

Consultation paper

Market review of card scheme and processing fees

An update and draft
terms of reference

June 2022

We welcome your views on these draft terms of reference. If you would like to provide comments, please send these to us by **5pm on Tuesday 2 August 2022**.

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

Scheme and processing fees market review team
Payment Systems Regulator
12 Endeavour Square
London E20 1JN

We will consider your comments when preparing the final Terms of Reference for the market review.

We will seek to make the responses to this consultation available for public inspection.

When considering whether we can disclose confidential information, we will have regard to the sensitivity of the information and how best to fulfil our obligations to act fairly. If you consider that you are providing information in your response that is so sensitive that we should not disclose it, this should be made clear to us in your response. For these purposes, we will not regard a standard confidentiality statement, for instance in an email message, as a request for non-disclosure, and we do not accept blanket claims of confidentiality. In your response, you should identify the specific items that you consider to be sensitive and explain why. If you include extensive tracts of sensitive information in your response, we will ask you to submit a version of your response that we can publish.

We may also be required to disclose certain types of information, including sensitive material, to meet our legal obligations – for example, if we are asked to disclose a confidential consultation response under the Freedom of Information Act 2000. We will endeavour to consult you if we receive such a request under the Freedom of Information Act 2000. Any decision we make not to disclose information can be reviewed by the Information Commissioner and the Information Rights Tribunal.

You can download this consultation paper from our website:

<https://www.psr.org.uk/publications/market-reviews/mr22-1-1-card-scheme-and-processing-fees>

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1 Introduction

- 1.1** We are carrying out a market review, under Part 5 of the Financial Services (Banking Reform) Act 2013 (FSBRA), of the scheme and processing fees associated with the two largest card payment system operators in the UK: Mastercard and Visa.
- 1.2** This document sets out our draft terms of reference (ToR). It reflects the work, that we commenced in November last year, gathering and analysing information to help us identify where we should direct our attention. We are looking for feedback on this document and, in particular, the proposed scope of and approach to the market review.
- 1.3** Card payments are critical to the smooth running of the UK economy as they enable people to pay for their purchases and merchants to accept payments for goods and services. They represent a well-established method for consumers to make payments, and their use is growing. In 2021, there were 21 billion UK issued debit card payments totalling £702 billion. UK issued credit card payments in the same year numbered 3.5 billion and amounted to £182 billion.
- 1.4** Scheme and processing fees are payments that acquirers and issuers make to card payment system operators.¹ We propose focusing the review on Mastercard's and Visa's scheme and processing fees, as these two card payment system operators account for the majority of debit and credit card payments in the UK.²

What are scheme and processing fees?

Four-party card payment systems

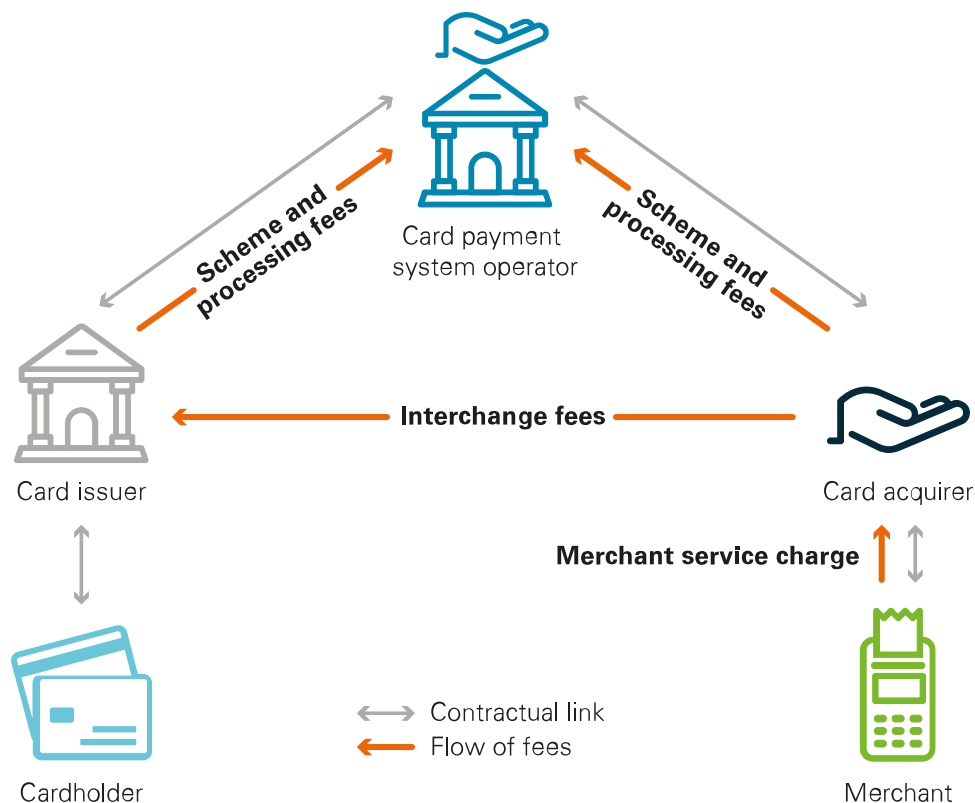
- 1.5** As well as cardholders (individuals or businesses that use cards to buy goods and services), there are at least four other parties involved in four-party card payment systems:
- **Merchants:** Organisations that accept payment by card.
 - **Operators of card payment systems (such as Mastercard and Visa):** Organisations that license issuers and acquirers to recruit cardholders and merchants, respectively. They manage the 'scheme rules' that govern how card payments are made and set the basis on which issuers, acquirers, merchants, cardholders and other parties participate in the card payment system.

1 The term 'scheme and processing fees' includes all fees acquirers and issuers pay to card payment systems operators. This is a change from the terminology we used in our card-acquiring market review. In that market review, we instead used the term 'scheme fees' to cover both scheme fees and processing fees. The change makes it clearer that processing fees are also within the scope of our market review.

2 Around 99% of all UK debit and credit card payments in 2021, both by volume and value.

- **Acquirers:** Banks or other organisations licensed by operators of card payment systems to recruit merchants to accept card payments.
- **Issuers:** Banks or other organisations licensed by operators of card payment systems to provide cards to cardholders. The issuer pays to the acquirer the money the merchant is owed for the transaction (less interchange fees) and debits the cardholder's account.

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



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

- **interchange fees (IFs)**, which acquirers pay to issuers each time a card is used to buy goods or services³; this is a per-transaction fee and is usually levied as a percentage of the transaction value⁴
- **scheme and processing fees**, which are set by Mastercard and Visa

³ The IF is typically deducted from the transaction amount that is paid by the issuer to the acquirer. Acquirers then typically pass the IF on to merchants through the MSC, so it represents a cost to merchants of accepting card payments.

⁴ The direction of an IF will differ in the case of ATM transactions.

- **merchant service charge (MSC)**, which is the total amount merchants pay to acquirers for card-acquiring services; this comprises interchange fees, scheme and processing fees and acquirer net revenue⁵
- **cardholder fees**, which cardholders may pay to the issuers

Scheme and processing fees

1.7 Examples of scheme or processing fees would be payments from acquirers or issuers to the card payment system operator for scheme or processing services.⁶

- Scheme fees are fees charged by a card payment system operator in return for services relating to participation in the card system, including any optional services provided by the card payment system operator.
- Processing fees are fees charged by processing entities (which includes card payment system operators) to their customers (issuers and acquirers) for services relating to technical processing for the authorisation, clearing and settlement of card payments, including for the provision of additional card payment functions, such as anti-fraud reporting.

1.8 We want to understand whether the market(s) in connection with scheme and processing fees are working well in line with our statutory competition, innovation and service-user objectives. Our market review will in particular examine the levels, structure and types of scheme and processing fees. We will also gain an understanding of payments made by card payment system operators to card issuers and card acquirers, to understand the overall flow of fees. This includes, but is not limited to, marketing assistance payments as well as discounts or rebates on scheme and processing fees.⁷

Why we are carrying out this review

1.9 In November 2021, we published the findings of our card-acquiring market review. As part of the market review, we undertook analysis of the fees that acquirers paid to card payment systems. Our analysis showed that scheme and processing fees (to which we referred as 'scheme fees' in the market review) paid by acquirers increased significantly over the period 2014 to 2018 as shown in Figure 2.⁸ We also found that a substantial proportion of these increases are not explained by changes in the volume, value or mix of transactions.⁹

⁵ Acquirer net revenue includes the costs the acquirer incurs (other than IFs and scheme and processing fees) to provide card-acquiring services, plus the acquirer's margin.

⁶ Relevant charges could be made by any company within the same corporate group as the card payment system operator. We also recognise that processing services may be provided by third parties.

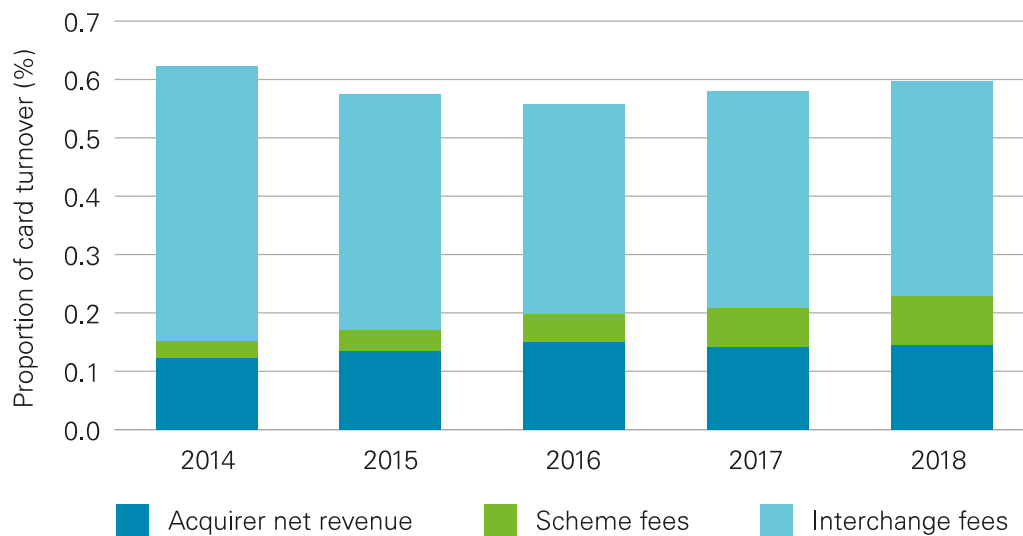
⁷ The scope of this market review may also include fees or payments that would be treated under Article 5 Interchange Fee Regulation as part of the interchange fee.

⁸ MR18/1.8, *Market review into card-acquiring services: Final report* (November 2021), paragraph 5.13 and Figure 11: www.psr.org.uk/publications/market-reviews/mr18-1-8-card-acquiring-report-final/

The merchant service charge is the total amount merchants pay to acquirers for card-acquiring services.

⁹ MR18/1.8, paragraph 1.16.

Figure 2: Average merchant service charge as a percentage of card turnover split by acquirer net revenue, scheme and processing fees and interchange fees



Source: MR18/8.1, *Card-acquiring market review: Final report*, paragraph 5.13 and Figure 11.

- 1.10** In addition, various stakeholders have raised concerns about increasing scheme and processing fees since 2018.
- 1.11** Given these concerns, we are carrying out this market review into scheme and processing fees. We will do so using our general powers under FSBRA. Market reviews are one of our tools for investigating how well markets or aspects of the markets for payment systems, or services provided by payment systems, are working for service-users in line with our statutory competition, innovation and service-user objectives.
- 1.12** In parallel with our market review of scheme and processing fees, we will also carry out a market review of cross-border interchange fees. Further information on this review can be found at <https://www.psr.org.uk/publications/market-reviews/mr22-2-1-UK-EEA-cross-border-interchange-fees>.
- 1.13** The remainder of this document is set out as follows:
- In **Chapter 2** we set out the proposed scope of, and approach to, the market review, including possible outcomes.
 - In **Chapter 3** we set out our consultation questions.

2 Proposed scope and approach

Proposed scope of the market review

- 2.1** We propose to focus on Mastercard and Visa scheme and processing fees because Mastercard and Visa accounted for around 99% of the combined total of UK debit and credit card payments in 2021, both by volume and value. In addition, the concerns that stakeholders have raised with us about card payment system scheme and processing fees largely relate to Mastercard and Visa.
- 2.2** While other cards are accepted by merchants and issued in the UK, Mastercard and Visa branded cards account for most card payments overall and are an important part of merchants' payment expenses. Therefore, our work will have the potential to make an important positive difference for UK merchants and consumers overall by ensuring that the market(s) or aspects of market(s) in connection with Mastercard and Visa scheme and processing fees are working well.
- 2.3** Our market review will examine:
- Scheme and processing fees set by Mastercard and Visa (the levels, structures and types of scheme and processing fees), including any changes in the fee levels.
 - Payments that Mastercard and Visa make to service-users including, for example, marketing assistance payments or rebates on scheme and processing fees.
We may look at levels, structures and types of payments made.
- 2.4** We plan to focus on the period from 2014 to present day. This would allow us to build on the analysis and data collected in our Card Acquiring market review.
- 2.5** At this stage, we do not limit the scope of the market review to the scheme and processing fees paid by any particular types of service-users.

Proposed approach to the market review

- 2.6** We want to understand whether the market(s) in connection with scheme and processing fees are working well in line with our statutory competition, innovation and service-user objectives.

- 2.7** We are planning to review whether there are factors that mean that Visa and Mastercard have market power and face weak constraints in setting scheme and processing fees, and the impact of this. Such factors may include:
- High barriers to entry, network effects or high fixed costs involved in setting up and running card payment systems, which alone or in combination may give Mastercard and Visa market power when it comes to setting scheme and processing fees.
 - Limited payment acceptance alternatives for merchants and the 'must take' status of Mastercard and Visa, either of which may lead to Mastercard and Visa having market power in setting acquirer scheme and processing fees.
 - Lack of transparency in the provision and pricing of scheme and processing services, which may mean that merchants do not have sufficient clarity about the services they are purchasing and are unable to assess the services they need or to refuse to purchase certain scheme and processing service components.
- 2.8** We are also planning to consider the differences in the structure and/or levels of scheme and processing fees levied on different participants (including issuers and acquirers), and their impact on competition, innovation and service-user interests.
- 2.9** To investigate these potential concerns, we propose to examine:
- the services provided by Mastercard and Visa and the associated scheme and processing fees, including how these differ between individual service-users
 - the factors Mastercard and Visa consider when setting the levels, structures and types of scheme fees
 - the process through which decisions about the levels, structures and types of scheme and processing fees are made
 - differences in the scheme and processing fees paid by different service-users; and reasons for those differences
 - changes in the Mastercard and Visa service offering, including the introduction of new services or service components and the associated scheme and processing fees
 - changes over time in the levels, structures and types of scheme and processing fees
 - the reasons for the changes in the levels, structures and types of scheme and processing fees (including those associated with changes in the service offering)
 - changes over time in the incentive payments and/or other support that Mastercard and Visa offer to issuers and acquirers
 - the profitability of the UK card businesses of Mastercard and Visa, and how these have changed over time

- current and future competitive constraints that Mastercard and Visa face when setting scheme and processing fees
- whether and how the competitive constraints faced by Mastercard and Visa differ for the services provided to issuers and acquirers
- the extent to which Mastercard and Visa are perceived as important or indispensable payment methods for merchants
- the extent to which the requirements and preferences of service-users, particularly merchants, are reflected in Mastercard and Visa's decision-making regarding changes to these services
- how contractual terms related to scheme and processing fees are arrived at

2.10 We expect our thinking to develop over the course of the market review, including the possibility that further issues or areas of analysis are included (if they relate to potential harm to competition, innovation or service-users) or some issues are not pursued further.

Possible outcomes

2.11 We will consider what actions, if any, to take should we identify a need to promote effective competition or address detriments to current or potential service-users.¹⁰ For example:

- making new, or amending existing, general directions
- making new specific directions
- requiring the operator of a regulated payment system to establish or change their operating rules, to notify us of rule changes or to seek our approval before making rule changes
- making recommendations for industry initiatives or enhanced industry self-regulation
- publishing guidance
- carrying out an investigation into a potential breach of the Competition Act 1998
- if applicable, open a regulatory enforcement investigation where it appears to us that there are circumstances suggesting that there may have been a compliance failure
- making a market investigation reference to the Competition and Markets Authority (CMA) to investigate a market or a feature of several markets

¹⁰ We recognise that the Bank of England is responsible for supervising systemically important financial market infrastructures (FMIs) in the UK, including payment systems, to ensure financial stability and operational resilience. Visa and Mastercard are both recognised as systemically important FMIs and so are supervised by the Bank. More detail on the Bank's approach to the supervision of FMIs can be found on its website: <https://www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision>

2.12 We aim to ensure that any action we take is effective and proportionate to any detriments we identify. The following three principles will generally be relevant when considering intervention:

- **The efficiency principle:** This is an expectation that resources are used in the most efficient and economical way.
- **The proportionality principle:** This is where a burden or restriction that is imposed on a person, or on the carrying on of an activity, should be proportionate to any benefits that are expected to result from the imposition of that burden or restriction.
- **The transparency principle:** This requires regulators to exercise their functions as transparently as possible.

2.13 In the absence of a need to promote effective competition and the absence of any detriments to current or potential service-users, we would not act.

3 Consultation questions and next steps

- 3.1** We welcome feedback on these draft ToR. We set out a list of consultation questions below.
- 3.2** You can provide your comments in writing until **5pm on Tuesday 2 August 2022**.
- 3.3** **We're planning a number of engagement events with stakeholders during the consultation.** We'd like everyone with an interest to provide their feedback and help us shape our work. Further details of the engagement events will be provided to participants in due course.
- 3.4** Our scoping of the market review will continue following the publication of these draft ToR. We will also continue to liaise with other authorities (including financial regulators and the CMA) where appropriate.
- 3.5** After reviewing the comments on these draft ToR, we plan to publish the final ToR for the market review in Autumn 2022. We will set out our full timetable for the market review in that document.

Consultation questions

- 3.6** You are welcome to provide whatever comments you see fit, but it will be helpful if you can provide responses in line with the following questions.

Scheme and processing fees

- 3.7** We describe what we mean by scheme and processing fees in paragraph 1.7.

Question 1

- Do you agree with our description of scheme and processing fees? If not, please explain:
 - how our description should be altered and whether there are alternative approaches to categorising Mastercard and Visa scheme and processing fees
 - why you think the description should be altered in this way. For example, you may think it is important to distinguish between fees which are mandatory and those which are optional
- Please include any evidence you think is relevant to your response.

Scope

3.8 We set out in paragraphs 2.1 to 2.5, the proposed scope of the market review.

Question 2

- Do you agree with the proposed scope of the market review? If not, please explain:
 - how the proposed scope should be altered
 - why you think the proposed scope should be altered in this way
- Please include any evidence you think is relevant to your response.

Our proposed approach

3.9 We set out in paragraphs 2.6 to 2.10 our proposed approach.

Question 3

- Do you agree with our proposed approach to the market review? If not, please explain:
 - how the proposed approach should be altered
 - why you think the proposed approach should be altered in this way
- Please include any evidence you think is relevant to your response.

Question 4

- Are there specific types of scheme and processing fees we should focus our work on? Perhaps because the scheme and processing fees represent a large percentage of total network fee revenues or because they have changed substantially?
- Are there specific types of scheme and processing fees we should not focus our work on? Perhaps because the fees represent a small percentage of total network fee revenues or because they have not changed substantially?
- In your response, please explain:
 - which scheme and processing fees we should or should not focus on
 - why you think we should focus on these scheme and processing fees
- Please include any evidence you think is relevant to your response.

Question 5

- Do you have views on the potential factors that we propose to investigate (set out in paragraphs 2.7 and 2.8)?
- Are there other factors in relation to scheme and processing fees that we should be considering?
- Please include any evidence you think is relevant to your response.

How to provide comments

- 3.10** Please send your comments by **5pm on Tuesday 2 August 2022**. You can email them to cardfees@psr.org.uk or write to us at the following address:

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- 3.11** We will consider your comments on these draft ToR when preparing the final ToR for the market review.

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