Payment Systems Regulator

Working paper

Market review of UK-EEA cross-border interchange fees

Stakeholder feedback to the discussion of impacts working paper

July 2023

MR22/2.5

Contents

1 Introduction

1.1 In December 2022 we published 'A discussion of the impact of the UK-EEA cross-border interchange fees increases' (the 'discussion of impacts working paper') in our market review of UK-EEA consumer cross-border interchange fees (IFs).[1] The working paper asked stakeholders for their feedback on our thinking and understanding so far. In particular, we asked for feedback and any supporting documents and information on:

- the broad set of issues discussed in the paper, including the way UK service users may be affected by the increases to UK-EEA cross-border IFs, and whether we had missed anything out
- our observations on relocation practice as a way to mitigate increases in cross-border IFs
- our observations on price differentiation and whether a merchant's ability to do this may be constrained by any rules on price surcharging

1.2 We received eight responses to our discussion of impacts working paper's invitation for stakeholder feedback. A variety of stakeholders provided submissions, including payment systems, issuers, acquirers and industry bodies representing over 5,000 retailers.

1.3 This working paper summarises the feedback we received from stakeholders who responded to our discussion of impacts working paper and sets out a brief response from the Payment Systems Regulator (PSR). We have also published the non-confidential versions of their responses.[2]

1.4 These stakeholder responses form part of the evidence base for our market review. We are collecting more evidence including information and data through bilateral engagements, voluntary questionnaires, and formal information and document requests.

1.5 Our market review is ongoing. We will take into account the points raised by stakeholders in our analysis of the issues underpinning this market review.

1.6 The remainder of this document is structured as follows:

- In **Chapter 2** we summarise the general comments we have received.
- In **Chapter 3** we summarise the comments received on relocation practice.
- In **Chapter 4** we summarise the comments received on price differentiation.
- **Annex** lists those who responded.

1 MR22/2.4, *Market review of cross-border interchange fees: A discussion of the impact of the UK-EEA cross-border interchange fee increases* (December 2022).

2 MR22/2.4 Submissions, *Market review of UK-EEA consumer cross-border interchange fees: Stakeholder submissions on discussion of impacts working paper* (July 2023).

2 General comments

2.1 In Chapter 2 of our discussion of impacts working paper, we set out that Mastercard and Visa have increased IFs for card-not-present (CNP) UK-EEA transactions using consumer and debit cards from 0.2% and 0.3% to 1.15% and 1.15% respectively.

2.2 That working paper also set out in Chapter 3 that, despite a decline in UK-EEA CNP transaction volumes and values compared with the previous year, outbound IFs paid by acquirers increased by approximately £75 million to £100 million in the first half of 2022. Inbound IFs increased by approximately £100 million to £125 million over the same period, compared with what acquirers would have paid without the increases in IFs.

2.3 The working paper shared our thinking and understanding at that time on the impact of the fee increases on UK service users. We invited stakeholder feedback on the broad set of issues raised, and whether we had missed anything out.

Respondents' views

Potential reasons for the fee increases

2.4 Three respondents highlighted that there was no real rationale for the substantial increase in these fees. Two of these respondents stated that Mastercard and Visa have an incentive to increase IFs due to a phenomenon referred to as 'reverse competition', which describes when increased competition leads to higher prices. They stated that card scheme operators raise IF levels to attract issuers, and the card transactions that come with them, to their scheme, against which they can charge higher scheme and processing fees.

2.5 One respondent said that in the absence of a cost justification, increasing IFs suggest that Mastercard and Visa potentially have anti-competitive agreements and the increases are representative of unfair pricing abuses.

2.6 However, two respondents stated that the previous IF rates were not appropriate as they did not take into account that cross-border fraud levels are typically higher than domestic ones. One respondent said that cross-border fraud levels tend to be two to three times higher than domestic fraud levels in both debit and credit cards. Frictions after the UK's exit from the EU and geographical factors were also cited as potential reasons for higher IF rates. Another respondent suggested that the EU Interchange Fee Regulations (IFR) cap levels, which applied to UK-EEA transactions prior to the UK's exit from the EU, are unlikely to be applicable to the UK after its exit from the EU and are out of date. Furthermore, the same respondent said that outbound and inbound IFs would need to be analysed independently and therefore a new Merchant Indifference Test would need to be conducted.

2.7 Three respondents highlighted the potential benefits of IFs to issuers and that cross-border IFs reflect the substantial value of cross-border transactions to merchants and consumers. One respondent considered that our approach, set out in the working paper, assumes that IFs represent only a cost to acquirers, and that setting the IF at the lowest level will benefit the acquiring side of the market. This respondent said that the working paper understates the criticality and overall positive impact of IFs for acquirers and merchants. The same respondent also highlighted the costs incurred by issuers which factor into the setting of interchange rates.

Impact of the increases in IFs

2.8 Two respondents said that increases in IFs had a negative impact on competition. It was suggested that the multilateral interchange fee (MIF) and increases to the MIF act as major factors against the introduction of new and alternative payment solutions, such as account-to-account payments, and that the PSR should be evaluating this.

2.9 One respondent highlighted that the total impact of the higher IF levels is negligible on a merchant's cost of acceptance and that there was little evidence of merchants passing on card-acquiring costs to consumers. They explained that while the larger merchants are most affected by the increases, they can also potentially mitigate the impacts through relocation. They went on to say that it would be more beneficial to reduce a UK merchant's domestic card acceptance costs.

2.10 One respondent said that since only the largest merchants have the ability to negotiate with the schemes, smaller merchants are put at a disadvantage from higher IFs.

2.11 Three respondents said the time period covered by the analysis in the working paper would have been affected by the COVID-19 pandemic and the UK's exit from the EU. One suggested that the PSR extend its data collection through to 2023 and 2024.

IFs need to be looked at more widely

2.12 One respondent stated there is currently a lack of regulation of UK to rest-of-world cross-border IFs and suggested that the PSR may want to monitor these as well.

2.13 One respondent said that our review should look into IFs more widely. This is because IFs were introduced to incentivise card use, and in the UK where 90% of transactions are made on card, this incentivisation is no longer necessary. They were one of two respondents who stated that multilateral IFs have been legally challenged.

Recommended interventions

2.14 Three respondents argued that cross-border IFs should be capped at 0.2% and 0.3%, as they previously were under the EU IFR. The reasons they argue for doing so are that there has not been any justification for higher fees following EU withdrawal and that Mastercard and Visa have yet to demonstrate that the increases are compatible with competition law and the PSR's statutory objectives.

2.15 One of the respondents suggested the reversal of cross-border IF rates to 0.2% and 0.3% should be a temporary intervention (as they believe there was no reason to increase these fees) while a broader review into the market is conducted. Another said that the conclusion of the review and the implementation of the appropriate remedy should not be delayed so that end users could benefit from a more competitive payments market.

2.16 One respondent suggested that the PSR could use the opportunity of this market review to provide legal certainty over the level of IFs in the future, both domestic and cross-border.

2.17 However, another commented that rather than considering re-imposing cross-border IF caps, the PSR should instead prioritise interventions that boost competition and innovation by encouraging alternative methods for cross-border payments.

Our response

2.18 As part of our market review, we are looking to understand the rationale and impact of the increases in cross-border IFs. The points raised by stakeholders noted above relating to the justification of price rises and the impacts from them will form part of our evidence base for our review of whether the market (or aspects of the market) is working well for service users. In addition to this feedback we received to the discussion of impacts working paper, we are gathering information and data from a broad range of stakeholders through targeted questionnaires, as well as conducting bilateral engagements.

2.19 Regarding the points raised about the PSR looking at IFs more broadly, we outlined our reasons for focusing on a specific set of IFs in our stakeholder input to the terms of reference paper[3], published alongside our final terms of reference. This followed points raised by stakeholders in response to our consultation on the draft terms of reference.[4]

2.20 Lastly, we note that several respondents made suggestions about potential remedies and the prioritisation of interventions. We consider it is premature to discuss these at this stage.

3 MR22/2.3, Market review of UK-EEA consumer cross-border interchange fees: Stakeholder input to the terms of reference (October 2022).

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

3 Relocation

3.1 In our discussion of impacts working paper we set out in Chapter 3 that the impact of IF increases on UK merchants may depend on the ability of a merchant to relocate their transactions. For example, transactions involving EEA-issued cards that are relocated by a UK merchant to the EEA would be treated as an EU domestic transaction and would therefore be subject to lower IF rates than UK-EEA cross-border transactions.

3.2 The paper noted that the largest, well-resourced merchants may be more capable of rebalancing their operations in this way while smaller merchants and/or merchants operating in certain sectors and/or in certain circumstances may not be able to mitigate the impacts of the increases through relocation. The paper also noted that UK merchants who are selling online to EEA customers and are not able to relocate may find themselves at a competitive disadvantage compared with EEA competitors selling online to the same EEA customers.

3.3 We invited stakeholders to provide feedback on our observations on relocation practice as a way to mitigate increases in cross-border IFs.

Respondents' views

Relocation is not a feasible option for many businesses

3.4 Most respondents who commented on relocation as a way of mitigating increases in cross-border IFs said that relocation was not a feasible option for many businesses. In summary, these respondents said that relocation represents a mitigation possibility only for large companies who can justify the additional costs arising from relocation. They explained that this is because a company must have substantial business operations in that country to be able to relocate transactions as domestic ones. For many companies this is very difficult.

3.5 Related to this, one respondent highlighted that relocation is an impractical solution for smaller merchants because they do not have the capability to carry out the necessary relocation to avoid being subject to this increase in fees. They are thus disproportionally affected by the rise in fees.

3.6 However, another respondent said that relocation is also not an option for large British businesses that have a focus on their British presence.

Scheme rules should allow for transaction re-routing

3.7 Two respondents said that cross-border IFs are charged based on the card location versus the merchant location, with the latter defined by where a merchant's principal place of business is or where they conduct 'substantial business activity'.

3.8 It was highlighted, however, that there is nothing in regulation that would prevent merchants from routing their transactions through their different acquirers in different countries. But existing scheme rules negate the importance of acquirer location and hence prevent the merchant from paying IFs at lower domestic rates in those countries.

3.9 Commenting on this, one respondent suggested that it would make sense for a merchant to be able to route any transactions made with cards from a particular country through the merchant's acquirer in that country. They believed that this would allow merchants to route transactions through domestic channels, and cross-border IFs would be less of a concern.

Our response

3.10 We will take into account the points raised by stakeholders around the feasibility of relocation in our analysis of whether and how UK service users are being harmed by the increase in IFs.

4 Price differentiation

4.1 In Chapter 2 of our discussion of impacts working paper we set out that the impact of IF increases on UK consumers depends on the merchant's ability to differentiate their pricing between domestic and EEA-based consumers, either based on where their card is issued or on some broader territorial basis (for example, the customer's home address or the website domain from which they purchase). Where merchants cannot do this, to the extent that costs are passed on, higher outbound IFs rates are likely to result in increased prices for UK consumers as well as EEA ones – even though the IF increases are related purely to EEA-issued cards. On the other hand, the impact of higher inbound IF rates on UK consumers would be more limited with a significant degree of price differentiation.

4.2 We asked for feedback on our observations on price differentiation and whether the ability of a merchant to do this may be constrained by any rules on price surcharging.

Respondents' views

Some price differentiation is already occurring

4.3 One respondent indicated that, as far as they were aware, price differentiation has been occurring in the industry for many years, mainly based on website domain as opposed to customer IP address. With regards to any legal constraints in place, another respondent added that the existing no card surcharging rules do not prevent merchants from price differentiating by levying additional charges with respect to UK-EEA cross-border card transactions to recover the costs associated with such payments.

Price differentiation is not a practical solution

4.4 One respondent stated that price differentiation based on where a customer's card is issued at point of sale for online transactions is not workable in practice since customers tend to only input their card details at the final stage of a transaction. Regarding discrimination based on where the consumer is located, this respondent expressed that consumers would likely catch on and either shop at a different merchant or circumvent the practice via virtual private networks (VPNs). Therefore, they believe price differentiation is not currently a sufficient tool to mitigate rises in IFs.

Our response

4.5 We note different opinions have been given by respondents regarding the ability and preference of merchants to exercise price differentiation. As we continue with our review, we will seek to gather further information (and data) on this to help inform our analysis on the impacts of the IF increases to service users.

Annex

Respondents to the working paper

- British Retail Consortium
- Coadec (rebranded as the Startup Coalition)
- Electronic Money Association
- Lloyds Banking Group
- Mastercard
- Revolut
- SaltPay (now known as Teya)
- Visa

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