

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

Final terms of reference

October 2022

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1 Introduction

- 1.1** This document sets out the final terms of reference (ToR) for our market review of consumer cross-border interchange fees between the UK and the European Economic Area (EEA). It follows our consultation on the draft ToR published on 21 June 2022.¹ The aim of our market review is to understand the rationale behind the increases in interchange fee (IF) rates for Mastercard and Visa's consumer debit and credit card-not-present (CNP) transactions between the UK and the EEA, since the UK's withdrawal from the European Union (EU). We also want to understand the impact of these increases.
- 1.2** We are conducting this market review under Part 5 of the Financial Services (Banking Reform) Act 2013 (FSBRA).
- 1.3** This ToR explains the scope of our review, the issues we will consider initially, the analysis we plan to conduct and the potential outcomes.

Why do cross-border UK-EEA card payments matter?

- 1.4** 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.
- 1.5** An important use of debit and credit card payments is for international transactions – financial transactions where the payer and the recipient are located in separate countries.

Defining cross-border interchange fees

- 1.6** Card transactions where the issuer, acquirer and the merchant point of sale location (the merchant location) are in the same country are typically defined as domestic transactions.² The IFs for these transactions are called domestic IFs. Transactions where the card was issued in a different country to the merchant location are typically referred to as cross-border transactions and the IFs are called cross-border IFs.

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

2 This is as per the UK Interchange Fee Regulation definition.

1.7 We distinguish between two types of UK-EEA cross-border transactions for the purposes of this market review:

- **Outbound IFs:** Transactions using non-UK-issued cards – that is, EEA-issued cards, in the context of UK-EEA transactions – to make payments to a merchant located in the UK.
- **Inbound IFs:** Transactions using a UK-issued card to make payments to a merchant not located in the UK – that is, merchants located in the EEA, in the context of UK-EEA transactions.

Regulation of cross-border interchange fees

1.8 From December 2015 until the end of the transition period following the UK's withdrawal from the EU, in December 2020, IFs for both consumer domestic UK transactions and UK-EEA (which up until then were intra-EEA) transactions were subject to caps under the EU interchange fees regulation (EU IFR). For all these transactions, a single set of caps applied, which were 0.2% of the value of the transaction for consumer debit cards (including prepaid cards) and 0.3% of the value of the transaction for consumer credit cards.

1.9 In addition, any card payments to a merchant located in the EEA using a card issued outside the EEA were subject to caps on interchange fees. These were set out in the commitments offered by Mastercard and Visa to the EU during the European Commission's inter-regional interchange fees investigation (the commitments). The commitments were made binding in 2019 and differentiate between card-present (CP) and card-not-present (CNP) transactions.³ The former are subject to the same caps as in the EU IFR (0.2% for consumer debit and 0.3% for consumer credit cards) while the latter are subject to higher caps (1.15% and 1.5% for consumer debit and credit cards respectively).⁴ The commitments are due to expire in 2024.

Recent changes

1.10 The transition period following the UK's withdrawal from the EU ended on 31 December 2020. From January 2021, the EU IFR no longer applied to UK domestic transactions and cross-border transactions between the UK and EEA. The onshored UK Interchange Fee Regulation (UK IFR) applies the cap levels set out in the EU IFR to UK domestic transactions.

³ Consumers and businesses commonly use debit and credit cards to pay both 'face-to-face' and 'non-face-to-face' (such as online or over the phone). The former are also referred to as card-present (CP) transactions while the latter are also known as card-not-present (CNP) transactions.

⁴ The higher caps on CNP transactions reflect the cost to EEA merchants of accepting alternative payment methods for such payments, such as e-wallets (digital wallets) funded via non-SEPA bank transfers.

- 1.11** A subset of cross-border UK-EEA transactions now fall within the scope of the caps set out in the commitments, which distinguish between CP and CNP transactions. The caps in the commitments apply to transactions involving a UK-issued card to make a payment to a merchant located in the EEA (inbound IFs), but do not apply to transactions using an EEA-issued card to make payments to a merchant located in the UK (outbound IFs). Outbound IFs are not currently subject to any caps.
- 1.12** Since the UK's withdrawal from the EU, Mastercard and Visa have decided to apply the same levels to both inbound and outbound IFs for UK-EEA transactions:
- for CP transactions using consumer debit and credit cards, IFs have remained at the same levels as when the EU IFR caps applied (0.2% and 0.3% respectively)
 - for CNP transactions using consumer debit and credit cards, IFs have increased from 0.2% and 0.3% to 1.15% and 1.5% respectively⁵
- 1.13** The level of IFs set by Mastercard and Visa for UK-EEA CNP transactions correspond to the levels of the caps in the inter-regional commitments accepted by the European Commission. The UK is no longer part of the EU but it remains part of the Single Euro Payments Area (SEPA). This makes UK-EEA transactions different to other inter-regional card transactions involving cards issued outside the EEA being used to pay merchants located in the EEA (for example, EEA-US or EEA-Japan transactions, where neither the US nor Japan are part of SEPA).

Why we are carrying out this market review

- 1.14** Before we published our draft ToR, various stakeholders had raised concerns with us about the approximately fivefold increase in Mastercard and Visa's IF rates for UK-EEA consumer CNP transactions. The concerns included the impact that the increases in the IFs may have on their businesses.
- 1.15** Further, as IFs represent a cost to merchants of accepting card payments, they may be passed on to some or all of their customers (at least in part) in the prices they pay for goods and services.
- 1.16** Many stakeholders raised similar concerns in their responses to the draft ToR, and the majority supported our intention to carry out a market review of UK-EEA consumer cross-border interchange fees.

5 Visa and Mastercard announced and introduced changes to cross-border IFs as follows:

- At the end of 2020, Mastercard announced it would increase inbound IFs for consumer CNP transactions (from 0.2%/0.3% to 1.15%/1.5% for debit and credit cards respectively). These increases became effective in October 2021.
- In March 2021, Visa announced increases in both inbound and outbound IFs for consumer CNP transactions (effective from October 2021).
- In late 2021, Mastercard announced an increase to outbound IFs for consumer CNP transactions. These increases to outbound IFs came into effect in April 2022.

- 1.17** Given these concerns, we are conducting a market review into UK-EEA consumer cross-border interchange fees using our powers under FSBRA. We can use market reviews to investigate how well markets (or aspects of markets) for payment systems, or services provided by payment systems, are working in line with our statutory competition, innovation and service-user objectives.
- 1.18** We want to understand the rationale behind the increases in IF rates for Mastercard and Visa’s consumer debit and credit UK-EEA CNP transactions since the UK’s withdrawal from the EU, as well as the impact of these increases and the interests of UK service users.
- 1.19** In parallel with this market review, we are also carrying out a market review of scheme and processing fees.⁶

Stakeholder input to the terms of reference

- 1.20** We received 16 responses to the consultation on the draft ToR from a variety of stakeholders. We have published our summary and responses to stakeholders’ main comments in a separate document.⁷ We have also published the non-confidential versions of their responses.⁸
- 1.21** The remainder of this document is set out as follows:
- In **Chapter 2** we set out the scope of the market review.
 - In **Chapter 3** we describe our approach to the market review, identify some specific issues of interest and outline the possible outcomes.
 - In **Chapter 4** we set out our next steps, invite evidence and summarise our approach to disclosure of information provided to us. This chapter should be read alongside **Annex 2**, which lists the indicative milestones for our market review.

6 www.psr.org.uk/publications/market-reviews/mr22-1-2-card-scheme-and-processing-fees/

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

8 www.psr.org.uk/publications/market-reviews/mr22-2-1-cross-border-interchange-fees-draft-terms-of-reference-feedback/

2 The scope of the market review

2.1 Our market review will examine UK-EEA consumer cross-border CNP interchange fees. This chapter sets out our scope.

Background

2.2 Mastercard and Visa's increases in CNP IFs relate to consumer debit and credit CNP transactions for:

- transactions using a UK-issued card to make a payment to a merchant located in the EEA (inbound IFs)
- transactions using an EEA-issued card to make payments to a merchant located in the UK (outbound IFs)

Our scope

2.3 In this market review, we will focus our investigation on UK-EEA cross-border CNP IFs in the Mastercard and Visa card payment systems.⁹ It will cover both debit and credit consumer cards. We will focus only on IFs which were covered by the caps imposed by the EU IFR before the UK left the EU. We will prioritise outbound IFs.

2.4 We want to understand the rationale for and the impact of the rises in CNP IF levels for UK-EEA consumer debit and credit CNP transactions. We are concerned that the ability of Mastercard and Visa to increase these fees is an indication that there are market(s) which are not working well and may not support our statutory competition, innovation or service-user objectives. Although the scheme operators have already provided some explanation for the increases to us, and also to the Treasury Select Committee, we wish to explore further the basis for them.¹⁰

9 For the purposes of this market review, the term 'interchange fee' means the fee paid by the acquirer to the card issuer on a per transaction basis only. We do not use the definition in the Interchange Fee Regulation which also includes certain other payments received by the issuer, including net compensation, that are treated as part of the interchange fee. Other payments flowing between the parties to a transaction will be considered as part of our [market review of scheme and processing fees](#).

10 Mastercard and Visa respond to Treasury Committee on card fees increases: www.committees.parliament.uk/committee/158/treasury-committee/news/172852/visa-and-mastercard-respond-to-treasury-committee-on-card-fee-increases/

- 2.5** We expect to develop our thinking over the course of the review. This includes the possibility that our concerns are amended or dropped, or new ones are added. These concerns do not imply any pre-judgement of the outcome.
- 2.6** To investigate these potential concerns, we propose to examine the following issues:
- The potential drivers and justifications for the increases in these IFs since the UK's withdrawal from the EU. As part of this, we shall examine the reasons provided by the card scheme operators and the considerations that Mastercard and Visa took into account when assessing the opportunity to increase these fees. This includes strategic, competition and regulatory aspects.
 - The impact of the increases in IFs for UK-EEA consumer debit and credit CNP transactions on competition, innovation and service users. In particular, we are concerned about the impact of the fee increases on UK service users.
- 2.7** We will consider what actions, if any, to take if we identify a need to promote effective competition or address detriments to innovation (now or in the future) or to the interests of potential service users.

3 Our approach

3.1 To investigate the potential concerns raised in the previous chapter, we will examine the following issues:

- The potential drivers and justifications for the increases in IFs since the UK's withdrawal from the EU. As part of this, we shall examine the reasons provided by the card scheme operators and the considerations that they took into account when assessing the opportunity to increase these fees. This includes strategic, competition and regulatory aspects.
- Whether there is evidence that the UK-EEA CNP interchange fees were increased because of an increase in relevant costs following the UK's withdrawal from the EU.
- The impact of the increases in IFs for UK-EEA consumer debit and credit CNP transactions on competition, innovation and service users. In particular, we are concerned about the impact of the fee increases on the interests of UK service users.

Possible outcomes

3.2 We will consider what actions, if any, to take if we identify a need to promote effective competition, innovation or the interests of service users.¹¹ 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

¹¹ We recognise that the Bank of England (the Bank) is responsible for supervising systemically important financial market infrastructures (FMIs) in the UK, including payment systems, to ensure financial stability and operational resilience. Mastercard and Visa 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: www.bankofengland.co.uk/financial-stability/financial-market-infrastructure-supervision

- opening a regulatory enforcement investigation where it appears to us that there are circumstances suggesting 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

3.3

We want any action we take to be effective and proportionate to any issues we identify. The following three principles will generally be relevant when considering intervention:

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

4 Next steps

4.1 The publication of this final ToR is an important step in our market review into UK-EEA consumer cross-border interchange fees. Annex 2 sets out an indicative timetable for our work. We plan to publish a report setting out our interim conclusions on UK-EEA consumer cross-border interchange fees in Q2/Q3 2023 and a final report in Q4 2023.

4.2 We are in the process of gathering evidence and information from a range of stakeholders using a variety of methods, such as roundtables, information requests and bilateral meetings. The parties include:

- card scheme operators
- acquirers
- issuers
- merchants

4.3 As we progress our market review, we may also seek information and evidence from other parties.

4.4 We will continue to liaise with other authorities as we progress our work. These include the FCA, which regulates payment service providers including issuers and acquirers, the Bank of England, which supervises Mastercard and Visa, and the CMA, with which we share concurrent competition powers. Where appropriate, we will also liaise with the European Commission regarding inbound IFs on transactions using a UK-issued card to make a payment to a merchant located in the EEA.

We welcome input to this market review

4.5 We welcome views and evidence that will help inform our assessment. You can email us at cardfees@psr.org.uk or write to us at:

Cross-border interchange fees market review team
Payment Systems Regulator
12 Endeavour Square London
E20 1JN

Disclosure of information

4.6 Please read our guidelines on submissions and disclosure of information in Annex 3.

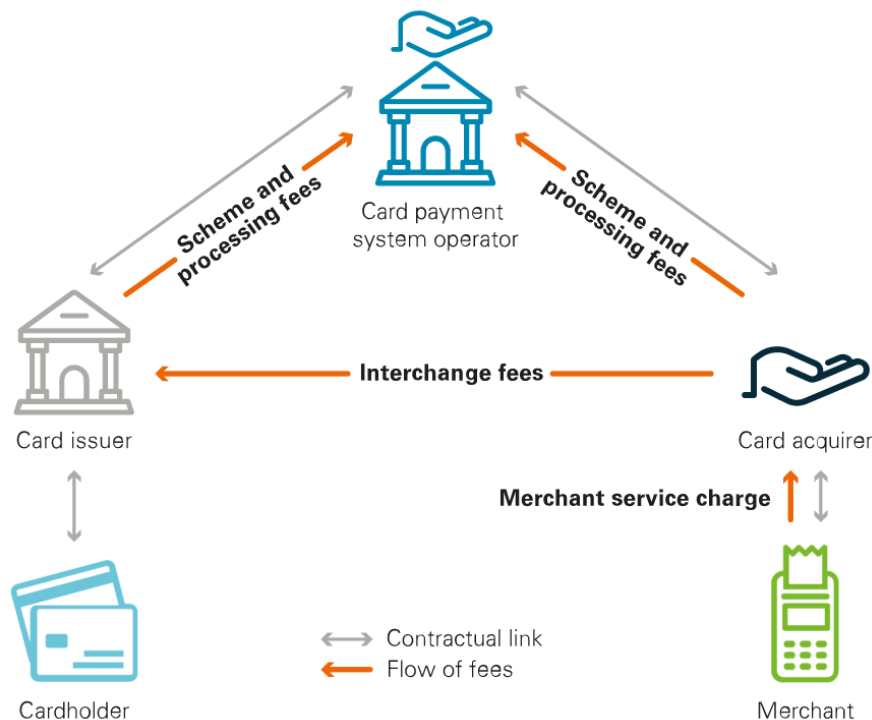
Annex 1

Four-party card payment systems

1.1 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.
- **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



1.2 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 services¹²; this is a per-transaction fee and is usually levied as a percentage of the transaction value¹³
- **scheme and processing fees**, which are set by Mastercard and Visa¹⁴
- **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 revenue¹⁵
- **cardholder fees**, which cardholders may pay to the issuers.

12 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.

13 The direction of an IF will differ in the case of ATM transactions. We are not including ATM transactions in this market review.

14 The terms 'scheme fees' and 'processing fees' include all fees acquirers and issuers pay to card payment systems operators. We note this is a change of terminology from our card-acquiring market review, where we used the term 'scheme fees' to cover both scheme fees and processing fees. For further details on scheme fees and processing fees, please see MR22/1.2, [Market review of card scheme and processing fees: Final terms of reference](#) (October 2022).

15 Acquirer net revenue is calculated as the revenue the acquirer receives from the merchant (the MSC) minus the IFs and scheme and processing fees it pays to other scheme participants (to issuers and the scheme operator, respectively). The acquirer's margin is the net revenue minus other costs incurred by the acquirer.

Annex 2

Indicative timeline of market review

- 2.1** The table below sets out the indicative timeline for our work on cross-border interchange fees.
- 2.2** This is an ambitious and challenging timetable, as it is dependent on timely and constructive engagement from Mastercard, Visa and other stakeholders. If we make significant changes to this timetable, we will publish a revised version on our website.

Phase	Activity	Timing
Launch	Publish final ToR	October 2022
Information-gathering and analysis	Publish working paper on theories of harm	Q4 2022
	Collect evidence and information from market participants	Q3 2022 to Q1 2023
	Analysis of evidence and information gathered	Q4 2022 to Q1 2023
Interim report	Publish interim report	Q2/Q3 2023
Final report	Publish final report	Q4 2023
Remedies	Publish remedies paper	Q4 2023

Annex 3

Disclosure of information

- 3.1** Generally, we will seek to publish views or submissions in full or in part. This reflects our duty to have regard to our regulatory principles, which include those in relation to:
- publication in appropriate cases
 - exercising our functions as transparently as possible
- 3.2** We will not accept blanket claims of confidentiality. If you wish to claim confidentiality over specific items in your submission, you must identify those specific items you claim to be confidential, and explain why this is the case. If you include extensive tracts of confidential information in your submissions, we will ask you to submit non-confidential versions.
- 3.3** We may be required to disclose information marked as confidential in order to meet legal obligations.
- 3.4** This will be the case, for example, if we are asked to disclose confidential information 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.
- 3.5** In accordance with the legal framework in the Financial Services (Banking Reform) Act 2013 (FSBRA), we will not disclose confidential information that relates to the business or affairs of any person that we receive for the purposes of our functions under FSBRA, unless:
- we have the consent of the person who provided the information and, if different, the person it relates to
 - there is a 'gateway' permitting such disclosure. One of the gateways is the 'self-help' gateway, whereby we will be able to disclose confidential information to third parties to enable or help us to perform our public functions. Where we disclose confidential information to a third party, we may impose restrictions on the further disclosure or use of the information by that party.
- 3.6** Information that is already lawfully publicly available is not confidential information for the purposes of FSBRA. This also applies if it is not possible to identify a particular person through the information – for example, if the information is summarised or made anonymous.

3.7 We have statutory powers under FSBRA to require a person to provide information or documents which we require to carry out our role. In such circumstances, you should note that there are serious consequences for you if you provide false or misleading information, or fail to comply with such a request. In particular:

- Sections 90(1) and (2) of FSBRA state: 'A person who fails to comply with a requirement imposed, without reasonable excuse, including a requirement to provide information, may be dealt with as if he or she were in contempt of court, which may result in imprisonment or a fine.'
- Section 90(6) of FSBRA states: 'It is a criminal offence, when, in response to a written requirement to provide information under section 81(1) FSBRA, a person either provides information which he or she knows is false or misleading in a material particular or recklessly provides information which is false or misleading in a material particular.'

3.8 Participants we regulate under FSBRA are also required to have an open and cooperative relationship with us and disclose relevant information to us, in accordance with our General Direction 1. Breaching a general direction is a compliance failure, which makes a participant liable for regulatory sanctions.

3.9 We take our data protection responsibilities seriously and will process any personal data that you provide to us in accordance with the Data Protection Act 2018, the General Data Protection Regulation and our PSR Data Privacy Policy. For more information on how and why we process your personal data, and your rights in respect of the personal data that you provide to us, please see our privacy policy on our website, available here: www.psr.org.uk/privacy-notice.

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