the UK-EEA cross-border IF* increases"), 5.25 *("we asked thirteen UK issuers, which collectively account for over 90% of UK card transactions by value*", and confirmed by 2.17 which indicates that the PSR engaged only with these 13 issuers), 5.29 *("we also asked UK issuers* […] *we have no reason to believe that EEA issuers take a different approach*"). [✂]

123 IR, paras. 2.9, 4.3, 4.4.

124 PSR, 'The PSR Strategy', January 2022. https://www.psr.org.uk/publications/psr-strategy-documents/the-psr-strategy/.

125 Natalie Timan, Speech, Panel introduction for PSR Annual Plan event 2023, 9 May 2023. https://www.psr.org.uk/news-and-updates/speeches/speeches/natalie-timan-panel-introduction-for-psr-annual-plan-event-2023-9-may/.

126 PSR, Letter to the TSC in response to the TSC's inquiry into Card Payment Fees, 17 December 2021. https://committees.parliament.uk/publications/8461/documents/85670/default/.

127 In that event, the supposed mitigation on which the PSR relies would actually result in harm having been caused to EEA issuers and significant disruption for UK acquirers.

128 IR, para. 9.76.

evidence, that the current levels are unjustifiably high and could never be supported by a detailed economic study, despite the significant evidence Visa has provided (including the [✂] Report).

The IR's proposed Enduring IF Caps

First, the IR's proposal for establishing Enduring IF Caps is flawed, particularly in its fundamental misunderstanding of the role of the MIT and how it should be applied to XB CNP Transactions

5.13 Visa understands that the PSR is considering undertaking its own MIT-based assessment to evaluate Visa's current XB CNP IFs and to set its proposed Enduring IF Cap.[129] To undertake such an assessment properly, it will be incumbent on the PSR to ensure that its proposed approach reflects the reality of XB CNP Transactions as they take place between EEA consumers and UK merchants today. Unfortunately, despite several submissions by Visa and the co-creator of the MIT, Professor Rochet, the PSR's approach as proposed in the IR continues not to do so. In particular, it errs on:

(a) **The purpose of the MIT –** which was specifically designed to verify that IFs are not excessive in a way that is harmful to one side of the payment system, i.e., for merchants. On that basis, the MIT is useful for determining a level below which IFs can be assumed not to be excessive for <u>merchants</u>. The MIT is not used to determine a competitive IF level (as is erroneously stated in the IR),[130] nor is it a methodology used by Visa to set IFs given that it is focused only on merchant costs and fails to consider wider factors, such as issuer costs and incentives and how they shape cardholder behaviour, both of which also impact merchants; and

(b) **The application of the MIT –** which requires a number of necessary and obvious adjustments given the context in which it was originally created and applied, i.e., in relation to F2F transactions. In particular, for the F2F transactions for which the MIT was developed, it was credible (at the time the MIT was developed) to conduct an assessment based on a single cash-based payment alternative. However, in the context of this CNP-focused market review, the competitive landscape has significantly evolved. Cash is not an alternative, and there are many other credible alternative payment methods all of which must be taken into account. The approach therefore proposed in the IR which "*compares card scheme transactions against one alternative payment method, even if it is the cheapest available alternative*"[131] is therefore in no way credible for conducting a robust and credible MIT assessment for XB CNP Transactions today, and far less when that one comparator comprises rarely (if ever) used SEPA bank transfers.

5.14 Against this background, Visa notes that it has provided to the PSR several submissions from Professor Rochet in which he has made clear that: "*It would be a mistake for the PSR to consider/conduct a MIT assessment based only on one comparator in a context where so many others are available and utilized by cardholders and accepted by merchants; and moreover it would be an even greater mistake for that (or any) comparators to include one that is rarely (if ever) a utilized option for EEA/UK consumer CNP payments, i.e., SEPA bank transfers as suggested by the PSR*". To the contrary, Professor Rochet has clearly explained that "*the MIT benchmark should be computed using the weighted average of the costs of alternative payments instruments,*

129 IR, para. 9.44 and 9.47.

130 IR, paras. 1.16 and 3.31.

131 IR, para. 9.133.

where the weights reflect the use and availability of these alternative payment instruments across transactions".[132]

5.15 Rather than adopting this established approach, the IR dismisses (as explained in **Section 2** above) the wide range of credible alternative payment methods actually used by EEA consumers and accepted by UK merchants, and instead continues to maintain that SEPA bank transfers should be the only relevant alternative to consider when assessing Visa's XB CNP IFs.[133]

Consistent with this, the IR also fundamentally misunderstands the approach adopted by the EC when assessing, and adopting, the 2019 Visa Commitments Decision that established the IF structure and levels applied by Visa to XB CNP Transactions today

5.16 Contrary to the IR's claims, the EC's assessment with respect to the IF caps contained in the EC's 2019 Visa Commitments Decision did not focus only on non-SEPA bank transfers.[134] Rather, the EC reviewed and endorsed a MIT assessment submitted by Visa[135] and established, after an extensive competition law investigation, and for the first time, a need for different IFs to apply between F2F and CNP transactions. In doing so, Visa and the EC agreed that XB CNP IFs of 1.15/1.50% were justified for inter-regional transactions (including now for UK to EEA transactions) based on an assessment which considered:

(a) **a wide range of alternative payment methods,** namely "*four-party card payment schemes; 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*", including American Express and PayPal,[136] and

(b) **other non-merchant cost-based considerations,** with the EC also reflecting on third-party international issuer feedback on the critical role of IFs in enabling issuers to "*better invest in the well-functioning of inter-regional transactions*".[137]

5.17 The EC also acknowledged a variety of other factors in adopting its 2019 Visa Commitments Decision, including:

(a) acknowledging that its 2015 'survey on merchants' costs of processing cash and card payments' study "*does not examine CNP transactions*", and that "*the choice of a comparator to cards in the CNP context would require an in-depth examination of the payment means [plural] available*";[138]

(b) looking at CP and CNP IFs in combination and taking into account the combined effect on merchants and issuers of Visa reducing CP IFs to 0.2%/0.3% alongside the introduction of the new 1.15%/1.5% caps for CNP transactions, and in particular the overall weighted average IFs for this transaction corridor;

(c) recognising that the combined CP and CNP EC 2019 Commitments caps would result in overall weighted average IFs that fell significantly below the cost of alternative payment methods, such as American Express and PayPal; and

132 [✂]
133 IR, paras. 5.57 and 5.145.
134 IR, paras. 3.28, 5.58, 5.88, footnote 153.
135 EC's 2019 Visa Commitments Decision, para. 71.
136 EC's 2019 Visa Commitments Decision, para. 79.
137 EC's 2019 Visa Commitments Decision, para. 57.
138 EC's 2019 Visa Commitments Decision, footnote 43.

(d) ensuring a level playing field for CNP transactions and recognising that other payment alternatives are significantly more expensive for merchants to accept than a Visa card, such that a reduction in the use of Visa (and Mastercard) cards as a result of a reduction in IFs would only lead to <u>an increase</u> in the cost to EEA merchants where consumers switch to more expensive alternatives, in particular for CNP transactions.

<u>The intervention proposed in the IR risks destabilising the balance that exists between the costs and incentives of merchants/acquirers on the one hand and cardholders/issuers on the other – particularly in the longer term</u>

5.18 Visa's global two-sided payment system enables secure and reliable transactions every day between over 4 billion cards (including over 600 million cards in Europe), 130 million merchants and 14,500 financial institutions in 200+ jurisdictions. Cross-border IFs play an important and legitimate role in supporting the delivery of Visa's global payment system including, in particular, by balancing the interests and costs of the two sides of Visa's payment system, namely UK merchants/acquirers and international cardholders/issuers, as is relevant to this market review. The importance of IFs in balancing the interests of all stakeholders in a two-sided payment system has been reflected in the significant stakeholder feedback received by the PSR.[139]

5.19 Indeed, while the PSR has failed to consult any EEA issuers in the context of this market review, UK issuers have provided relevant feedback on the challenges associated with supporting cross-border transactions, including that:

(a) "*international CNP transactions [carry] a substantially greater risk and operational overhead, even with strong customer authentication*";[140]

(b) issuer costs can be "*higher depending on whether transactions are domestic or cross-border, for example cross-border fraud levels tend to be two to three times higher in both debit and credit cards*";[141] and

(c) XB CNP Transactions have "*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*".[142]

5.20 The IR, however, fails to take this feedback properly into account. It also fails to reflect properly on the potential longer-term risks that may be created by disrupting the balancing role of interchange – for example via:

(a) **a growth in transaction declines** – where, without investments largely funded by IF revenue, issuers may be incentivised to decline a greater number of transactions or would take longer to verify and authorise payments in order to minimise their liability. Examples of such reactions by issuers were, for example, seen following Visa's IF reduction in order to implement the IF levels in the EC's 2019 Visa Commitments Decision, with the number

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139 See, e.g., PSR, 'Stakeholder submissions on discussion of impacts working paper', Lloyds Banking Group, 18 July 2023, p. 29: That IFs offset *"the significant costs issuers incur in relation to processing and servicing card payments e.g. authorising and processing transactions, customer service costs, costs of fraud detection and reimbursement, consumer protections and many other relevant costs*" while also supporting "*innovation and competition to provide consumer and merchant benefits such as contactless payments, card and gambling controls, virtual cards, mobile wallets to name a few".*

140 IR, Annex 2 para. 2.127.

141 PSR, 'Stakeholder submissions on discussion of impacts working paper', Lloyds Banking Group, 18 July 2023, p. 29.

142 IR, Annex 2 para. 2.133.

of declined Visa transactions at EEA merchants involving non-EEA card issuers increasing by approximately [✂][143] compared with no (or very little) change in the equivalent decline rates for EEA domestic and intra-EEA transactions where no IF reduction was applied;[144]

(b) **the imposition/increase of cardholder fees and/or reduction of cardholder benefits –** such an approach was adopted by several UK issuers in response to the IF reductions introduced by the EU IFR caps. MoneySavingExpert reported at the time that "*a number of major providers, including Capital One, RBS and Tesco Bank have already scaled down cashback and loyalty point schemes, citing the forthcoming caps as the reason why*".[145] It also reported that Santander's decision to increase fees on its 123 current accounts at the time may have been driven in part by the EU IFR.[146] Similarly, issuer feedback received by the EC as part of Visa's 2014 commitments decision noted that "*the excessive decrease of MIFs will not lead to a decrease of consumer prices, but rather to an increase in cardholder fees and as a result reduced card use and therefore less efficient use of resources*".[147] And actions taken by the Reserve Bank of Australia to reduce IFs by 50% in 2002 also resulted in consumers paying AU$500 million more in additional card use fees, with similar reactions observed in Spain following the introduction of IF caps in 2005, which resulted in a 50% increase in card fees;[148]

(c) **greater numbers of lost sales and/or higher costs for UK merchants** - where EEA consumers could, in response to less convenience, more friction or an overall less attractive payment experience, choose to transact less with UK merchants (e.g. choosing instead to transact with EU-based merchants), particularly given that the vast majority of XB CNP Transactions comprise discretionary purchases. Similarly, such consumers may also choose to use other popular payment methods available to them, such as other cards like American Express, digital wallets like PayPal, and BNPL providers like Klarna, all of which are significantly more expensive for UK merchants to accept than a Visa card; and

(d) **reduced investments in innovative payment technologies –** including innovations that improve the cross-border payment experience. Without appropriate IF revenue, issuers might not invest, or might invest less, in providing innovative payment solutions that stand to benefit merchants and consumers significantly – e.g., investments in Artificial Intelligence to detect and prevent fraudulent transactions at scale and speed so as to maintain higher transaction authorisation rates,[149] and other market-wide investments

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143 [✂]

144 Based on Visa data.

145 MoneySavingExpert.com, 'Cashback credit card rates to drop as Govt confirms lower interchange fees' (October 2015). https://www.moneysavingexpert.com/news/2015/10/government-confirms-card-charges-shake-up-but-does-it-spell-the-end-for-credit-card-deals/.

146 MoneySavingExpert.com, 'Santander to hike 123 current account and 123 credit card fees' (September 2015).https://www.moneysavingexpert.com/news/2015/09/santander-to-shake-up-123-current-account-and-credit-card-fees-whats-happening/.

147 European Commission Decision of 26.2.2014 in Case AT.39398 – Visa MIF, para. 46.

148 The Centre for Responsible Credit, Money Advice Trust, MoneySavingExpert.com, Christians Against Poverty, the Money Charity and Toynbee Hall, 'Joint statement by consumer bodies expressing concerns about the European Commission's proposal to regulate interchange on card transactions'. https://www.parliament.uk/globalassets/documents/commons-committees/european-scrutiny/Consumer-bodies.pdf.

149 The Fintech Times, https://thefintechtimes.com/how-artificial-intelligence-is-helping-finance-firms-in-the-fight-against-fraud/, 6 June 2022.

that promote, for example, the use, acceptance and risk management of contactless payments in the UK, with the majority of UK transactions (63% of credit card transactions and 76% of debit card transactions) now taking place quickly, seamlessly and conveniently via contactless technology.[150]

5.21 By failing to adopt a reasoned and economically rational approach, which considers both sides of Visa's payment platform, the PSR risks significantly undermining the value currently derived by all users of Visa's platform.

6. CONCLUSION

6.1 The IR's provisional findings and proposed remedies, namely an interim IF cap at 0.2%/0.3% and an enduring IF cap to be determined after publication of the final report:

(a) are not based on any evidence which indicates that Visa's current XB CNP IFs are in fact "*unduly high*", with the IR instead confirming that the PSR does not intend to undertake the necessary assessment of Visa's XB CNP IFs until *after* it has published the final report in this market review; and

(b) are instead based on entirely theoretical and flawed assumptions, including that SEPA bank transfers are the only relevant alternative payment method for assessing XB CNP Transactions and that Visa's XB CNP IFs have benefitted Visa and have directly harmed UK merchants/SMEs, despite all evidence pointing to the contrary including (i) there being a wide range of popular alternative payment options for XB CNP Transactions (e.g., American Express, Diners Club, PayPal, BNPL), all of which are significantly more expensive for UK merchants to accept than a Visa card, and SEPA bank transfers being rarely (if ever) used by EEA consumers for XB XNP Transactions and (ii) the vast majority of merchants with significant volumes of EEA/UK transactions (being large merchants) have relocated their operations post-Brexit in order to route transactions as EEA domestic or intra-EEA transactions, and the PSR having previously found that UK acquirers rarely pass on IF savings to smaller merchants/SMEs.

6.2 Visa has, on the other hand, submitted significant evidence which demonstrates that the UK payments landscape is currently working well for all end-users of its payment system, in line with the PSR's statutory objectives and strategic priorities, and in particular that:

(a) IFs support safe, reliable and efficient payments between millions of EEA consumers with UK merchants, as well as wider innovations that benefit all UK merchants including SMEs; and

(b) Visa's current XB CNP IFs are justified by a number of robust expert economic studies, regardless of whether assessed from an issuer or merchant cost perspective and are in no way harmful to UK merchants.

6.3 Against this background, the IR proposes a significant and onerous regulatory intervention which the PSR does not have the legal powers to implement, and which is not based on a robust assessment of evidence nor any detailed economic analysis conducted by the PSR. The IR altogether fails to consider the short- and long-term impact of its proposals on UK merchants, despite there being evidence that smaller merchants/SMEs are very unlikely to benefit from any interim IF reduction (which instead stands to significantly disrupt and distort the market to the

150 UK Finance, Card Spending data - Updated 18 December 2023. https://www.ukfinance.org.uk/data-and-research/data/card-spending.

detriment of EEA issuers and UK acquirers) and that any unjustified reduction of IFs risks, in the long-term, distorting EEA issuers' incentives to promote efficient and safe cross-border transactions, with the consequence that UK merchants benefit less from participating in the Visa payments system.

6.4 The proposals set out in the IR are therefore clearly inconsistent with, and risk hindering, the PSR's statutory objectives to promote competition and innovation in the interests of all users, in circumstances where the IR has not established any basis on which intervention is necessary, and where Visa's changes to its XB CNP IFs have resulted in an overall impact for UK acquirers of less than 1 pence per transaction with UK merchants that involve a Visa card.

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