

Interchange fees



November 2014

This Supporting Paper supports the PSR's Consultation Paper '*A new regulatory framework for payment systems in the UK*'. It specifically outlines our approach to interchange fees that forms part of our broader overall framework for the regulation of UK payment systems.

As with all of our proposals in this consultation, they have been designed to further our objectives of promoting competition, innovation and the interests of service-users. This Supporting Paper is designed for those stakeholders who want a more detailed understanding of our proposed approach.

We are asking for comments on this Consultation Paper by 5pm, Monday, 12 January 2015.

You can send your comments and responses to our consultation questions by email to PSRconsultations@psr.org.uk.

You can also respond in writing to the address below (although we ask all respondents to also provide electronic Word and PDF versions of their response).

Payment Systems Regulator
Consultation response team
25 The North Colonnade
Canary Wharf
London E14 5HS

We will publish all non-confidential responses to our Consultation Paper along with our final Policy Statement.

We will not regard a standard confidentiality statement in an email message as a request for non-disclosure. Stakeholders who wish to claim commercial confidentiality over specific items in their response should make sure to fill in the cover sheet accordingly, and to identify those specific items which they claim to be commercially confidential by **highlighting them in yellow**.

We may nonetheless be required to disclose all responses which include information marked as confidential, in order to meet legal obligations, in particular if we are asked to disclose a confidential response under the Freedom of Information Act 2000. We will endeavour to consult you in handling such a request. Any decision we make not to disclose a response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this Consultation Paper from our website: www.psr.org.uk

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A.

Introduction

- 5.1 We want to ensure that card payment systems are operated and developed in the interests of service-users. Within our Consultation Paper we outline a number of proposals to further our objectives in relation to card payment systems. We will monitor how our package of proposals promotes the interests of service-users, competition and innovation in card payment systems.
- 5.2 As interchange fees can also have an impact on competition and because stakeholders have expressed concerns about the level of fees we have considered whether it would be appropriate for us to take action. We note that the level of these fees has been the subject of sustained competition law scrutiny for many years. The CMA has open investigations into interchange fee arrangements and we expect the EU to introduce an Interchange Fee Regulation (IFR) in the coming months which includes interchange fees caps. Consequently we will follow these developments, the progress of which will determine the actions that we will take.
- 5.3 This Supporting Paper is divided into four parts:
- **Part A:** this introduction
 - **Part B:** background, explaining what interchange fees are
 - **Part C:** the proposed European Interchange Fee Regulation
 - **Part D:** our proposed approach.
- 5.4 Expressions and acronyms we use are defined as appropriate in this Supporting Paper and in our *Glossary*. Where expressions are capitalised in the text (e.g. 'Operator'), a more detailed definition is included in our *Glossary*, which is included as *Annex 1* to our *Consultation Paper*.

B. Background

- 5.5 We will regulate payment systems that have been designated by the Treasury. We anticipate that MasterCard and Visa will fall within our regulatory regime as indicated by the Treasury in its consultation document on designation of payment systems.¹ To advance our objectives we may issue directions and requirements using our powers under the Financial Services (Banking Reform) Act 2013 (FSBRA). We may also use our concurrent competition powers, and our powers under the forthcoming IFR, to address any areas of concern within card payment systems.
- 5.6 A few stakeholders raised concerns around card payment systems in response to our stakeholder engagement programme (see the *Consultation Paper*). These centred on their governance, especially the ability to influence the decision-making process, and access to the systems, including technical standards and interoperability.² Our package of proposals set out in our *Consultation Paper* aims to address these.
- 5.7 In this Supporting Paper, we focus on the interchange fee arrangements present in four-party card payment systems. Examples of four-party card payment systems are MasterCard and Visa. In a three-party card payment system, the issuer and acquirer are the same entity (see *Supporting Paper 1: The PSR and UK payments industry* for more detail on the industry).
- 5.8 Interchange fees are fees paid to a cardholder's PSP (the 'issuer') by a merchant's PSP (the 'acquirer') for each transaction made at a merchant using a payment card within the four-party MasterCard and Visa systems. There are also interchange fees payable on ATM transactions, which are paid by the card issuer to the ATM acquirer (which may be an independent ATM deployer), but these are not the subject of this Supporting Paper.
- 5.9 Based on Visa's published tariffs (dated July 2013), and MasterCard's published tariffs (dated July 2013), current interchange fees on consumer card transactions in the UK vary from £0.01 to £0.18 per transaction (debit cards) and 0.65% to 1.85% of the value of the transaction (credit cards) depending on the card payment system (MasterCard or Visa), the card type (e.g. immediate debit, deferred debit, credit or charge card) and the type of transaction (e.g. contactless, Chip & PIN or card not present).

¹ See the Treasury's open consultation 'Designation of the Payment Systems for Regulation by the Payments Systems Regulator' (14 October 2014), available at <https://www.gov.uk/government/consultations/designation-of-payment-systems-for-regulation-by-the-payment-systems-regulator/designation-of-payment-systems-for-regulation-by-the-payment-systems-regulator>

² See *Supporting Paper 2: Payments industry strategy and areas for collaboration*, *Supporting Paper 3: Ownership, governance and control of payment systems* and *Supporting Paper 4: Access to payment systems*.

- 5.10 Interchange fees have been the subject of sustained competition law investigations and regulatory scrutiny at a European level and globally for many years. In the UK, the CMA has open investigations into MasterCard and Visa's domestic interchange fee arrangements.³
- 5.11 The arguments for and against interchange fees, and in respect of the methodologies for how the fees are set, have also been the subject of a substantial economic literature. The commonly cited justification for interchange fees is that they help to balance the demand on both sides of the 'two-sided network' (that is, the network which brings together those wishing to make payments with those wishing to receive payments) in a way that leads to the greatest uptake and use of the payment system. On the other hand, longstanding concerns have been expressed about whether interchange fees set in line with such commercial incentives also serve the public interest.
- 5.12 Interchange fees are passed on to merchants through the Merchant Service Charges (MSC) that merchants pay to their acquirers. Ultimately, these costs will affect the prices paid by consumers. Where a merchant charges different prices depending on the means of payment, cardholders may face a surcharge. Where a merchant charges uniform prices, the costs will fall on all consumers, whatever their chosen means of payment.
- 5.13 Some merchants face a 'blended' MSC which does not separate out the interchange fee component of the overall MSC. Competition between acquirers, which can be affected by transparency of interchange fees, will impact the speed and extent to which changes in interchange fees are passed through to merchants.

³ For more information on the CMA's investigations, see <https://www.gov.uk/cma-cases/investigation-into-interchange-fees-mastercard-visa-mifs>. The UK Government, with the Office of Fair Trading acting as the lead department, intervened before the General Court and the Court of Justice of the European Union in support of the European Commission's infringement decision against MasterCard regarding its intra-EEA cross-border interchange fee arrangements. On 11 September 2014, the Court of Justice handed down its judgment in case C-382/12P *MasterCard and Others v Commission*, which upheld that infringement decision. The judgment confirmed that MasterCard was an association of undertakings and that its cross-border interchange fee arrangements restricted competition, without being objectively necessary for the operation of the system. On 4 November 2014, the CMA announced its decision not to progress its investigations into MasterCard's and Visa's interchange fee arrangements at the present time. The CMA reached this decision in light of the proposed IFR, which is expected to cap MasterCard's and Visa's interchange fees. The CMA has indicated that its investigations remain open and, if the IFR were to not address the suspected harm, the CMA would look again at continuing proactively with its investigations. See <https://www.gov.uk/government/news/cma-decides-not-to-progress-interchange-fee-investigations-at-the-present-time>.

C.

Proposed European Interchange Fee Regulation

- 5.14 On 24 July 2013, the European Commission (the Commission) published a proposal for a Regulation of the European Parliament and Council on interchange fees for card-based payment transactions.⁴ This is commonly known as the IFR.
- 5.15 We expect the IFR to be adopted in the coming months, with some or all of its provisions coming into force during 2015. However, this may be subject to delay. The exact scope and content of the IFR may also change up to its adoption. We expect to become the competent authority for the IFR once it comes into force.
- 5.16 The most significant feature of the IFR is the proposal for caps on cross-border and domestic interchange fees. The Commission's initial proposal was for a cap of 0.2% (of the value of the transaction) for consumer debit card transactions and 0.3% for consumer credit card transactions.
- 5.17 The proposal of the IFR is tied up with the competition law scrutiny of interchange fees by the Commission and national competition authorities over many years. A full explanation of the grounds for, and objectives of, the IFR can be found in its Explanatory Memorandum. In summary, the Commission proposed the IFR due to competition concerns about:
- the potential upward pressure on interchange fees where Card Operators compete to attract issuing PSPs by offering high interchange fees
 - merchants finding it difficult to refuse payment cards (where they are 'must take' forms of payment) or being obliged to accept all cards of a given brand as a result of the card payment systems' rules
 - merchants facing obstacles or costs in surcharging consumers who wish to pay by card
- 5.18 Taking these concerns together, the Commission felt that competition between card payment systems can lead to increased costs of acceptance for merchants, which they pass on to all consumers (whether or not they pay by card) through higher retail prices.
- 5.19 The Commission also had related concerns that:
- new and innovative providers of mobile or online payment services may face a barrier to entry where issuing PSPs expect at least the same level of revenue as from traditional card payments
 - interchange fees vary widely across the EU, leading to market fragmentation and preventing merchants and consumers from enjoying the benefits of an internal market for goods and services

⁴ COM/2013/0550 final – 2013/0265 (COD), available at http://ec.europa.eu/internal_market/payments/framework/index_en.htm

- 5.20 The Commission indicated that competition enforcement alone could not address its concerns in a comprehensive and timely way, hence its proposal of the IFR which *“aims at providing legal clarity to ensure effective integration and competition, thereby improving economic welfare for all relevant stakeholders and in particular consumers”*.⁵

⁵ See the Explanatory Memorandum to the IFR, available at <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52013PC0550>

D.

Our proposed approach

- 5.21 We are aware that concerns regarding domestic interchange fee arrangements have existed for many years and that many parties await the IFR to give clarity on the maximum permitted levels of interchange fees for both domestic and cross-border transactions.
- 5.22 We will track and take account of competition law and legislative developments before our operational launch in April 2015 so that we can properly define and assess what, if any, action we might need to take regarding domestic interchange fees. Accordingly, we will continue to:
- liaise with the CMA regarding its MasterCard and Visa competition investigations
 - work closely with the Treasury in respect of the negotiations on the IFR which will determine the final text of the legislation
- 5.23 In the event that the adoption of the IFR is delayed, or the implementation of its domestic fee caps is deferred to a later and separate date from the caps on cross-border interchange fees,⁶ we will give careful consideration to whether it is appropriate to take any action in advance of the IFR through the exercise of our FSBRA or concurrent competition powers. Assuming the IFR is adopted, we may still consider whether it is appropriate to take any further action under our FBSRA or concurrent competition powers.
- 5.24 We expect to be responsible for investigating and taking enforcement action against breaches of the IFR's provisions. To prepare for taking on these additional responsibilities, and to inform our understanding of domestic interchange fee arrangements more generally, we will continue to engage with relevant stakeholders. This will likely include considering the transparency of any interchange fee changes and the wider impact of such changes on payment systems, PSPs, merchants and consumers.⁷
- 5.25 In addition, we will monitor how the package of proposals discussed elsewhere in this Consultation Paper is promoting competition and innovation in payment systems. In particular, greater competition between PSPs in the services provided by payment systems might exert competitive pressure on the cost to merchants of accepting payments. We welcome views from stakeholders on this.

SP5-Q1: Are there other matters regarding interchange fees that you think we should consider at this stage?

⁶ On 15 October 2014, the Council of the EU published a Presidency compromise text, which specified that both caps should apply six months after the entry into force of the IFR. See <http://data.consilium.europa.eu/doc/document/ST-14355-2014-INIT/en/pdf>. This was also the position set out in the Presidency compromise text dated 24 October 2014.

⁷ The FCA has announced it will launch a market study into the credit card market, focusing on the relationship between card issuers and cardholders (<http://www.fca.org.uk/news/credit-cards-competition-review>). We will liaise with the FCA on their study.

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