

# Market review of card scheme and processing fees

British Retail Consortium  
submission to:

MR22/1.9: Market review of  
card scheme and processing  
fees interim report

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Names of individuals and information that may indirectly identify individuals have been redacted.  
The places in this document where confidential material has been redacted are marked with [X].

# British Retail Consortium

## **BRC response to the PSR's consultation on its market review of card scheme and processing fees interim report**

### **About the BRC (British Retail Consortium)**

The BRC is the lead trade association for UK retail. Our purpose is to make a positive difference to the retail industry and the customers it serves, today and in the future. Retail is the 'everywhere economy,' a vital part of the socio-economic fabric of the UK.

The industry makes up 5% of the UK GDP and is the largest private sector employer, providing 3 million direct jobs and 2.7 million more in the supply chain. Retail has a presence in every village, town, and city across the country. Over 200 major retailers are members of the BRC, with thousands of smaller, independents represented by BRC's trade association members. Together, these businesses operate across all retail channels and categories and deliver over £350 billion of retail sales per year.

We build the reputation of the retail industry, work with our members to drive change, develop exceptional retail leaders, and use our expertise to influence government policy so retail businesses thrive and consumers benefit. Our work helps retailers trade legally, safely, ethically, profitably, and sustainably.

### **Overview**

- We welcome the Payment System Regulator's (PSR) interim report and strongly support its findings that regulatory interventions by the PSR are needed to address the harms arising from the lack of effective competition to the dominant card scheme providers in the UK payments market for core payment processing services.
- The report has confirmed retailers' longstanding concerns that this lack of competition has led to complex, opaque fees and ever-increasing costs. The 30% increase in scheme and processing fees quoted in your report since 2019 has cost retailers at least an additional £250 million per year but this has not been accompanied by commensurate improvements in value, service, or innovation.
- The cards issued by the dominant card scheme providers are well established in the UK market, with high take up by UK consumers, resulting in retailers having no choice but to accept them. This 'must take' status continues to cause significant harm to retailers due to the lack of viable alternative payment methods in the market. We are concerned that the card scheme providers are exploiting their 'must-take' status, with fees to retailers being introduced without clear justification or valuation, and certainly without consultation.
- In light of such clear anti-competitive findings, the PSR must urgently implement remedies (including interim measures if necessary while long-term solutions are developed) that can sufficiently address the anti-competitive behaviour and bring in effective and enduring reform to the market.
- While we welcome the proposals in the PSRs interim report to increase transparency and simplify fees, it is clear that these alone will not effectively address the harms identified. This is particularly the case because, as the PSR itself notes, alternative providers, when present, cannot match the card scheme providers 'one-stop shop' solution for core and optional services.
- The PSR must therefore go further than the remedies being considered in its interim report.

- We strongly believe that the most effective interim solution is for the PSR to require the card scheme providers to rebalance prices charged to issuers and acquirers in order to reduce fees charged to retailers (i.e. mandate that average net pricing to acquirers charged by the schemes must be no greater than average net pricing to issuers). This would be implementable in the short term, increase competition, act to cap fees paid by acquirers and retailers compared with issuers (saving retailers at least £0.6bn annually), and would not increase costs for consumers.
- However, in the longer term only the introduction of a Price Cap by the PSR that sets prices at a level that is fairer to retailers will bring enduring reform to the market.

### **Responses to relevant questions**

Below we provide responses to questions in the consultation that are relevant to the retail sector. We have omitted questions where we do not provide a response. In some cases, a single response has been provided for two or more 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 relevant context to our market review?**

Chapter 3 of the report provides very helpful context, terminology, and explanation for the way that card payment systems operate in the UK, alongside an overview of the different types of cards and transaction types, such as credit v. debit cards, card-present (CP) v card-not-present (CNP) and so forth.

We agree about the significant role that cards play in the UK payments market. Our own research, quoted in your report, shows that in 2022 consumer credit and debit cards accounted for 85% of the total value of UK payments. This is likely to further increase with the use of digital wallets and the decreasing use of cash. Given their prevalence, cards now have a 'must take status' amongst retailers, who must accept them regardless of the harms that have emerged from the lack of competition to the dominant card scheme providers.

We understand the logic in seeking to analyse competition on the issuing side (issuers and cardholders) and on the acquiring side (acquirers and merchants) whilst considering the interaction between both when relevant. This approach has enabled the PSR to find that the competition is stronger on the issuing side than the acquiring side, which we agree with. We agree that a card issuer's ability to switch between card scheme providers encourages the schemes to compete on incentives and pricing for scheme and processing fees to issuers. We also agree with the finding that none of the three potential competitive constraints identified on the acquiring side were determined to be effective, resulting in higher prices and fees for users (which includes retailers) on that side of the system.

#### **2. Do you have any views on our analysis and provisional finding that Mastercard and Visa are subject to ineffective competitive constraints on the acquiring side?**

The report provides a very well-evidenced analysis of the lack of competition facing the dominant card scheme providers, and the associated supply of card scheme and processing services. As mentioned in response to Question 1, we agree with the finding that there is a large imbalance of pricing between the issuing and acquiring sides of the market, namely that the schemes compete on the issuing side to acquire business but not on the acquiring side; with the result of low (and negative) pricing on the issuing side but high and growing pricing on the acquiring side.

This imbalance hugely favours issuers over acquirers and retailers in different – and increasingly diverging – pricing and opportunities for the card schemes to generate revenue. This could be considered discriminatory (through unfair terms of access by the card scheme operators for acquirers and merchants), and creates a double harm to UK payment users:

- direct harm to business-users of payments (i.e. retailers) – of high prices and poor service (i.e. monopolisation); and
- indirect harm to all users of payments – of artificial entry barriers to lower-cost/more-efficient payment alternatives because of the dominance of the card scheme providers which limits the viability of alternative payment types (i.e. predation).

The evidence for the harms that emerge from this pricing imbalance is set out in the provisional findings in the report and the very high profitability of the dominant card schemes. This is why it is necessary for the PSR to urgently introduce a remedy that will require the card scheme providers to rebalance how they charge fees between the issuer and acquirer sides of the market to reduce the unfair and higher costs and fees paid by retailers.

**3. Do you have any views on our analysis and provisional finding that the constraint that consumer steering can pose on Mastercard and Visa is limited by the small number of effective alternatives and by the increased friction that steering could generate in the payment process?**

**4. Do you have any views on our analysis and provisional finding that decisions by operators of wallets are unlikely to result in an effective competitive constraint on Mastercard's and Visa's fees?**

We agree that retailers have limited ability and incentives to steer customers towards alternative payment methods in response to scheme or processing fees, and this is due to the lack of credible alternatives with significant customer uptake in the UK market. The card schemes enjoy a market dominance due to their widespread acceptance, network size and established infrastructure. Retailers have little choice but to accept cards from these schemes otherwise they risk being able to appeal to a large segment of the UK consumer market and consumers may choose to shop elsewhere.

Whilst alternative payment types, such as Open Banking and other account to account transfers are exciting developments in the payments landscape, consumers currently have little incentive to look beyond card payment methods. They incur none of the costs, they have security and enable frictionless transactions, as well as familiarity. Therefore, alongside the 'must take' status of cards, alternative payment types, where they exist, are likely to struggle to rapidly gain a foothold in the marketplace. Further, encouraging the use of alternative payment methods can add complexity and additional friction points to a payment journey and alternatives may lack the consumer protections that exist with cards, impacting consumer take up. This low uptake may impact a retailer's decision whether to implement alternative payment methods given the potential for a low return on investment.

Similarly, digital wallets have not (up to now) increased competition to the card schemes. This is largely because the dominant digital wallets in the UK market such as Apple Pay and Google Pay predominantly have a card(s) as the payment instrument and hence this is not an 'alternative' method of payment, and where they do offer new services (e.g. tap to pay) it often comes with a premium price. As part of it remedies options under Encouraging Steering, Boosting Competition, and Competition Law Enforcement (see response to question 31), the PSR should however explore how digital wallet providers *could* add greater competition by giving thought to their implementation and utility, alongside ensuring that any costs to retailers for their usage are fair.

**5. Do you have any views on our analysis and provisional findings that: (i) alternatives available to acquirers in the UK do not provide an effective competitive constraint on decisions made by Mastercard and Visa in the supply of core processing services; and (ii) that no alternative suppliers of core processing services currently operate in the UK?**

We agree that the lack of alternatives available to acquirers in the UK means there is ineffective competition to the card schemes in the supply of core processing services and that no real viable alternative suppliers of core processing services currently operate in the UK. This has created a situation where the dominant card scheme providers make pricing decisions heavily in their own favour, without constraint, as the PSR report highlights.

The extensive network and established relationships of the dominant card scheme providers with banks, issuers and retailers create high barriers for new entrants and limits the effectiveness of alternative providers as they may struggle to match the economies of scale that the card schemes benefit from. Further, alternative providers need to offer a value proposition that appeals to retailers and consumers to encourage take up, and to the banks as well, as they ultimately hold the customers money, and it is ease of access to these funds without some intermediary step (e.g. loading funds to a wallet) that is critical to uptake by consumers.

**6. Do you have any views on our analysis and provisional findings that: (i) acquirers and merchants typically have limited alternatives available to them for Mastercard and Visa's optional services; (ii) acquirers and merchants face significant implications if they do not use these optional services; and (iii) acquirers and merchants have limited countervailing buyer power when negotiating prices for these optional services.**

**7. Do you think there are any other competitive constraints on Mastercard and Visa in the supply of optional services which we have not yet considered, but that we should consider? If yes, please describe those constraints and their effect on Mastercard and Visa's ability to set prices of optional services.**

**8. Do you have any views on the alternatives to their own optional services suggested by Mastercard and Visa as described in Annex 4? If yes, please explain whether you consider the alternatives to be suitable for all or some purposes and the extent to which they compete with Mastercard and Visa for the supply of a particular optional service (or services).**

**9. Do you have any views on the optional services that we have not focussed on in our analysis (in particular those presented in Annex A to Annex 4)? If yes, please explain what these additional optional services are and what competition concerns you have around the supply of these services.**

*Here we provide a single response to questions 6 and 7. It is our understanding that you also plan to engage directly with retailers to understand more about their experience of the availability of optional services referred to in questions 8 and 9.*

We agree that acquirers and retailers typically have limited alternatives available to them for the card schemes' optional services and that they have limited countervailing buyer power when negotiating prices for these optional services. This means retailers having to accept terms set by these card schemes that often results in higher fees and less favourable conditions.

Many so-called "optional" card scheme services are in practice unavoidable as the schemes may not clearly inform acquirers and retailers that so-called "optional" services are in fact optional, so acquirers and merchants end up purchasing them anyway even if not needed; and even for services that are

genuinely optional, there are few if any realistic alternatives available. There is often a lack of demonstrable value from adopting optional services. Further, the definition of optional in practice can mean even if the merchant chooses not to opt for a service, there is another fee to which they are subject. An example one retailer highlighted is the direct to authorisation fee from MasterCard, where a retailer is charged if an Acquirer TRA exemption is requested in the authorisation flow. While this may be optional, the alternative is to either request it in the authentication flow or to do authentication, and this has its own fee associated. In other words, there are two choices and both result in fees. Additionally, the card scheme's fee structures are extremely complex and opaque, which in turn makes it difficult for merchants to ascertain what they are paying for different transaction types or to avoid 'optional fees'. Some fees are so generically or obscurely described in fee schedules that merchants (particularly SMEs) cannot easily identify them and therefore merchants cannot even attempt to avoid or reject those fees (SCA fees, for example). Merchants can request fee schedules from acquirers, but this is difficult and still not fully transparent. For example, different acquirers pass the same fees with different names and sometimes even diverge from the network interpretation on optionality. Given some services defined as optional by the card schemes often include critical functions such as fraud detection, chargeback management, and enhanced security features, retailers may face substantial operational and financial repercussions for if they are not taken up.

The proposed remedy to increase transparency could increase clarity on the nature, utility and value of a fee to enable retailers to make more informed decisions, but it will not address the lack of alternatives for services which are genuinely optional or address the pricing imbalance that exists within the market, which is leading to higher fees and costs for retailers.

**10. Do you have any views on our analysis and provisional finding that Mastercard and Visa are subject to competitive constraints on the issuing side?**

Whilst we understand the need for incentives to support the cost of issuers' changing to or adopting a particular card scheme, we do agree that the market is characterised by a fundamental imbalance of competition where the card schemes compete to attract issuers (which ultimately benefits the card schemes commercially) and the resultant lower fees on this side of the market, and the higher fees charged to retailers and acquirers on the other side, where there is less competition. Issuers can choose between, and make use of, one card scheme (known as single homing) whereas retailers and acquirers must accept all scheme types used by card holders (known as multi homing) to appeal to as wide a range of consumers as possible and cover market share.

As the evidence shows, this means the card scheme providers benefit from setting higher fees on the side of the acquirers and retailers, where profits can be maximised. The competition for the issuer side of the market should not be used as justification to limit the introduction of remedies that will rebalance prices and increase competition on the acquiring side of the market. Only by tackling this pricing imbalance by requiring the schemes to ensure that average net pricing to acquirers charged by the schemes must be no greater than average net pricing to issuers will bring in much needed reform and lower fees for retailers.

**11. Do you have any views on our analysis and provisional finding that the revenue from the acquiring side accounts for the large majority of net scheme and processing fee revenue for both card schemes in recent years?**

**12. Do you have any views on our analysis and provisional finding that the average scheme and processing fees (as a proportion of transaction value) paid to Mastercard and Visa by acquirers have increased substantially in real terms in recent years?**



Evidence from our members would support this analysis. It is worth highlighting that since the Interchange Fee Regulation came into effect in and capped interchange fees for consumer debit and credit card transactions (within the UK and EU) at 0.2% and 0.3% from 2015, the schemes appear to have supplanted their (regulated) interchange fees with rapidly increasing scheme and processing fees (fees chiefly charged to acquirers) and rebates and incentives (exclusively paid to issuers). The PSR report indicates that incentives paid to issuers in some cases more than totally offset any fees charged to issuers. The net effect is that merchants are now worse off than they were before the Interchange Fee Regulation was created. Namely, scheme and processing fees have gone up by more than interchange fees went down (and continue going up), which may be indicated by the profit margins of the card schemes. The card schemes financial information shows that they are highly profitable, the direct result of high and growing scheme and processing fees.

**13. Do you have any views on the extent to which changes in average fees levels in recent years have been accompanied by commensurate changes in: The value to customers of the services provided by Mastercard and Visa? The quality of service provided by Mastercard and Visa? Innovation by Mastercard and Visa? Aspects of the transaction mix or characteristics of acquirers or merchants that we may not have fully captured in our econometric analysis (see Annex 7)?**

Data and feedback from our members indicate that the fees for non-optional services charged by the card scheme operators have risen significantly over the past few years, often without a commensurate increase in value or service that justify the higher fees. As stated earlier, the lack of transparency and clarity provided by the schemes and acquirers on fees can make it difficult for retailers to determine the necessity and utility of fees.

As we have set out in responses to previous PSR consultations, card schemes have not ever been forthcoming with evidence of the quantification of any supposed value, which we would argue is because the fees do not represent equal value. Additionally, the card schemes often defer the responsibility of explaining fee changes to the acquirers, without equipping them with clear and transparent information to inform retailers. Most of the time when fee changes are introduced, retailers see no difference in the service they are receiving. This is not to say that the card schemes have no value; cards are critical to the UK market at present, but that means that additional fees are added without justification or quantification of the value of said new fee when the schemes are already gathering significant profit from retailers. It is an abuse of the must-take status the card schemes currently hold. So greater transparency, as the PRS is proposing, would be welcome but only a price rebalancing remedy will bring the change needed to reduce costs to retailers.

**14. Do you have any views on our analysis and provisional findings in our profitability analysis? In particular: Are there any factors that we have not covered in our report that may provide information on the relative profitability of Mastercard's and Visa's UK operations compared to their global and European operations? Are there any other comparators that have greater similarity to Mastercard's and Visa's UK operations than those that we have identified in our report?**

The lack of alternatives on the acquirer side of the market means the cards scheme providers do not have to compete on costs and fees in this area, which has led to increasing costs and unduly high fees on this side of the market. The card schemes compete for business with issuers, which has resulted in lower fees and costs on that side of the market. These factors, coupled with the increasing scheme and processing fees, may contribute to excessive profits or at the very least profits that are not justified due to the lack of demonstrable value from accompanying fee changes. This is why a price rebalancing remedy is necessary to ensure fairness across both sides of the market, which the remedies that the PSR is proposing will not, alone, directly address.

Further, the card schemes' financial information, and share price growth, indicate that they make very high levels of profits since they became for-profit public companies in 2006 and 2008, the direct result of the high and growing scheme and processing fees.

**16. Do you have any views on our analysis and assessment of the materiality of issues experienced by acquirers?**

We do not have direct experience of the relationship between the card schemes and acquirers. However, it is important to note that acquirers create another layer of separation between retailers and the card schemes. As set out in our response to question 13, the card schemes may not provide acquirers with the information needed for them to understand and then articulate clearly to retailers the fee changes or to adequately answer any resultant questions. This can mean that not only are retailers not consulted on fee changes, but also sometimes find that information about new fees is communicated late on and fees can be imposed before there is complete readiness across the ecosystem. We have provided fuller details in our response to previous consultations about the impact this separation can have on retailers' operations and costs, including the ability to forecast accurately and perform effective account reconciliations.

**17. Do you have any views on our analysis and assessment of our analysis in respect of behavioural fees, and acquirers' ability to pass these fees on to merchants (as set out in Table 4)? If so, do you have any experience and/or views how widespread the issues identified are and their underlying cause or causes?**

Acquirers' ability to pass behavioural fees on to retailers can have implications for the cost structure and competitiveness of retailers who often have little choice but to accept these fees, even if they are not transparent or justified. Retailers frequently report concerns about unexpected behavioural fees, their complexity, and the lack of clarity around their application. Retailers often find it challenging to understand the basis for these fees and how they are calculated. The increasing complexity of scheme fees is becoming a major challenge for retailers, who must often dedicate entire teams to decode the many hundreds of fees imposed by these schemes. Acquirers may also delay communicating fee changes to retailers which can then result in new fees being applied with little warning and this can impact costs and hinder budgeting and financial planning. This lack of clarity and delay in communication would be helped by the proposed information and transparency remedies but the ever-increasing fees for retailers will only be tackled by introducing a remedy that rebalances how the card schemes charge prices on both sides of the market.

**Responses to questions relating to the proposed remedies.**

It is important to note that the BRC has long brought complaints about the excessive costs of card payments because of the dominance of the card scheme providers. Whilst complaints have led to successive regulatory reviews and indeed reports and conclusions which evidence and support retailers' concerns, the costs of retail payments – and dominance of the card schemes – has continued to increase, as the PSR report shows. This enduring market dominance is a serious market failure, causing harm to UK retailers of increased costs which are far from competitive levels, and a lack of value offered when new services with fees are introduced.

The Government established the PSR to be a *“a new competition-focused, utility style regulator for retail payment systems”*<sup>1</sup> to fix the *“profound competition problems and inefficiencies [in payment systems, ...in*

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<sup>1</sup>HM Treasury, Opening up UK payments, 2013 [2.4].

particular of] anticompetitive dominant card schemes.”<sup>2</sup> The PSR report confirms that these same competition problems and inefficiencies are still present. The PSR therefore needs to put in place meaningful and effective remedies to regulate the payment card firms’ wholesale pricing. Absent this, the dominant card scheme providers fees will continue to rise – imposing even greater costs on retailers, consumers, wider business, and society.

Our response to the remedies section of the report draws on the experience of our members and insights provided by Mark Falcon of Zephyre Ltd, an antitrust and regulatory economics advisory firm. A copy of the full report containing substantive analysis and further details on the proposed remedies provided to us by Zephyre is available separately and we would welcome the opportunity to discuss this with you.

## **20. What are your views on our proposed remedies? Which remedy or category of remedy set out in Chapter 8 do you think we should prioritise implementing?**

We welcome the work that the PSR has done to uncover the harm in the market. However, the remedies that the PSR is considering are primarily ‘information remedies’ about providing the PSR, acquirers, and/or merchants with greater information, and while we welcome these steps, alone they will be insufficient to address the substantial harms of ineffective competitive and large (and rapidly growing) pricing asymmetries highlighted in the report. Alternative (and more effective) remedies that directly regulate scheme and processing fees are therefore urgently needed and the PSR must instead as a matter of urgency:

- develop and implement a “**Price Rebalancing/Non-Discrimination**” remedy as an immediate priority, firstly on a transitional/ interim basis and then permanently (see responses to Question 21 and 31).
- develop and implement a long-term **Price Cap** remedy (see response to Question 29).
- initiate **Interchange Fee Regulation Enforcement** (see response to Question 31).
- explore **Competition Law Enforcement**, especially in relation to digital wallets – (see response to Question 31) and
- explore **Prohibition of Network Exclusivity/Least-Cost Routing** – a type of “boosting competition” remedy mandated in the US and Australia (see response to Question 31).

Information remedies, in particular the PSR’s proposed Regulatory Financial Reporting, Complexity & Transparency, and Timely Notification remedies, will nonetheless be important to support the alternative remedies we propose and should anyway be introduced as a measure of good regulatory practice (see response to Questions 22, 23, and 25).

The PSR should also reconsider how the proposed Pricing Methodology & Governance and Mandatory Consultation remedies are delivered to avoid any unintended consequences and potential legal challenges to the way its implementation is currently proposed.<sup>3</sup> Requiring the schemes to consider the cost, service quality, and service users in pricing of new services and (potentially) the of review of existing services via the schemes preparing a pricing methodology for approval (and/or “non-objection”) by the PSR is unlikely to have a disciplining effect on the schemes’ pricing decisions or address harms identified in the PSR report unless this were to amount to a full Price Cap remedy, namely in which the PSR regulated the schemes’ scheme and processing fees directly. Firstly, if this remedy were only to cover the introduction of new services and changes to prices of existing scheme and processing services (what the PSR calls “*UK pricing decisions*”) but not include review of existing

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<sup>2</sup> Competition in UK Banking: A Report to the Chancellor of the Exchequer, Don Cruickshank, 2000 (the Cruickshank Review) [36, 3.62, 3.98].

<sup>3</sup> Fuller details on these points can be found in the report provided to us by Zephyre Ltd.

prices, then this remedy would likely not prevent increases in scheme and processing fee prices (and may even accelerate increases in average prices) because of the differences in fee levels between the schemes and their market share, which one scheme may argue puts them at a disadvantage.

Secondly, if such a remedy were also to include a review of existing prices, then the PSR would have to address the pricing differences between the card schemes directly – and determine whether one scheme would have to reduce its prices to the same level as the other and/or whether both schemes should both reduce their prices to a new “*cost reflective*” level (and how they should do that). That would in effect then be a full Price Cap remedy (which the PSR says that it is not intending to pursue at the current time). See response to question 29.

## **21. Are any transitional provisions needed?**

The PSR report highlights that whilst it may take up to two years for certain remedies to be implemented (such as the Regulatory Financial Reporting remedy), it may be possible for certain alternative measures to be implemented relatively quickly, and therefore that it may be necessary or appropriate (in line with the PSR's statutory objectives) to put in place short-term interim remedies, while also developing longer-term “enduring” remedies. We agree that transitional measures should be introduced whilst longer term remedies are implemented due to the harm that will continue in the meantime. The price rebalancing remedy could at first be implemented on a transitional basis before becoming enduring whilst the feasibility of a Price Cap is explored. See response to question 31.

## **22. Please explain (with reasons) if you think we should be considering a regulatory financial report remedy?**

Such a remedy is unlikely to change the card schemes business practices to any material degree and therefore is unlikely to address the harms found in the PSR report. However, as a component of a wider set of remedies, it should be considered as standard good regulatory practice in line with the reporting requirements of other UK economic regulators. This would enable the PSR to overcome the significant challenges it says it encountered in looking at the UK profitability of the card schemes, as it would therefore require the card schemes to prepare profit & loss and balance sheet reports in relation to their UK activities in accordance with an appropriate methodology (which could be based on templates used by other regulators) on an enduring basis. The information obtained about the card schemes UK pricing and profitability could then form the basis of introducing a Price Cap remedy in the longer term.

## **23. Please explain (with reasons) if you think we should be considering possible mandatory consultation and timely notification requirement remedies?**

## **24. Do you have any views on ways in which other stakeholders, for example merchants, merchant associations and consumer groups could participate in consultative discussions with the card schemes?**

A Timely Notification remedy would be welcome. This would give retailers much needed opportunity to plan and prepare for potential implications of any scheme fee changes - both from a financial planning perspective and being able to plan in any changes which require resources and development (i.e. to be able to comply and/ or avoid any 'behavioural' fees, or benefit from new services being charged for) before they are introduced.

A Mandatory Consultation remedy however, whilst welcome if implemented correctly, is unlikely to be effective in addressing the ineffective competition, pricing imbalances, and price rises that the PSR

report has found. Whilst important, it is very unlikely that a requirement for the schemes to consult acquirers on fee changes – and to report to acquirers (and the PSR) how the schemes have taken such feedback into account – could make any material difference to changes to future fee changes (or to reverse past fee changes), unless:

- acquirers had a right to refuse such fee changes; and/or
- the PSR specified the circumstances (in advance) in which it might disallow a proposed fee change.

Further, it is unlikely that merchant associations and/or consumer group consultative discussions with the card schemes could resolve the harms identified in the PSR report unless such merchant associations and/or consumer groups had a right to veto any such scheme fee changes. This is why the PSR should focus its interventions on rebalancing prices on both sides of the market.

**25. Please explain (with reasons) if you think we should be considering possible remedies to address complexity and transparency issues? In particular, do you think that more detailed, timely and accurate information in respect of behavioural fees would help acquirers and merchants? Do you think a taxonomy or system for classifying fees into different categories would help service users?**

As we have described throughout this response, retailers have long identified significant concerns in relation to the complexity and lack of transparency provided to them by the schemes and its impacts on costs, which the PSR report also finds. Therefore, we would welcome a remedy that effectively leads to clearer information to merchants on how scheme and processing fees work and more timely, accurate and relevant information about the card schemes “optional” and behavioural fees including a clear justification of the fees and (where applicable) the anticipated benefits to acquirers and merchants of new fees or fee changes. Any rules for scheme and processing fees should be like those that already apply to interchange fees, i.e. full publication, and a requirement for a reduced number of categories. This remedy would not however negate the need for direct regulation that would require the schemes to rebalance the fees charged on the issuing and acquiring sides of the market which, in lieu of a price cap, remains the only effective way to bring fairness to the market and reduce fees for retailers.

**26. On the assumption that some or all of our proposed remedies are taken forward, do you have views on whether the costs (implementation or other) incurred by various market participants, including the schemes, issuers, acquirers and merchants, would 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 remedy be captured (or absorbed) through ‘business as usual’ activity?**

We are not able to comment on the costs of implementing the proposed remedies, but we would urge that any costs are not passed onto retailers, who already pay significant amounts to use the payment networks.

**27 Do you agree that the initiatives we considered to boost competition are unlikely to achieve the outcomes we would want to see in a timescale that removes the need for regulatory intervention? Please explain your position either way.**

**28. Do you agree that the initiatives we considered to encourage surcharging or other forms of steering are unlikely to remove the need for regulatory intervention? Please explain your position either way.**

We agree that initiatives to encourage surcharging or other forms of steering are unlikely to remove the immediate need for regulatory intervention, for the reasons we set out in response to question 4. The current PSR market review nevertheless itself provides opportunities to boost competition, including:

- “structural” competition between card payments and alternative payment methods (such as account-to-account/open banking payments); and
- competition between the card schemes by introducing the Price Rebalancing/Non-Discrimination remedy which would remove exclusionary barriers created by the schemes to alternative payment methods, and competition on the acquiring side of the card scheme platforms.

A Prohibition of Network Exclusivity/Least-Cost Routing-type remedy (as mandated in the US and Australia, see our response to Question 31) could also have the potential to boost competition significantly between the card schemes, and potentially also with alternative payment methods.

Digital wallets could also provide significant scope to boost competition between the card schemes alongside alternative payment methods but only if designed in a way that constrains the dominant schemes current anticompetitive position, and subject to the PSR addressing competition law infringements that appear to be preventing such competition (see response to Question 31).

The Payment Services Regulations 2017 in any event prohibits merchants from surcharging UK domestic consumer card payments (which constitute the vast majority of UK card payments) so even if merchants wanted to steer customers by surcharging (the most likely method of steering) then such steering would not be possible anyway without a change in UK law. Further, surcharging consumers, which most retailers would not likely favour, does not directly address the harm identified by the PSR.

**29. Do you agree with that a price cap or price control could not be implemented following this market review given the issues identified in this interim report, in particular with regard to collective robust and reliable data from the card schemes? Please explain your position either way.**

The PSR explains that it does not consider that a Price Cap is an appropriate remedy for now because the schemes compete on the issuing side of the market, and that there may be competition in the supply of certain optional services. The lack of robust and transparent data from the card schemes was also cited as a reason for not implementing a Price Cap at this time. The PSR nonetheless says it would consider a Price Cap in future, especially with access to better data.

We believe these reasons are why the PSR should start developing a Price Cap as a matter of priority (given the time needed to implement it), and work with retailers, trade bodies and others to determine how it should work in practice (for example, considering whether a cap would apply per transaction or an average basis, and so forth).

Firstly, the fact that the schemes compete on the issuing side but not on the acquiring side is – in the case of multi-sided platform markets such as the card schemes – evidence of substantial overall harm (i.e. on both sides of the card scheme platforms), namely of *monopolistic* conduct towards acquirers/merchants and *predatory/exclusionary* conduct towards rival payment methods. Such harm must therefore be addressed holistically.

Moreover, the fact that the schemes compete on the issuing side of the market and may compete in the supply of certain optional services, is not a reason against a Price Cap. A direct analogy to this is the regulation of electronic communications wholesale voice call termination services – also multi-



sided platform markets, in which fixed and mobile telecoms network operators face effective constraints one side of their platforms (the markets for fixed and mobile telecoms subscribers), but face no competitive constraints on the other side (the markets for fixed and mobile voice call termination services – when a call is terminated from one fixed or mobile telecoms network to another). Ofcom therefore applies a long-established Price Cap on call termination rates.

Whilst we understand the value and need for incentives on the issuer side, rebalancing the fees charged on both sides of the market is key to ensuring fairness in the system and a remedy that addresses this in the short to medium term whilst a Price Cap is developed in the longer term is the only viable solution to tackling the harms identified in the report.

Second (as explained in response to Question 20), the PSR's proposed Price Methodology & Governance remedy would only be effective if it amounted to a full Price Cap, namely a remedy in which the PSR regulated the card schemes and processing fees directly (or at least approved the schemes' proposed pricing methodologies for all the schemes' new and existing prices). Such a remedy would moreover indirectly regulate the cards exclusionary conduct (on the issuing side of the card scheme platforms) – by considerably limiting the revenues and profits that the schemes can make on the acquiring side, and therefore their funds (and incentives) to pay “incentives” on the issuing side (except by greater efficiency or other genuine competitive advantage).

Nonetheless, to be workable, such a Price Methodology & Governance/Price Cap-type remedy would also need to be accompanied by the PSR's proposed Complexity & Transparency remedy to reduce scheme and processing fees to a manageable and far lower number. Thus, such a remedy would inevitably take time to implement. But that would appear to be a major reason to start it sooner rather than later.

A Price Rebalancing/Non-Discrimination remedy would however provide an interim (and permanent), remedy until the PSR were able to put in place a full Price Cap remedy (as explained in reply to Question 31).

**30. Should any remedies be time-limited? If so, please provide a recommended timescale together with your reasons.**

Except for a transitional price rebalancing remedy, all other remedies should be permanent, but of course be subject to regular review (as are all regulatory instruments) at minimum for example every five years (and sooner under certain defined conditions, e.g. emergence of clear unintended consequences).

**31. Are there other remedies we should consider on either an interim or long-term basis? We would be particularly interested in evidence to demonstrate why any such remedy was proportionate and capable of being effective in addressing the problems we (or you) have identified.**

Below we provide further details and rationale for the remedies that we have proposed in response to questions 20-31. Further details on these remedies can be found in the report provided to us by Zephyre Ltd.

**1. Price Rebalancing/ Non-Discrimination remedy**

As we have detailed, a Price Rebalancing/Non-Discrimination remedy would require that a card scheme's average net pricing to acquirers, i.e. their average scheme and processing fees net of rebates and incentives if any (as a proportion of its transaction value) must be no greater than its

corresponding average net pricing to issuers.<sup>4</sup> Such average fees must also not discriminate by type of merchant (e.g. large or small), type of card (e.g. consumer or commercial card), or type of transaction (e.g. card present or not-present, domestic or inter-regional), absent PSR-approved cost justification, and must apply to all transactions at UK merchants (i.e. whether domestic or inter-regional, as defined in the Interchange Fee Regulation). The report by Zephyre Ltd provides further details on how this remedy would work in practice, but its design and implementation should be discussed with retailers, trade associations and others to determine how best to rebalance fees to ensure fair pricing across different end users (for example, considerations such as whether a fee should be based on a percentage of a transaction value or on a per transaction basis or a flat scheme fee).

This remedy reflects that the essential evidence of the PSR Report of:

- **substantial imbalance of competitive-constraints** – i.e. competitive constraints on the issuing side, but no effective competitive constraints on the acquiring side; and
- **substantial imbalance of pricing** – i.e. low or negative prices on the issuing side, but high prices on the acquiring side.

This evidence together shows that the harms associated with the card schemes scheme and processing fees entail:

- monopoly conduct on the acquiring side – of excessive prices to acquirers and merchants; and
- exclusionary/predatory conduct on the issuing side – of creating artificial barriers to lower-cost and/or more-innovative alternative payment methods.

A Price Rebalancing/Non-Discrimination remedy would therefore be a clear and demonstrable remedy to these harms, by:

- removing the imbalance of competitive constraints (by creating an indirect competitive constraint on the acquiring side from the issuing side); and
- removing the pricing imbalance.

It would also be directly aligned with the PSR's Financial Services (Banking Reform) Act 2013 statutory objectives to (1) *promote effective competition between different operators of payment systems*, (2) *to promote the development of, and innovation in, payment systems in the interests of those who use, or are likely to use, services provided by payment systems* and (3) *to ensure that payment systems are operated and developed in a way that takes account of, and promotes, the interests of those who use those services*.

A Price Rebalancing/Non-Discrimination could rapidly and readily be implemented on an initial self-reporting basis (assuming a three-year phase-in period from 2025<sup>5</sup>) although it could be implemented much sooner. Figures 1 below shows how net acquirer and issuer scheme and processing fees would converge to a common level, split initially 75%:25% between acquirers before equalising in 2027. Using fee and profit calculations from the PSR report, this would imply a reduction in UK acquirer scheme and processing fees of 33% – or £0.6 billion annually to UK merchants.

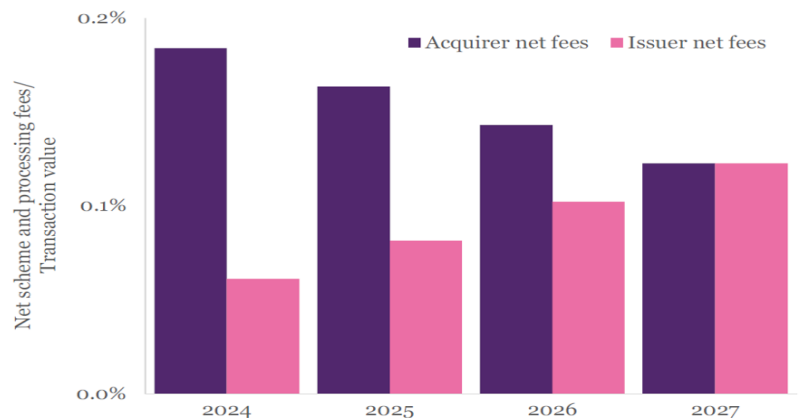
**Figure 1 A Price Rebalancing/Non-Discrimination remedy would mean equalisation of net acquirer and issuer scheme and processing fees**

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<sup>4</sup> For example, if a schemes average net fees to issuers were 0.1% in a given year (as a proportion of transaction value) then they would have to ensure that its average net fees to acquirers were also 0.1% (and/or otherwise pay rebates back to acquirers and merchants on a pro rata basis to keep their average acquirer fees below that level).

<sup>5</sup> This period is indicative and could be introduced sooner.





Source: Zephyre calculations.

A *transitional* Price Rebalancing/Non-Discrimination remedy is a clear candidate for such a short-term remedy (in anticipation of a longer-term package of enduring remedies, including a *permanent* Price Rebalancing/Non-Discrimination and a Price Cap (see response to Q31).

The price rebalancing remedy could be introduced after the interim period as a longer-term remedy by introducing a rule that a card scheme's average net pricing to acquirers must be no more than "X" times greater than its average net pricing to issuers, where "X" is number greater than one and would gradually reduce over time. The PSR Report indicates that X is currently approximately 3 (three), i.e. that average net pricing to acquirers is currently three times average net pricing to issuers. The PSR could therefore implement an interim/transitional rule that X had to be 2.5 for example during the first year of implementation and then subsequently fall to 2.0 during the second year (and so forth). Such a rule would initially be subject to self-reporting requirements by the schemes (with penalties if later found to be non-compliant).

An interim Price Rebalancing/Non-Discrimination remedy would mean progressive equalisation of net acquirer and issuer scheme and processing fees. This would then allow time for the PSR to implement longer-term remedies including a *permanent* Price Rebalancing/Non-Discrimination remedy and/or Price Cap remedy (supported by the Regulatory Financial Reporting, and Complexity & Transparency remedies).

## 2. Prohibition of Network Exclusivity/Least-Cost Routing remedy

As explained in response to question 10, the asymmetric competitive constraints and pricing found in the PSR Report tends to reflect asymmetric "*homing*" decisions between acquiring and issuing, namely:

- issuers (and cardholders) generally "*single home*" choose either scheme; and
- acquirers (and merchants) thereby invariably "*multi-home*" and have no choice but to accept both card schemes.

This explains why the card schemes face competitive constraints on the issuing side of card platforms – but ineffective constraints on the acquiring side. A solution to this problem therefore adopted by some countries – notably the US and Australia – is to mandate that debit cards must multi-home between at least two alternative card networks.

This then means that merchants have a choice of card network and that is therefore likely to increase competition. This regulatory solution is known as Prohibition of Network Exclusivity (in the US) and Least-Cost Routing (in Australia) and studies from Australia show these have been effective in reducing

card acceptance costs. Consideration would need to be given as to how this could be practically implemented in the UK (given the lack of a UK domestic card scheme) and how issuers and schemes could be supported to introduce this remedy.

### **3. Interchange Fee Regulation Enforcement remedy**

The PSR should investigate if the behaviour and practices of the card schemes amount to breaches of the Interchange Fee Regulation (or other statutory breaches), especially the PSR's evidence that: *"Visa and Mastercard provide high incentives to issuers, in some cases more than totally offsetting the fees charged to issuers"* and *"[among other things] incentives [to issuers are] used to secure issuing portfolios"*. The Interchange Fee Regulation caps interchange fees and prohibits practices that: *"[the interchange fee caps are] circumvented by alternative flows of fees to issuers [such that... when] calculating the interchange fee [...] the total amount of payments or incentives received by an issuer from a payment card scheme with respect to the regulated transactions less the fees paid by the issuer to the payment card scheme should be taken into account."*

The findings in the report suggest that the combination of scheme and processing fees charged by the schemes to acquirers plus the high rebates and incentives to issuers may constitute alternative flow of fees from card acquirers to card issuers identical to interchange fees. The PSR should investigate and take enforcement action where necessary.

### **4. Competition Law Enforcement remedy**

In announcing its recent Strategy, the PSR said that when facing problems stemming from insufficient competition, the PSR has the option of:

- creating or improving the conditions for the development of effective competition;
- taking action to address the harm directly, such as a Price Cap; or
- undertaking an enforcement investigation, such as under the Interchange Fee Regulation, PSRs2017, FSBRA2013, or competition law, under the Competition Act 1998 (CA1998), where there is reasonable suspicion of a breach.

Further to this, evidence in the PSR report indicates multiple potential breaches of competition law – in relation to scheme and processing fees – that the PSR should therefore investigate, including:

- scheme and processing fees (in combination with incentives) themselves constitute a breach of CA1998;
- digital wallet operators' apparent contractual limitations to steer customers to non-card payments represent a breach of CA1998; and
- the mechanisms by which the card schemes generate substantial FX conversion income also constitute a breach of CA1998.

**32 Are there any relevant customer benefits that we should consider as part of our assessment of any possible remedies?**

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

As well as the direct benefits to retailers of lower prices (from the price rebalancing remedy) and demonstrable value for fees and services and clearer value for money (from the information remedies), the PSR should also consider indirect benefits to all payment users that would result from reducing barriers to entry and expansion of innovation and alternative payment methods.

Additionally, lower operating costs for retailers from a reduction in scheme and processing fees could mean lower costs to serve customers and should therefore result in better outcomes for consumers.

Additional considerations include (1) the international experience of payment cards regulation – especially from the European Union (EU), United States (US), and Australia/New Zealand; (2) UK experience of payments card regulation before the PSR was set up (and how this informed the PSR's statutory powers and objectives); and (3) economics and regulation of multi-sided platform markets more generally. These factors are especially relevant to analysing the dynamics of competition and pricing in the card schemes, and to insights for the alternative remedies proposals that we provide in our response.

### **Commercial cards**

Between 2020 and 2023 average commercial card interchange fees (for a sample of BRC members) have increased from 0.8% to 1.2% (much greater than increases in average scheme and processing fees). This has been driven by:

- high switching of commercial debit cards from Visa to Mastercard;
- much higher Mastercard commercial debit card interchange fees than Visa; and
- increase also in Visa's commercial debit card interchange fees.

Such an increase in average commercial card interchange fees has cost UK merchants over £200m<sup>6</sup> annually and almost £400m in total since 2020<sup>7</sup> – of which over half is explained by issuers switching from Visa to Mastercard, and the remainder by Visa increasing its interchange fees in response.

In total, commercial card interchange fees now represent almost 30% of UK merchants' total interchange fee bill (in 2023) – up from just over half that amount in 2020. So, this is a big impact for all UK merchants and even greater of course for merchants with a large share of commercial card transactions.<sup>8</sup>

This substantial recent increases in commercial card interchange fees are another case of how the cards market is not working (and closely linked to scheme and processing fees). Some BRC members have expressed concerns that the PSR should be considering unregulated interchange fees as well as scheme and processing fees – and moreover that focusing on scheme and processing fees in isolation may create a situation of even further unregulated interchange fee increases.

The PSR should therefore start an additional card fee review of commercial card interchange fees. Further context and analysis on the commercial card market is provided in the report produced for us by Zephyre Ltd.

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<sup>6</sup> Assuming commercial card purchases equal to 5% of total Mastercard and Visa card purchases of £940 billion in 2023 (source: UK Finance UK Payment Statistics).

<sup>7</sup> For 2020-23 inclusive.

<sup>8</sup> For some merchants, all their card transactions will be commercial cards, i.e. merchants in wholesale/business-to-business only sectors.

# PSR Market review of card scheme and processing fees: Report for the British Retail Consortium

August 2024



# Zephyre

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## About the British Retail Consortium

The BRC is the trade association for the UK retail industry, the UK's largest employer, spanning large multiple and international retailers to small independents; from high street, out-of-town, to online; and from fashion, food & drink, to media & entertainment.

The BRC supports and campaigns on behalf of its members on a wide range of issues – including business tax & rates, sustainability & climate action, digital transformation, trade, diversity & inclusion, and retail violence & crime.

The BRC has campaigned against the high cost of accepting card payments for over 30 years – most recently playing a leading role in the industry-wide Axe the Card Tax campaign. Despite that, the BRC's annual *Payments Surveys* shows that UK card scheme and processing fees have increased year-on-year for at least the last seven years, by on average 36% per year.

## About Zephyre

Zephyre is a competition and regulatory economics advisory firm focusing on financial services, retail, technology, and utilities markets. Zephyre supports businesses, investors, law firms, public bodies, and civil society organisations.

Zephyre is acting/has acted for parties in significant competition law and regulatory actions in the UK, EU, and US, including antitrust litigation, merger reviews, price control reviews, regulatory appeals, and super-complaints.

Zephyre was founded in 2016 by [REDACTED]. [REDACTED] has over 25 years' experience as an expert economist in front of UK, EU, and US competition authorities, sector regulators, courts, and legislators, as an independent expert and a principal.



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## 1. Executive summary



## 1. Executive summary continued

1. The British Retail Consortium (**the BRC**) asked [REDACTED] of Zephyre Ltd (**Zephyre**) – an antitrust and regulatory economics advisory firm – for an expert economist report for responding to the Payment System Regulator (**the PSR**)’s Market review of card scheme and processing fees (**the PSR Review**) and PSR Interim report consultation paper (**the PSR Report**)<sup>1</sup>.
2. In summary, the cards market is not working well.
3. This has resulted in UK retailers, led by the BRC, bringing longstanding and repeated complaints about the high cost of card payments to UK (and EU) regulators: a market dominated by global payment card firms Mastercard and Visa.
4. The BRC’s initial complaints led to successive regulatory interventions – but the cost of card payments and dominance of the card schemes has nonetheless continued to increase, as the PSR Report shows.
5. In particular, the PSR Report shows the enduring dominance of the global card schemes, resulting in:
  - harm to retailers (and “*merchants*” generally) – of prices and services far from competitive levels; and
  - harm to all consumers, businesses, and wider UK economy<sup>2</sup> – of high costs, low efficiency, and low innovation.
6. Further to merchants’ complaints the Government established the PSR to be a “*competition-focused, utility-style regulator for retail payment systems*”<sup>3</sup> – to fix the “*profound competition problems and inefficiencies [in payment systems, ...in particular of] anti-competitive and inefficient wholesale pricing [...] most severe in the Visa and Mastercard [...] card schemes*”<sup>4</sup>.
7. The PSR Report confirms these enduring competition problems and inefficiencies, especially of anti-competitive and inefficient wholesale pricing.
8. So now is the time for the PSR to act – to put in place meaningful remedies to regulate the payment card firms’ wholesale pricing and related terms of business.

<sup>1</sup> Payment Systems Regulator Consultation Paper: Market review of card scheme and processing fees Interim report MR22/1.9, May 2024 (**the PSR Report**).

<sup>2</sup> Including many charities and large parts of the public sector. For example, HM Revenue and Customs is currently one of the largest damages claimants against Mastercard and Visa (see case 1585/5/7/23 (T) *The Commissioners for His Majesty’s Revenue and Customs v Mastercard & Others* at the Competition Appeal Tribunal (**the CAT**)).

<sup>3</sup> HM Treasury, Opening up UK payments, 2013 [2.4].

<sup>4</sup> Competition in UK Banking: A Report to the Chancellor of the Exchequer, Don Cruickshank, 2000 (**the Cruickshank Review**) [36, 3.62, 3.98].





## 1. Executive summary continued

Absent this, Mastercard's and Visa's fees will only go on rising – imposing even greater cost on merchants, consumers, and the UK economy.

### (I) The PSR Report confirms Mastercard's and Visa's dominance of UK retail payments

9. The BRC (along with EU retail trade associations) have brought successive complaints to UK and EU regulators about the high costs of card payments over the last 30 years. This led to the UK/EU Interchange Fee Regulation<sup>5</sup> and to creation of the PSR among other things.
10. The Interchange Fee Regulation caps payment card interchange fees for consumer debit and credit card transactions – within the UK and European Economic Area (EEA) – at 0.2% and 0.3%<sup>6</sup>.
11. Figure 1 below (reproduced from the PSR Report) illustrates that interchange fees are the fees paid by card acquirers (the firms that provide card acceptance services to retailers and more generally “*merchants*”) – to card issuers (the firms that provide cards to consumers and businesses to be able to make payments at such merchants)<sup>7</sup>.
12. Figure 1 also shows the other types of fees paid (or received) by card payment system operators, card issuers, acquirers, cardholders, and merchants.

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<sup>5</sup> EU Regulation (EU) 2015/751 and UK Payment Card Interchange Fee Regulations 2015 (**the Interchange Fee Regulation**).

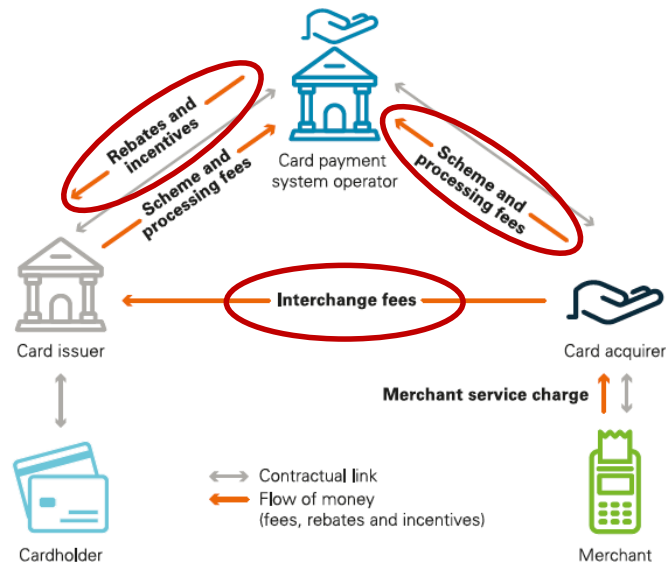
<sup>6</sup> As a proportion of transaction value.

<sup>7</sup> Interchange fees are generally set by card payment system operators – chiefly Mastercard and Visa (or set by regulation). Card issuers are mostly banks and building societies, whereas card acquirers are mostly non-bank financial firms.



## 1. Executive summary continued

**Figure 1: Acquirer “scheme and processing fees” and issuer “rebates and incentives” have supplanted interchange fees**



Source: PSR Report, Figure 3 (highlighting added).

13. But as the Interchange Fee Regulation came into effect – in 2015 – Mastercard and Visa supplanted regulated interchange fees with “*scheme and processing fees*” (charged by the card schemes to acquirers) and “*rebates and incentives*” (paid by the card schemes to issuers), as also illustrated at Figure 1<sup>8</sup>.
14. Hence, as Figure 1 shows, scheme and processing fees plus incentives are essentially a means of bypassing the Interchange Fee Regulation. The net effect is that merchants are now worse off than they were before the Interchange Fee Regulation came into effect – with scheme and processing fees up by more than interchange fees went down. Namely, as one set of card fees became regulated (i.e. interchange fees) then new fees popped up (i.e. scheme and processing fees): a case of regulatory “whack-a-mole”.
15. In particular, the PSR Report finds that Mastercard and Visa UK scheme and processing fees (and rebates and incentives) have been rising rapidly – “*by more than 30% in real terms [...] over the past five years*” [1.4] and that “*merchants [now] pay annually [...] at least £250 million*” higher in fees [6.89].

<sup>8</sup> The PSR moreover reports that such incentives paid to issuers in some cases “*more than totally offset any fees charged to issuers*” [1.20], i.e. Mastercard and Visa pay net fees to issuers.

## 1. Executive summary continued

16. The PSR should nonetheless have compared the whole period since the Interchange Fee Regulation came into force (rather than just the past five years) – for which the PSR’s evidence shows that scheme and processing fees have actually risen by almost 300%<sup>9</sup>. This equates to almost £1 billion annually in higher fees to UK merchants<sup>10</sup> – or over £4 billion cumulatively in higher fees between 2015 and 2023.
17. Such estimates are moreover highly conservative given other evidence sources and could be much higher still.
18. Furthermore, rapidly rising Mastercard and Visa fees and incentives reflect not just the UK, but also the rest of the World, as illustrated by Figure 2. This is also despite interchange fee regulation in all the most advanced payment cards markets (especially the UK, EU, US, Australia, and New Zealand).

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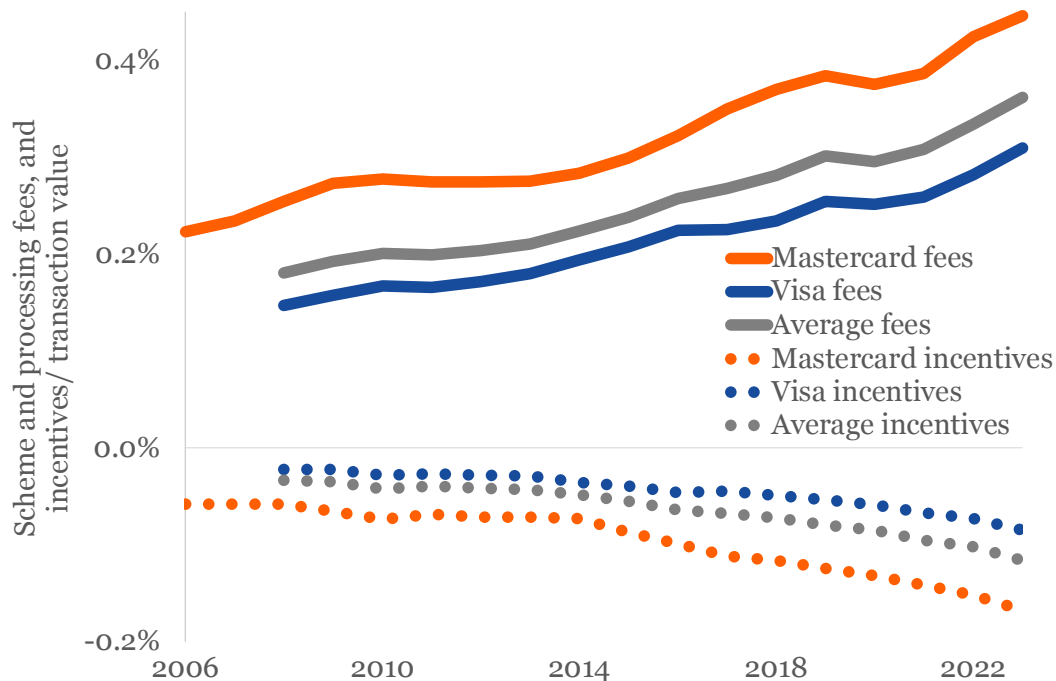
<sup>9</sup> Namely, since the last full year before the Interchange Regulation came into force (2014), in which the PSR reports that scheme and processing fees charged to acquirers were 0.03% (as a proportion of transaction value) rising to 0.09% by 2018 (see PSR Report Figure 1) and then a further 30% since then, a total increase of almost 300% or four times.

<sup>10</sup> Assuming Mastercard and Visa total payment card purchases of £940 billion in 2023 (source: UK Finance) and PSR estimated scheme and processing of 0.12% of card transaction value for 2023.



## 1. Executive summary continued

**Figure 2: Mastercard and Visa fees and incentives have grown ever upwards despite interchange fee regulation**



Source: Mastercard and Visa annual reports plus Zephyre calculations.

19. In particular, Figure 2 shows that:
- Mastercard's and Visa's global average fees<sup>11</sup> and incentives (as a proportion of transaction value) have grown ever upwards year-on-year<sup>12</sup> (with the exception only of the pandemic in 2020); and
  - Mastercard's fees and incentives have been consistently above Visa's<sup>13</sup>.
20. Mastercard's and Visa's global fees and incentives are indicative of corresponding UK levels and increases<sup>14</sup>.
21. The PSR Report moreover provides far-reaching evidence and analysis of the competitive dynamics that explain these rapidly rising fees and incentives in the Mastercard and Visa payment systems.

<sup>11</sup> Namely, gross scheme and processing fees (i.e. before incentives) stated as a proportion of total card transaction value, also including foreign exchange (FX) margins on cross-border payment card transactions.

<sup>12</sup> Since Mastercard and Visa became for-profit public companies in 2006 and 2008.

<sup>13</sup> On average by 55% or 0.11 percentage points between 2008 and 2023.

<sup>14</sup> Or at least the level of fees that the card schemes aim to achieve in the UK.



## 1. Executive summary continued

22. Visa has already said though that it “*fundamentally disagrees with PSR Report findings*” – on grounds that the PSR Report “*doesn’t reflect the dynamic and competitive nature of the markets that Visa operates in, as Visa’s pricing and fee structure is [in actual fact] based on the value that Visa brings [...especially the] reliability, security, stability, as well as the consumer protections that Visa offers to consumers and merchants...*”<sup>15</sup>
23. In contrast to this Mastercard former Executive Chairman Ajaypal S. Banga<sup>16</sup> explains that “[Mastercard’s] pricing is a function of what [Mastercard] thinks the market can bear, both on acquiring pricing and issuing pricing”<sup>17</sup>, i.e. what Mastercard can get away with charging.
24. The PSR Report does not deny that Visa or Mastercard bring great reliability, security, and user protections – to the benefit of consumers, merchants, and the economy. It does not follow though that the markets that the card schemes operate in – or fees that they set – are competitive.
25. On the contrary, the PSR Report shows a highly skewed balance of competition and pricing between the acquiring and issuing sides of the Mastercard and Visa platforms, of:
- competitive constraints on the issuing side – but no competitive constraints on the acquiring side; and
  - low (and negative) pricing on the issuing side – but high and growing pricing on the acquiring side.
26. Namely “*Mastercard and Visa [...] cards are must-take [cards] for merchants in the UK*” [1.16]: i.e. Mastercard and Visa are monopoly suppliers to UK retailers. They face no effective competition especially with each other. Hence, it is unsurprising that Mastercard and Visa charge high and ever-growing fees to retailers, along with providing poor and inadequate service, as the PSR finds.
27. Retailers (and merchants generally) are the chief business-users of payment services in the UK: so Mastercard’s and Visa’s fees are a huge cost to UK business.
28. In contrast, on the issuing side of the card schemes, Mastercard and Visa compete for card issuers – chiefly banks – to issue their cards. This has two large negative effects.

<sup>15</sup> Chris Suh, Chief Financial Officer (CFO), Visa Inc, at Bank of America Securities 2024 Global Technology Conference, 4 June 2024 (transcript).

<sup>16</sup> Now President of the World Bank.

<sup>17</sup> Mastercard Q3 2018 Results – Earnings Call Transcript.



## 1. Executive summary continued

29. First, it means that card issuers, i.e. banks, have significant influence and control over Mastercard and Visa – something also that the PSR was set up to stop.
30. Second, it means that Mastercard and Visa pay large “incentives” to issuers to issue their cards (paid out of the scheme and processing fees charged to acquirers and merchants). And such incentives harm consumers, businesses, and the economy – as they fuel excessive use of card payments at the expense of lower-cost and more-innovative alternatives. (This is also called entry-deterrence, predation, and market exclusion.)
31. Evidence of such predation is the fact that *higher-cost* Mastercard is steadily overtaking *lower-cost* of Visa, as illustrated by Figure 3 below. Namely, since 2008, Mastercard has grown globally by 256% (or 9% annually) compared to 160% for Visa (or 7% annually)<sup>18</sup> – from a 33% Mastercard global card market share<sup>19</sup> in 2008 to 38% in 2023.

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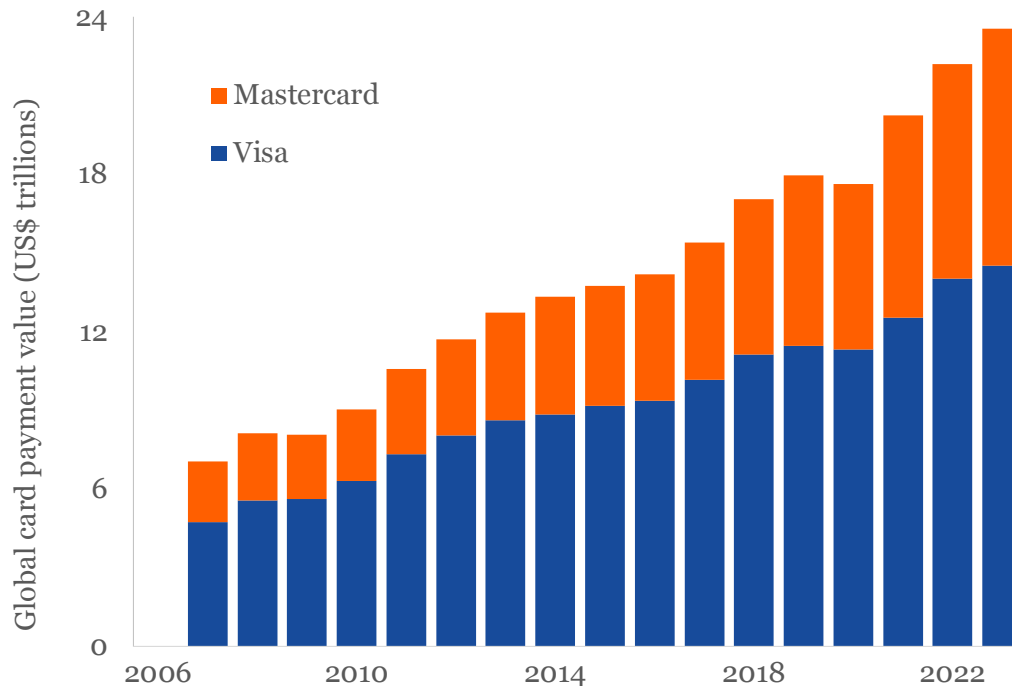
<sup>18</sup> In global card transaction value (measured in US dollars).

<sup>19</sup> Of Mastercard and Visa globally combined.



## 1. Executive summary continued

**Figure 3: Mastercard has grown much faster than Visa – despite having much higher fees**



Source: Mastercard and Visa annual reports plus Zephyre calculations.

32. How is this possible – i.e. that apparent competition drives higher prices?
33. It is what the European Commission has called “**reverse competition**: market mechanisms in the payments market drive fees up rather than down”<sup>20</sup> – also called Gresham’s Law: “*bad money drives out good*”<sup>21</sup>.
34. It is because the card scheme with the highest merchant fees (i.e. Mastercard) can pay the most to win card issuers. So, Visa then increases its merchant fees just to “*catch up*” with Mastercard<sup>22</sup> – and Mastercard keeps increasing its fees to stay ahead, in an ever-upward spiral.
35. This is for example the main factor in what caused Santander and NatWest to switch recently from lower-cost Visa debit to higher-cost Mastercard debit. And these alone explain more than half of the annual increase in UK merchants’

<sup>20</sup> European Competition Policy Brief, The Interchange Fees Regulation, Issue 2015-3, June 2015; and European Commission Staff Working Document: Interchange Fee Regulation Impact Assessment, SWD(2013) 288 final, 2013 (**Interchange Fee Regulation Impact Assessment**) Volume 1, page 86.

<sup>21</sup> Routledge Dictionary of Economics.

<sup>22</sup> PSR Report [6.60].

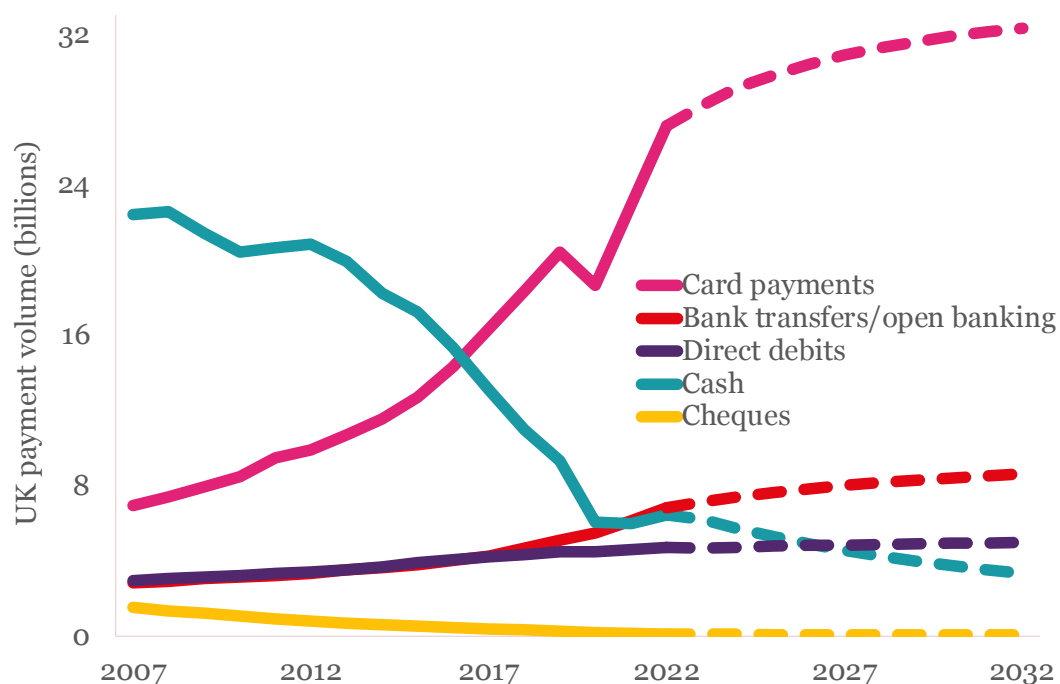


## 1. Executive summary continued

scheme and processing fees since the Interchange Fee Regulation (i.e. almost £0.5 billion annually).

36. Such reverse competition has also caused over £0.2 billion of annual increases in unregulated commercial card interchange fees since 2020 – similarly owing to higher Mastercard fees than Visa, and Visa then increasing its fees to “catch up”.
37. And it is also a major factor in the demise of cash and slow growth of bank transfer/open banking payments in the UK in the last 10 years, as illustrated by Figure 4.

**Figure 4: Payment card “reverse competition” fuels excessive card use, slow growth of open banking payments, and demise of cash**



Source: UK Finance UK Payments Statistics.

38. Hence, as well as causing direct harm to the business-users of payments, Mastercard’s and Visa’s fees and incentives cause significant indirect harm to all payment users and the wider UK economy – of greater costs and inefficiency, and weaker innovation and investment.





## 1. Executive summary continued

- 39. The card scheme pricing imbalance – favouring card issuers over card acquirers and merchants – is also highly discriminatory (something else the PSR was set up to end).
- 40. The PSR has an overriding duty and powers to remedy these harms – and should make this its greatest policy priority.

### (II) The PSR’s proposed remedies will be ineffective: the PSR needs to regulate Mastercard’s and Visa’s scheme and processing fees directly

- 41. The PSR Report proposes four main remedies to address the harms it has identified, namely:
  - (i) **Regulatory Financial Reporting** – a requirement for the card schemes to provide the PSR with their UK financial information on an ongoing basis [1.25];
  - (ii) **Pricing Methodology & Governance** – a requirement for the card schemes to develop and publish a pricing methodology to explain how scheme and processing fee services relate to costs [1.28];
  - (iii) **Mandatory Consultation and Timely Notification** – a requirement for the card schemes to consult acquirers (and provide timely notification) on all fee changes [8.24]; and
  - (iv) **Complexity & Transparency** – a requirement for the card schemes to provide clear information to merchants on how scheme and processing fees work [8.32].
- 42. The PSR Report also outlines other possible remedies that it is not minded to consider further at this stage, including:
  - (v) **Boosting Competition;**
  - (vi) **Encouraging Steering;** and
  - (vii) a **Price Cap.**
- 43. In reality though, the PSR’s four proposed remedies will not be effective at addressing the serious harms that the PSR Report identifies. That is because the PSR remedies are all essentially “information remedies”, i.e. requirements for the card schemes to provide more information (to the regulator and/or to



## 1. Executive summary continued

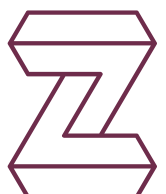
customers). The PSR should nonetheless implement some of these in any event (in support to more effective remedies)<sup>23</sup>.

44. The PSR must though consider seriously its alternative remedies – as well as also enforcement of the Interchange Fee Regulation and enforcement of UK competition law, and review of other unregulated card fees.
45. In particular, the PSR should implement a transitional (and ongoing) **Price Rebalancing/ Non-Discrimination** remedy: a requirement that Mastercard and Visa must rebalance their fees (and incentives) between issuers and acquirers. Namely, a rule that a card scheme's average net fees to acquirers (as a proportion of transaction value) must be no greater than its average net fees to issuers<sup>24</sup>.
46. Such average fees must also not discriminate by type of merchant (e.g. large or small), type of card (e.g. consumer or commercial card), or type of transaction (e.g. card present or not-present, domestic or inter-regional), absent a PSR-approved cost justification for any such pricing differentials.
47. Such a Price Rebalancing/ Non-Discrimination remedy would fix the main harms identified in the PSR Report – as it would bring a competitive constraint from the issuing side of the card schemes to act on the acquiring side, and would remove the imbalance of pricing between issuers and acquirers, as illustrated by Figure 5 (assuming a three year phase-in period from 2025).

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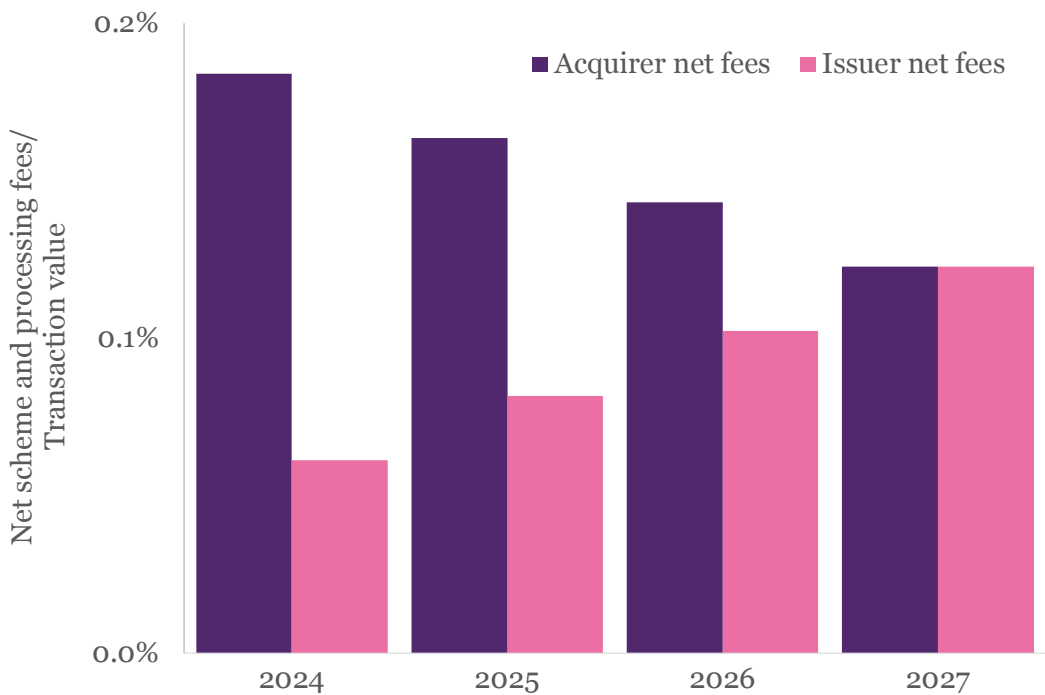
<sup>23</sup> Regulatory Financial Reporting, Transparency and Complexity, and Timely Notification.

<sup>24</sup> I.e. fees net of incentives.



1. Executive summary continued

**Figure 5: A Price Rebalancing/Non-Discrimination remedy would mean equalisation of net acquirer and issuer scheme and processing fees**



Source: Zephyre calculations.

48. Figure 5 shows in particular how net acquirer and issuer scheme and processing fees would converge to a common level, split initially 75%:25% between acquirers and issuers (as the PSR Report finds)<sup>25</sup>. This would imply a reduction in UK acquirer scheme and processing fees of at least 33% – or £0.6 billion annually to UK merchants<sup>26</sup>.
49. In all likelihood Mastercard and Visa net revenue would fall though, with issuer fees unlikely to rise materially above current levels, as illustrated at Figure 6.

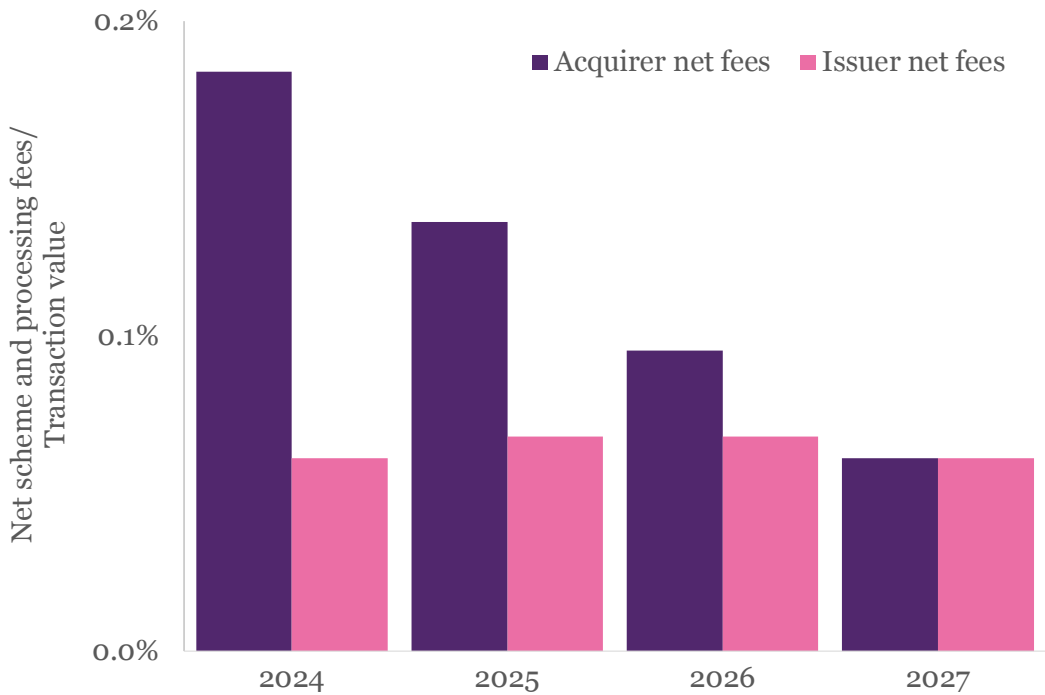
<sup>25</sup> Assuming Mastercard and Visa global average net revenue of 0.25% in 2023 as a proportion of transaction value.

<sup>26</sup> I.e. reduction in net fees of 0.06-percentage points on 2023 UK Mastercard and Visa annual card payment volume of £940 billion (source: UK Finance).



1. Executive summary continued

Figure 6: A Price Rebalancing/Non-Discrimination remedy would also likely drive acquirer fees to current issuer fee levels



Source: Zephyre calculations.

- 50. This would then imply a reduction in acquirer scheme and processing fees of 67% – or £1.2 billion annually to UK merchants<sup>27</sup>.
- 51. Such a Price Rebalancing/Non-Discrimination remedy is moreover wholly within the PSR’s statutory powers and duties (and the Government’s objectives in establishing the PSR).
- 52. As well as a transitional Price Rebalancing/Non-Discrimination remedy, the PSR should also develop and implement a long-term Price Cap remedy – on a similar model as applied in electronic communications wholesale voice call termination markets. A UK (and EU) price cap applies in these markets on the basis of a similar absence of competitive constraints as in the supply of card scheme and processing services to acquirers.
- 53. As well as these central (transitional and longer-term) remedies, the PSR should also consider:

<sup>27</sup> I.e. reduction in scheme and processing fees to below the levels of fees immediately prior to the Interchange Fee Regulation.



## 1. Executive summary continued

- **Interchange Fee Regulation Enforcement** – given prima facie evidence in the PSR Report of infringement of the Interchange Fee Regulation (and a potentially significant part of the harms that the PSR has identified); and
  - **Competition Law Enforcement** – given prima facie evidence in the PSR Report of breaches of UK competition law, potentially significantly contributing to the harms the PSR has identified, especially in relation to anti-competitive restrictions on steering in the Apple Pay and PayPal digital wallets<sup>28</sup>, as well as scheme and processing fees themselves;
  - **Least-Cost Routing/Prohibition of Network Exclusivity** – a “boosting competition”-type remedy successfully implemented in the US and Australia; and
  - a **Commercial Card Interchange Fee Market Review** – given substantial recent increases in UK commercial card interchange fees.
54. The PSR should reconsider though its Pricing Methodology & Governance, and Mandatory Consultation remedies, as these are likely to be counter-productive<sup>29</sup> and/or unlikely to make a difference.
55. Mastercard and Visa will undoubtedly complain that a Price Cap (and/or other) remedies will have negative adverse consequences, such as “*stopping the card schemes from continuing to invest*”. For example, when pressed by investment analysts:

*“**Lisa Ellis – Sanford C. Bernstein & Company:** [If] you look back to the [...] U.S. interchange related regulation [this regulation] really hasn’t had any meaningful effect on [Visa’s] fees [...] but yet regulation always seems like this sort of ever looming risk or presence, [so] what is [it] about regulation that you feel [would] actually impact your business [...]?”*

***Charlie Scharf – former Chief Executive Officer, Visa Inc:** I think the biggest fear [...] when [you] think about regulation [...] is about what [it] is going to do directly to [the scheme and processing fees] that we receive. The biggest fear that I have when it comes to regulation is*

<sup>28</sup> Further to the PSR Report, the PSR and Financial Conduct Authority (FCA) have launched a joint **Big tech and digital wallets call for information** (July 2024) which asks whether digital wallets are working well for consumers, businesses, and other payment users [1.5], and especially of potential restrictions of competition between payment systems [3.12, 3.17, and Question 4]. In reply, it is readily evident that agreements between Mastercard, Visa, and PayPal; between Mastercard, Visa, and Apple; and potentially between Mastercard, Visa, and Google may restrict competition and/or constitute abuses of dominant positions contrary to UK competition law.

<sup>29</sup> Leading potentially to even higher scheme and processing fees, as well as likely legal challenge.



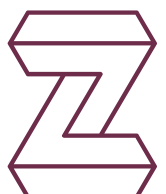
## 1. Executive summary continued

*[...] that governments do things [...] which stop the willingness of people that participated in payment system to invest in it.”<sup>30</sup>*

56. Hence, Visa is essentially saying that, if the PSR were to impose a price cap, then Visa (and card issuers) would stop investing in the Visa system. The purpose of course though of a price cap is to promote greater competition, innovation, and investment (not to stop innovation and investment).
57. Mobile communications providers made similar arguments (and regulatory appeals) that the UK electronic communications regulator the Office of Communications (**Ofcom**)’s proposed regulation of wholesale mobile voice call termination rates would likewise stop innovation and investment.
58. But the then UK regulatory appeals body the Competition Commission firmly rejected those appeals – on grounds that, in the absence of regulation, mobile communications providers would have the ability and incentive to set excessive termination rates, resulting in a structure of wholesale and retail prices that would restrict or distort competition<sup>31</sup>.
59. The PSR must therefore be sceptical of any similar complaints from Mastercard and Visa against a Price Cap and related regulatory proposals.
60. The remainder of this report includes the BRC’s terms of reference, answers to the PSR’s consultation Questions (1-33), and a glossary of terms.
61. The report responds to Questions 2-19 (the PSR’s analysis and findings) together, as these questions all address the same underlying issues.

<sup>30</sup> Visa Inc. Sanford C. Bernstein Thirty-First Annual Strategic Decisions Conference, 27 May 2015 (Transcript).

<sup>31</sup> See Competition Commission Determination in *BT v Ofcom*, *EE v Ofcom*, *Hutchison 3G v Ofcom*, *Vodafone v Ofcom*, and *Telefónica UK* (Cases 1180-1183/3/3/11), of 9 February 2012 [1.5].



## 2. BRC terms of reference



## 2. BRC terms of reference continued

62. The BRC asked [REDACTED] of Zephyre for an expert economist report for responding to the PSR's Market review of card scheme and processing fees interim report consultation paper (**the PSR Report**).
63. The BRC agrees with the main conclusions of the PSR Report, especially its findings of ineffective card scheme competition, but is concerned that the PSR's proposed remedies will not be effective; most likely resulting in UK merchants continuing to pay unfairly high (and growing) card fees in the short- and medium-term.
64. The BRC therefore requested a report from [REDACTED] to assist the BRC's response to the PSR, in particular, to:
- address the PSR's proposed remedies;
  - propose alternative remedies that are likely be more effective (and potentially more immediate);
  - provide additional context from other parts of the PSR Report;
  - include international insights where applicable;
  - represent the views and interests of BRC membership as a whole; and
  - provide material for members to draw on for their individual responses.





## 3. Responses to PSR consultation questions



## 3. Responses to PSR consultation questions continued

### Question 1: Background

**Do you have any views on how we have described the background facts and considerations in the PSR Report? Do you think there are any other factors we should consider as relevant context to our market review?**

65. The PSR Report Chapter 3 (“Background”) provides very helpful context, terminology, and explanation for the way that payment card systems operate in the UK, especially of:
- the prevalence of payment cards in the UK (relative to other payment methods);
  - the “*four-party*” card scheme model;
  - a taxonomy of different types of card and transaction types, i.e. credit v. debit cards, consumer v. commercial cards, card-present (**CP**) v card-not-present (**CNP**), spontaneous v. regular, domestic v. cross-border, and consumer-to-business (**C2B**) v. business-to-business (**B2B**); and
  - the PSR’s approach to analysing competition in payment card systems.
66. Other factors that the PSR should nonetheless consider as relevant context to its market review include:
- international experience of payment cards regulation – especially from the European Union (**EU**), United States (**US**), Australia, and New Zealand;
  - UK experience of payments card regulation from before the PSR was set up (and how this informed the PSR’s statutory powers and objectives, and the Government’s objectives for the PSR);
  - the economics and regulation of multi-sided platform markets; and
  - what Mastercard and Visa executives say to investment analysts<sup>32</sup>.
67. These factors are all relevant to analysing the dynamics of competition and pricing in the Mastercard and Visa card networks, and to insights for alternative remedies.

<sup>32</sup> In presenting their regular financial results and at other investor conferences, especially in answer to questioning.



## 3. Responses to PSR consultation questions *continued*

### Questions 2-19: The PSR's analysis and findings

**Do you have any views on our analysis and provisional findings that:**

- **Mastercard and Visa are subject to ineffective competitive constraints on the acquiring side? (2)**
- **the constraint that consumer steering can pose is limited? (3)**
- **digital wallets are unlikely to result in an effective competitive constraint? (4)**
- **alternatives available to acquirers do not provide an effective competitive constraint on Mastercard and Visa? (5)**
- **acquirers and merchants have limited alternatives available to them for Mastercard and Visa's optional services? (6-9)**
- **Mastercard and Visa are subject to competitive constraints on the issuing side? (10)**
- **revenue from the acquiring side accounts for the large majority of net scheme and processing fee revenue for both card schemes in recent years (11)?**
- **average scheme and processing fees (as a proportion of transaction value) paid to Mastercard and Visa by acquirers have increased substantially in real terms in recent years (12)?**
- **changes in average fee levels have not been accompanied by commensurate changes in value, quality, or innovation in the services provided by Mastercard and Visa (13)?**
- **the PSR's profitability analysis is indeterminate (14)?**
- **issuers have a positive experience from Mastercard and Visa (15)?**



## 3. Responses to PSR consultation questions continued

- **acquirers experience material service issues (16)?**
- **behavioural fees are opaque? (17-18)**
- **non-price outcomes experienced by issuers, acquirers or merchants do not explain fee increases? (19)**

68. It makes most sense to answer Questions 2-19 (the PSR's overall analysis and findings) together – as these questions and issues are very substantially overlapping.
69. In summary, the PSR Report provides a very well-evidenced and highly cogent analysis of the competitive constraints facing Mastercard and Visa, and associated supply of card scheme and processing services.
70. Bringing together the multiple strands of the PSR Report analysis and findings is essential through to showing the overall picture of the markets that Mastercard and Visa operate in – combined also with the economics of multi-sided platform markets, international market and regulatory evidence, and statements made by Mastercard and Visa executives to investment analysts.
71. This response – to PSR Questions 2-19 together – seeks to do that.
72. First, the PSR Report highlights that “*four-party card schemes*” like Mastercard and Visa are “*two-sided networks*” (also called “*multi-sided platforms*”) – that simultaneously serve acquirers and merchants on one side (“*the acquiring side*”) and issuers and cardholders on the other side (“*the issuing side*”).
73. Second, the PSR Report finds that the acquiring sides and issuing sides of the Mastercard and Visa platforms face substantially different competitive conditions.
74. Third, the PSR similarly finds that the acquiring sides and issuing sides of the Mastercard and Visa platforms face substantially different (and increasingly diverging) pricing levels.
75. Fourth, Mastercard's and Visa's scheme and processing fees result in very high card scheme profitability.
76. Fifth, Mastercard and Visa are a case study in the economics of multi-sided platforms.
77. Sixth, the “commercialisation” of Visa Europe's pricing has meant in practice: increase-prices-at-every-opportunity (but keep it well hidden);



### 3. Responses to PSR consultation questions continued

- 78. Seventh, substantial recent increases in commercial card interchange fees are another case of how the cards market is not working (similar to scheme and processing fees);
- 79. Eighth, concerns about high card acceptance costs to merchants are not new but reflect longstanding merchant complaint and regulatory investigations.
- 80. In conclusion, Mastercard's and Visa's card scheme and processing fees cause considerable harm to all payment users and to the economy.
- 81. The remainder of this section (response to Questions 2-19) explains each of these points in turn, plus summary answers to the specific Questions 2-19 at the end.

#### **(I) The Mastercard and Visa card schemes are multi-sided platforms**

- 82. The PSR Report highlights that “*Four-party card schemes like Mastercard and Visa are two-sided networks [...serving] issuers and cardholders on one side (the issuing side), and acquirers and merchants on the other side (the acquiring side)*” [3.21].
- 83. Two-sided networks such as payment card schemes are also generally called “*multi-sided platforms*”. This reflects that such platforms enable different groups of users (i.e. on either side of a platform) to interact with each other – and that each user group values the existence of the other.
- 84. For example, payment card networks enable cardholders to interact with merchants (i.e. to buy goods and services). Cardholders thereby value merchants being on the Mastercard and Visa platforms (i.e. accepting Mastercard or Visa cards) – and merchants correspondingly value cardholders being on the Mastercard or Visa platforms (i.e. holding Mastercard or Visa cards).
- 85. Payment cards networks are moreover frequently cited as “*typical*” examples of multi-sided platforms, for example in the European Commission's recently revised EU Market Definition Notice<sup>33</sup>.

<sup>33</sup> European Commission, Communication from the Commission: Commission Notice on the definition of the relevant market for the purposes of Union competition law C(2023) 6789 final Brussels, 8.2.2024 (**the EU Market Definition Notice**), footnote 127.



## 3. Responses to PSR consultation questions continued

### (II) The acquiring and issuing sides of the Mastercard and Visa platforms face substantially different competitive conditions

86. The PSR Report finds that the acquiring and issuing sides of the Mastercard and Visa platforms face substantially different competitive constraints, in particular that:

*“on the acquiring side [of the card scheme platforms], Mastercard and Visa do not face effective competitive constraints in the provision of core [or optional] scheme [...] processing services” [4.177-4.179];*

*“[whereas] on the issuing side [...] Mastercard and Visa face stronger competitive constraints [...] mainly [as] a result of competition between Mastercard and Visa” [5.38].*

87. The PSR Report explains that the card schemes do not face effective competitive constraints on the acquiring side in the provision of scheme and processing services, as (among other reasons):
- it is important for acquirers to offer merchants a comprehensive card acceptance service including both Mastercard and Visa;
  - most merchants cannot decline to accept either Mastercard or Visa, nor can meaningfully steer their customers to other payment methods;
  - digital wallets also make it difficult to steer away from card payments;
  - acquirers cannot unilaterally choose alternative payment card processors without the agreement of issuers (and issuers have no incentive to migrate to alternative processors);
  - the availability of genuine alternatives to Mastercard’s and Visa’s “optional” card network services is limited [4.175-4.181]; and
  - Visa (in particular) was able to increase its scheme and processing fees materially without any discernible merchant demand response [6.60].
88. In contrast, on the issuing side of the payment card networks, the PSR explains that Mastercard and Visa face stronger competitive constraints, as:
- issuing side competition is mainly a result of competition between Mastercard and Visa to win card issuing portfolios from issuers (rather than competition with providers of other payment methods); and
  - competition between Mastercard and Visa results also in “high incentive payments and rebates” to issuers, in some cases “more than totally



## 3. Responses to PSR consultation questions continued

*offsetting the fees charged to issuers”, and such incentives having become larger in recent years [1.14, 5.38-5.40].*

89. In general, opposite sides of a multi-sided platform are not expected to face the same competitive constraints. Indeed, the defining feature of a multi-sided market (as distinct from a “single-sided” market) is that the opposite sides face different competitive constraints (i.e. different substitution possibilities)<sup>34</sup>.
90. Further, the fact that the PSR finds different competitive constraints on either side of the platform reflects that the issuing and acquiring are of course distinct products with different customers – as already found in various regulatory decisions, notably the European Commission’s decision in case AT.34579 *Mastercard* (2007)<sup>35</sup> that:

**“Market definition in industries with two-sided demand**

*[...There] are two groups of consumers in the payment cards industry: cardholders and merchants (as well as subsequent purchasers). This two-sided demand is a feature of the payment card industry. [...]*

*The platform run by MasterCard [...] is a vehicle for issuers and acquirers to offer distinct services to two groups of customers.” [257, 261]*

91. The Commission ultimately concluded in that case (and other similar cases) that issuing and acquiring are separate product markets [279] and that it can be “left open” whether the acquiring market can be further sub-divided, e.g. between credit and debit cards, or between Mastercard and Visa [306].
92. Mastercard appealed against the Commission’s Decision – but the EU General Court, and EU Court of Justice, subsequently dismissed Mastercard’s appeals<sup>36</sup>, specifically finding that:

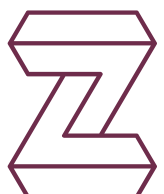
*“[Despite the complementary nature of issuing and acquiring services, and the presence of indirect network effects], services provided to cardholders and those provided to merchants can be distinguished, and, moreover, cardholders and merchants exert separate competitive pressure on issuing and acquiring banks respectively.” [176-177]*

93. Hence, the PSR Report firmly echoes the findings of the European Commission and the EU’s highest courts.

<sup>34</sup> See for example Jens-Uwe Franck and Martin Peitz, *Market Definition and Market Power in the Platform Economy*, Centre on Regulation in Europe, 2019.

<sup>35</sup> European Commission Decision of 19 December 2007 case AT.34579 *Mastercard* (the **Mastercard Prohibition Decision**).

<sup>36</sup> *Mastercard v European Commission*, Case T-111/08, Judgment of the General Court, 12 May 2012.





## 3. Responses to PSR consultation questions continued

94. The Commission's EU Market Definition Notice moreover specifically refers to the *Mastercard* case's finding that the issuing and acquiring sides of the Mastercard platform are distinct relevant product markets<sup>37</sup>. The UK courts have also firmly adopted the Commission's position in related UK cases<sup>38</sup>.
95. The revised EU Market Definition Notice also generally emphasises that when there are significant differences in the substitution possibilities on different sides of a multi-sided platform market, then it is appropriate to define separate markets<sup>39</sup>.
96. The UK Competition Appeal Tribunal (the UK's specialist competition court) has also strongly endorsed this same approach to analysing multi-sided markets: "*as a general precept, the markets in which the different focal products provided by [multi-sided] platforms are sold should always be assessed separately*"<sup>40</sup>.
97. Hence, the PSR Report's finding that acquiring and issuing sides of the Mastercard and Visa platforms face substantially different competitive constraints is fully consistent with other regulatory decisions, case law, and standard economic principles.

### (III) Mastercard and Visa set substantially different – and increasingly diverging – prices to acquirers and issuers

98. The PSR's finding of differences in the competitive constraints between the acquiring and issuing sides of the card schemes results – unsurprisingly – in correspondingly different pricing and revenues between sides, namely:

*"The balance of scheme and processing fees that Mastercard and Visa charge falls heavily on the acquiring side of the schemes rather than on the issuing side [...with] revenue from the acquiring side [accounting] for over 75% of net scheme and processing fee revenue"* [6.81, 1.18].
99. This imbalance reflects in particular that "*Visa and Mastercard provide high incentives [i.e. direct payments] to issuers, in some cases more than totally offsetting the fees charged to issuers*" [1.20].
100. In other words, Mastercard and Visa set highly asymmetric prices – i.e. highly discriminatory pricing – between acquirers and issuers: high prices to acquirers and low (or negative) prices to issuers.

<sup>37</sup> Footnote 130.

<sup>38</sup> In particular *Sainsbury's v MasterCard*; *Asda, Argos, and Morrison's v MasterCard*; *Sainsbury's v Visa* [2018] at the Court of Appeal EWCA 1536 (Civ) and Supreme Court [2020] UKSC 24.

<sup>39</sup> Revised EU Market Definition Notice [95].

<sup>40</sup> Compare *The Market v Competition & Markets Authority* [2022] CAT 26 [147].





## 3. Responses to PSR consultation questions continued

101. Alongside this, the PSR highlights that the increase in acquirer prices (and reduction in issuer prices) has grown significantly in the last 10 years:

*“There have been significant increases in gross scheme and processing fee revenues for both schemes since 2017, with total revenues earned by Mastercard and Visa more than doubling.” [1.18]*

*“[...] incentives [paid to issuers] have become larger in recent years, reflecting increased competition between the schemes.” [1.20]*

*“we do see a substantial increase in the level of fees that Visa charged to acquirers over [the 2014-22] period [...] and ] the increase [in Visa’s fees is even] greater than the comparable change for Mastercard fees [...] and] as such, this could be consistent with Visa fee levels ‘catching up’ to Mastercard levels.” [6.60]*

102. Namely, Mastercard’s scheme and processing fees were higher than Visa’s to start with (at the beginning of the period that the PSR looked at). So, Visa has then increased its fees by even more than Mastercard to “catch up” with Mastercard’s higher fees. This is ultimately because the scheme and processing fees that Mastercard and Visa charge to acquirers is what enables them to then pay incentives to compete for issuers.

103. Hence, charging ever higher prices to acquirers creates a competitive advantage in being able to compete better for issuers<sup>41</sup>. So, Mastercard and Visa have a fundamental incentive to “compete” with each other to charge ever higher prices to merchants until they reach the monopoly level – which itself could be very high, especially given the PSR’s finding that Mastercard and Visa are “*must-take for merchants in the UK*” [1.16] (and given international evidence)<sup>42</sup>.

104. These dynamics are of course the opposite of normal competition – where firms compete to reduce prices(!) – which is why the European Commission has called payment card competition “*reverse competition*”:

**“Reverse competition:** *In the context of card payments, reverse competition means that card schemes compete with each other by offering higher [...] revenues to banks that issue their cards. This results in higher fees for card payments in general [...].”*<sup>43</sup>

<sup>41</sup> Up to a monopoly (i.e. profit-maximising) level.

<sup>42</sup> Especially the US, where total merchant service charges generally are even higher still than the UK.

<sup>43</sup> European Commission Staff Working Document: Interchange Fee Regulation Impact Assessment, SWD(2013) 288 final, 2013 (**Interchange Fee Regulation Impact Assessment**) Volume 1, page 86.



## 3. Responses to PSR consultation questions continued

*“Reverse’ market mechanisms in the payments market drive fees up rather than down.”<sup>44</sup>*

105. Such “reverse competition” is nonetheless a general feature of many platform markets, although most evident between Mastercard and Visa<sup>45</sup>.
106. Such reverse competition between Mastercard and Visa is not readily visible though from the PSR Report, especially as the PSR has redacted almost all of Mastercard’s and Visa’s UK pricing data from the published PSR Report version<sup>46</sup>.
107. Mastercard’s and Visa’s scheme and processing fees – and incentives – are nonetheless readily evident for Mastercard and Visa at a global level (and Europe level for Visa). And the card schemes’ global (and Europe level) scheme and processing fees – and incentives – are strongly indicative of corresponding UK fees and incentives.
108. Namely, Figure 7 below shows average<sup>47</sup> scheme and processing fees<sup>48</sup> for:
  - Mastercard globally<sup>49</sup>;
  - Visa globally (excluding Europe)<sup>50</sup>;
  - Visa Europe; and
  - (weighted) average of Mastercard and Visa globally.
109. Figure 7 covers the period 2006-23 – from when Mastercard converted from a not-for-profit member association to a for-profit public company in 2006 (followed by Visa in 2008<sup>51</sup>).

<sup>44</sup> European Competition Policy Brief, The Interchange Fees Regulation, Issue 2015-3, June 2015.

<sup>45</sup> In few other industries are two of the largest firms in the World competing to increase prices.

<sup>46</sup> It is difficult though to see valid grounds for this level of redaction, especially on commercial-confidentiality grounds – given that the large majority of UK merchants need to know Mastercard’s and Visa’s scheme and processing fees under so called “unblended” pricing, also called “interchange fee++” pricing, as required by the Interchange Fee Regulation Article 9 as default acquirer pricing, and especially for merchants to be able to verify that they have been charged correctly by their acquirer.

<sup>47</sup> I.e. weighted-average by Mastercard and Visa card transaction values.

<sup>48</sup> On a gross basis, i.e. before incentives, and stated as a percentage of card transaction value, and also including foreign exchange (FX) margins on cross-border payment card transactions (on a similar basis as the PSR Report [8.13] says).

<sup>49</sup> Namely Mastercard Inc.

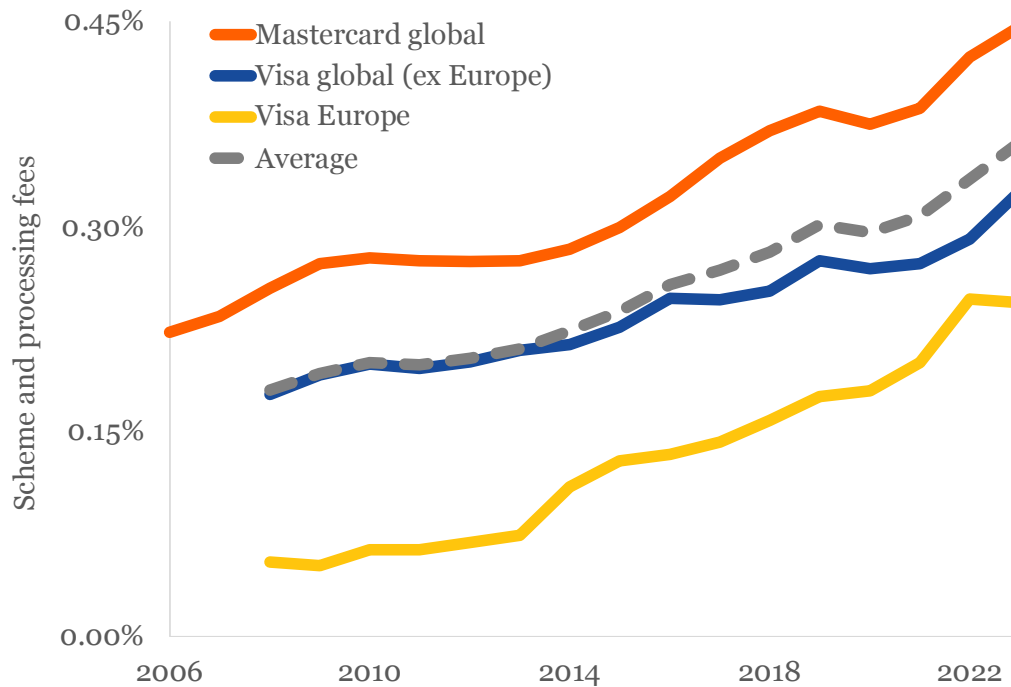
<sup>50</sup> Namely Visa Inc from 2008 to 2016 (when Visa Europe was separate from Visa Inc) and then Visa Inc net of Visa Europe from 2017 to 2023.

<sup>51</sup> Except for Visa Europe, which remained a not-for-profit membership association until it became fully part of Visa Inc in 2016-17.



## 3. Responses to PSR consultation questions continued

**Figure 7: Mastercard and Visa have competed scheme and processing fees ever upwards since becoming for-profit public companies**



Source: Mastercard Inc, Visa Inc, and Visa Europe annual reports plus Zephyre calculations.

110. In particular, Figure 7 shows that:

- Mastercard started with the highest level of scheme and processing fees globally, of 0.22% (when Mastercard Inc became a public company in 2006) – and has increased its fees every year since (excepting the pandemic in 2020), to 0.45% in 2023 (i.e. more than doubling);
- Visa (excluding Europe) started with a lower level of scheme and processing fees globally, of 0.18% (when Visa Inc floated in 2008) – so has been perpetually “catching up” with (but falling behind) Mastercard’s fee level increases – to 0.33% in 2023 (i.e. less than double);
- Visa Europe started with the lowest level of scheme and processing fees, of just 0.05% in 2008 – and has therefore increased its fees by the most(!) – to 0.24% in 2023, almost five times, to catch up with the rest of Visa (excluding Europe) and with Mastercard; and
- global average card scheme and processing fees have exactly doubled, from 0.18% in 2008 to 0.36% in 2023.



## 3. Responses to PSR consultation questions continued

111. This illustrates therefore the PSR’s finding of “a substantial increase in the level of fees that Visa charged to acquirers over [the] period [...] the increase [in Visa’s fees being even] greater than the comparable change for Mastercard fees [...] and] as such, this could be consistent with Visa fee levels ‘catching up’ to Mastercard levels.” [6.60]
112. Figure 7 is also consistent with the PSR’s finding that Mastercard and Visa UK scheme and processing fees have been rising rapidly – “by more than 30% in real terms” over the past five years [1.4], and also reports by international regulators, notably in the EU, Australia, and New Zealand:

**The EU:** “According to a recent study by the European Commission, the average net merchant service charges applied by card schemes in the EU almost doubled between 2018 and 2022 (from 0.27% to 0.44%), resulting in significant additional costs for merchants. [...]

*European merchants criticise [in particular] the complexity and opacity of card scheme fees, which make it difficult to understand why they are charged so much.”<sup>52</sup>*

**Australia:** “Scheme fees have been rising, increasing costs for merchants. These fees can be very complex and opaque [...]

*In response to concerns about trends in scheme fees, since 2021/22 we have been collecting annual data to improve transparency. [...]*

*Net scheme fees of around [AU] \$1.9 billion were paid by Australian acquirers and issuers to the card networks in 2022/23. This was a 43 per cent increase relative to 2021/22 and was significantly higher than the 16 per cent growth in card transactions in that period.”<sup>53</sup>*

**New Zealand:** “Scheme fees – the other significant cost [along with interchange fees] driving high merchant service fees. We are concerned about the limited competitive constraints on scheme fees. Other international payment system regulators also appear to share the same concern [...such as the PSR].

*We are currently undertaking monitoring of the scheme fees acquirers pay which will enable us to understand how they have changed over time and how they differ between Mastercard and Visa. [...]*

<sup>52</sup> Speech by Piero Cipollone, Member of the Executive Board of the European Central Bank (ECB), Innovation, integration and independence: taking the Single Euro Payments Area to the next level, 2024.

<sup>53</sup> Speech by Ellis Connolly, Head of Payments Policy, Reserve Bank of Australia, Online Retail Payments – Some Policy Issues, June 2024.



### 3. Responses to PSR consultation questions continued

*We will continue to monitor scheme fees. This will inform whether this is something we seek to regulate in future.”<sup>54</sup>*

- 113. Visa Europe is moreover a good proxy for Visa UK – especially as Visa’s scheme and processing fees are broadly similar across the UK and EU – and Visa UK is also a large part of Visa Europe by card transaction value<sup>55</sup>.
- 114. In contrast, Mastercard’s global scheme and processing fees are likely to be a reasonable proxy for Mastercard’s UK fees – especially as Mastercard has been operating as a for-profit commercial card scheme on a global basis (including the UK and EU) since 2006. (This is in contrast to Visa Europe which has only been operating a “commercial” basis in the UK and EU since 2017 – so is still “catching up” with the rest of Visa and with Mastercard’s fee levels.)
- 115. As well as the card schemes’ global scheme and processing fees, Figure 8 shows Mastercard’s and Visa’s corresponding “incentives”, i.e. the money they pay to issuers.

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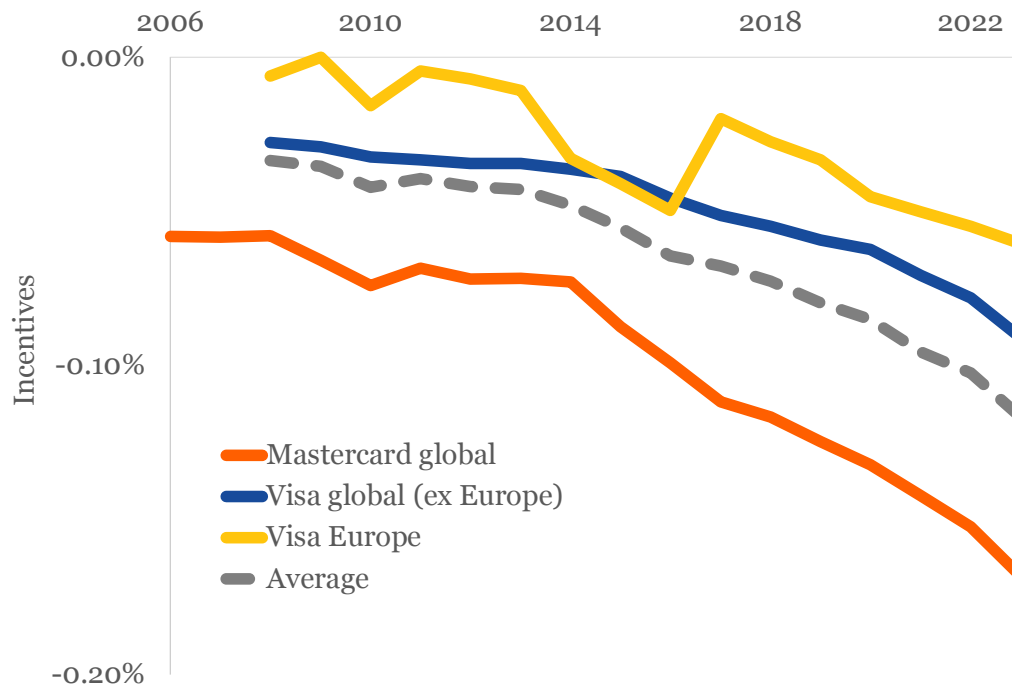
<sup>54</sup> New Zealand Commerce Commission, Retail Payment System: Costs to businesses and consumers of card payments in Aotearoa New Zealand: Consultation Paper, 2024 [3.16-3.17].

<sup>55</sup> Given that the UK has always been the largest card market in Europe (i.e. UK and EU) and that Visa has a very high share historically of the UK card market (more than in any other Visa Europe country).



## 3. Responses to PSR consultation questions continued

**Figure 8: Mastercard and Visa have correspondingly competed incentives (to issuers) ever upwards**



Source: Mastercard Inc, Visa Inc, and Visa Europe annual reports plus Zephyre calculations.

116. Figure 8 in particular shows that:

- Mastercard globally has competed most aggressively on incentives to win issuers, from (0.06%) (i.e. minus 0.06%) in 2006 to (0.17%) in 2023 – with Visa (excluding Europe) following Mastercard downwards, from (0.03%) to (0.09%);
- Visa Europe in contrast started with the lowest level of incentives, of (0.01%) in 2008, increased its incentives rapidly up to 2016, then cut back substantially in 2017<sup>56</sup>, and then resumed significant incentives up to 2023, of (0.06%), most likely in response to Mastercard; and
- average incentives globally have grown four times since 2008, from (0.03%) to (0.12%).

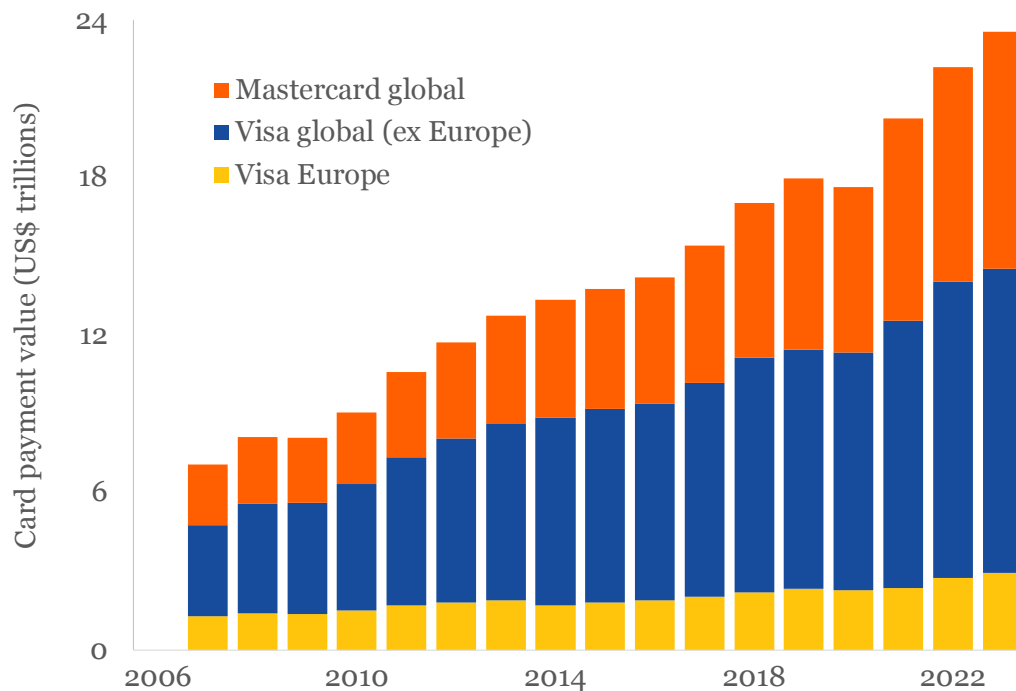
<sup>56</sup> Ostensibly in response to the EU Interchange Fee Regulation, which prohibits incentives to issuers over and above regulated interchange fees.



## 3. Responses to PSR consultation questions continued

117. At the same time Mastercard has progressively increased its global market share<sup>57</sup> – from 33% in 2008 to 38% in 2023 – as illustrated by Figure 9<sup>58</sup>.

**Figure 9: Mastercard has grown much faster than Visa, despite much higher fees**



Source: Mastercard Inc, Visa Inc, and Visa Europe annual reports plus Zephyre calculations.

118. Namely, Mastercard has grown far faster than Visa (by 256% from 2008 to 2023, or 9% annually, compared to 160% for Visa, or 7% annually) – despite much higher fees.
119. This is paradigm evidence of the paradox of “*reverse competition*” in action – of: “*reverse market mechanisms in the payments market [driving] fees up rather than down*”.
120. It means as well that average scheme and processing fees have increased even faster owing to the progressive share increase from lower-cost Visa to higher-cost Mastercard.

<sup>57</sup> Of Mastercard and Visa combined.

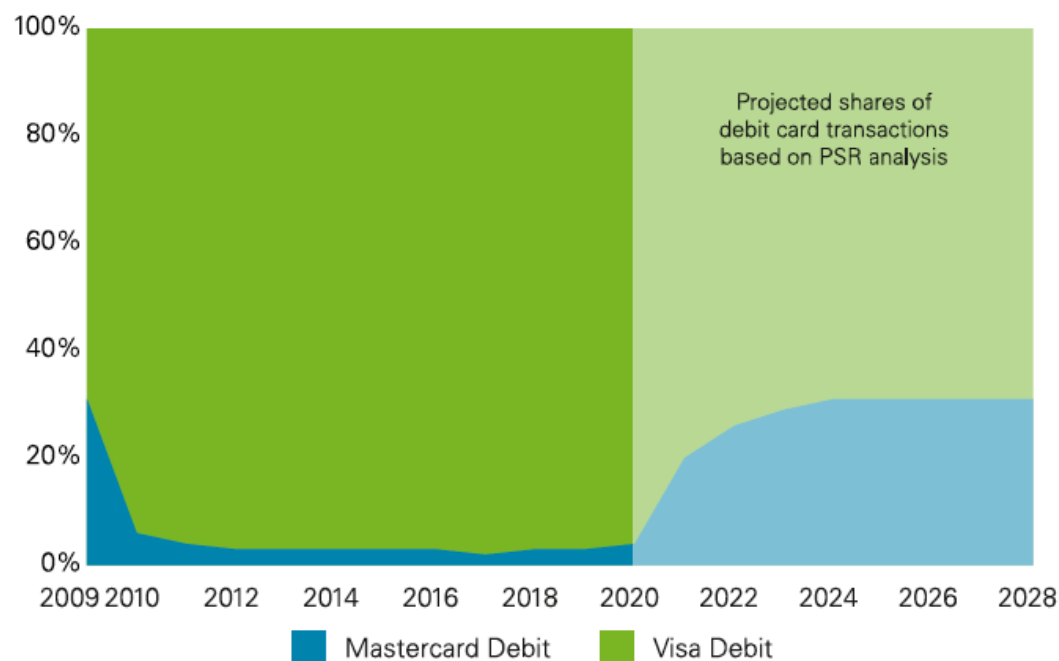
<sup>58</sup> Note that Visa Europe has grown more slowly than Visa global (excluding Europe), mainly owing to Europe being an already highly developed card market (i.e. already high card usage) compared the rest of the World.



## 3. Responses to PSR consultation questions continued

121. Mastercard's increase of UK market share is moreover even greater than globally, as illustrated by Figure 10 (reproduced from a previous PSR report<sup>59</sup>) – which shows that Mastercard's UK debit card market share has increased from around 3% from 2010-20 to around 30% in 2024, a ten-fold increase.

**Figure 10: Mastercard has grown even faster still in the UK than globally**

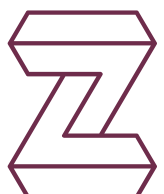


Source: The PSR: The PSR Strategy, 2022, Figure 3.

122. The (current) PSR Report explains that this increase in Mastercard's UK debit card share is because:

*“there has been an increase in the number of issuers switching their issuing portfolios between Mastercard and Visa [...] notably, Santander and NatWest have both transferred their debit card book from Visa to Mastercard since 2018 [...] which] has resulted in a marked increase in Mastercard's share of debit card spending value [and overall UK card value]” [5.16].*

<sup>59</sup> The PSR Strategy, 2022.





## 3. Responses to PSR consultation questions continued

123. Such shift of UK issuers from Visa to Mastercard is driven of course by Mastercard having much higher scheme and processing fees than Visa – and therefore offering to pay much higher incentives to card issuers.
124. Such shift of NatWest and Santander from Visa to Mastercard is itself is likely to account for around 0.06%-points of UK debit card scheme and processing fee increases since 2020<sup>60</sup>, equivalent to 30% of debit card interchange fees (of 0.20%) – or £500 million annually<sup>61</sup> to UK merchants.

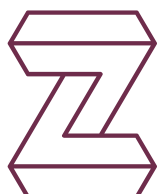
### (IV) Mastercard’s and Visa’s scheme and processing fees result in very high profitability

125. The PSR finds that Mastercard’s and Visa’s “*profitability is likely to be above the level that we would expect to observe in a competitive market*” [6.61] but that “*there is insufficient data available to reach a firm conclusion on the existence of unduly high prices or excessive profits (and the level of harm arising from it)*” [1.18].
126. In reality, the PSR’s evidence of absence of competitive constraints, rapidly rising scheme and processing fees, and incentives – and associated “reverse competition” – is sufficient alone to show that Mastercard and Visa set unduly high prices to acquirers and merchants, irrespective of whether Mastercard or Visa make overall excessive profits.
127. In any event, Mastercard’s and Visa’s financial information, and share price growth, indicate that they make very high levels of excess profits, the direct result of high and growing scheme and processing fees<sup>62</sup>.
128. First, Figure 2, Figure 7, and Figure 8 show that Mastercard’s and Visa’s scheme and processing fees, and incentives, (as a proportion of transaction value) have grown inexorably since the card schemes became for-profit public companies in 2006 and 2008.

<sup>60</sup> I.e. assuming a 0.2% difference between Mastercard UK and Visa UK scheme and processing fees (the average difference between Mastercard global and Visa Europe scheme and processing fees) multiplied by the 30%-point increase in Mastercard’s UK debit card market share since 2020.

<sup>61</sup> Given total UK debit card transaction value of £776 billion in 2024 (source: UK Finance, UK Payment Statistics 2023).

<sup>62</sup> The best measure of Mastercard’s and Visa’s profitability would be their adjusted-return on capital employed (ROCE) (namely, after inclusion of internally generated intangibles assets, exclusion of externally generated intangible assets, and exclusion of excess cash) compared to their weighted-average cost of capital (WACC). Such an approach was adopted in the CMA (formerly Competition Commission) 2006 Home credit market investigation, in particular, Competition Commission Home credit market investigation, Appendix 3.6: Provisional assessment of profitability, using return on capital employed, 2006; and Appendix 3.7: Revised assessment of profitability, using ROCE, 2006.



3. Responses to PSR consultation questions continued

129. At the same time, so have Mastercard’s and Visa’s operating profits. Table 1 illustrates that Mastercard’s and Visa’s operating profit (or loss) is equal to their gross revenue, less incentives, less operating expenses – where gross revenues is essentially the same thing as scheme and processing fees<sup>63</sup>.

**Table 1: Mastercard and Visa operating profit (or loss) is equal to gross revenue, less incentives, less operating expenses**

Gross revenue – essentially the same as scheme and processing fees	\$100
(Incentives)	(\$40)
Net revenue	\$60
(Operating expenses)	(\$25)
Operating profit <sup>64</sup>	\$35

Source: Zephyre illustration.

130. Figure 11 then shows the card schemes’ combined operating profits for 2008-23.

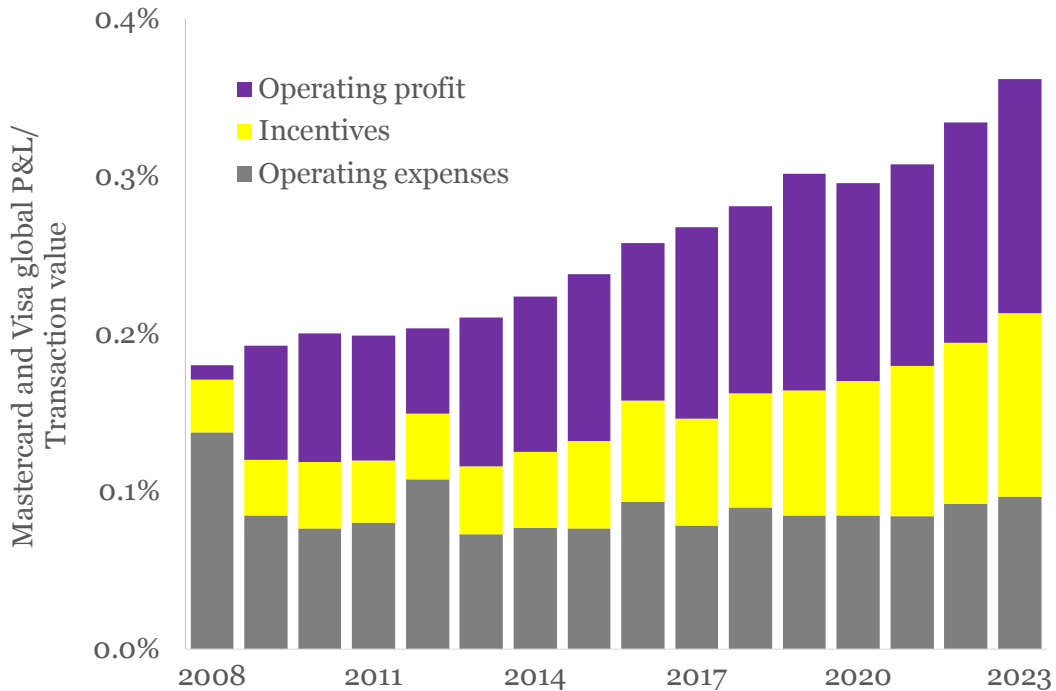
<sup>63</sup> As already noted, the only additional component of Mastercard’s and Visa’s gross revenues are foreign exchange (FX) margins on cross-border payment card transactions.

<sup>64</sup> Also called earnings before interest and tax (**EBIT**).



## 3. Responses to PSR consultation questions continued

**Figure 11: Mastercard and Visa operating profit has grown along with growing scheme and processing fees**



Source: Mastercard and Visa annual reports plus Zephyre calculations.

131. In particular, Figure 11 shows that, as Mastercard’s and Visa’s scheme and processing fees have grown (i.e. Mastercard’s and Visa’s total revenue – so the sum of operating profit, incentives, and operating expenses), so has operating profit. That is because incentives have grown more slowly than scheme and processing fees, and operating expenses (as a proportion of transaction value) have generally been constant or falling.
132. As the PSR Report says: “*Mastercard and Visa’s global and European operations are highly profitable*” [6.133].
133. The PSR said that it encountered challenges though looking at Mastercard’s and Visa’s UK profitability [1.25]. It is not plausible though that Mastercard’s and Visa’s UK profitability would be materially different than for Europe or globally (as the card schemes are evidently seeking to claim [6.137] and the PSR is right to question [6.140]).



## 3. Responses to PSR consultation questions continued

134. On the contrary, Mastercard's and Visa's global (and European) profitability is a wholly plausible proxy for the card schemes' UK profitability, as their business models are essentially the same everywhere in the world<sup>65</sup>.
135. Moreover, the fact that Mastercard's and Visa's pricing and profitability has increased by so much since they converted from not-for-profit member associations to public companies is itself probably the best comparator evidence to show that Mastercard's and Visa's pricing and profitability is excessive.
136. Namely, the fact that Visa Europe could operate on scheme and processing fee prices of 0.05% (as a proportion of transaction value) and covers its costs while it was a not-for-profit member association is strong evidence that Visa Europe's current scheme and processing fees of 0.24%, Visa's globally of 0.31%, and Mastercard's globally of 0.45% are highly excessive (i.e. almost ten times or 900% greater).
137. Probably the most telling evidence though of Mastercard's and Visa's excessive pricing and profitability is the card schemes' share price growth since becoming for-profit public companies in 2006 and 2008, as shown at Figure 12 below.

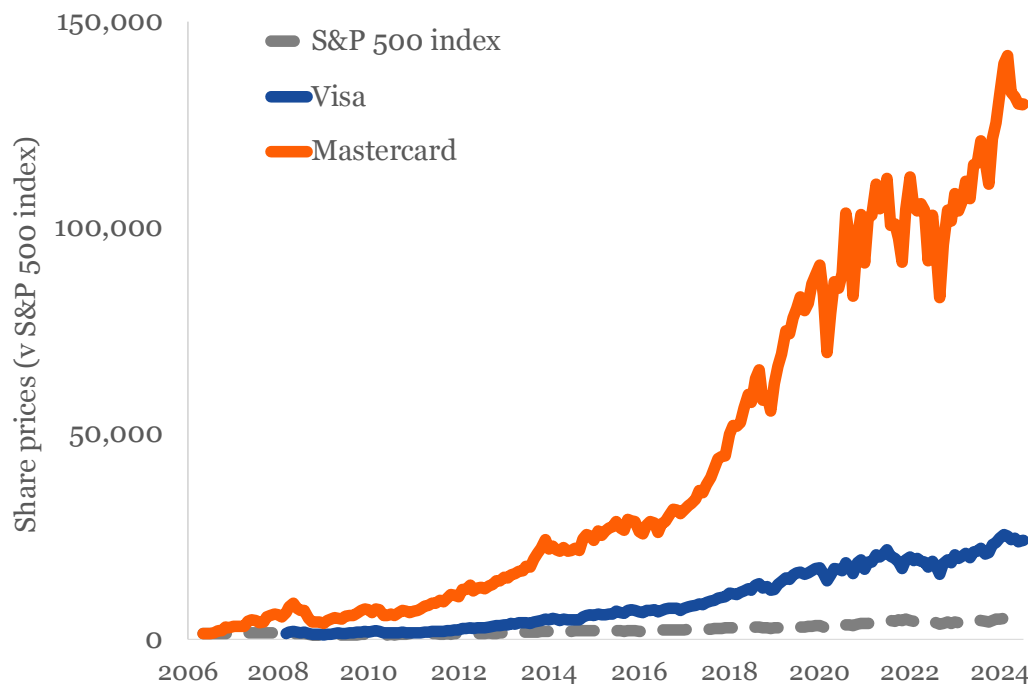
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<sup>65</sup> Give or take local and historical pricing differences, such as for Visa Europe, albeit these differences are disappearing over time, e.g. as Visa Europe "catches up" with Visa's higher pricing elsewhere in the World and with Mastercard



## 3. Responses to PSR consultation questions continued

**Figure 12: Mastercard and Visa have massively outperformed the stock market since becoming public companies**



Source: Yahoo Finance plus Zephyre calculations.

138. In particular, Figure 12 shows Mastercard's and Visa's share prices from date of becoming public companies, in 2006 and 2008<sup>66</sup>, rebased to the S&P 500 index<sup>67</sup>, namely:

- since Mastercard's floatation in 2006, the S&P 500 has increased by 4.4 times (i.e. from 1,270 in 2006 to 5,600 today), whereas Mastercard's share price has increased by 102 times(!) (i.e. to an equivalent S&P 500 level of 130,000); and
- since Visa's floatation in 2008, the S&P has increased by 4.2 times (from 1,320 in 2008), whereas Visa's share price has increased by 18 times (i.e. to an equivalent S&P 500 level of 24,000).

139. Few if any companies have achieved such massive share price growth over such a sustained period, especially not Mastercard's, a clear indicator of Mastercard's

<sup>66</sup> Namely, Mastercard and Visa share prices rebased to the S&P 500 index

<sup>67</sup> A stock market index tracking the stock performance of 500 of the largest companies listed on stock exchanges in the US.



## 3. Responses to PSR consultation questions continued

and Visa's very high profitability and expectation of continued profitability growth (i.e. of continuing higher prices and payment market shares).

### (V) Asymmetric competitive constraints and pricing in multi-sided markets are a case study in the economics of multi-sided platforms

140. The PSR's evidence of asymmetric competitive constraints and asymmetric pricing between the acquiring and issuing sides of the Mastercard and Visa payment card networks is a case study in the economics of multi-sided platforms.
141. In particular, Mastercard and Visa are a case of two large platforms ostensibly in competition with each other. Such competition though does not generally benefit consumers, i.e. the end-users of the Mastercard and Visa payments systems: merchants and end-consumers.
142. This does not mean that Mastercard and Visa have not brought significant benefits to merchants and consumers, and to the economy – of highly reliable, secure, and convenient payments. It is just that those benefits could have been far greater (and that merchants and consumers should have seen a greater share of those benefits).
143. In particular, competition between Mastercard and Visa (and with potential alternatives) has harmed users of payment systems, by causing:
  - direct harm to the business end-users of the Mastercard and Visa systems – i.e. merchants – of excessively high prices and poor service; and
  - indirect harm to all users of payments – i.e. all businesses and all consumers – of artificial entry and expansion barriers to rival lower cost/more innovative payment alternatives.
144. Of these, the *direct harm* (to merchants), as the PSR Report shows, is that there are no effective competitive constraints on Mastercard and Visa for the provision of scheme and processing services to acquirers and merchants.
145. Namely, Mastercard and Visa have monopoly power over acquirers and merchants: and can use this to set prices far above the level such that there had been effective competitive constraints (and at the same time get away with poor and inadequate service to acquirers and merchants).
146. Correspondingly, the *indirect harm* (to payment users generally and the economy) is that Mastercard and Visa use the large profits they generate from acquirers and merchants to create an entry and expansion barrier against lower-cost and/or more efficient rival payment methods, i.e. of predatory (also called exclusionary) conduct.



## 3. Responses to PSR consultation questions continued

147. Mastercard moreover uses the higher prices it generates from acquirers and merchants (relative to Visa) to predate Visa, i.e. to win market share from Visa despite – and moreover because – of being more costly to merchants.
148. Hence, the indirect harm (of predatory pricing towards rival payment systems) exacerbates the direct harm (of high prices to acquirers and merchants) in an ever upward spiral.
149. This is an example of Gresham’s Law of economics, that: “*bad money drives out good*”<sup>68</sup>. In the case of payments, that the most-costly payment method (i.e. Mastercard) drives out a less-costly payment method (e.g. Visa), and the most-costly payment methods together (i.e. card payments) drive out (and/or stop the expansion of) less-costly and/or more innovative or customer-preferred alternatives, such as account-to-account/open banking payments and cash<sup>69</sup>.
150. These competitive dynamics are also well explained by the economics of multi-sided markets. A central concept in this is “*homing decisions*”:

*“[The] decision by users to use one platform for a given product (**single-homing**) or use multiple platforms in parallel for the same product (**multi-homing**).”<sup>70</sup>*

151. Homing decisions are essential to the analysis of multi-sided platform markets, for example (from two foremost authorities):

*“The extent of single-homing and multi-homing by customers on each side of the market is a key competitive aspect of multi-sided platforms.”<sup>71</sup>*

*“[The] Commission takes into account [...] factors such as [...] (single- or multi-) homing decisions for the purpose of defining the relevant product market(s).”<sup>72</sup>*

152. Figure 13 illustrates homing decisions in the Mastercard and Visa platforms.

<sup>68</sup> Routledge Dictionary of Economics.

<sup>69</sup> See Gresham’s Law of Payments, Reserve Bank of Australia, 2005; Alan S. Frankel, Monopoly and Competition in the Supply and Exchange of Money, *Antitrust Law Journal*, 1998; John Vickers, Public policy and the invisible price: competition law, regulation, and the interchange fee, Proceedings of Payments System Research Conferences, 2005.

<sup>70</sup> Revised EU Market Definition Notice footnote 131 (emphasis added).

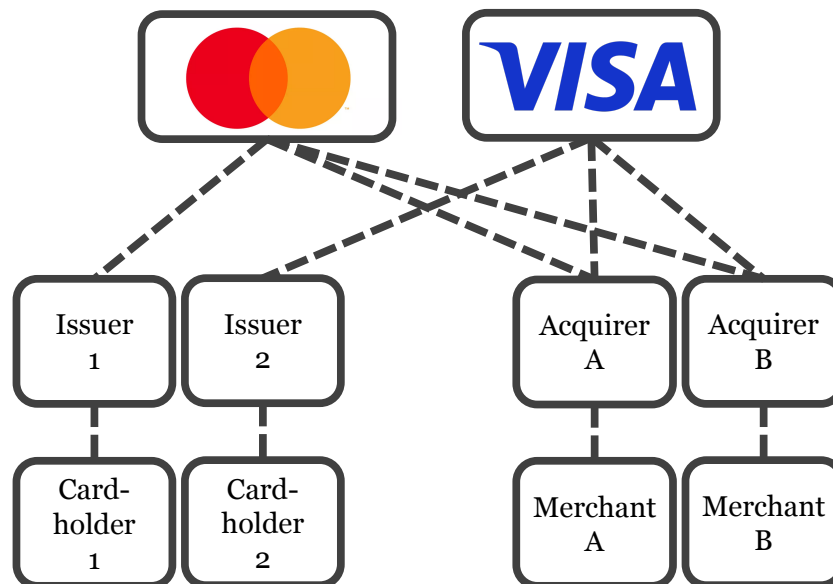
<sup>71</sup> Jean-Charles Rochet and Jean Tirole, Platform Competition in Two-Sided Markets, *Journal of the European Economic Association*, 2003. (Probably the widely cited paper on competition in multi-sided markets. Source: Google Scholar – reported 7,880 citations.)

<sup>72</sup> EU Market Definition Notice [104].



## 3. Responses to PSR consultation questions continued

**Figure 13: Issuers and cardholders “single-home” – but acquirers and merchants “multi-home”**



Source: Zephyre.

153. Namely, Figure 13 highlights that:

- acquirers and merchants (almost without exception) “*multi-home*” between Mastercard and Visa (i.e. accept both Mastercard and Visa); and
- issuers and cardholders (invariably) “*single-home*” between Mastercard and Visa (i.e. use only Mastercard or Visa but not both<sup>73</sup>).

154. In particular, issuers (and cardholders) always have a choice of whether to single-home or multi-home (and generally choose to single-home<sup>74</sup>, as the PSR Report explains:

- “Issuers may choose to issue cards on only one card scheme (single-homing) or use multiple card schemes (multi-homing)” [Annex 5, 5.16];
- “In 2022, 63% of debit cardholders had a single debit card, while 55% of credit card holders had a single credit card” [4.44].

155. In contrast, acquirers and merchants generally have no choice but to multi-home:

<sup>73</sup> Or at least have the option to single-home if they choose to.

<sup>74</sup> Especially at the level of a payment card account, e.g. debit card (current) account or credit card account, there is always single-homing by payment scheme, i.e. always either Mastercard or Visa, but never both.

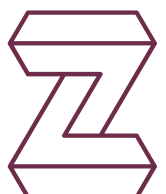


## 3. Responses to PSR consultation questions continued

- “almost every [UK] acquirer responding to our information requests told us that they have to offer acquiring services for both Mastercard and Visa” [4.8]; and
  - “Mastercard and Visa have must-take status [among UK merchants] as there is only very limited scope for a merchant to decline [either] card brand or limit acceptance of either card brand” [4.35].
156. The PSR’s 2021 Card acquiring market review similarly found that: “nearly all merchants accept Mastercard and Visa [whereas] they don’t always accept other card brands.”<sup>75</sup>
157. The pivotal analysis of competition in multi-sided markets (and significance of homing decisions) was by Professor Mark Armstrong<sup>76</sup>, who explained that:
- “When an agent chooses to use only one platform, it has become common to say the agent is ‘single-homing’. When an agent uses several platforms, she is said to ‘multi-home’. It makes a significant difference to outcomes whether groups single-home or multi-home.*
- In broad terms, there are three cases to consider: (i) both groups single-home, (ii) one group single-homes while the other multi-homes, and (iii) both groups multi-home. If interacting with the other side is the primary reason for an agent to join a platform, then we might not expect case (iii) [or case (i)] to be very common.*
- By contrast, there are several important markets that resemble configuration (ii) termed ‘competitive bottlenecks’. Here, if it wishes to interact with an agent on the single-homing side, the multi-homing side has no choice but to deal with that agent’s chosen platform. Thus, platforms have monopoly power over providing access to their single-homing customers for the multi-homing side. This monopoly power naturally leads to high prices being charged to the multi-homing side [...]. By contrast, platforms do have to compete for the single-homing agents, and high profits generated from the multi-homing side are to a large extent passed on to the single-homing side in the form of low prices (or even zero [or negative] prices).*
- This feature—that the single-homing side is treated well and the multi-homing side’s interests are ignored [...].—is a characteristic of [many platform markets].*

<sup>75</sup> PSR Market review into the supply of card-acquiring services: Final report, Annex 1: Industry background, 2021 [1.342] (emphasis added).

<sup>76</sup> Mark Armstrong, Competition in Two-Sided Markets, *RAND Journal of Economics*, 2006 (Armstrong 2006). (Reported 5,349 citations, source: Google Scholar.)



## 3. Responses to PSR consultation questions continued

*It does not make sense to speak of the competitiveness of ‘the market’. There are two markets: the market for single-homing agents which is, to a greater or lesser extent, competitive, and a market for multi-homing agents where each platform holds a local monopoly. The excessive prices faced by the multi-homing side do not necessarily result in excess profits for platforms, since platforms might be forced by competitive pressure to transfer their monopoly revenues to the single-homing agents. Rather, the market failure is a suboptimal balance of prices to the two sides of the market.”*

158. Professor Armstrong therefore directly pre-empted the PSR Report findings of asymmetric competitive constraints and pricing between the acquiring and issuing sides of the Mastercard and Visa platforms, namely that:
- issuers (and cardholders) generally single-home;
  - acquirers (and merchants) invariably multi-home;
  - Mastercard and Visa have monopoly power over acquirers and merchants, naturally leading to high prices and poor service;
  - Mastercard and Visa nonetheless compete for issuers, leading to much of the profit generated from acquirers and merchants being passed on to issuers (and to some extent cardholders) in low (or even zero or negative) prices;
  - issuers (and cardholders) are treated well, whereas the interests of acquirers (and merchants) are generally ignored; and
  - the market failure is that prices are too high to acquirers (i.e. monopolistic) and too low to issuers (i.e. predatory) – a suboptimal balance of prices.

159. Armstrong’s 2006 paper is also strongly affirmed (and frequently cited) in another recent authority, the 2018 OECD’s Report on Antitrust Regulation of Multi-Sided Platform Markets<sup>77</sup>, which explains that:

*“[...] examination of exclusionary unilateral conduct in multi-sided markets should be a greater priority for [regulatory] agencies than it is in traditional markets. [...]*

*[...] the incentive for [an] incumbent to exclude is larger, the stronger the cross-platform network externality. [...]*

<sup>77</sup> Organisation for Economic Co-operation and Development (OECD), *Rethinking Antitrust Tools for Multi-Sided Platforms*, 2018 (OECD Report on Antitrust Regulation of Multi-Sided Platform Markets).



## 3. Responses to PSR consultation questions continued

*[there are] greater risks from predation in multi-sided markets due to the opportunities for platforms to predate by sacrificing profit on one-side while in parallel recouping by setting a high price on the other side. [...]*

*a [multi-sided] platform can predate by reducing its total price to unsustainable levels, but that it can also do so by changing the balance of prices across the different sides of the market.”<sup>78</sup>*

160. And PSR Non-Executive Director Professor Valletti in particular describes these same general effects in the OECD Report:

*“One of the important features of multi-sided platforms [such as payment card networks] is that [...] network externalities [the value that one group of users, e.g. cardholders, places on other groups of users, e.g. merchants] affect the pricing decisions of platforms. It is a well-known result that platforms can price one side [e.g. the card issuer side] below costs. [...] Moreover, [...] a dominant platform [such as a payment card scheme] may predate [i.e. seek to exclude actual and potential competitors] through asymmetric pricing between the two sides of the market [i.e. too high on one side and too low on the other].”<sup>79</sup>*

161. Namely, the chief harm in multi-sided platform markets such as payment cards is the same highly asymmetric pricing between the two sides of the market, e.g.:

- prices too high to acquirers and merchants<sup>80</sup> – paying far more than they would in a competitive market; and
- prices too low to issuers and cardholders<sup>81</sup> – fuelling excessive use of card payments at the expense of lower-cost/more-innovative alternatives.

162. The PSR Report affirms of course that the Mastercard and Visa payment card schemes are multi-sided markets [3.21].

163. The PSR Report shows that Mastercard and Visa are each dominant in the supply of core (and optional) scheme and processing services to acquirers. Namely, the PSR Report shows that Mastercard and Visa do not face effective competitive constraints in the supply of these services – as Mastercard and Visa each behave to an appreciable extent independently of their competitors (i.e. of each other and

<sup>78</sup> Chris Pike, Introduction and key findings, OECD Report on Antitrust Regulation of Multi-Sided Platform Markets.

<sup>79</sup> Andrea Amelio, Liliane Karlinger, and Tommaso Valletti, Exclusionary practices and two-sided platforms, in Organisation for Economic Co-operation and Development (OECD), *Rethinking Antitrust Tools for Multi-Sided Platforms*, 2018 (OECD 2018).

<sup>80</sup> To the extent that Mastercard/Visa acquirer pricing is passed on to merchants, which is generally very high.

<sup>81</sup> To the extent that Mastercard/Visa issuer pricing is passed on to cardholders, which is generally low.



## 3. Responses to PSR consultation questions continued

of other payment methods), of their customers (i.e. acquirers and merchants), and ultimately of consumers (the definition of “*dominance*” in EU and UK competition law<sup>82</sup>).

164. And the PSR Report shows that the Mastercard and Visa card schemes set highly (and increasingly) asymmetric pricing to the acquiring and issuing platform sides.
165. Many other authors (and competition law/antitrust and regulatory cases) have affirmed the same conclusions, in particular:

**EU Market Definition Notice review:** “Where users on one side of competing two-sided platforms single-home, these platform services are substitutes belonging to the same market. If, however, users on the other side multi-home, each platform provides monopoly access to its set of users on the single-homing side. Thus, for given user behaviour on the single-homing side, each platform acts as a monopolist vis-à-vis users on the multi-homing side. This suggests that there is a [monopoly] market for each platform regarding the service provided to the multi-homing side.”<sup>83</sup>

**Google Android EU antitrust case:** “[The] European Commission assumed [in case AT. 40099 Google Android] the existence of a market for app stores for the Android mobile operating system, which is dominated by Google’s app store. This rests upon the assumption that consumers are single-homers as they make a discrete choice to use a device based on Android’s, Apple’s or another firm’s operating system, while app developers tend to be multi-homers.”<sup>84</sup>

**OECD Antitrust Regulation of Multi-Sided Platform Markets Report:** “[If] one customer group predominantly practices single-homing while another one practices multi-homing, there might be fierce competition to attract customers from the single-homing group, but little competition for customers from the multi-homing group. [...]”

[One] or more platforms can [therefore] become ‘bottlenecks’ that provide exclusive access to single-homing customers. This means that one platform or even several similar platforms may possess market

<sup>82</sup> See Communication from the European Commission: Guidance on the Commission’s enforcement priorities in applying [Article 102] of the [TFEU] to abusive exclusionary conduct by dominant undertakings (2009/C 45/02) [10].

<sup>83</sup> J.-U. Franck and M. Peitz, Market Definition in the Platform Economy, Discussion Paper Series – CRC TR 224, 2021.

<sup>84</sup> European Commission Support study accompanying the Commission Notice on the evaluation of the definition of relevant market for the purposes of Community competition law: Final report, 2021.



## 3. Responses to PSR consultation questions continued

*power vis-à-vis [multi-homing customers]. Where market power is high it might be reasonable to define a [monopoly] market that comprises only one platform (at least on [the multi-homing side of the market]).”<sup>85</sup>*

**T-Mobile/Orange EU merger case:** “As established in previous Commission decisions, there is no substitute for [fixed or mobile telecoms] call termination on each individual [fixed or mobile telecoms] network since the operator transmitting the outgoing call can reach the intended recipient only through the operator of the network to which the recipient is connected. Each individual network therefore constitutes a separate market for termination.”<sup>86</sup>

**Travelport/Worldspan EU merger case:** “The two-sided [airline global distribution system] market contains a number of elements which are characteristic of multi-homing /single homing situations [...] As long as [customers on one side of the market] use single-homing, [platform] providers have exclusive access to [such single-homing customers]. Each [platform] provider therefore has a certain degree of monopoly power in relation to [the multi-homing side of the market] that need to reach the [single-homing side] exclusively connected to one [platform]. This monopoly power allows the [platform] provider to charge higher prices to [the multi-homing side].”<sup>87</sup>

166. Hence, “homing” decisions are central to the analysis of multi-sided platforms such as the Mastercard and Visa card networks.

167. Lastly, the European Commission’s previous extensive analysis of the competitive dynamics of payment cards found that these markets are characterised by high fees to merchants (i.e. monopolisation) and restricted market entry (i.e. predation/exclusion), in summary:

*“[Interchange and/or equivalent card scheme fees have] a negative impact on merchants and consumers and prevents innovation.”<sup>88</sup>*

*“Interchange [and/or other equivalent] fees also restrict market entry as their revenues for issuing payment service providers function as a minimum threshold to convince issuing payment service providers to issue payment cards or other payment instruments, such as online and mobile payment solutions, offered by new entrants. [...]”*

<sup>85</sup> Arno Rasek and Sebastian Wismer, Market definition in multi-sided markets, in OECD 2018.

<sup>86</sup> European Commission case M.5650 T-Mobile/Orange (2010)

<sup>87</sup> European Commission case M.4523 Travelport/Worldspan (2007).

<sup>88</sup> Interchange Fee Regulation, Recital 11.



## 3. Responses to PSR consultation questions continued

*[Regulation of such fees] will create a level playing field [...allowing] for the successful market entry of [...] newcomers and for innovation [...in which] consumers and retailers would benefit from new entry in the payments market.”<sup>89</sup>*

*“In the context of card payments, reverse competition means that card schemes compete with each other by offering higher [...] 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 [incentives to card issuers] are considered as a minimum threshold by banks that issue cards.”<sup>90</sup>*

### **(VI) The “commercialisation” of Visa Europe’s pricing meant in practice: increase-prices-at-every-opportunity (but keep it well hidden)**

- 168. According to Visa’s statement to the PSR, the acquisition of Visa Europe by Visa Inc in 2016 was “an important driver of [Visa’s] pricing decisions in the period that followed the acquisition [...] and led to major benefits to [Visa’s] clients” [6.59].
- 169. This depends though of course which “clients” Visa is referring to – to issuers or to acquirers<sup>91</sup>?
- 170. The clearest answer though to this is probably what Visa Inc executives have said to investment analysts since Visa first announced the acquisition of Visa Europe in 2015, especially in reply to questions on Visa’s pricing strategy in Europe:

#### **Visa (V) Q4 2015 Results – Earnings call transcript**

**Charles W. Scharf – Chief Executive Officer (CEO), Visa Inc:** *We [just] announced the acquisition of Visa Europe. [...] On the pricing side, we believe there is an opportunity to expand yields [i.e. acquirer pricing net of issuer incentives] in Europe as we [...] evaluate pricing from the*

<sup>89</sup> Proposal for the Interchange Fee Regulation, page 3-4.

<sup>90</sup> Interchange Fee Regulation Impact Assessment, Volume 1, 2013, page 86.

<sup>91</sup> The PSR Report defines issuers and acquirers as the “main clients of the card schemes” [1.15].





## 3. Responses to PSR consultation questions continued

*perspective of a commercial enterprise rather than a member-owned association.*

**Vasant M. Prabhu – Chief Financial Officer (CFO), Visa Inc:** *We expect the full integration [of Visa Europe] to take until the end of 2020. As Charlie indicated, net revenue yields [i.e. acquirer pricing less incentives] are expected to expand as we move to market-based pricing over time depending on client, competitive, and regulatory factors.*

**Sanjay Sakhrani – Keefe, Bruyette & Woods:** *I guess, Vasant, I heard you say, I think, that Visa Europe and Visa Inc. margins [i.e. acquirer pricing less incentives] you're assuming will be equal at some point in time. Could you just talk about whether or not there might be some deviation in that?*

**Vasant M. Prabhu:** *We feel good that by the time we're done with the integration, Visa Europe margins should be in the Visa Inc. range [i.e. much higher than they are now].*

### **Visa (V) Q3 2016 Results – Earnings call transcript**

**David Mark Togut – Evercore Group:** *Thanks and congratulations on completing the Visa Europe acquisition. Now that you own Visa Europe, can you update us on your thoughts with respect to the pricing opportunity there to move Visa Europe's prices over time closer to MasterCard's, which are currently at a significant premium [to Visa's in Europe]?*

**Charles W. Scharf – CEO, Visa Inc:** *In the process of moving to a commercial enterprise, we obviously know what the market is. But we're also keenly aware that pricing should be reflective of the value that's added. And so I think that's a conversation that we'll have directly with our clients. And when it's appropriate, we'll talk more broadly about it.*

### **Visa (V) Q4 2017 Results – Earnings call transcript**

**Alfred F. Kelly – CEO, Visa Inc:** *In terms of [Visa Europe] revenue, we have worked hard to commercialize the business by selectively introducing new pricing [i.e. acquirer price increases...] And again, more to do, but we are off to an excellent start. [...]*



## 3. Responses to PSR consultation questions continued

*I think as I said, we're bullish on Europe. In addition to that you know that we have taken some pricing [increases] and our yields [acquirer fees net of incentives] have run a little better than we expected. [...]*

*So from a price standpoint, there have been some actions taken [i.e. price increases...]*

*In terms of pricing as we said that, it's not our practice to talk about pricing we take around the world. I mean occasionally we talk about pricing we've taken in the US, because it's quite visible, everybody tends to know about it [...]*

*And we said before that, we don't plan to change that policy and talk about specific pricing actions we're taking in Europe or any one market, nor do we ever talk about pricing plans for the future. [...]*

*I think that there is good fundamental growth opportunities in Europe independent of share [i.e. dependent on price increases alone].*

### **Visa's (V) Management Presents at Barclays Emerging Payments Forum (transcript), Q1 2018**

**Darrin Peller – Barclays:** *With regard to Visa Europe you mentioned [...] that there could be some pricing opportunities still to come, right. [...] on the pricing front, I will be curious to hear more about what the competitive dynamics are.*

**Vasant Prabhu – CFO, Visa Inc:** *Yeah. I mean in generally in Visa Europe, we are really happy with where we are. [...] We were able to take some pricing [i.e. acquirer price increases] last year and some more pricing [increases] this year, which clearly, we want to be very prudent on [to minimise the risk of regulatory attention]. And we don't really want to sort of -- we sort of take it one step at a time. We think there is some more opportunities in Europe, but we'll have to watch and see how things play out [i.e. see if merchants or regulators react] and decide what we want to do next.*

### **Visa's (V) Q1 2018 Results – Earnings call transcript**

**James Schneider – Goldman Sachs:** *[...] maybe going back to the Europe topic for a second [...] can you maybe opine on where you see opportunities to improve that position [...]*





## 3. Responses to PSR consultation questions continued

### **Vasant Prabhu – CFO, Visa Inc**

*And in terms of [Visa Europe] pricing I think we've told you earlier that there is pricing [i.e. acquirer price increases] but this year there is the pricing goes into effect in the second half. And then we'll evaluate further pricing actions [price increases] in the future.*

### **Visa (V) Q2 2018 Results – Earnings call transcript**

**Daniel Perlin - RBC Capital Markets:** *I had a question around pricing and the demand environment in Europe in particular. There seems to be some suggestions, I think, in the market that scheme fees on acquirers are rising pretty quickly and have been so for the past couple quarters. And I'm just wondering is there a dynamic that [Visa] have been able to take advantage of recently?*

**Alfred F. Kelly – CEO, Visa Inc:** *On the pricing front, when we first made the acquisition of Visa Europe, we took some pricing [i.e. increased acquirer pricing]. We've subsequently taken some pricing [i.e. increased pricing again]. And as I look out, I think there's pricing opportunities [i.e. to keep increasing prices]. I'm talking about Europe now, pricing opportunities in Europe looking forward as well.*

### **Visa Inc. (V) Management Presents at Deutsche Bank 2018 Technology Brokers Conference (transcript), Q3 2018**

**Bryan Keane – Deutsche Bank Securities:** *Is there still room to increase yields in pricing. One of the things I think surprised us was that Mastercard increase prices as well [in Europe]. So it feels like there's still some room to grow there?*

**Vasant Prabhu – CFO, Visa:** *Yes, I mean we've been – I think we've acknowledged that there is still a pricing gap [between Visa and Mastercard]. And it's a pricing gap that needs to be addressed [i.e. by Visa raising its prices]. It is something we have to deal with overtime. And we have to be prudent about it [...]. So, as [Visa's CEO] has said [...] before, we are aware of it, we are addressing it, we will address it over time, and we will do it in as prudent manner as we can [i.e. to minimise merchant and regulatory attention].*



## 3. Responses to PSR consultation questions continued

### **Visa Inc. (V) Management Presents at Autonomous Research Future of Commerce Symposium Conference (transcript), Q3 2018**

**Craig Maurer – Autonomous Research:** *[In the previous quarters], there was significant pricing taking [i.e. acquirer pricing increases in Europe...]. Could you discuss where you think you are versus your competition at this point? How much progress has been made there? And how the regulatory landscape might color what Visa chooses to, going forward, especially with the optionality the PSR left to extend there [in its Card-acquiring market review], look into the network pricing structure?*

**Mike Milotich – Head of Investor Relations, Visa Inc:** *Yes. So there is a pricing gap [between Visa and Mastercard in Europe] that is -- it's not an insignificant one. And so we're aware of that, and we have every intention of closing it, but we're going to do it overtime and we're going to be prudent about it. We don't want to have unintended consequences or disrupt the market in any way. [...] And so the finish line [of closing the pricing gap] we see right now two years from now maybe somewhere different. And so it's hard to say where we are but we are making progress. And -- but it will take time for us to close the gap that exists.*

### **Visa, Inc. (V) Presents at Citi 2018 Financial Technology Conference (transcript), Q4 2018**

**Ashwin Shirvaikar – Citigroup:** *[...] the Visa Europe integration. To what extent is that an opportunity yet to come? Can you talk a little bit about the [pricing] framework, not obviously the specifics but the framework of how you think of that?*

**Bill Sheedy – Executive Vice President, Visa Inc:** *You've seen in the two plus years that we've owned the Europe business and we've helped them transition away from their bank-owned association structure. We've made quite a bit of pricing changes in Europe I think successfully [i.e. acquirer price increases]. And while I wouldn't talk about any specific region or any specific element of our pricing, I'd say that it's a part of what we're obligated to do is to continue to look at where we have an opportunity.*



## 3. Responses to PSR consultation questions continued

### **Visa, Inc. (V) Management Presents at 2018 RBC Capital Markets Technology, Internet, Media and Telecommunications Conference (transcript), Q4 2018**

**Daniel Perlin – RBC Capital Markets:** So let's [...] go over to this multi-pronged journey that you have in Europe, right? And I say multi-pronged because I'm thinking commercialization of your pricing model [...] so let's start with where you stand in terms of commercializing the pricing model in Europe.

**Mike Milotich – Senior Vice President of Investor Relations, Visa Inc:** So we're not going to comment too much about European pricing. I think we're clearly on...

**Daniel Perlin:** We're on the journey. Where are we on that journey, I guess?

**Mike Milotich:** There is opportunity in pricing in Europe and that's about what I'm going to say.

### **Visa Inc. (V) Management Presents at Wolfe Research Fintech Forum Conference (transcript), Q1 2019**

**Darrin Peller – Wolfe Research:** I remember [Visa's CEO] had mentioned pricing opportunities [in Europe] but you still see there being a decent runway of pricing opportunities in Europe given kind of where you were left off after the acquisition of Visa Europe?

**Vasant Prabhu – CFO, Visa:** Yes I mean we typically don't like to talk about pricing and so what we would say is we do think that our opportunities in Europe we will need to sort of approach them over time and do what we normally do on pricing. It has to be sort of focused on value, it has to be focused on competitive alternatives, it has to be focused on what's prudent et cetera. So it will play out over time.

### **Visa Inc. (V) CEO Al Kelly on Q2 2019 Results – Earnings Call transcript**

**Jamie Friedman – Susquehanna:** I guess my question is, are you closer to the beginning or middle or end of the pricing journey in Europe? Maybe if you could help us characterize that and update that will be helpful. Thank you.



## 3. Responses to PSR consultation questions continued

**Al Kelly – CEO, Visa:** *Thanks, Jamie. I don't really want to get caught up in this game of where we are in pricing. Pricing is something we look at in the business on a continual basis. And we will continue to do that around the globe and in Europe. And it's a lever that we're well aware of and will continue to pull as we think the value that we deliver is commensurate with that.*

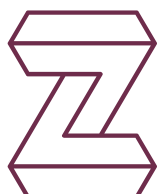
### **Visa Inc. (V) at Bernstein Strategic Decisions Conference (transcript), Q2 2024**

**Harshita Rawat – Bernstein:** *Can you talk about Europe? I know after Visa Europe acquisition, things changed quite a lot for you in Continental Europe.*

**Ryan McInerney – CEO, Visa Inc:** *Yeah. Europe has been – it's been great for us since we closed on the Visa Europe acquisition. We closed on Visa Europe I think in 2016. To put it in context, since 2016, we've essentially kind of doubled a lot of the key metrics in our Europe business [such as pricing].*

171. Hence, it is evident from the outset that the objective of Visa Inc's acquisition of Visa Europe was to increase Visa Europe's acquirer pricing (i.e. scheme and processing fees) – to close the gap with Mastercard's pricing in Europe and Visa's pricing in the rest of the World (as illustrated at Figure 7 above).
172. Visa's explanations and answers to investment analysts therefore emphatically confirm the PSR's conclusion that the “commercialisation' of Visa pricing [following Visa Europe's acquisition by Visa Inc] was not effectively constrained by competition” [6.61].
173. Hence, Visa Europe's acquisition by Visa Europe certainly did not lead to “major benefits” to Visa's acquirer (and merchant) clients at all, who on the contrary have faced very substantial price increases. Instead only Visa Europe's issuer clients have benefited (very substantially) – receiving €19.4 billion for the sale of Visa Europe<sup>92</sup>, as well as rising incentive payments since then (as shown at Figure 8 above).
174. It is also clearly evident that Visa has sought to raise prices by stealth – i.e. to limit merchant and regulatory attention – and with investors asking directly

<sup>92</sup> See Visa press releases: Visa Inc. to acquire Visa Europe Visa Inc. (November 2015); Visa Inc. Reaches Preliminary Agreement to Amend Transaction with Visa Europe (April 2016); and Visa Inc. Completes Acquisition of Visa Europe (June 2016).



## 3. Responses to PSR consultation questions continued

about the regulatory risk of Visa’s progressive acquirer price increases, for example of “*the optionality the PSR left [in the PSR’s 2018 Card-acquiring market review to...] look into the [card] network pricing structure*”<sup>93</sup>.

### **(VII) Substantial recent increases in commercial card interchange fees is another case of how the cards market is not working (similar to scheme and processing fees)**

175. Following the PSR’s Card-acquiring market review the PSR announced two new market reviews into card fees – “[to] look into how well [the cards] market is working, including the issue of increasing card fees”<sup>94</sup> – namely, the:
- **Card scheme and processing fees review** – “because our card-acquiring market review (CAMR) found that the fees paid by acquirers had increased significantly from 2014 to 2018”; and
  - **Cross-border interchange fees review** – “[which] have also increased significantly in the last year”<sup>95</sup>.
176. At the same time the *PSR Strategy* highlighted significant projected shift in debit card transactions from Visa to Mastercard – owing to First Direct, NatWest, Santander, and TSB having announced their intention to switch from Visa to Mastercard [5.58].
177. It could have been forecast therefore that such shift of cards from *lower-cost* Visa to *higher-cost* Mastercard would itself drive significant new card fee increases, of:
- higher card scheme and processing fees (as already discussed) – owing to Mastercard’s scheme and processing fees on average 100% higher than Visa’s around 2020<sup>96</sup>; and
  - similarly much higher commercial card interchange fees (interchange fees on cards issued to businesses, self-employed persons, or public sector entities for payment of business expenses)<sup>97</sup>.
178. In particular, between 2020 and 2023 average commercial card interchange fees (for a sample of BRC members) have increased from 0.8% to 1.2% (much greater than increases in average scheme and processing fees). This has been driven by:

<sup>93</sup> Visa Inc. (V) Management Presents at Autonomous Research Future of Commerce Symposium Conference (transcript), Q3 2018, Craig Maurer – Autonomous Research.

<sup>94</sup> PSR, Statement on card scheme fees, 17 November 2011.

<sup>95</sup> PSR, Two new market reviews into card fees, 21 June 2022.

<sup>96</sup> Comparing Mastercard global against Visa Europe on average.

<sup>97</sup> Source: BRC member sample (and also substantially public domain information).

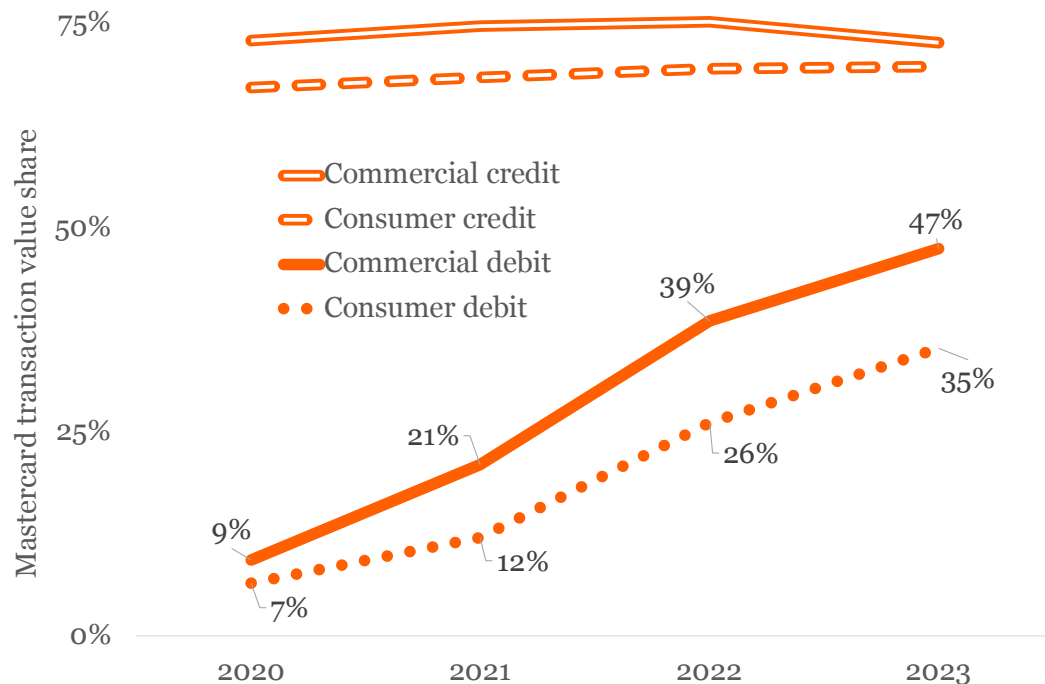


## 3. Responses to PSR consultation questions continued

- even higher switching of commercial debit cards from Visa to Mastercard;
- much higher Mastercard commercial debit card interchange fees than Visa; and
- increase also in Visa's commercial debit card interchange fees.

179. First, switching from Visa to Mastercard has been faster for commercial cards than consumer cards, as illustrated by Figure 14.

**Figure 14: Mastercard commercial debit card share grown faster than consumer card share**



Source: BRC member sample data.

180. Namely, based on a BRC member sample, Mastercard's transaction value share of commercial debit cards has increased from 9% to 47% between 2020 and 2023, compared to 7% to 35% for consumer cards<sup>98</sup>.
181. Greater switching of commercial debit cards is more likely because issuers that have switched (especially NatWest) have a larger share of business banking/

<sup>98</sup> At the same time, Mastercard commercial and consumer credit card share was already much higher at around 70%-75%.



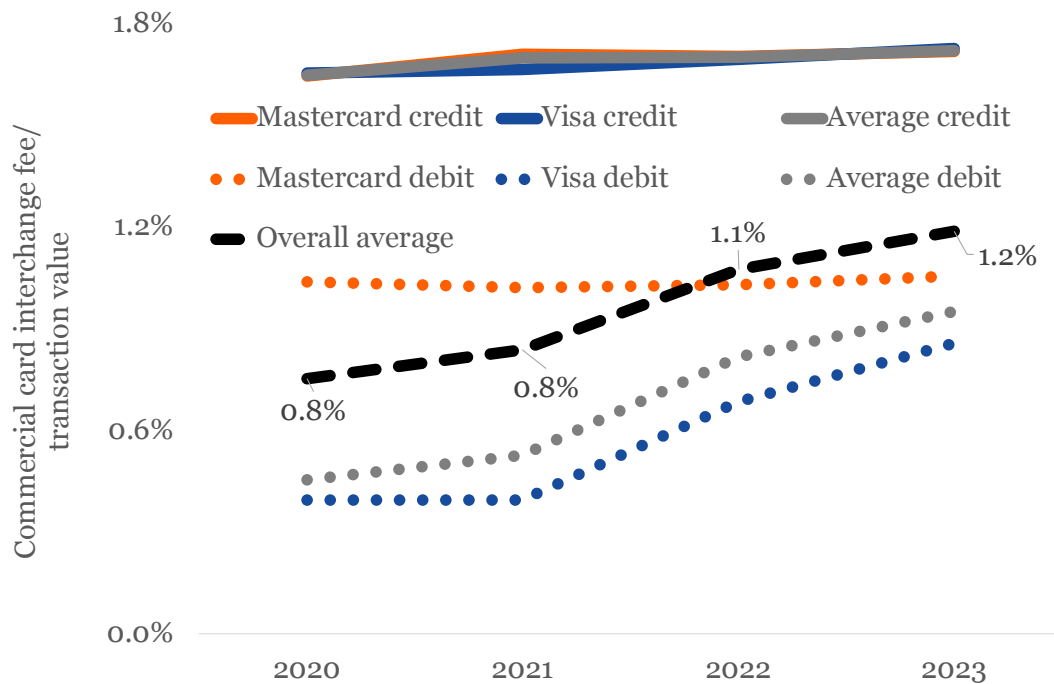


## 3. Responses to PSR consultation questions continued

commercial debit cards than consumer banking/consumer debit cards, as well also rapid growth of new business banks (such Metro, Monzo, Starling, and Tide – all issuing Mastercard cards only).

182. Second (and third), Mastercard’s commercial debit card interchange fees are much higher than Visa’s, although Visa has increased its commercial card interchange fees now significantly towards Mastercard’s levels, as shown at Figure 15.

**Figure 15: Average commercial card interchange driven by increasing Mastercard share plus increasing Visa rates**



Source: BRC member sample data.

183. Such increase in average commercial card interchange fees has cost UK merchants over £200m annually<sup>99</sup> and almost £400m in total since 2020<sup>100</sup> – of which over half is explained by issuers switching from Visa to Mastercard, and the remainder by Visa increasing its interchange fees in response.

<sup>99</sup> Assuming commercial card purchases equal to 5% of total Mastercard and Visa card purchases of £940 billion in 2023 (source: UK Finance UK Payment Statistics).

<sup>100</sup> For 2020-23 inclusive.



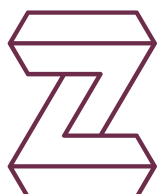
## 3. Responses to PSR consultation questions continued

184. Such switching of commercial cards from lower-cost Visa to higher-cost Mastercard, and Visa in turn increasing its commercial card interchange fees, are all part of the same “*reverse competition*” driving card scheme switching and similar increases in scheme and processing fees.
185. Likewise, higher Mastercard commercial debit card interchange fees will undoubtedly have been a major factor in card issuers’ decision to switch from Visa to Mastercard – as well as higher Mastercard issuer incentives.
186. Hence, while the PSR Card-acquiring market review found that average “*non-capped*” interchange fees *[...including] transactions involving commercial cards and transactions where the issuer was located outside the EEA, which were not capped by the IFR*” [5.13] had “*remained approximately at the same broad level*” – of 0.75%-0.80% – between 2016 and 2018 [Figure 2, Annex 2], such non-capped interchange fees has increased significantly since then, especially commercial debit card and UK-EEA cross-border interchange fees.
187. In total, commercial card interchange fees now represent almost 30% of UK merchants’ total interchange fee bill (in 2023) – up from just over half that amount in 2020. So, this is a big impact for all UK merchants and even greater of course for merchants with a large share of commercial card transactions<sup>101</sup>.
188. BRC members are therefore concerned that the PSR must consider unregulated interchange fees as well as scheme and processing fees – in particular because focusing on scheme and processing fees in isolation may create a new “whack-a-mole” situation of even further unregulated interchange fee increases (i.e. if scheme and processing fees were regulated in isolation).
189. The PSR should therefore start an additional card fee review of commercial card interchange fees.

### **(VIII) Concerns about scheme and processing fees reflect longstanding complaints and investigations about the costs of card payments**

190. The BRC has been raising complaints about the high cost and lack of competition in card payments for the last 30 years – in the UK and the EU – leading to successive regulatory investigations and changes. The PSR Report is the latest in these investigations and should of course build on the learnings from those past investigations.

<sup>101</sup> For some merchants all their card transactions will be commercial cards, i.e. merchants in wholesale/business-to-business only sectors.

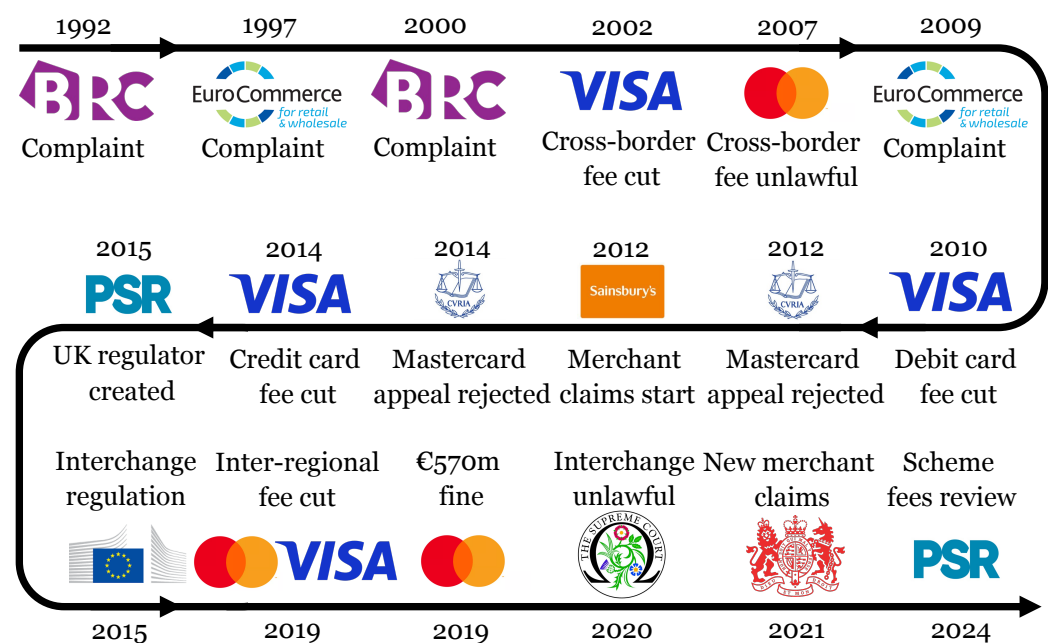




3. Responses to PSR consultation questions continued

191. In summary, in 1992, the BRC (followed by EuroCommerce<sup>102</sup>) brought complaints to the European Commission about the costs of card payments. This has then led to 30 years of public and private competition law and regulatory enforcement action against Mastercard and Visa<sup>103</sup>, as illustrated at Figure 16 below.

Figure 16: Longstanding merchant complaints and regulatory investigations of the cost of card payments – but still rising costs



Source: Zephyre.

192. See also similar summary at the PSR’s Market review of UK-EEA cross-border interchange fees Interim report Table 2.
193. The BRC and EuroCommerce complaints led among things to the European Commission’s 2007 decision finding Mastercard’s cross-border multilateral interchange fees were unlawful<sup>104</sup>, on grounds that interchange fees restricted

<sup>102</sup> The trade association for EU retail.

<sup>103</sup> I.e. public regulatory investigations and private commercial litigation.

<sup>104</sup> The Mastercard Prohibition Decision.



## 3. Responses to PSR consultation questions continued

competition between acquirers by setting a floor and artificially inflating merchant service charges<sup>105</sup>.

194. Mastercard subsequently reduced its interchange fees – while increasing its scheme fees at the same time. Following merchant complaints and new EU enforcement action, Mastercard repealed its scheme fee increases<sup>106</sup>, which the Commission said could have a similar effect on the market as interchange fees<sup>107</sup>.
195. Visa also subsequently offered to reduce its interchange fees (to avoid enforcement action), with the Commission this time expressly prohibiting Visa from “*setting and implementing other fees that are economically and/or legally equivalent to Intra-Regional Multilateral Interchange Fees [...], including but not limited to Visa Europe’s scheme fees charged to acquirers and / or issuers*”<sup>108</sup>.
196. The EU subsequently introduced the EU Interchange Fee Regulation<sup>109</sup>, in 2015, with the express objective to:

*“cut the cost of payments substantially for merchants, especially SMEs”*<sup>110</sup>.
197. As for the UK, in 2000, the landmark Cruickshank Review of Competition in Banking<sup>111</sup> recommended the creation of an independent payment systems regulator, which would be “*a new regulator with strong powers to deliver competitive outcomes*” [38], in particular, non-discriminatory access and efficient wholesale pricing in payment systems [39].
198. This reflected findings of “*profound competition problems and inefficiencies*” in payment systems [36], in particular of “*anticompetitive and inefficient*” wholesale pricing – including interchange fees and scheme and processing fees [3.95] – and that these problems were “*most severe*” in the Mastercard and Visa systems [3.98].

<sup>105</sup> Summary at Interchange Fee Regulation Impact Assessment, Volume 1, page 22-23.

<sup>106</sup> European Commission, Antitrust: Commissioner Kroes takes note of MasterCard’s decision to cut cross-border Multilateral Interchange Fees (MIFs) and to repeal recent scheme fee increases, IP/09/515, 2009.

<sup>107</sup> See Interchange Fee Regulation Impact Assessment, Volume 1, page 23.

<sup>108</sup> European Commission Case AT.39398 – Visa Europe Commitments offered to the European Commission, 10 September 2010 (§5.2) (emphasis added) and similarly Case AT.39398 – Visa Europe Commitments offered to the European Commission, 15 November 2013 (§9.3).

<sup>109</sup> Regulation (EU) 2015/751 (**the Interchange Fees Regulation**).

<sup>110</sup> European Commission – Statement/14/2767: Commission welcomes political agreement reached by European Parliament, 2014.

and Council on capping inter-bank fees for card-based payments

<sup>111</sup> Competition in UK Banking: A Report to the Chancellor of the Exchequer, Don Cruickshank, 2000 (**the Cruickshank Review**).



## 3. Responses to PSR consultation questions continued

199. In establishing the PSR, 15 years' later, the Government reaffirmed that the PSR would have powers to require operators of payment systems (e.g. Mastercard and Visa) to “*adhere to principles on efficient and transparent pricing*”<sup>112</sup>.
200. At the same time as the Cruickshank Review, the BRC complained about the cost of card payments to the then Office of Fair Trading (**OFT**), leading to the OFT's subsequent finding of anti-competitive card fees<sup>113</sup> and continuing investigation.
201. The Competition & Markets Authority (**CMA**) (successor to the OFT) only ceased this investigation in 2015 – on the express grounds that:

*“[The EU] interchange fees regulation [...] is expected to cap Mastercard's and Visa's fees and ensure they are fair and transparent [...] and will benefit consumers and retailers by dealing with the harm which, it is suspected, is caused by current levels of interchange fees [...];*

*The CMA, and its predecessor the [OFT], has played a significant role in the ongoing drive to deal with interchange fees [...including] an important role in making a case for the establishment of the [PSR];*

*The PSR will have powers [...] to give directions and impose requirements on participants in regulated payment systems, including [...] to vary the fees, charges, terms and conditions provided for in agreements relating to payment systems; and*

*The PSR will also be a concurrent competition authority with powers under the Competition Act 1998 and the Enterprise Act 2002.”*<sup>114</sup>

202. The CMA nonetheless said that:

*“if the CMA were to consider that the interchange fees regulation will not address the suspected harm as expected, [then the CMA] would look again at continuing proactively with the investigations.”*<sup>115</sup>

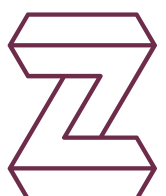
203. The current PSR Report of course shows that the Interchange Fee Regulation has not achieved its stated objective to “*cut the cost of payments substantially for merchants*” (at least not in the UK) – given the rapid increase in scheme fees and processing fees since the Interchange Fee Regulation came into full effect, 2016, as illustrated by Figure 17 below.

<sup>112</sup> HM Treasury, Opening up UK payments, 2013 [4.14].

<sup>113</sup> OFT Decision No. CA98/05/05, Investigation of the multilateral interchange fees provided for in the UK domestic rules of Mastercard UK Members Forum, 2005.

<sup>114</sup> CMA News story: CMA decides not to progress interchange fee investigations at the present time, 2014.

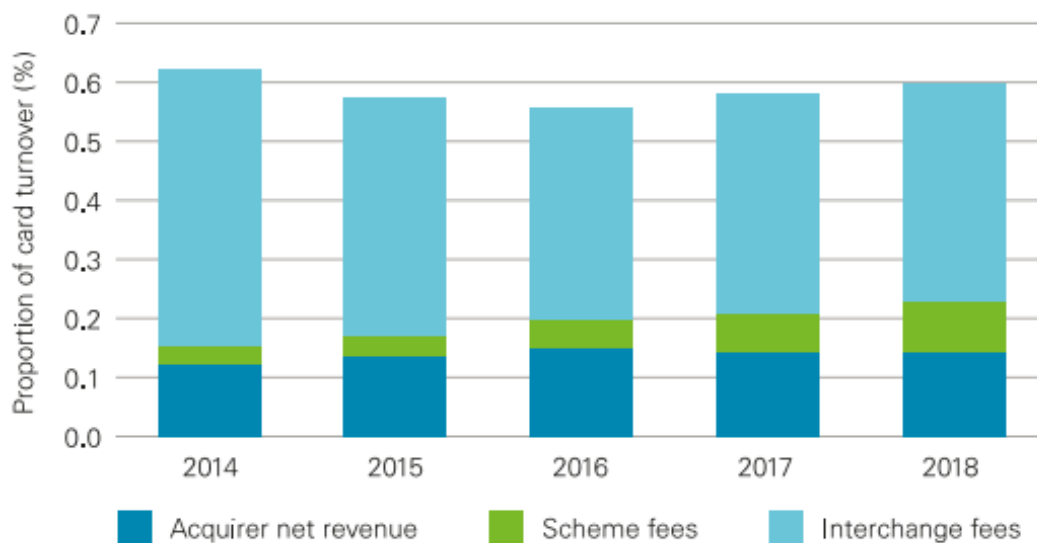
<sup>115</sup> CMA News story: CMA decides not to progress interchange fee investigations at the present time, 2014.



## 3. Responses to PSR consultation questions continued

204. Hence, the CMA (and/or PSR) must certainly look at the effectiveness of the Interchange Fee Regulation (as the current PSR Review is in part doing).

**Figure 17: Regulated interchange fee reductions (from 2016) have been offset by rising scheme (and processing) fees**



Source: PSR Market review of card scheme and processing fees: interim report, 2024, Figure 1.

205. Namely, Figure 17 shows that following the first full year that the Interchange Fee Regulation came into effect (2016) increases in scheme fees<sup>116</sup> had already offset the regulated reductions in interchange fees by 2017 (i.e. compared to the pre-Interchange Fee Regulation year 2015). The PSR Report of course explains that scheme and processing fees have continued to increase rapidly since 2018 too.
206. This is of course why the BRC has brought successive further complaints to the PSR<sup>117</sup> about rising scheme and processing fees since 2017 (supported by evidence from the BRC's annual member *Payments Survey*).
207. For example, the BRC said in 2017 that it had made a complaint to the PSR concerning *“the recent surge in scheme fees and other charges for processing credit and debit cards [...and had] expressed concern that card scheme fees may*

<sup>116</sup> What the PSR has subsequently redefined as “scheme and processing fees”.

<sup>117</sup> And to the House of Commons Treasury Committee among many others.



## 3. Responses to PSR consultation questions continued

*be used as a means of circumventing the [Interchange Fee Regulation]*<sup>118</sup>. That evidence has ultimately led to the current PSR market review.

208. It is apparent therefore that the PSR is facing Groundhog Day (“a situation in which events are or appear to be continually repeated”<sup>119</sup>) i.e. of successively repeated merchant complaints and investigations about the costs of card payments now for the last 30 years.

209. It will be critical therefore that the PSR finds effective remedies this time, to avoid the same cycle once more again.

### (IX) In conclusion, Mastercard’s and Visa’s card scheme and processing fees cause considerable harm to all payment users

210. As explained in the above sections, the PSR’s analysis and findings need to be considered together, with reference also to the economics of multi-sided platform markets, plus international market and regulatory insights.

211. Hence, in summary answer to the PSR’s consultation Questions 2-19:

212. **Questions 2, 10-12, 13, 15-16, and 19:** The fact that Mastercard and Visa are subject to competitive constraints on the issuing side, but ineffective competitive constraints on the acquiring side, must be considered together – as these represent opposite sides of the same underlying harms, namely:

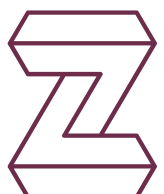
- direct harm to the business end-users of the Mastercard and Visa systems – i.e. merchants – by causing high prices and poor service; and
- indirect harm to all users of payments (and wider economy) – i.e. all businesses and all consumers – by creating artificial entry barriers to rival lower-cost/more-innovative payment alternatives and investment.

213. The fact that acquirer revenue accounts for the large majority of net scheme and processing revenues (i.e. net of rebates and incentives paid to issuers) for Mastercard and Visa in recent years – and that scheme and processing fees have increased substantially (as a proportion of transaction value) paid to Mastercard and Visa by acquirers – is central evidence of these harms, i.e. the substantial imbalance of pricing between the issuer and acquirer sides of the card scheme platforms.

214. Such divergence in average fee levels are explained by the competitive dynamics of multi-sided platform markets – i.e. of monopolisation of the acquirer side and

<sup>118</sup> BRC Payments Survey 2016 (published 2017).

<sup>119</sup> CollinsDictionary.com.



## 3. Responses to PSR consultation questions continued

predation on the issuer side – rather than by any changes in the value of services or innovation provided by Mastercard and Visa.

215. It is unsurprising therefore that Mastercard and Visa treat issuers well – but treat acquirers and merchants badly (among other adverse “*non-pricing*” outcomes).

216. **Question 3:** Merchant steering poses a limited competitive constraint on Mastercard and Visa for the reasons that the PSR Report explains, i.e. in practice merchants have limited ability and incentives to steer customers towards alternative payment methods in response to scheme or processing fees [8.41].

217. **Questions 4-5:** Digital wallets have not (up to now) resulted in an effective competitive constraint on Mastercard and Visa for the reasons that the PSR Report explains, i.e. of wallet operators’ apparent unwillingness to steer consumers and/or by contractual limitations to their ability to do so [4.176].

218. Digital wallets could nonetheless exercise a much greater competitive on Mastercard and Visa, especially Apple Pay, Google Pay, and PayPal, as the PSR Report indicates – and the PSR should scrutinise this as part of its remedies options (in particular under Competition Law Enforcement remedies).

219. **Questions 6-9 and 17-18:** Acquirers and merchants have limited alternatives available to them for Mastercard and Visa’s “*optional*” services, in particular given the PSR’s evidence that:

- many so-called “*optional*” Mastercard and Visa services are in practice unavoidable;
- Mastercard and Visa do not clearly inform acquirers and merchants that so-called “*optional*” services are in fact optional, so acquirers and merchants end up purchasing them anyway even if they are not needed; and
- even for Mastercard and Visa services that are genuinely optional, there are few if any realistic alternatives available.

220. Overall, the PSR’s evidence on Mastercard and Visa’s provision of “*optional*” services and operation of “*behavioural*” fees illustrates the poor service that the card schemes provide to acquirers and merchants.

221. **Question 14:** The chief harms resulting from Mastercard’s and Visa’s scheme and processing fees (and incentives) is the suboptimal balance of pricing between the acquirer and issuer sides of the payment card platforms, i.e. too-high to acquirers and too-low to issuers, rather than the overall level of Mastercard’s and Visa’s prices and profitability.



## 3. Responses to PSR consultation questions continued

222. So, even if the overall level of Mastercard's and Visa's prices and profitability were normal, i.e. no "*super-normal*" overall profits – because all of the monopolistic fees charged to acquirers were passed in negative predatory prices to issuers – then there would still be considerable harms to payments users.
223. Mastercard's and Visa's financial information nonetheless shows that they are both highly profitable, the direct result of high and growing scheme and processing fees (and incomplete pass-through in negative prices to issuers).
224. The profitability of scheme and processing fees (and of Mastercard and Visa overall) should in any event be assessed gross of incentives, as such incentive are in effect a sharing of the profitability of the Mastercard and Visa schemes with card issuers<sup>120</sup>.

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<sup>120</sup> In particular given that the EU and UK courts have found that card issuers are parties to "*associations of undertakings*" (along with the card schemes) in relation to setting of interchange fees (and other card scheme rules), of which the Interchange Fee Regulation (and other EU antitrust/regulatory decisions) defines scheme and processing fees, and incentives, to be a part of.





## 3. Responses to PSR consultation questions continued

### Question 20: Remedies overview (and Pricing Methodology & Governance remedy)

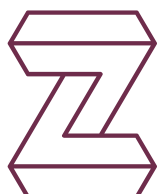
#### What are your views on our proposed remedies? Which remedy or category of remedy do you think the PSR should prioritise implementing?

225. In summary none of the PSR’s proposed remedies will be sufficient or effective (alone or in combination) to address the harms identified in the PSR Report, but only in combination with other remedies.

226. The PSR should therefore instead:

- develop and implement a transitional (and longer-term) “**Price Rebalancing/Non-Discrimination**” remedy as an immediate priority – see responses to Question 21 and 31;
- develop and implement a long-term **Price Cap** remedy – see response to Question 29;
- investigate **Interchange Fee Regulation Enforcement** – see response to Question 31;
- investigate **Competition Law Enforcement**, especially in relation to digital wallets – see response to Question 31;
- start a **Commercial Card Interchange Fee Market Review** – see response to Question 31;
- explore **Least-Cost Routing/Prohibition of Network Exclusivity** – a type of “boosting competition” remedy mandated in the US and Australia – see response to Question 31;
- develop and implement the PSR’s proposed **Regulatory Financial Reporting, Complexity & Transparency**, and **Timely Notification** remedies (as supporting remedies) – see response to Questions 22, 23, and 25; and
- reconsider the PSR’s proposed **Pricing Methodology & Governance** and **Mandatory Consultation** remedies – see further below and response to Question 23.

227. As explained in response to Questions 2-19 on the PSR’s analysis and findings (and Executive Summary of this report), none of the PSR’s four main proposed remedies will be sufficient or effective to address the harms identified in the PSR Report (alone or in combination) – but only in combination with other remedies.





## 3. Responses to PSR consultation questions continued

228. That is because the PSR’s proposed remedies are all *information* remedies – i.e. requirements to provide the PSR, acquirers, and/or merchants with greater information. But information alone will be insufficient to address the substantial harms identified in the PSR Report of ineffective competitive constraints and large (and rapidly growing) pricing asymmetries.
229. Alternative – more effective – remedies are therefore needed, in particular an interim and longer-term Price Rebalancing/Non-Discrimination remedy, a longer-term Price Cap remedy, Interchange Fee Regulation Enforcement and Competition Law Enforcement remedies, unregulated interchange fee investigation, plus potential Boosting Competition remedies.
230. The PSR should also implement a Price Rebalancing/Non-Discrimination remedy on a transitional/ interim basis. See response to Question 21.
231. The PSR’s information remedies will nonetheless be important to support other alternative remedies – to enable effective monitoring and enforcement – in particular, the PSR’s proposed Regulatory Financial Reporting, Complexity & Transparency, and Timely Notification remedies.
232. The PSR Report doesn’t include a specific question on the PSR’s proposed Pricing Methodology & Governance – so see comment below here.

### **The PSR’s proposed Pricing Methodology & Governance remedy is likely to have significant unintended consequences (and face strong legal challenge)**

233. In background, the PSR’s proposed Pricing Methodology & Governance remedy would require Mastercard and Visa to consider the cost, service quality, and service users in pricing of new services and (potentially) review of the pricing of existing services [8.16, 8.22].
234. This remedy would then mean the schemes preparing a pricing methodology for approval (and/or “*non-objection*”) by the PSR – and restriction from taking pricing decisions other than in accordance with this approved methodology [8.19-8.20].
235. The PSR says that it considers that this remedy may be capable of having a disciplining effect on the schemes’ pricing decisions – and of addressing the complexity and transparency issues that the PSR has identified [8.22].
236. In summary response: this proposed remedy is unlikely to address harms identified in the PSR Report – of ineffective competition and pricing imbalances, and even of addressing rapidly rising prices – unless this remedy were also to



### 3. Responses to PSR consultation questions continued

amount to a full Price Cap remedy, namely a remedy in which the PSR regulated Mastercard's and Visa's scheme and processing fees directly.

237. First, if this remedy were only to cover the introduction of new services and changes to prices of existing scheme and processing services (what the PSR calls "*UK pricing decisions*" [8.18]) but not include review of existing prices, then this remedy would not prevent increases in average scheme and processing fee prices (and may even accelerate increases in average prices). That is because:
- Mastercard's UK scheme and processing fees are substantially higher than Visa's (as the PSR indicates at [6.60] and is readily apparent globally); and
  - Mastercard has also been rapidly increasing its UK card issuing market share, owing to issuers switching from Visa to Mastercard (as the PSR explains [5.16]), itself owing to Mastercard being able to pay higher incentives to issuers than Visa (out of higher Mastercard scheme and processing fees).
238. This remedy would itself prevent Mastercard from continuing to increase its UK market share – therefore driving further average scheme and processing fee increases (even if Mastercard's and Visa's individual scheme and processing fees remained the same).
239. Such a remedy would moreover enable Mastercard to compete (even) more aggressively for new issuers than Visa (by preventing Visa from responding with its own fee increases) – a thereby further increasing the likelihood of other UK issuers switching from Visa to Mastercard, and of Mastercard's market share of UK card spend (and average scheme and processing fees) increasing still further.
240. Hence, this remedy could even accelerate the increase in UK average scheme and processing fees – relative to no remedies at all.
241. Visa moreover would undoubtedly complain that such a remedy – of effectively freezing current scheme and processing fees – discriminated against Visa, by allowing Mastercard to continue charging much higher fees than Visa, thereby putting Visa at a financial and competitive disadvantage. Visa would then most likely bring a legal challenge against the PSR for discriminatory regulatory treatment.
242. Second, if such a remedy were also to include review of existing scheme and processing fee prices, then the PSR would have to address the large pricing differences between Mastercard and Visa directly – and determine whether Mastercard would have to reduce its prices to the same level as Visa's (and how Mastercard should do that) and/or whether Mastercard and Visa should both



## 3. Responses to PSR consultation questions continued

have to reduce their prices to a new “*cost reflective*” level (and how they should do that).

243. That would in effect then be a full Price Cap remedy (which the PSR says that it is not intending to pursue at the current time).

244. Hence, the PSR’s proposed Pricing Methodology & Governance remedy is likely to be counter-productive and face strong legal challenges (unless it effectively becomes a full Price Cap remedy) and the PSR should therefore reconsider this.



## 3. Responses to PSR consultation questions continued

### Question 21: Transitional remedies

#### Are any transitional provisions needed?

245. In summary, yes. In particular, a transitional Price Rebalancing/Non-Discrimination remedy is needed and would be proportionate to the harms that the PSR has identified.
246. As context, the PSR Report highlights that it may take up to two years for certain remedies to be implemented (such as the Regulatory Financial Reporting remedy), whereas it may be possible for certain alternative measures to be implemented relatively quickly, and therefore that it may be necessary or appropriate (in line with the PSR's statutory objectives) to put in place short-term interim remedies, while also developing longer-term "*enduring*" remedies [8.47, 8.49].
247. A transitional Price Rebalancing/Non-Discrimination remedy is a clear candidate for such a short-term remedy (in anticipation of a longer-term package of enduring remedies, including a permanent Price Rebalancing/Non-Discrimination and a Price Cap).
248. As described in response to Question 31 (and the Executive summary of this report), a Price Rebalancing/Non-Discrimination remedy would be a regulatory rule that a card scheme's average net pricing to acquirers (as a proportion of transaction value) must be no greater than its average net pricing to issuers.
249. A transitional Price Rebalancing/Non-Discrimination remedy would therefore be an interim phased-in adoption of such a longer-term remedy, namely, a rule that a card scheme's average net pricing to acquirers must be no more than "X" times greater than its average net pricing to issuers, where "X" is number greater than one and would gradually reduce over time.
250. The PSR Report indicates that X is currently approximately 3 – i.e. that average net pricing to acquirers is currently three times average net pricing to issuers<sup>121</sup>.
251. Hence, the PSR could implement an interim/transitional rule that X had to be 2.5 for example during the first year of implementation and then subsequently fall to 2.0 during the second year (and so forth). Such a rule would initially be subject to self-reporting requirements by Mastercard and Visa (with penalties if later found to be non-compliant).

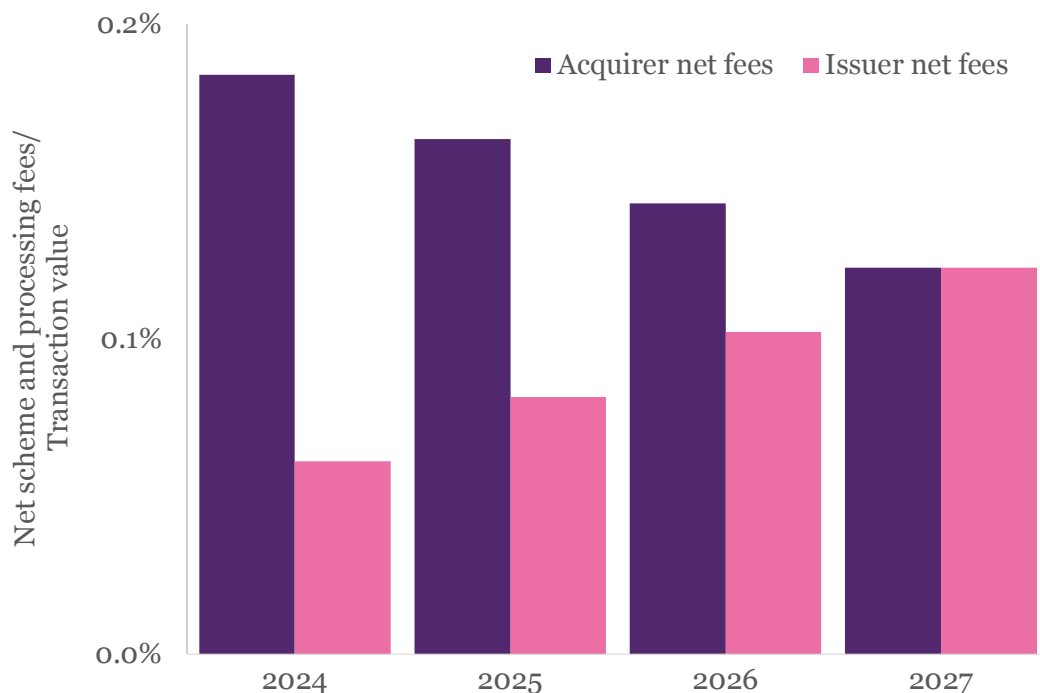
<sup>121</sup> As the PSR Report explains that revenue from the acquiring side currently accounts for 75% of total net scheme and processing fee revenue, i.e. revenue from the acquiring and issuing side together [1.18, 6.81]



## 3. Responses to PSR consultation questions continued

252. As shown at Figure 5 and also Figure 18, an interim Price Rebalancing/Non-Discrimination remedy would mean progressive equalisation of net acquirer and issuer scheme and processing fees.

**Figure 18: An interim Price Rebalancing/Non-Discrimination remedy would mean progressive equalisation of net acquirer and issuer fees**



Source: Zephyre calculations.

253. This would then allow time for the PSR to implement longer-term remedies including a permanent Price Rebalancing/Non-Discrimination remedy, Price Cap remedy, Regulatory Financial Reporting, and Complexity & Transparency remedies, among other things.

## 3. Responses to PSR consultation questions continued

### Question 22: Regulatory Financial Reporting remedy

#### Please explain (with reasons) if you think we should be considering a regulatory financial report remedy?

255. In summary, yes – the PSR should implement a Regulatory Financial Reporting remedy, in particular as a component of a wider remedies package (and in any event as a matter of good regulatory practice).
256. As background, the PSR said that it encountered significant challenges in looking at the UK profitability of the card schemes, as “bespoke” datasets prepared by the schemes did not resolve such challenges, especially owing to cost allocation issues [1.25].
257. These problems reflect that Mastercard and Visa do not have UK-specific legal entities (but only Europe, other region, and global level entities) – and therefore do not prepare UK-specific statutory financial reports (i.e. a profit & loss statement and balance sheet) in the normal course of their business, but rather at a Europe and global level only [8.7].
258. This remedy would therefore require the card schemes to prepare profit & loss and balance sheet reports in relation to their UK activities in accordance with an appropriate methodology on an enduring basis [8.11].
259. The PSR says that it already separately considering Regulatory Financial Reporting for all UK designated payment systems [8.14].
260. In summary response – the PSR should implement a Regulatory Financial Reporting remedy to support other remedies (albeit this remedy is unlikely itself to address the harms identified in the PSR Report).
261. First, every other UK economic regulator requires regulatory financial reporting from their regulated firms, especially:
- the Civil Aviation Authority (**the CAA**);
  - the Office of Communications (**Ofcom**);
  - the Office of Gas and Electricity Markets (**Ofgem**);
  - the Office of Rail and Road (**the ORR**); and
  - the Water Services Regulatory Authority (**Ofwat**).
262. In establishing the PSR the Government moreover said that: “[The PSR] would be built on a similar model to other regulated sectors such as gas, electricity and water with providers being licensed [and/or designated] and the regulator



## 3. Responses to PSR consultation questions continued

*enforcing license condition [such as regulatory financial reporting requirements].”<sup>122</sup>*

263. For example, the CAA imposes regulatory financial reporting requirements on Gatwick and Heathrow airports:

*“[...to] enable the CAA, airlines and [end] users of air transport services to assess on a consistent basis the financial position of [Gatwick and Heathrow] and the financial performance of provision of airport operation services and associated services [...] in conformity with the [CAA’s] Regulatory Accounting Guidelines [...which must include] a report by the Auditors addressed to the CAA which provides their opinion on those accounts [...and to] be made publicly available [...].”<sup>123</sup>*

264. Similarly, the ORR says that:

*“Good quality financial information is important for effective regulation as it helps to ensure that the interests of customers [...] are properly protected. [...In particular, the ORR-regulated company] Network Rail’s regulatory financial statements [...are] more relevant for regulatory purposes than the information contained in statutory financial statements [...as] the [regulatory] statements are set out in a format consistent with our relevant policies and regulatory framework.”<sup>124</sup>*

265. And Ofwat similarly highlights that:

*“[...] regulatory accounting statements form part of a wider regulatory report which companies will be required to submit annually [...] Statutory accounts on their own are insufficient to assess the performance of vertically integrated, price-controlled monopolies [...but the] regulatory accounting statements can [nonetheless] be reconciled back to statutory accounts [...].”<sup>125</sup>*

266. Hence, the regulatory financial reporting approaches of the other UK economic regulators provide templates for the PSR to apply to Mastercard and Visa (and other PSR-regulated payment systems).

267. Second, Mastercard and Visa have claimed to the PSR that their UK businesses are less profitable on average than their wider European and global businesses [6.133].

<sup>122</sup> HM Treasury, Setting the strategy for UK Payments, July 2012.

<sup>123</sup> CAA Licence granted to Heathrow Airport, May 2023 Version, Part E1: Regulatory accounting requirements.

<sup>124</sup> ORR CP7 regulatory accounting guidelines for Network Rail, 2024, Executive summary.

<sup>125</sup> Ofwat RAG 1.09 – Principles and guidelines for regulatory reporting under the ‘new UK GAAP’ regime, 2021, [1.2-1.3].





### 3. Responses to PSR consultation questions continued

268. The PSR has evidently considered though that Mastercard and Visa have not provided satisfactory reconciliation of their purported UK financial information to their Europe- and global-level statutory financial reports, such as by not including all relevant income and by over-allocating costs [6.134].
269. A formal Regulatory Financial Reporting remedy would thereby address such reconciliation issues by requiring application of standard accounting principles (e.g. of revenue recognition, cost allocation, etc) plus independent auditing (i.e. as required by the other UK economic regulators).
270. The PSR was right therefore to suggest that Mastercard's and Visa's Europe- and/or global-level profit margins are in fact good (or at least plausible) proxies for Mastercard's and Visa's corresponding UK profit margins (and/or other financial measures) especially given that Visa UK in particular represents a significant part of Visa Europe<sup>126</sup>.
271. In conclusion – the PSR should implement a Regulatory Financial Reporting remedy, in particular, as a component of a wider remedies package and as a matter of standard economic regulation practice.
272. Such a Regulatory Financial Reporting remedy should include standard profit & loss and balance sheet statements. It must also include a full transaction breakdown (of number and value of transactions) at UK merchants and by UK cardholders split by card type (i.e. credit, debit, prepaid, commercial cards, etc) and by transaction type (i.e. domestic, UK/EEA, inter-regional, card-present, card-not-present, retail purchase, cash acquisition, etc), including interchange fees, and scheme and processing fees by card and transaction type.
273. A Financial Reporting Remedy is nonetheless itself unlikely to change Mastercard's or Visa's business practices to any material degree, and therefore to address the harms found in the PSR Report.

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<sup>126</sup> E.g. by annual card transaction value (source: UK Finance UK Payments Statistics and Visa Europe Annual Reports).





## 3. Responses to PSR consultation questions continued

### Questions 23-24: Mandatory Consultation and Timely Notification remedies

**Please explain (with reasons) if you think we should be considering possible mandatory consultation and timely notification requirement remedies?**

**Do you have any views on ways in which other stakeholders, for example merchants, merchant associations and consumer groups, could participate in consultative discussions with the card schemes?**

274. In summary – yes, the PSR should require a Timely Notification remedy but reconsider its proposed Mandatory Consultation remedy.
275. That is because a Mandatory Consultation remedy is unlikely to make a difference to addressing the ineffective competitive constraints, pricing imbalances, and price rises that the PSR Report has found.
276. A Timely Notification remedy is also unlikely to make a difference to addressing the ineffective competition constraints (but would be welcome nonetheless).
277. As background, the PSR explains that Mastercard and Visa often have limited records of their pricing decisions, so the PSR cannot verify the considerations that have informed those decisions. The schemes notify acquirers to some degree in advance of fee changes (after they have been set) but this can be substantially revised soon before implementation [8.23].
278. The PSR is therefore considering:
- a requirement to consult acquirers on all fee changes before they have been approved internally;
  - a requirement to report to acquirers (and the PSR) on how the schemes have taken acquirer feedback into account; and
  - a requirement to give due notice of fee changes [8.24].
279. The PSR has nonetheless already found that the card schemes pricing decisions (for fees charged to acquirers) are driven primarily by absence of competitive constraints (i.e. they will charge whatever they can get away with). The card schemes nonetheless have sought to justify such price increases to the PSR as “*determined by the value to customers*” [6.34-6.37].



### 3. Responses to PSR consultation questions continued

280. Mastercard former Executive Chairman Ajaypal S. Banga probably more accurately explained that “[Mastercard’s] pricing [and Visa’s] is a function of what [we] think the market can bear, both on acquiring pricing and issuing pricing”<sup>127</sup>, i.e. monopoly pricing.
281. Hence, there will inevitably be conflicting explanations and justifications for the card schemes’ price increases.
282. The PSR has also found that acquirers have limited incentives to resist scheme fee increases [4.127] and that individually negotiated acquirer discounts or rebates are very uncommon [4.128].
283. Hence, it seems very unlikely that a requirement for the schemes to consult acquirers on fee changes – and to report to acquirers (and the PSR) how the schemes have taken such feedback into account – could make any meaningful difference to such fee changes, unless:
- acquirers had a right to refuse such fee changes; and/or
  - the PSR specified the circumstances (in advance) in which it might disallow a proposed fee change.
284. Hence, assuming the absence of such options (which would effectively be the same as the PSR’s proposed Pricing Methodology & Governance remedy), a Mandatory Consultation remedy is unlikely to make a difference to future fee changes (or to reverse past fee changes).
285. A Timely Notification remedy is also unlikely to make a difference to fee changes (but would be welcome nonetheless as a matter of transparency and fairness).
286. The PSR notes also that a formal merchant consultation obligation has been suggested as a way to improve the ability of merchants to understand and challenge fee increases, such that the card schemes would be required to provide merchants with an opportunity to provide representations before the implementation of significant fee changes. The PSR is nonetheless focusing on ways in which acquirers could be consulted instead. [8.26]
287. In comment, it is unlikely that merchant association and/or consumer group consultative discussions with the card schemes could resolve the harms identified in the PSR Report (unless such merchant associations and/or consumer groups had a right to veto any such scheme fee changes – but that would essentially be the same as the PSR’s proposed Pricing Methodology & Governance remedy, as addressed in response to Question 20).

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<sup>127</sup> Mastercard Q3 2018 Results – Earnings Call Transcript.



## 3. Responses to PSR consultation questions continued

### Question 25: Complexity & Transparency remedy

**Please explain (with reasons) if you think we should be considering possible remedies to address complexity and transparency issues? In particular, do you think that more detailed, timely and accurate information in respect of behavioural fees would help acquirers and merchants? Do you think a taxonomy or system for classifying fees into different categories would help service users?**

288. In summary – yes, the PSR should be implementing a Complexity & Transparency remedy, in particular, a requirement for clear information to merchants on how scheme and processing fees work [8.32] plus more accurate and relevant information about card scheme “*optional*” and “*behavioural*” fees [1.28].
289. Along with the general problem of high costs of card acceptance, the problem of complexity and transparency of card fees is another case of *Groundhog Day*: something that merchants have complained about repeatedly before and regulators have sought to address, but nonetheless keeps coming back.
290. The PSR must therefore ensure that a Complexity & Remedy is actually effective, taking into account at minimum past experience.
291. First, as context, the PSR Report highlights repeatedly that scheme and processing fees are “*overly complex and lacking in transparency*” – and that this is raising acquirers’ costs and distorting acquirers’ ability to respond to pricing signals among other problems [8.31].
292. These findings of course corroborate the PSR’s finding of ineffective competitive constraints on the acquiring side of the Mastercard and Visa platforms – and therefore why the schemes inevitably provide poor service and generally ignore the interests of acquirers and merchants (in contrast to the position of issuers).
293. The PSR is therefore proposing a combination of Complexity & Transparency measures “*to simplify the increasingly complex range of services provided via acquiring contracts to merchants*” [8.33] and which must “*deliver meaningful transparency*” to acquirers and merchants [8.34].
294. Second, as noted, merchants and regulators have been raising complaints about the complexity and transparency of card scheme fees for at least the last 30 years, followed by successive regulatory attempts to address these.



## 3. Responses to PSR consultation questions continued

295. As described in response to Questions 2-19, the BRC and EuroCommerce first brought complaints to the European Commission about the complexity and transparency of Mastercard's and Visa's fees and rules (among wider concerns) in the 1990s<sup>128</sup>.
296. Further to antitrust investigations by the Commission, Visa agreed to reduce certain of its interchange fees and to make these transparent to merchants<sup>129</sup> (which Visa had previously opposed on confidentiality grounds<sup>130</sup>).
297. The Commission nonetheless noted that *"the measures to increase transparency, while welcomed by retailers, will not significantly increase the negotiating power of merchants, since the [card interchange fees] will still effectively constitute a floor to merchant fees"*<sup>131</sup>.
298. In 2000, the landmark Cruickshank Review, which first recommended the creation of the PSR, found that *"poor transparency to end users"* was one of the key problems with UK payment systems, especially concerning wholesale prices [3.146, 3.191] – which the Cruickshank Review defined as including both interchange fees and scheme and processing fees [3.95].
299. The Review thereby recommended price transparency as a key outcome for a new regulatory regime for payments, i.e. to be led by the PSR [39, 3.186].
300. In 2009-14, further to new merchant complaints and antitrust investigations, the card schemes made new transparency commitments, including to:
- publish all their interchange fee rates<sup>132</sup>; and
  - simplify their interchange fee structure<sup>133</sup>.
301. In 2015, the subsequent Interchange Fee Regulation introduced transparency rules requiring that acquirers shall by default *"un-blend"* their merchant service charges, i.e. offer individually specified merchant service charges for different categories and brands of cards, and to provide a full breakdown of those charges by interchange fee and scheme fee<sup>134</sup>. This was to address the Commission's

<sup>128</sup> Including but not limited to Mastercard's and Visa's interchange fees.

<sup>129</sup> Commission Decision of 24 July 2002 case AT.29373 *Visa International (Visa II Decision)* [92, 99].

<sup>130</sup> *Visa II Decision* [36].

<sup>131</sup> *Visa II Decision* [37(g)].

<sup>132</sup> European Commission Decision of 8 December 2010 case AT.39398 *Visa MIF (Visa First Commitments Decision)* [26(c)] and Interchange Fee Regulation Impact Assessment, Volume 1, p. 108.

<sup>133</sup> European Commission Decision of 26 February 2014 case AT.39398 *Visa MIF (Visa Second Commitments Decision)* [33(b)] and Interchange Fee Regulation Impact Assessment, Volume 1, p. 243.

<sup>134</sup> Interchange Fee Regulation Article 9 (Unblending).



## 3. Responses to PSR consultation questions continued

concern that Mastercard and Visa rules restricted the ability of merchants to identify the cost of accepting a given type of payment card<sup>135</sup>.

302. In 2019, following further antitrust investigation by the Commission, Mastercard and Visa agreed (among other things) to make fully transparent their inter-regional interchange fees<sup>136</sup>.
303. Third, international regulators (notably in Australia<sup>137</sup>) have recently sought to implement scheme fee Complexity & Transparency rules on Mastercard and Visa. In particular, the Reserve Bank of Australia (**RBA**) Payment Systems Board (which is responsible for the RBA's payment systems policy) found in 2021, as part of its 2019-21 Review of Retail Payments Regulation that:

*“[Scheme fees] are a significant component of the costs faced by merchants in accepting card payments [...]. The [RBA Payment Systems] Board has held concerns for some time about the opacity of scheme fee arrangements to end-users of the payments system, with some indications that this has allowed for scheme fees to increase over recent years. The opacity could also, in principle, make it easier for schemes to implement fees or rules that may be anti-competitive or have the effect of circumventing the Bank's interchange fee regulation.*

*Meaningful disclosure of scheme fees could partly address these concerns, thereby improving efficiency and promoting competition in the payments system. [...therefore:]*

- *Schemes will be required to provide the Bank with access to their scheme fee schedules and all scheme rules, and to notify the Bank promptly of any changes to these.*
- *Schemes will also be required to provide quarterly data on scheme fee revenue and rebates to the Bank. The Bank will consider publishing some of the aggregate data, to provide stakeholders with greater visibility over the average levels and growth rates of these fees across schemes. Larger issuers and acquirers will also be required to provide annual data on scheme fee payments to act as a cross-check on the data reported by the schemes.”<sup>138</sup>*

<sup>135</sup> Interchange Fee Regulation Impact Assessment, Volume 1, p. 98.

<sup>136</sup> European Commission decisions of 29 April 2019 case AT.39398 Visa Inter-regional MIF and case AT.40049 Mastercard Inter-regional MIF.

<sup>137</sup> Also the first country to implement interchange fee regulation.

<sup>138</sup> RBA, Review of Retail Payments Regulation: Conclusions Paper, 2021 [1.3].



## 3. Responses to PSR consultation questions continued

304. Such measures though have not stopped scheme fees from rising in Australia, as updated recently by the RBA, reporting that scheme fee increases in 2022/23 were significantly higher than corresponding growth in card transactions, and remained highly complex and opaque (like in the UK). The RBA is therefore now proposing full publication of scheme fee data by each scheme<sup>139</sup>.
305. Hence, given this past (and international) experience, the PSR should apply similar Complexity & Transparency rules to scheme and processing fees as already apply to interchange fees, i.e. full publication and requirement for considerably reduced numbers of scheme and processing fee categories.

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<sup>139</sup> See speech by Ellis Connolly, Head of Payments Policy, Reserve Bank of Australia, Online Retail Payments – Some Policy Issues, June 2024.



## 3. Responses to PSR consultation questions continued

### Question 27: Boosting Competition remedies

**Do you agree that the initiatives we considered to boost competition are unlikely to achieve the outcomes we would want to see in a timescale that removes the need for regulatory intervention? Please explain your position either way.**

306. In summary – yes, the PSR’s wider initiatives to boost competition (in particular, the PSR’s work programme to unlock the potential of account-to-account payments) is unlikely to achieve lower card scheme and processing fees in a timescale that removes the need for regulatory intervention as part of the current PSR review.
307. The PSR explains moreover that the fact that Mastercard and Visa face ineffective competitive constraints underscores the importance of the PSR’s pre-existing work to unlock the full potential of open banking payments, especially in retail use cases [8.36] and that the PSR is therefore “*considering what further action may be necessary to accelerate the introduction of structural competition from account-to-account payments*” [1.23].
308. The current PSR Market Review nevertheless itself provides opportunities to boost such competition which the PSR should implement, including:
- “*structural*” competition between card payments and alternative payment methods (such as account-to-account/open banking payments); and
  - competition between Mastercard and Visa.
309. First, a Price Rebalancing/Non-Discrimination remedy (as explained at Question 31 and the Executive Summary) should achieve both these outcomes, by:
- removing exclusionary barriers created by Mastercard and Visa to alternative payment methods; and
  - adding a competitive constraint on the acquiring side of the Mastercard and Visa platforms (so increasing competition between Mastercard and Visa).
310. Second, a Least-Cost Routing/Prohibition of Network Exclusivity-type remedy (as mandated in the US and Australia, and as explained in response to Question 31) could also have the potential to boost competition significantly between Mastercard and Visa, and potentially also with alternative payment methods.
311. Third, digital wallets also provide significant scope to boost competition between Mastercard, Visa, and alternative payment methods – subject to the PSR





## 3. Responses to PSR consultation questions continued

addressing likely competition law infringements that appear to be preventing such competition. See response to Question 31 (Competition Law Enforcement Remedies – digital wallets).



## 3. Responses to PSR consultation questions continued

### Question 28: Encouraging Steering remedies

**Do you agree that the initiatives we considered to encourage surcharging or other forms of steering are unlikely to remove the need for regulatory intervention? Please explain your position either way.**

312. In summary – yes, initiatives to encourage surcharging or other forms of steering are unlikely to remove the immediate need for regulatory intervention.
313. The PSR should nonetheless consider longer-term remedies to encourage steering, including:
- a potential Least-Cost Routing/Prohibition of Network Exclusivity remedy – to enable merchants to steer directly between alternative payment card networks (see response to Question 31); and
  - a potential Competition Law Enforcement remedy to remove obstacles to digital wallet consumer steering (see also response to Question 31).
314. As background, the PSR notes that merchants might in theory “*steer* their customers to choose a payment method that is advantageous for the merchant” – e.g. a lower cost alternative payment method – and thereby “*could theoretically let those UK merchants avoid higher scheme and processing fees*” [8.38, 8.41].
315. The PSR has nonetheless found that there are currently limited alternative ways to pay for UK card transactions and that merchants in any event have limited ability and incentives to steer customers away towards them in response to scheme or processing fees [8.41].
316. Remedies requiring merchants to actively steer their customers are unlikely therefore to be effective in addressing the issues identified in the PSR Report [8.42].
317. The PSR notes also that the Payment Services Regulations 2017 (**PSRs2017**) in any event prohibits merchants from surcharging UK domestic consumer card payments (which constitute the vast majority of UK card payments) [4.86]. PSRs2017 implemented the second EU Payment Services Directive (**PSD2**)<sup>140</sup> into UK law.

<sup>140</sup> Directive (EU) 2015/2366 on payment services in the internal market (the second EU Payment Services Directive) (**PSD2**).



## 3. Responses to PSR consultation questions continued

318. So even if merchants wanted to steer customers by surcharging (the most likely method of steering<sup>141</sup>) then such steering would not be possible anyway without a change in the law.
319. Such PSD2-surcharge prohibition was moreover expressly linked to the capping of interchange fees under the Interchange Fee Regulation, namely:
- “Given the significant reduction of the fees that the merchant will have to pay to his bank [as a result of the Interchange Fee Regulation], surcharging is no longer justified for the [interchange fee]-regulated cards which will represent more than 95% of the consumer card market”<sup>142</sup>.*
320. The Interchange Fee Regulation has nonetheless not led to a “significant reduction of the fees that the merchant will have to pay” as the Interchange Fee Regulation and PSD2 had promised (as Figure 17 above from the PSR Report shows). On the contrary, the (total) fees that merchants have to pay have risen since the Interchange Fee Regulation came into force – owing to the growth in scheme and processing fees.
321. But the PSD2/PSR2017 surcharging prohibition on cards regulated by the Interchange Fee Regulation nonetheless remains in place, thereby stopping UK merchants from surcharging even if they wanted to (i.e. in the event of increases in scheme fees).
322. This is further reason therefore why the PSR needs to address increases in scheme and processing fees as a matter of policy priority.

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<sup>141</sup> As noted at [4.87].

<sup>142</sup> European Commission Proposal for a Directive on payment services in the internal market and amending Directives 2002/65/EC, 2013/36/EU and 2009/110/EC and repealing Directive 2007/64/EC, COM(2013) 547 final 2013/0264 (COD), Brussels 2013, page 11 (section on Article 55(3) and (4) – Charges applicable). See also PSD2 recital 66.



## 3. Responses to PSR consultation questions continued

### Question 29: Price Cap remedy

**Do you agree with that a price cap or price control could not be implemented following this market review given the issues identified in this interim report, in particular with regard to collective robust and reliable data from the card schemes? Please explain your position either way.**

323. In summary – no, a Price Cap/price control remedy could readily be implemented following this market review. In particular, collecting robust and reliable data from the card schemes should not be an obstacle or reason against implementing a Price Cap – especially given the PSR’s function as a “utility-style” economic regulator and the PSR’s statutory powers and objectives.
324. As background, the PSR explains that it does not consider that a Price Cap is an appropriate remedy for now as:
- “Mastercard and Visa offer hundreds of scheme and processing fees, and whilst we have clear evidence of ineffective competitive constraints in the supply of core scheme and processing services to acquirers, we have also found that Mastercard and Visa compete on the issuing side of the market, and that there may be competition in the supply of certain optional services. As such, we think that it would be challenging, based on the evidence we currently have, to design a price cap that was consistent with our statutory objectives.” [8.45]*
325. The PSR nonetheless says it would consider a Price Cap in future, especially with access to better data [8.46].
326. These reasons though are why the PSR should start developing a Price Cap as a matter of priority (given the time that will inevitably be needed to implement it).
327. First (as explained in response to Questions 2-19), the fact that Mastercard and Visa compete on the issuing side but not on the acquiring side is – in the case of multi-sided platform markets such as the card schemes – evidence of substantial market harm (i.e. on both sides of the Mastercard and Visa platforms), namely of *monopolistic* conduct towards acquirers/merchants and *predatory/exclusionary* conduct towards rival payment methods. Such harm must therefore be addressed holistically.
328. Moreover, the fact that Mastercard and Visa compete on the issuing side of the market, and may compete in the supply of certain optional services, is not a



## 3. Responses to PSR consultation questions continued

reason against a Price Cap. On the contrary, this is a reason why Mastercard's and Visa's scheme and processing fees can safely be directly regulated.

329. A direct analogy to this is the regulation of electronic communications wholesale voice call termination services – also multi-sided platform markets, in which fixed and mobile telecoms network operators face effective constraints one side of their platforms (the markets for fixed and mobile telecoms subscribers), but face no effective competitive constraints on the other side (the markets for fixed and mobile voice call termination services – when a call is terminated from one fixed or mobile telecoms network to another).

330. Ofcom therefore applies a long-established price cap on call termination rates, for example, as Ofcom most recently stated:

***“[Ofcom has] decided: To continue to set caps on the charges for terminating landline and mobile calls in the UK.***

*Call termination is a wholesale service provided by a phone company to connect incoming calls to a customer on its network. Without charge caps, providers would be able to charge high rates for termination. This is because the originating provider has no other choice than to buy the termination service from the terminating provider. The caps apply to termination charges for landline and mobile calls that are made within the UK. The cap for mobile call termination [in the current review period – 2021-26] has been reduced to reflect the lower costs faced by mobile operators.”<sup>143</sup>*

331. And similarly in the EU:

*“An analysis of demand and supply substitutability shows that currently or in the foreseeable future, there are no substitutes at wholesale level which might constrain the setting of charges for [fixed or mobile voice call] termination in a given network. [...] Those potential competition problems are common to both fixed and mobile voice call termination markets. Therefore, in light of the ability and incentives of terminating operators to raise prices substantially above cost, cost orientation is considered to be the most appropriate intervention to address this concern over the medium term. Future market developments may alter the dynamics of those markets to the extent that regulation would no longer be necessary.”<sup>144</sup>*

<sup>143</sup> Ofcom, Wholesale Voice Markets Review 2021-26: Statement, 2021, Page 1.

<sup>144</sup> Directive (EU) 2018/1972 establishing the European Electronic Communications Code, (the EU Electronic Communications Code Directive), Recital 195.



## 3. Responses to PSR consultation questions continued

332. The EU has therefore established maximum voice termination rates for mobile services and maximum voice termination rate for fixed services that applies EU-wide, according to “*detailed criteria and parameters on the basis of which the values of voice call termination rates are set*”<sup>145</sup>.
333. Second (as explained in response to Question 20), the PSR’s proposed Price Methodology & Governance remedy would only be effective if it amounted to a full Price Cap, namely a remedy in which the PSR regulated Mastercard’s and Visa’s scheme and processing fees directly (or at least approved the schemes’ proposed pricing methodologies for all the schemes’ new and existing prices).
334. Such a remedy would moreover indirectly regulate Mastercard’s and Visa’s exclusionary conduct (on the issuing side of the Mastercard and Visa platforms) – by considerably the limiting the revenues and profits that Mastercard and Visa can make on the acquiring side, and therefore their funds (and incentives) to pay “*incentives*” on the issuing side (except by greater efficiency and/or other genuine competitive advantage).
335. Nonetheless, to be workable, such a Price Methodology & Governance/Price Cap-type remedy would also need to be accompanied by the PSR’s proposed Complexity & Transparency remedy – to cull the hundreds of current scheme and processing fees to a manageable and far lower number.
336. Hence, such a remedy would inevitably take time to implement. But that would appear to be a major reason to start it sooner rather than later.
337. A Price Rebalancing/Non-Discrimination remedy would nonetheless provide an interim (and enduring) remedy until the PSR were able to put in place full Price Cap remedy (as explained in reply to Question 31).

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<sup>145</sup> EU Electronic Communications Code Directive, Recital 197.



## 3. Responses to PSR consultation questions continued

### Question 30: Remedy time limits

**Should any remedies be time-limited? If so, please provide a recommended timescale together with your reasons.**

338. In summary, no – except for transitional/interim remedies (as suggested in response to Question 21).
339. Except for any such transitional/interim remedies, all other remedies should be permanent, but of course be subject to regular review (as are all regulatory instruments) at minimum for example every five years (and sooner under certain defined conditions, e.g. emergence of clear unintended consequences).



## 3. Responses to PSR consultation questions continued

### Question 31: Alternative remedies

**Are there other remedies we should consider on either an interim or long-term basis? We would be particularly interested in evidence to demonstrate why any such remedy was proportionate and capable of being effective in addressing the problems we (or you) have identified.**

340. Yes – the PSR should consider several other remedies (on an interim and a long-term basis, or long-term basis only), namely:
- a **Price Rebalancing/ Non-Discrimination** remedy;
  - a **Least-Cost Routing/Prohibition of Network Exclusivity** remedy;
  - an **Interchange Fee Regulation Enforcement** remedy;
  - **Competition Law Enforcement** remedies; and
  - a **Commercial Card Interchange Fee Market Review** remedy.
341. Of these, a Price Rebalancing/ Non-Discrimination remedy could operate on an interim (i.e. transitional) and long-term basis, whereas the other remedies would need to be longer-term only. See explanation of each of these.

#### **(I) Price Rebalancing/ Non-Discrimination remedy**

342. As outlined in response to Questions 2-19, 20, and 29 (and the Executive summary) a Price Rebalancing/Non-Discrimination remedy would be a remedy requiring that a card scheme's average net pricing to acquirers, i.e. their average scheme and processing fees net of rebates and incentives if any (as a proportion of its transaction value) must be no greater than its corresponding average net pricing to issuers.
343. Such average fees must also not discriminate by type of merchant (e.g. large or small), type of card (e.g. consumer or commercial card), or type of transaction (e.g. card present or not-present, domestic or inter-regional) – absent a PSR-approved cost justification – and must apply to all transactions at UK merchants (i.e. whether domestic or inter-regional, as defined at the Interchange Fee Regulation).
344. For example, if Mastercard's average net fees to issuers were 0.1% in a given year (as a proportion of transaction value) then Mastercard would have to ensure that its average net fees to acquirers were also 0.1% (and/or otherwise pay rebates





### 3. Responses to PSR consultation questions continued

back to acquirers and merchants on a pro rata basis to keep their average acquirer fees below that level).

345. This remedy reflects that the essential evidence of the PSR Report of:
- **substantial imbalance of competitive-constraints** – i.e. competitive constraints on the issuing side, but no effective competitive constraints on the acquiring side; and
  - **substantial imbalance of pricing** – i.e. low or negative prices on the issuing side, but high prices on the acquiring side.
346. This evidence together shows that the harms associated with Mastercard's and Visa's scheme and processing fees entail:
- monopoly conduct on the acquiring side – of excessive prices, and poor service to acquirers and merchants; and
  - exclusionary/predatory conduct on the issuing side – of creating artificial entry and expansion barriers lower-cost and/or more-innovative alternative payment methods.
347. A Price Rebalancing/Non-Discrimination remedy would therefore be a clear and demonstrable remedy to these harms, by:
- removing the imbalance of competitive constraints (by creating an indirect competitive constraint on the acquiring side from the issuing side); and
  - removing the pricing imbalance.
348. A Price Rebalancing/Non-Discrimination remedy would moreover be directly aligned with the PSR's Financial Services (Banking Reform) Act 2013 (**FSBRA2013**) statutory objectives [§49], namely, the PSR's:
- a) **competition objective** – to promote effective competition between different operators of payment systems, i.e. between Mastercard and Visa, and between Mastercard, Visa, and other actual or potential payment systems (among other payment system participants), including having regard (among other things) to:
    - a. the needs of, and ease with which, different persons who use, or may use, services provided by payment systems (e.g. merchants);
    - b. the level and structure of fees, charges or other costs associated with participation in payment systems, i.e. payment card scheme and processing;





## 3. Responses to PSR consultation questions continued

- c. the ease with which new entrants can enter the market; and
    - d. how far competition is encouraging innovation [§50];
  - b) **innovation objective** – to promote the development of, and innovation in, payment systems in the interests of those who use, or are likely to use, services provided by payment systems, with a view to improving the quality, efficiency and economy of payment systems [§51]; and
  - c) **service-user objective** – to ensure that payment systems (e.g. Mastercard and Visa) are operated and developed in a way that takes account of, and promotes, the interests of those who use, or are likely to use, services provided by payment systems (e.g. merchants and end-consumers) [§52].
349. Namely, a Price Rebalancing/Non-Discrimination remedy would address each of the PSR’s competition, innovation, and service-user objectives, in particular by:
- promoting competition between Mastercard, Visa, and with alternative payment methods;
  - removing current barriers to innovation, i.e. artificial barriers to lower cost and/or more efficient alternative payment methods; and
  - ensuring that Mastercard and Visa operate in the interest of their users (rather than just the interest of card issuers, and Mastercard’s and Visa’s shareholders).
350. To enable these PSR objectives, FSBRA2013 empowers the PSR to give directions to operators of regulated payment systems (i.e. Mastercard and Visa), including requiring them to:
- change their rules in a specified way or to achieve a specified purpose [§54-55]; and/or
  - vary any agreements made between operators of regulated payment system and payment service providers (e.g. acquirers and issuers) concerning fees or charges payable, and/or other terms and conditions, in connection with participation in a regulated payment system and/or the use of services provided by a regulated payment system (i.e. payment card scheme and processing fees), including the power to vary any fee or charge includes power to specify a maximum fee or charge [§57].



## 3. Responses to PSR consultation questions continued

351. As context, the PSR's statutory objectives reflect the Government's overall objective – in setting up the PSR – for the PSR to become “a new competition-focused, utility-style regulator for retail payment systems”<sup>146</sup>.

352. In particular, the Government said that it would bring “payment systems under economic regulation” and that the “new regulator [the PSR] will operate in accordance with the Government's Principles for Economic Regulation”<sup>147</sup>, which say that:

*“Competitive markets are the best way in the long run to deliver [high quality and efficient economic infrastructure] to consumers and provide incentives to invest and improve efficiency and service quality. [...]*

*In the UK, economic regulation has aimed to promote effective competition where this is possible, and to provide a proxy for competition, with protection of consumers' interests at its heart, where it is not meaningful to introduce competition. [...]*

*The role of economic regulators should be concentrated on protecting the interests of end users of [the applicable] services by ensuring the operation of well-functioning and contestable markets where appropriate or by designing a system of incentives and penalties that replicate as far as possible the outcomes of competitive markets.”<sup>148</sup>*

353. Hence, the PSR's primary job should be “to promote effective competition where this is possible” and only where competition is not possible should the PSR then step in to act a “proxy” for competition, for example, in regulating prices directly.

354. Hence, the primary function of a Price Rebalancing/Non-Discrimination remedy would be to promote effective competition.

355. The Government said moreover that:

*“Operators of payment systems [such as Mastercard and Visa] [...] will be required through statute to adhere to principles on:*

- *Efficient and transparent pricing*
- *Non-discriminatory access*
- *Good governance [...]*

*On efficient and transparent pricing, the requirement will be that prices are set at the appropriate level to benefit current and future end-users of*

<sup>146</sup> HM Treasury, Opening up UK payments, 2013 [2.4].

<sup>147</sup> HM Treasury, Opening up UK payments, 2013.

<sup>148</sup> Department for Business Innovation & Skills, Principles for Economic Regulation, April 2011.



## 3. Responses to PSR consultation questions continued

*the payment system [...where such prices include] prices for (1) direct access to a payment system [i.e. scheme and processing fees...] and (3) interchange fees.*

*On non-discriminatory access, [...such that] payment systems can be accessed on a fair basis [...]*

*On good governance [...such that] that control of the [payment systems operator] cannot be abused, either individually or collectively, in a way that is detrimental to end-users, for instance by erecting unnecessary barriers to entry, or unfairly discriminating between users”<sup>149</sup>*

356. Scheme and processing fees, and incentives, represent of course the prices that Mastercard and Visa set to acquirers and issuers for access to their payment systems.
357. The PSR Report nonetheless shows that Mastercard’s and Visa’s scheme and processing fees fail to adhere to any of these principles, as they:
- are inefficient (and non-transparent), as do not benefit either current or future end-users of payment systems (especially as they bear no relationship to cost);
  - are discriminatory between users, especially between acquirers and issuers (in terms of the fairness of acquirers’ and issuers’ respective access to the Mastercard and Visa payment systems); and
  - reflect poor governance, especially in that they give issuers undue influence and control over the Mastercard and Visa payment systems, to the detriment of merchants, as well by erecting barriers to entry and expansion to alternative payment systems.
358. In contrast, a Price Rebalancing/Non-Discrimination remedy would adhere to all the principles that the Government set for the PSR, by securing:
- efficient and transparent pricing – by operating to the benefit of all current and future payment users;
  - non-discriminatory access – by enabling equitable access to the Mastercard and Visa payment systems to issuers and acquirers; and

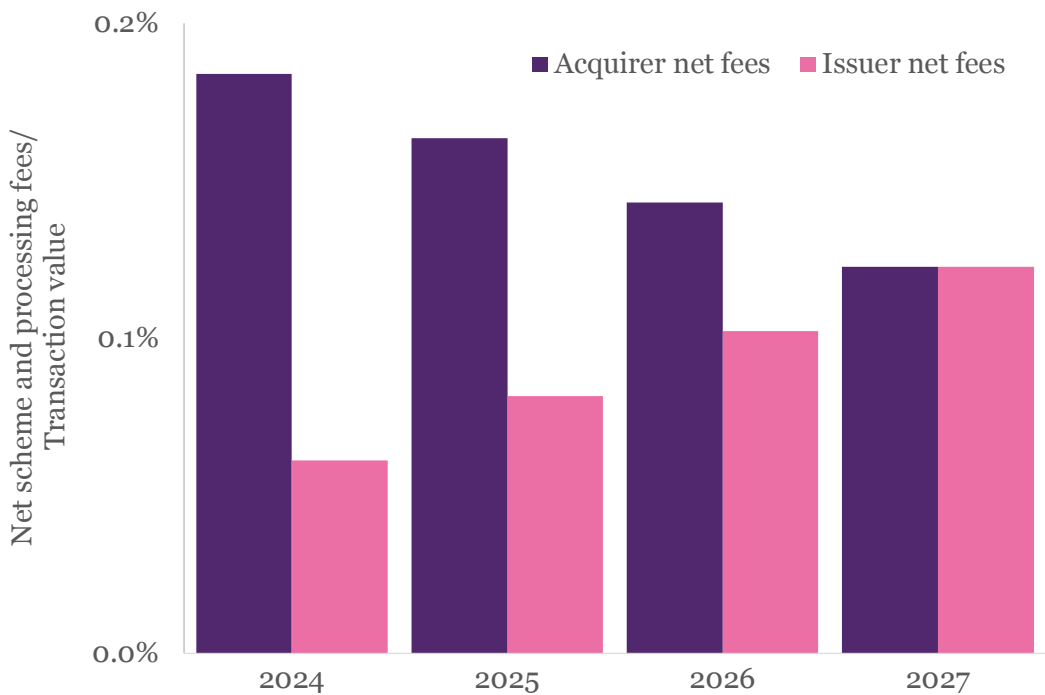
<sup>149</sup> HM Treasury, Opening up UK payments, 2013 [4.14, 4.16-4.18].



3. Responses to PSR consultation questions continued

- good governance – by preventing abuse of control of the Mastercard and Visa payment systems (especially by issuers<sup>150</sup>), and unnecessary entry and expansion barriers.
359. In summary, a Price Rebalancing/Non-Discrimination directly addresses the harms identified in the PSR Report by securing the PSR’s statutory objectives.
360. As explained in answer to Question 21 (and also the Executive summary), a Price Rebalancing/Non-Discrimination could rapidly and readily be implemented on a self-reporting basis, as illustrated at Figure 5 and Figure 19 (assuming a three-year phase-in period from 2025).

**Figure 19: A Price Rebalancing/Non-Discrimination remedy would mean equalisation of net acquirer and issuer scheme and processing fees**



Source: Zephyre calculations.

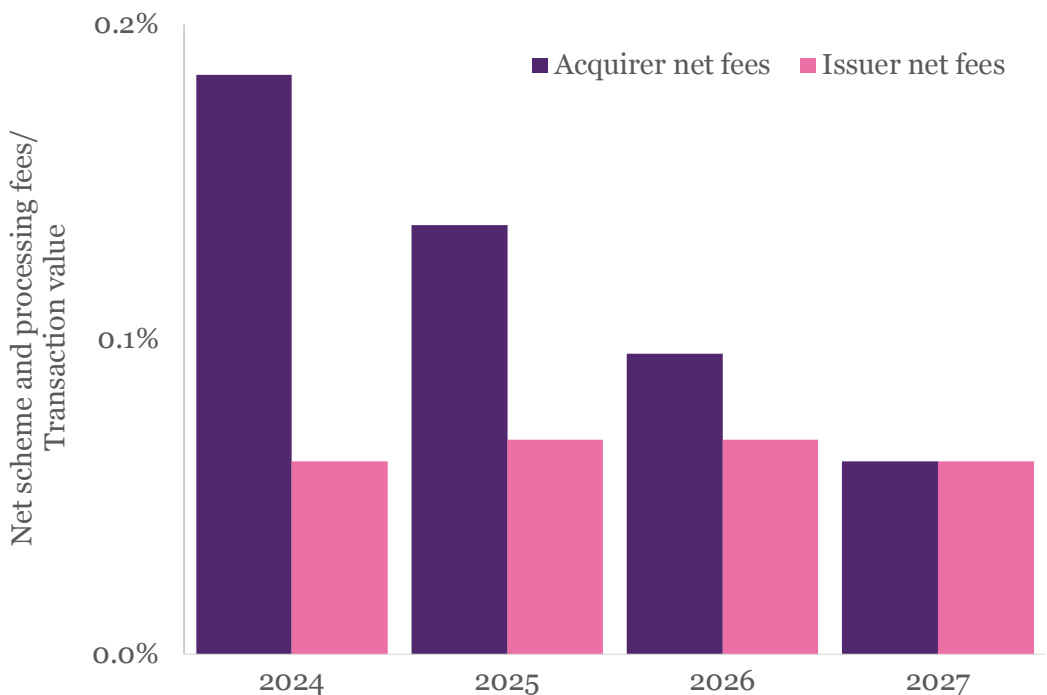
<sup>150</sup> Owing to receipt of incentives, which give issuers considerable influence over the card schemes, and which the PSR and card schemes themselves indicate are larger for larger issuers, i.e. large issuers have even greater control and influence over the card schemes than smaller issuers.



3. Responses to PSR consultation questions continued

361. Figure 19 shows in particular how net acquirer and issuer scheme and processing fees would converge to a common level, split initially 75%:25% between acquirers and issuers as the PSR finds<sup>151</sup>. This would imply a reduction in UK acquirer scheme and processing fees of 33% – or £0.6 billion annually to UK merchants<sup>152</sup>.
362. In all likelihood Mastercard and Visa net revenue would fall though, with issuer fees unlikely to rise materially above current levels, as illustrated at Figure 6 and Figure 20.

**Figure 20: Mastercard has grown much faster than Visa – despite much higher scheme and processing fees**



Source: Zephyre calculations.

363. This would then imply a reduction in acquirer scheme and processing fees of at least 67% – or £1.2 billion annually to UK merchants.

<sup>151</sup> Assuming Mastercard and Visa global average net revenue of 0.25% in 2023 as a proportion of transaction value.

<sup>152</sup> I.e. reduction in net fees of 0.06-percentage points on 2024 UK annual card payment volume of £979 billion (source: UK Finance).



## 3. Responses to PSR consultation questions continued

### (II) Least-Cost Routing/Prohibition of Network Exclusivity remedy

364. As explained in response to Questions 2-19, the asymmetric competitive constraints and pricing found in the PSR Report tends to reflect asymmetric “*homing*” decisions between acquiring and issuing, namely:
- issuers (and cardholders) generally “*single-home*” between Mastercard and Visa (i.e. choose to use Mastercard or Visa); and
  - acquirers (and merchants) thereby invariably “*multi-home*” between Mastercard and Visa (i.e. have no choice to accept both Mastercard and Visa).
365. This is essentially why Mastercard and Visa face competitive constraints on the issuing side of card platforms – but ineffective constraints on the acquiring side.
366. A solution to this problem therefore adopted by some countries – notably the US and Australia – is to mandate that payment cards must multi-home between at least two alternative card networks. This then means that merchants have a choice of card network and that is therefore likely to increase competition. This regulatory solution is known as **Prohibition of Network Exclusivity** (in the US) and **Least-Cost Routing** (in Australia).
367. First, in the US, the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act directs the US Federal Reserve to regulate debit card interchange fee transactions and to establish rules for payment card transactions<sup>153</sup>.
368. Among other things, this law prohibits card issuers and card networks from restricting the number of card networks over which a debit card transaction may be processed to fewer than two unaffiliated networks on any given debit card (known as the US Regulation II (Debit Card Interchange Fees and Routing)<sup>154</sup> Prohibition of Network Exclusivity).
369. Namely, card issuers must multi-home been two unaffiliated card networks, either one of Mastercard, Visa, or a US domestic debit card network, i.e. must card issuers must issue dual-network cards (also called “*dual-badged cards*”)<sup>155</sup>.
370. This US regulatory prohibition was intended to promote competition between card networks by ensuring that merchants have an opportunity to choose between at least two unaffiliated networks. The Federal Reserve has recently

<sup>153</sup> See summary at Board of the Governors of the Federal Reserve System, Final Amendments to Regulation II to Clarify the Prohibition on Network Exclusivity, 2022.

<sup>154</sup> Also known as the “Durbin Amendment” to the Dodd-Frank Act.

<sup>155</sup> Such dual-badged cards are commonplace in many EU countries, i.e. cards dual-badged between Mastercard or Visa plus a national debit card scheme, such as Cartes Bancaire in France or Girocard in Germany.



## 3. Responses to PSR consultation questions continued

clarified that the prohibition also includes card-not-present as well as card-present debit card transactions in the US.

- 371. Market evidence indicates that the Prohibition of Network Exclusivity rule has been somewhat effective at putting pressure on card acceptance costs in the US<sup>156</sup>.
- 372. The US Congress has also recently proposed to extend such Prohibition of Network Exclusivity (and interchange fee regulation) from debit cards to credit cards<sup>157</sup>.
- 373. Second, in Australia, banks have historically issued cards on both the Australian domestic debit card scheme (known as eftpos) as well also on Mastercard or Visa (to enable international card acceptance), similarly as in many EU member states.
- 374. In addition to this, like the US, Australian regulators have mandated that merchants can choose which card network used to process debit card transactions on, known in Australia as Least-Cost Routing (i.e. to enable merchants to route transactions by the least-cost card network available)<sup>158</sup>.
- 375. Australian debit card issuers have unsurprisingly sought to stop issuing such dual-network cards in favour of Mastercard or Visa cards only (similarly as many EU card issuers have) – but Australian regulators (and parliament) have put strong pressure on card issuers to continue issuing dual-network cards to enable such Least-Cost Routing (including also for online/card-not present and mobile wallet payments) and this may soon be mandated in law.
- 376. A recent study by the Reserve Bank of Australia finds moreover that Least-Cost Routing has been effective at reducing card acceptance costs<sup>159</sup>.
- 377. Hence, the PSR should at minimum consider whether Least-Cost Routing/Prohibition of Network Exclusivity could be an effective remedy in the UK, taking into account the potential implementation costs, the US and Australian experience, and also absence of a domestic debit card network in the UK (as present in the US and Australia)<sup>160</sup>.

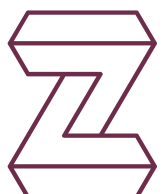
<sup>156</sup> See for example CMSPI, Five Takeaways from the Fed's Latest Announcement on Regulation II, 2023.

<sup>157</sup> In the Credit Card Competition Act of 2023.

<sup>158</sup> This contrasts with the EU, where the Interchange Fee Regulation mandates that cardholders decide which network to process a transaction on for dual-badged cards.

<sup>159</sup> Reserve Bank of Australia Bulletin, The Effect of Least-cost Routing on Merchant Payment Costs, April 2024.

<sup>160</sup> Hence, Least-Cost Routing/Prohibition of Network Exclusivity would have to mean card issuers issuing dual Mastercard and Visa cards and/or on account-to-account/open banking, or expansion of another UK payment system in retail payments, e.g. the LINK ATM payment system).





## 3. Responses to PSR consultation questions continued

### (III) Interchange Fee Regulation Enforcement remedy

378. At the same time as announcing the card scheme and processing fee market review, the PSR said that it would undertake enforcement investigations if it had reasonable suspicion that there has been a breach of the Interchange Fee Regulation (or any other statutory breaches) to address harms in the UK payments market<sup>161</sup>.
379. The PSR Report provides strong grounds for such suspicions, especially the PSR's evidence that:
- “Visa and Mastercard provide high incentives to issuers, in some cases more than totally offsetting the fees charged to issuers” [1.20, 3.7, 5.39, 6.154] and*
- “[among other things] incentives [to issuers are] used to secure issuing portfolios” [5.40].*
380. This is prima facie evidence of breach of the Interchange Fee Regulation – because the Interchange Fee Regulation caps interchange fees and prohibits that:
- “[the interchange fee caps are] circumvented by alternative flows of fees to issuers [such that... when] calculating the interchange fee [...] the total amount of payments or incentives received by an issuer from a payment card scheme with respect to the regulated transactions less the fees paid by the issuer to the payment card scheme should be taken into account.”<sup>162</sup>*
381. Namely, Figure 1 and Figure 21 (reproduced from the PSR Report) illustrate how combination of scheme and processing fees plus rebates and incentives constitute alternative flow of fees from card acquirers to card issuers identical to interchange fees.

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<sup>161</sup> The PSR Strategy, 2022 [5.70].

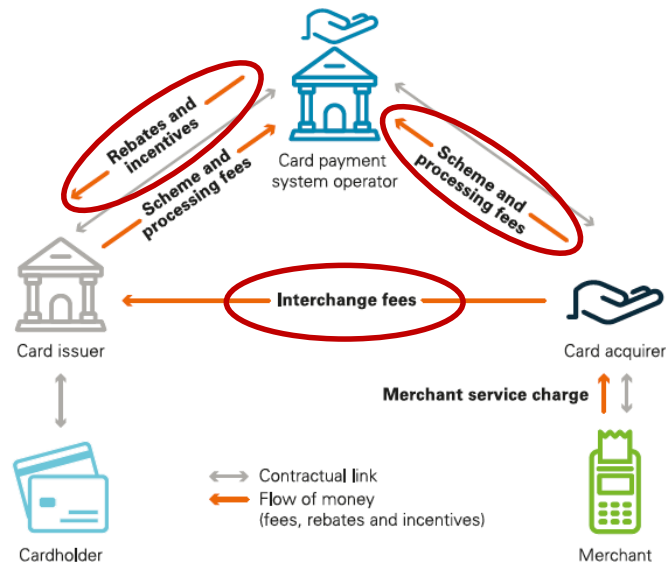
<sup>162</sup> Interchange Fee Regulation Recital 31.





## 3. Responses to PSR consultation questions continued

**Figure 21: Scheme and processing fees plus rebates and incentives: alternative flow of fees from acquirers to issuers**



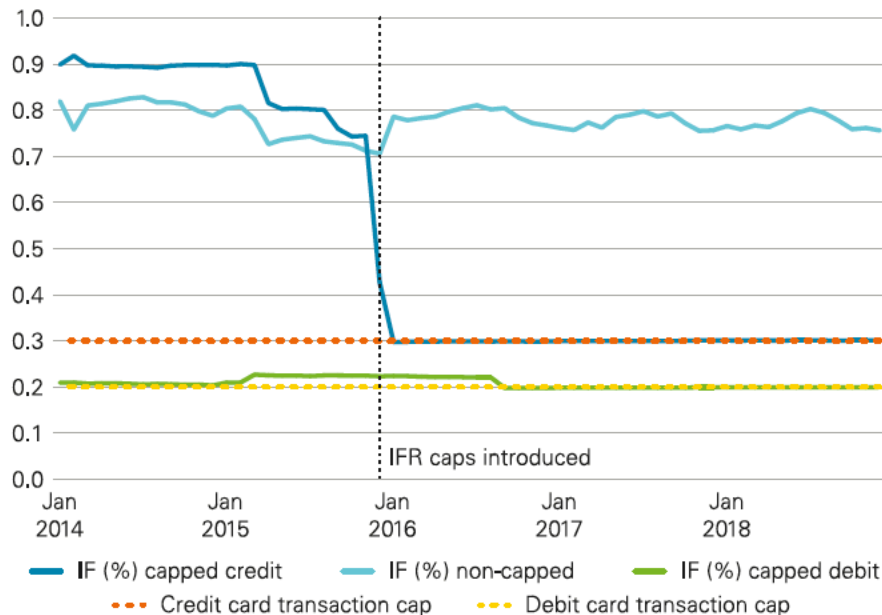
Source: PSR Report, Figure 3 (highlighting added).

382. The Interchange Fee Regulation moreover defines such net amount of payments, rebates or incentives received by an issuer from the payment card scheme (or acquirer or any other intermediary) as “*net compensation*” – and that such net compensation “*is considered to be part of the interchange fee*”<sup>163</sup> for the purpose of the regulated interchange fee caps [Article 2(10-11)].
383. Hence, if Visa and Mastercard provided “*high incentives to issuers, in some cases more than totally offsetting the fees charged to issuers*”, as the PSR says – i.e. “*net compensation*” as defined at the Interchange Fee Regulation, then such net compensation must also be considered as part of the interchange fee.
384. The PSR moreover has reported separately (in its Card-acquiring market review) that UK monthly average interchange fees (IFs) for capped debit and credit cap cards were at the level of the regulated caps, of 0.2% and 0.3% (of card turnover) since soon after the Interchange Fee Regulation came into effect, as reproduced at Figure 22.

<sup>163</sup> Interchange Fee Regulation, Article 2(10).

## 3. Responses to PSR consultation questions continued

**Figure 22: Scheme and processing fees plus rebates and incentives = an alternative flow of fees as interchange fees**



Source: PSR Market review into the supply of card-acquiring services: Final report, 2021, Annex 2: Pass-through analysis, Figure 2.

385. Net compensation (in the form of net incentives) paid (over and above interchange fees) must therefore count as circumvention of the Interchange Fee Regulation.
386. The PSR does not say whether *both* Mastercard and Visa pay incentives that “*totally offsetting the fees charged to issuers*”. Figure 2 and Figure 8 nonetheless show that Mastercard pays consistently higher incentives than Visa – and (consistent with this) several large UK issuers have switched from Visa to Mastercard since 2018, notably NatWest and Santander.
387. The PSR must therefore at minimum establish how the “*high incentives*” paid by Mastercard to “*secure [NatWest’s and Santander’s] issuing portfolios*” can be compatible with the Interchange Fee Regulation prohibition-of-circumvention provision.
388. Australia and New Zealand moreover highlight similar concerns (and necessary monitoring and enforcement) of how scheme and processing fees and incentives are a vehicle for circumvention of interchange fee regulation, for example:

**Australia:** “*The opacity [of scheme and processing fees, and incentives] could also, in principle, make it easier for schemes to implement fees or rules*”



## 3. Responses to PSR consultation questions continued

*that may be anti-competitive or have the effect of circumventing [...] interchange fee regulation. [...]*

*Disclosure requirements could discourage any changes to fee schedules or related rules that may be anti-competitive or could have the effect of circumventing the interchange fee regulations. [...]*

*[Stakeholders said there needs] to be close monitoring to dissuade and detect potential [interchange fee regulation] circumvention.”<sup>164</sup>*

**New Zealand:** “[We] consider that the scheme and the issuer may have either contravened, or been involved in the contravention of, the [New Zealand Interchange Pricing Standard (**IPS**)] [in the event that]: The issuer adopts a compliant rate of 0.20% for contactless debit, but due to the payment of monetary compensation by the scheme to the issuer [...], the total interchange fee for contactless debit was assessed by the Commission to be 0.22%.

*The issuer has received a total interchange fee for contactless debit transactions which exceeds the applicable cap under the IPS.*

*That is to say, the scheme is aware or ought to be aware that the provision of net compensation by it to the issuer would cause the IPS cap to be breached for contactless debit transactions.”<sup>165</sup>*

### (IV) Competition Law Enforcement remedy

389. In announcing its recent Strategy<sup>166</sup> the PSR said that when facing problems stemming from insufficient competition, the PSR has the option of:

- creating or improving the conditions for the development of effective competition;
- taking action to address the harm directly, such as a price cap; or
- undertaking an enforcement investigation, such as under the Interchange Fee Regulation, PSRs2017, FSBRA2013, or competition law under the Competition Act 1998 (**CA1998**), where there is reasonable suspicion of a breach [5.70].

<sup>164</sup> Reserve Bank of Australia, Review of Retail Payments Regulation: Conclusions Paper, 2021 [1.3, 5.4, 7.2.2].

<sup>165</sup> New Zealand Commerce Commission, Retail Payment System Act 2022: Guidance on the initial pricing standard, 2022 [5.28].

<sup>166</sup> PSR Strategy, 2022.



## 3. Responses to PSR consultation questions continued

390. Further to this, evidence in the PSR Report indicates multiple potential breaches of competition law in relation to scheme and processing fees – that the PSR should therefore investigate, including:

- scheme and processing fees (in combination with incentives) themselves constitute a breach of CA1998;
- digital wallet operators’ apparent contractual limitations to steer customers to non-card payments represent a breach of CA1998; and
- the mechanisms by which the card schemes generate substantial FX conversion income also constitute a breach of CA1998.

### ***Scheme and processing fees (in combination with incentives) are likely to breach competition law***

391. In summary, scheme and processing fees (in combination with incentives) may constitute a breach of:

- the CA1998 Chapter I prohibition (restriction of competition), in the way that scheme and processing fees combined with incentives are essentially interchange fees in all but name – and are therefore (like interchange fees) decisions of associations of undertakings that may prevent, restrict, or distort competition (and which the card schemes have not shown are exemptible); and/or
- the CA1998 Chapter II prohibition (abuse of dominance), in the way that such combination of scheme and processing fees, and incentives, constitute exclusionary and/or exploitative abuses of dominant market positions by Mastercard and/or Visa.

392. On **restriction of competition**, scheme and processing fees, and/or incentives are already recognised as being equivalent to interchange fees, namely in:

- the Interchange Fee Regulation – which defines interchange fees as including the total net amount of payments, rebates or incentives received by an issuer from the payment card scheme, the acquirer or any other intermediary in relation to card-based payment transactions or related activities<sup>167</sup>;

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<sup>167</sup> Article 2(10-11).



## 3. Responses to PSR consultation questions continued

- the Visa 2010 and 2014 interchange fee commitments – which defined scheme fees charged to acquirers as “*economically and/or legally equivalent*” to interchange fees<sup>168</sup>; and
  - the Interchange Fee Regulation Impact Assessment – which similarly highlighted that scheme and processing fees could have had a similar effect on the market as interchange fees<sup>169</sup>.
393. It is also established in UK and EU law that various categories of interchange fees infringed competition law, in particular, Mastercard’s and Visa’s historic intra-EEA and domestic interchange fees. The lawfulness of other categories of Mastercard and Visa interchange fees are currently subject to trial in the Merchant Interchange Fee Umbrella Proceedings at the UK Competition Appeal Tribunal.<sup>170</sup>
394. The essential legal finding of the unlawfulness of interchange fees was that:
- (i) the interchange fee is determined by a collective agreement between undertakings (in particular, reflecting a “*commonality of interest*”<sup>171</sup> between card issuers, and card schemes, of high interchange fees);
  - (ii) it has the effect of setting a minimum price floor for merchant service charges;
  - (iii) the non-negotiable interchange fee element of merchant service charges is set by collective agreement rather than by competition;
  - (iv) the counterfactual is no default interchange with settlement at par (that is, a prohibition on ex post pricing);
  - (v) in the counterfactual there would ultimately be no bilaterally agreed interchange fees; and
  - (vi) in the counterfactual the whole of the merchant service charge would be determined by competition and the merchant service charge would be lower.
395. These same conditions would all apply too in the case of *equal-and-opposite* scheme and processing fees, and incentives, i.e. scheme and processing fees with corresponding equal and opposite incentive payments.

<sup>168</sup> European Commission Case AT.39398 – Visa Europe Commitments offered to the European Commission, 10 September 2010 (§5.2) (emphasis added) and similarly Case AT.39398 – Visa Europe Commitments offered to the European Commission, 15 November 2013 (§9.3).

<sup>169</sup> Volume 1, page 23.

<sup>170</sup> See summary at PSR Market review of UK-EEA cross-border interchange fees Interim report, 2024 [3.35-3.46].

<sup>171</sup> See case AT.34579 *Mastercard* [3, 383, 386, 501].



## 3. Responses to PSR consultation questions continued

396. On **abuse of dominance**, the PSR Report readily establishes that Mastercard and Visa are each dominant in the supply of card scheme and processing services to acquirers and merchants, namely that Mastercard and Visa do not face effective competitive constraints in the supply of these services – as Mastercard and Visa each behave to an appreciable extent independently of their competitors (i.e. of each other and of other payment methods), of their customers (i.e. acquirers and merchants), and ultimately of consumers (the definition of “*dominance*” in UK and EU competition law).
397. The European Commission has already established that incentive payments to issuers (paid out of scheme and processing fees)<sup>172</sup> are exclusionary – by restricting market entry and innovation (as explained in response to the PSR consultation Questions 2-19).
398. The PSR Report also provides strong evidence that Mastercard’s and Visa’s scheme and processing fees are exploitative in that they impose unfair selling prices and other unfair trading conditions, in particular that they bear no reasonable relation to the economic value of the services supplied, and Mastercard and Visa would not have reaped these prices had there been normal and effective competition<sup>173</sup>.

### ***Digital wallet operators’ (apparent) contractual limitations to steer customers to non-card payments are likely to breach competition law***

399. In summary, digital wallet operators’ contractual limitations to steer customers to (or prevent customers from using) non-card payments breach:
- the CA1998 Chapter I prohibition (restriction of competition) in the way that such contractual limitations are agreements between undertakings (i.e. between digital wallet operators and Mastercard and/or Visa) that prevent, restrict, or distort competition; and/or
  - the CA1998 Chapter II prohibition (abuse of dominance) in the way that such combination of fees (and incentives) are exclusionary and/or exploitative abuses of dominant positions by Mastercard and/or Visa.
400. As context, the PSR Report concludes that any constraint that digital wallet operators – such as Apple Pay, Google Pay, and PayPal – impose on Mastercard’s and Visa’s scheme and processing fees is limited to the transactions processed

<sup>172</sup> Defined as part of interchange fees for the purpose Interchange Fee Regulation.

<sup>173</sup> From *United Brands v Commission* (EU:C:1978:22), the authoritative legal test for exploitative pricing.



## 3. Responses to PSR consultation questions continued

through the wallets and is constrained by their operators' unwillingness to steer consumers, or by contractual limitations on their ability to do so [4.124, 4.176].

401. The PSR nonetheless finds that digital wallets could impose a competitive constraint on Mastercard and Visa [4.120], by:
- making more payment options available to consumers (i.e. non-card payment options, as PayPal already does, e.g. non-card bank transfers) [4.115, 4.120];
  - actively steering consumers to lower-cost alternative (i.e. non-card) payment options (which PayPal should have an incentive to do, given that PayPal bears the cost of those alternative payment methods, e.g. card scheme and processing fees) [4.117].
402. The PSR calls such competition “*back-end*” or “*rail substitution*” competition, whereby a wallet operator “*allows consumers to fund their wallet using means alternative to cards, like bank transfers [...thereby] cutting [card] scheme operators out of payment flows entirely*” [4.100-4.103].
403. The PSR finds also that PayPal may have a sufficiently strong bargaining position to negotiate discounts on Mastercard’s and Visa’s scheme and processing (given PayPal’s large customer base) [4.121].
404. The PSR Report says further that “*Mastercard and Visa take the competitive threats from digital wallets seriously*” [1.170].
405. The PSR Report finds nonetheless that digital wallets have adopted a “*card friendly’ approach*” [1.16], in particular that:
- PayPal has entered into agreements with Mastercard and Visa “*not to steer customers towards using non-card payment methods*” [Annex 1, 1.173] and “*not to encourage [...] cardholders to link to a bank account [i.e. to prevent non-card payment methods, ...in return for] certain economic incentives*” [Annex 1, 1.133]; and
  - Apple Pay and Google Pay currently can *only* be used for card-payments [Annex 1, 1.147, 1.158], albeit “*they do pose a risk of rail substitution in the longer term, but there is significant uncertainty over their incentive to move away from cards*” [Annex 1, 1.172].
406. Separately, it is well known that Apple Pay was developed jointly by Apple, American Express, Mastercard, Visa, and major card issuers<sup>174</sup>.

<sup>174</sup> See for example Wikipedia *Apple Pay* article (*History* section).





### 3. Responses to PSR consultation questions continued

407. Also, further to the PSR Report, the PSR and Financial Conduct Authority (FCA) have launched a joint **Big tech and digital wallets call for information**<sup>175</sup>. This finds that UK digital wallet use has grown rapidly, with more than half of UK adults now using digital wallets [1.1] – and asks whether digital wallets are working well for consumers, businesses, and other payment users [1.5], and especially of potential restrictions of competition between payment systems [3.12, 3.17, and Question 4].
408. In reply, it is readily evident that agreements between Mastercard, Visa, and PayPal; between Mastercard, Visa, and Apple; and potentially between Mastercard, Visa, and Google may restrict competition and/or constitute abuses of dominant positions.
409. First, the fact that PayPal has entered into agreements with Mastercard and Visa not to steer customers towards using non-card payment methods and not to encourage cardholders to link to a bank account (in return for certain economic incentives) is prima facie an agreement between undertakings that restricts competition contrary to the CA1998 Chapter I prohibition, with no objective justification or mitigating consumer benefits.
410. Namely, such agreements prevent or restrict “*rail substitution*” on PayPal digital wallets – between card and non-card payments – that (as the PSR has found) could impose a competitive constraint on Mastercard and Visa (i.e. of PayPal actively steering consumers to lower-cost payment methods) and which PayPal would have the incentive to do but for the anti-steering agreements between Mastercard, Visa, and PayPal.
411. The agreements are also prima facie exclusionary abuses of dominant positions, contrary to the CA1998 Chapter II prohibition – namely of Mastercard and Visa abusing their dominant positions in the supply of scheme and processing services to acquirers and merchants by imposing the anti-steering provisions on PayPal which have the object and/or effect of excluding alternative payment methods from competing.
412. Such agreements and/or abuses are also likely to be breaches of Mastercard’s and Visa’s FSBRA2013 statutory duties as designated payment systems, as well as CA1998.
413. Mastercard and Visa of course benefit from their anti-steering agreements with PayPal – as the agreements eliminate the competitive threat to Mastercard and Visa from digital wallets (which the PSR says that they “*take seriously*”). And

<sup>175</sup> PSR and FCA, Call for Information: Big tech and digital wallets CP24/9, July 2024 (**PSR/FCA Big tech and digital wallets call for information**).





## 3. Responses to PSR consultation questions continued

PayPal benefits because of the “*certain economic incentives*” that the PSR says Mastercard and Visa offered to PayPal for making the agreements.

414. Second, the fact that Apple Pay can only be used for card-payments is widely suspected to be the result of agreement between Apple, Mastercard, and Visa (and other global card schemes) to restrict Apple Pay to card-payments only, in particular, as Apple Pay was developed jointly between Apple, Mastercard, Visa, American Express, and major card issuers and was built as a way to migrate card payments on to mobile devices<sup>176</sup>.

415. Hence, such exclusive agreement between Apple, Mastercard, and Visa (and others) is prima facie an agreement between undertakings that restricts competition contrary to the CA1998 Chapter I prohibition, with no obvious objective justification or mitigating consumer benefits, especially given the evident threat to Mastercard and Visa (and card issuers) that:

- Apple Pay could readily have supported non-card payment methods, and therefore could have created a risk of *rail substitution*, as Mastercard for example admits to the PSR [Annex 1, 1.148]; and
- Apple could also have developed its own “*closed-loop*” payment method, processing transactions between consumers and merchants within the Apple ecosystem, as the PSR Report describes and in which Mastercard and Visa readily admit poses a threat to them [Annex 1, 1.148, 1.53, 1.54].

416. Apple of course benefits from Apple Pay through the fees it charges card issuers (in effect a share in the interchange fees/incentives that card issuers receive from Mastercard and Visa, so a share in the overall monopoly profits that Mastercard and Visa generate from foreclosing new competitors).

417. Additionally, such exclusive agreement between Apple, Mastercard, and Visa is prima facie an abuse of dominant positions by Apple, Mastercard, and Visa, of excluding competition between card and non-card payment methods.

418. US merchants have moreover brought class action claims against Apple, Mastercard, and Visa, on a similar basis that:

“*Visa, Mastercard, American Express, and Discover [...] have dominated [...] Payment Card Network Services since the 1960s [...] and] as a result [...] have long imposed inflated fees on Merchants. [...]*”

<sup>176</sup> See in particular RPCG Group, *Payment Insecurity: How Visa and Mastercard Use Standard-Setting to Restrict Competition and Thwart Payment Innovation: An Investigative White Paper*, 2019.



## 3. Responses to PSR consultation questions continued

*One company and device – Apple and its iPhone – had the power to disrupt the [Payment Card] Networks’ dominance and restore competition. [...]*

*[...But] rather than compete in the [...] POS Payment Card Network Services market, however, Apple and the [Payment Card] Networks agreed to allocate that market. [...]*

*In exchange, the [Payment Card] Networks agreed that Apple would be paid a portion of the fees generated through the [Card] Networks’ respective [payment card] Transaction Payment systems.”<sup>177</sup>*

419. The position of Google Pay is less clear.

### ***The mechanisms by which the card schemes generate substantial FX conversion revenues breach competition law***

420. In summary, the mechanisms by which the card schemes generate substantial foreign exchange (FX) conversion revenues potentially breach:

- the CA1998 Chapter I prohibition (restriction of competition) in the way that such mechanisms constitute agreements between undertakings (i.e. card issuers) that prevent, restrict, or distort competition; and/or
- the CA1998 Chapter II prohibition (abuse of dominance) in the way that such mechanisms constitute exclusionary and/or exploitative abuses of dominant positions by Mastercard and/or Visa.

421. As background, the PSR Report says that FX conversion revenues are not outside the scope of its review – in particular, because the PSR’s assessment of the economic benefits that card schemes derive from their UK operations would be incomplete if it did not take into account “*ancillary revenue that arise as a result of operating scheme and processing services, such as FX conversion revenues*” [6.135].

422. The PSR therefore proposes that its Regulatory Financial Reporting remedy must apply to the full UK activities of Mastercard and Visa, including all international and cross-border transactions (including FX conversion revenues) and activities with a UK nexus [8.13].

423. International/cross-border transactions are highly profitable for Mastercard and Visa, owing to combination of much higher scheme and processing fees (than

<sup>177</sup> *Mirage Wine & Spirits and on Behalf of All Others Similarly Situated v. Apple Inc, Visa Inc, and Mastercard Inc*, Class Action Complaint, Case 3:23-cv-03942 Document 1 Filed 14 December 2023 [1-4].



## 3. Responses to PSR consultation questions continued

domestic transactions), plus FX conversion revenues. In particular, international/cross-border transactions are an order of magnitude (i.e. ten times) more profitable than domestic transactions (as a proportion of transaction value).<sup>178</sup>

424. The PSR should therefore consider as part of its review how Mastercard and Visa are able to generate such high revenues and profits from international/cross-border transactions – most likely because:

- Mastercard and Visa face even fewer competitive constraints in the supply of scheme and processing services to merchants accepting international/cross-border transactions (e.g. in the travel sector); and
- Mastercard and Visa face limited competitive constraints in the supply of FX conversion services (paid directly by cardholders in higher home-currency amounts on customers' credit and debit card statements for foreign-currency transactions).

425. Most cardholders moreover are unlikely even to be aware that Mastercard and Visa impose FX conversion charges on international/cross-border, as:

- many UK card issuers advertise debit and credit cards with “*no fees abroad*”, “*no foreign transaction fees*”, “*you won't pay foreign transaction fees*”, etc<sup>179</sup> – but such claims only relate to card issuers' FX conversion fees, not to Mastercard's and Visa's underlying FX conversion fees; and
- UK card issuers that charge foreign usage/non-sterling fees are moreover only required to advertise (and show on customer account statements) the foreign usage fees that they charge (e.g. 2.99% for a Barclaycard Platinum Visa), with only a link to the underlying rates that Mastercard and Visa charge (and overall FX mark-up).

426. UK regulations require that card issuers show the total FX mark-up that cardholders pay for a selection of European currencies – including both the issuers' mark-up and Mastercard's or Visa's mark-up<sup>180</sup> – but the majority of cardholders will be unaware of such disclosure requirements (generally buried on card issuer websites).

427. There is no obvious reason though why card issuers should not set – and advertise – the total FX mark-up that cardholders pay on foreign currency card

<sup>178</sup> For example, international transaction revenues were 24% of Mastercard's and Visa's global gross revenues in 2023 (source: Mastercard Inc and Visa Inc annual reports) – an order of magnitude (i.e. 10 times) greater than corresponding international/cross-border transaction volumes.

<sup>179</sup> For example, Barclaycard Rewards card, Halifax Clarity credit card, and NatWest Reward Black credit card.

<sup>180</sup> For example, [www.barclaycard.co.uk/personal/help-and-support/spending-abroad-comparison](https://www.barclaycard.co.uk/personal/help-and-support/spending-abroad-comparison).



## 3. Responses to PSR consultation questions continued

transactions, precluding Mastercard and Visa therefore from adding an additional hidden (and highly profitable) FX margin.

428. Hence, the fact that Mastercard and Visa set the underlying FX conversion rates on international/cross-border card transactions (at all) is prima facie evidence of an agreement between undertakings (namely card issuers and card networks) that restricts competition contrary to the CA1998 Chapter I prohibition.
429. Namely, the fact that Mastercard and Visa set the underlying FX conversion rates is an agreement between undertakings within the meaning of the CA1998 Chapter I prohibition because card issuers, Mastercard, and Visa have a *commonality of interest* in Mastercard and Visa setting the rates, as card issuers are likely to enjoy appreciably greater incentives on international/cross-border (funded by Mastercard's and Visa's FX conversion revenues), as well as card issuers not needing to advertise the Mastercard and Visa FX rates to their customers.
430. In that way, Mastercard's and Visa's setting of FX conversion rates on international/cross-border transactions represent horizontal price-fixing agreements – that set a minimum price floor on the FX rates paid by cardholders – in a similar way as the EU found that Mastercard's cross-border interchange fees constituted a horizontal price-fixing agreements that set a minimum price for merchant service charges<sup>181</sup>.
431. Additionally, Mastercard's and Visa's setting of FX conversion fees on international/cross-border transactions are prima facie exploitative and/or exclusionary abuses of dominant positions contrary to the CA1998 Chapter II prohibition – namely of Mastercard and Visa abusing their dominant positions in the supply of scheme and processing services to acquirers and merchants (and/or of FX conversion services to cardholders) by setting excessive and/or unfair rates and/or by foreclosing competing FX conversion methods (such as merchants offering competing FX rates direct to cardholders).

### (V) Commercial Card Interchange Fee Market Review remedy

432. Following the PSR's Card-acquiring market review the PSR announced its Card scheme and processing fees and Cross-border interchange fees reviews: “[to] look into how well [the cards] market is working, including the issue of increasing card fees”<sup>182</sup>.

<sup>181</sup> EU Case AT.34579 *Mastercard*.

<sup>182</sup> PSR, Statement on card scheme fees, 17 November 2011.



## 3. Responses to PSR consultation questions continued

433. But (as described in answer to Questions 2-19), along with scheme and processing fees, and cross-border interchange fees, commercial card interchange fees have also increased significantly in the last five years (owing to similar factors driving scheme and processing fee increases).
434. In consequence, commercial card interchange fees represented almost 30% of UK merchants' total interchange fee bill in 2023 – up from just over half that amount in 2020.
435. BRC members are therefore concerned that the PSR must consider unregulated interchange fees as well as scheme and processing fees, in particular in the event that regulation of scheme and processing fees results in even higher commercial card interchange fees (and/or other unregulated interchange fees).

The PSR should therefore commence a card fees review of commercial card interchange fees as an additional priority.



## 3. Responses to PSR consultation questions continued

### Questions 32-33: Other factors

**Are there any relevant customer benefits that we should consider as part of our assessment of any possible remedies?**

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

437. Yes, as well the direct benefits to merchants of lower prices (and better service) resulting from the PSR's intended remedies, the PSR should also consider indirect benefits to all payment users (and the wider economy) that would result from reducing barriers to entry and expansion of alternative payment methods (as addressed extensively in response to Questions 2-19).
438. The PSR should consider relevant international experience, especially from the EU, US, Australia, and New Zealand.
439. The PSR should also consider the extensive evidence of what Mastercard and Visa executives say to investment analysts in their regular financial results presentations and other card scheme investor events<sup>183</sup>.

[REDACTED]

[REDACTED], Zephyre

August 2024

<sup>183</sup> All available in the public domain as required by US (and UK) stock market listing rules.



## 4. Glossary



## 4. Glossary continued

440. Glossary of acronyms and other defined terms used in the report:

**Armstrong 2006:** Mark Armstrong, Competition in Two-Sided Markets, *RAND Journal of Economics*, 2006

**B2B:** Business-to-business

**BRC:** the British Retail Consortium

**C2B:** Consumer-to-business

**CA1998:** the Competition Act 1998

**CAA:** the Civil Aviation Authority

**CAMR:** PSR Card-acquiring market review final report MR18/1.8, 2021

**CAT:** the Competition Appeal Tribunal

**CEO:** Chief Executive Officer

**CFO:** Chief Financial Officer

**CMA:** the Competition & Markets Authority

**CNP:** card-not-present

**CP:** card-present

**Cruickshank Review:** Don Cruickshank, Competition in UK Banking: A Report to the Chancellor of the Exchequer, 2000

**EBIT:** Earnings before interest and tax

**EEA:** the European Economic Area

**European Central Bank:** ECB

**EU Electronic Communications Code Directive:** Directive (EU) 2018/1972 establishing the European Electronic Communications Code

**EU Market Definition Notice:** European Commission, Communication from the Commission: Commission Notice on the definition of the relevant market for the purposes of Union competition law C(2023) 6789 final Brussels, 8 February 2024

**FCA:** the Financial Conduct Authority

**FSBRA2013:** the Financial Services (Banking Reform) Act 2013

**FX:** foreign exchange

**IFs:** Interchange fees





## 4. Glossary continued

**Interchange Fee Regulation:** Regulation (EU) 2015/751 and the (UK) Payment Card Interchange Fee Regulations 2015

**Interchange Fee Regulation Impact Assessment:** European Commission, Staff Working Document: Interchange Fee Regulation Impact Assessment, SWD(2013) 288 final, 2013

**IPS:** the New Zealand Interchange Fee Pricing Standard

**Mastercard Prohibition Decision:** European Commission Decision of 19 December 2007 case AT.34579 *Mastercard*

**OECD Antitrust Regulation of Multi-Sided Platform Markets Report:** Organisation for Economic Co-operation and Development (OECD), Rethinking Antitrust Tools for Multi-Sided Platforms, 2018

**Ofcom:** the Office of Communications

**Ofgem:** the Office of Gas and Electricity Markets

**OFT:** the Office of Fair Trading

**Ofwat:** the Water Services Regulatory Authority

**ORR:** the Office of Rail and Road

**PSD2:** Directive (EU) 2015/2366 on payment services in the internal market

**PSR:** the Payment Systems Regulator

**PSR/FCA Big tech and digital wallets call for information:** PSR and FCA Call for Information: Big tech and digital wallets CP24/9, July 2024

**PSR Report:** PSR Market review of card scheme and processing fees interim report consultation paper MR22/1.9, May 2024

**PSR Review:** PSR Market review of card scheme and processing fees

**PSR Strategy:** PSR, The PSR Strategy, 2022

**PSRs2017:** the Payment Services Regulations 2017

**RBA:** the Reserve Bank of Australia

**ROCE:** Return on capital employed

**Visa II Decision:** Commission Decision of 24 July 2002 case AT.29373 *Visa International*

**Visa First Commitments Decision:** European Commission Decision of 8 December 2010 case AT.39398 *Visa MIF*



## 4. [Glossary](#) continued

**Visa Second Commitments Decision:** European Commission Decision of 26 February 2014 case AT.39398 *Visa MIF*

**WACC:** Weighted-average cost of capital



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