Payment Systems Regulator

Market review into the supply of card-acquiring services

Stakeholder submissions to consultation on interim report

November 2021

MR18/1.7 Submissions

Contents

Adyen	4
American Express	7
Association of Convenience Stores (ACS)	16
Association of Independent Risk & Fraud Advisors (AIRFA)	23
Barclays	28
Bename	46
Breathe Payments	49
Br-dge	51
British Retail Consortium (BRC)	58
Confederation of British Industry (CBI)	84
CMSPI	87
Elavon	91
Electronic Money Association (EMA)	100
Federation of Small Businesses (FSB)	111
Fidelity Payment	120
Global Payments (GPUK)	122
GPUK Technical Annex	142
Handepay	159
Judopay	162
Lloyds Bank Cardnet	166
Mastercard	172
Mastercard Technical Annex	190
National Federation of Retail Newsagents (NFRN)	201
Nets	204
North East Interiors	211
Paypal/Zettle	213
Paytek	217
Phoenix Edge	228
Retail Merchant Services (RMS)	273

Scottish Grocers' Federation (SGF)	275
Square	280
Stripe	283
Takepayments	292
Tesco	297
The Money Charity	299
UK Finance	306
UTP Merchant Services	317
Visa	322
Worldpay	355
Worldpay Technical Annex	504

Names of individuals and information that may indirectly identify individuals have been redacted.

Adyen

Payment Systems Regulator
12 Endeavour Square
London E20 1JN

Attn: Card-acquiring market review team

Amsterdam, 4 December 2020

Market review into the supply of card-acquiring services – Interim Report

In response to the Interim Report - market review into the supply of card-acquiring services dated September 2020 (**Interim Report**), Adyen N.V. (**Adyen**) is pleased to provide the following feedback for your consideration.

General Comments

Having reviewed the Interim Report, Adyen generally agrees with the overall message and appreciates the time taken by the PSR to collate such a thorough document. In particular, Adyen is pleased to see the importance of fair and transparent pricing for all card-acquiring merchants being stressed, including to ensure merchants can benefit from the cap on interchange as intended by the Interchange Fee Regulation and as implemented by Adyen through its IC++ pricing model. In Adyen's view, this allows for IFR savings to be more widely passed through.

Proposed Remedies – Contract Limits

Adyen notes the PSR's concerns regarding the length of card-acquiring contracts, including the potential additional barriers to exit with POS terminals and the proposed remedy of auto-termination per paragraphs 1.19 and 1.22. While Adyen agrees that extensive lock-in periods and/or automatic renewal for lengthy fixed terms are typically not beneficial, automatic termination can also result in detriment for merchants. Such detriment includes a lack of certainty and continuity and the potential for un-necessary re-contracting (including related efforts and costs). Most importantly, it may unexpectedly leave merchants that don't have a system or focus on expiry of these contracts without payment processing capabilities, which may create a harmful business interruption.

As such, Adyen believes that this concern can best be addressed through offering and enforcing flexible contracting whereby an initial and reasonable minimum length may be agreed to, with the option to terminate at any time following such a period (i.e. without lengthy fixed-period extensions). If desired on both sides, the parties may at any time agree to re-contract for a new fixed, initial period. [redacted]

Adyen believes that this flexible contracting approach would [redacted] achieve an appropriate balance between certainty and flexibility for merchants.

In support of a flexible contracting approach, Adyen would also like to emphasise the importance of clear, transparent, and simple invoices to ensure merchants are informed of, and can compare, acquiring costs when deciding whether to extend a flexible contract or enter into a new one with a different acquirer. This is particularly the case for smaller merchants who may be more vulnerable to the impairments potentially caused by complex and unclear pricing models, combined with lengthy rolling lock-in periods.

Adyen's traditional focus on enterprise merchants

As the PSR is aware, Adyen has traditionally focused on large enterprise merchants. Notwithstanding this, Adyen has always been open to, and regularly does, provide services to mid-market merchants (otherwise referred to as medium sized merchants per the Interim Report). While Adyen's merchant base and volumes continue to be contributed to by the large enterprise merchants, mid-market is still important to Adyen and forms part of Adyen's longer term strategy.

With this in mind, it is our view that in emphasizing Adyen's traditional enterprise focus (as repeated throughout at paragraphs 4.12, 4.86 and 7.14), the Interim Report could be read to understate the importance of mid-market to Adyen. This is particularly so when considering that the statements referenced above were commonly juxtaposed against (implicit and explicit) statements around a lack of focus on small to medium sized merchants. To address this imbalance, we propose that the references to Adyen's enterprise focus be caveated with wording to reflect that this has been a traditional focus of Adyen's growth *up until recently*. We also believe such changes will also ensure the accuracy and long-term relevance/applicability of the final report.

Please do not hesitate to reach out if you have any further queries.

Kind regards,

[redacted]

[redacted]

P.O. Box 10095
1001 EB Amsterdam
the Netherlands

[redacted]

[redacted]

American Express

American Express: Response to PSR Interim Report on card-acquiring market study

9 February 2021

Introduction

American Express welcomes the opportunity to respond to the Payment Systems Regulator's ("**PSR**") interim report on its market review of the supply of card-acquiring services, published in September 2020.

As the PSR is aware, unlike other acquirers, American Express operates a closed loop three party scheme in the UK whereby it is both the issuer and acquirer of transactions. As the PSR has recognised in its interim report, American Express accounts for only a very small share of card transactions in the UK[1]. American Express is always a choice for merchants. To compete, American Express must prove its value to both consumers and merchants.

While American Express supports the PSR's focus on card-acquiring services for the dominant four party schemes in its market review, we urge the PSR to be mindful that regulatory interventions designed to address concerns emanating from the dominant schemes may nonetheless have implications for the ability of smaller three party schemes such as American Express to compete.

We understand that the PSR intends to consult in more detail on the design of any remedy proposals that it concludes are necessary based on the outcome of the current consultation. American Express is strongly supportive of further detailed engagement if remedies are deemed necessary and will work constructively with the PSR on the remedies going forward.

We have set out in this response American Express' observations on the PSR's provisional findings and potential remedies and would welcome the opportunity to discuss these further with the PSR should that be helpful.

The PSR's provisional findings

American Express welcomes the work done by the PSR in its interim report and the provisional finding that the supply of card-acquiring services works well for merchants with annual card turnover above £50 million. This is consistent with American Express' own experience that the supply of card-acquiring services is competitive in the UK.

We also acknowledge the PSR's finding that the supply of card-acquiring services is not working well for merchants with annual card turnover of less than £50 million. While American Express recognises some of the issues the PSR has identified – for example around merchants' ability to easily compare the complex pricing that results from the dominant four party schemes – we are concerned that the scope of the PSR's finding does not fully take into consideration the broad range of merchants captured by a threshold of £50 million annual card turnover; the importance of non-price considerations for merchants; and the competitive constraint that is increasingly imposed by technological innovations in the broader payments landscape. We also observe that the evidence from the merchant survey is, at best, mixed and does not clearly support a finding that the proposed remedies are warranted. These concerns are set out in further detail below. As American Express has neither interchange nor scheme fees and is therefore not within scope of the PSR's financial analysis, we have not commented on the financial analysis in this response.

[1] See page 17 of the PSR's interim report, which states that Visa and Mastercard accounted for around 98% of all card payments at UK outlets in 2018, by both volume and value.

- The provisional finding that the supply of card-acquiring services is not working well for all merchants with annual card turnover of less than £50 million is overly broad and does not fully consider differing levels of merchant sophistication and resource.
    - The PSR's finding appears to be based predominantly on the conclusion that merchants receive little or no pass through of interchange fee savings. However, as the PSR is aware, the range of merchants whose annual card turnover is less than £50 million is extremely broad and includes merchants with significantly different resources, expertise, requirements and priorities. These differing needs and capabilities are relevant to both their ability and incentive to switch or shop around. In particular, larger merchants, with annual card turnover of less than £50 million, are likely to share characteristics with the largest merchants for whom the PSR concluded the supply of card-acquiring services is working effectively. For example, they are likely to be sophisticated buyers who may use multiple acquirers to ensure ongoing competition, have dedicated internal resource to overcome search costs, and be in a relatively stronger bargaining position with providers of card-acquiring services.
    - Moreover, there appears to be an absence of detailed evidence from merchants with annual card turnover of £10 million to £50 million, who were not within scope of the merchant survey, yet are included in the finding that the supply of card-acquiring services is not working well and proposed remedies.[2] We note the PSR has found that a number of, but not all, larger merchants may receive the same standard pricing or terms as smaller and medium sized merchants. However, it does not follow that larger merchants will necessarily share the views expressed by smaller and medium-sized merchants in the merchant survey as their experiences and switching decisions are likely to be influenced by factors beyond their contractual terms.

- The provisional findings focus disproportionately on pricing outcomes and do not fully consider the value of non-price considerations to merchants. The PSR's overall provisional finding that the supply of card-acquiring services is not working well for merchants with annual card turnover of below £50 million appears to be based predominantly on conclusions regarding pricing outcomes. However, it is necessary to recognise that non-price factors are also an important element of the service that is offered to merchants which may in themselves influence or dictate merchant choices on whether to shop around or switch acquiror. The value that American Express offers when competing to acquire merchants includes investments and efforts in targeted marketing, business-building initiatives, including dedicated payment consultants, services such as Safekey, rewards and other cardholder and merchant benefits and services. For example, American Express runs the Shop Small Campaign, which in addition to running an extensive marketing campaign encouraging people to shop small, incentivises our Cardmembers through our Shop Small Offer. When Cardmembers spent £10 at participating small businesses, they received a £5 credit statement. The campaign is now in its tenth year. In 2020, over and above and beyond the traditional December campaign, responding to the unprecedented circumstances of COVID-19 American Express invested £16million in an additional three month Shop Small Campaign to help independent retailers.
- The significance of non-price value to merchants in switching decisions is most clearly illustrated by merchants who value and may choose to pay a higher price for the simplicity and convenience

[2] We also note that the interim report indicates nearly all of the large merchants included in the PSR's information requests had annual card turnover above £50 million.

offered by a particular payment facilitator. Further consideration should therefore be given by the PSR to how non-price elements influence merchants' decisions on switching and shopping around.

- Competitive constraints from the broader payments landscape. The UK payments landscape is evolving rapidly, supported by the launch of Open Banking in the UK. This evolution has been significantly accelerated by COVID-19, for example, as a result of the movement towards contactless and digital payments. Alternative payment methods such as those offered by Open Banking will increasingly act as a competitive constraint on card payments, including in the context of merchant acquisition. As the PSR will be aware, in its recent HMT Landscape Review consultation the UK Government sought inputs on how to increase the ability of such alternatives to compete with cards in the UK and indicated that it will seek to support and encourage such competition. Thus, while the interim report provides a valuable insight into the card-acquiring environment to date, as the PSR looks to finalise its findings and proposed remedies for the future, we would welcome greater recognition of the competitive constraint that exists and will increase from the broader payments ecosystem, both:
    - directly in the context of card-acquiring services, as new technologies facilitate new entry and different service offerings for example by Payment Initiation Service Providers; and
    - more broadly, as merchants increasingly have new alternatives to card payments such as payment initiation services and technologies such as mobile point of sale ("**mPOS**") and soft-point of sale ("**soft-POS**") products, which provide cheaper and faster options for merchants to accept both card and non-card alternative payments without the need for traditional terminals. Card-acquiring is just one element of a complex broader payments landscape providers of card-acquiring services will face increasing competition from non-card payments.

  The payments landscape is also seeing significant policy interest from regulators and government. We would welcome further clarity on how the PSR's review will tie in with the UK Government's broader Payments Landscape Review, including during the current and later phases.

- The merchant survey is inconsistent with and does not support a finding that the supply of card-acquiring services is not working well for the merchants surveyed. Nor does it provide robust evidence that regulatory intervention – including the remedies proposed by the PSR – is either warranted or would be beneficial to merchants with annual card turnover of less than £50 million:
    - The merchant survey indicates that smaller merchants have a high level of satisfaction and the ability to switch or shop around; most merchants that did search and switch didn't report facing barriers; and very few respondents highlighted contractual terms or lack of information as barriers to switching.[3] This survey data is difficult to reconcile with the provisional findings that the three features identified by the PSR (ISO and acquirer pricing, the indefinite duration of merchant contracts and ISO and acquirer POS terminal contracts) restrict merchants' ability and willingness to search and switch, nor the overall finding that the supply of card-acquiring services does not work well for small and

[3] For example, the majority of merchants reported that they are happy with their terms. A significant proportion (58%) of those surveyed were either new customers, had switched or had considered switching provider in the previous 2 years; with merchants with annual card turnover between £380k and £1 million being the most likely to have actually switched. 70% of merchants shopped around for providers when they considered switching. A majority of those who had not considered switching provider in the last two years or who never switch reported that they did not do so because they are happy with their existing provider (in fact only 1% of those who never switch reported the reason as being that it is too difficult or complicated to compare providers).

medium-sized merchants and large merchants with annual card turnover of up to £50 million.

- The PSR's provisional conclusion that regulatory intervention in the form of remedies is required is based on a finding that merchants would benefit from greater switching or shopping around. However, to ascertain the benefit to merchants from switching or renegotiating, it is necessary to measure objectively the benefits obtained from switching or renegotiating against the costs incurred from this process. The key component to the PSR's conclusion that smaller and medium-sized merchants would benefit from greater switching or negotiating appears to be merchant survey data that of the 21% of small and medium-sized merchants who reported that they had tried to renegotiate with their current provider, 88% obtained better terms. In considering this data, it should be noted that the question posed to merchants is inherently subjective and there may be a high degree of variability in how respondents have interpreted the meaning of "better terms". The merchant survey data does not demonstrate the relative value of the "better terms" or provide insight into how these compare to the time and resource costs of negotiating. We also note in the context of this data that the survey results indicated that being more likely to negotiate did not lead to a higher success rate[4].

The PSR's proposed remedies

American Express believes that competition drives better services and better prices for customers. Regulatory interventions carry the risk of unintended consequences – as illustrated by the cumulative regulatory burden introduced by the EU Payments Package, which rendered American Express' licensing business no longer viable. Regulators should therefore intervene only where necessary to address a clearly defined harm and target any measures accordingly in a focused and proportionate manner.

As outlined above, American Express has concerns regarding the scope and basis of the PSR's provisional finding that remedies are required. However, American Express is committed to delivering value for merchants and is, in principle, supportive of the PSR's aim of improving the ease of switching for small merchants. We have therefore sought to engage constructively by setting out below the potential unintended consequences and concerns that American Express sees around the PSR's proposed remedies, as well as providing observations on potential alternative options that the PSR may wish to consider if remedies are found to be necessary.

We note that the PSR has indicated that – should remedies be required – it will provide more detailed remedy proposals for full consultation in due course. We welcome this and urge the PSR to engage extensively with industry participants to ensure that any remedies are designed to be proportionate and mitigate the risk of unintended consequences. It is important that any proposed remedies are tested with relevant merchants to assess objectively whether they are necessary or effective and quantify the cost vs benefit of intervening. In particular, being mindful of the different models that exist and the potential for remedies to introduce a regulatory burden and administrative costs that may, ultimately, affect the ability of card-acquiring service providers to compete or be passed on to merchants and consumers.

As regards the scope of merchants for whom any potential remedies relating to pricing transparency or contract terms would apply, our strong view, as outlined above, is that the PSR's proposed £50 million annual card turnover is too high. Any remedies should be focused on small merchants. In

[4] See para 6.35 of the interim report, which notes that "*Merchants with a higher card turnover were more likely to negotiate with their provider and slightly less likely to be successful*."

addition, irrespective of annual card turnover, merchants who negotiate bespoke commercial terms or pricing should fall out of scope of any remedies. The ability to negotiate bespoke arrangements would likely reflect that a merchant is sufficiently sophisticated and has negotiating power to allow them to shop around or switch in order to obtain more favorable pricing outcomes. Regulatory intervention would therefore be neither warranted nor proportionate for these merchants.

(i) ISO and acquirer pricing of card-acquiring services

As American Express is always a choice for merchants our pricing is transparent and competitive based on the value that we deliver so that merchants will choose to accept American Express. Our fees are consistent across all our credit and charge card products to help make acceptance simple. Moreover, as we operate a closed loop three party scheme, American Express does not have the fees involved in four party payment systems such as interchange fees or scheme fees, which may introduce additional complexity into pricing. There are also no extra set up costs or additional monthly fees involved.

As acquiring on behalf of the dominant four party schemes accounts for the vast majority of card transactions in the UK, we recognise that such complexity may be a concern for small merchants. Anecdotally, our experience supports the PSR's finding that merchants – particularly smaller merchants who may have less resources and expertise than larger merchants – may find it difficult to understand the full price that they pay to providers of card-acquiring services in relation to card acceptance for the dominant four party schemes.

In order to improve the ability of small merchants to compare pricing, it is important to recognise that more data alone is unlikely to be effective. It is key that any remedy targeted at improving pricing transparency for small merchants is designed to ensure that these merchants are given the ability to compare like-for-like pricing that reflects the total fees that will apply. Simply providing small merchants greater visibility of the underlying fees – for example using a summary box or key facts document – will not necessarily enable them to compare prices effectively. Given that small merchants typically have limited resources to spend on shopping around for card-acquiring services, additional measures that further overload small merchants with data will not help them make an informed choice. Moreover, seeking to provide a breakdown of specific fees may cause unintended confusion or difficulties where such fees do not exist, as is the case for American Express in relation to interchange and scheme fees. For example, given American Express doesn't have interchange fees or scheme fees, it would not be possible for American Express to disclose interchange and scheme fees in a standardised box, as they are not a feature of our pricing. Any obligations to adopt a specific template or disclose specific fees must therefore either carve out schemes that don't have such fees or allow scope for schemes to answer "not applicable", in the context of any new requirements to disclose information that simply doesn't exit.

Should the PSR nonetheless conclude that a remedy is necessary, American Express would propose that the PSR instead considers the introduction of a headline merchant effective rate that provides small merchants clear visibility of the overall rate that they are paying (including the cost of any applicable fees such as interchange or scheme fees where such fees exist). Detailed consultation would be required on the precise mechanism for calculating such a rate, but one idea could, for example, be to use a weighted average. To ensure transparency and allow meaningful price comparison, such a headline merchant effective rate would need to be calculated separately for debit cards or credit cards and for individual card schemes, giving the merchant a clear price per transaction for different services. It may be possible for such headline merchant effective rates to be provided initially as an indicative rate at the time of acquisition, as well as subsequently on an annual basis to provide a retrospective figure that helps merchants understand the rate that they are actually paying. The inclusion of such a point of comparison in regular statements would likely also act as a natural prompt for small merchants to review the costs of their card-acquiring services and potentially look for comparisons to make a switch.

(ii) Contracts for card-acquiring services

American Express does not agree that contracts without a fixed end date act as a barrier to switching where a merchant is able to terminate at will on reasonable notice. Moreover, we wish to draw the PSR's attention to the potential for significant unintended consequences of introducing a 'hard stop' end date to all contracts, particularly creating a cliff edge for business continuity for small merchants, and significant costs of negotiating and agreeing new contracts for merchants who are typically already time and resource poor. These would lead to poor outcomes for small merchants and, ultimately, consumers. The current COVID-19 pandemic has, if anything, highlighted the potential for unexpected events to result in drastic challenges to the environment in which merchants operate and the importance of both flexibility and the business continuity that 'evergreen' card acceptance agreements can provide. Contrary to the PSR's intention, it is also conceivable that requiring end dates might actually create barriers to switching if contracts ceased to allow parties to terminate at will as a result of introducing a fixed term.

Indefinite contracts may be beneficial for merchants, particularly where they can terminate at any time, with limited notice periods and no exit fees. These 'evergreen contracts' allow small merchants to be flexible and gives them the confidence work with smaller players (knowing they can cancel anytime). In addition, the ability to adjust pricing for merchants (including downwards) under such contracts provides flexibility and fair pricing over time. American Express' experience has been that many merchants prefer the flexibility offered by 'evergreen' contracts and [redacted]

It is notable that the evidence from the PSR's own merchant survey does not indicate that contract duration is a barrier to switching or that contract end dates would be an appropriate remedy. Only 9% of merchants who had not tried to negotiate better terms reported that this was due to being locked into a contract[5] and, significantly, only 1% of merchants reported that the expiry of a contract would make them consider switching in future.[6] From a behavioral perspective, while merchants are not in the same situation as consumers, given the business context in which they operate day to day, some learnings can nonetheless be drawn from similar initiatives in consumer context where it is already clear that individuals do not typically react to contract end-dates. The retail savings and energy markets are good example. In both these sectors, consumers are often slow to switch to a new tariff or rate even when their promotional period may have ended. This is despite the fact they could be saving money by switching. The same logic will apply to merchants in the card-acquiring sector. We therefore believe that – if remedies are ultimately required - less invasive alternatives, such as developing 'behavioral' prompts for merchants to encourage them to review their current arrangements and consider switching could achieve the PSR's aims, without creating any negative unintended consequences. American Express welcomes the PSR's confirmation during the consultation period that it recognizes the potential adverse consequences outlined above of requiring contract end dates and has also been considering the scope for a softer behavioural prompt as an alternative.

If contrary to our primary position above, the PSR considers remedies are nonetheless required, American Express would encourage the PSR to consider whether the remedy for pricing transparency could also act as the softer behavioural prompt for these purposes. American Express believes that

[5] Slide 15, PSR Card-acquiring market review: merchant survey results, September 2020.
[6] Slide 31, PSR Card-acquiring market review: merchant survey results, September 2020.

the headline merchant effective rate described above, for example, if provided in annual statements would provide merchants a clear and regular insight into their actual costs, thereby acting as trigger to consider whether they are satisfied with the price they are paying. 'Evergreen contracts' in combination with a headline merchant effective rate can be very effective mechanism, creating flexibility for merchants and a prompt to evaluate and switch.

In developing a behavioral prompt the PSR might alternatively want to consider introducing a requirement for merchants to be offered a cancellation window following notification of a pricing change (excluding price increases that are agreed at the outset of the agreement, e.g. in a fee schedule). Following notification of a fee increase or the introduction of a new fee, or a reduction in applicable interchange rates not passed on to merchants, merchants could be allowed a time limited window to cancel their contracts without penalty. As a remedy this option would achieve the dual purpose of: ensuring that merchants are notified of pricing changes in a way that will act as a prompt to consider switching; and ensuring that contract terms are not a barrier to merchant switching where existing merchants are subject to a price increase.

(iii) ISO and acquirer POS terminal contracts

American Express is broadly supportive of the PSR's aim of ensuring that POS terminal contracts do not act as a barrier to merchants switching their provider of card-acquiring services.

As the PSR is aware, American Express does not supply POS terminals to merchants. While we are therefore not in a position to comment in detail on the PSR's proposed remedies in relation to ISO and acquirer POS terminal contracts, we urge the PSR to consider potential the additional practical barriers – both technology and process driven – that may act as a barrier to merchant switching. [redacted]

[redacted]

[redacted]

Association of Convenience Stores (ACS)

ACS Submission: Market review into the supply of card-acquiring services

1. ACS (the Association of Convenience Stores) welcomes the opportunity to respond to the Payment Systems Regulator market review into the supply of card-acquiring services. ACS represents over 33,500 local shops and petrol forecourt sites including Co-op, BP, McColls and thousands of independent retailers, many of which trade under brands such as Spar, Budgens and Nisa. Further information about ACS is available at Annex A.

2. Convenience retailers access acquirer services via several routes. Multiple retailers typically commission payments consultancies to negotiate complex fee structures and find a deal on their behalf. Symbol groups will often have an agreement with an acquirer whereby the group provides permission for the acquirer to approach the symbol group's independent retailers. This may involve the symbol group recommending the acquirer to its independent retailers but the acquirer will conduct a business negotiation directly with the symbol group retailer, based on the type and number of card transactions going through that business.

3. Switching acquirers is especially complex for unaffiliated independent retailers. These retailers cannot draw on payments expertise or symbol group oversight when comparing the acquirer market. The complexity of fee structures and switching acquirers makes it difficult for retailers to find the best deal for them. November 2020 polling of 1,210 independent and symbol retailers finds that 61% have not compared or switched acquirers in the past three years, while 48% of retailers who have compared in the past three years did not choose to switch[1].

4. We support the remedies proposed by the PSR but would encourage further action to amend the packaging of bills via the IFR, investigate scheme fees and help retailers establish their business needs from an acquirer. The key outcome of this review must be a far easier market for retailers to compare providers and switch to better deals. The payments industry is diversifying and innovating at a rapid pace and the PSR must act promptly and assertively to protect businesses and ultimately consumers.

5. We have responded to the consultation questions below. [redacted].

Q1) Do you have views on the provisional findings set out in this report?

6. The report is an accurate reflection of our understanding of the acquirer market.

7. There are two key factors which demonstrate how rises in card payment processing costs are relatively acute for convenience retailers. Firstly, the report recognises that the interchange fee cap has failed to result in lower per transaction fees for retailers, indicating that cost savings are either being retained by acquirers or not being wholly passed onto convenience retailers. Secondly, the doubling of scheme fees between 2014 and 2018, mainly linked to transaction numbers than values, has disproportionately affected convenience retailers due to a low average basket spend (£7.46)[2].

8. There is a clear need to encourage competition within the acquirer market to prevent the escalation of scheme fees seen in that duopolistic market. The report shows how Barclaycard and Worldpay

[1] ACS Voice of Local Shops Survey: November 2020
[2] ACS Local Shop Report 2020

account for three-quarters of card transactions by volume and 60-70% of card transactions by value. Payment facilitators remain a very small part of the market and only suitable for very small merchants. Encouraging and enabling switching behaviour will be key to maintaining a diverse acquirer market.

Retailer Needs

9. We have identified with members the following factors which are key when approaching the acquirer market; price, fast settlement, ease of onboarding, assistance with legal requirements, customer service and omnichannel services. Considerable emphasis is given to fast settlement by retailers for cashflow purposes and related to onboarding, integrating effectively with ePOS till systems. Retailers value support with PCI DSS certification and the pandemic has caused 56% of retailers to now accept card-not-present payments due to the growth of home delivery from local shops[3].

Comparing Acquirers

10. The complexity of bills makes it very difficult for convenience retailers to accurately compare card acquirers. Some smaller retailers are still receiving 'blended' bills with no breakdown of costs, while retailers receiving 'interchange ++' pricing can struggle to forecast acquirer bills or account for costs outside the MSC when comparing acquirers. Poor transparency about costs and changes in MSC bills can act as a barrier to retailers understanding bills and comparing the wider acquiring market.

11. Retailers are made aware by acquirers when their bills are changing but have difficulties determining why their bills are changing. When fees increase, acquirers typically inform merchants they are passing on increases from card schemes or other supply chain costs. Retailers querying cost increases when they have not matched increased card scheme fees or other costs struggle to gain further explanation of the changes to their bill.

12. Increasingly complex fee structures make comparisons between acquirers more difficult to make. Fees outside the MSC are adding to these costs, ranging from new acquirer authorisation fees, payment gateway fees, PCI compliance fees, setup fees, chargeback fees and minimum monthly MSCs. These costs make it harder for merchants to compare the acquiring market and influence how acquirers compete for merchants.

Switching Acquirers

13. The following two issues can discourage switching behaviour and are often linked to a fear of costly downtime for acceptance of card payments.

14. Switching card acquirers can become a further elongated process for retailers when handling the switchover of acquirer-supplied payment terminals. Contracts for these terminals typically run for five-year terms and auto renew. The associated termination fees are a barrier to switching, especially as often this hardware only works with a specific acquirer.

15. Switching requires merchants to ensure they remain compliant with PCI DSS (the Payment Card Industry Data Security Standard). Retailers must organise a PCI compliance assessment and self-assess the validation requirements they must achieve to be compliant. The IT changes needed to be compliant can be substantial and discourage switching acquirers, for example installing firewalls and anti-virus software, encrypting cardholder data and monitoring networks. The process can take around three months. The IT processes needed to switch POS equipment without restricting the use of card payments for consumers is complex and a notable consideration for retailers.

[3] Covid-19 impact survey

Q2) Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

16. Remedies should focus on encouraging and enabling switching behaviour from smaller retailers to address the barriers detailed under Q1. Excluding retailers which do not accept card payments or were unsure, 61% of independent and symbol convenience retailers have not compared or switched acquirers in the past three years[4]. This supports the findings of the SME merchant survey and is too high for a functioning market.

17. We support all three proposed remedies and encourage the PSR to build on these further (see Q3).

Remedy One: Requiring all contracts for card-acquiring services to have an end date

18. End dates for acquirer contracts could provide a clear prompt for retailers to shop around. This is dependent on easily comparable pricing information and therefore the implementation of remedy three. Without this coordinated approach, there would be a risk of retailers being auto-enrolled onto new excessively priced contracts, as can occur after promotional periods expire within utility and telecoms markets. Retailers not interested in comparing or switching could simply sign another contract which provides continuity of service.

Remedy Two: Requiring changes to POS terminal contracts to; a) limit their length, b) ban contracts that auto-renew for successive fixed terms and c) make it easier to exit POS terminal contracts

19. Limiting the length of POS terminal contracts could encourage retailers to search out a better deal. The maximum contract length would need to strike a balance between encouraging switching behaviour and higher potential fees to cover hardware and installation costs. Banning the automatic rollover of contracts would provide a clear prompt to retailers to consider their options and a drop-off in service is unlikely as providers would be motivated to maintain their business.
20. We would also support banning termination fees from POS terminal contracts where that hardware does not have universal functionality across acquirer or ISO platforms and whenever terms or conditions are changed. Termination fees already do not apply in acquirer contracts longer than six months – the same should apply for POS equipment.

Remedy Three: Making it easier for merchants to research and compare prices

21. Two aspects are vital to researching and comparing prices effectively. One – access to data on the number, value and type of card transactions a retailer accepts or expects to accept. Two – accessible quotes from acquirers which are accurate for both expected MSC and non-MSC fees (see para 12). Without both of these requirements being met, higher levels of comparing and switching behaviour becomes unlikely.

22. Convenience retailers rarely understand what value-added service (non-MSC) fees they are paying, with fees often incoherent within the terms and conditions despite the real impact they have on monthly bills. Larger retailers in the sector are also frustrated about the transparency of billing information, which is typically provided in complicated formats and requires formal requests to access breakdowns.

23. Therefore, acquirers and ISOs should be required to provide pricing information in an easily comparable format. This could be done via amendments to the Interchange Fee Regulation (see para 25). Retailers are typically told by their acquirer that providing an MSC breakdown or

[4] ACS Voice of Local Shops Survey: November 2020

‘interchange ++’ pricing is cost-prohibitive, despite Article 9(1) of the IFR providing legal guarantees for all merchants to access full bill breakdowns.

24. We would also support actions which enable price comparison tools. There is one price comparison website (Cardswitcher) which works off business data estimates, but mainly provides quotes from ISOs. ISOs ultimately get a commission from acquirers and the data required still requires retailers to interpret their bills and gather related information.

<u>Q3) Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?</u>

Interchange Fee Regulation

25. The IFR already requires retailers to be provided with a full breakdown of acquirer costs. The implementation of this requirement requires review; the vast majority of convenience retailers do not receive breakdowns and are not aware of this entitlement.

26. The IFR should further support easily comparable pricing information by adding another line to interchange ++ pricing to cover all non-MSC fees. This would halt the proliferation of other fees and value-added services from making it harder to compare and switch. Retailers often want a ‘one stop shop’ solution on accepting card payments, so tend to want their acquirer to cover; managing the processing of transactions, associated hardware and PCI DSS compliance. Effective comparison tools would allow retailers to complete a checklist of services they want from an acquirer after assessing their business needs (see para 21).

Scheme Fees

27. The complexity of scheme fees does make it harder for acquirers to offer simpler pricing. The card schemes levy fees based on many variables, making it impractical to accurately forecast costs regardless of viable resource. This has made increases in scheme fees harder to interpret, although we recognise the PSR’s extensive work to establish that scheme fees have doubled between 2014 and 2018.

28. We believe the PSR should investigate the possible circumvention of the IFR by the card schemes. It is possible that the card schemes responded to the IFR by rapidly increasing scheme fees paid by card acquirers and rebating the level of scheme fees paid by issuers, producing a net benefit to card issuers. The effect of this would be that the intention of the IFR has been avoided – with retailers unable to avoid higher scheme fees and both absorbing these costs and passing them onto consumers.

29. This could breach the anti-avoidance provisions of the IFR by artificially replacing an income stream to card issuers. This could also be anti-competitive by establishing a floor below which MSCs cannot fall – as was deemed the case with interchange fees. The duopolistic position of Visa and Mastercard as card schemes means that retailers cannot avoid paying these increased scheme fees, which they would not have to do in a market with wider competition.

Communications

30. There is a need to ensure retailers can assess their business needs before effectively comparing the market. The PSR should produce easy and accessible guidance aimed at small merchants about how to do so. ACS would be happy to work with regulators on such guidance.

31. One further area this review should address is the perception amongst retailers that switching will simply be too much hassle or too complicated to achieve. Therefore, combined with the business

guidance mentioned, the PSR/FCA should consider a concerted communications campaign to encourage such activity, looking to the successful Current Account Switch Service as a best practice proxy.

<u>Q4) How does COVID-19 impact on our review?</u>

32. The pandemic has accelerated existing trends across the payments market, specifically a growth in card payments, reduction in cash payments and shift to online transactions as shopping preferences change. The acceleration of these trends only supports the need for this review.

[redacted]

Annex A

ABOUT ACS

The Association of Convenience Stores lobbies on behalf of over 46,000 convenience stores across mainland UK on public policy issues that affect their businesses. ACS' membership is comprised of a diverse group of retailers, from small independent family businesses running a single store to large multiple convenience retailers running thousands of stores.

Convenience stores trade in a wide variety of locations, meeting the needs of customers from all backgrounds. These locations range from city centres and high streets, suburban areas such as estates and secondary parades, rural villages and isolated areas, as well as on petrol forecourts and at travel points such as airports and train stations.

ACS the voice of local shops

WHO WE REPRESENT

INDEPENDENT RETAILERS

ACS represents almost 19,000 independent retailers, polling them quarterly to hear their views and experiences which are used to feed in to Government policy discussions.

These stores are not affiliated to any group, and are often family businesses with low staff and property costs. Independent forecourt operators are included in this category.

SYMBOL GROUPS AND FRANCHISES

ACS represents over 14,000 retailers affiliated with symbol groups. Symbol groups like SPAR, Nisa, Costcutter, Londis, Premier and others provide independent retailers with stock agreements, wholesale deliveries, logistical support and marketing benefits.

Symbol group forecourt operators and franchise providers like One Stop are also included in this category.

MULTIPLE AND CO-OPERATIVE BUSINESSES

ACS represents over 13,000 stores that are owned by multiple and co-operative retailers. These businesses include the Co-Operative, regional co-operative societies, McColls and others.

Unlike symbol group stores, these stores are owned and run centrally by the business. Forecourt multiples and commission operated stores are included in this category.

THE CONVENIENCE SECTOR

WHAT WE SELL

In 2020, the total value of sales in the convenience sector was £44.7bn.

The average spend in a typical convenience store transaction is £7.46.

WHO WE ARE

There are 46,955 convenience stores in mainland UK. 72% of stores are operated by independent retailers, either unaffiliated or as part of a symbol group.

OUR COLLEAGUES

The convenience sector provides flexible employment for around 412,000 people.

13% of independent/symbol stores employ family members only.

HOW WE OPERATE

22% of shop owners work more than 60 hours per week, while 24% take no holiday throughout the year.

72% of business owners are first time investors in the sector.

OUR COMMUNITIES

Convenience stores and Post Offices poll as the two services that have the most positive impact on their local area according to consumers and local councillors.

80% of independent/symbol retailers have engaged in some form of community activity over the last year.

ECONOMIC CONTRIBUTION

Between August 2019 and May 2020, the convenience sector invested over £585m in stores.

The most popular form of investment in stores is refrigeration.

OUR RESEARCH

ACS polls the views and experiences of the convenience sector regularly to provide up-to-date, robust information on the pressures being faced by retailers of all sizes and ownership types. Our research includes the following regular surveys:

ACS VOICE OF LOCAL SHOPS SURVEY

Regular quarterly survey of over 1,200 retailers, split evenly between independent retailers, symbol group retailers and forecourt retailers. The survey consists of tracker questions and a number of questions that differ each time to help inform ACS' policy work.

ACS INVESTMENT TRACKER

Regular quarterly survey of over 1,200 independent and symbol retailers which is combined with responses from multiple businesses representing over 3,000 stores.

ACS LOCAL SHOP REPORT

Annual survey of around 2,400 independent, symbol and forecourt retailers combined with responses from multiple businesses representing 6,700 stores. The Local Shop Report also draws on data from Lumina Intelligence, IGD, Nielsen and William Reed.

BESPOKE POLLING ON POLICY ISSUES

ACS conducts bespoke polling of its members on a range of policy issues, from crime and responsible retailing to low pay and taxation. This polling is conducted with retailers from all areas of the convenience sector.

For more information and data sources, visit www.acs.org.uk

Association of Independent Risk & Fraud Advisors (AIRFA)

[redacted]

Date: 07 December 2020 13:50:58

Dear PSR Team

I am pleased to attach some feedback from the Association of Independent Risk and Fraud Advisors on the Market Review into the supply of card-acquiring services - interim report Card-acquiring Market Interim Review - September 2020

Stakeholder feedback and next steps

7.53 We welcome stakeholder feedback on our provisional findings and potential remedies, including on the following questions:

1. Do you have views on the provisional findings set out in this report?
2. Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?
3. Doyouthinkthereareotherremediesthatweshouldbeconsidering?Ifso,what remedies and how do you think they would address the concerns we have identified?
4. How does COVID-19 impact on our review?We are responding to this consultation as follows:

Question 1 & question 2 together

1. Do you have views on the provisional findings set out in this report?

2. Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

General
- The report contained some good analysis with strong quantitative consideration of stakeholders, environmental details and the financials.

- The conclusions appeared to be rather 'one-dimensional' and appeared to have a complete focus of the recommendations being ONLY to address the margin that the acquirers take - i.e. without having concluded in the report that it is the margin that the acquirers take that is the problem. The findings are that the costs to merchants (and ergo the consumer) are significant and by inference 'could be reduced'. It would be useful to identify the breakdown numerically of the costs and have action plans separated out for each of the cost elements.

- Disrupting the market with only recommendations that address margins and thereby business profitability will in turn increase costs for smaller acquires, drive-out some aspects of competition, increase barriers to entry, reduce profits for UK companies and possibly reduce UK tax flows. The key recommendations (all recommendations) are all

focussed this way - i.e.
a) Reduce contract length / terms
b) Remove terminal contract lengths
c) Create environment for competitive pricing visibility

- Whilst these initiatives ***should be*** progressed, there should be recommendations that focus upon other costs and for creating more UK businesses, retaining more UK revenues and strengthening the UK payments infrastructure. Other recommendations should encourage competition and UK revenues and UK business development as well as innovation to align with the PSR objectives.

- The PSR recommendations might have been strengthened with an attempt to address issues (with actions) the outward flow of card scheme costs (clearly replacing the interchange fees) out of the UK and seemingly coinciding with the EU initiatives to reduce costs to merchants through interchange reductions. The PSR does not seem to have 'grasped this nettle' with acknowledgment of this nor explicitly addressing this with an action plan.

- Long-term contracts with 'revenue-sharing' for ISOs have not been addressed or provided for in the recommendations.

- Initiatives for other cost elements (other than the acquirer margins and thereby only a small aspect of the review and of the costs) have not been identified.

- Open banking initiatives have been designed to displace these costs with direct payments: which has not been referenced here as a strategic direction or as an aim in the reporting. The impact of progressing with the 'open banking' agenda could be encouraged with some actions to migrate transactions in this direction.

- There could be competition issues or disruption issues for Open Banking companies that are increasingly being bought by existing card processing companies to either kill or avoid cost displacement for merchants.

- The highest turnovers and lowest payments costs are reserved for the biggest merchants. These include supermarkets, large food and clothing retailers and petrol retailers; who can, through their size better control and 'negotiate' tighter margins. Together with the absence of the need for underlying 'payment guarantees' by these 'face-to-face' merchants (i.e. they will be less likely to need card 'chargeback' processes), it is less likely that these merchants might drive open-banking payment alternatives and innovation attached thereto.

- For the smaller merchants, such 'payment guarantees' (card based chargeback arrangements) are more valuable and less capable of being displaced by open banking initiatives.

- Penalties/ taxes could be considered for the outflow of revenues from the UK - provided that these did not automatically then involve a 'pass-through'.

- We welcome the introduction of flexibility on terminal contracts and linkage to acquiring contracts but less in favour of specific mandates on contract period reductions. Communication on pending expiration is strongly encouraged but commercial decisions should be permitted that may warrant both short (1 year) or long contract terms.

3. Do you think there are other remedies that we should be considering? If so, what remedies and

how do you think they would address the concerns we have identified?

There clearly remains confusion over where the fees go, i.e. interchange fees goes to schemes, MSC fees go to acquirers - there two items often get confused.

The MSC components split was previously more heavily weighted by the interchange fee amount; now it is more heavily weighted by the 'scheme fees' that are contained within the MSC.

As acquirers compete, they get less profitable. This assumes that they cannot dramatically reduce costs further. In the meantime, the schemes make more revenue on transactions processing - authorisation and clearing. With a dramatic reduction in cross-border transactions (covid / travel / airline related), the schemes have become more reliant upon domestic processing (i.e. inter-country fees).

There are probably limited further remedies available within the area of increasing competition and reducing the margins/competition/UK tax revenues etc.

Focus should be applied to other areas where costs can be reduced with other initiatives, innovation etc.

However, most importantly

- The PSR must 'bite the bullet' in respect of the card scheme fees, now that we are outside the EU and with the EU having 'white-washed' this issue in the summer (2020).

- Evidence is compelling that interchange fee reduction benefits to retailers have been outweighed by increased scheme fees or new charges to an acquirer, which are in turn passed through to the merchant.

4. How does COVID-19 impact on our review?

We have no specific opinion or comments here, but more generic observations are detailed below.

Suffice to say, COVID-19 has provided significant additional and unplanned benefits for card acceptance and therefore concerns for some stakeholders. Two key areas identified:

a) Concerns over handling "dirty" cash and coins by consumers and/or retail staff have driven awareness and use of contact card payments. Many retailers have expressly communicated card-only acceptance environments, where practicable. It is also apparent that retailers have trained customer-facing staff to promote its use and explain how it works.

This has required a delicate balance of education and encouraging consumers to use this, if contactless was not already familiar to them or they are one of the many 'strong' cash users at any amount.

This has led to additional card acceptance costs for card transactions that have displaced coin and note payments. These are not necessarily low-value payments now that the single contactless transaction limit is £45.00.

Furthermore, the increased usage of contactless payments has also meant that on-card contactless parameters were being more readily spent, requiring PIN verification to complete the purchase. This often brought retailer and consumer confusion.

It would also be useful to understand the reported increase in contactless fraudulent transactions reported during the COVID-19 period to date.

b) COVID-19 led to the temporary restrictions and closures on many retailers with a physical presence and therefore card present transactions. This drove new thinking from both retailers and payments stakeholders to quickly expand remote payment acceptance opportunities, which was welcomed by all parties.

E-commerce, telephone order transactions have seen significant increase for remote ordering and with home delivery or 'click n collect' models.

This has been a critical lifeline to save many retailers where they could take advantage of remote payments.

However, due to specific and increased charges applied by the acquirer, card scheme and other service providers, the cost of accepting remote payments for previously card present transactions is higher for the merchant. We are aware of merchants attempting to calculate the additional costs of this essential measure.

Kind regards

[redacted]

[redacted]

[redacted]

Barclays

[redacted]

9 FEBRUARY 2021

BARCLAYS

PAYMENT SYSTEMS REGULATOR

MARKET REVIEW INTO THE SUPPLY OF CARD-ACQUIRING SERVICES

INTERIM REPORT

Executive summary

1. Barclays is supportive of many of the findings set out in the Interim Report, and considers that the market is innovative, competitive and responsive to merchant needs. This, coupled with high merchant satisfaction, strongly suggests that the card-acquiring market is in good overall health.
2. Barclays does not agree with the broad PSR observation that the market is not working well for smaller merchants, and that acquirers have not passed through the savings associated with the interchange fee caps to that cohort. [redacted]
3. In relation to the three proposed remedies, Barclays considers that:
    a. As to **remedy 1**, there is no suggestion that acquiring contracts form a barrier to switching.
        i. Accordingly, an intervention that introduces an "end date" in acquiring contracts, with the aim of promoting switching, is not warranted – and could have negative consequences, including a sudden loss of service.
        ii. In Barclays' experience, merchants can, and do, switch with relative ease – [redacted], and the findings from the Merchant Survey.
        iii. Barclays notes that there are other, less intrusive and more proportionate solutions that may achieve the same goal of "triggering" merchants – this could include merchants being sent periodic reminders of their existing price plan, or being permitted to switch/re-contract when their pricing is revised upwards.
    b. As to **remedy 2**, Barclays is in principle supportive of a measure that would limit contractual terms, or the use of onerous provisions (including high termination fees) for POS terminals.
        i. However, such a measure should apply equally to all providers of such payment terminals, [redacted] - this in an environment where acquiring services and POS terminals may be provided to merchants by different parties, through separate contracts.
        ii. It is not clear on what regulatory basis the PSR would be able to effect such a level playing field between providers, or how any measure could be enforced.
    c. As to **remedy 3**, Barclays does not believe that there is a convincing case for intervention, particularly if this could have the effect that bespoke pricing structures would need to be simplified/harmonised across acquirers - to facilitate like-for-like comparison.
        i. Barclays does not believe that the evidence suggests that such a measure is necessary - and considers that there could be unintended adverse consequences for merchants, including upwards pressure on pricing.
        ii. A measure whereby acquirers give their cost for a limited number of likely transaction types would be a less intrusive, and more proportionate step.

Question 1: Do you have views on the provisional findings set out in this report?

4. Barclays broadly welcomes the Interim Report (***Report***) and endorses many of the findings. In particular:

    a. The PSR has correctly concluded that the market is working well for large merchants.

    b. The Report demonstrates the highly competitive nature of the acquiring market; with a large number of effective players; low barriers to entry and expansion; and strong evidence of innovation in the market.

    c. Barclays is pleased that merchants have reported uniformly high levels of satisfaction – providing strong evidence that the market is working well.

5. However, Barclays believes that the PSR has underestimated the level of pass through of interchange fee savings to SMEs due to an error in the adopted methodology. The PSR approach, that (i) groups merchants into categories based on turnover; and (ii) estimates pass-through based on simple average transaction values (***ATV***), fundamentally ignores market developments since 2015 - which have seen a significant increase in the volume of low ATV debit transactions. Consequently, the groupings proposed by the PSR, coupled with the decision to perform analysis on a percentage of total turnover basis, obscures key determinants of interchange fee pass-through, namely the volume of transactions and low ATV. [redacted]

6. Barclays disagrees with certain conclusions adopted in the Report, which do not follow from the evidence gathered by the PSR, notably:

    a. The evidence does not support the conclusion that the supply of card-acquiring services does not work well for SME merchants. The balance of evidence gathered in the Merchant Survey supports the opposite conclusion.

    b. The PSR does not properly recognise investments that have been made by Barclays (and likely other acquirers) in recent years to better serve SME merchants.

7. Each of these points is further discussed below.

The market is working well for large merchants

8. Barclays welcomes the PSR's finding that the market works well for large merchants. These merchants account for the overwhelming majority of UK card transaction volumes.

9. The PSR has found that there was full pass-through of savings associated with the Interchange Fee Regulation (***IFR***)[1] in relation to around 77% of the overall value of transactions in 2018. This underestimates the extent of the pass through of IFR savings (as discussed below); but in any case demonstrates that most IFR savings have been passed through by acquirers.

[1] Regulation (EU) 2015/751 of the European Parliament and the Council of 29 April 2015 *On interchange fees for card-based payment transactions*.

Positive outcomes are driven by a highly competitive market

10. Barclays' own experience is that the card acquiring market is highly, and increasingly, competitive. Barclays is pleased that this competitive dynamic at all levels of the market is reflected in the findings.

11. First, there are clearly low barriers to entry in relation to the supply of acquiring services to merchants of all sizes:

    a. The Report identifies entry and expansion in all merchant segments; despite looking at a relatively short period (2014 to 2018).[2] These findings are consistent with Barclays' own experience of an increasingly crowded and competitive market.

    b. The Report identifies several recent examples of successful market entry; driving falling shares of supply amongst the largest acquirers.[3] For example, the Report recognises that Adyen was able to enter the market and take a significant share of supply between 2015 and 2018.[4] The success of market entrants and shifting shares of supply provide compelling evidence of the highly competitive nature of the market – with larger acquirers being under constant pressure.

    c. The trend of entry and expansion is likely to have continued and accelerated since 2018; particularly in light of an increase in e-commerce and card-not-present transactions. This will further facilitate the growth of new and/or specialised acquirers/payment facilitators (such as Stripe and other Fintechs) who are able to offer integrated solutions in a nimble and efficient way, targeting SME merchants in particular.

12. Secondly, a broad range of effective competitors operate on the market. It is striking that the Report identifies over 100 acquirers and over 50 payment facilitators serving merchants in 2018.[5] Although the Report suggests that a limited number of acquirers account for a large proportion (95%) of transactions by volume, this still encompasses fifteen acquirer and payment facilitator brands;[6] a strong competitor set, with 'shares of merchants' split evenly between the various classes of 'main providers' of card acquiring services.[7]

13. PSR findings further show that this general competitive pressure on acquirers is supported by the ease with which merchants switch:

    a. The merchant survey showed 76% of merchants who recently switched found it easy; with nearly half of merchants who had switched provider reporting that "nothing" would have made them more confident in doing so.[8]

    b. Merchants at all levels consider searching and switching; even among SME merchants, 30% search for providers at least once every two years,[9] while most of those who do not do so cite as their reason high levels of satisfaction with their incumbent provider.[10]

---

[2] *PSR Card-Acquiring Market Review Interim Report,* September 2020, paras 4.77 to 4.82.
[3] *Ibid*, figure 3.
[4] *Ibid*, para 4.14.
[5] *Ibid*, para 3.44.
[6] *Ibid*, para 3.45.
[7] *Ibid*, figure 4.
[8] *PSR Card-Acquiring Market Review: Merchant survey results* September 2020, slides 29 and 30.
[9] *PSR Card-Acquiring Market Review Interim Report,* September 2020, para 6.13.
[10] *Ibid*, para. 6.94.

BARCLAYS

14. [redacted]

15. The competitiveness of market conditions is evidenced in the finding by the PSR that acquirer net revenue has remained broadly flat since 2014[11] [redacted] This shows that Barclays (with other market players) is having to work harder to stand still.

Market conditions have delivered high merchant satisfaction

16. Barclays is very pleased that the Report notes high levels of merchant satisfaction, for all merchant types. This shows that the acquiring market is delivering for merchants.

17. It is striking that all merchants report high satisfaction with:

    a. Customer service;
    b. Information provided to help merchants comply with rules relating to payment acceptance; and
    c. Information provided by providers in relation to the pricing of their card acquiring services.

18. It follows that the main reason some merchants might not look to switch acquirers is their satisfaction with an existing provider – this is borne out by the Merchant Survey.[12]

19. These highly positive responses from merchants are the context in which any remedies (discussed below) should be assessed. There is very strong evidence that the market is functioning well, is fiercely competitive, and delivers a service that merchants are highly satisfied with. The PSR should, therefore, approach any intervention with caution.

The rise in scheme fees has stabilised the MSC

20. Barclays is glad that the Report acknowledges the increase in scheme fees in recent years. The PSR's findings show that scheme fees – more than doubling over the period from 2014 to 2018 – have counter-balanced falling interchange fees, with a stabilising effect on the average MSC and acquirer net revenue being flat.[13]

The PSR's findings underestimate the pass-through of IFR savings to smaller merchants

21. Barclays recognises the PSR conclusion that merchants on IC++ pricing will receive full pass through of the savings associated with the interchange fee caps[14]. [redacted]

22. The PSR observation that the remaining merchants (i.e. those with an annual card turnover of up to £50 million) received little pass through of IFR savings [redacted]. Barclays is concerned that the methodology that the PSR has used ignores the decline in ATV across the reference period – leading to the inaccurate impression that no, or very little, pass-through has been achieved in merchant groupings 1-7.

---

[11] *Ibid*, figure 11.
[12] *PSR Card-Acquiring Market Review: Merchant survey results* September 2020, slide 40.
[13] *PSR Card-Acquiring Market Review Interim Report,* September 2020, figure 11 and para 5.10.
[14] *Ibid*, para 1.14. The PSR confirms that merchants on IC++ pricing represent c. 77% of the total transactional value across the market. [redacted]

23. In contrast, if declining ATVs are properly accounted for, and the pass-through analysis takes into consideration transaction volumes, rather than transaction values, it becomes clear that pass-through has been achieved across each of the 7 merchant groupings the PSR has identified.

24. More specifically, within each of the 7 merchant groupings, Barclays notes that differences exist between merchants – some have a high volume of low-value transactions, whereas others have a low volume of high-value transactions. Taking a simple ATV across these groupings ignores these differences, as a few very high-value transactions can skew the overall average.

25. [redacted]

[redacted]

26. [redacted]

BARCLAYS

[redacted]

27. [redacted]

<u>The Report is wrong to conclude that the supply of card-acquiring services does not work well for small and medium-sized merchants</u>

28. The finding that the supply of card-acquiring services does not work well for SME merchants is simply too strong a conclusion to draw on the basis of the evidence in the Report, which is, overall, highly positive.

29. As noted above, the Report contains evidence demonstrating the competitive nature of card acquiring at all levels; the range of acquiring options available to merchants (including new entrants, such as Stripe, that target smaller merchants); and, critically, the very high levels of satisfaction among merchants of all sizes. This overwhelmingly positive evidence cannot be set aside, simply because a very small number of SME merchants reported some concerns with searching and switching.

30. The Report also places too much emphasis on a comparison between SME merchants who <u>prefer</u> standard pricing, and corporate / IC++ clients. The PSR must recognise that there are important

differences in the demands of different types/sizes of merchants, as well as the nature of their businesses and the costs involved in supplying them with acquiring services. A comparison of pricing as between those two broad categories of merchants, cannot in itself reveal whether the market works well for one or the other. Acquirers face different costs and risk profiles in serving different types of merchants; and it is natural that pricing is similarly varied. [redacted]

31. The focus on pricing fails to account for the complexity of the market, and the fact that merchant decisions are often driven or influenced by non-price factors. Merchant acquiring has become an increasingly commoditised process and Barclays is pressured to innovate at various levels of the value chain to win customers, with merchant decision-making informed by various factors, such as:

    a. The ability to offer an end-to-end service to merchants, that can include card-acquiring, gateway and additional "bolt-on" services (e.g. FX, PCI DSS, POS terminals);
    b. Settlement times;
    c. Uptime/stability of the payment service;
    d. Range of card readers and screen-friendly payment acceptance solutions;
    e. Card-not-present and e-commerce expertise;
    f. Acceptance of a range of payment types, through multiple channels; and
    g. Customer service [redacted]

32. This commoditisation is part of a general trend whereby merchants can effectively demand more from providers, for less.

The PSR has not properly recognised investments made by Barclays (and, it is likely, other providers) in recent years

33. Barclays is disappointed that the PSR has identified, in general terms, a "mixed picture of the quality of service" from 2014-2018 and no overall "evidence of improved quality of service" or "investments in quality of service".[15]

34. In response to strong competitive pressure, Barclays has made very large investments in its acquiring offering, including:

    a. The introduction of Barclaycard Anywhere in 2015. This offers micro-merchants a pay-as-you-go" type of set up, with no contractual obligations, no monthly fees and no lock-in – giving small businesses the flexibility to switch and allowing them to manage costs more easily.

    b. [redacted] As a result, Barclays can now offer a single integrated platform with improved billing and settlement functions, and a simplified onboarding process. This improves efficiencies, customer service support and responsiveness.

[15] *Ibid,* paras 5.36 and 5.37.

c. The expansion of Barclays' card-acceptance capacity through the commercial agreements with Discover Global Network and UnionPay (both made in 2019). Barclays-acquired merchants can now accept a much wider range of cards, including those issued overseas.

35. These investments and upgrades constitute a necessary and concerted effort on Barclays' part to remain competitive. The PSR has recognised that these kind of investments (particularly in relation to the quality and range of card acceptance products) are likely to be more important to SME merchants.[16]

Question 2: Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

Potential remedy 1 – Contracts for card-acquiring services

36. Based on the evidence in the Report, Barclays does not believe this remedy is necessary. Moreover, it could impose a burden on acquirers that is disproportionate to the harm alleged - and risks having a considerable negative impact on merchants.

37. Should the PSR nevertheless wish to proceed with a remedy, Barclays notes, as set out in this response, that there are other, less intrusive, and more suitable ways of encouraging merchants to consider their card-acquiring need from time to time and whether to switch.

There is no need for an acquiring-contract remedy

38. Barclays considers that acquirer/merchant contract terms work well for merchants and do not present a barrier to switching. This aligns with the findings in the Report, which show that acquirer contract terms are not currently unduly restrictive:

    a. Merchants can generally terminate their acquiring contracts at short notice (one month).[17]

    b. The initial terms in acquirer contracts tend to be relatively short (12 months) and would not restrict merchants' ability to switch.[18]

39. [redacted] Merchants to which Barclays provides acquiring services are in any case free to terminate their contract at any time, and will only need to give 30 days' notice. There are no additional barriers to termination, and [redacted][19].

40. Thus, there appears to be general agreement that the terms of acquirer contracts with merchants do not create barriers to switching. As Barclays understands, the PSR concern is simply that these contracts do not do enough *proactively* to encourage merchants to switch. However, this conclusion is not supported by the evidence:

    a. Barclays' own business experience shows that merchants are able to, and in fact do, switch. [redacted]

[16] *Ibid*, paras 4.71 to 4.73.
[17] *Ibid*, para 6.64.
[18] *Ibid*, para 6.65.
[19] [redacted]

[redacted]

b. [redacted]. This appears to be in line with what the PSR has itself observed for the market more generally[20].

c. Barclays takes pro-active steps to stay in touch with its merchants, on a regular basis – this includes contacting **<u>all</u>** merchants by direct mail/ email each time we give notice of changes to terms and conditions. Merchants are also encouraged to use a wide range of other channels to reach Barclays, including through our website and social media platforms, but also via our inbound telephony team, to which all merchants have access. [redacted]. There are therefore a number of opportunities for merchants to raise queries on their acquiring terms.

41. The pace of market entry and expansion by new providers also demonstrates that merchants can and do move from their existing acquirer. The Report recognises the entry and rapid expansion of Stripe, in the smaller SME segment; large payment facilitators; EVO Payments; and Tyl, among others.

42. Evidence gathered during the Merchant Survey presents a similarly favourable picture of high levels of satisfaction by merchants with existing providers and very little evidence that merchants are not making conscious decisions about switching:

a. Among merchants who never shop around for different providers, a negligible proportion (2%) cited as their reason simply '*not having thought about it'*. This suggests there is a very small minority of merchants who are actually in need of a 'clear trigger to switch'.

b. This compares to the majority (54%) of respondents who did not shop around simply because they were satisfied with their current provider, or the strong minority (29%) who did not want to take the time or resource away from running their businesses. Clearly merchants are aware of the possibility of moving providers; but most take a proactive decision against exploring switching – generally because they are content with their current provider. For the large minority of merchants who elect not to devote time and resource to switching, because they do not consider it to be worth the distraction from their commercial priorities (running a business), forced switching / contract renewal would be a bad outcome.

c. There is, moreover, little evidence of merchants having long-term ties to an incumbent provider. Just one third of merchants reported having been with their provider for five years or more.[21] This can be contrasted with market reviews in other sectors that have shown much longer supplier relationships.[22]

d. Of merchants that had not considered switching over the last two years, only a very small minority (c 4%) cited contractual barriers to switching.[23]

[20] *PSR Card-Acquiring Market Review: Merchant survey results,* September 2020, slide 15
[21] *Ibid*, slide 11
[22] For example, the Competition Commission's Statutory Audit Services Market Investigation found that among FTSE 100 companies, 67% appointed their current auditor for more than ten years and 31% had audit engagements exceeding <u>twenty years</u>; see the Competition Commission's final report dated 15 October 2013, paragraph 8.
[23] *PSR Card-Acquiring Market Review: Merchant survey results*, September 2020, slide 25

43. Overall, Barclays sees no reason for the PSR to make any intervention in relation to acquirer and payment facilitator contracts with merchants.

The remedy would not achieve the PSR's goals

44. Given the overall high levels of merchant satisfaction outlined in the Report, [redacted] and the fact that just 1% of merchants said in response to the PSR survey that the expiry of a contract would make them consider switching in future, Barclays does not believe that the proposal to introduce a contractual end date would encourage significantly more switching.[24]

The remedy imposes significant burdens and risks a substantially negative outcome for merchants

45. The key concern with imposing a 'hard' end-date in an acquirer contract is that a merchant may suddenly, and unexpectedly, lose the ability to accept card-based payments if they have not proactively renewed their acquiring contract or switched provider, for any reason. This risk is greater for smaller merchants, which are more likely to fail to pro-actively renew their acquiring contract. It is a significant concern as the loss of ability to accept card based payments could result in substantial harm to a merchant.

46. As is made clear in the Merchant Survey, a large number of merchants do not want to bear the burden of cost and time involved in switching acquirers. For these merchants, an acquiring contract that continues on a rolling basis of successive short terms, once the initial contractual period has finished, [25]may be a convenient model, as it offers the certainty of continuity of service, but also the flexibility to change acquirer.

47. In addition a "contractual end-date" may have the effect of driving up acquiring prices and creating barriers to entry. More specifically:

    a. A hard end-date to merchant contracts may incentivise acquirers and payment facilitators to include longer initial terms in the merchant contracts, or apply additional fees (e.g. termination fees) to recoup costs incurred – both of which create an increased barrier to switching.

    b. While the Report identifies that larger acquirers typically have relatively short initial contract durations, this does not mean that those initial contract periods would be suitable for all suppliers. For example, new entrants seeking market penetration may offer more attractive (even loss-making) pricing in order to drive customer volumes. If contract terms are strictly limited, this is likely to be a less viable business strategy.

    c. Finally, more proactive contract-management – due to a requirement to actively renew or cancel acquiring services – will introduce an increased administrative burden (and cost) to acquirers. This may then be passed on in the form of higher prices to customers.

48. It would be disproportionate to impose these burdens and run the risk of these negative outcomes based upon the little evidence in support of the proposed remedy.

An alternative approach to 'trigger' switching

49. As explained above, Barclays sees a significant risk, and a variety of potentially negative consequences, to imposing a hard end-date to an acquirer contract.

50. While Barclays does not agree that any remedy is required in this area, an alternative (and lower risk) remedy to the hard end-date could be an obligation for an acquirer or payment facilitator to

[24] *Ibid*, slide 31
[25] [redacted]

provide periodic statement/review of costs and a reminder that the merchant has the right to cancel the acquiring contract – for instance on an annual basis.

51. While this remedy would still impose a burden upon acquirers, this would avoid the critical 'cliff-edge' risk for merchants and allow smaller merchants to elect when they wished to invest time in exploring switching options. As the PSR has not identified any material contractual bar to switching in acquirer contracts, this 'informational' remedy would be effective in addressing the PSR's concern that merchants require a 'trigger' to switch.

52. A variation on this alternative could include merchants being able to switch/re-contract when their pricing is revised upwards- [redacted]

<u>Potential remedy 2: ISO and acquirer POS terminal contracts</u>

<u>The proposed remedy</u>

53. In principle, Barclays is supportive of measures that may moderate POS terminal hire contracts, so that these are not materially out of step with contracts for card acquiring. However, we see two key concerns that would need to be addressed in designing an effective remedy:

    a. The powers the PSR has to implement/ enforce rules around POS terminal hire contracts, and [redacted]

    b. The practical difficulties associated with linking contracts for POS terminal hire and card-acquiring services - given that acquiring services and POS terminal hire are often governed by entirely separate contractual relationships.

<u>Concern 1: The power for the PSR to implement and enforce a remedy</u>

54. The PSR identifies a "regulatory gap", in respect of those merchants that hire a POS terminal from their acquirer or an ISO, but that fall outside the scope of the Consumer Credit Act 1974 as they are neither sole traders, nor small partnerships, nor other unincorporated bodies. As the Payment Services Regulations 2017 specifically except from their scope the provision and maintenance of payment devices[26], POS terminal hire agreements to these merchants are currently unregulated.

55. Any steps that the PSR intends to take in the context of this remedy would first need to address this regulatory lacuna, and more specifically:

    a. whether the PSR considers it has the regulatory power to address this gap – and, if so, how it intends to use these in a way that ensures fair and equal application across the market, [redacted]

    b. [redacted]

<u>Concern 2: 'Linking' contracts for card-acquiring services and POS terminals</u>

56. It is important to understand that POS terminal hire contracts may be wholly independent of an acquiring contract. Barclays may lease a POS terminal to a merchant as part of its acquiring relationship – but in the majority of cases, the POS terminal will be supplied to a merchant by a

[26] Schedule 1 Part 2(j)(vi) of the Payment Services Regulations 2017.

third party, e.g. an ISO.[27] [redacted]

57. As noted above, for any remedy in respect of POS terminal hire contract terms to be effective, it should apply to, and be enforceable against, [redacted]

58. The PSR would therefore need to consider how consistent rules around POS terminal provision can be implemented and, importantly, enforced, in the context of varying models of supply. [redacted]

Potentially negative outcomes

59. As is the case for acquiring contracts, there would be a risk that a 'hard-stop' POS terminal hire agreement could leave merchants suddenly unable to process payments, if they fail to renew or switch provider prior to the end-date. This could have a significant impact on business continuity.

60. While Barclays agrees POS terminals hire contracts should not have long, tacitly renewable terms, there are significant advantages to smaller merchants in allowing contracts to auto-renew. For that reason, rather than requiring contracts to have a strict end-date, Barclays suggests that the PSR should instead consider imposing limits as to the length of any auto-renewal period (for example, to a one-month rolling term only). The contracts may then be effectively terminable-at-will by merchants; while giving merchants flexibility as to if and when they want to change their POS terminal lease arrangements.

Interoperability of POS terminals

61. In the Report we note that the PSR refers to a lack of easy interoperability between POS terminals and acquirer services. We also note that the PSR does not propose a remedy regarding interoperability. Barclays is fully supportive of initiatives to harmonise terminal standards thereby increasing the ease of interoperability.

62. This is however an extremely complex issue with consequences that go to the integrity and security of the whole payment system. There will always be some measure of diligence required by an acquirer to satisfy itself that it is not compromising the integrity or security of the system when permitting payment instructions from a third party terminal.

63. If the PSR is considering a remedy regarding interoperability then we request that it consult with acquirers on the scope of any such remedy before publishing its Final Report.

[27] [redacted]
.

Alternative remedies

64. Rather than imposing restrictions around auto-renewal and contract duration, the PSR might consider instead limiting POS terminal suppliers' ability to charge termination fees in relation to POS terminal hire contracts.

65. The PSR has a model for this, in the form of the Payment Services Regulations 2017. If providers were prohibited from imposing termination fees beyond an initial term of six months, this would introduce a degree of alignment between card acquiring contracts and POS terminal supply, without mandating alignment for specific contracts.

Potential remedy 3: ISO and acquirer pricing of card-acquiring services

66. Barclays has significant concerns about the proposed pricing remedy. In summary there is no evidence that a PSR intervention is necessary. Furthermore, price-comparison measures could have very significant practical challenges and unintended adverse consequences. The measures that the PSR is considering are disproportionate to the harm alleged.

67. [redacted]

A pricing remedy is not necessary

68. In the Report the PSR provisionally concludes that current pricing structures create "*significant search costs*" for merchants, and that this "*restricts their willingness and ability to search and switch, or negotiate a better deal*".

69. Barclays does not believe that the Report contains evidence to substantiate that conclusion. Furthermore Barclays disagrees that merchants face significant search costs or that their willingness (or the ability) to switch, or to negotiate a better deal, is constrained. Accordingly, Barclays does not consider that a remedy is necessary.

70. More particularly, the PSR merchant survey confirms that:

    a. Only 3% of merchants that did not switch in the past two years feel that search costs are an impediment to switching [28] - and no merchants cited as a reason for not switching that they were not aware, or did not understand, that they might get a better deal elsewhere.

    b. 92% of merchants confirm that they receive enough support from their provider to help them comply with their requirements to accept card payments, and 89% confirm that they receive enough information from their provider to help them understand the price they currently pay for card-acquiring services.[29]

    c. 76% of merchants that do consider switching confirm that the process is "easy". [30]

    d. 88% of merchants that try to negotiate with their current provider are successful in getting a better deal.[31]

71. The survey does not offer any indication that current pricing models create significant search costs for merchants or that this forms a barrier to switching. The Report itself notes[32] that pricing is not the most important factor on which acquirers compete and that access to comparable, or better

[28] *PSR Card-Acquiring Market Review: Merchant survey results*, September 2020, slide 22
[29] *Ibid*, slide 17
[30] *Ibid* slide 29
[31] *Ibid*, slide 15
[32] *PSR Card-Acquiring Market Review Interim Report*, September 2020, para 4.59

quality information are far from decisive factors that could drive a merchant to a switching decision.[33] [34]

72. [redacted] New entrants at the lower end of the SME market (e.g. Stripe) have been able to obtain significant market presence in a short space of time, as the PSR acknowledges.

73. Taking all of the above together, Barclays is not convinced that the PSR has established that a pricing remedy is necessary – there is no obvious demand/need from merchants, and existing switching behaviour is such that the value-add of an additional measure to promote this even further is far from clear.

Simplifying price comparisons risks negative outcomes for merchants

74. The PSR recognises the inherent complexities of pricing for acquiring services in the Report - with headline rates reflecting a host of underlying variables[35], and additional incidental fees being charged in certain situations, e.g. chargebacks, international transactions. The IFR intends to resolve some of the complexity, by requiring acquirers to offer details of charges to merchants, if they so wish.

75. The PSR also recognises that it is a feature of the card-acquiring market that there can be significant variation in how acquirers/ISOs reflect this complexity in headline pricing – with some acquirers charging a higher headline rate that gives merchants a clearer upfront picture of expected costs, and others charging a lower topline rate, but recovering costs through e.g. additional charges.[36]

76. Further to what the PSR has already noted, Barclays draws out the key factors that drive this complexity:

    a. For many merchants, the pricing for acquiring services must reflect their specific acquiring demands (including their mix/profile of transactions, the number of anticipated transactions, cardholder profile etc). Any complexity in pricing is therefore reflective of merchants' needs and individual situations.

        i. Acquirers will accordingly need to be flexible enough in their approach to reflect the individual profile of each merchant, the economic risk that that profile represents to that acquirer (as not all acquirers will assess the same merchant in the same way) and the price that is charged. There must therefore be room for negotiation between acquirer and merchant to reflect these factors.[37] With the

[33] *PSR Card-Acquiring Market Review: Merchant survey results*, September 2020, slide 30.

[34] The Merchant Survey confirms that of the merchants that did switch in the past two years, only 10% note that having comparable/standard pricing information would have made them more confident, and only 6% say that better quality information would have the same effect. The vast majority of merchants confirm they receive enough information from their existing provider to understand their current pricing.

[35] With different rates applying to a transaction, depending on card instrument (credit or debit card), the payment scheme used to process the transaction, type of authentication (CNP/CP). *PSR Card-Acquiring Market Review Interim Report*, September 2020, paras 3.61-3.64, and 6.45-6.49.

[36] *Ibid*, paras 6.49 – 6.50

[37] [redacted]

exception of those that are on a fixed rate (e.g. Barclaycard Anywhere), one-size-fits-all approaches - such as those that would result from standardised pricing- would bypass for many merchants the specific nature of acquiring services and the negotiation that occurs between provider and merchant.

ii. In addition, if pricing is over-simplified, standardised, or based on some degree of harmonisation/uniformity, Barclays is concerned that merchants could experience worse outcomes. If acquirers need to cover their costs for a range of factors (including variations in types of transaction, different card schemes, incidental costs etc) and reflect this into a single, easily comparable price, the expectation is that this would put upwards pressure on that price, to cover off all variables and eventualities. In addition, a single price may reflect factors/situations/fees that are not especially relevant for all merchants in all cases (e.g. some merchants may never need to accept interregional card transactions – but would, through the flat rate, be indirectly paying for this). These two factors may result in merchants paying relatively more for their services, as there could be a mismatch between their individual profile and the more one-size-fits-all price they pay under a flat/standardised rate - which may in turn lead to sub-optimal outcomes.

b. The complexity of pricing is for a large part not within the control of the acquirer, but has its ultimate source in the payment schemes.

i. As already noted in our submission of 2 September 2019[38], Barclays is, as a member of the payment schemes, obligated to comply with scheme rules. These, in broad terms, cover specifications of what scheme fee Barclays will be liable to pay away in a wide variety of specific card payment scenarios, but also other standards, e.g. compliance with the Payment Card Industry Data Security Standard (***PCI DSS***).

ii. The scheme rules are [redacted] For clarity, each payment scheme of which Barclays is a member (which covers Visa, Mastercard, JCB and others) will have its own "compliance handbook" – and Barclays will have to comply with all conditions contained in each of those handbooks.

iii. [redacted]

[redacted]

Any step towards comparing pricing for acquiring services must therefore necessarily involve the schemes, to at least some degree, to reflect their role in imposing requirements on acquirers, and on overall market dynamics.

77. Taking these factors together, it is clear that comparing acquirer pricing in a standardised manner is complex, and different from price comparison for e.g. utilities, where there is uniformity across the product/service being supplied and where pricing is the only variable - with the consequence that it is much easier to compare providers, and much more likely for the market to organically develop price comparison solutions in response to consumer demand.

78. The complexities inherent to acquiring, and the bespoke nature of the pricing model mean, in consequence, that a full like-for-like price comparison remedy, that reflects all relevant factors for all types/sizes of merchant, will be extremely difficult to achieve in practice – and could require significant regulatory intervention, e.g. to harmonise the process that acquirers must follow when developing their pricing, and the factors that they can/cannot take into account when doing so.

79. As mentioned above, such measures, including harmonisation, or standardisation of pricing structures, do not necessarily lead to the best outcomes for merchants – because the price they pay may not necessarily align with the profile of their individual needs/requirements. In addition, Barclays is concerned that a more standardised model could have the effect that new and innovative pricing structures do not make it to market – and that, in effect, the standard model of pricing may act as a barrier to entry.

80. If the PSR envisages that the end stage solution of this remedy is to facilitate a full like-for-like comparison (for instance in the form of a price comparison website) that reflects inherent pricing complexity, then Barclays considers that this would require steps - from regulators, schemes, acquirers and others – that are disproportionate to any alleged harm that has been caused. The value add of additional measures seems modest from a merchant perspective, and could impose significant requirements on acquirers and ISOs.

81. Furthermore, unless very strictly designed there is a risk that a comparison may simply be misleading and incomplete – making it easier for merchants to make a comparison between providers; but not necessarily an effective one. As noted above, acquirers' headline rates do not necessarily reflect all the costs that a merchant may eventually incur, as scheme and other fees are not uniformly interpreted and implemented across the market. A merchant may, putting it differently, think that they are making a like-for-like comparison, without realising that additional fees may be payable as well.

[redacted]

82. [redacted]

83. [redacted]

84. [redacted]

85. [redacted]

a. [redacted]

b. [redacted]

c. [redacted]

d. [redacted]

i. [redacted]

ii. [redacted]

86. As noted above, Barclays does not believe that there is a convincing case that would justify taking a remedy at all.

Question 3. Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?

87. Barclays does not have comments in response to this question.

Question 4. How does COVID-19 impact on our review?

88. Barclays does not have comments in response to this question.

Bename

[redacted]
Date: 17 September 2020 14:02:00

Dear PSR

Having been sent your report from various parties and read it this morning I have the following which I hope will help and give a further insight into the UK's small Payments Iso community:

As an Iso Entrepreneur for over ten years I have built and sold one payments company [redacted] The leasing money a small Iso is paid from a 3 or 4 year lease, I am not aware of anyone selling 5 year leases and agree these are too long, can be a significant contributor towards the payment of the physical payment device. These devices such as the current models released to the market over the last year, the VeriFone V240, the Ingenico Move 5000 and the Pax S920 are all expensive to buy, approximately [redacted], with additional annual services payable for Support, Warranty and Swap out services annually coming in at [redacted]. Therefore a 3 year contract has a [redacted] price tag.
Then we have to factor in the cost of sale into the model, and this is key and where the SME gets added value from the small Iso community in UK Payments. Getting out in the marketplace and in front of the potential client is key. We can then explain the product, the reporting tools, demonstrate the product while they are there, they can see the speed of the transactions, understand the nuances of how a WIFI and Gprs combo product works and in which circumstances this can help them and additionally how a desktop PSTN IP combo product can work and provide very important resilience in their communications. We also provide a breakdown, to a switcher, of the ancillary costs which they are paying such as Pci, Pci non compliance, Authorisation fees, MMSC, Monthly management schemes and any other erroneous fees that crop up. A vast majority of merchants do not understand these costs and have never had them explained to them at the initial point of signing. It is an invaluable service.
Of course the lease money is not the only part of the business model that an Iso relies on, ultimately the transaction rebate is the key, however it is a contributor. Without it the Iso may require significant up front investment, this could infringe on the autonomy of the model and limit the scope of any new potential entrepreneurs entering the market as the equity value is no longer there.

Switching SME's who turnover £1 000 to £100 000 a month is our USP, we always explain where and how they are being over charged and always manage to save them on their MSC and other ancillary fees while providing a personal face to face service. Yes they maybe in a 3 or 4 year contract however this is worthwhile as we are saving them on average £600 annually, that is £2400 over four years, our interchange plus contracts allow us to offer great deals and something the larger providers and Acquirers will not entertain for small turnover businesses in the UK. A good analogy that we use when discussing a switch is a fixed rate fixed term mortgage. We fix their rental term and we fix their MSC rate giving them peace of mind for the long term. Many people like this and if it is not their cup of tea then shorter term options are of course on offer elsewhere in the market place today.

My fear is that we hand more power and see less competition for the big players from the US such as Izettle, Square and Worldpay and some of our huge UK Acquirers to leverage their immense commercial power, take control of the online presence from anyone else, buy the

payments product at a much reduced rate because of their buying power, or in some cases manufacture the hardware themselves as we are already seeing, and take control of the market place. Ultimately the pricing on offer could narrow, the lack of face to face sales will diminish and the end Sme customer will suffer.
We have converted and continue to convert many Sme clients from the Izettle, Square type offering. Here is a prime of example of UK businesses suffering from using an online facilitator without understanding the costs, getting charged [redacted] % on all cards and as their business grows paying an exorbitant amount on their MSC. We change this and reduce their rates typically down to [redacted] on debit. It represents a huge saving for them. And they get best or breed payment devices that do not need to tether to their phone, are very reliable and super-fast.

I hope this insight helps and would welcome any feedback, request for further information from you or inclusion in your final review.

Many thanks

[redacted]

Spaces, Albion House, High Street, Woking, Surrey, GU21 6BG
[redacted]

[redacted]

Breathe Payments

[redacted]

Date: 05 November 2020 09:48:16

Attachments: [redacted]

HI

I just wanted to put my views forward on this as a small business owner. I run an ethical card payments business offering businesses card payment solutions. We only talk to customers who contact us via our marketing channels and offer a cheaper solution to izettle type products, but they come with a [redacted] month or [redacted] month contract.

Moving to a max of 18 month contracts will mean that we are no longer able to profitably offer these services and to offer these businesses a lower cost solution to paying 1.75% per transaction.

For many businesses a longer contract is a better option and if they are an established business then this should cause no problems. I agree that anything longer than 36 months seems a little overboard and is not necessary, but stopping 36 month contracts will just lead to smaller businesses like mine being locked out of the market.

This seems like a barrier to entry and favours bigger corporate payment businesses with deeper pockets, so feels like it's actually anti competitive behaviour. It will only lead to a monopoly or oligopoly situation with bigger institutions like Worldpay winning even more customers and market share.

While I understand that there are a lot of smaller unscrupulous payment companies out there, I really worry that the findings and proposed plans won't help in a positive way.

Thanks

Regards

[redacted]
Breathe Payments
[redacted]
breathepay.co.uk

[redacted]

Br-dge

BR-DGE feedback on:

PSR Card Acquiring services

Interim report

Dec 2020

PSR stated objectives

Encourage merchants to shop around for card acquiring services and consider alternative payment services / methods

Consider consumers interests in terms of how they would like to pay

Create an improved environment for innovation

Increase market competition

Remove barriers for merchants considering searching or switching service providers

Minimise the “hassle” and risk in switching

BR—DGE

Considerations:

For larger merchants in particular the challenge can be more complex than just switching a payment service provider

In todays global markets diverse consumer preferences needs to be considered. It’s unlikely one payment provider can meet all the needs of the merchant and indeed it may not be wise to place “all your eggs in one basket” from a dependency perspective, resilience and commercial leverage.

Merchants need to consider wider aspects such as:

- Payment optimisation (reducing failure rates or mitigating the impact of service provider outages)
- Allowing consumers to pay with their payment preferences
- Catering for different geographical currencies and payment methods
- Controlling the end to end customer journey, including check-out, with supporting analytics to monitor performance
- Creating flexibility and agility to introduce new innovative alternative payment methods, without the integration and operational complexity

BR—DGE

Feedback on interim report findings

The PSR interim report is detailed and extensive, covering many stakeholders and aspects across the payments landscape.

However, we don’t see any reference to the role of payments orchestration as a capability and option to address the stated PSR objectives

We believe payments orchestration could address many of the objectives outlined in the report and make it easier for merchants to switch payment service providers, without the barriers alluded to in the report.

We recognise payments orchestration is a relatively new concept and we would welcome PSR to consider how it’s role could support and enhance payments opportunities and innovation for both merchants and consumers

Opportunities payments orchestration can offer

An independent payments orchestration service, acting in the interests of the merchant could provide the following benefits and opportunities:

- Make it easier for merchants to switch / introduce new payment services and methods without the integration complexity and mitigates the risk in changing
- Intelligent routing can ensure payments are routed in the most optimum way to ensure success, performance and cost
- Can mitigate the impact of individual payment service provider outages, ensuring consumer payments continue to flow
- With the ability to dynamically switch payment traffic between service providers, offers the merchant significantly increased bargaining power
- Offers a simple access to payments methods prevalent across the world, making it easier to enter new markets / attract new customers
- Offers a safe environment to innovate
- Gives control of the customer journey throughout the checkout process and underpinned by holistic analysis of all transactions to monitor performance and act on issues
- Creating market competition – by removing the "hassle" factor of switching, merchants will be more likely to shop around and introduce new services. In addition by making it easier for new payment providers to access merchants, enhanced competition can be created

BR—DGE

Thank you

Bridge
c/o Comcarde Limited
1st Floor, Stanhope House
12 Stanhope Place
Edinburgh, Scotland
EH12 5HH

[redacted]

[redacted]

BR—DGE

British Retail Consortium (BRC)

BRC response to PSR consultation:
Market review on supply of card-acquiring services, interim report

February 2021

Introduction

0.1 The British Retail Consortium (BRC) is the trade association for the retail industry – the UK's largest employer – with a membership accounting for half of all UK retail by turnover. Our diverse industry spans large multiples, independents, high street, and out of town retailers, from online to bricks-and-mortar, selling goods across all sectors to increasingly discerning consumers.

0.2 All BRC members have an interest in the UK payment system as one of the chief end-users. In fact, along with consumers, retailers are the most significant other end-user group, processing more than 50 million transactions per day and around £394 billion per year for products & services sold in store, online, and over the phone. A high priority for the BRC is therefore to seek an innovative, transparent, and competitive payments market for all retail end-users and their customers.

0.3 The BRC therefore welcomes this PSR Market Review and importance of it given the ever-increasing dependence on card payments among British businesses and consumers. Within the retail industry alone, cards were used to pay for £308.5 billion worth of goods in 2019, constituting almost 80% of retail purchases by value, or almost two thirds by volume. We are yet to see just how much the pandemic has shifted retail payments for the long-term towards cards, but there is little doubt that the share of card payments has grown substantially further in 2020, and with it the cost of payment acceptance (see section 4, below).

0.4 **Pace of regulation:** The BRC first presented evidence to the PSR in 2017 about card payments, raising concerns over findings now confirmed three years' later in the PSR's Interim Report, in particular, the increasing costs to merchants resulting from large payment card "scheme fee" increases (see section 1). The PSR subsequently promised to take "a look at the cards market" in its Annual Plan published in March 2018, with the Terms of Reference for this Market Review published in January 2019. It is disappointing therefore that it has taken so long to reach this Interim Report stage.

0.5 In the meantime, almost all of the problems identified in the Terms of Reference have become much worse, in particular, continuing rises in card scheme fees. For an industry as fast moving and changing as payments, swift and decisive regulatory action is necessary to protect end-users that suffer relevant economic harms. The BRC therefore considers that a much more agile approach to payment regulation is needed in what is still Europe's largest card market, with the reflexes to serve its businesses and consumers well.

0.6 Indeed, the PSR's Market Review marks the continuation of 30 years of UK and EU regulatory and competition law investigation into payment cards, first raised in BRC complaints to the EU in 1992[1].

0.7 **Terms of Reference**: We note that in its final Terms of Reference, the PSR said that the aim of the review was "to consider whether the supply of card-acquiring services is working well for merchants and ultimately consumers" and that the PSR review "would be mainly informed by stakeholders' concerns", in particular that:

[1] See Annex 1 below for further information.

- “savings made from the interchange fee caps introduced by the Interchange Fee Regulation (‘the IFR’) have not been passed on to merchants”;
- “the fees that card scheme operators charge to acquirers (called ‘scheme fees’) are increasing significantly”; and
- “there is a lack of transparency around the fees merchants pay to accept card payments”.

0.8 Furthermore, the Terms of Reference recognised that the supply of card-acquiring services depends on two main inputs, namely:

I. the supply of services provided by card acquirers; and
II. the supply of services provided by card scheme operators.

0.9 Notwithstanding this, the PSR decided that it would “not examine whether the supply of services provided by card scheme operators is working well for the users of card payment systems”[2]. The Terms of Reference did nevertheless acknowledge merchants’ concern that scheme fees have risen significantly in recent years[3] and said that it would “consider any effects of the services provided by card scheme operators […] to the extent that […] they may adversely affect the supply of card-acquiring services.”[4]

0.10 **Interim Report remedies:** The retail industry welcomes some of the individual remedies set out in the interim report. However, the BRC does not believe that the package of remedies goes at all far enough to tackle the problems identified in the PSR’s own findings (see section 2). Indeed, the alarming increases in scheme fees (see 1.1 a) – which are captured only in part by the Interim Report, given the limited window of data collection – are not addressed in the PSR remedies whatsoever.

0.11 **Interim Report findings:** In summary, the Interim Report provisionally found that, for the “largest merchants” (defined as annual turnover greater than £50m), the supply of card-acquiring services “works well”, whereas, for “small and medium-sized merchants” (annual turnover less than £50m), the market “does not work well”. The Interim Report therefore proposes measures that “[the PSR considers] will help [small and medium-sized] merchants get a better deal and lead to better outcomes for merchants, and ultimately consumers”, including:

- requiring all contracts for card-acquiring services to have an end-date;
- limiting the length of point of sale (“POS”) terminal contracts, ending POS terminal contracts that automatically renew, and linking the contracts for card-acquiring services and POS terminals; and
- making it easier for merchants to research prices and compare different offerings.

0.12 In comment, the BRC agrees that the card-acquiring market does not work well for smaller merchants. However, the BRC emphatically disagree that the market “works well” for larger merchants. Indeed, the market for supply of card-acquiring services does not work well for **any** size of merchants, small or large. Regrettably, the measures proposed by the PSR are unlikely to address these wider concerns.

0.13 In particular, the evidence in the PSR Interim Report itself confirms that services provided by card scheme operators are significantly “adversely affecting” the supply of card-acquiring services, and by far more than any other factor. The PSR is therefore duty-bound to address such concerns.

---

[2] Para. 1.15.
[3] Para. 1.14.
[4] Para. 1.19.

0.14 First, the Interim Report shows that increases in scheme fees have substantially exceeded increases in card acquirer margins (namely, "acquirer net revenue") over the period of the review (from 2014 to 2018), and that such scheme fee increases represent 50% of the reported interchange fee reductions over the same period. Namely, the Interim Report shows that average scheme fees increased by 0.06% (as a percentage of UK card turnover) from 2014 to 2018, from 0.03% to 0.09%[5]. In comparison, average acquirer net revenue increased by just 0.02%, from 0.12% to 0.14%, while average interchange fees decreased by 0.12%, from 0.35% to 0.22%.

0.15 Second, the Interim Report finds that card acquirers do not compete effectively for small and medium-sized merchants, in particular because of the "absence of published prices and complexity of comparing prices"[6]. The Interim Report does not, however, offer any explanation for this.

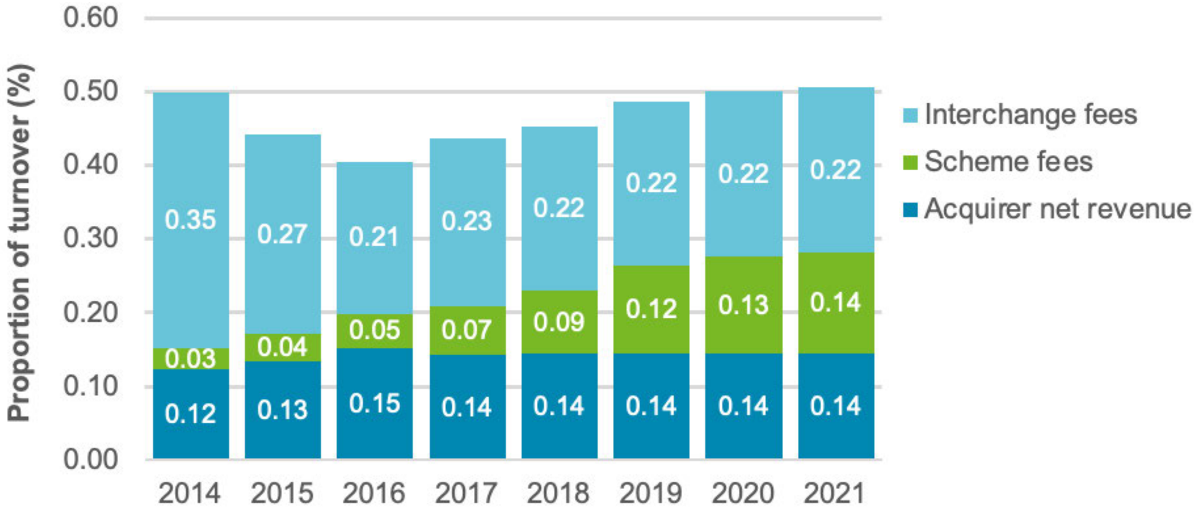
0.16 It is clear though that such "absence of published prices and complexity of comparing prices" is a direct consequence of card-acquirers' largest costs being outside their control – namely, the cost of interchange fees and scheme fees – and that such interchange and scheme fees are themselves subject to great complexity and frequency of changes[7]. Furthermore, card acquirers are specifically obliged by regulation to notify such interchange fees and scheme fees as "applicable with respect to each category and brand of payment cards" in their agreements with merchants[8]. Absence of published prices and complexity of comparing prices is therefore an inevitable and unavoidable consequence of the commercial and regulatory constraints on acquirers, except only for the smallest merchants that may be willing to accept "blended" acquirer pricing[9].

0.17 Given that these features of the services provided by card scheme operators – rises in scheme fees and complexity of scheme fees – are unambiguously "adversely affecting" the supply of card-acquiring services, the PSR is duty bound to address these as part of its review, as committed in the review's Terms of Reference.

0.18 In addition, BRC member data[10] shows that since 2018, average scheme fees have continued to increase by a further 0.05% of card turnover, from 0.09% at 2018 to 0.14% for 2021, based on the latest announced Mastercard and Visa scheme fee rises, a total increase of 0.11% since 2014. Hence, average scheme fee increases since of 2014, of 0.11%, combined with increases in acquirer net revenue, of 0.02%, have now more than offset reported average interchange fee reductions for the same period, of 0.12%. See Figure 1 below, which reproduces Figure 11 from the card-acquiring market review interim report (for 2014-18 data), combined with BRC member data for 2019-21. It shows the average merchant service charge ("MSC") as a percentage of card turnover split by interchange fees, scheme fees, and acquirer net revenue.

[5] Figure 11.
[6] Para. 1.14.
[7] Scheme fees and unregulated interchange fees have been subject to successive increases since the IFR came into effect, as well as the creation of multiple new categories of scheme fees, without any apparent justication or explanation, except to increase the card schemes' (and card issuers') profits.
[8] IFR, Article 9(2).
[9] Namely, without MSCs, interchange fees, and scheme fees individually specified for different categories and different brands of payment cards, as otherwise required by the IFR.
[10] Collected and analysed with the assistance of CMSPI (a global payments consultancy) and Zephyre (an antitrust advisory firm).

Figure 1: Average MSC as a percentage of card turnover split by interchange fees, scheme fees, and acquirer net revenue



Source: PSR Interim report (2014-18) data; BRC (2019-21 data).

0.19 Namely, Figure 1 shows that the average UK MSCs, as a proportion of card turnover, are now higher in 2021 than prior to the IFR coming into effect, in 2014. As is clear from the Figure, this is chiefly the result of large increases in scheme fees.[11]

0.20 Moreover, the BRC fully anticipates that – absent regulatory action – scheme fees will continue to rise rapidly. This expectation is based on combination of Mastercard and Visa statements (chiefly aimed to their shareholders), and on evidence of Mastercard and Visa scheme fees in other markets, especially the US.

0.21 We therefore do not consider that the PSR's proposed measures, which focus exclusively on card acquirers, will have any material impact on the concerns that merchants have consistently raised and which the PSR Interim Report now confirms.

0.22 The BRC therefore proposes several additional remedies (see section 3) to complement the PSR's own remedies. Primarly, this involves reform of the IFR – as it now applies in the UK (the "UK IFR") – to ensure effective regulation of all wholesale payment card fees (interchange fees and scheme fees). We also proposal a "portable accreditation" scheme for merchants to support ease of switching.

0.23 In particular, two chief reforms of the UK IFR are now needed:

I. abolition of interchange fees; and
II. bringing scheme fees within scope of the UK IFR.

0.24 First, abolition of interchange fees is needed to bring regulation into line with the decisions of the courts, in particular, the 2020 UK Supreme Court judgment in *Sainsburys v MasterCard*,

[11] We note also that Figure 2 is likely to understate the overall MSC, as it does not include increases in unregulated interchange fees since the IFR came in effect, in particular, of commercial card interchange fees, and of the card schemes' reclassification of regulated "intra-EEA" interchange fees (for cross-border transactions between the UK and EU) as unregulated "inter-regional" interchange fees.

Sainsbury's v Visa, and AAM v MasterCard; and Sainsbury's v Mastercard (see Annex A), and the associated anti-competitive prevention of competition that they create.

0.25 Second, bringing scheme fees within scope of the UK IFR is clearly needed given the evidence of how scheme fee rises have now entirely negated the purpose and effect of the IFR, as also recognised by other national regulators.

0.26 Furthermore, the BRC considers that abolition interchange fees and bringing scheme fees within scope of the UK IFR are fully within scope of the PSR's powers (and duties), without need for new legislation. This reflects that the PSR was primarily established as a "utility-style" economic regulator, namely, with powers and duties to regulate wholesale access prices to payment systems, such as interchange fees and scheme fees, in a similar way as the other main UK economic regulators, namely, Ofcom (electronic communications), Ofgem (energy), and Ofwat (water and sewerage services).

0.27 Alternatively, or additionally, we call on the PSR to refer the supply of services provided by card scheme operators to the Competition and Markets Authority ("the CMA") for market investigation under the Enterprise Act 2002 – given the clear evidence in the Interim Report of features of the market that appreciably impoact competition – an option that the PSR outlined in its Terms of Reference for the current review.

1. Do you have views on the provisional findings set out in this report?

1.1 The BRC welcomed this PSR Market Review into card-acquiring services and commends the extensiveness of the PSR's work, clearly evident in the Interim Report. We are encouraged by some of the PSR's findings which support the BRC's claims and the findings of our own research confirming that:

a) "Average scheme fees more than doubled over the period from 2014 to 2018, with most of this increase occurring between 2016 and 2018, after the IFR caps came into force… (and) scheme fees were passed through by acquirers in full." Indeed, we note though that Figure 11 of the Interim Report suggests that scheme fees – as a proportion of card turnover – increased by closer to three-fold between 2014 and 2018, from 0.03% to 0.09%. Based on BRC member data, since 2018, scheme fees have subsequently increased to 0.14%, an increase of five times (i.e. by 400%) since 2014 (see Figure 1 above). The BRC also anticipates scheme fees are to continue rising rapidly, based on combination of Mastercard and Visa statements, and evidence of scheme fees in other jurisdictions, especially the US.

b) "Merchants with annual card turnover between £15,000 and £50 million got little or no pass-through of the Interchange Fee Regulation (IFR) savings." We note that the Interim Report shows that this is chiefly due to increases in scheme fees, rather than by increases in card acquirers' margins. The BRC agrees that the card-acquiring market does not work well for smaller merchants. However, we emphatically disagree that the market "works well" for larger merchants. Indeed, the market for supply of card-acquiring services does not work well for any size of merchants, small or large.

c) “Acquirer pricing creates significant search costs for merchants because of the absence of published prices and the complexity of comparing pricing.” We note that such absence of published prices and complexity of prices is chiefly because card-acquirers’ largest cost is outside their control – namely, the cost of interchange fees and scheme fees – and that such interchange and scheme fees are themselves subject to considerable complexity, frequency of changes, and absence of publication[12]. Furthermore, acquirers are specifically obliged by regulation to specify such interchange fees and scheme fees as in their agreements with merchants. Absence of published prices and complexity of comparing prices is therefore an inevitable and unavoidable consequence of these constraints on acquirers, except only for the smallest merchants that may be willing to accept blended acquirer pricing.

d) “Restrictions on the merchant’s right to terminate will discourage merchants from searching for other providers and create a barrier to switching.” We note that this is primarily a contractual matter between merchants and their acquirers, albeit certain regulatory measures may assist in reducing such barriers to switching.

2. Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

2.1 The retail industry welcomes some of the individual remedies set out in the Interim Report. However, we do not accept that the package of remedies is sufficient or suitable to tackle the problems identified in the PSR’s own findings.

2.2 Of the three primary remedies set out by the PSR, the BRC supports the aims of each proposal on a) contracts for card-acquiring services, b) ISO and acquirer POS terminal contracts, and c) ISO and acquirer pricing of card-acquiring services. However, we consider that further steps are required to prevent unintended consequences for remedies a) and b), whilst remedy c) requires much greater intervention to achieve its own objective effectively.

Contracts for card-acquiring services

2.3 The BRC agrees with the PSR’s position that the indefinite duration of merchant contracts for card-acquiring services does not provide a clear trigger point for merchants to think about searching for another provider or consider switching.

2.4 Hence, the BRC supports the aim of the PSR in wishing to encourage merchants to shop around more regularly, of evaluating if their current provider still offers the best deal and considering alternative providers, or renegotiating with their current provider.

2.5 The BRC therefore supports the PSR’s proposed remedy to require all contracts for card-acquiring services to have an end-date for merchants with annual card turnover of up to £50 million. Nevertheless, the BRC is concerned at the potential unintended consequence to these retailers, either of:

a) seeing an unexpected abrupt and disruptive end to their card-acquiring service; or

---

[12] Absence of publication in the case of scheme fees and also until recently in the case of certain interchange fees, especially inter-regional interchange fees, in general, the highest priced interchange fee category.

b) risk-averse card acquirers being unwilling to renew or extend card-acquiring services to certain merchants, resulting in those merchants being unable to find an alternative card acquirer without impacting their cash flow or needing to offer extensive bank guarantees; or
c) being auto-enrolled onto new excessively priced contracts, as is common after so-called promotional periods come to an end for (for example similar to retail customers of mortgage, utility, telecoms, and other services).

2.6 The PSR should therefore consider additional steps to ensure that business end-users do shop around, but not that they are unfairly penalised when existing contacts end, such as protection against undue price rises or termination.

ISO and acquirer POS terminal contracts

2.7 The BRC shares the PSR's concern over the coupling of card-acquiring and POS terminal contracts for certain merchants, and the associated length of those contracts, automatic fixed term renewals, and termination fees.

2.8 As identified by the PSR in its key findings, "restrictions on the merchant's right to terminate will discourage merchants from searching for other providers and create a barrier to switching". These contracts indeed act as a barrier to switching.

2.9 The BRC therefore supports the PSR's proposed remedies of making it easy for merchants to exit POS terminal contracts if terms change in the card-acquiring services contract (including price) without incurring termination fees, and of ending POS terminal contracts that automatically renew for successive fixed terms, though rolling monthly contracts, without exit penalties, should be allowed as an alternative option.

2.10 The BRC also supports, in principle, the PSR's proposed remedy of limiting the length of POS terminal contracts to align with the 18-month limit set in the Consumer Credit Act 1974. The BRC is nevertheless concerned by the potential unintended consequence of higher costs through higher turnover of POS terminals. The PSR should consider additional steps to ensure that measures implemented for the protection of business end-users do not lead to a significant increase in cost or additional restrictions on end-users. For example, merchants should not be forced to change or upgrade their terminals at a cost simply to align with the introduction of new card scheme rules, as the result of such shorter mandated terminal contracts.

ISO and acquirer pricing of card-acquiring services

2.11 The BRC strongly agrees with the PSR's finding that pricing of card-acquiring services discourages searching and switching due to the absence of transparent published prices, and the complexity of comparing quotes, which together create a large search cost for merchants.

2.12 As above, such absence of published prices and complexity of prices is primarily because card-acquirers' largest cost is outside their control – namely, the cost of interchange fees and scheme fees – and that such fees are themselves subject to considerable complexity, frequency of changes, and absence of publication. Hence, imposing new obligations on acquirers alone, without addressing the corresponding complexity and variability of scheme fees, will not address the problem of difficulty of searching and switching. Indeed, requiring acquirers to provide published and comparable prices, without any such corresponding obligation on card schemes, is likely to impose an unfair and unreasonable burden on acquirers, or result in acquirers having to make large increases in pricing in order to mitigate the associated risk to them. We also question how such an obligation on acquirers is compatible with their pricing obligations under the IFR.

2.13 Indeed, the IFR and Payment Services Regulations ("PSRs") include requirements on payment services providers ("PSPs"), including acquirers, to provide information on all charges payable and provide certain information on transactions. Moreover, this is why acquirers do make available certain information to merchants on card transactions as they are obliged to. However, even the largest BRC members have complained of this information from their acquirers being often unintelligible, provided in unusable formats, and/or of long delays in the supply of this information. Such price information obligations on acquirers are of even less use to SMEs, given the complexity of such data in order facilitate basic checks and comparisons.

2.14 We note also that a secondary obstacle to published acquirer pricing is differences in risk between merchants. Namely, acquirers are liable to issuers (and cardholders) in the event of a merchant business failure or merchant fraud. Indeed, a large part of the role of an acquirer is to perform due diligence on prospective merchant customers and ongoing merchant monitoring. This can therefore result in legitimate pricing differences between merchants across sectors or between individual merchants according to risk profile (similar to insurance or credit pricing), thereby making it difficult for acquirers to offer guaranteed published pricing.

2.15 The BRC therefore shares the PSR's ambition to make it easy for merchants to research prices and compare different offerings, and the BRC support the PSR's aims to i) facilitate shopping around and increase customer awareness of the prices and offerings of different firms, and ii) enable easy comparison of firms' prices. However, to enable merchants to do this, the current plethora and complexity of fees must be significantly simplified, much in the same way that the IFR (and previous regulatory requirements) imposed obligations on the payment card schemes to simplify and publish interchange fees, which were previously subject to similar high levels of complexity and lack of transparency.

2.16 Accordingly, the BRC supports the PSR's proposal to deliver "enabling or enhancing tools to facilitate price comparison for merchants" and "requiring acquirers and ISOs to provide pricing information in an easily comparable format". Nevertheless, a remedy that only makes adjustments to existing information obligations will not be adequate to deal with the underlying complexity of pricing resulting from the card schemes' scheme fee pricing.

2.17 Further detail of how the BRC propose the PSR expand on this remedy is set out below.

3. Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?

3.1 In our view, the PSR's proposed remedies do not address the underlying problems identified in the PSR's own findings. Indeed, the alarming increases in scheme fees and anticipation of future ongoing scheme fee rises (see 1.1 a) – which are captured only in part by the Interim Report – are not addressed in any of the remedies proposed, despite the review's Terms of Reference's commitment to address "the effects of the services provided by card scheme operators to the extent that they may adversely affect the supply of card-acquiring services". Indeed, the two to three-fold increase in scheme fees since 2014 – documented in the Interim report – resulting in the IFR interchange fee reductions being substantially negated, is in our view, demonstrable evidence alone that such scheme fee rises are adversely affecting the supply of card-acquiring services. This is also of course at a time when the use of digital payments, particularly contactless card payments, have grown significantly resulting in greatly increased merchants reliance on card payments.

3.2 The BRC therefore calls on the following additional remedies to complement the PSR's Interim Report remedies, to support switching and the address harms to consumer and business end-users identified in the Interim Report:

a) **Reform the UK IFR – I. Abolish interchange fees:** The PSR should use its existing powers to abolish card interchange fees in the UK, to bring regulation into line with the decisions of the courts, in particular the 2020 Supreme Court judgment[13], that Mastercard's and Visa's UK interchange fees are unlawful.

b) **Reform the UK IFR – II. Bring scheme fees within scope of the IFR:** The PSR should use its existing powers to bring scheme fees within scope of the IFR, given that rises in scheme fees have now fully negated the intended purpose of the IFR.

c) **Enforce the IFR**: The BRC and EuroCommerce have brought several complaints to the PSR about likely infringement of IFR, but have not received timely (or in some cases any) formal response. As recognised in the European Commission's IFR assessment report, there is need for much greater enforcement and monitoring of industry with the IFR.

d) **Establish a portable accreditation scheme:** The PSR should promote common standards and interoperability, such as a "portable accreditation" report that summarises key merchant data such as volumes, value, and type of transactions being acquired to help facilitate the switching process for merchants, as well as prohibiting clauses that tie merchants to card-acquirers.

Reform the UK IFR – I. Abolish interchange fees

3.3 In June 2020, the Supreme Court confirmed that Mastercard's and Visa's multilateral interchange fees ("MIFs") are unlawful. It is therefore a considerable anomaly that the UK IFR continues to allow such MIFs. The PSR must therefore use its regulatory (and competition law) powers to bring the IFR (in the UK) into line with the court's ruling.

3.4 The Supreme Court found that Mastercard's and Visa's domestic and intra-EEA multilateral interchange fees for consumer debit and credit cards infringed TFEU article 101(1) and did not meet the exemption criteria under article 101(3), hence are unlawful. The Supreme Court ruling expressly stated that its finding was without prejudice to the IFR, namely, that Mastercard's and Visa's interchange fees since the IFR came into effect were equally unlawful as before the IFR. See Annex at the end of this response for further description as to the detail and context of the Supreme Court judgment.

3.5 The judgment also gave no grounds for distinguishing Mastercard's and Visa's commercial card or inter-regional interchange fees as being any more lawful than the domestic and intra-EEA consumer card interchange fees.

3.6 The IFR is itself explicit that its application is "without prejudice to the application of [EU] and national competition rules [and] should not prevent member states from maintaining or

[13] Sainsburys v MasterCard, Sainsbury's v Visa, and AAM v MasterCard;

introducing lower caps or measures of equivalent object or effect through national legislation"[14]. Namely, just because interchange fees are equal to or less than the IFR's regulated caps does not make them lawful. The Supreme Court judgment reaffirmed the same fact[15].

3.7 Moreover, the Supreme Court (following the Court of Appeal and the European Commission) specifically rejected the methodology for setting the interchange fee caps as applied in the IFR, known as the Merchant Indifference Test ("MIT"), as an appropriate basis for assessing the lawfulness of Mastercard's and Visa's interchange fees[16].

3.8 In addition, the levels of the interchange fee caps in the IFR, the of 0.2% and 0.3% for consumer debit cards and consumer credit cards, are based on considerably out of date sources. In particular, the IFR caps were based on the same caps as already adopted in the Mastercard 2009 Undertakings and Visa 2010 Commitments made to the European Commission. The Commission reported that these rates were themselves based on studies by the Belgium, Sweden, and Netherlands central banks, from 2004-07, comparing the costs of cards and cash. Subsequently to these Undertakings and Commitments, in 2015, the Commission published a new study comparing the costs of cards and cash (having taken 3 years to complete). This study shows that the MIT-based caps should be much lower than the IFR caps (close to zero, or even negative). The study also explicitly rejected the caps from the earlier central bank studies, saying that "the Central Bank studies did not provide comprehensive information on merchants' total costs of processing payments". The Commission study was nevertheless too late to include in the final IFR text, which had been approved in 2014 and due to come into effect from June 2015.

3.9 Furthermore, following the Supreme Court judgment, over 1,000 additional UK merchants have reasserted their claims for payment of unlawful interchange fees, with new merchants joining all the time.

3.10 It is not reasonable though that merchants should have seek such private enforcement of the law, at considerable cost to the court system, and to the merchants and ultimately consumers, when the PSR could enforce the law directly. Moreover, the effect of such private enforcement will itself create a significant distortion of competition between those merchants that secure repayment and cessation of interchange fees, albeit at considerable cost and delay, and those remaining merchants that continue to pay interchange fees and receive no recompense.

3.11 The UK of course is no longer bound by the EU IFR and the PSR has its own powers (and duties) to regulate interchange fees and to enforce competition law, in particular, as set out in PSR's statute and in the government's intentions in establishing the PSR, for example:

> *"[Designated payment system operators, such as Mastercard or Visa] will be required through statute to adhere to principles on:*
> - *Efficient and transparent pricing*
> - *Non-discriminatory access*
> - *Good governance.*
> - *Maintaining and developing the payment system.*
> - *Co-operation. [...]*
>
> *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 the payment system. [...] Where the regulator is not satisfied that the [payment system operator] is using an acceptable pricing methodology, and having*

[14] Recital 14.
[15] Para. 133.
[16] Para. 137.

given it sufficient opportunity to remedy the situation, the regulator will have the power to intervene to directly set prices for (1) direct access to a payment system, [...] and (3) interchange fees."[17]

3.12 Namely, over and above competition law, the PSR has its own duties and powers to regulate interchange fees directly.

3.13 By way of example, one of the chief ways that card interchange fees infringe competition law is by preventing, restricting, or distorting competition with rival payment methods, i.e. non-card based payments, such as "Open Banking"/PSD2-enabled "payment initiation services" ("PISPs"). Such new payment were expressly intended to compete with (and address the longstanding dominance of) card payments in the EU and UK. Card interchange fees nevertheless create a substantial and continuing incentive for banks to promote card payments over and above non-card payments, and continue to represent a considerable share of banks' overall income. For example, in the case of challenger/fintech banks, such as Monzo and Revolut, interchange fees can represent over 90% of their total revenue[18]. They also represent a sizable revenue share for all other banks.

3.14 In summary, the PSR must use its existing powers to abolish all categories of interchange fees in the UK, including consumer cards, commercial cards, and inter-regional cards, bringing regulation into line with UK competition law, as upheld in the courts.

Reform the UK IFR – II. Bring scheme fees within scope of the IFR

3.15 The European Commission's stated promise for the IFR was that "*It will lead to lower prices and visibility of costs for consumers*"[19] and, in particular, that "*It will cut the cost of payments substantially for merchants, especially SMEs and that in turn should lead to a fall in consumer prices*"[20].

3.16 It is clear though from the PSR Interim Report that the IFR has not achieved this promise at all, at least not in the UK. On the contrary, as the PSR has found, the IFR has not cut the costs of payments substantially for merchants, especially not for SMEs. Moreover, the BRC's evidence now shows that cost of card payments for all UK merchants has risen on average since the IFR came into effect. The PSR's (and BRC's) evidence shows that the overwhelming cause of this is rising Mastercard and Visa scheme fees. In order to have any prospect of achieving the IFR's objective – of lower costs of payments for merchants, and thereby for consumers – scheme fees must therefore be brought within scope of a revised UK IFR.

3.17 The problem of rising scheme fees has also recently been noted by US regulatory authorities, namely:

[17] HM Treasury, Opening up UK payments, March 2013, para. 4.14-41.6.
[18] See annual reports.
[19] Margrethe Vestager, Commissioner in charge of competition policy, reported in European Commission Statement/14/2767 "Commission welcomes political agreement reached by European Parliamentand Council on capping inter-bank fees for card-based payments", December 2014.
[20] Jonathan Hill, Commissioner for Financial Stability, Financial Services and Capital Markets Union, reported in same statement with Margrethe Vestager.

"Recognizing the burden imposed by high debit fees and the barriers to competition in the market for debit transactions, Congress sought to 'correct the market defects that were contributing to high and escalating fees' with the Durbin Amendment of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act […]. The Durbin Amendment aimed to reduce high fees charged by debit networks with a regulatory cap and increase the number of meaningful debit competitors.

But the Durbin Amendment caps only interchange fees that accrue to Visa's large issuing banks, and does not regulate the network fees that accrue to Visa. As a result, Visa has responded by imposing new fees on merchants that undermine the effectiveness of the Durbin Amendment's fee caps. Even after enactment of the Durbin Amendment, Visa estimates that it earns an 88% operating margin from its network fees on debit payments, illustrating its durable monopoly power."[21]

3.18 Regretably, merchants' – and regulators' – concerns with scheme fees is not a new one.

3.19 First, in 2009, following the Commission's 2007 prohibition of Mastercard's intra-EEA cross-border interchange fees, Mastercard made large increases in its corresponding scheme fees. Further to complaints raised by merchants about such fees, the Commission started new antitrust action against Mastercard, subsequently causing Mastercard to withdraw its scheme fee rises, as reported by the Commission:

"European Commissioner for Competition Neelie Kroes has indicated that, on the basis of information currently available, she [now] sees no need to pursue MasterCard for non-compliance with a 2007 Commission decision that MasterCard's cross-border multilateral interchange fees (MIF) were in breach of EC Treaty rules on restrictive business practices. Following the 2007 Decision, MasterCard provisionally repealed its cross-border MIF on 12 June 2008 but increased its scheme fees from October 2008. […] MasterCard has [now] agreed to withdraw as of July 2009 the increases of its scheme fees imposed in October 2008."[22]

3.20 Second, following Mastercard's 2008 attempt to raise it scheme fees, EuroCommerce raised concerns to the Commission that Visa would similarly seek to increase scheme fees if such scheme fee increases were not explicity prohibited, namely:

"EuroCommerce submits that increases in scheme fees have the same anticompetitive effects on end users as a higher MIF. […] A problem with [regulating just MIFs] though is that there would be no way to stop the card schemes significantly increasing the card scheme fees they charge acquirers (and which will be passed on to merchants) […] EuroCommerce therefore submits that any decision on the MIF should include strong restrictions on scheme fees. The fact that MasterCard committed to repeal its increased acquirers' scheme fees in April 2009 [under threat of new investigation by the Commission] reinforces this argument."[23]

3.21 In reply to such concerns, the Commission specifically assured EuroCommerce that Visa would refrain from increasing its scheme fees – following Visa's commitment to reduce its interchange fees – and that any non-compliance would be met with strict enforcement action, namely:

---

[21] *United States of America (Plaintiff) v. Visa Inc. and Plaid Inc. (Defendents): Complaint*, United States Department of Justice, Antitrust Division, 2020.

[22] Commission press release IP/09/515: "Antitrust: Commissioner Kroes takes note of MasterCard's decision to cut cross-border Multilateral Interchange Fees (MIFs) and to repeal recent scheme fee increases", 2009.

[23] EuroCommerce REPLY TO THE NON-CONFIDENTIAL VERSION OF THE STATEMENT OF OBJECTIONS ADDRESSED TO VISA EUROPE LIMITED, VISA INTERNATIONAL SERVICES ASSOCIATION, VISA INC. (CASE COMP/D1/39398/VISA MIF), 2009, para. 16.

"*As regards EuroCommerce's concern that Visa Europe could increase scheme fees or other charges […] the [Visa 2010 Interchange Fee] Commitments […] contains an anti-circumvention clause according to which Visa Europe shall refrain from setting and implementing other fees that are economically and/or legally equivalent to Intra-Regional Multilateral Interchange Fees applicable to Immediate Debit transactions, including but not limited to Visa Europe's scheme fees charged to acquirers and / or issuers. […] Non-compliance could lead to opening of proceedings or the imposition of penalty payments under Regulation (EC) No 1/2003.*"[24] (our emphasis added)

3.22 Accordingly, Visa made commitments in 2010 and 2014 to reduce its multilateral interchange fees containing specific undertakings that Visa would refrain from setting any new scheme fees charged to acquirers, namely:

"*During the period of these Commitments, Visa Europe shall refrain from setting, or in respect of the MIFs referred to in […] these Commitments implementing, other fees that are economically and/or legally equivalent to the MIFs referred to in […] these Commitments, including but not limited to Visa Europe's scheme fees charged to acquirers and/or issuers.*" (our emphasis)

3.23 The Commission considered the problem of scheme fees again in 2013, in the context of developing the IFR:

"*In 2009, MasterCard offered Undertakings to reduce its cross-border consumer MIFs […]; and it repealed the increases in its scheme fees to acquirers which could have had a similar effect on the market to MIFs.*

[…] Possible circumvention [of the Regulation] could be the increase of fees from card schemes to merchants, i.e. the raising of non-MIF elements of fees, paid by merchants directly to the card schemes."[25]

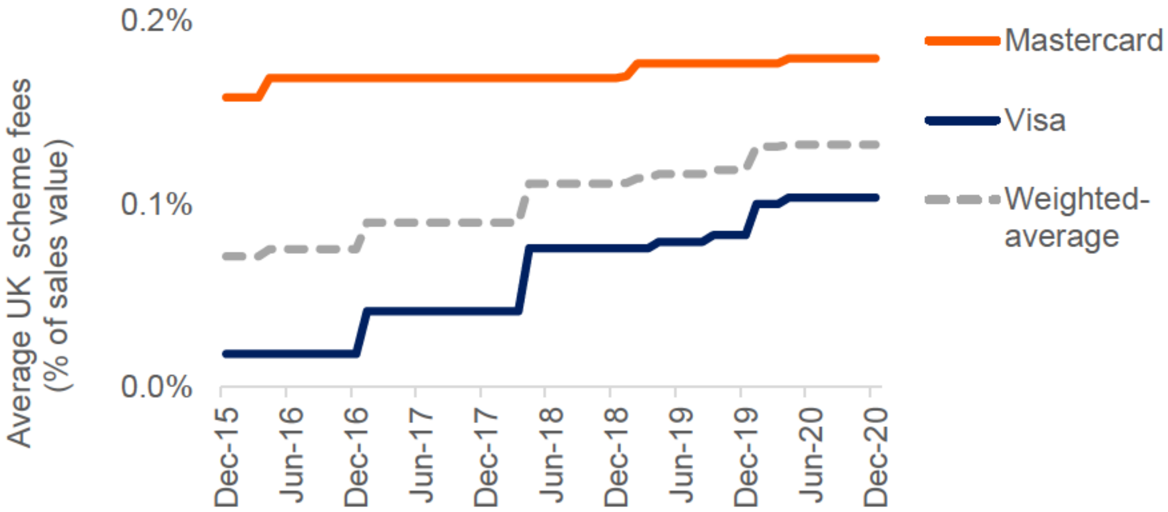
3.24 It is regrettable however that the text of the IFR did not carry over the same anti-circumvention provisions as contained in Visa's 2010 and 2014 Commitments, namely, that Visa shall refrain from setting other fees that are economically and/or legally equivalent to interchange fees Commitments, including but not limited to scheme fees charged to acquirers.

3.25 It evident therefore that Mastercard and Visa have treated the IFR as an invitation to increase scheme fees.

3.26 Figure 2 below shows Mastercard's and Visa's UK average scheme fees since the IFR came into effect, at the end of 2015. In particular, it shows the initial large gap between Visa's and Mastercard's scheme fees, with Visa's average fee at 0.02% of sales value, and Mastercard of 0.16%, followed by the progressive upward convergence in fees, Visa's rising to 0.10%, and Mastercard's to 0.18% by the end of 2020, and overall weighted-average fees rising from 0.07% to 0.13% over the period.

[24] ANTITRUST PROCEDURE Case 39398 –- VISA MIF: Public letter from the European Commission to EuroCommerce of 5th Jun 2012, European Commission C (2012) 4776 final.
[25] European Commission IFR Impact Assessment.

Figure 2: Mastercard and Visa UK average scheme fees has risen rapidly since the IFR came into effect.



Source: BRC member data.

3.27 As the Figure shows, Visa's scheme fees started at a much lower level than Mastercard's, reflecting that, up until 2016, Visa Europe was a non-profit member organisation, with scheme fees set to cover's Visa's central costs, but without a profit element. In 2016, Visa Europe merged with Visa Inc, a for-profit public company. Visa gave as the explicit stated rationale for the merger that Visa Europe would now operate as "commercial card scheme", namely, by rapid rises increases scheme fees. Moreover, Visa has repeatedly stated its intention to continue raising it scheme fees in regular public communications with its shareholders. In contrast, Mastercard has been a public company since 2006, so has already been operating on a commercial basis for a much longer period.

3.28 It is clear that there are two main pressures driving rising scheme fees (especially Visa's fees):

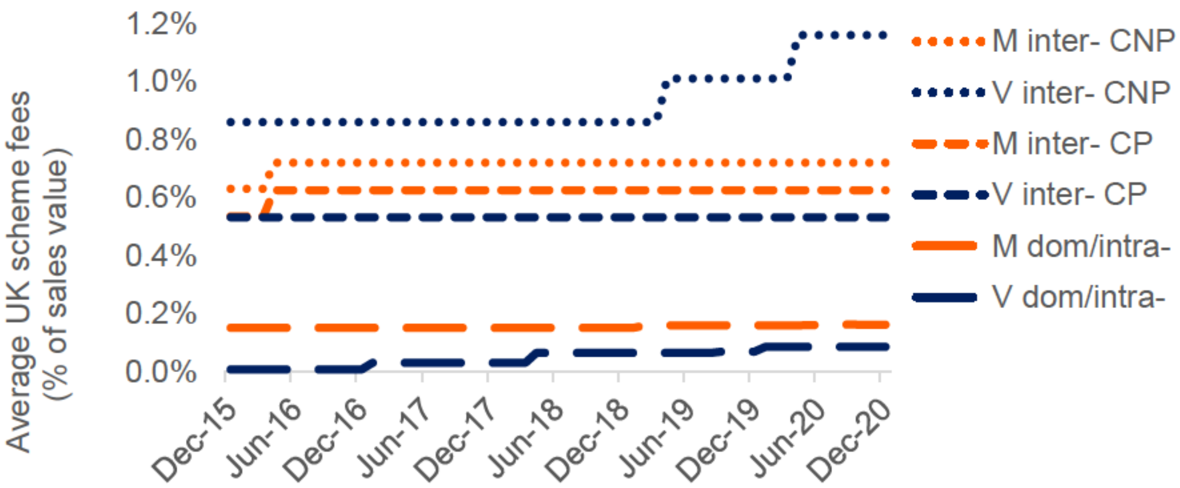
- pressure from shareholders to generate greater returns (in particular, pressure on Visa from shareholders to match Mastercard's scheme fee levels); and
- pressure on Mastercard and Visa to win and/or retain card issuers' business (by rebating scheme fees charged to acquirers as incentive payments to issuers).

3.29 One of the chief effects of Mastercard's higher scheme fees is that this gives Mastercard much greater funds to win issuers' business. This is clearly evident by Mastercard's success in winning an increasing share of the UK debit cards issued (with several issues having switched from Visa to Mastercard since the IFR came into effect, including Virgin Money, First Direct, Santander, TSB, and most recently NatWest, as recently announced), as well as the business of almost all the new UK and European challenger banks (including Monzo, N26, Revolut, Starling, and Transferwise). Hence, a large part of the rise in average scheme fees has been the result of Mastercard's increasing issuer share. This is an illustration of the highly perverse competition in the payments card market, that Mastercard and Visa "compete" with other by raising fees, thereby directly harming the chief users of payments, merchants and consumers.

3.30 Beyond the average scheme fees, Figure 3 below shows Mastercard's and Visa's respective scheme fees split by:

- domestic and intra-regional scheme fees (namely, scheme fees for transactions within the UK and between the UK and other EU member states up until Brexit); and
- inter-regional scheme fees (namely, scheme fees for transactions between the UK and any country outside the EU before Brexit, and any EU country after Brexit) split by card not present ("CNP") transactions (e.g. online or telephone-based payments) and card present ("CP"), i.e. face-to-face transactions.

Figure 3: Very large differences between domestic/intra-regional and inter-regional scheme fees.



Source: BRC member data.

3.31 In particular, Figure 3 shows an almost ten-fold difference between domestic and inter-country scheme fees, with domestic scheme fees in the range 0.08% (Visa) and 0.16% (Mastercard), but inter-regional scheme fees from 0.53% (Visa CP) up to 1.16% (Visa CNP). The Figure shows rises in almost all scheme fee categories, especially inter-regional CNP.

3.32 Mastercard recently announced the reclassification of transactions between the UK and EU27 (i.e. EU tourists visiting the UK and vice versa, and cross-border e-commerce sales and bookings) from "intra-regional" to "inter-regional" rates. This will itself have a double impact on UK merchants, namely, of:

- large rise in interchange fees, from the former regulated rates of 0.2%-0.3%, to Mastercard's inter-regional rates of 1.15%-1.50%; and
- corresponding rises in scheme fees, from around 0.2% to 0.6%-0.7%.

3.33 Mastercard's transaction reclassification will have the largest effect on travel sector and ecommerce merchants. Visa is expected to follow with a the same transaction reclassification shortly.

3.34 The PSR must therefore use its regulatory powers to bring scheme fees within scope of the UK IFR, namely, to regulate Mastercard's and Visa's scheme fees directly, as expressely required as part of the PSR's function, namely:

"[Designated payment system operators, such as Mastercard or Visa] will be required through statute to adhere to principles on:

- *Efficient and transparent pricing*
- *Non-discriminatory access*
- *Good governance.*
- *Maintaining and developing the payment system.*
- *Co-operation. […]*

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 the payment system. […] Where the regulator is not satisfied that the [payment system operator] is using an acceptable pricing methodology, and having given it sufficient opportunity to remedy the situation, the regulator will have the power to intervene to directly set prices for (1) direct access to a payment system, (2) indirect access to a payment system via an agency relationship and (3) interchange fees."[26]

3.35 Scheme fees are an example of such a "price" – paid by acquirers and merchants – for "direct [or indirect] access to a payment system", namely to Mastercard's or Visa's payment system. Hence, it is unambiguous that the PSR has both the power and duty to regulate such fees.

Enforce the IFR

3.36 The BRC and EuroCommerce have brought several complaints to the PSR about likely infringement of IFR, but have not received timely (or some cases any) formal response. As recognised in the European Commission's IFR assessment report, there is need for much greater enforcement and monitoring of the IFR: "Reinforced data collection, continuous and robust monitoring at both national and EU level together with consistent implementation of the existing rules are necessary to ensure compliance."[27]

3.37 The BRC has several examples of likely or potential non-compliance.

3.38 First, Article 5 of the IFR specifies that – for the purpose of the application of the regulated interchange fee caps – "any agreed remuneration, including net compensation to card issuers, with an equivalent object or effect of the interchange fee, received by an issuer from the payment card scheme, acquirer or any other intermediary in relation to payment transactions or related activities shall be treated" as being part of the interchange fee.

3.39 The BRC considers that various significant forms of agreed remuneration received by issuers from payment card schemes, acquirers, or other intermediaries in relation to payment transactions or related activities – including direct payments, incentives or fees, or indirect marketing incentives, bonuses, or rebates, and including special programmes carried out jointly by issuers and payment card schemes – have occurred since the IFR came into force and which have not properly been treated as being part of the interchange fee for the purpose of application of the interchange fee caps. Hence, such agreed remuneration to issuers represents a likely IFR infringement.

3.40 One example of this is the net consideration paid to Visa Europe card issuers as part of Visa Inc's acquisition of Visa Europe in 2016, of €17.7bn, i.e. the amount paid by Visa Inc to former shareholders of Visa Europe for the purchase of their shares of €19.4bn, from Visa Europe card issuers, over and above Visa Europe's fair value, of approximately €1.7bn. Such an amount paid to

[26] HM Treasury, Opening up UK payments, March 2013, para. 4.14-41.6.
[27] European Commission, Report on the application of Regulation (EU) 2015/751 on interchange fees for cardbased payment transactions, Brussels, 29.6.2020 SWD(2020) 118 final.

Visa Europe issuers – over and above the fair value of shares in Visa Europe – represented an upfront flow of fees from Visa Inc to Visa Europe card issuers in anticipation of future flows of fees from card acquirers to Visa, i.e. through the introduction of new or increased Visa scheme fees charged to acquirers. Such flows represent a "disguised" form of interchange fee payment, as prohibited by the IFR.

3.41 The BRC has raised successive written concerns to the PSR about the Visa Inc/Visa Europe transaction.

3.42 Second, it is widely understood from industry sources that certain payment card schemes have engaged in hidden "joint special programmes" with card issuers, whereby the card schemes have paid for or contributed to issuers' costs as a way to win issuers' business. Such hidden programmes and hidden payments would represent a further form of net compensation to card issuers, with an equivalent object or effect as interchange fees. We note in particular the successive switching of major UK card issuers from Visa to Mastercard, most recently NatWest.

3.43 The PSR considers that the PSR should use it powers – as mandated in by the IFR – to investigate such programmes, in order to monitor effective compliance with the regulation, to counter attempts to circumvent the regulation, and to take all necessary measures to ensure such compliance.

3.44 Third, in October 2015, immediately before the IFR came into force, Mastercard introduced a revised interchange fee structure for refund transactions in the Europe region, such that, in the event that a cardholder returns or cancels goods or services and pays a refund to the cardholder, the merchant will not receive a full refund of the original interchange fee paid, but only up to a cap of €0.05 (or equivalent non-euro amount).

3.45 This appears a self-evident circumvention of the IFR, by increasing the effective interchange fee paid from acquirers to issuers for Mastercard transactions. This has particularly impacted merchants with high average transaction values and high refund rates. For example, a merchant with a €100 average transaction value and 10% refund rate would pay an effective credit card interchange fee of 0.33% (rather than the 0.30% regulated cap). In contrast, Visa refunds interchange fees in full in the event of such refund transactions.

3.46 We understand that EuroCommerce raised Mastercard's refund policy repeatedly with the PSR.

3.47 Last, EuroCommerce has documented multiple other potential infringements of the IFR in a submission made to the European Commission calling for reform, and effective enforcement, of the IFR[28]. The Commission acknowledged EuroCommerce's concerns in its 2020 report on the application of the IFR.

Establish a portable accreditation scheme

3.48 For many (Tier 1) retailers, a full merchant accreditation is required to change acquirer and even for minor acquiring alterations such as a change of PIN pad or a change of card processing software on the POS.

[28] EuroCommerce submission to the EU Interchange Fee Regulation Review, February 2020.

3.49 A full accreditation follows card scheme rules and tests which can take between 8 and 12 weeks, depending on the speed of the acquirer, costing approximately £50,000 depending on the size of the merchant.

3.50 The BRC suggests that a "portable accreditation" could support the switching process for larger merchants, acting as a Current Account Switching Service of card-acquiring to help merchants reduce the time, cost and hassle of changing their card acquirer.

3.51 Our view is that if a merchant changes acquirer while all other factors remain constant (so the underlying platform is the same – hardware and software) then the merchant has already successfully accredited the platform and further accreditation is not required.

3.52 "Portable accreditation" would mean that the accreditation process generates a certificate for the retailer that can be presented to a new acquirer and accepted in lieu of a new accreditation process. Exceptionally, the new acquirer may ask for a small sample of transactions as "comfort testing", perhaps 5 test transactions covering the different ways a card can be processed.

3.53 The PSR should also consider how common standards and interoperability could help facilitate competition and switching, as well as prohibiting clauses that tie merchants to card-acquirers.

4. How does COVID-19 impact on our review?

4.1 The most recent BRC Annual Payments Survey shows that cards were used to pay for approximately £309 billion worth of goods in 2019 – accounting for almost 80% of retail spending even before the pandemic.

4.2 A range of sources indicate that the pandemic has gone significantly further to increase the UK's reliance on card payments, particularly Contactless payments.

4.3 The cost to the retail industry of processing card transactions remains very high, accounting for 61% of retail transactions, but 83% of retailers' cost of acceptance. Debit cards are around four times as expensive as cash to process, whilst credit cards are more than three times as expensive to process than debit cards, on a like-for-like basis.

4.4 Costs are only increasing further for end users, with evidence from annual BRC Payment Surveys showing that card scheme fees rose 39% in 2017 and 56% in 2018, measured as a percentage of retailers' turnover, with businesses having also received notices in the past year of new secure customer authentication ("SCA")-related fees that will now be charged for on-line payments – even if the transaction is declined!

4.5 Given this increasing dependency and increasing cost of card acceptance on top of already excessive charges, it has never been so important that the PSR take decisive action to protect consumers and businesses from the adverse impacts of market failures in Europe's largest card market, and that the supply of card acquiring services works well for merchants.

4.6 Furthermore, there has never been a more appropriate time for action following the Payments Landscape Review of HM Treasury and the PSR's future Strategy as well as this Market Review into card-acquiring.

5. We also want to hear from industry about actions it might take to address the features of concern we have identified.

5.1 The BRC shares the PSR's ambition to make it easy for merchants to research prices and compare different offerings, and the BRC supports the PSR's aims to i) facilitate shopping around and increase customer awareness of the prices and offerings of different firms, and ii) enable easy comparison of firms' prices.

5.2 The BRC believes switching and competition could be supported through a **merchant** finance information or price comparison resource, similar to MoneySavingExpert for consumers. However, a straightforward price comparison of card-acquiring services for merchants looking for the best deal is not possible today given the underlying complexity of card pricing set by the card schemes identified in the Interim Report.

5.3 Apart from the wide range of card interchange fees, the next biggest obstacle to transparency of acquirer pricing is currently scheme fees, which make it difficult for card acquirers to offer simple pricing. If interchange fees were to be abolished and regulation of the range and level of scheme fees by a national regulator (as set out above) imposed, the total wholesale fees associated with card payments would no longer hinder an easy comparison of the price of card acquiring services for business end users. Only then will the PSR's proposal to deliver "enabling or enhancing tools to facilitate price comparison for merchants" and "requiring acquirers and ISOs to provide pricing information in an easily comparable format" be realised.

5.4 "Payments orchestration" could also make it easier for merchants to switch payment service providers and we would welcome consideration of how it could support and enhance payments opportunities and innovation for both merchants and consumers. For larger merchants in particular, the challenge can be more complex than just switching a payment service provider as diverse consumer preferences also need to be considered. It's therefore unlikely one payment provider will meet all the needs of a merchant and indeed some retailers prefer not to place "all their eggs in one basket" for reasons of dependency, resilience and commercial leverage. Merchants also need to consider wider aspects such as:

- Payment optimisation (reducing failure rates, mitigating the impact of provider outages, speed and simplicity of the checkout process etc);
- Allowing consumers to pay with their preferred choice of payment;
- Catering for different geographical currencies and payment methods;
- Controlling the end to end customer journey, including check-out, with supporting analytics; and
- Creating flexibility and agility to introduce new innovative alternative payment methods, without the integration and operational complexity normally associated with it.

[redacted]

[redacted]

Annex 1: Sainsbury's v Visa/Mastercard Supreme Court judgment and background

6.1 In June 2020, the UK Supreme Court upheld a 2018 judgment by the Court of Appeal "concerning whether certain rules of the Mastercard and Visa payment card schemes have the effect of restricting competition, in breach of the Treaty on the Functioning of the European Union ('the TFEU') and equivalent national legislation"[29].

6.2 The Supreme Court judgment follows a 30-year history of complaints – first initiated by the BRC – and subsequent regulatory investigations, antitrust decisions, new regulation, and damages claims relating to the lawfulness of payment card interchange fees and other payment card scheme rules, in the UK and EU. This Annex summarises these developments.

6.3 First, in 1992, the BRC made a complaint to the European Commission that Mastercard's and Visa's interchange fees unlawfully restricted competition. In 1997, EuroCommerce (the leading European retail trade association) made a follow-up complaint, that Mastercard's and Visa's Europe-wide interchange fees – in combination with other card scheme rules, including the "no discrimination rule" ("the NDR") and "honour all cards rule" ("the HACR") – also unlawfully restricted competition.

6.4 The European Commission opened various investigations in reply to these complaints.

6.5 In 2000, the Commission subsequently found that Visa's Europe-wide multilateral interchange fees ("MIFs") represented a restrictive price agreement[30].

6.6 In 2002, the Commission exempted Visa's cross-border MIFs within the European Economic Area ("EEA"), known as "intra-EEA" interchange fees, following Visa's agreement to reduce these fees[31].

6.7 In 2005, the UK Office of Fair Trading ("OFT") found that Mastercard's intra-UK MIFs restricted competition under TFEU article 101(1) and were not exempt under article 101(3). On appeal, the OFT subsequently withdrew its decision (on procedural grounds). The OFT, and its successor, the Competition and Markets Authority ("the CMA"), continued to investigate Mastercard's and Visa's UK MIFs.

6.8 In 2007, the Commission found that, since 1992, Mastercard's intra-EEA MIFs had been in breach of TFEU article 101(1), and Mastercard had not proved to the requisite standard that the article 101(3) exemption criteria had been met, and hence prohibited Mastercard's intra-EEA MIFs[32]. Mastercard appealed successively to the EU General Court ("CGEU") and EU Court of Justice ("CJEU"), who rejected Mastercard's appeals, in 2012 and 2014 respectively.

---

[29] Supreme Court judgment in Sainsbury's Supermarkets Ltd (Respondent) v Visa Europe Services LLC and others (Appellants) Sainsbury's Supermarkets Ltd and others (Respondents) v Mastercard Incorporated and others (Appellants) [2020] UKSC24, June 2020.
[30] Commission Decision of 9 August 2001, Case No COMP/29.373 — Visa International (the "Visa I Decision").
[31] Commission decision of 24 July 2002, Case No COMP/29.373 — Visa International — Multilateral Interchange Fee (the "Visa II Decision").
[32] Commission Decision COMP/34.579 MasterCard COMP/36.518 EuroCommerce and COMP/38.510 Commercial Cards, 2007.

6.9 In 2008, the Commission announced new proceedings against Visa's cross-border intra-EEA consumer debit MIFs and Visa's HACR, leading Visa to make voluntary commitments to address the Commission's concerns[33].

6.10 In 2012, the Commission made further objections that Visa's intra-EEA consumer credit card MIFs and "cross-border acquiring rule" ("CBAR") violated EU competition law, leading Visa to offer new voluntary commitments to address these concerns[34].

6.11 In 2013, the Commission opened a further investigation into Mastercard's interchange fees for payments made by cardholders from non-EEA countries within the EEA (known as "inter-regional" MIFs) along with MasterCard's CBAR. This subsequently led to Mastercard offering voluntary commitments to reduce its inter-regional interchange fees combined with EU fines of €570 million[35].

6.12 In 2013, the Commission proposed an "ex ante" European regulation of payment card interchange fees and associated payment card scheme rules across Europe – the Interchange Fee Regulation ("the IFR"). After reaching political agreement, the IFR came into force from 2015. Owing to the IFR, the CMA announced that had ended its investigation of Mastercard's and Visa's UK MIFs.

6.13 In 2017, the Commission sent objections to Visa concerning Visa's inter-regional consumer card interchange fees, which led Visa to make voluntary commitments to reduce these fees[36].

6.14 Further to the 2012 GGEU judgment, UK (and other EU) merchants started issuing claims for damages against Mastercard and Visa in the English courts, for payment of unlawful MIFs. Many of these claims were settled, but three of the largest claims went to trial, in the Competition Appeal Tribunal ("the CAT") and High Court, namely Sainsbury's v Mastercard, 2016[37], Sainsbury's v Visa, 2017[38], and Asda, Argos, Morrison ("AAM") v Mastercard, 2017[39]. Of these, the CAT decided that Mastercard's MIFs were unlawful, while the High Court found the opposite. These judgments were each appealed by the parties and consolidated into a single trial at the Court of Appeal, in 2018.

6.15 At the Court of Appeal, the central question for the court to determine was "whether the setting of default [MIFs] within the MasterCard and Visa payment card systems contravenes article 101 of the [TFEU]"[40], of which three primary (and various other) significant questions arose, namely:

(i) **The article 101(1) issue**: "Do the schemes' rules setting default MIFs restrict competition under article 101(1) in the acquiring market, by comparison with a counterfactual without default MIFs?"

(ii) **The ancillary restraint death spiral issue**: "Should the schemes' argument that the setting of a default MIF is objectively necessary for their survival be evaluated on the basis of a counterfactual that assumes that the rival scheme would be able to continue to impose (unlawful) MIFs?"

---

33 Commission Decision Case COMP/39.398 - Visa MIF C (2010) 8760 final (2010).

34 Commission Decision Case AT.39398 –- VISA MIF C (2014) 1199 final (2014).

35 Commission Decision of 22 January 2019, Case AT.40049 – MasterCard II; and Commission Decision of 29 April 2019, Case AT.40049 – MasterCard II.

36 Commission Decision of 29 April 2019, Case AT.39398 – Visa MIF.

37 Sainsbury's v Mastercard [2016] CAT 11.

38 Sainsbury's v Visa [2017] EWHC 3047 (Comm).

39 Asda and others v Mastercard 2017 EWHC 93 (Comm).

40 Sainsburys v MasterCard; AAM v MasterCard; Sainsbury's v Visa [2018] EWCA 1536 (Civ).

(iii) **The article 101(3) exemption issue**: "If the setting of default MIFs infringes article 101(1), [then] should it have been held that the four conditions required for the application of the exemption in article 101(3) were applicable in these cases, and if so at what level(s) were the MIFs exemptible?"

(iv) **The quantum issues**: "Should any damages to which the merchants are entitled be reduced or eliminated because they passed the MIFs on to their customers?"

6.16 In conclusion, the Court of Appeal concluded that:

(i) **The article 101(1) issue**: The MIFs infringed article 101.

(ii) **The ancillary restraint death spiral issue**: The card schemes' "death spiral" argument was invalid.

(iii) **The article 101(3) exemption issue:** The Court of Appeal found that, in order to show that consumers receive a fair share of the benefits generated by the MIFs – for the purpose of satisfying the test for exemption under article 101(3) – Mastercard and Visa were required to prove that the benefits provided to merchants alone, as a result of the MIFs, outweighed the costs arising from the MIFs to merchants, without taking any account of the benefits received by cardholders as a result of the MIFs. The Court of Appeal thereby determined that the article 101(3) exemption issues should be remitted back to the CAT for reconsideration.

(iv) **The quantum issues:** The Court of Appeal found that the merchants do not bear the burden of proving the lawful level of MIF and, in assessing the quantum of damages, the court said that "the correct analysis is to apply articles 101(1) and (3) in order to determine whether or not the default MIF, as charged, is in whole or in part unlawful, and then to assess damages on the unlawful amount or level as so determined".

6.17 Mastercard and Visa (and AAM) subsequently appealed the Court of Appeal Judgment to the Supreme Court, on four grounds, namely:

(i) **The restriction issue**: "Did the Court of Appeal err in law in finding that there was a restriction of competition in the acquiring market contrary to article 101(1) TFEU and equivalent national legislation?"

(ii) **The standard of proof issue**: "Did the Court of Appeal find, and if so did it err in law in finding, that Visa and Mastercard were required to satisfy a more onerous evidential standard than that normally applicable in civil litigation, in order to establish that their MIFs were exempt from the prohibition on restrictive agreements pursuant to article 101(3) TFEU, because of the economic benefits to which they contributed?"

(iii) **The fair share issue**: "Did the Court of Appeal err in law in finding that in order to show that consumers receive a fair share of the benefits generated by the MIFs, for the purpose of satisfying the test for exemption under article 101(3) TFEU, Visa was required to prove that the benefits provided to merchants alone as a result of the MIFs outweighed the costs arising from the MIFs, without taking any account of the benefits received by cardholders as a result of the MIFs?"

(iv) **The broad axe issue:** "Did the Court of Appeal find, and if so did it err in law in finding, that a defendant has to prove the exact amount of loss mitigated in order to reduce damages?"

6.18 In judgment, the Supreme Court found:

(i) **The restriction issue**: The Supreme Court dismissed this ground.

(ii) **The standard of proof issue**: The Supreme Court dismissed this ground.

(iii) **The fair share issue**: The Supreme Court dismissed this ground, in particular, confirming that – in order to show that consumers receive a fair share of the benefits generated by the MIFs for the purpose of satisfying the test for exemption under article 101(3) – Mastercard and Visa were required to prove that the benefits provided to merchants alone, as a result of the MIFs, outweighed the costs arising to merchants.

(iv) **The broad axe issue:** The Supreme Court allowed this ground, on the basis that "The degree of precision [for quantification of the loss] requires a balance between achieving justice by precisely compensating the claimant and dealing with disputes at a proportionate cost."

6.19 The European Commission intervened in both the Court of Appeal and Supreme Court proceedings.

6.20 Furthermore, a large number of other merchant claims against Mastercard and Visa – by approximately 1,000 UK and EU merchants – are also still outstanding, stayed pending the Supreme Court judgment. In addition, many of these other claims expand beyond the Sainsbury's v Mastercard, AAM v MasterCard, and Sainsbury's v Visa claims, in also claiming damages in respect of Mastercard's and Visa's MIFs since the IFR came into effect, for commercial card MIFs, for inter-regional card MIFs, and for Mastercard and Visa "scheme fees".

6.21 As above, notwithstanding the Court of Appeal's remission of the article 101(3) exemption issues to the CAT, the Court of Appeal and Supreme Court held that, in order to show that consumers receive a fair share of the benefits generated by the MIFs – for the purpose of satisfying the test for exemption under article 101(3) – the card schemes are required to prove that the benefits provided to merchants alone, as a result of the MIFs, outweighed the costs arising from the MIFs, without taking any account of the benefits received by cardholders as a result of the MIFs.

6.22 In defence against the merchant claims, Mastercard and Visa have put forward multiple alleged benefits to merchants of MIFs, all of which were rejected by the Court of Appeal and Supreme Court, in particular:

- the "business stealing effect", namely "what merchants would pay from fear of losing business to rivals if they did not accept cards", on grounds that one merchant gains from such business stealing is other merchants' loss, but does not benefit all merchants in total; and
- other "net efficiencies" owing to the MIFs, including alleged "increase in card usage", on grounds that such increase in card usage is both unproven and, in any event, was unlikely to result in a benefit to merchants.

6.23 Further, in support of the Court of Appeal judgment, the European Commission said that:

- "[the judge in AAM v Mastercard] made a serious error treating so-called business stealing as a competitive advantage for the purposes of the Article 101(3) analysis"; and
- "[the judge in Sainsbury's v Visa was correct in finding that Visa could not support the claim that] Visa established to the requisite standard that UK MIFs contribute to net efficiencies […] on the evidence deployed at trial because it failed to establish that (i) MIFs incentivise issuers to take steps to stimulate card usage which they would not otherwise have taken; and (ii) that those steps did in fact lead to increased card usage than would have taken place absent the MIF"[41].

6.1 It is therefore implausible that Mastercard or Visa will now be able to prove that the benefits provided to merchants alone, as a result of the MIFs, outweigh the costs arising from the MIFs – the test set by the Supreme Court – especially given the Court of Appeal's emphasis that the cases

[41] EUROPEAN COMMISSION'S WRITTEN OBSERVATIONS to the Court of Appeal, OF 21 FEBRUARY 2018 and 6 APRIL 2018.

remitted to the CAT are for "reconsideration and not for retrial" and that the CAT is of course bound by the Supreme Court judgment. Hence it will be inevitable that the CAT will confirm that none of the relevant MIFs are capable of satisfying the test for exemption under article 101(3), and therefore that all such MIFs subject to the appeals were unlawful, as well as Mastercard's and Visa's MIFs more generally, namely, MIFs since the IFR came into effect, commercial card MIFs, and inter-regional card MIFs.

6.2 The other matter for remission to the CAT – the quantum issues – is not relevant to the lawfulness of the MIFs, but only to extent that the costs of the MIFs has been passed on from merchants to their customers.

6.3 The Supreme Court judgment also implies a strong case that Mastercard's and Visa's scheme fees are unlawful, especially to the extent that such fees have equivalent object and/or effect as the MIFs. In addition to infringement of TFEU article 101, a large number of merchants have alleged that such fees also represent a breach of article 102, for as being an unfair selling price set by dominant undertakings. These claims will be subject to trial in due course if they do not reach settlement.

Confederation of British Industry (CBI)

CBI

CBI response to the PSR Market review into the supply of card-acquiring services: Interim Report

About the CBI

The CBI is the UK's leading business organisation, speaking for some 190,000 businesses that together employ around a third of the private sector workforce. With offices across the UK as well as representation in Brussels, Washington, Beijing and Delhi, the CBI communicates the British business voice around the world.

This high-level submission was completed following consultation with the CBI's members from across the whole economy.

Our response

The CBI welcomes the PSR's card acquiring market review and its objective to assess how well the supply of these services is working. The COVID-19 crisis has changed shopping preferences, prompting a switch to increased levels of card acceptance in businesses across the UK. As the growth in card payments continues, it is critical to ensure the supply of card-acquiring services works for merchant businesses in the long term.

The CBI sees the UK's payment systems as a central pillar of the UK's infrastructure, enabling growth in the wider economy. The CBI holds a unique cross-sectoral perspective to ensure the corporate voice is at the heart of the debate over the future direction of financial services policy.

In this response, we highlight:

- The importance of having a regulatory framework focused on better outcomes, enabling choice and innovation in payments
- The importance of piloting the proposed measures to test the real impact with merchant businesses ahead of publication of the final remedies in 2021.

A regulatory framework focused on better outcomes

The future payments strategy will need to be based on driving better outcomes for users, looking at the set of social, regulatory and policy changes that can help deliver improved products and better experiences. A key part of this will be to ensure the card-acquiring services are working well for everyone, enabling competition for merchants and innovation in the interest of users.

The PSR is considering taking action on the indefinite duration of merchant contracts for card-acquiring services, the POS terminal contracts and the complexity of comparing the pricing of card-acquiring services. These remedies are designed to make it easier to search and switch to a new provider or a better deal.

In the CBI's view, the future framework for payments will need to encourage innovation, addressing present risks and opportunities and removing barriers to developing better products and services that can achieve better outcomes for all users in the payments eco-system.

The PSR's proposed remedies are a first step towards this framework, encouraging innovation and competition in the market. These remedies can also benefit smaller merchants, encouraging them to shop around more regularly, embrace innovations to achieve cost savings.

The importance of piloting to test the real impact with merchants

Although the CBI agrees with the overall principles of the review to increase competition and ensure better outcomes for merchants, the PSR needs to ensure they conduct a pre-assessment of the likely real impact for merchant businesses before fully finalising a set of remedies.

The CBI welcomes the PSR's efforts to ensure the supply of card-acquiring services is working for everyone and its ongoing engagement with industry stakeholders ahead of this interim review. However, given the impact of the COVID-19 crisis on payment methods and the UK's exit from the EU, the CBI believes piloting and testing should be a central focus ahead of the publication of the Final Report in 2021.

Conclusion

The CBI welcomes the PSR's efforts to improve competition in the supply of card-acquiring services. Whilst the future framework for payments will be defined by encouraging competition and enabling innovation, it will also need to ensure better outcomes for merchant businesses and ultimately consumers. Within this, the CBI believes a 'trial and test' approach to the proposed remedies would be a key element to consider as the PSR works towards the publication of its Final Report in 2021.

[redacted]

CMSPI

About CMSPI

CMSPI is a global leader in retail payments consulting. Our expert team works to empower the retail community with insights, expertise, benchmarking, and analysis to drive value in their payments supply chain. This consultation response was constructed by CMSPI's market-leading '*Insights Team*', which is made up of economists, data and statistical experts, and experienced payments professionals.

CMSPI Response to the Payment Systems Regulator (PSR)

CMSPI welcomes the PSR's review into the card acquiring market. We think there's great analysis and the recommendations will help to address some of the problems in the UK card market, but we believe further measures need to be taken to ensure all the issues identified by the PSR's report are addressed. Our consultation response focuses on 3 main areas where we believe the PSR should investigate in more detail: acquirer absorption, scheme fees and interchange fees.

Acquirer Absorption

The interim report suggests acquirers kept most or all the interchange savings intended for small merchants as well as large merchants on blended pricing structures. While the remedies outlined in the interim report will be beneficial for small merchants, we believe proper enforcement of article 9 of the Interchange Fee Regulation (IFR) will also be beneficial in reducing the cost of acceptance for all merchants.

Article 9 (1) of the IFR mandated that "Each acquirer shall offer and charge its payee merchant service charges individually specified for different categories and different brands of payment cards with different interchange fee levels unless payees request the acquirer, in writing, to charge blended merchant service charges". This was to ensure merchants automatically received the full benefits of interchange reduction.

However, many acquirers in the UK and Europe appear to have interpreted this as 'opt in' instead of 'opt out'. As a result, acquirers have been able to absorb a lot of the interchange savings intended for merchants. Like the PSR's interim report, the Ernst & Young study commissioned by the European Commission which included data from the UK, found significant acquirer absorption, estimating that 45% of interchange savings had been absorbed by acquirers.[1] We believe that the PSR should take a more active role in enforcing article 9 of the IFR which will reduce the cost of acceptance for merchants.

Scheme Fees

Merchants in the UK and Europe have seen huge scheme fee increases since the IFR. The interim report acknowledges that acquirer scheme fees paid to Mastercard and Visa approximately doubled between 2014 and 2018.[2] Furthermore, scheme fees have continued to increase even

[1] See European Commission Study on the application of the Interchange Fee Regulation, page 158.
[2] See Interim report of PSR Market review into the supply of card-acquiring services, page 10.

CMSPI
Oxford Place, 61 Oxford Street
Manchester, M1 6EQ
United Kingdom
+44 (0) 161 300 8767
info@cmspi.com
www.cmspi.com | @CMSpay

beyond 2018. Our estimates suggest that in the UK, average scheme fees have increased from around 5 basis points to 11 basis points (figure 1).[3] If scheme fees remain unregulated, they will continue to increase as seen in Australia and the U.S. (figure 1) where interchange regulation was introduced much earlier.

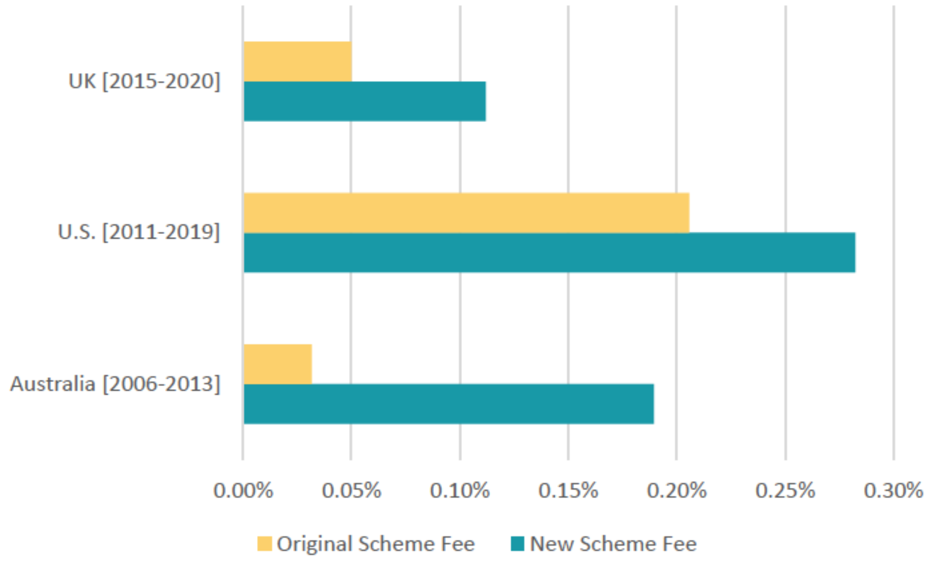


Figure 1 – Scheme Fee Increases by Region[4]

These scheme fee increases, in conjunction with acquirer absorption, are estimated to have completely eroded the benefit of the IFR in Europe where the average Merchant Service Charge (MSC) is estimated to have increased from 46 basis points in 2015 to 48 basis points in 2020.[5]

Interchange

As part of the ongoing merchant litigation regarding interchange fees, the UK Supreme Court found Multilateral Interchange Fees (MIFs) to be unlawful and in contravention of Article 101 (1) of the Treaty on the Functioning of the European Union and section 2 of the Competition Act 1998.

[3] CMSPI analysis.
[4] Europe and U.S. scheme fees estimated using retail data. Europe estimates include inter-regional transactions and exclude local networks. Percentage fees for Australia were calculated using average transaction value of card spend in Australia from Euromonitor. Australian scheme fee data from: https://www.rba.gov.au/publications/rdp/2014/pdf/rdp2014-14.pdf
[5] The estimate for the average MSC in Europe in 2015 has been taken from the European Commission's study on the Interchange Fee Regulation (EY Study). The estimate for the average MSC in Europe in 2020 is made using data from the EY study as well as analysis of retail data. For more information on sources, please refer to the Study published in the following press release: https://www.eurocommerce.eu/resource-centre.aspx#All/13565

Given that the most senior court in the UK has found the MIFs set by Visa and Mastercard to be unlawful, we believe there should be an investigation as to the necessity of ongoing interchange fees in the UK.

We have seen evidence of local card schemes functioning successfully without interchange fees such as BankAxept in Norway, Dankort in Denmark, and Interac in Canada.[6] Furthermore, abolishing interchange completely was also recommended in Australia by the Australian Productivity Commission in 2018.[7] This recommendation was made on the basis that the cost of a consumer's choice to use card payments is borne, in part or in full, by the merchant through interchange fees. While these costs may fund things like reward programs that are useful in expanding card networks in their infancy, a mature card market should not require such incentives. Further to this, our analysis suggests that issuing is profitable without interchange fees[8] with the great majority of issuing revenue coming from consumer overdraft fees on debit cards and interest fees on credit cards. For these reasons, we believe the abolition of interchange fees should be strongly considered by the PSR.

[6] BankAxept does not charge interchange fees for transactions at the point of sale and Interac have introduced a small interchange fee for contactless transactions.
[7] https://www.pc.gov.au/inquiries/completed/financial-system/report
[8] Our analysis suggests interchange fees constitute around 10% of an issuer's income, while their profit margins are typically 20-25%.

Elavon

FEEDBACK ON THE PSR's PROVISIONAL FINDINGS AND POTENTIAL REMEMDIES

[redacted]

[redacted]

Date: 09/02/2021

Re: *Elavon response to the Payment Services Regulator interim report on its market review into the supply of card-acquiring services*

Elavon is committed to providing our customers ("merchants") a positive experience and good outcomes throughout all stages of our relationship with them. We welcome the PSR market review into the supply of card-acquiring services in the UK and the assessment of how well it is working for merchants. We greatly appreciate the continued and open engagement from the PSR throughout the assessment, from scoping of the review to the proposed remedies set out in the interim report.

Whilst we believe the card-acquiring market works well for merchants in general, we recognise that for smaller merchant there are opportunities to further improve the market, including:

- Unreasonably lengthy Point of Sale ("PoS") contracts should not act as a barrier to merchants availing of better acquiring solutions or offerings; and
- Increased transparency and comparability allows merchants to make regular and informed choices about payment acceptance arrangements.

In the sections below we have set out our views on:

- The scope of the market review and its relevance for the proposed remedies;
- The role played by acquirers in protecting consumers; and
- The proposed remedies of the PSR to address the features of concern in the interim report.

We look forward to future engagement with the PSR in finalising and executing any outcomes of the review.

The scope of the market review and its relevance for the proposed remedies

The payments market is rapidly evolving. PSD2[1] and Open Banking, technological innovation and the role of fintech have resulted in an increasing number of payments market players providing new payment options to both consumers and merchants.

Card-acquiring is now only one of many payment options and even with respect to card-acquiring, the continued growth and importance of payment facilitators and payment gateways demonstrate the widespread diversification and evolution throughout all aspects of the payments market.

---

[1] The Revised Payment Services Directive (PSD2), Directive (EU) 2015/2366

Elavon believes increased competition is key to ensuring consumers and merchants continue to enjoy a positive experience and good outcomes. We also believe the proposed remedies developed by the PSR should apply to all payments market players.

While Elavon broadly agrees with the PSR assessment of the UK market for card-acquiring services in relation to point of sale devices, we believe the assessment:

- Did not fully consider the role and effect of key players in the payments market such as payment facilitators, marketplaces and payment gateways;
- Did not fully consider alternative payment method providers, i.e. non-card payments; and
- May not provide an accurate current reflection of an ever evolving market as data considered covers the period 2014-2018.

We believe that not fully considering these factors creates a risk of an incomplete assessment of the UK payments market as a whole, which may not reflect the full extent of competition in market.

An incomplete assessment of the market creates a risk the proposed remedies of the PSR will exclude certain payments market players in card-acquiring (payment facilitators, marketplaces and payment gateways) and therefore will not address any barriers to movement of merchants that are potentially created by those players. It could also lead to the exclusion of other sectors of the payments landscape in their entirety e.g. alternative payment methods.

Elavon also believes the scope of the market review did not consider the role acquirers play in both protecting consumers and in ensuring confidence in the payments system through the management of risk arising from delayed delivery and chargebacks. The assessment did not consider contingent liabilities for acquirers generated by this risk, or the capital requirements (and associated costs) that acquirers must hold in order to manage this risk.

Below, we expand on the risk posed by chargebacks and its implication for both acquirers and the payments market more generally. It is important to note alternative payment methods such as bank transfers do not require the provision of this level of protection to consumers and therefore providers of these methods do not incur the associated risks and costs which acquirers incur.

In light of these observations, it is Elavon’s view that the final remedies designed by the PSR should:

- Apply to the payments market as a whole and not be limited to acquirers and ISOs; and
- Reflect the level of protection provided to consumers by acquirers and ensure consistency of this level of protection across all payment methods, or alternatively, ensure that the risk to consumers through use of non-card payments is clear and transparent.

The role played by the acquirer in protecting consumers

Under card scheme rules, a consumer is entitled to raise a chargeback (for example, to seek refunds of the amount of a card transaction for goods or services they did not receive). Businesses that incur chargebacks are liable for them in the first instance. Typically, chargebacks are netted off against payments received by the acquirer from the card transaction revenue of the business.

However, in a scenario where a business is unable to fund the chargeback (for example, if it becomes insolvent) this liability will ultimately transfer to the acquirer. While this transfer service provides protection to the consumers and confidence to the payments system, it creates significant contingent liabilities for acquirers. [redacted]

- [redacted]
- [redacted]
- [redacted]

[redacted]

- [redacted]
- [redacted]

[redacted]

[redacted] In light of the significance of the risk faced by acquirers and the associated capital and funding costs, we believe that PSR's assessment of the payments market should acknowledge and consider:

- Chargeback risk and its associated capital and funding costs are significant for acquirers. Acquirers pricing and margins reflect chargeback risk and the continued growth of this risk;
- The significance of the chargeback risk and the capital and funding costs acts as a potential barrier to entry for new acquirers in the UK market for card-acquiring services.
- A process similar to chargebacks for payment methods other than card-acquiring. Alternatively, if other payments methods do not guarantee this level of protection then consumers should be made aware of this is in a clear and transparent way at the point of payment.

The functioning of the card-acquiring market

While we believe the card-acquiring market works well for merchants in general, we recognise that for smaller merchant there are opportunities to further improve the market. Notable findings from the PSR's merchant survey which support the assertion that the market is working well include:

- When the sample of merchants is assessed in its entirety, acquirers' margins have increased slightly (1 bps) during the period 2015-2018[2];
- The majority of the available IFR savings were passed-through to merchants, and the estimated benefit of the savings to these merchants was around £600 million in 2018 (noting that this saving was driven by merchants with IC++ pricing who received full pass-through);
- The PSR's merchant survey results indicate that merchant satisfaction with their main provider is high; 82% of merchants are satisfied with the customer service they received from their provider and 89% agree they receive enough information from their provider to help them understand the price they pay for card-acquiring services.
- The merchant survey results indicate there is a relatively high level of 'churn' or attrition in the payments market. Nearly two thirds (63%) of merchants surveyed had been with their main provider for less than five years, while more than half (54%) of merchants surveyed indicated they shopped around for different providers in the past.
- The merchant survey also indicates most merchants have found the experience of shopping around an easy experience: 51% of those that switched found shopping around an easy experience; 65% of those that considered switching found it an easy experience; and 80% of new merchants found shopping around an easy experience.

We believe further evidence of the market working well for merchants generally is the actions taken by acquirers to support merchants throughout the COVID-19 pandemic. In particular, fee postponement and fee waivers have assisted merchants manage the impacts of the pandemic on trading.

[redacted]

[Non-confidential response:] **The proposed remedies of the PSR**

Finding 1: Contracts for card-acquiring services

Elavon generally agrees that the indefinite duration of card-acquiring contracts could result in merchants not seeking out better card-acquiring solutions or offerings.

However, although the term of card-acquiring contracts is indefinite, the contracts themselves are not restrictive and merchants are able to terminate their contract after six months without termination fees. While Elavon does not apply termination fees to merchants who seek to exit their contract in the first six months, we are aware that other acquirers do charge these termination fees.

Given this level of flexibility for merchants, Elavon is concerned that fixed-term contracts may create additional obstacles to customers in exiting their card-acquiring arrangements. For example, if a merchant renews their contract after the fixed-term, acquirers may be entitled to re-apply a six month period clause, during which merchant must pay termination fee in order to exit the arrangement.

Furthermore the indefinite duration of contracts can also work in a merchant's favour. If contracts close after set periods then there would be a requirement to re-underwrite those customers. That may well deteriorate the terms that a customer receives or may prevent them securing card facilities at all if their

[2] Due to limitations with the underlying data our Economic Advisors were not able to reliable assess equivalent rate for 2014

financial situation has changed for the worse in the intervening period. Failure to secure successive card facilities then risks jeopardising the customer's business.

Conclusion

Elavon are supportive of the introduction of a 'prompt' mechanism informing merchants that they may consider, or switch to, another acquirer. We believe these prompts should be standardised across the industry to allow merchants compare 'like with like' and would welcome the opportunity to work with the PSR on designing a remedy which takes into account this requirement.

Finding 2: ISO and acquirer POS terminal contracts

Elavon agrees that unreasonably lengthy Point of Sale ("PoS") contracts should not act as a barrier to merchants availing of better acquiring solutions or offerings. However, we believe that any remedy to limit contract lengths should consider:

- The benefits ISOs bring to the payments market;
- The implications on ISO business models of shortened contract lengths; and
- The risk that the remedy may results in ISOs exiting the payments market.

We have also set out our recommendation on how we believe the terminal contract length concern may be addressed without the risk of ISOs exiting the market.

The benefits ISO bring to the market

There has been a proliferation of ISOs operating in the UK market since 2016 and we now annually receive hundreds of inquiries from ISOs about potential partnership arrangements.

ISOs generally focus on MSC price savings for merchants. Therefore, Elavon views that the growth of ISOs in the UK over the last five years has and will continue to increase options for merchants, drive competition and generate price reduction.

This viewpoint has been validated by our Economic Advisor's assessment of the data collected by the PSR review. The data demonstrates that ISOs play a significantly positive role in delivering better MSC rates for merchants. This assessment concluded:

- **ISO merchants with volumes < £180,000** on average received MSC rates **5% cheaper** than non-ISO merchants.[3] This is equivalent to a **£238 annual saving** for a merchant with volumes of £180,000;
- **ISO merchants with volumes between £180,000 and £380,000** on average received MSC rates **15% cheaper** than non-ISO merchants.[4] This is equivalent to a **£555 annual saving** for a merchant with volumes of £380,000; and
- **ISO merchants with volumes between £380,000 and £1 million** on average received MSC rates **13% cheaper** than non-ISO merchants.[5] This is equivalent to a **£870 annual saving** for a merchant with volumes of £1 million.

[3] MSC of 1.112% vs 1.244%
[4] MSC of 0.855% vs 1.001%
[5] MSC of 0.815% vs 0.902%

The implications on ISO business models on shortened contract lengths

The ISO business model is typically based on 36-month to 60-month contracts in order to recover costs and generate margin. Limiting of ISO contract lengths could have the following impact on the market:

- ISOs will seek an increase in their terminal rental (potentially in the region of 50% to 100%);
- If ISOs are unable to achieve higher terminal rental costs, they will compensate for lost income through higher MSC. This is likely to lead to merchants paying more overall on their bill;
- Reduced competition as:
  - Acquirer direct sales and large ISOs will leverage better financial positions to win shares;
  - Established but smaller ISOs will sell their business/portfolio and exit the market as their business model will no longer work; and
  - There will be no incentive for new ISOs to enter the market.

In summary, we are concerned that limiting an ISO contract length could ultimately reduce competition in the UK acquiring market and be detrimental to merchants.

Conclusion

It is Elavon's view that ISOs play an important role in providing merchants with choice and enabling costs savings. We agree that the length of terminal contracts should not act as a barrier in preventing merchants from seeking better acquiring offerings. However, any solution that is proposed should take account of the ISO business model and consider if the shortening of contracts could reduce options in the market; ultimately to the detriment of merchants.

We would welcome the opportunity to engage with the PSR on a potential remedy that ensures the benefits ISOs bring to the market are not negatively impacted.

Finding 3: ISO and acquirer pricing of card-acquiring services

Elavon agrees increased transparency and simplicity of pricing is particularly important to smaller merchants. Elavon has sought to meet this need through our '*Simplicity MSC Proposition*' which launched in the UK market in 2019.

In the section below we have considered the challenges with the standardised/published pricing approach; potential unintended consequences; and other factors we believe the PSR should consider before finalising its proposed remedy.

The challenges of standardised pricing

We note in the PSR's interim report that it raises concerns about "absence of published prices" and the "complexity of comparing" creating "significant search costs". However, the key challenge in producing a simplified or standardised schedule of pricing is the inherently complex cost base which acquirers face.

For example, the interchange and scheme fee costs of two transactions that may appear similar to a small merchant can range from under 25 basis points to over 300 basis points. This variation in cost base is derived from differences in modes of transaction acceptance; the card type and card brand used; geography; the average transaction value; and transaction security. In addition to this variable cost base, additional complexity is created by the fact that chargeback and credit risk (detailed in the sections above) must be reflected in acquirers' margins.

The variable cost base, combined with the pricing of chargeback and credit risk means that it is inherently difficult to develop a 'one size fits all' approach to the publication of rates in a way that will ensure competitive pricing for merchants and the prudent management of costs and risks by acquirers. We accept that simplified or standardised pricing can be produced for smaller merchants, however, as the transaction volumes of the merchants grow, so too does the level of unknowns and associated risks for acquirers.

Potential unintended consequences of the proposed remedy

To enable effective price comparison, a level of industry standardisation would be required. In order to achieve this standardisation, acquirers would need to 'blend' a number of factors from their cost base, including modes of transaction acceptance; the card type and card brand used; the average transaction value; and transaction security.

A potential outcome of this 'blending' is that acquirers may set their costs sufficiently high in order to protect themselves from the inherent volatility in the costs of these factors and their associated risks. This action by acquirers could lead to higher prices for merchants.

Other factors for the PSR's consideration

It is Elavon's view that many aspects of the UK acquiring market are working well for merchants and particularly larger merchants. This view is supported by the findings within the PSR's analysis and merchant survey. We also believe that merchants' decisions to switch provider are not solely driven by the price of the service they receive but also by its quality. For example, we would see little benefit for a merchant receiving a lower price in their MSC if it was accompanied by a higher fraud rate, higher levels of chargebacks, slower funding and settlement times and more frequent acquirer systems downtime.

It is Elavon's view that any proposed remedy by the PSR to address transparency and comparability should be based on a consideration not of price alone, but on the quality of the service provided, taking account of key acquirer performance metrics (i.e. fraud rates; level of chargebacks and defence rates; funding and settlement timelines; and acquirer systems' 'uptime').

Conclusion

We agree that a solution to provide transparency and comparability – to the extent it is both feasible and effective – are desirable goals particularly for small and medium-sized merchants (typically merchants with volume of less than £10 million). We would welcome the opportunity to work with the PSR on designing a remedy, enabling small and medium-sized merchants to make decisions on their card-acquiring services based on price and quality.

Next Steps

As noted in the introduction Elavon is committed to providing merchants a positive experience and good outcomes throughout all stages of our relationship with them. We welcome the PSR market review into the supply of card-acquiring services in the UK and the assessment of how well it is working for merchants.

We would welcome the opportunity to discuss our observations with you further and we look forward to continued engagement as you finalise your report and proposed remedies.

[redacted]

[redacted]

Electronic Money Association (EMA)

Electronic Money Association
Crescent House
5 The Crescent
Surbiton, Surrey
KT6 4BN
United Kingdom
Telephone: +44 (0) 20 8399 2066
www.e-ma.org

[redacted]
Payment Systems Regulator
12 Endeavour Square
London E20 1JN

By email: cards@psr.org.uk

9 February 2021

[redacted]

Re: EMA response to PSR Market review into the supply of card-acquiring services – Interim report ("MR" or "Report")

The EMA is the EU trade body representing electronic money issuers and alternative payment service providers. Our members include leading payments and e-commerce businesses worldwide, providing online payments, card-based products, electronic vouchers, and mobile payment instruments. Most members operate across the EU, most frequently on a cross-border basis. A list of current EMA members is provided at the end of this document.

I would be grateful for your consideration of our comments and proposals.

Yours sincerely,

[redacted]

[redacted]
Electronic Money Association

EMA Response

Initial EMA comments

Scheme Fees: The EMA considers that a competition review of a market should include a review of the price charged for services in that market. Acquirers charge merchants a fee, or merchant service charge (MSC), which comprises three elements - interchange, card scheme fees and the acquirer's fees. The Report comments extensively on IFR savings and the acquirer's fees. However, the assessment of scheme fees in Annex 4 is heavily redacted and the conclusions are not drawn out in the same detail in the report.

The EMA notes that limiting an assessment to two out of three of the components that comprise the price charged for services is insufficient to determine whether a market is competitive. The limited assessment of the Scheme fee component may have a significant effect on the final price paid by merchants. The conclusion stated in paragraph 5.49 of the Report, namely, "fees for scheme services paid by acquirers to Mastercard and Visa increased significantly between 2014 and 2018" would suggest this may be the case in the market for card acquiring services.

As the PSR finalises its findings and proposed remedies for the future, we would welcome greater recognition of the competitive constraints that exist and will increase from the broader payments ecosystem.

Proportionality of the remedies: It is in issue whether the savings made by a merchant on price are proportionate to the time and resources employed by the merchant to compare options and ultimately switch providers.

The EMA considers it would useful for the PSR to assess whether the savings justify the resources used by the merchant in order to switch, particularly as the Report notes most merchants made their savings simply by negotiating "with their provider – of those that do, nearly 90% are successful in negotiating better terms" [MR paragraph 6.37]. The report does not appear to present any evidence around the amount of savings made by those merchants, or whether they would have saved more, had they shopped around and switched provider instead. In other words, the value of savings for merchants, should the remedies proposed by the PSR be introduced, is unclear.

Findings and Proposed Remedies

PSR's overarching concern

The PSR identified three impediments to small and medium-sized merchants being able to search for and switch acquirers or negotiate a better deal with their existing acquirer.

Concern1

1.1 Prices are not published and therefore cannot be easily compared

Acquirer and ISO pricing creates significant search costs for merchants because of the absence of published prices and the complexity of comparing prices. [MR paragraph 6.97]

ISO and acquirer pricing of card-acquiring services discourages searching and switching due to the absence of published prices, and the complexity of comparing quotes, which together create a search cost for small and medium-sized merchants and large merchants with annual card turnover up to £50 million. [MR 7.48]
Once a merchant has decided to shop around, we want to make it easy for them to research prices and compare different offerings. [MR 7.49]
The aims of a remedy in this area would be to i) facilitate shopping around and increase customer awareness of the prices and offerings of different firms, and ii) enable easy comparison of firms' prices. [MR 7.50]
There are already obligations on acquirers to provide information to merchants on their prices. The IFR requires acquirers to offer and charge MSCs broken down for the various different categories of cards and different brands of cards with different interchange fee levels (Article 9(1)), and specify the amount of each MSC, and show the applicable interchange fee and scheme fees separately for each category and brand of card in their agreements with merchants (Article 9(2)). Article 12 IFR requires that merchants' PSP provide (or make available) certain information to the merchant on each card transaction (Article 12). The PSRs 2017 include requirements to provide information on all charges payable (Regulation 48) and provide certain information on transactions (Regulation 54). [MR 7.51]

<u>1.2 Measures proposed by PSR to remedy concern</u>
A remedy in this area would be designed to complement existing requirements and could take several forms, including:

- *enabling or enhancing tools to facilitate price comparison for merchants*
- *requiring acquirers and ISOs to provide pricing information in an easily comparable format.* [MR 7.52]

<u>1.3 Applicable law</u>

<u>Article 9 IFR</u>
1. Each acquirer shall offer and charge its payee merchant service charges individually specified for different categories and different brands of payment cards with different interchange fee levels unless payees request the acquirer, in writing, to charge blended merchant service charges. [IFR 9(1)]
*2. Acquirers shall include **<u>in their agreements with payees</u>** individually specified information on the amount of the merchant service charges, interchange fees and scheme fees applicable with respect to each category and brand of payment cards, unless the payee subsequently makes a different request in writing.* [IFR 9(2)]

<u>Regulation 48 PSR</u>
*(1) A payment service provider **<u>must provide to the payment service user</u>** the information specified in Schedule 4 (prior general information for framework contracts), either—*
(a) in good time before the payment service user is bound by the framework contract; or
(b) where the contract is concluded at the payment service user's request using a means of distance communication which does not enable provision of such information in accordance with sub-paragraph (a), immediately after the conclusion of the contract. [PSR 48(1)(a) and (b)]

<u>Regulation 54 PSR</u>
*(1) The payee's payment service provider under a framework contract **<u>must provide to the payee</u>** the information specified in paragraph (2) in respect of each payment transaction on paper or on another durable medium at least once per month free of charge.*
(2) The information is …

(c) the amount of any charges for the payment transaction and, where applicable, a breakdown of the amounts of such charges, or the interest payable by the payee; [54(1) and 2(c) PSR]

Regulation 40 PSR
(7) If the payment service user is not a consumer, a micro-enterprise or a charity, the parties to a contract for payment services may agree that any or all of the provisions of this Part [6] do not apply. [PSR 40(7)]

Article 2 (3) of the Annex to Recommendation 2003/361/EC of 6th May 200
Within the SME category, a microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million. [Article 2(3), Recommendation 2003/361/EC]

1.4 EMA comment
As a principle, the EMA supports price transparency. The EMA has previously supported regulatory information requirements giving effect to greater transparency of pricing at both a UK and European level. The EMA is of the view that price transparency can improve competition in the market.

However, we consider that the benefits of price transparency can be more limited in relation to services for business customers where the services are bundled or bespoke to the customer(s) in question. We also believe there may be a number of unintended consequences resulting from requiring fully transparent pricing for all acquiring services, which we have set out below.

Payment facilitators
The PSR may wish to consider whether acquirers publishing pricing may have unintended and negative effects on payment facilitators. The buy rate or margin a payment facilitator has agreed with their acquirer can be easily calculated by comparing the acquirer's price with the payment facilitator's price, revealing the payment facilitator's commercial arrangements with its acquirer to its competitors. This may have the effect of reducing the payment facilitator's (already small) margin and making it impossible for them to compete, thereby reducing competition in the market for acquiring services.

References to PSR and IFR charges disclosure requirements
The references to the information requirements set out in the IFR and PSR do not relate to the proposed remedy of a price comparison tool. The purpose of the above articles from the IFR and PSR is to require PSPs to disclose pricing information directly to the payment service user (i.e. the merchant) – not to disclose prices to third parties. Accordingly, the articles quoted above should not be used as a basis to support a price comparison tool or disclosing prices to parties outside the PSP / payment service user relationship.

The information requirements set out in regulations 48 and 54 of the PSR are contained in part 6 of the PSR. A PSP and a payment service user may agree not to apply part 6 (as well as certain regulations in part 7) permitting the payment service is not a consumer, micro enterprise or charity. Accordingly, a majority of merchants would not be classed as a micro enterprise and would likely not be afforded the rights in regulations 48 and 54 by their PSP.

Price comparison must be clear

The price of acquiring services is variable and depends on many factors such as the merchant's transaction volume, type of cards supported, total turnover, location of the transaction and certain other factors. As factors differ significantly between merchants, it would not be possible to disclose a general price for services. Any published price that was not tailored to a specific set of factors would have to be heavily caveated in order to not run the risk of being considered misleading and would therefore be of little value to prospective customers. Accordingly, any price comparison tool must be usable and acquirers must not be required to provide pricing information for the purpose of providing information.

Please further note that acquiring services are often bundled with other ancillary services and, therefore, displaying a true comparison is always going to be challenging. Ancillary services are arguably equally as important as core acquiring services as they are often the means through which the core acquiring services are delivered. Accordingly, comparing acquirers on solely the price for their core acquiring services is likely to be misleading, as some firms might subsidise their acquiring costs with higher costs for other ancillary services or vice versa. The price for acquiring services is not the only factor merchants consider when choosing an acquirer. We therefore consider any pricing comparison tool should take into consideration ancillary services offered by acquirers and not merely the acquiring service.

Concern 2

2.1 Merchant services contracts are entered into for an indefinite term therefore there is no trigger point to renegotiate or shop around

The indefinite duration of merchant contracts for card-acquiring services doesn't provide a clear trigger point for merchants to think about searching for another provider and switching and, for this reason, isn't in merchants' interests. This applies to both acquirer and payment facilitator contracts. [MR paragraph 6.97]

We want to encourage merchants to shop around more regularly – evaluating if their current provider still offers the best deal and considering alternative providers or renegotiating with their current provider. [MR 7.38]

2.2 Measures proposed by PSR to remedy concern

We're considering a remedy requiring all contracts for card-acquiring services to have an end date. This would apply to both acquirer and payment facilitator contracts. [MR paragraph 7.39]

This remedy would be targeted at contracts with small and medium-sized merchants and large merchants with annual card turnover of up to £50 million. However, rather than using an annual card turnover limit, there may be more practical ways to target merchants in this segment, such as applying the remedy to all merchants on standard pricing (many merchants with annual card turnover up to £50 million have standard pricing). [MR 7.40]

Contracts with no end date may provide benefits for some merchants. For example, merchants who want to renew with their provider do not need to invest time in agreeing a new contract and they also protect merchants by providing continuity of service for those who have forgotten to renew. This is something we would consider further if we decide to develop this remedy. [MR 7.41]

2.3 EMA comment

Imposing an end date on merchants' contracts for acquiring services will have a series of unintended consequences, with the ultimate effect of hindering competition. Imposing an end date will not only create uncertainty for merchants, but likely put them in weaker positions to negotiate their current terms or procure new terms.

We also consider that the causal link between the finding (merchants do not shop around) and the proposed remedy (imposing an end-date on merchant contracts) has not been substantiated. In other words, it is not immediately clear how the proposed remedy will address the findings. We would welcome additional analysis in this regard.

Uncertainty for merchants

Requiring merchant services contracts to terminate after a set timeframe would put merchants at risk of being unable to accept card payments and therefore, in some cases, be unable to trade. Merchant services contracts of an indefinite duration give a merchant certainty. Under a merchant services contract for an indefinite term, the merchant can continue with their business without the concern they will lose their acquiring partner at some stage in the future. Under merchant services contracts, acquirers are afforded certain termination rights and there is always a risk the acquirer will cease providing the services, however, these termination rights are specific. Usual termination rights given to the acquirer are in the case of (i) the merchant's default such as not paying charges that have fallen due for a set period of time, (ii) the merchant's insolvency, (iii) the merchant's failure to adequately fund a reserve account, (iv) fraud, (v) excessive chargebacks or an unforeseen increase in transaction volume or turnover and so on.

Accordingly, the merchant can feel secure that their contract for acquiring services will continue unless there is some fault attributable to the merchant (e.g. defaulting on the contract or becoming insolvent). We note that the majority of merchant responses to the PSR's survey indicated that switching provider was not a consideration as they were satisfied with the performance of their current provider.

Remedy does not distinguish between traditional and e-commerce merchants

There appears to be a lack of distinction between traditional and e-commerce (physical and online merchants) for this remedy. There are significant differences between tradition and e-commerce merchants in terms of their needs for acquiring services. There are also significant differences between merchants who have engaged the same acquirer for a significant time period (e.g. over a decade) versus merchants on short-term contracts with a one-month termination right for convenience. In contrast, neither this remedy, nor the other proposed remedies, distinguish between different types of merchants and specifically what affects them. The Report appears to assert that all merchants experience the same impediments to shopping around. As merchants' needs for acquiring services are so varied, this is unlikely to be the case.

It would be helpful if the PSR were to assess, in more detail, whether the same issues affected all merchants by category, e.g. traditional versus e-commerce or long-term versus short-term, and tailor remedies to the particular type of merchant rather than create a uniform remedy.

Finally, as aspects of the card-acquiring market have changed since the PSR initially conducted their research, as well as the research focussing on established market participants, it would be useful for the PSR to revisit their research by collecting further data and feedback from new entrants in order to update their findings.

Infringes parties' freedom to negotiate

This proposed measure also unnecessarily infringes on acquirers' and merchants' commercial freedoms to agree their own contractual terms. The specific circumstances of microenterprises with limited ability to negotiate the terms of their payment services contracts are already adequately addressed in the PSR by affording microenterprises equivalent rights to that of consumers. The proposed remedy is aimed at merchants with a turnover of up to £50 million. Merchants who are not microenterprises with a turnover of £50 million or more, are capable of negotiating their own commercial terms.

Other terms (than MSC) may be renegotiated
Requiring contracts for acquiring services to terminate after a set period of time and not automatically renew further puts merchants at a disadvantage as each time the contract is open, both parties have the power to renegotiate its terms. This means that, although the Report indicates that renegotiating is beneficial to the merchant because it results in a lower price for a standard transaction, other terms may also be renegotiated. For example, the contract may now contain a new term that requires the merchant to transfer additional funds to the reserve account.

Imposing an end date on merchant contracts is also disadvantageous for merchants as this measure may result in a merchant paying more at the commencement of the contract to fund implementation, particularly in the case of physical POS terminal contracts. Implementation and set up are steps the acquirer takes to invest in the relationship with their new customer. However, if the services are only provided for a limited time and that time is not sufficient to justify making such an investment, the merchant will be charged the cost of implementation up front.

Requirement to establish a reserve
An unintended consequence of this proposed remedy that could hinder competition relates to the merchant's reserve account. When procuring acquiring services, a merchant is often required by their contract with their acquirer to fund a reserve account. The funds in the reserve account are used as collateral in the event the merchant, and by extension, the acquirer, incurs liabilities such as chargebacks. When the merchant contract terminates *for any reason*, the acquirer is entitled by contract to hold on to the funds in the reserve account in case of trailing merchant liabilities, for example, an influx of chargebacks. Accordingly, shopping around could be expensive for the merchant as there may be instances where their previous acquirer has retained the funds in their reserve account (as allowed by contract), whilst the merchant is required to fund a reserve account with their new acquirer. This would likely be expensive for most merchants and in some cases, not feasible.

Information requirement
During the PSR webinar held on Wednesday 18 November, the PSR representatives indicated that it is not their intention for a merchant to experience "down time" or, in other words, to find themselves in a position where the merchant does not have any acquiring services by omission. The PSR representatives indicated this remedy may take the form of requiring the acquirer to engage with the merchant at certain points throughout the contractual relationship and notify the merchant of their right to shop around (i.e. the merchant's termination rights).

The EMA would support an information requirement such as a notification to merchants from time to time. However, please note the EMA would not support terminating a merchant's contract after a set period of time. We further note that the EMA would support a notification in the form of an email or by way of a notification in an online account, however, we would not support a notification in the form of a physical letter sent in the post.

Concern 3

3.1 Term of contacts for POS devices are too long

Acquirer and ISO POS terminal contracts with long initial terms or which automatically renew for successive fixed terms represent a barrier to switching. Typically, a POS terminal from an acquirer or ISO (or from a third-party POS terminal provider working with such firms) cannot be used with another provider of card-acquiring services. To change provider of card-acquiring services, merchants need to terminate their POS terminal contract. Long initial terms, of three to five years, or contracts that automatically renew for successive fixed terms, where the merchant cannot terminate before the end of the minimum or renewal term without incurring early termination fees, affect merchants' willingness to search for other providers and switch and are not in merchants' interests. Some merchants will be prevented from switching to a different provider because the financial cost of doing so is too high. Some merchants may be able to absorb this cost, but many will be unwilling to do so. [MR paragraph 6.97]

3.2 Measures proposed by PSR to remedy concern

- Limiting the length of POS terminal contracts, for example to align with the 18-month limit set in the Consumer Credit Act 1974.

- Ending POS terminal contracts that automatically renew for successive fixed terms.

- Linking the contracts for card-acquiring services and POS terminals, where they are sold together as a package by acquirers or ISOs. For example, by making it easy to exit POS terminal contracts if terms change in the card-acquiring services contract (including price) without incurring termination fees. [MR paragraph 7.44]

These remedies would apply to acquirers and ISOs. They would not apply to payment facilitators, who sell card readers to merchants upfront. [MR 7.45]

3.3 EMA comment

Further clarification

The report does not appear to comment on the reason as to why contracts for POS are so long, for example, three to five years in some cases. The PSR may wish to explore this further before designing the final remedy, and elaborate further on this matter in the Final Report. The more in-depth the investigation, the greater the opportunity to develop remedies that will prove to be the most effective in the long run. Accordingly, it would be useful for the PSR to review the data collected with respect to this finding and collect more data if necessary to determine why POS contracts are lengthy. The reasoning for lengthy POS contracts may lead to the PSR considering a different remedy (i.e. more effective remedy).

Consumer standard not applicable to incorporated businesses

The Consumer Credit Act 1974 extends its protections with respect to hire agreements, to individual consumers and partnerships of two or three partners. The Consumer Credit Act 1974 does not provide protections to incorporated businesses with an annual turnover of up to £50 million. Unless the contracting merchant is an individual or an unincorporated partnership or two or three partners, the Consumer Credit Act 1974 would not apply to the agreement and therefore cannot be used as a standard to align the term of a POS contract.

Frustration

The EMA considers that the most effective proposed remedy of the three POS-related remedies, is the third and final remedy i.e. to link contracts for POS with the contract for acquiring when POS and acquiring as sold together as a package. This would give effect to the doctrine of frustration of contract, which is a long-established doctrine of common law now codified in statute. In the event the contract for acquiring was terminated and the POS could not be used with a different acquirer, arguably, the merchant would be able to discharge the contract for the POS due to frustration.

A contract may be discharged on the ground of frustration when something occurs after the formation of the contract which renders it physically or commercially impossible to fulfil the contract, or transforms the obligation to perform into a radically different obligation from that undertaken at the moment of entry into the contract.

Here, it is impossible to continue using the POS because it cannot be used with a different acquirer and there is a good argument that the contract is frustrated.

We would welcome clarification on what the PSR means by "linking" in the context of this proposed remedy. Please note that the contracts for acquiring and POS are offered by different parties i.e. the acquirer and the ISO respectively. We would therefore welcome further information on how the PSR intends for these two contracts to be linked, for example, a contractual mechanism.

Members of the EMA, as of February 2021

AAVE LIMITED
Account Technologies
Airbnb Inc
Airwallex (UK) Limited
Allegro Group
American Express
Azimo Limited
Bitstamp
BlaBla Connect UK Ltd
Blackhawk Network Ltd
Boku Inc
CashFlows
Circle
Citadel Commerce UK Ltd
Coinbase
Contis
Corner Banca SA
Crosscard S.A.
Crypto.com
Curve
eBay Sarl
ECOMMPAY Limited
Em@ney Plc
emerchantpay Group Ltd
ePayments Systems Limited
Euronet Worldwide Inc
Facebook Payments International Ltd
Financial House Limited
First Rate Exchange Services
FIS
Flex-e-card
Flywire
Gemini
Globepay Limited
GoCardless Ltd
Google Payment Ltd
IDT Financial Services Limited
Imagor SA
Ixaris Systems Ltd
Modulr FS Europe Limited
MONAVATE
Moneyhub Financial Technology Ltd
MuchBetter
myPOS Europe Limited
Nvayo Limited
OFX
OKTO
One Money Mail Ltd
OpenPayd
Optal
Own.Solutions
Park Card Services Limited
Paydoo Payments UAB
Paymentsense Limited
Payoneer
PayPal Europe Ltd
Paysafe Group
Plaid
PPRO Financial Ltd
PPS
Remitly
Revolut
SafeCharge UK Limited
Securiclick Limited
Skrill Limited
Soldo Financial Services Ireland DAC
Stripe
SumUp Limited
Syspay Ltd
Token.io
Transact Payments Limited
TransferMate Global Payments
TransferWise Ltd
TrueLayer Limited
Trustly Group AB
Uber BV
Vitesse PSP Ltd
Viva Payments SA
WEX Europe UK Limited
Wirex Limited
WorldFirst
WorldRemit LTD

Federation of Small Businesses (FSB)

8th December 2020

Via Email to: cards@psr.org.uk

Market review into the supply of card-acquiring services: Interim report

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to the above-named consultation. The Federation of Small Businesses (FSB) is the UK's leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that's led by our members, for our members.

Our mission is to help smaller businesses achieve their ambitions. As experts in business, we offer our members a wide range of vital business services, including legal advice, financial expertise, access to finance, support, and a powerful voice in government. FSB is the UK's leading business campaigner, focused on delivering change which supports smaller businesses to grow and succeed.

Our lobbying arm starts with the work of our team in Westminster, which focuses on UK and English policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

The work and role held by the Payment Systems Regulator (PSR) is vital, as it has the capacity to help strengthen the choice and fairness of a critical market that so many small businesses use each and every day.

Transparency in this area has often been lacking, with many small businesses being bounced into contracts that are not their best option, with little to no knowledge of free structures or alternatives or rights under legislation.

We welcome the PSR review into the supply of card-acquiring services, and hope it goes some way to addressing these fundamental unbalances.

We trust that you will find our comments helpful and that they will be taken into consideration.

Yours sincerely,

[redacted]

Federation of Small Businesses

FSB response to the PSR: Market review into the supply of card-acquiring services

December 2020

Notes on Recommendations

Requiring all contracts for card-acquiring services to have an end date, providing a prompt for merchants to shop around.

Whenever small businesses are making decisions, transparency is critical. This is true regardless of market, as without the full knowledge of alternatives available and rolling contractual agreements, small businesses are unlikely to seek out alternatives.

Requiring contracts for card-acquiring services to have a specified end date will help encourage small businesses to consider wider options, and review their previously existing agreement. But this can only be made possible with full transparency on all fee structures and constituents across providers, otherwise switching will remain just as difficult.

Requiring changes to POS terminal contracts to limit their length, ending contracts that auto-renew for successive fixed terms and making it easier to exit POS terminal contracts without incurring exit fees.

We see this recommendation as a natural succession to the first recommendation, to stop card-acquiring service contracts introducing terms so lengthy as to prohibit comparison or consideration of alternatives.

Making it easier for merchants to research and compare prices and options available to them.

The overall goal is to establish a competitive market where end users (merchants) have a choice over the services they choose to acquire to receive and process payments. However, part of this end goal is encouraging businesses to search out alternative options alliable, educate, and make use of a competitive and dynamic market. Although attempts can and should be made to bring contracts to a time limited end, thus encouraging small businesses to look at alternatives, many will renew existing agreements without full transparency and knowledge of market-based alternatives.

This is perhaps where we have our most suggestions, and where the PSR report could explore options to improve this dramatically.

Improving transparency and accessibility in the market

Merchant Service Charge (MSC)

Arguably this is the most important factor many small businesses will consider when contracts are due for renewal, however the current picture of fees and charges is too complex for many small businesses to spend resource understanding, let alone making a business decision to change provider based on that understanding. small businesses understanding of the MSC if often better than the additional charges (see below) however the MSC can itself be opaque and is often an small businesses only tool of comparison.

At present there are a number of factors that determine fees and charges (e.g. size of merchant, channel, transaction type, etc.). The most visible being the MSC which is charged monthly and comprised of an interchange fee (capped in the EU by the IFR), card scheme fees (unregulated) and an acquirer margin.

This combination of charges is then presented to businesses in a number of ways, Interchange+, Interchange++ and blended rates.

Each of the 3 above represent a different way of expressing the MSC to businesses, with only Interchange++ offering full visibility to the business of the interchange amount, card scheme fees, and the acquirer margin.

On the two interchange models, the transparency around the different aspects of the MSC allows businesses more flexibility to negotiate the percentages charged. However, these models are often reserved for larger businesses, with the majority of small businesses only presented with Blended rates which offer little transparency and therefore no scope for negotiation. This is often the headline rate presented to merchants, and this bears no resemblance to what a merchant ends up paying every month.

This practice, we believe, to be in contravention of EU regulations requiring that card-acquiring services present fee information to businesses in an understandable manner, setting out all the different aspects and rates together in the overall charge. i.e. Interchange++.

Regulations go as far to say that blended rates should only be offered if the business (merchants) request in writing that they are offered a blended representation of the fees[1].

FSB strongly feel that this regulation must be enforced, and that the PSR should hold card-acquiring services providers who fail this measure to account.

The PSR could go further and stipulate exactly how this information should be presented to businesses, including average market rates.

Additional or Hidden Charges

As well as the merchant service charge mentioned above (and the complex and multiple ways in which it is represented), there are also a number of hidden charges that many smaller businesses may incur, and may not understand.

For example, minimum monthly charges are far more likely to impact small businesses than larger businesses, as small businesses are more likely to fall short of the minimum monthly requirement on transaction levels. small businesses are also unlikely to know if they are paying any value-added service fees, for additional services attached to their contract, regardless if they are actually using these add-ons or not.

Termination fees are also likely to be levied on small businesses, making the cost of seeking alternatives too great to consider switching. This is particularly concerning given that many small businesses will have seen changes in payment profiled and methods due to the pandemic, and previous contractual agreements may no longer be cost effective.

Operational fees are the most concerning in this category. This could include terminal rental, cashback fees, authorisation charges, gateway access charges and fees levied for breach of card scheme mandates. Some other fees can be made to mean whatever the card-acquiring service provider desires, and businesses are often left

[1] Article 9 EU 2015/751 - https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015R0751

with no choice but to pay. All of these operational fees are often hidden away deep in the Terms and Conditions, meaning many small businesses fail to spot them in advance and will be surprised by the amount they have to pay each month.

FSB believe that the PSR must act in this space, requiring all Card-acquiring service providers to set out all fees and charges at the outset, to greatly improve transparency and the ability for the merchant to make a competitive decision.

Another specific area of concern amongst small merchants is the PCI DSS fees that some acquiring services providers charge. We suggest that these fees, only levied on small merchants, may be abolished or only charged on the basis of separate merchant consent (i.e. not contingent to contract signature) and demonstrability of the merchant value provided.

FSB also recommend that card scheme fees should be examined, and possibly regulated, to find ways acceptable to all parties in terms of the transparency required for the benefit of small merchants.

Key Recommendations

Although FSB supports the high-level recommendations made so far by the PSR, we would encourage the PSR to go further and be more ambitious in its actions.

It is clear that greater enforcement on current regulations is needed, with the majority of small businesses forced into Blended charges as standard, with little to no possibility of negotiation, and a number of hidden charges that may not be understood by merchants prior to contract signature.

We recommend greater transparency in the Merchant Service Charge and other applicable charges, in line with the Interchange Fee Regulation and the PSR 2017 for all providers of acquiring services.

We recommend that all charges must be presented in a way that is easily understood, recognised, and comparable across different card-acquiring service providers. We also recommend that this should be provided to merchants prior to contract signature, with a cool-off period.

We note that the interim report makes a mention of the increase in card scheme fees, and acknowledges that these have significantly increased, but does not provide any recommendations. We also note that on Tuesday 1st December 2020, a UK tribunal ruled in favour of merchants as Visa lost its bid to refer a dozen merchant UK interchange fee suits to the European Council of Justice. We recommend that card scheme fees should be examined, and possibly regulated, further to find ways acceptable to all parties in terms of the transparency required for the benefit of small merchants.

The current pandemic is already a heavy burden, and the costs that accompany acceptance of card payments represent yet another overhead for embattled small retailers.

We hope you have found our recommendations to the interim report helpful, and we look forward to the publication of the final report.

Yours faithfully,

[redacted]

Federation of Small Business

For further information

[redacted]

Fidelity Payment

[redacted] [redacted]
Date: 20 October 2020 18:45:44
Attachments: [redacted]

To Whom it may concern

This is in response to the Card acquiring market review that we feel came to the wrong conclusions

Clearly this interim report was compiled after limited research and has come to the conclusion (mistakenly in our view) that mandating shorter term contracts and more transparent pricing will lead to a better deal for merchants. Clearly, they have not taken account of the crucial role that companies like Fidelity Payment in the ISO community have already played in bringing down the cost of acquiring for merchants and delivering real choice that never previously existed. They also overlook the importance of being able to offer the best choice of technology for rapidly changing payments environment and the best acquiring terms, neither of which could be economically delivered if there were no reasonable commitment from the merchant on the other side. It is also likely to damage the levels of help and support services that are currently offered to merchants and which are vital to the smooth running of their businesses.

I trust that our views will be carefully considered

Regards,

[redacted]
[redacted]
[redacted]
www.fidelitypayment.co.uk

[redacted]

[redacted]

Global Payments (GPUK)

[redacted]

MARKET REVIEW INTO THE SUPPLY OF CARD-ACQUIRING SERVICES

GLOBAL PAYMENTS' RESPONSE TO THE PAYMENT SYSTEMS REGULATOR'S INTERIM REPORT

1. **Executive summary**

1.1 This response is prepared on behalf of Global Payments Limited ("**GPUK**").

1.2 GPUK welcomes the opportunity to respond to the Payment Systems Regulator's ("**PSR**") Interim Report of its market review into the supply of card-acquiring services, September 2020 (the "**Interim Report**").

1.3 GPUK supports the PSR's provisional finding that the supply of card acquiring services to large merchants (i.e. those with annual card turnover over £50 million) is working well. However, GPUK does not agree with the PSR's provisional finding in the Interim Report that the supply of card-acquiring services does not work well for small and medium-sized merchants and large merchants with annual card turnover up to £50 million.

1.4 First, we do not agree with some of the PSR's key findings in the Interim Report. These are summarised below:

1.4.1 we do not agree with the conclusion reached by the PSR that small and medium-sized merchants received little or no pass-through of interchange fee regulation ("**IFR**") savings. We consider the PSR's analysis, as set out in Annex 2 of the Interim Report, is fundamentally flawed and that a correct analysis of the data reviewed by the PSR in fact clearly indicates high levels of pass-through;

1.4.2 we do not agree with the PSR's conclusion based on its Merchant Survey results that despite having a variety of providers to choose from, many small and medium-sized merchants do not regularly, if ever, search for providers and rarely consider switching their provider. We consider that an objective interpretation of the results concludes that merchants are engaged, that they do search and switch and that there are no material barriers restricting merchants' willingness and ability to do so;

1.4.3 we do not agree that there is robust evidence to indicate that acquirer and ISO pricing creates significant search costs for merchants due to the absence of published prices and the complexity of comparing prices. Indeed of merchants surveyed, only 3% of the merchants who did not consider switching said it was because it would cost too much[1], a mere 1% of the merchants who never shopped around said that it is due to it being too difficult or complicated to compare providers[2]; and only 10% of merchants who have switched recently said comparable/standard pricing information would make them feel more confident in making their decision about switching[3];

1.4.4 we consider the PSR's observation that small and medium-sized merchants would benefit in terms of pricing outcomes if they switched is overstated.

1.5 Second, although we are generally supportive of the PSR's description of the industry in Section 3 and of competition between providers of card-acquiring services in Section 4 of the Interim Report, we do not think the PSR has given sufficient consideration to, or fully understood, the roles that acquirers and ISOs play in the market. A more extensive consideration of their respective roles and responsibilities is important not only to portray

[1] Merchant Survey, slide 25. The total number of merchants who did not consider switching is 448.

[2] Merchant Survey, slide 40. The total number of merchants who never shopped around is 348.

[3] Figure 15 of the Interim Report and Merchant Survey, slide 30.

a more accurate picture of how competition works but because this should also inform the PSR's approach to the scope and design of any remedies.

1.6 Third, we have serious concerns about the remedies proposed. While we acknowledge that the PSR's thinking on proposed remedies is at a very early stage, we nonetheless consider that the PSR would face immense challenges in the design and implementation of the remedies as proposed and that they would give rise to material unintended consequences. If not carefully constructed, the remedies proposed run a real risk of delivering worse outcomes for merchants and consumers as well as dampening competition.

1.7 GPUK is willing to work closely with the PSR should the PSR ultimately conclude that there are features of the market for the supply of card-acquiring services to remedy. Any proposed remedies could have an impact on the sector for years and we would therefore encourage the PSR to work closely, and fully engage, with the whole industry.

1.8 We set out below our comments on the provisional findings and proposed remedies in the Interim Report and GPUK look forward to discussing these more fully with the PSR.

1.9 [redacted]

[redacted] [redacted]

[redacted] [redacted]

2. Industry background and supply-side competition

2.1 GPUK agrees broadly with the PSR's description of the industry as set out in Section 3 of the Interim Report and its description of competition between providers or card-acquiring services set out in Section 4.

2.2 We note in particular the PSR's findings of a competitive landscape in which barriers to entry and expansion are low[4] with examples of entry and growth both in respect of serving smaller and larger merchants, findings that there are many suppliers and concentration is low[5][6][7], that the largest 5 acquirers account for just 36% of merchants, other acquirers a further 31%, and the payment facilitators the remaining 33%. We also support the PSR's recognition that while ISOs sell acquiring services on behalf of acquirers, they also compete with acquirers and payment facilitators for merchants based on price and non-price factors.[8] In 2018, ISOs were a significantly more important channel for new customer acquisition for acquirers, accounting for over 50% of all new customers signed-up. Most of these customers are likely the smallest merchants.[9]

2.3 However, we consider that there are four points which need to be addressed. These concern:

---

[4] Page 35, the Interim Report.

[5] Figure 4 of the Interim Report. (This is the relevant measure of concentration for small and medium-sized merchants because shares of transactions are skewed by the relatively few large merchants that account for the large majority of transactions.)

[6] Paragraph 4.14, the Interim Report.

[7] Page 39-44, the Interim Report.

[8] Page 35, the Interim Report.

[9] Paragraph 4.39 and Figure 9, the Interim Report.

2.3.1 the degree of risk taken on by acquirers not just when onboarding merchants but more broadly in the provision of card-acquiring services;

2.3.2 the extent and level of investment made by acquirers both in essential infrastructure and by way of innovation in new products and services;

2.3.3 the role of ISOs – their relationship with acquirers and their merchants; and

2.3.4 how the competitive landscape has developed since the PSR's review of the market, particularly in the light of Covid-19.

We deal with each of these points below.

(i) Risk

2.4 The Interim Report acknowledges that acquirers assume responsibility for the risks associated with onboarding merchants and granting them access to the card payment systems. However, we consider that the Interim Report fails to recognise the full extent of the risks that acquirers take on and the impact this has on an acquirer's business model and cost base. An understanding by the PSR of the extent and nature of risks assumed by acquirers is important, because it illustrates the unique role that acquirers play in the payments eco-system and the consequences this has for acquirers' cost base and pricing - relative to other players, such as ISOs.

2.5 The Interim Report focuses principally on credit risk and chargeback: *"these risks include the credit risk that comes from being liable under scheme rules for disputes between cardholders and merchants."*[10] Only brief reference is made to other risks assumed by acquirers, for example, *"acquirers carry out know your customer and anti-money laundering checks"*[11], and Annex 1 refers to regulatory risk, card payment system risk and reputational risk[12]. The PSR also notes that an acquirer remains responsible for compliance with scheme rules, even when it chooses to outsource some activities to other parties[13].

2.6 The scheme rules of Visa and Mastercard require that if a merchant's annual card turnover exceeds more than $1 million the acquirer must contract directly with the merchant. Payment facilitators, for example, therefore avoid taking on risk directly for merchants with annual card turnover above this threshold. This requirement also means that acquirers are also subject to more intense screening by card payment systems to ensure the acquirer does not represent an undue security risk and acquirers undergo a process of testing and certification. Acquirers may also be required to provide collateral to the card payment systems to manage and mitigate the risk of a merchant defaulting[14]. Funds held by the card scheme as collateral cannot be used by the acquirer to invest either in its own systems, customer acquisitions or *"other means to expand their business or improve their product offering, and therefore make it harder for a new or smaller acquirer to expand and compete effectively"*[15].

2.7 The focus on credit risk and only a passing acknowledgement that acquirers take on other significant risks which are fundamental to the overall payments eco-system, fails materially to appreciate the extent and variety of risks that acquirers assume and how this is different to other providers of card acquiring services including payment facilitators and ISOs. This is important because the greater degree of risk acquirers are required to assume has a

[10] Paragraph 3.18 of the Interim Report.

[11] Paragraph 3.20 of the Interim Report.

[12] Annex 1 paragraph 1.43.

[13] Paragraph 3.21 of the Interim Report.

[14] See Annex 5 paragraph 1.18.

[15] Annex 5 paragraph 1.18.

direct bearing on an acquirer's business model, cost base and ultimately its pricing – relative to other players in the payments ecosystem.

2.8 Importantly, these differences need to be understood by the PSR in order to inform its thinking on possible remedies.

(ii) Investment

2.9 We note that the PSR's consideration of the levels of investment made by acquirers was included only in the context of its assessment of levels of pass-through of reductions in interchange fees. Based on the data of two acquirers, the PSR concluded that total unit costs decreased over the period 2014-2018 and that it would have expected to see unit costs increasing if acquirers were making investments to enhance quality of service and therefore increasing the cost for any given volume, all else being equal[16]. The assessment of levels of investment in this context ignores the high levels of investment made by acquirers such as GPUK which would not have been captured in the revenue and direct cost data requested by the PSR as they are not costs that can be measured at transaction level. Nor does the assessment consider material investment made since 2018.

2.10 The degree of investment and the associated costs is important to the PSR's understanding of acquirers' businesses as responsibility falls to acquirers in large part to invest in the fundamental infrastructure which supports the payments network. Additionally, acquirers continue to invest in ensuring their products and services are competitive and deliver what merchants need.

2.11 [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

2.12 We would ask the PSR to reflect in the Interim Report the material investments acquirers make to support the payments eco-system and to stay relevant and compete effectively. This is important as it differentiates the role of acquirers from other types of providers of card-acquiring services and evidences the high level of investment made at a global and local level which in turn affects the products and services provided and the underlying costs for doing so.

---

[16] Annex 3 Paragraph 1.65.

(iii) The role of ISOs

2.13 The PSR identified that ISOs play an important role within the market, and GPUK agrees with this finding. Indeed, GPUK agrees that there appear to be more ISOs established within the market now more than ever.

2.14 However, it is important for the PSR to understand that ISOs do not merely act as outsourcing agents for acquirers but rather that they are standalone organisations, in business to predominantly sell to, and service merchants directly. They are not tasked by acquirers, and offer merchants bundled services without necessarily separately highlighting the cost and provider of acquiring services. To describe ISOs merely as agents of acquirers fails to recognise the extent of the role they play in the market and the way in which they contract with merchants.

2.15 ISOs are not therefore to be understood as an outsourced sales function over which an acquirer has a high degree of leverage or control. Rather, acquirers are used by ISOs to provide processing services but the ISO itself will provide other products and services to the merchant including hardware. Acquirers partner with ISOs to recruit merchants and to process those merchants' transactions but otherwise do not exert control or have visibility over the relationship between the ISO and the merchant. ISOs procure their own terminals and strike their own deals and this is not something the acquirer is able to control.

2.16 The nature of the ISO / acquirer relationship means that it would not be possible to implement a remedy that would rely on acquirers to enforce or police its terms over ISOs – for example, it is not possible for an acquirer to require that an ISO does not tie in merchants to membership agreements of a certain duration, and to make such a request would clearly interfere in the ISO's way of doing business.

2.17 In addition, GPUK has concerns that the low barriers to entry and the lack of regulatory oversight of ISOs has resulted in a proliferation of ISOs, especially small organisations, that provide a low level of service and typically include tie-ins and cross-subsidisation in their contracts which do not serve merchants well.

(iv) ***The impact of Covid-19***

2.18 The PSR has asked specifically for comments on the impact of Covid-19 on its review. The PSR recognises that Covid-19 "*may accelerate well-established trends, such as the growth in card payments, changing shopping preferences (including the shift to online spending), and increasing levels of card acceptance amongst businesses (particularly small businesses). If these trends continue to accelerate, it's even more important that the supply of card acquiring services works well for merchants*"[17]. No further consideration is given to the impact of the pandemic in the Interim Report.

2.19 We would agree with the PSR's view that the Covid-19 crisis has accelerated change in the market for the provision of card-acquiring services. Not least this has been a catalyst for innovation with acquirers acting quickly to service merchants in new ways.

2.20 For example:

2.20.1 [redacted]

[17] Paragraph 1.5 of the Interim Report.

[redacted]

2.20.2 in April 2020 allpay made available a prepaid card programme specifically to help local councils disburse emergency funds to those affected by Covid-19. Programs for individual councils could be set up within two weeks of receiving instructions. The solution offers a secure, accessible payment method for those in need of urgent funds for point of sale transactions, online purchases, contactless and chip and PIN payments and ATM withdrawal;

2.20.3 [redacted]

2.21 The market for the supply of card acquiring services had already changed since 2018, and the impact of Covid-19 has accelerated that change, resulting in a more dynamic and fragmented market with providers competing fiercely to retain their merchant base and win new merchants. The pandemic has also exacerbated the risks faced by acquirers, discussed above, such as chargeback risk resulting from consumers cancelling transactions involving future delivery (such as air tickets, accommodation, sporting and / or music events), or fraud risk resulting from an increase in phishing attacks and the sheer volume of additional online transactions.

2.22 The impact of Covid-19 should therefore be more fully reflected in the PSR's Final Report. GPUK expects the speed of change to continue and any interventions proposed by the PSR must take this fully into account to ensure that any remedies are fit for purpose as the market evolves further over the coming years.

3. Pass through analysis

3.1 We set out below our assessment of the PSR's pass through analysis as set out in Annex 2 of the Interim Report. We also attach a confidential report prepared by RBB Economics ("**RBB**") which considers in more detail the merchant sample data made available in the confidentiality ring – see **Appendix 1**.

3.2 Based on analysis of the merchant sample data (the "**Data**") submitted by the five largest acquirers, the PSR concluded that:

3.2.1 merchants with annual card turnover up to £50 million received, on average, little or no pass-through of the IFR savings – indicating that the supply of card-acquiring services may not be working well for these merchants;

3.2.2 merchants can secure better deals in the form of lower merchant service charges ("**MSCs**") by switching their provider of card-acquiring services because, on average, new customers pay less.[18]

3.3 We consider that both conclusions are misconceived. Specifically:

3.3.1 on the analysis of interchange fee pass-through, we reiterate that the pass-through rate cannot be used as a reliable indicator of the intensity of competition. Such an approach is not supported by economic theory;

3.3.2 putting that (fundamental) concern to one side, the PSR has interpreted its econometrics results incorrectly. The results presented in the Interim Report in fact show a high level of interchange fee pass-through. This applies to the full

[18] Page 56 of the Interim Report.

range of merchants, large and small. This is confirmed by sensitivity checks of the results carried out by RBB;

3.3.3 RBB's proper analysis of the Data demonstrates that the extent to which new customers pay less is likely to be smaller than found by the PSR and applies only to certain merchant groups. Moreover, the Data do not enable the PSR to infer that merchants obtain these benefits by switching – it is not possible to track whether a merchant has switched in the Data;

3.3.4 there are significant shortcomings in the Data, inter alia due to missing information on important costs. This means that any conclusions drawn from analysis of the Data should be made with caution.

3.4 These points are addressed below in turn.

(i) The pass-through rate cannot be used as a reliable indicator of the intensity of competition

3.5 According to economic theory, there is no basis for using industry-wide pass-through ("**IWPT**") rate to gauge the degree of competition in the market. In other words, the rate of pass-through of the interchange fee by the five largest acquirers examined does not provide a reliable measure of the intensity of competition among acquirers.

3.6 As explained in RBB's previous submission to the PSR on pass-through[19]:

3.6.1 Under the setting of perfect competition (i.e. where competition is most intense), the IWPT rate need not be 100%. Indeed, a rate of anything between 0% and 100% would be compatible with perfect competition.

3.6.2 Under the setting of oligopolistic competition (i.e. where competition is imperfect), there is no general result that higher IWPT rates are associated with more intense competition. Moreover, there is also no absolute level of the IWPT rate below which competition can be presumed ineffective.

3.6.3 The characteristics of the card acquiring market, especially its dynamism (such as new entry and growth), ongoing innovation, and frequent regulatory changes do not satisfy the assumptions required in theory to derive a positive correlation between IWPT rates and the intensity of competition.[20]

(ii) The results presented in the Interim Report show a high level of interchange fee pass-through

3.7 Secondly, even if the IWPT rate were to convey meaningful information about the intensity of competition, the PSR's interpretation of its econometric analysis is misconceived.

3.8 The variable of interest captures the extent to which a fall in the interchange fee ("**IF**") directly causes a fall in the MSC. The PSR presents a number of approaches to measuring this variable.

3.9 The PSR's preferred (i.e. "baseline") approach is "Model 2". Here, the PSR focuses on what it calls the "interchange fee margin" (the MSC less interchange fee costs) and estimates

---

[19] See "Global Payments A response to the PSR Notice requesting data for pass-through analysis", RBB Economics, July 2019 (the "RBB pass-through note").

[20] See section 4 of the "RBB pass-through note".

how much this margin has changed in the period after the IFR came into force compared to that in the period before.[21]

3.10 The PSR claims that interchange fee margins increased for merchants with turnover between £15,000 and £50 million by a similar or larger amount than the reduction in average interchange fees. On this basis, the PSR concludes that, on average, these merchants received little or no pass-through of the interchange fee savings.[22] This model cannot be used to estimate pass-through, which is easily seen by noting that the PSR itself observes that its approach (i.e. Model 2) is *valid only if pass-through is 100%*. In other words, Model 2 measures an effect on the MSC after taking into account the high degree of pass-through that exists.[23]

3.11 This conclusion cannot be drawn. The finding of the PSR's baseline model only indicates that the *average* margin for the period after the IFR came into force is higher than the *average* margin for the period before. It is not possible to infer from this result whether the increase in the interchange fee margin occurred at the time of the IFR – the interchange fee margin could have increased before the IFR, much later in the post-IFR time period (e.g. in 2017-2018), or gradually over the entire time period examined (i.e. 2014-2018).

3.12 To resolve the preceding problem requires adopting a different method, in which influences on the MSC are assessed *separately*. This is, in essence, the approach of the PSR's "Model 1". Model 1 allows the following separate effects to be estimated: (a) the extent to which a fall in the IF has led to a fall in the MSC, holding other factors constant (i.e. IF pass-through); (b) the extent to which an increase in scheme fees ("**SF**") has led to an increase in the MSC, holding other factors constant (i.e. SF pass-through); and (c) the extent to which the MSC has changed over time (after stripping out the influence of the IF and SF on the MSC).

3.13 The Interim Report (Annex 2, Table 20) presents the results of this approach. The pass-through of interchange fees is at least 63% (which applies for the sample as a whole) and even higher when individual merchant groups are considered.[24] RBB's sensitivity checks on the Data confirm that these estimates are robust. [redacted][25] In other words, the Data suggest that interchange fee pass-through by acquirers is substantial.

3.14 This model also finds that scheme fee pass-through is positive and significant in several cases, although for the IC++ merchants the value is too high – likely reflecting errors in the SF data (as discussed further below).

3.15 Finally, there is no basis to presume that weaker competition has led to higher interchange fee margins over time. First, the PSR's model is unable to test the impact of competition on the interchange fee margin – it contains no variable that captures the degree of competition. Second, the PSR's own evidence suggests that, if anything, competition has increased since 2014. Specifically, the PSR has provisionally found that competition is working well in the card-acquiring market: competition is fierce for large merchants with

[21] In terms of econometrics modelling, the PSR used the interchange fee margin as the dependent variable, and estimated the coefficient on the IFR dummy (which equals 0 in the period before the IFR and 1 after the IFR came into force). A range of control variables are included in the model. See page 35 of Annex 2 of the PSR's interim report.

[22] Paragraph 1.69, Annex 2 of the interim report. The data on merchants with annual turnover less than £15,000 are not reliable and therefore excluded from the conclusion, see Box 3 of Annex 2 for more details.

[23] "Moving from model (1) to model (2) imposes the restriction that the coefficient on interchange fees is equal to one. This would hold under full pass-through of interchange fees" (paragraph 1.13, Annex 2 of the interim report).

[24] Estimated coefficients of the interchange fee variable are significant and positive for all merchant groups in Table 20 of Annex 2. The magnitude of the estimates seems sensible as the estimate for merchants with IC++ tariff is 100% - as expected since these merchants receive automatic full pass-through of interchange fees.

[25] [redacted]

annual turnover over £50 million and for the remaining merchants, market concentration is low and there are no significant barriers to entry.[26] In our view, therefore, the most likely reason for the increase in interchange fee margin is that costs have risen that are not captured in the PSR's dataset (see further below on missing cost data).

(iii) The Data do not permit gains from switching to be estimated

3.16 The PSR also finds that new merchants pay less, and argues that this shows that when merchants switch provider of card-acquiring services, they can secure better prices.[27] However, the Data only allow us to identify merchants who are new to a given acquirer and do not allow the distinction to be made between merchants new to card acquiring and merchants who switched from another acquirer. Therefore, the estimated benefit for merchants that are new to a particular acquirer cannot confidently be interpreted as a benefit of switching.

3.17 Furthermore, RBB found that the extent to which new merchants pay less is likely less than that estimated by the PSR. The PSR estimated that small and medium-sized merchants who signed up with their acquirer within the previous year paid between 0.03 and 0.30 percentage points less than merchants who have been with their acquirer for several years. However, this finding is not robust: adding standard "controls" for the year causes the estimates drop significantly [redacted].

3.18 Finally, unlike the PSR, RBB found the time a merchant has contracted with an acquirer did not affect the MSCs for merchants with annual card turnover between £10 million and £50 million. This provides further evidence that the PSR's findings are not robust.

(iv) Significant shortcomings in the Data mean any conclusions should be made with caution

3.19 There are significant shortcomings in the Data. This means that any conclusions based on econometric analysis should be drawn with caution.

3.20 Most notably, the data on scheme fees are flawed:

3.20.1 one acquirer could not provide scheme fee data for 2014/2015, and the PSR relied on imputation to fill in these gaps;[28]

3.20.2 acquirers told the PSR that not all scheme fees can be allocated to the merchant level and may therefore not be recorded in the data; and

3.20.3 there may be some discrepancies between acquirers in the way they allocated scheme fees to individual merchants.[29]

3.21 The PSR noted the flaws of the SF data but said that it did not think this problem "*significantly impacts on our ability to examine pass-through of IFR savings*" since scheme fees are small as a percentage of total MSC.[30] We disagree. Data limitations mean that the PSR cannot properly account for the influence of SF on the MSC, which in turn makes it harder to estimate the impact of interchange fees on the MSC (since the latter impact should be measured 'holding constant' any other influence on the MSC). Indeed, the PSR also notes in its Interim Report that "*while the effect of scheme fee increases on the MSC is likely to be less significant than changes in interchange fees, it isn't negligible*".[31]

---

[26] As discussed in Section 2 above.

[27] Paragraph 5.41 of the Interim Report.

[28] Page 17, Annex 2 of the Interim Report.

[29] Page 16, Annex 2 of the Interim Report.

[30] Page 16, Annex 2 of the Interim Report.

[31] Paragraph 5.10 of the Interim Report.

3.22 In addition, the Data do not allow analysis of the IFR capped transactions separately from those that remain uncapped (e.g. non-EU international transactions and transactions on commercial cards). The IFR only put in place a cap on the interchange fees for domestic consumer debit and credit cards. Therefore, to analyse IF pass-through, the sample would ideally include only the capped transactions. This is however not possible, as tariffs are often blended, and acquirers may not be able to record MSC data at a level disaggregated by transaction types. The PSR's analysis is therefore based on data for all transactions, including those that attract very high IFs (e.g. commercial cards and international cards). Although the PSR tried to control for this in its model, the fix is imperfect.[32] This may bias the estimates.

3.23 Lastly, the Data only include the interchange fee and some (but by no means all) scheme fee costs, and exclude all other direct and indirect costs incurred when providing acquiring services. By focusing only on the MSC and the interchange fee and scheme fee costs, the PSR does not take into account other important factors that are likely to impact the MSC. In particular, the need for frequent innovation and compliance with evolving regulations (e.g. improving data security and infrastructure) are key characteristics of the card acquiring market (the costs of which likely have an impact on the MSC). Excluding these important costs may bias the results.

3.24 For the reasons set out above, it would be wrong for the PSR to draw any adverse conclusions about the extent to which IFR savings are passed through to small and medium-sized merchants. It would further be wrong to suggest that the PSR's pass-through findings indicate issues in the market for the supply of card-acquiring services. Furthermore, we would ask the PSR to remove from the Interim Report any conclusion that small and medium-sized merchants received little or no pass-through of the IFR savings as these statements are incorrect. Specifically, we would ask that the statement at page 9, bullet point 7 of the Interim Report, that small and medium sized merchants "*got little or no pass-through of IFR savings (on average)*" is removed, along with all equivalent statements elsewhere in the Interim Report, including, but not limited to, those in Chapter 5 and in paragraphs 6.1, 7.18. 7.25, and 7.30 of the Interim Report.

4. **Searching and switching**

4.1 In Chapter 6 of the Interim Report, the PSR considered the results from the IFF Research survey of 1,037 small and medium-sized merchants (for this purpose being merchants with annual card turnover of up to £10 million) (the "**Merchant Survey"**) along with other evidence and provisionally concluded that:

4.1.1 the Merchant Survey showed that many small and medium-sized merchants (with annual card turnover up to £10 million) do not regularly search for other providers or consider switching their provider; and

4.1.2 three features (individually and in combination) restrict small and medium-sized merchants' ability and willingness to search and switch, and result in worse outcomes for them: ISO and acquirer pricing creates significant search costs due to the absence of published prices and the complexity of comparing prices; the indefinite duration of merchant contracts for card acquiring services, and ISO and acquirer POS terminal contracts with long duration.[33]

4.2 Furthermore, we note that the evidence from the Merchant Survey often fails to support (or even contradicts) the PSR's conclusions regarding small and medium-sized merchants with annual card turnover up to £10 million. A more objective reading of the Merchant Survey shows that:

[32] In its analysis, the PSR controls for the share of transactions on domestic consumer debit cards and the share of transactions on domestic consumer credit cards.

[33] Paragraphs 6.94 and 6.97 of the Interim Report.

4.2.1 the majority of merchants have switched or considered switching regularly, even if they do not shop around frequently (see below); and

4.2.2 switching is not difficult and barriers to switching or shopping around are very rarely identified.

4.3 These points are addressed below in turn.

(i) Most merchants surveyed regularly switch or consider switching

4.4 The Merchant Survey suggests that most merchants regularly switch or consider switching.

4.5 As shown in Figure 13 of the PSR's Interim Report, 16% of the merchants surveyed have switched provider in the last 2 years, and a further 29% have considered switching in the last 2 years. This Figure also includes a further 13% of the merchants surveyed that started accepting card payments in the last 2 years. Excluding these merchants because they are new to card acquiring (and so would not be expected to have switched recently) and recalculating these percentages, leads to the finding that 18% of the merchants have switched providers and a further 33% have considered switching in the last 2 years. In other words, more than half (52%) of merchants who have accepted card payments for more than 2 years have either switched or considered switching in the last two years. It cannot be concluded that merchants do not regularly switch or consider switching providers.

(ii) Merchants switch without shopping around

4.6 As for whether merchants regularly shop around, the Interim Report notes that 43% of merchants reported that they never shop around; a further 17% said that they do so less than once every three years or hardly ever.[34] However, merchants may switch without shopping around (for example if they are approached with a better offer than their current one). For example, of the merchants who have switched providers in the last 2 years, 40% did not shop around.[35] A failure to shop around regularly does not therefore demonstrate an absence of merchant engagement.

(iii) No material barriers to switching

4.7 The Merchant Survey offers little to support the PSR's proposed interventions to facilitate switching. There is very little evidence from the Merchant Survey that suggests material barriers to merchant switching. Indeed, the PSR itself notes, "*most small and medium-sized merchants that search and switch don't report facing difficulties when doing* so".[36] In fact 76% of merchants surveyed said it was very or fairly easy to switch.[37]

4.8 As for the merchants who did not consider switching or did not shop around, the majority reported that this is because they are satisfied with their current provider.[38] Very few identified any "pain points" in the market that prevent them from switching:

4.8.1 of the merchants who did not consider switching, only 4% (about 18 merchants) explained that it was because they are in a contract;

---

[34] Paragraph 6.13 of the Interim Report and slide 39 of the Merchant Survey.

[35] Merchant Survey, slide 37.

[36] Paragraph 6.25 of the Interim Report.

[37] Merchant Survey, slide 29

[38] Merchant Survey, slide 25: 64% of merchants who did not consider switching in the past 2 years said that they are satisfied with their current provider and a further 8% specifically said that they are happy with the price of the current provider; Merchant Survey, slide 40: 54% of the merchants who never shop around said they were happy with the current provider, and a further 1% said that they are happy with the price of their current provider.

4.8.2 just 3% (about 13 merchants) said it would cost too much[39];

4.8.3 of the merchants that never shopped around, only 6% (about 20 merchants) reported that this is because they are tied into a contract, and a mere 1% (about 3 merchants) said that it is too complicated to compare providers.[40]

4.9 This suggests that only a very small minority of surveyed merchants would consider complex pricing information, being tied into contracts or the costs of searching as a barrier to switching. This is in line with the finding that a relatively small percentage of switchers consider that better pricing information would have given them greater confidence when switching.

4.10 The Interim Report notes that around 30% of merchants who switched in the last 2 years considered that better quality information (combining the four answers on slide 30 of the Merchant Survey – access to more comparable/standard pricing information, knowing more about the provider, better quality information, and more accessible information) would have made them more confident when switching. When broken down, of the merchants surveyed, only 10% said comparable/standard pricing information would make them feel more confident about deciding which provider to switch to.[41]

4.11 This does not indicate material barriers to switching as (i) these merchants were able to switch successfully, and (ii) a large proportion of merchants who switched in the last 2 years (46%) identified that nothing would have made them more confident about deciding which provider to switching to.

(iv) No material evidence that expiry of the card-acquiring contract would trigger switching in the future

4.12 Furthermore, the Merchant Survey provides no evidence that the expiry of a contract for card-acquiring services would trigger many merchants to switch in the future: when all surveyed merchants were asked what would make them consider switching in the future, only 1% said that the expiry of a contract would be a trigger.[42]

4.13 We note that some merchants identified lack of time or resources as the reason they did not consider switching, did not shop around, or considered switching but did not actually switch. However, this was not a common response.[43] Moreover, this is not in itself an indication that the time needed to switch or compare providers is excessive; neither does it imply that the process is too complex.

4.14 Overall, the Merchant Survey does not identify systematic and significant demand-side failings, such as widespread disengagement in the switching process or material barriers to switching.

4.15 [redacted]

[39] Merchant Survey, slide 25. The total number of merchants who did not consider switching is 448.

[40] Merchant Survey, slide 40. The total number of merchants who never shopped around is 348.

[41] Paragraph 6.24 of the Interim Report.

[42] Merchant Survey, slide 31.

[43] Merchant Survey, slides 25, 27, and 40. 7% of merchants who did not consider switching said it was because they had no time, 10% of merchants who considered switching but did not said it was because they are too busy, and 29% of merchants who never shopped around said that this is because they had no time.

[44] See GP response to Notice 1 Annex B.

[redacted]

4.16 We note that the Merchant Survey was limited to merchants with annual card turnover of up to £10 million. However, the PSR concluded that the "*features that restrict small and medium-sized merchants' ability and willingness to search and switch will affect many large merchants with annual card turnover between £10 million and £50 million*."[45] The PSR seemed to base this conclusion on two reasons: (i) that many large merchants with turnover between £10 million and £50 million share characteristics with small and medium sized merchants, and (ii) that many of these merchants are clustered at the lower end of the turnover range - with 35% clustered in a group with card turnover between £10 million and £15 million and a further 20% with card turnover between £15 million and £20 million[46]. The PSR appears to infer that merchants with card turnover between £10 million and £20 million share the same characteristics and that this would therefore indicate similar searching and switching behaviour. This inference cannot be drawn. First, the merchant survey itself does not provide compelling evidence of barriers to switching and low engagement. Second, the PSR has provided no evidence that its (incorrect) findings carry over to larger merchants.

4.17 In addition, the searching and switching analysis fails to consider at all the searching and switching behaviour of merchants with card turnover between £20 million and £50 million, which also account for a substantial part (45%) of the group of merchants with card turnover between £10 million and £50 million. It is therefore an overstatement for the PSR to find by reference to all small and medium sized merchants as well as merchants with turnover up to £50 million that there are features in the market that restrict these merchants' ability and willingness to search and switch. The evidence produced by the Merchant Survey does not concern merchants with card turnover between £10 million and £50 million, and as such it is inaccurate to state such findings as if they can be applied equally to all merchants with annual card turnover up to £50 million. Though, as noted above, the merchant survey itself does not provide compelling evidence of barriers to switching and low engagement.

4.18 Taken together with the supply-side findings that the market structure is competitive and that the Data indicates a high level of pass-through of IFR savings, the evidence calls into question the basis for the PSR's proposed remedies.

5. **Proposed remedies**

5.1 We acknowledge the PSR is at the very early stages of considering remedies and that these have not yet been developed. GPUK therefore welcome the opportunity now and in the future to work with the PSR and to assist with any remedies, should the PSR ultimately conclude that there are features in the market which adversely impact competition and outcomes for merchants which need to be addressed.

5.2 As we have already explained, we do not agree with a number of the PSR's key findings and on that basis we do not think that the remedies proposed in relation to ISO and acquirer pricing or including an end date in a card-acquiring contract are either necessary or proportionate. Furthermore, the Merchant Survey results suggest these remedies would be unlikely to change merchant behaviour.

5.3 We also have concerns that the proposed remedies:

5.3.1 would face significant implementation challenges given the complex and diverse array of regulated and unregulated entities across the payments ecosystem to whom the proposed remedies may apply;

---

[45] Paragraph 6.99 of the Interim Report

[46] Paragraph 6.11 of the Interim Report.

5.3.2 may give rise to unintended consequences, including those that ultimately harm merchants;

5.3.3 could lead to an unlevel playing field where the scope of a remedy is not sufficiently comprehensive or future-proof;

5.3.4 could lead to costs being incurred that would outweigh the benefits derived; and

5.3.5 could lead to a reduction in innovation and competition amongst suppliers of card-acquiring services.

5.4 Notwithstanding our disagreement with the PSR's findings, in the spirit of seeking to assist the PSR in this process, we nonetheless provide our comments on the remedies proposed. We also encourage the PSR to continue to consult with the full range of stakeholders within the payments ecosystem prior to trialling, concluding on or imposing any remedies – so as to assist the PSR in understanding the full impact of such remedies.

(i) Pricing

General comments

5.5 First we do not agree with the finding leading to this proposed remedy. As set out in this response, our interpretation of the Merchant Survey results is not consistent with the conclusion that ISO and acquirer pricing creates significant search costs for merchants because of the absence of published prices and the complexity of comparing pricing. In particular, the PSR's own evidence states that:

5.5.1 of merchants surveyed who have switched providers in the past 2 years, only 10% said comparable / standard pricing information would have helped them feel more confident in making their decision about switching[47];

5.5.2 no merchants appear to have cited lack of pricing information as a reason for not switching or considering switching.[48]

5.5.3 in fact, nearly all merchants (89%) felt they received enough information to understand the cost of card-acquiring services[49].

5.6 These results confirm that merchants already have access to the level of information they need to understand pricing. The PSR seems merely to assume a remedy is needed because "*many merchants have little or no experience of assessing their own needs, accessing information (including prices) about different providers and assessing that information – so they won't be able to tell if they are getting a good deal or not*"[50]*.* We see no evidence to support this statement and it is unclear on what basis the PSR has come to this view. This statement also ignores that merchants may decide that the costs of card-acquiring are not material enough for them to spend time searching or switching, or that on the whole merchants are satisfied with the quality of service they receive. We do not therefore agree with a general proposition that merchants are unable to work out what they need.

5.7 Second, the PSR appears to rely on "other evidence" and "other surveys"[51] in the Interim Report to suggest that acquirer and ISO standard pricing creates search costs for small and medium-sized merchants. No details have been provided in respect of this other data, aside

---

[47] Slide 30, Merchant Survey.

[48] Slide 25 and 27, Merchant Survey.

[49] Slide 17, Merchant Survey.

[50] Paragraph 7.22 of the Interim Report

[51] For example, paragraph 7.23 of the Interim Report.

from a suggestion that some of it has been submitted by other acquirers and ISOs[52], and it is therefore unclear on what basis the PSR has come to this view or how heavily the PSR has relied on this information.[53] If this other evidence is considered by the PSR to be material, then in order for the PSR to rely on it, further detail of its precise findings should have been disclosed.

5.8 Third, we think a remedy focussed solely on pricing has only very limited potential to change merchant switching behaviour. The Interim Report expressly acknowledges that acquirers, payment facilitators ("**PFs**") and ISOs compete for merchants based on price and non-price factors.[54] The PSR also refers in Annex 1 to other surveys it has seen that "*find that price is an important consideration for merchants but not significantly more important than other factors"*.[55] Furthermore, Annex 1 refers to a recent survey conducted by RFi Group that "*found that trust in the provider was the most commonly cited reason merchants that had switched in the last three years gave for choosing their provider. Speed of settlement and ease of doing business with the provider were also important. The same survey found that high fees, settlement speed and speed of transaction processing were the main drivers of switching in the last three years"*[56]*.* The findings referred to in this survey would suggest that price although cited as a factor relevant to switching, is not identified as the main or only factor for switching.

5.9 We therefore do not consider that a pricing remedy as proposed is necessary or proportionate or likely to achieve the PSR's aims.

5.10 GPUK is however keen to support the PSR and to consider alternative approaches to ensure merchants can easily access information which they are able to assess and act on. We have therefore included in our comments below some suggestions for the PSR to consider. However, GPUK is strongly of the view that any intervention by the PSR in this respect must be extremely "light touch": it must neither materially raise industry costs nor impede the way competition is working for the supply of card-acquiring services to small and medium sized merchants, which it considers to be working well.

The proposed remedy would be difficult to achieve

5.11 We consider that it will be extremely difficult, if not impossible, to design and implement either a price comparison tool for merchants that could work across all acquirer and ISO pricing for card-acquiring services or that acquirers and ISOs could provide pricing information in an easily comparable format in a way that would deliver good outcomes for merchants or lead to higher levels of searching or switching. The key reasons for this are summarised below:

5.11.1 the proposed remedies assume that card acquiring services offered by acquirers and ISOs can be easily compared – the PSR fails to take account not only of the differing business models and strategies between acquirers (which the PSR itself acknowledges)[57], and amongst ISOs, but also the fundamental differences between the roles, responsibilities, products and services and cost bases between acquirers and ISOs. It cannot therefore be assumed that there is a simple way in which to provide pricing information to merchants across acquirers and ISOs on a comparable basis. The PSR's starting point is therefore misconceived or unrealistic;

---

[52] For example paragraphs 6.31-6.33 and 6.54 of the Interim Report.

[53] For example, paragraph 6.54 of the Interim Report.

[54] Page 35 Interim Report 5th bullet point.

[55] Interim Report Annex 1 Industry Background, paragraph 1.104.

[56] Interim Report Annex 1 paragraph 1.104 – reference to a survey carried out by RFi Group for the UK Merchant Acquiring Council in H2 2019.

[57] For example in Interim Report Annex 1 paragraph 1.177.

5.11.2 ISOs offer bundled services without necessarily separating out the costs of different components included in the package. In other words, ISO pricing for card-acquiring services is not offered on a standalone basis and would have to be unbundled;

5.11.3 pricing is inherently complex and variable based on a range of factors such as the nature and sector of the merchant's business, the size of the merchant, the types of transactions they process, and the type of supplier offering the services etc, not least because these give rise to a wide range of different scheme fees which are not under the control of acquirers. Pricing is not therefore generic but bespoke to each merchant and cannot therefore be easily reduced to a number of standard components which are meaningfully comparable on an industry-wide basis (see also unintended consequences below);

5.11.4 different acquirers and ISOs target different merchant types and verticals, and their product offering and pricing is developed accordingly meaning that, at the least, different 'standard' or comparable pricing information would need to be arrived at for each merchant type, segment and/or sector;

5.11.5 the complexity of pricing cannot in any event be resolved in isolation of the way scheme fees are set – these in part drive the extent of variables included when acquirers set prices for their services to merchants.

Unintended consequences

5.12 We are also concerned that the proposed remedies could have a number of potentially serious unintended consequences:

5.12.1 simplified pricing would lead to higher prices for merchants. Driving pricing towards some form of blended pricing therefore comes at a cost (because acquirers and ISOs have to estimate and account for a higher level of uncertainty within the 'headline' price);

5.12.2 leaving PFs out of scope fails to take account of the risk that i) the remedy could impose more onerous disclosure obligations on ISOs and acquirers; and ii) that PFs' pricing practices may change over time; both of which could give PFs an unfair competitive advantage and skew the playing field in their favour;

5.12.3 seeking to reduce price competition to a standard set of comparable prices risks dampening price competition by limiting the extent to which suppliers of card-acquiring services can compete by way of differentiated pricing. GPUK's pricing model allows it to offer prices to correspond to the profile of any merchant, based on factors such as the size of the merchant, the types of transactions it accepts, its risk profile, its sector etc as well as offering a wide range of value added products and services. A remedy which effectively forces an acquirer to commoditise its offering (e.g. by steering merchants to focus on a "plain vanilla" comparable offer, as opposed to more bespoke offers that suit them better) will reduce its incentive to offer innovative and differentiated products to meet evolving merchant needs.

Alternative approach

5.13 GPUK has considered what approach the PSR could consider in the alternative to ensure merchants are able to access, assess and act on information to help them search and switch.

5.14 GPUK considers that there is an opportunity for the PSR to achieve its objective by requiring minimum standards for information disclosure to be met across the industry by all providers of card-acquiring services, in other words a "levelling up" to enhance the quality of information all providers offer to merchants.

5.15 Acquirers are already held to a higher standard than PFs and ISOs under regulation which requires disclosure of pricing / charges information to a granular level[58]. ISOs are not under such obligations given they operate outside the regulatory perimeter. This means that merchants do not currently have access to equivalent levels of transparent pricing information from ISOs and other third parties. While it may be argued that equivalent levels of disclosure are not required because ISO and PF pricing is simpler, merchants may achieve better outcomes should ISOs and PFs be held to minimum disclosure standards, for example a requirement to 'unpack' and clearly state the costs of all services provided as part of a bundled offering.

5.16 We would therefore invite the PSR to consider an approach which would not focus on driving pricing to a focal point or "plain vanilla" benchmark by way of some attempt to facilitate price comparisons, which we consider could be harmful to competition, but rather consider a remedy that would ensure that merchants are able to access transparent pricing information from all providers across the sector to a minimum standard. This approach would address the PSR's concerns that merchants are not sufficiently aware of the prices and offerings of differing firms. As a starting point, ensuring merchants fully understand what they are paying for from all types of providers would help them make more informed choices. As part of a remedy, merchants could be assisted in this respect with a guide or set of pro forma questions they should ask providers in order at least to help them understand which of the many prices and pricing components are most important to them.

5.17 This type of remedy would avoid driving providers to a non-differentiated offering and a race to the bottom, but rather raise transparency standards for the benefit of merchants, irrespective of the provider with whom they contract and guide merchants to ask the right questions to enable them to evaluate the range of pricing offers and work out which offer is best for them.

5.18 Post-Brexit, the PSR will have discretion to review the disclosure obligations under the IFR. It may be appropriate for the PSR to consider using its discretion to revise the IFR to support a remedy that would apply information disclosure obligations across all providers of card-acquiring services to a standard that could then be adopted under some form of self-regulation across the sector as a whole.

(ii) Card acquiring contracts

5.19 As referred to at 4.12 above, the Merchant Survey results found that only 1% of merchants surveyed said the expiry of a contract would be a trigger for them to switch in the future. Therefore, we do not agree that there is robust evidence that the expiry of a card-acquiring contract would encourage more switching.

5.20 Furthermore, we have real concerns that imposing an end date in a card-acquiring contract risks leaving merchants exposed and without access to ongoing card-acquiring products and services and that this would be a bad outcome. [redacted] [redacted][59]. We agree with this view.

5.21 In principle, GPUK would be willing to engage with the PSR to discuss softer measures which could require providers of card-acquiring services to inform merchants that the term of their contracts is coming to an end in the period leading up to the contract expiry date. The format and content of such "nudges" could remind the merchant of the contract end date, prompt the merchant to consider shopping around and switching or making the decision to renew its existing contract. GPUK would be open to discussing further with the PSR whether this remedy could be linked to a proposed remedy on information disclosure (as suggested at paragraphs 5.14-5.18 above). For example, linking nudges to sharing information on the prices a merchant is currently paying.

[58] In particular Article 9(1), 9(2) and 12 of the IFR and Regulation 48 of the PSRs 2017.

[59] [redacted]

5.22 The PSR should be aware though that even a remedy of this nature will require investment and incur cost. The extent of these costs would depend on the precise shape and scope of the remedy. [redacted]

[redacted]

5.23 [redacted]

(iii) POS terminal contracts

5.24 In principle, GPUK do not object to the PSR imposing a remedy to address the impact being tied into a POS terminal contract has on merchants' ability to switch. We agree that the length, automatic renewal, and exit fees of POS terminal contracts may represent a barrier to small and medium sized merchants switching to a different provider of card-acquiring services.

5.25 We do however have concerns that the remedy proposed may be very difficult to achieve for the reasons set out below:

5.25.1 the proposal to limit the length of POS terminal contracts, for example to 18 months to align with the Consumer Credit Act ("**CCA**") creates friction between the requirements under PSD2 to restrict acquirers from offering card acquiring contracts longer than 12 months and an 18 month term for the POS terminal contract. It is not clear how the PSR sees these contractual periods working together – any remedy must clearly remain in line with the different regulatory requirements already in place. This issue is relevant also to the proposal to link the card-acquiring and POS terminal contracts. We do agree however in principle that a merchant should easily be able to exit a POS terminal contract where changes are made to the card-acquiring contract;

5.25.2 the PSR will need to consider carefully how any remedy relating to ISOs can be implemented on the basis that many ISOs are not regulated entities. Currently a majority of ISO's do not offer CCA contracts on terminal hire, it is considered as part of their membership agreement. Will these membership agreements also be subject to the 18 month end date? If not, it could create imbalance across the market, and still mean merchants face a barrier to switching. For example, typically ISOs will offer membership agreements for on average 3 years, which will tie the customer to the terms of the contract for this time. Often an ISO will charge full early termination fees, usually the full amount remaining on the contract;

5.25.3 the PSR would need to consider how ISOs will be brought into scope of the remedy without placing undue pressure on the industry. The role and responsibilities of acquirers versus ISOs means that acquirers are not well placed to monitor or police the behaviour and business practices of ISOs;

5.25.4 there is a risk that if the term for POS terminal contracts is reduced this could lead to a different cost model and increased prices and/or or higher exit fees to enable ISOs to recoup the cost of the asset during a shorter contract term;

5.25.5 we do not consider there is a workable technical solution (e.g. universal accreditation) in the short term to enable interoperability between all POS terminals and acquirers.

5.26 [redacted]

5.27 In principle we consider that an option for the PSR to consider would be for exit fees to reduce after 3 years so that merchants can more easily terminate their POS terminal contract and switch their card-acquirer at that point. The merchant would have the choice to remain under contract but the reduction in exit fee would facilitate switching at that point and thereafter at any point during the remainder of the contract. This may result in ISOs front loading the asset cost to protect against the risk of not being able to amortise the cost over a longer period, but it could reduce the impact of long term POS terminal contracts acting as a barrier to switching. The PSR would need to weigh up the benefits to merchants of being able to switch more easily with the increased initial cost under a shorter POS terminal contract. GPUK would be willing to discuss such an approach further with the PSR, but it wishes to stress that the introduction of any such remedy would be subject to further engagement and consultation with industry stakeholders.

GPUK Technical Annex

RBB | Economics

[redacted]

PSR Acquirer Review

Response to pass-through analysis

RBB Economics, 09 February 2021

1 Introduction and Executive Summary

This report is prepared by RBB Economics at the request of Eversheds Sutherland, counsel to Global Payments UK, responding to the PSR's findings in Section 5 of its Interim Report.

Based on analysis of the merchant sample data (the Data) submitted by the five largest acquirers, the PSR concluded in Section 5 of its Interim Report that:

- Merchants with annual card turnover up to £50 million received, on average, little or no pass-through of the IFR savings – indicating that the supply of card-acquiring services may not be working well for these merchants;
- Merchants can secure better deals in the form of lower MSCs by switching their provider of card-acquiring services because, on average, new customers pay less.[1]

After reviewing the PSR's analysis and carrying out our own assessment on the disclosed Data in the PSR's Confidentiality Ring, we explain in this note that both of these conclusions are misconceived. Specifically:

- In Section 2, we reiterate that the pass-through rate cannot be used as a reliable indicator of the intensity of competition. According to economic theory, there is no basis for using the industry-wide pass-through ("IWPT") rate to gauge the degree of competition in the market. In other words, the extent to which interchange fee reductions are passed-on by the five largest acquirers examined does not provide a reliable measure of the intensity of competition among acquirers.

[1] Page 56 of the Interim Report.

- In Section 3, we show that putting the above fundamental concern to one side, it is also the case that the PSR has interpreted its econometric results incorrectly. In fact, the PSR's own results presented in Annex 2 of the Interim Report suggest that pass-through of interchange fees is high.
  - The PSR's baseline model ("model 2") uses the interchange fee margin (defined as MSC less interchange fees) as the dependent variable. This model cannot be used to estimate pass-through. In fact, *the model is only valid if pass-through is 100%* - it *assumes* full pass-through. The model can only capture *other* influences on the MSC.
  - To estimate the extent to which a fall in the IF has led to a fall in the MSC, holding other factors constant (i.e. to estimate IF pass-through), Model 1 of the PSR's analysis should be used. Results of Model 1 presented in the Interim Report in fact show a high level of interchange fee pass-through for the full range of merchants. This finding (i.e. that pass-through is high) is robust to sensitivity testing.
  - The IFR dummy employed by the PSR in its baseline model estimates how much the interchange fee margin has changed in the period after the IFR came into force compared to that in the period before. A positive coefficient means that the *average* margin for the period after the IFR came into force is higher than the *average* margin for the period before. It is not possible to infer from the IFR dummy whether the increase in margin occurred at the time of the IFR – the interchange fee margin could have increased before the IFR, much later in the post-IFR time period (e.g. in 2017-2018), or gradually over the entire time period examined (i.e. 2014-2018). A positive coefficient of the IFR dummy does not indicate that the increase in margin is due to a failure to pass-through interchange fee reductions.
  - Therefore, based on this model, the PSR cannot draw the conclusion that, on average, merchants with annual turnover between £15,000 and £50 million received little or no pass-through of the interchange fee savings. This is wrong. If the model is valid, the cause of a higher interchange fee margins is something else.
  - There is no basis to presume that weaker competition has led to higher interchange fee margins over time. First, the PSR's model is unable to test the impact of competition on the interchange fee margin – it contains no variable that captures the degree of competition. Second, the PSR's own evidence suggests that, if anything, competition has increased since 2014. Specifically, the PSR has provisionally found that competition is working well in the card-acquiring market: competition is fierce for large merchants with annual turnover over £50 million and for the remaining merchants, market concentration is low and there are no significant barriers to entry.[2] In our view, therefore, the most likely reason for the positive coefficient is that costs that are not captured in the PSR's dataset have risen (see further below on missing cost data).
- Additionally, we show in Section 4 that a proper analysis of the Data demonstrates that the extent to which new customers pay less [...]. Moreover, the Data do not enable the

[2] Further discussed in section 2 of GPUK's response to the Interim Report.

PSR to infer that merchants obtain these benefits by switching – it is not possible to track whether a merchant has switched in the Data.

- Finally, in Section 5 we set out the significant shortcomings in the Data, inter alia due to missing information on important costs. This means that any conclusions drawn from analysis of the Data should be made with caution.

2 Pass-through is not a reliable indicator of the intensity of competition

According to economic theory, there is no basis for using the industry-wide pass-through ("IWPT") rate to gauge the degree of competition in the market. In other words, the rate of pass-through of interchange fee changes by the five largest acquirers examined does not provide a reliable measure of the intensity of competition among acquirers.

As we explained in a previous submission to the PSR:

- Under the setting of perfect competition (i.e. where competition is most intense), the IWPT rate need not be 100%. Indeed, a rate of anything between 0% and 100% would be compatible with perfect competition.
- Under the setting of oligopolistic competition (i.e. where competition is imperfect), there is no general result that higher IWPT rates are associated with more intense competition. Moreover, there is also no absolute level of the IWPT rate below which competition can be presumed ineffective.
- The characteristics of the card acquiring market, especially its dynamism (such as new entry and growth), ongoing innovation, and frequent regulatory changes do not satisfy the assumptions required in theory to derive a positive correlation between IWPT rates and the intensity of competition.[3]

3 The PSR's finding of no pass-through is incorrect

In its econometric analysis, the PSR is interested in estimating the pass-through rate of interchange fee, which captures the extent to which a fall in the IF directly causes a fall in the MSC. The PSR presented three models to measure this in paragraphs 1.11 and 1.12 of Annex 2. Controlling for the same additional variables, the three models differ in that each of them has a different dependent variable:

- Model 1 uses MSC (as a percentage of monthly card turnover) as dependent variable;
- Model 2 uses MSC less interchange fee ("the interchange fee margin") as dependent variable; and

---

[3] See section 4 of "Global Payments A response to the PSR Notice reques ing data for pass-through analysis", RBB Economics, 24 July 2019 (the "RBB pass-through note")

- Model 3 uses MSC less interchange fee, less scheme fee ("the merchant net revenue") as dependent variable.

In all the three models, the PSR estimated the coefficient of the IFR dummy variable, which equals 1 after the IFR caps came into force, and 0 before.

The PSR focused on Model 2 and used this as its baseline model. Based on the estimates of the coefficient of the IFR dummy variable, the PSR claims that interchange fee margins increased for merchants with turnover between £15,000 and £50 million by a similar or larger amount than the reduction in average interchange fees. On this basis, the PSR concludes that, on average, these merchants received little or no pass-through of the interchange fee savings.[4]

This conclusion is misconceived. The pass-through rate captures the extent to which the MSC changes when the IF changes. The PSR's Model 1 is the only approach among the three that allows the IF pass-through rate to be estimated. This regresses the MSC on the IF and other explanatory variables. The pass-through rate is simply the coefficient on the IF variable (to verify this, note that the pass-through rate is the partial derivative of the MSC with respect to the IF.) The results of Model 1, published in Table 20 of Annex 2, show a substantial level of interchange fee pass-through for all groups of merchants (see section 3.2 below).

3.1 The PSR's analysis of its baseline model does not estimate the level of pass-through

The PSR's baseline model (Model 2) is not valid as it uses the interchange fee margin as the dependent variable. As the PSR itself pointed out, moving from Model 1 to Model 2 imposes a restriction that the coefficient on interchange fees is equal to one, which would hold under full pass-through of interchange fees.[5] In other words, the model is <u>only valid</u> if interchange fee pass-through is <u>100%</u>. In addition, by imposing the restriction that there was full pass-through of interchange fees, Model 2 was not estimating pass-through, but rather estimating other impacts on the interchange fee margin, holding pass-through constant (at 100%).

Specifically, a positive coefficient of the IFR dummy variable shows that the *average* interchange fee margin was higher in the period after the IFR came into force compared to that in the period before, after controlling for other factors including scheme fees. This is not a finding that there is little or no pass-through for merchants: the positive coefficient of the IFR dummy does not indicate that interchange fee margin went up at the time of the IFR, much less that the interchange fee margin went up *due to* a failure to pass-on interchange fee reductions from the IFR. The positive coefficient of the IFR dummy could indicate an increase in interchange fee margin before the IFR, much later in the post-IFR time period (e.g. in 2017-2018), or a gradual increase over the entire time period examined (i.e. 2014-2018).

4 Paragraph 1.69, Annex 2 of the Interim Report. The data on merchants with annual turnover less than £15,000 are not reliable and therefore excluded from he conclusion, see Box 3 of Annex 2 for more details.

5 Paragraph 1.13, Annex 2 of the Interim Report.

3.2 The Data shows a high level of pass-through of interchange fees

To estimate the pass-through of interchange fees, influences on the MSC need to be assessed separately. This is, in essence, the approach of the PSR's "Model 1". Model 1 allows us to estimate the following separate effects: (a) the extent to which a fall in the IF has led to a fall in the MSC, holding other factors constant (i.e. IF pass-through); (b) the extent to which an increase in scheme fees has led to an increase in the MSC, holding other factors constant (i.e. SF pass-through); and (c) the extent to which the MSC has changed over time (after controlling for the influence of the IF and SF on the MSC).

Table 20 of Annex 2 presents the results of this approach. The column "Model 1" in Table 1 below summarises the estimated coefficient of the interchange fee variable in Table 20 of Annex 2. The estimated coefficient is at least 0.63 for the full sample, and is even higher for individual merchant groups. This indicates that pass-through of interchange fees is at least 63% and even higher when individual merchant groups are considered. The estimated coefficient is very close to 1 for the IC++ merchants, which is what we would expect as these merchants automatically receive 100% of interchange fee pass-through. These results therefore seem sensible as estimates of interchange fee pass-through.

We have run additional sensitivity checks on the Data and the results seem to confirm that these estimates are robust. Focusing on the MSC as the dependent variable and estimating the coefficient of the interchange fee variable, we ran the following regressions:

- Model 1 omitting the IFR dummy;
- Model 1 omitting the IFR dummy while including a monthly time trend; and
- Model 1 omitting the IFR dummy while including year dummies.

The estimated coefficients of the interchange fee variable from these regressions are also summarised in Table 1 below. We find that interchange fee pass-through to merchants is generally over [...], and usually above [...] even for the smallest merchants. In other words, the Data suggest that interchange fee pass-through by acquirers is substantial. This is also the case based on regressions using the Data without imputed information.[6]

The results reported in the Interim Report for Model 1, [...], also find that scheme fee pass-through is positive and significant in several cases, although for the IC++ merchants the value is too high – likely reflecting errors in the scheme fee data.[7] This is further discussed in section 5.

---

6 For the variables used in the estimation of Model 1 (specifically the scheme fee variable), observations from [...]'s sample account for most of the imputed data, as the 2014 and 2015 data on scheme fees are not available. We have therefore excluded he [...] sample altogether when es imating the model using non-imputed dataset. In any case, the conclusions do not change whether we use the non-imputed dataset as it is, or exclude the [...] sample. See the STATA code and output in he accompanying analysis files for more details.

7 The estimated coefficient of the scheme fee variable is in general statistically significant and positive. In Model 1, this is [...] for IC++ merchants, see Table 20 of Annex 2. For the estimates in our alterna ive models, see Tables 3 and 4 in Annex A below.

Table 1: Comparison between the coefficients on the interchange fee variable in different models

	Model 1[8]	Model 1 omitting the IFR dummy[9]	Model 1 omitting the IFR dummy while including a monthly time trend[10]	Model 1 omitting the IFR dummy while including year dummies[11]	Number of observations
Group 1	0.7635***	[...]	[...]	[...]	84,694
Group 2	0.8964***	[...]	[...]	[...]	466,227
Group 3	0.9834***	[...]	[...]	[...]	129,109
Group 4	0.9454***	[...]	[...]	[...]	85,917
Group 5	0.7915***	[...]	[...]	[...]	48,534
Group 6	0.7898***	[...]	[...]	[...]	5,406
Group 7	0.7689***	[...]	[...]	[...]	1,482
Group IC++	1.0006***	[...]	[...]	[...]	5,484
All sample	0.6278***	[...]	[...]	[...]	828,139
Groups 2 - 7	-	[...]	[...]	[...]	736,675

Source: *Table 20, Annex 2 of the Interim Report; RBB analysis of data submitted by the 5 largest acquirers; asterisks denote the level of statistical significance: *** p<0 001, ** p<0.01, * p<0.05.*

3.3 An increase in the interchange fee margin over time is likely explained by costs increases not accounted for in the Data

In addition, even if there is interest in understanding whether the interchange fee margin has gone up over time (holding IF pass-through constant at 100%), the estimated coefficients of the IFR dummy in Model 2 are not robust. To show this, we add a monthly trend to Model 2 and present in Table 2 below the comparison of the resulting estimates with those from the PSR's Model 2.[12]

Table 2 shows that the estimated coefficient on the IFR dummy [...] when a time trend is added to the PSR's Model 2. [...].

[...]. Since, as the PSR noted, data for Group 1 is unreliable, and that IC++ merchants have a markedly different pricing structure, we also carried out the regression for an alternative aggregated sample of merchants in Groups 2 - 7.[13] For these merchants overall, the estimated coefficient of the IFR dummy is [...].

8 See Table 20, Annex 2 of the Interim Report.
9 For full results, see Table 2 in Annex A below.
10 For full results, see Table 3 in Annex A below.
11 For full results, see Table 4 in Annex A below.
12 [...].
13 The PSR explained that data on merchants with annual turnover less than £15,000 (i.e. Group 1 merchants) are not reliable, see Box 3 of Annex 2 for more details.

Table 2: Estimated coefficients of the IFR dummy

	Model 2[14]	Model 2 adding time trend[15]	Number of observations
Group 1	0.3261***	[...]	84,694
Group 2	0.1742***	[...]	466,227
Group 3	0.1390***	[...]	129,109
Group 4	0.1367***	[...]	85,917
Group 5	0.1141***	[...]	48,534
Group 6	0.1218***	[...]	5,406
Group 7	0.0459***	[...]	1,482
Group IC++	-0.0225***	[...]	5,484
All sample	0.1864 ***	[...]	828,139
Groups 2 - 7	-	[...]	736,675

*Source: Table 10, Annex 2 of the Interim Report; RBB analysis of data submitted by the 5 largest acquirers; asterisks denote the level of statistical significance: *** p<0.001, ** p<0.01, * p<0.05.*

[...].[16] [...].[17] Although these estimates after including a monthly time trend are still statistically significant, their values are very low and their significance should not be over-interpreted in an economic analysis.

These results are very different from those summarised by the PSR in paragraph 1.69 of Annex 2 of the Interim Report, namely that the estimated coefficients of the IFR dummy are "*higher than or not significantly different from the average reduction in their interchange fees*". Therefore, the results after controlling for the time trend *do not* indicate that "*on average, these merchants [with annual card turnover between £15,000 and £50 million] received little or no pass-through of the IFR savings*".[18]

[...]. Most likely, the increasing interchange fee margin reflects the rising costs to acquirers that are not included in the Data, which will be explained further in Section 5.

Importantly, there is no basis to infer that the increase in interchange fee margin was due to weakening competition over time. The PSR's own evidence suggests that, if anything, competition has increased since 2014. Specifically, the PSR has provisionally found that competition is working well in the card-acquiring market: competition is fierce for large merchants with annual turnover over £50 million and for the remaining merchants, market concentration is low and there are no significant barriers to entry.[19]

14 See Table 10, Annex 2 of the Interim Report.
15 For full results, see Table 1 in Annex A below.
16 The average reduction in interchange fees is calculated by the PSR, see Table 4 of Annex 2 of the Interim Report.
17 Paragraph 1.69, Annex 2 of the Interim Report.
18 Paragraph 1.69, Annex 2 of the Interim Report.
19 Further discussed in section 2 of GPUK's response to the Interim Report.

4 The Data do not permit gains from switching to be estimated

We also challenge the PSR's finding that new merchants pay less, and that this shows that when merchants switch provider of card-acquiring services, they can secure better prices.

First of all, we note that the Data only allow us to identify merchants who are new to a given acquirer and do not allow the distinction to be made between merchants new to card acquiring and merchants who switched from another acquirer. Therefore, the estimated benefit for merchants that are new to a particular acquirer cannot confidently be interpreted as a benefit of switching.

Secondly, the PSR's estimates are not robust. The PSR estimated the impact of merchant age (i.e. the time a merchant has contracted with an acquirer) on MSC using Model 1, and presented the results in Table 12 of Annex 2 of the Interim Report.[20] Since the MSC seems to vary over time (as evident from Section 3.1 and results from the PSR's analysis), we have estimated the model including controls for year.[21]

Table 3 below summarises the estimates of indicators of merchants' contracted time with an acquirer from (i) the PSR's model (Table 12 of Annex 2) and (ii) our analysis where we add controls for years ("annual dummies"). We found that:

– [...].

– [...].

As a sensitivity check and an alternative to control for the evolution of MSCs over time, we also ran a regression with a monthly time trend instead of a yearly dummy variable. [...]. The results are presented in Table 6 of Annex A below.

Table 3: Comparison between the coefficients on the age dummies in PSR's Model 1 and when adding annual dummies.

	Model 1 (Table 12 of Annex 2)			Model 1 (Table 12 of Annex 2) adding annual dummies[22]			Number of observations
Age indicator	1	2	3	1	2	3	
Group 1	0.6394***	0.9861***	1.3326***	[...]	[...]	[...]	84,694
Group 2	0.1021***	0.1898***	0.2982***	[...]	[...]	[...]	466,227
Group 3	0.0534***	0.1051***	0.1681***	[...]	[...]	[...]	129,109
Group 4	0.026 6***	0.0806***	0.1385***	[...]	[...]	[...]	85,917

20 Model 1 with MSC as dependent variable, including indicators for how long a merchant has contracted with the acquirer ("age indicators"). These indicators are defined in paragraph 1.84 of Annex 2 of the Interim Report.

21 Table 25, Annex 2 of the Interim Report shows that the coefficients of annual dummies are significant for all merchant groups except the IC++ merchants. This suggests that MSC (less interchange fee) is on average different for merchants in different years.

22 For full results, see Table 5 in Annex A below.

	Model 1 (Table 12 of Annex 2)			Model 1 (Table 12 of Annex 2) adding annual dummies[22]			Number of observations
Age indicator	**1**	**2**	**3**	**1**	**2**	**3**	
Group 5	0.0343***	0.0906***	0.1187***	[...]	[...]	[...]	48,534
Group 6	-0.0025	0.0378**	0.0729***	[...]	[...]	[...]	5,406
Group 7	0.0055	0.0306*	0.0512***	[...]	[...]	[...]	1,482
Group IC++	-0.0057	-0.0610*	-0.0603*	[...]	[...]	[...]	5,484
All sample	0.2140***	0.3385***	0.4712***	[...]	[...]	[...]	828,139
Groups 2 - 7	-	-	-	[...]	[...]	[...]	736,675

Source: *PSR's Interim Report and RBB analysis using data submitted by the 5 largest acquirers; asterisks denote the level of statistical significance: *** p<0.001, ** p<0.01, * p<0.05.*

5 Significant shortcomings in the Data mean any conclusions should be made with caution

It is also important to note the significant shortcomings in the Data. This means that any conclusions based on econometric analysis should be drawn with caution.

Most notably, the data on scheme fees are flawed: (i) one acquirer could not provide scheme fee data for 2014/2015, and the PSR relied on imputation to fill in these gaps;[23] (ii) acquirers told the PSR that not all scheme fees can be allocated to the merchant level and may therefore not be recorded in the data; and (iii) there may be some discrepancies between acquirers in the way they allocated scheme fees to individual merchants.[24]

The PSR noted the flaws of the scheme fee data but said that they do not think this problem "*significantly impacts on our ability to examine pass-through of IFR savings*" since scheme fees are small as a percentage of total MSC.[25] We disagree. Data limitations mean that the PSR cannot properly account for the influence of scheme fees on the MSC, which in turn makes it harder to estimate the impact of interchange fees on the MSC (since the latter impact should be measured 'holding constant' any other influence on the MSC). Indeed, the PSR also notes in its Interim Report that "*while the effect of scheme fee increases on the MSC is likely to be less significant than changes in interchange fees, it isn't negligible*".[26] As noted in section 3.2 above, the regressions of IC++ merchants show that the estimated coefficient of the scheme fee variable is larger than 1.[27] This is too high and may indicate that the scheme fee data are indeed unreliable as IC++ merchants should have automatic scheme fee pass-through – we would expect the estimated coefficient to be 1.

23 Page 17, Annex 2 of the Interim Report.
24 Page 16, Annex 2 of the Interim Report.
25 Page 16, Annex 2 of the Interim Report.
26 Paragraph 5.10 of the Interim Report.
27 See Table 3 and Table 4 in Annex A below.

In addition, the Data do not allow analysis of the IFR capped transactions separately from those that remain uncapped (e.g. non-EU international transactions and transactions on commercial cards). The IFR only puts in place a cap on the interchange fees for domestic consumer debit and credit cards. Therefore, to analyse IF pass-through, we would ideally limit the sample to include only the capped transactions. This is however not possible, as tariffs are often blended, and acquirers may not be able to record MSC data at a level disaggregated by transaction types. The PSR's analysis is therefore based on data for all transactions, including those that attract very high IFs (e.g. commercial cards and international cards). Although the PSR tried to control for this in its model by including the share of transactions on domestic consumer debit cards and the share of transactions on domestic consumer credit cards, this fix is imperfect. The estimates may therefore be biased.

Lastly, the Data only include the interchange fee and some (but by no means all) scheme fee costs, and exclude all other direct and indirect costs incurred when providing acquiring services. By focusing only on the MSC and the interchange fee and scheme fee costs, the PSR does not take into account other important factors that are likely to impact the MSC. In particular, the need for frequent innovation and compliance with evolving regulations (e.g. improving data security) are key characteristics of the card acquiring market and require significant ongoing investments from acquirers.[28] The costs of such investments likely have an impact on the MSC. Excluding these important costs may therefore bias the results.

[28] Further discussed in section 2 of GPUK's response to the Interim Report.

Annexes

A Regression results

Table 1: Regression results with time trend, interchange fee margin as dependent variable, by merchant group.

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
IFR dummy	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Scheme fees	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Log of transaction volume	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Proportion of chargebacks	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of face-to-face transactions	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped credit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped debit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Monthly time trend	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Constant	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Number of observations	84,694	466,227	129,109	85,917	48,534	5,406	1,482	5,484	828,139	736,675

*Source: RBB analysis of data submitted to the PSR by the 5 largest acquirers. Robust standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05.*

Table 2: Regression results, MSC as dependent variable, by merchant group.

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
Interchange fees	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
Scheme fees	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Log of transaction volume	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Proportion of chargebacks	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Share of face-to-face transactions	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Share of capped credit	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Share of capped debit	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Constant	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Number of observations	84,694	466,227	129,109	85,917	48,534	5,406	1,482	5,484	828,139	736,675

Source: *RBB analysis of data submitted to the PSR by the 5 largest acquirers. Robust standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05.*

Table 3: Regression results with time trend, MSC as dependent variable, by merchant group.

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
Interchange fees	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Scheme fees	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Log of transaction volume	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Proportion of chargebacks	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Share of face-to-face transactions	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
Share of capped credit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped debit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Monthly time trend	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Constant	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Number of observations	84,694	466,227	129,109	85,917	48,534	5,406	1,482	5,484	828,139	736,675

Source: *RBB analysis of data submitted to the PSR by the 5 largest acquirers. Robust standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05.*

Table 4: Regression results with annual dummies, MSC as dependent variable, by merchant group.

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
Interchange fees	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Scheme fees	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Log of transaction volume	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Proportion of chargebacks	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of face-to-face transactions	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped credit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped debit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Annual dummy (2015 as base year)										
	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
2014	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
2016	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
2017	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
2018	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Constant	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Number of observations	84,694	466,227	129,109	85,917	48,534	5,406	1,482	5,484	828,139	736,675

Source: *RBB analysis using data submitted to the PSR by the 5 largest acquirers. Robust standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05.*

Table 5: Regression results with annual dummies and age indicators, MSC as dependent variable, by merchant group.

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
Interchange fees	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Scheme fees	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Log of transaction volume	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Proportion of chargebacks	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of face-to-face transactions	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped credit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped debit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Annual dummy (2015 as base year)										

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
2014	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
2016	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
2017	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
2018	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Age indicator										
1	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
2	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
3	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Constant	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Number of observations	84,694	466,227	129,109	85,917	48,534	5,406	1,482	5,484	828,139	736,675

Source: *RBB analysis using data submitted to the PSR by the 5 largest acquirers. Robust standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05.*

Table 6: Regression results with time trend and age indicators, MSC as dependent variable, by merchant group.

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
Interchange fees	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Scheme fees	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
Log of transaction volume	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]
	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])	([…])
	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]	[…]

	Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7	Group IC++	All sample	Groups 2 - 7
Proportion of chargebacks	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of face-to-face transactions	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped credit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Share of capped debit	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Monthly time trend	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Age indicator										
1	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
2	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
3	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Constant	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]	[...]
	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])	([...])
Number of observations	84,694	466,227	129,109	85,917	48,534	5,406	1,482	5,484	828,139	736,675

Source: *RBB analysis using data submitted to the PSR by the 5 largest acquirers. Robust standard errors in parentheses; *** p<0.001, ** p<0.01, * p<0.05.*

Handepay

Handepay Limited response to PSR in respect of Interim Report on the supply of card-acquiring services dated 15th September 2020.

Handepay are pleased to be able to offer feedback following the PSR's interim report from September 2020. In preparing our feedback, we have considered the points raised in the interim report, how we operate in the market today and how we deliver value to merchants. We have prepared feedback in direct response to the points raised in the report and also made some general comments for the PSR to consider.

All Handepay comments are below in red.

As a reminder – what we found

The interim report on the supply of card acquiring services showed that merchants could make savings by shopping around and either switching or negotiating with their current provider – but many small and medium ones don't.

While many small and medium merchants may not be getting a good deal, the report found the market for card acquiring services works well for the largest merchants. Broadly speaking, the PSR identified three areas of concern: on merchant contracts for card acquiring services, on point-of-sale (POS) terminal contracts, and on the difficulty for merchants to compare prices.

The interim report includes several potential remedies to make it easier to search and switch for a new provider or better deal, including:

- *Requiring all contracts for card-acquiring services to have an end date, providing a prompt for merchants to shop around.*
  Handepay comment – we would suggest that a fixed end date to either terminal agreements or acquiring contracts would create a huge risk for merchants who might inadvertently miss the deadline and have their services cancelled.
- *Requiring changes to POS terminal contracts to limit their length, ending contracts that auto-renew for successive fixed terms and making it easier to exit POS terminal contracts without incurring exit fees.*
  Handepay comment – limiting contract length could have the effect of driving up the price a customer pays as there are fixed costs involved in the supply of POS terminals which need to be recovered. As above, auto renewal does provide a guaranteed continuation of service which would not necessarily happen at the end of a fixed term. Currently Handepay offers to pay (in most cases completely) the cost of a customer exiting their existing contract to switch to us and other providers offer similar propositions so we don't agree this is a barrier to customers switching in all cases.

- *Making it easier for merchants to research and compare prices and options available to them.*
  Handepay comment – We agree that it can be complicated for customers to compare prices which is why we offer a no obligation price comparison and produced a free guide to card payments to help customers compare. There are two issues here 1) The underlying fee structure for card acceptance is complicated i.e. interchange and scheme fees which differ between card brands, card types and the territory the card was issued in and 2) providers are often not clear on all the costs that a customer may incur when accepting a card payment e.g. PCI fees, authorisation fees etc and there is no uniformity in how the costs are presented on a quote or statement.

Handepay would also like to make the following general points for the PSR to consider:

1) It is important that any regulation be applied equally to all types of contract under which POS equipment is provided in the market e.g. rental, membership and service agreements.
2) It is important that any regulation covers all equipment types provided in the market e.g. standalone POS devices, card reader only (with connected app), EPOS lite (standalone POS with additional basic EPOS functionality), semi integrated solutions (standalone POS connected to EPOS), fully integrated solutions (card reader/PED only connected to EPOS).
3) There is no mention in the report of Gateway services for e-commerce and / or Virtual Terminal contracts. Will the PSR clarify if such contracts would be in or out of scope of any regulation?
4) Will any regulation cover new business and / or re-signs only from a point in time, or also be applied retrospectively to existing contracts already in the market? We believe the latter would be extremely disruptive as investments made in winning customers have been done so under conditions prevailing at the time the customer signed up.
5) The PSR have offered no indicative timescales for either a) the publication of a final report or b) when any new regulation might take effect. We would encourage early engagement on proposed timescales to give providers time to adapt if required.

Judopay

Judopay

Alternative Payments Ltd . (t/a Judopay)
41 Luke Street, London, EC2A 4DP
UK: +44 (0) 203 503 0600
www.judopay.com
Registered company number: 07959933

[redacted]
Payment Systems Regulator
12 Endeavour Square
London
E20 1JN
By email: cards@psr.org.uk

8th December 2020

Dear Sirs

Re: MR18/1.7 - Market review into the supply of card-acquiring services: Interim report

Alternative Payments Limited (trading as Judopay), is a mobile-centric payments solutions provider, focused on helping merchants to remove friction from the checkout so that consumer shopping experiences are enhanced.

Judopay has two business models – a 'gateway only' model and a 'full stack' acquiring model working as an ISO to three established acquirers. Connecting to 100+ acquiring institutions and payment technology partners, a single integration to Judopay opens the door to global commerce, loyalty software, fraud solutions, alternative payment methods (eg. Apple Pay, Google Pay) and innovative payment technology. Our focus is on medium-sized merchants looking to embrace the digital age, which in our opinion is a segment currently underserved by the market, and particularly the large incumbent players.

Judopay welcomes the opportunity to respond to the Payment Systems Regulator's Interim Report on the market review into the supply of card-acquiring services (MR18/1.7). In this response, we make our Introductory Comments on the issue, we set out our Key Points, then answer the questions posed in the Interim Report.

Introductory Comments

Judopay commends the PSR for launching this review. We encourage more competition as a means of providing more options to merchants, encouraging more value-add services and to trigger greater innovation in product offerings.

At Judopay, “transparency” is a core value, enabling merchants to stay informed and understand their business dynamics is part of our DNA. As an organization providing services to the medium-sized merchants we aim to be as transparent as possible.

Key Comments

Judopay is in agreement with a number of the proposed remedies which the PSR has stated in the interim report - making it easier to search and switch to a new provider and seek better deals. Judopay does not have restrictive contractual terms, but instead relies on our best breed of service and value-adds to maintain and extend our customer relationships. Judopay agrees that the payments system is not particularly transparent as it relates to fee structures and card scheme fees.

Significant risks are taken on by acquirers and payment facilitators whether operationally or regulatory, these factors should also be considered in levelling the playing field for all players. In particular to make that compliance obligations are not unnecessarily being passed to smaller players such as PSP’s and ISO’s which then require the implementation of sophisticated systems without much flexibility to reap a cost benefit.

There are other barriers than pricing which should be considered in more detail when merchants decide on switching, it would be good to see a more comparative study done alongside other factors to include specific product features, reliability etc.

Answers to Consultation Questions

1. **Do you have views on the provisional findings set out in this report?**
   It is our opinion that pricing, although a significant factor is not the only reason that a merchant would consider choosing a different provider for their acquiring service. There are many other variables to consider, such as value added services, reliability, operating jurisdictions, contractual obligations, data insights to mention a few. Therefore it is our suggestion that further analysis could be done on these competing demands in order to have a more comparative perspective.

2. **Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?**
   - **The PSR has proposed that all contracts for card-acquiring services to have an end date, providing a prompt for merchants to shop around.**

   Judopay agrees with this proposed remedy, however we have not found that having an end date in our contracts has significantly impacted our rate of attrition. We currently do not have restrictive contracts in place and our experience has not been that coming up to the end date that our merchants are opting to terminate.

   - **Making it easier for merchants to research and compare prices and options available to them.**

Judopay is supportive of the proposed switching remedies by the PSR . These will help provide greater transparency and remove existing contractual barriers. A requirement for pricing to be more readily available will achieve this objective but as already discussed there are other factors to be considered when a merchant decides to switch or not. In some cases, the need for a reliable service will outweigh the cost of paying that bit more.

3. **Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?**

N/A

4. How does COVID-19 impact on our review?

We agree with the PSR's interim report where the Covid-19 has accelerated many established trends within the e-commerce and m-commerce space in the growth of online spending. Businesses started to see an increasing need for in app and mobile payments for their customers. Many smaller businesses who were not yet at the point of going online were forced to do so overnight. This acceleration in our view should be seen as a positive indicator that online payments have grown and become more seamless in order to rapidly respond to the needs of new customers.

Yours faithfully

[redacted]

Alternative Payments Ltd. t/a Judopay
41 Luke Street, London, EC2A 4DP
UK: +44 (0) 203 503 0600
www.judopay.com
Registered company number: 07959933

Lloyds Bank Cardnet

[redacted]

LLOYDS BANK CARDNET

LLOYDS BANK CARDNET

Response to the PSR's Interim Report on the Market Review into the Supply of Card-Acquiring Services

Submission Date: 9th February 2021

Views on Consultation

1.0 INTRODUCTION

Lloyds Bank Cardnet (Cardnet) welcomes the Payment Services Regulator's (PSR) Market Review (Review) regarding the supply of card acquiring services and the opportunity to comment on the Interim Report.

Without looking to provide detailed comments on the PSR's description of the industry, Cardnet consider (and this appears to us clear from the PSR's description) that the provision of card acquiring services for all types of merchants is a dynamic and competitive market without significant barriers to entry or expansion.

Cardnet is also pleased to note the PSR's views that most small and medium-sized merchants that search and switch providers do not report facing difficulties when doing so and merchants' general satisfaction with provider customer service and the level of information provided, including on price.

However, Cardnet shares the PSR's commitment to ensuring all merchants can benefit from competition to the greatest extent possible. Cardnet therefore very much welcome the opportunity to have a constructive and ongoing dialogue with the PSR on potential remedial action.

Please note that this response is primarily focused on the potential remedial actions outlined in the PSRs Interim Report, though general observations regarding the report are contained in section 2.0 below.

2.0 GENERAL OBSERVATIONS ON THE INTERIM REPORT

Before responding to the PSR's proposed remedial actions, Cardnet would first like to share general observations on the Interim Report.

2.1 Turnover level

In the report it is stated that the PSR believe the supply of card acquiring services does not work well for small and medium-sized merchants with an annual card turnover up to £50m. Cardnet does not agree this is the appropriate level to consider and a more appropriate level may be in the region of £10m, which Cardnet proposes is a more accurate reflection of SME sized businesses.

2.2 Interchange fees

From the outset, [redacted]

[redacted]

2.3 Scheme fees

[redacted]

[redacted]

[redacted]

Due to the evolvement of the highly complex pricing structure and based on growing feedback from Cardnet merchants, Cardnet is increasingly looking to provide SMEs with simple pricing tariffs that effectively provide the merchant [redacted]. However, this is increasingly difficult for acquirers to calculate based on the multitude of card price points that the schemes now use in determining rates for different cards and transactions.

Cardnet does appreciate the decision made by the PSR in its ToR decision not to focus on scheme fees and that these may be subject to a separate review. This is however an area that Cardnet would welcome more discussion on in the context of providing simple pricing for merchants and feels it needs to be considered with respect to some of the remedial actions the PSR is looking to propose, most notably the introduction of price comparisons.

2.4 Regulation

Cardnet believe that all participants involved in the selling of card-acquiring services should be subject to the same legislative rules and codes of conduct as acquirers. This would go some way to ensuring a level playing field for all participants.

Cardnet would also like to highlight that given the complexities of the merchant acquiring ecosystem, consideration should be given to ensure that all providers within this ecosystem adhere to the same regulatory standards.

3.0 POTENTIAL PSR REMEDIES

3.1 Contracts for card-acquiring services

Although the PSR highlights the possibility of enforcing end dates on acquiring contracts, it is important to highlight that according to the Review only 1% of merchants interviewed said that the expiry of the contract would make them switch and indicated they had managed to negotiate a better acquiring deal.

Cardnet refers the fulfilment and servicing of its POS Terminals (terminals) to third parties who have the contractual relationship with those merchants. Aligning the duration of the acquiring contract with the terminal leasing contract would therefore be problematic and may result in a complicated merchant journey and could have other unintended consequences such as increased cost.

The PSR proposes a fixed length contract as a potential remedy but Cardnet is concerned that taking this proposed remedy in its literal sense would mean ceasing a merchant's acquiring service because the merchant has not renewed their current contract or switched to another provider. This could be detrimental to the merchant and cause them to lose trade and income by having their acquiring service terminated. In our experience, previous communication with merchants on an "opt in" basis has typically seen a response rate of between [redacted].

If the contract is simply terminated at 18 months, the PSR needs to consider how 'active chargebacks' would be managed as if this was not managed effectively key stakeholders in the payments ecosystem could be detrimentally impacted e.g. cardholders.

As per the current Payment Services Regulations, merchant acquirers are required to provide one month's notice to terminate a merchant's contract, so consideration needs to be given regarding how this regulation operates under the PSR's proposed 'fixed term' contract.

A possible solution to this would be to keep the contracts as they are now but to have a robust communication process in place that informs merchants that they can now renegotiate terms. If however the merchant doesn't respond to communication, Cardnet doesn't feel it is right to terminate their service which would disadvantage them by ceasing their card processing ability.

Cardnet thought it would also be helpful to note, by analogy with the comments above, that the FCA in its market study on General Insurance Pricing Practices moved away from the possibility of banning auto-renewal in insurance contracts (or making auto-renewal opt-in only). This was due to a widely held concern that this could result in consumers being inadvertently uninsured. Consequently, the FCA's proposed remedies in this area now focus on ensuring customers are provided with adequate information on auto-renewal and the possibility to "opt-out" should the customer be so minded.

3.2 ISO and acquirer POS terminal contracts

Cardnet, through its third-party POS providers, currently offers its merchants [redacted] However, the merchant makes a decision based on the information and options given to them and usually elects for a longer duration as this offers better value for money.

If the PSR mandates 18-month contracts, this will have an impact on "value for money" for merchants as the cost of leasing the asset over a shorter period is more expensive.

It is also important to note that Cardnet actually offers its merchants, through its third-party POS providers, the ability to purchase their terminal outright at the commencement of their contract but for similar "value for money" reasons, the merchant prefers to spread the cost of their terminal over a leasing period.

[redacted]

3.3 Pricing of card-acquiring services

Cardnet supports the PSR's initiative to better allow merchants to research prices and compare different offerings.

However, and as highlighted in the introduction of this document, given the complex nature of merchant acquiring pricing, which includes numerous different fees applied by the schemes (as per section 2.3), Cardnet feel the PSR should give careful consideration and clear parameters on how a price comparison initiative would be structured.

As part of this consideration, Cardnet also feel the PSR should ensure price comparisons are truly transparent so that any acquirer(s) that currently provide detailed pricing breakdowns are not disadvantaged by 'headline rates' given by other acquirers.

Cardnet would be happy to take part and support any discussions regarding this important aspect of the merchant acquiring service.

3.4 Piloting remedies

The payments ecosystem is complex so Cardnet would strongly advocate that any proposed remedies by the PSR are initially piloted to a controlled group of merchants to ensure the remedies are tested and truly achieve the best outcome for merchants.

Cardnet would also strongly encourage that the consultation process regarding remedies includes merchants, ISOs and third parties before any final actions are proposed.

Given the complexities of the payment's ecosystem, Cardnet would advise that the PSR gives due consideration to implementation timelines, even for those initiatives that are initially piloted.

4.0 SUMMARY

In summary, Cardnet entirely supports the objectives the PSR is trying to achieve and will assist with any initiatives that the PSR introduces to support SME's regarding their merchant acquiring needs.

However, as detailed in this response, due consideration needs to be given to ensure that any remedies the PSR proposes, are of no detriment to the merchant.

Cardnet would welcome the opportunity to further discuss the review as part of the PSR's iterative process before any final report is issued. Cardnet appreciates the complex nature of the acquiring pricing structure which it would also be happy to discuss further given this is fundamental to any final recommendations the PSR makes regarding this industry.

Mastercard

[redacted]

ACQUIRING MARKET REVIEW INTERIM REPORT RESPONSE

Mastercard response to PSR *'Market review into the supply of card-acquiring services – Interim Report'*

8 FEBRUARY 2021

Introduction

Mastercard agrees with the PSR that the effective functioning of the card-acquiring market is vital in order to ensure that it continues to best serve the interests of merchants and ultimately card-holders. We are pleased that the PSR has chosen to undertake this market review in order to determine whether there are steps which might be taken in order to increase competition and improve the functioning of the market.

As we explain further below, Mastercard has a close interest in the outcome of the review, because our commercial interests will be directly affected by any measures which impact how or the extent to which card payments are used. This includes the price paid for card-acquiring services (even where fees are not paid directly to Mastercard). Although Mastercard is not a party to commercial relationships between merchants and acquirers, as a four-party system operator the success of our business is dependent upon them, including in many ways in which we cannot influence.

Mastercard believes strongly in the value of competition across the entire payments value chain. We experience it ourselves both in bidding for issuing portfolios and through the many competing forms of payment which merchants may choose to accept. We agree that competition drives better outcomes for end-users as well as for market participants themselves, as it creates incentives to enhance product offerings and value, which should ultimately lead to commercial rewards.

Although the PSR's proposed remedies may be viewed as relatively light, we believe that they could have a significant impact on how the market develops in the medium term. For that reason, it is important that they are designed and implemented carefully and with proper consideration for any potential or unintended effects on the market as a whole and the participants on whom the primary burden will fall.

How well is the acquiring market working?

Mastercard does not intend to provide a detailed analysis of the functioning of the acquiring market and how effective competition may be. We have no direct involvement in acquiring and therefore lack the specific insight which acquirers, payment facilitators, ISOs, merchants or others more closely engaged, may be able to provide. In particular, we have no knowledge of the commercial arrangements between those parties and therefore cannot comment on how effectively they are working.

1) A well-functioning market

However, from our perspective, we believe that the market is broadly working well. There are demonstrably a large number of providers and (as the PSR highlights) some examples of recent market entrants which have been relatively successful in beginning to build a market share or appear to be well-resourced and positioned to be able to do so. Anecdotally, from Mastercard's conversations with smaller/new entrant acquirers, they view the UK market as commercially attractive partly due to its scale and one in which they expect to be able to build successful businesses. They have not highlighted any significant concerns regarding barriers to entry or expansion.

The role of payment facilitators has obviously been hugely welcome both in driving the adoption of card payments and exerting competitive pressure on existing providers, primarily through their simplified approach to service delivery, which has been particularly beneficial to smaller merchants. We are pleased that Mastercard has been able to play an important role in bringing them to the UK market and we believe that their positive impact will only increase in the future.

Anecdotally, Mastercard believes that the competitiveness of the UK market compares favourably with other markets in which we operate, in terms of number and diversity of providers, market shares and levels of entry and expansion. Many other markets have a far greater concentration, with commensurately reduced levels of innovation and new market entry. We are also pleased to note that Brexit does not appear likely to have any material detrimental impact on the number of providers serving the UK market, as might have been feared.

2) The importance of price and non-price factors

Mastercard notes the PSR's provisional finding that the market may not be working well for the vast majority of merchants, based on its finding that they received little, if any, pass-through of the interchange reductions in the Interchange Fee Regulation. Mastercard's independent advisers have not had the opportunity to analyse the PSR's pass-through findings and so regrettably we are unable to comment directly on that point. However, we would not necessarily agree with the PSR's broader characterisation that the market may not be working well for nearly all merchants.

We recognise that this conclusion is a reflection of the PSR's findings in relation to interchange reduction pass-through, but we believe that it is potentially misleading as a broader statement about the functioning of the card acquiring market. Mastercard has no view as to whether or not acquirers are passing on interchange reductions to some or all merchants, but we do believe that the vast majority of merchants are well-served by the wider card payments market, of which acquiring is a key element.

The price paid for payments products or services is, of course, a critical factor for the PSR to consider when assessing the functioning of the market, but it should not be the only factor. In Chapter 4, the PSR refers to the many other forms of non-price competition which acquirers have highlighted, but it does not appear to consider them in reaching its provisional findings on how well the market is working. Instead, it focuses only on its findings in relation to price in Chapter 5.

For many merchants (particularly smaller merchants) these other non-price factors may be equally (if not more) important in their assessment as to how well card payments are working for them. Settlement speed, value-added services, customer service or payment methods accepted, might be more important to some merchants than the potentially marginal cost differences between competing acquirers. Although we note that the merchant survey results do suggest that price is a key consideration, they also highlight the significance of other factors.

The importance of non-price factors is also demonstrated by the ability of new acquirers to enter the market and be successful in persuading merchants to switch. The existing margins available to new entrants provide the right incentives and this will result in the right outcomes for merchants that will look at both price and non-price factors.

Therefore, whilst Mastercard does not disagree that there may be value in the PSR seeking to increase the effectiveness of price competition, it should also recognise that merchants are generally very well served. Slide 42 of the merchant survey demonstrates that (even aside from consumers' preferences) cards are clearly merchants' most preferred payment method, which would not be the case if the market was not working well for them. The increase in card acceptance that the PSR has recognised, provides further strong evidence that card payments work very well for merchants across an incredibly wide range of service sectors. Indeed, the number of merchants who are choosing to become 'card-only' shows in a very practical way that the overall value proposition of cards is extremely compelling, when judged against any available alternative (although Mastercard fully recognises wider public policy concerns about any decline in the level of cash acceptance).

The importance to Mastercard of competition in the acquiring market

The PSR is well aware of the importance of competition in the acquiring market generally and particularly the benefits which it drives for merchants and ultimately for their payers. An uncompetitive acquiring market is likely to mean that merchants incur higher acceptance costs and receive a reduced level of service, value and product innovation. This is in turn will lead to a variety of adverse impacts on payers.

However, it is important also to outline why effective competition between acquirers is just as important to Mastercard as a card scheme, as it is to merchants and how payers benefit in a different way. As the PSR recognises, acquirers sit right at the centre of the payments' acceptance ecosystem. Crucially, they maintain the unique relationship with merchants (and/or with payment facilitators and ISOs), which four-party card schemes do not have. They often also provide gateway services – another critical component in the payments chain.

Although merchants and payers are the ultimate users and beneficiaries of payments (and all the services which a card scheme provides), those four-party schemes have no direct relationship with the merchants and derive no income directly from them. Therefore, the schemes dependence on acquirers means that the effectiveness of acquirer competition is very important to schemes, in at least two material ways:-

- Firstly, acquirers drive card acceptance amongst merchants much more directly than schemes are able to do. Both through their own sales functions, as well as through payment facilitators and ISOs, acquirers play the key role in influencing the number of merchants which accept cards and in turn the total volume of card payments. These factors are of paramount importance to Mastercard's revenue income and overall commercial success.

  Competition provides a crucial incentive to acquirers to increase card acceptance. In an uncompetitive market, acquirers may decide to increase revenue by raising prices, rather than by investing in order to acquire more customers. This would be a poor outcome not only for the merchants (and therefore their customers), but also for Mastercard, both as a result of some merchants incurring higher acceptance costs and other merchants not accepting cards at all.

  By contrast, effective competition between acquirers drives down acceptance costs (encouraging more merchants to accept and promote card payments). Likewise, it drives up the level of card acceptance amongst merchants, both due to lower acceptance costs and the efforts which acquirers are incentivised to make, in order to acquire new customers. This in turn is beneficial for Mastercard's card products making them more attractive to issuers and cardholders.

- Secondly, much of the innovation and new product development in card payments comes from the schemes. Although new products and services are designed for the benefit of merchants and payers, the schemes have no ability to promote them directly to the vast majority of those merchants. Even in cases where a scheme may engage directly with a large merchant, the scheme product cannot actually be made available to a merchant, unless and until it is adopted and technically integrated by the acquirer. There are many examples of such products and innovations, but contactless and mobile payments are perhaps the most obvious.

  In considering whether or not to enable the product, competition between acquirers is key. If the product provides a clear benefit to merchants (as contactless/mobile payments certainly do), an acquirer cannot risk losing market share to competitors who offer it. Alternatively, a lack of effective competition means that an acquirer might not have sufficient incentive to invest in enabling the product, leaving the merchant without access to it and the card scheme with no other effective options.

  The continued development of Mastercard's business largely depends on its new products and services being made available to merchants and payers, over which acquirers have significant control. The effectiveness of competition between them is therefore a critical factor in determining commercial success.

It is clear, therefore, that Mastercard benefits commercially from effective competition between acquirers and is likely to suffer reduced revenues over the longer term, if it is ineffective. Although Mastercard's limited role within card acceptance means that there are consequential limits to what it can do to maximise acquirer competition, it has taken steps wherever possible to remove barriers to market entry and expansion including:-

- Assisting the entry of payment facilitators into the market, through a variety of rule changes and increasing the volume threshold, thereby allowing them to 'acquire' larger merchants. Mastercard also provides training to payment facilitators and helps partner them with acquirers.
- Re-aligning pricing in order to ensure that larger acquirers do not benefit at the expense of smaller acquirers, merely as a result of their existing incumbency in the market – ensuring that merchants pay the same scheme fees, regardless of their acquirer should be an important means of simplifying the nature of competition
- Reducing unnecessary card-acquiring costs, for example by removing the requirements for magnetic stripe readers on mobile POS terminals in Europe, thereby reducing terminal costs for payment facilitators targeted merchants
- Ensuring that all rules and waivers operate on a non-discriminatory basis – Mastercard rules are an important element of how the acceptance market operates and ensuring that no acquirer is able to benefit from a different application or enforcement of the rules is critical in ensuring fair competition
- Providing managed support to new and potential entrants, both as acquirers and payment facilitators, particularly following the opening up of the market to allow non-bank providers – this allows them better to understand the rights and obligations associated with being part of the Mastercard franchise.

Mastercard welcomes the PSR's findings that card schemes have not created any barriers to entry or expansion in the acquiring market. It is important to recognise that schemes exist to facilitate and grow the use of payments by all participants in the value chain and so it will never be in their interests to create any obstacles to that expansion.

Provisional findings

1. *Market features*

The PSR has identified three features of the market which it believes may restrict small and medium sized merchants' ability and willingness to search and switch. In the following sub-sections, we suggest that price-focussed search and switch should not be the sole focus of the PSR's attention and additional factors should also be considered. But first, we comment on the specifics of the features which the PSR has identified:-

- ISO and acquiring pricing
- The indefinite duration of merchant contracts for card-acquiring services
- ISO and acquirer POS terminal contracts

In principle, Mastercard has no view as to whether or not these are the features of the card-acquiring market which have the greatest potential adverse impact on competition, but it is not clear that the PSR has provided sufficient evidence that this is indeed the case. Perhaps more importantly, it is not clear that remedies which seek to address these market features will actually enhance competition and generate net benefits for merchants, which we address in greater detail in the following section.

The merchant survey sought views from small and medium-sized merchants on questions directly relevant to the features which the PSR subsequently identified. In particular, it asked several questions related to the comparability of pricing and whether acquiring or terminal contracts act as a barrier to search and switching. Unfortunately, Mastercard was denied access to the underlying data on which the survey results were based and so we are unable to comment in detail. However, the more limited published results include the following:-

- 89% of merchants received enough information to understand the price they paid
- Only 4% of merchants have not considered switching because they are tied into a contract and only 10% who considered decided not to do so for this reason
- Only 10% of switchers said comparable pricing information would have helped and only 6% said more accessible information would have helped
- 80% of new merchants found shopping around easy and only 14% found it difficult
- Only 26% who switched found shopping around difficult
- Only 1% said the expiry of a contract would make them consider switching
- Only 6% have not shopped around because they were tied into a contract and only 1% thought it was too difficult to compare providers

Mastercard understands (and agrees) that survey results cannot always be interpreted literally. Answers might sometimes be inconsistent or incompatible with other evidence or respondees might have misunderstood the question. However, the answers to these particular questions are fairly consistent and read objectively, the survey results do therefore cast significant doubt on whether the PSR has correctly identified the relevant market features, which may be limiting competition.

In particular, the survey results do not suggest that merchants being tied into contracts is a barrier to search or switching or that the expiry of a contract would act as an effective prompt. This is in line with the (albeit anecdotal) feedback which Mastercard has also received from a variety of market participants. We note that the PSR has reviewed various contracts and is particularly concerned about the long initial terms and the automatic renewals. It may therefore have identified a theoretical issue from its reading of the contracts which is not actually borne out by the reality i.e. the fact that a merchant may be tied into a contract, has not in practice been the reason why the merchant has not considered switching. Therefore, addressing this issue might not actually have any impact on merchant behaviour.

The evidence related to shopping around and comparable pricing appears to be almost as clear. Although merchants consistently cite the importance of price considerations, they also seem to have no significant difficulty in searching and do not suggest that more easily comparable pricing information is necessary or currently insufficient. Again, this aligns with anecdotal feedback which Mastercard has received, along with the fact that many smaller merchants do not actually want more detailed pricing information which is more likely to confuse, rather than assist them.

As with the length of contracts, it might be that the PSR has identified an issue from its own reading and analysis of acquirer pricing information, which may not in practice act as a barrier to search and switching. As we outline in greater detail below in relation to the remedies themselves, there seems to be a possibility that by addressing what might actually be a theoretical, rather than genuine issue, the PSR risks intervening in a manner which may not have the positive impacts that it expects.

To reiterate, Mastercard does not necessarily disagree with the PSR's provisional findings that the three features of the market which it has identified are limiting competition in general or search and switching in particular, because we have no alternative or better evidence base than the PSR has provided. But we are concerned that the PSR has not presented sufficient evidence to support its findings (and some of its evidence contradicts its findings), which may mean that its proposed remedies are ineffective.

2. *Search and switch*

As discussed, the PSR's provisional findings focus solely on three features of the market which it believes restrict small and medium-sized merchants' ability and willingness to search and switch. It therefore concludes that current levels of search and switching are inadequate, or at least could be improved to the benefit of those merchants.

The PSR's evidence concerning levels of switching is based largely on its merchant survey. Although this may not always provide an entirely reliable measure of past switching, it suggests that: 29% of merchants had either recently switched or starting accepting cards; a further 29% had considered switching and 42% had not considered switching. The PSR's focus is therefore naturally on this latter 71% of non-switchers.

As is usual in similar surveys, the majority of respondents who neither switched nor considered switching tended to cite either broad satisfaction with their current provider or a perceived lack of benefit or reason to switch to an alternative. It would therefore be helpful for the PSR to explain why it believes that the behaviour of those 71% of merchants needs to be changed (or what level of switching would be considered adequate).

The response may be that the merchant survey revealed that 88% of merchants who did try to renegotiate with their current supplier were able to obtain "*better terms*", which we interpret as meaning a lower price for the same service (although this is not specified). The PSR also refers to data that merchants who had signed with their acquirers more recently, obtained a lower price than others.

However, both forms of evidence appear to be inconclusive, lack necessary detail and specifically do not reveal the precise level of financial benefit. So for example, it is not possible to conduct a cost benefit analysis, in order to determine whether the costs of regulatory intervention are justified by the total expected financial savings. Ideally, this should also be done separately for each merchant category, such that the potentially very marginal benefits to the majority of small merchants, are not distorted by the aggregate savings to larger merchants. Indeed, it is possible that the benefits to individual merchants may be outweighed either by the search costs which they will still incur even following the PSR's intervention or by the total cost of the intervention itself. The PSR has not presented the evidence to make that assessment.

In addition, the "*better terms*" which the merchants obtained are not weighed or considered against other factors which might be relevant to whether or not the merchants have benefitted overall. For example, a reduced price might be accompanied by a longer contract to which the merchant is now tied or a new terminal that they did not need, which might ultimately not be in their best interests. Alternatively, a merchant who has switched acquirer may now be paying a lower price, but could be receiving a poorer service overall. Although merchants were asked for their reflections on the search and switch <u>process</u> they were not asked about the <u>outcome</u> and whether overall they felt that it was beneficial, although this appears to have been generally assumed.

As we outlined above, non-price factors are potentially a very important consideration when assessing how well the market is functioning. We note that the merchant survey suggests that price was usually the main consideration for both switchers and non-switchers, but it does not necessarily follow that switching or not switching for that reason alone will always produce the best outcome. Therefore, the PSR provisionally concludes that levels of switching are inadequate because non-switchers would obtain unspecified financial benefits if they did switch, but it risks overlooking what may actually be more important factors in choosing an acquirer.

To be clear, Mastercard does not necessarily disagree with the PSR's provisional findings. Nor are we opposed in principle to intervention designed to increase merchant search and switching. It may well be that the PSR has correctly identified features in the market, which if adequately addressed would increase competition and overall merchant benefit. As explained above, Mastercard itself directly benefits from acquirer competition and is supportive of effective action to improve the functioning of the market.

However, we are concerned by the fact that the PSR's provisional findings with respect to search and switching may not be based upon robust evidence. As a matter of principle, the PSR should be able to provide strong evidence in support of its conclusions. But more importantly there is a risk that the remedies which flow from these findings may therefore not be effective (which we address in more detail in the following section).

3. *Alternative factors to consider*

Although levels of switching may be a sign of the effectiveness of competition, it is not the only measure by which the functioning of a market may be judged. But because the PSR has chosen to focus only on search and switch, it would be helpful for it to explain to what extent it has considered other measures and why it has discounted them.

To reiterate, Mastercard benefits from effective competition between acquirers and in principle is supportive of measures to increase its effectiveness. But from our perspective, levels of search and switching may not be the most useful or relevant factors to focus on when assessing how well the market is working.

For example, Mastercard believes that the level of product and service innovation and development is also a very relevant factor to investigate when considering whether the acquiring market is delivering in the interests of its merchant end-users. Objectively, we think that increased levels of acquirers' innovation and investment may provide better overall outcomes for merchants than potentially marginal cost savings. That is not to say that there is necessarily a problem with current levels of innovation and investment which needs to be addressed, but it is very relevant for the PSR to understand within the context of a card-acquiring market review.

We note that the acquirers were unable to provide details of particular investments, but it is open to the PSR to investigate further the level of product and service differentiation between acquirers and how it has developed over recent years, in response to changing competitive conditions. It would be a useful benchmark to measure how well the market is working.

Without this evidence base, it is difficult for the PSR to reach a fully-rounded view of competition in card-acquiring and therefore to be confident that it has correctly identified the features of the market which may need remedying.

Proposed remedies

Mastercard recognises that the PSR is very early in its thinking about remedies and they have intentionally been outlined only at a very high level. We understand that the PSR intends to issue a remedies consultation in advance of the final report and look forward to engaging in that process to the extent to which it is relevant for us to do so.

As currently proposed, we do not believe that the contractual remedies will have any identifiable impact on Mastercard and so we will only provide some high level observations on them, which hopefully the PSR may find useful. The comparable pricing remedy might have a more direct impact, depending on how it is designed, but still we regard it has being principally a matter for acquirers, rather than schemes.

1. *Cost Benefit Analysis*

Mastercard's primary concern is that whatever remedies the PSR ultimately decides upon and however they are designed that they meet the key tests of being workable, effective and proportionate. This is in the interests not only of the acquirers themselves on whom the primary regulatory burden will fall, but also in the interests of the merchants and other participants in the payments ecosystem who will ultimately pay the costs, directly or indirectly.

Poorly designed remedies risk not only failing to achieve the PSR's desired positive outcomes, but also wasting the time and resources of those who must implement them, which might otherwise have been used in ways which generate greater value. From Mastercard's perspective, this would be a particular concern, because as described at the outset, we are dependent on acquirers implementing and enabling Mastercard's new products and services and making them available to their merchant customers. We firmly believe those products and services are beneficial both to merchants and their customers and would be concerned if they could not be made available because the required resources had to be spent elsewhere. At worst, poorly designed remedies might even be harmful by incentivising behaviour that leaves merchants worse off and so the PSR must ensure that all risks are carefully taken into account.

For that reason (an in accordance with all good regulatory practice), we believe it is essential that as the PSR now begins to design the remedies, it undertakes a full cost-benefit analysis before any final decision is taken as to which remedies to adopt. Whilst we broadly agree with the PSR that the remedies are fairly limited in the overall impact which they are likely to have on the market, the costs of implementing the remedies (particularly in relation to comparable pricing) are not so limited that they can be overlooked.

As we highlight elsewhere in this response, there is a potential risk that the costs of the remedies might outweigh the benefits. However well-intentioned it may be, no regulation should ever be introduced, if it might fail that basic test. As far as Mastercard is aware, the PSR has not yet attempted to calculate either the financial cost or benefit of its proposed remedies. We understand that it may not have been possible to do up until this point, but believe it must now be done before progressing further.

2. *Comparable pricing remedy*

In principle, Mastercard recognises why the PSR is considering some form of comparable pricing remedy. Assuming that the PSR is able to provide sufficient evidence to demonstrate that the level of search and switching is a core competition concern and that it has correctly identified the three relevant market features, it is understandable that the PSR would want to adopt this type of remedy.

However, in designing the remedy, there are several important factors to consider:

- ***Should the remedy extend beyond pricing*** – as has been highlighted above, although price is an important consideration for merchants choosing an acquirer, it is not the only consideration. Acquirers are likely to argue that they provide significant additional value beyond the lowest price and seek to differentiate themselves from their competitors on that basis. Mastercard agrees that non-price factors are very important and merchants should be encouraged to assess which acquirer offers them the best overall value and payment experience. In doing so, they should consider the additional value-added services which the acquirer offers, because for example, settlement speed or customer service may be more important considerations than marginal cost savings.

  Mastercard recognises that this presents the PSR with a particular difficulty in designing the remedy. On the one hand, it should be cognisant of the risk of inadvertently commoditising the acquiring market by placing undue focus on price. This could ultimately be harmful to merchants by encouraging them to make purchasing decisions purely on that basis and thereby potentially overlooking better service offerings from alternative acquirers. This in turn will incentivise the acquirers to reduce costs and focus on price and increased commoditisation, rather than to make the additional investments necessary to provide enhanced services. Reduced innovation and investment are not in the long-term interests of merchants or the broader card payments market and should be avoided. On the other hand, the PSR must be careful not to over-engineer a solution and produce an overly complex and costly comparability model, as we now explain.

- ***The difficulties of comparison*** – Mastercard anticipates that the PSR may be looking to other markets such as telecoms, energy or insurance as a template for how price comparison might be made more simple and straightforward. The PSR might be considering whether these consumer markets provide any lessons which can be learned for SME merchants. But every market is different and acquirer pricing may be less suited to this type of standardised comparison than those other markets. Primarily this is due to the large number of variables in the types of transaction for which acquirers may wish to charge (as opposed to the markets referred to above, in which a total monthly/annual charge is usually levied) e.g. in relation scheme, channel and location, combined with their various additional, non-transaction related charges. Acquirers will legitimately want to take very different approaches to pricing these various elements – some will want to bundle them all for the sake of simplicity, whilst others will want to separate them to provide the best price for whatever is the merchant's primary focus. That makes any form of standardised, comparable pricing model very difficult to implement, without reducing acquirers' freedom to design their own approach to pricing, which would in turn limit competition.

  To be clear, Mastercard has no objection to a comparable pricing remedy. In principle, we are strongly in favour of clear pricing, because we want merchants to receive the best overall service possible and this is an important element, which may help to increase the effectiveness of competition. In particular, we would like to ensure that any comparable pricing model clearly separated the various elements of the merchant service charge, such that merchants could readily understand that scheme and switch/processing fees constitute the smallest part. We would be very willing to engage in the detailed design of the remedy so that our charges (the vast majority of which are made up from a very small number of fees) can be clearly presented in whichever way is most readily understandable and comparable, noting that they will always be the same, regardless of the merchant.

  But Mastercard's concern is that in designing a remedy in a way which may not best-suited to acquiring, the PSR risks creating a hugely complicated underlying model, which could have several adverse effects namely: significant time and resource from the entire industry to design and maintain; onerous data input requirements which might not be best suited to the merchants for whom it is designed; complicated and ambiguous results which might not provide any clear indication of the best option for the merchant.

  As we highlighted earlier, it may be that following implementation of the remedy, merchants search and switch costs (even aside from the costs incurred by the acquirers) may still exceed the benefits which accrue. This will even more be the case if the comparability remedy is extended beyond pricing into other areas. Mastercard anticipates that it will be all too easy for the costs and complexities of this remedy to outweigh the benefits which it produces and so we would urge the PSR to prioritise proportionality and simplicity, even if that means that the end product may not allow for perfect comparability.

3. *Contractual remedies*

Although Mastercard anticipates that these two remedies may raise fewer concerns with respect to the cost and complexity of implementation, they may have a much greater impact on the functioning of the market (particularly the automatic termination of acquiring contracts) and therefore should be very carefully designed and considered.

Mastercard recognises why the PSR has a concern about the indefinite duration or renewable nature of contracts. In a market in which inertia may be a problem, indefinite or automatically renewing contracts may provide a disincentive or even an active barrier to merchants switching.

But the challenges in designing these remedies will also be clear to the PSR. Of course, it will never be in the interests of merchants, cardholders or acquirers for the imposition of an acquiring contract end date to mean that services are automatically terminated on that date. Mastercard believes that this should only even be considered if the merchant has actively opted-in to this type of contract. Even then, extreme caution should be taken, because it is hard to believe that any merchant would want or have envisaged a scenario in which its acquiring services are terminated without alternative arrangements having been made.

Therefore, Mastercard believes that it would be far preferable for this remedy to focus on a series of increasingly forceful contractual reminders or nudges to prompt the merchant into considering shopping around. As can be seen in other sectors, the wording of these reminders could highlight the length of time that the merchant has been with the acquirer and the possibility that better deals are available elsewhere.

As businesses, SMEs also need to be trusted to take responsibility themselves and so if (having been clearly prompted) they choose to take no action, it should be safe to assume that their preference and best interests are to continue with their current supplier, rather than to lose acquiring services altogether. Adequate safeguards could be introduced by prohibiting the automatic renewal of fixed term contracts, meaning that if (at any point) after the expiry of the initial contract, the merchant wanted to switch, it would be able to do so on minimal notice, rather than having to wait for the expiry of its renewed term.

Mastercard has no strong views on either limiting the length of POS terminal contracts to 18 months or linking them with card-acquiring contracts. These remedies appear broadly sensible, although it is unclear to Mastercard to what extent terminal contracts act as a significant barrier to search and switching.

4. *Remedy implementation*

As highlighted earlier, Mastercard broadly agrees with the PSR that its proposed remedies are fairly limited in the overall impact which they are likely to have. Nevertheless, they are unprecedented in the cards market and it is impossible to know at this stage, exactly what the impact will be.

Mastercard therefore strongly believes that as the PSR begins to finalise its <u>proposed</u> form of remedies, it must also carefully design a plan to pilot and test their effectiveness. Depending on the outcome of the pilots, the PSR must be prepared to amend (possibly significantly) the workings of the remedies, before re-testing them. In advance of finalising the remedies in regulation (and requiring that they be fully rolled out), the PSR must be certain that they will in fact achieve the desired outcome. In order to be able to measure whether that is the case, the PSR will need to specify the benchmarks against which their success and effectiveness will be judged.

Mastercard recognises entirely that this is not a straightforward task, as it requires a careful balance between developing remedies to the point at which they can meaningfully be tested, whilst not requiring providers to incur unnecessary costs in the process. Whilst this may appear to be an onerous or time-consuming undertaking, it is vital if the PSR is to ensure that the remedies will be workable and effective.

Without adequate testing, there is a real risk that the PSR could require many months and significant resources to be spent developing remedies which prove either to be ineffective or even detrimental to the functioning of the market. In view of time and the resources which the PSR itself has already spent on this market review, that is an outcome which it will be anxious to avoid.

Scheme & Switch Fees

The PSR refers to representations which it has sometimes received about the level of scheme and switch fees. Whilst the purchaser of any product or service will always want to obtain it for a lower price, Mastercard is a commercial entity and sets it charges within a competitive and rapidly evolving market.

In its role as a four-party scheme and network provider, Mastercard benefits by increasing the overall adoption and usage of card payments, in many forms. In order to achieve this simple objective, card payments must continually be made attractive to issuers and acquirers, but ultimately to cardholders and merchants. If as end-users they did not derive sufficient value and benefit from them or believed that the charges were too high, they would not use them.

Achieving the simple objective of continuing to make card payments attractive to cardholders and merchants is a huge task, which requires significant resources. From the resilience of the network and the speed of settlement operations to chargeback protection and fraud controls, Mastercard continually invests to meet expectations and required standards. Nor can it be assumed that success today, will guarantee success in the future. From open banking and Faster Payments to Buy Now, Pay Later and cryptocurrencies, there will always be alternative and often new ways to pay and competition to the existing methods. Mastercard must continue to invest and evolve, just to keep up with developments in the market.

It is within that context that PSR has undertaken its analysis of how the levels of scheme and switch fees have evolved over time, although Mastercard recognises that it does not form a core part of the market review. As a result, the sections on scheme and switch fees sit awkwardly in the interim report and contains some stark (and potentially inaccurate) statements which seem not to be relevant to the objectives or outcomes of the market review.

1. The PSR's approach to scheme and switch fees

Mastercard is concerned by the disjointed (and at times evasive) approach which the PSR has adopted with regards to its analysis of scheme and switch fees, which has made it more difficult for Mastercard to engage constructively in the process.

In the Terms of Reference, the PSR referred to methodologies which it would use for its pass-through analysis, profitability analysis and merchant survey. Those draft methodologies were subsequently published and consulted upon. The PSR made no mention of a methodology for analysing scheme and switch fees either in the Terms of Reference or at any point subsequently. Indeed, Mastercard was unaware that such analysis was being undertaken before the interim report was published.

Mastercard believes that not publishing the methodology for consultation was a significant failing for which no explanation has been given. As mentioned below, we attach by way of annex to this response a confidential submission compiled by Oxera. The submission highlights weaknesses in the PSR's methodology which we believe have a significant impact on the PSR's findings and its headline conclusion that fees for scheme services "*approximately doubled*". If the methodology had been consulted upon, we would have the opportunity to provide feedback and offer Oxera's expert analysis and so these difficulties might have been avoided. We understand that the PSR did send out the draft methodology to unnamed parties for peer review, but unfortunately no reference has been made to who those parties were or what comments they may have provided.

It is unclear why the PSR has adopted a different approach to its analysis of scheme and switch fees, compared with its pass-through or profitability analysis. The fact that the consultation on the profitability analysis led to the PSR significantly amending its approach should have highlighted the value and need for consultation.

Mastercard is concerned that the reason for the different approach may be because the PSR was aware that its analysis of scheme and switch fees went beyond the remit of its Terms of Reference. That was limited to the statement that the PSR "*will seek to understand how the fees that merchants pay have been affected by changes in scheme fees (and interchange fees) that acquirers pay to card scheme operators (and issuers)*", rather than it would conduct a review of the level of the fees themselves.

Mastercard understands that the PSR collected scheme and switch fee data from the acquirers and relies upon this data for its pass-through analysis. Mastercard has requested for its expert advisers to be given access to the PSR's pass-through analysis but this has been denied and so we cannot be certain exactly how it was undertaken or comment constructively on it. However, we would assume that the data supplied by the acquirers would have been provided in a format more suitable for use in the pass-through analysis than the data supplied by Mastercard. In that context, it is unclear therefore why the PSR required additional scheme fee data from Mastercard and how (if at all) that formed part of its pass-through analysis.

We believe that the PSR could have been much more open and involving in its approach to analysing scheme fees from earlier in the process, up to its most recent decision to deny Mastercard's advisers access to its pass-through analysis. It is unclear why the PSR has been reluctant to engage with us on this topic, but it has meant that we have been unable fully to participate in the review and to provide constructive assistance to the PSR.

2. *Terminology – scheme & switch fee separation*

The PSR will be aware of the concerns and sensitivity which exists in relation to scheme and switch fees and therefore the statements which it makes and even the language which it uses, are very important.

In advance of publication of the interim report, Mastercard highlighted that a generic reference to 'scheme fees', when the PSR actually means to refer to scheme and switch fees would be unhelpful and misleading. The Interchange Fee Regulation requirement for card schemes to separate their scheme and switch activities is a fundamental feature of the operation of four-party schemes in Europe. Article 7 requires both accounting separation and that schemes "*shall not present prices for payment card scheme and processing activities in a* *bundled manner*". The PSR's decision to 'bundle' its fees terminology is therefore surprising and unfortunate, particularly as the term used is misleading.

The interim report makes only very brief reference to the fact that "*we use the term 'scheme fees' to refer to all fees acquirers pay to operators of card payment systems including fees for scheme services and fees for processing services*". Aside from the peculiarity of this approach, this critical point is likely to have been overlooked by many readers. However, its effect is that throughout the rest of the report, the PSR is forced to make the very fine and somewhat illogical distinction between "*scheme fees*" and "*fees for scheme services*", as the only means to avoid making otherwise factually incorrect statements. Again, Mastercard believes that this distinction will have not have registered with the vast majority of readers.

This is critical because the PSR's headline statements that '*fees for scheme services … approximately doubled*' is very likely to be read as '*scheme fees approximately doubled*', which the PSR well-knows is not the case. (Indeed, Oxera's analysis demonstrates that its finding that [redacted] is not robust). The brief reference to the fact that "*there is not enough evidence to assert that the level of fees for processing services have increased*" might also easily be missed by anyone who has not read the detail in Annex 4, despite its significance.

Despite the fact that the PSR finds it convenient to refer throughout the report to '*scheme fees*' (i.e. fees for scheme <u>and</u> switch services) and that its stated objective is to analyse how those fees "*evolved between 2014 and 2018*", it does not in fact reach any conclusions or make any statements as to how '*scheme fees*' overall changed during that time. (The PSR does however make joint references to how Mastercard and Visa fees for scheme services combined, have changed, even though they have obviously been set entirely independently.)

This is a key failing because (as the Oxera annex further highlights) the PSR's analysis of how 'scheme fees' changed during that period should have been significantly impacted by the separation of scheme and switch fees which took place mid-way through. Specifically, prior to the separation, scheme and switch fees were not viewed separately, so the separate observations which the PSR makes as to how the fees changed from 2014 to 2018 are dependent upon business-wide decisions which Mastercard made as to what the objectively correct level of the fees should be following separation (and not determined at that stage, by independent scheme and switch decisions as to the level of their fees).

To put it another way, the PSR's findings assume that scheme and switch fees had been separate throughout the time period, when in fact they were not. Therefore, its statements about how the scheme and switch fee levels independently changed are misleading and potentially not relevant, because that is not how the pricing decisions were made. It would be far more accurate for the PSR to make overall observations as to how scheme and switch fees combined have evolved (which in any case is more in line with the terminology which it adopts).

Instead, the PSR reaches separate (and very different) conclusions in relation to '*the fees for scheme and switch services*', but as we have highlighted, its conclusions in relation to '*fees for scheme services*', will almost certainly be confused with its stated objective to analyse '*scheme fees*'.

As the PSR appears to acknowledge by its generic reference to '*scheme fees*', it is the combination of the fees for scheme and switch services which matters, because both must be paid by acquirers/merchants. Therefore, it is odd that the PSR has chosen to make no statement about how they have changed, perhaps because it would not permit a simple conclusion that they have doubled. Arguably, any conclusion about how fees for scheme and switch services have changed independently, is not actually relevant to the market review.

Finally, even use of the term "fees" can be ambiguous and open to misunderstanding. In different circumstances, different parties use the term as either meaning: total scheme revenue/acquirer cost; price levels of specific products or services; or (as the PSR does) percentage of transaction value. Whilst we understand the validity of the PSR's approach, we suspect that it may not readily be understood by all stakeholders and they may interpret the PSR's statement that '*scheme fees approximately doubled*' as meaning that the average price of products and services doubled. In practice, the PSR's findings in relation to price are much more nuanced and it appears to recognise are not supported by robust evidence. We believe that it would be helpful for the PSR to explain this much more clearly throughout the interim report.

We address the validity of the PSR's provisional findings on scheme and switch fees below, but overall we feel that the manner in which they have been presented and the language which has been used, is at times very misleading and makes it more difficult for stakeholders fully to understand.

3. PSR's scheme & switch fee analysis methodology

We are grateful to the PSR for providing us with access to the stata do file and code to allow us to understand the analysis which the PSR undertook of the scheme and switch fee data which Mastercard provided. This information was provided to our expert economic advisers, Oxera, who have provided a report on their findings with respect to the PSR's analysis, following a detailed investigation. Oxera's report was further peer reviewed by [redacted] and is attached as a confidential annex. We believe the contents of the report are self-explanatory and so here we provide brief additional comments.

Oxera's review highlights six significant weaknesses in the PSR's analysis which undermine its overall findings and specifically its conclusion that "*scheme fees approximately doubled*". It is clear that this conclusion is not sustainable (even aside from the points made above). The PSR would therefore need to reconsider its approach to the econometric analysis taking account of Oxera's findings, if it wanted to include accurate conclusions in its final report. We also believe that further significant amendments need to made the parts of the report which refer to scheme fees for all of the reasons outlined above.

However, this may not be a worthwhile use of time and resources because the PSR's conclusions with respect to scheme and switch fees are not directly relevant either to the features which the PSR believes may restrict competition in the market or to the remedies which it is proposing as a result. The PSR may therefore conclude that it is preferable to remove this part of the report entirely, as it is not required.

[redacted]

Mastercard Technical Annex

Review of the PSR's scheme fee analysis

Prepared for Mastercard

23 November 2020

1 Introduction

As part of its market review into the supply of card-acquiring services, the Payment Systems Regulator (PSR) has looked into how fees for scheme services, as well as fees for processing (switch) services, paid by acquirers have changed from 2014 to 2018.

This note sets out Oxera's review of the PSR's methodology, analysis and findings. It includes inputs from [redacted].[1]

The note is structured as follows:

- Section 1.1 clarifies the terminology used in the PSR market study;
- Section 1.2 summarises the findings of the PSR analysis;
- Section 1.3 summarises the conclusions of Oxera's review;
- Section 2 provides an overview of the PSR's methodology, including how the fees for scheme and processing services have been defined, as well as the set-up and findings from its econometric analysis;
- Section 3 sets out our critique of the PSR's methodology, focusing on the econometric analysis of scheme fee revenues.

1.1 Terminology

Scheme and switch fees are paid by acquirers and result in revenues to the Mastercard Scheme and Switch. These are based on Mastercard's fee schedule, which determines the fee level for different transaction types. The

[1] [redacted]

[redacted]

PSR analysis considers the revenue earned by Mastercard from each of the acquirers, which is determined by both the fee schedule and the transaction composition for each acquirer. In this context, the PSR uses the following terminology:

- **'total fee'**—used by the PSR to refer to Mastercard revenues from the fees paid by acquirers for scheme and switch services;
- **'average fee as a percentage of GBP transacted'**—used to refer to unit revenue.

The PSR analysis considers changes in revenue for scheme and switch services and undertakes an econometrics analyses to understand to what extent these changes are driven by changes in the mix of transactions and changes in the level of the fees in the fee schedule. To avoid confusion, it is better to make a clear distinction between changes in the fee schedule and changes in what acquirers pay in total or on average. We adopt the following terminology: we use the terms **'revenue'** and **'unit revenue'** to refer to Mastercard revenues from scheme fees paid by acquirers, while the term **'fee levels'** refers to the fee schedule in this note.

1.2 PSR findings

Following Mastercard's response to the market review Terms of Reference, the PSR considers the below factors that can cause changes in the total annual scheme fees revenues.

- **Change in total transaction volume and value:** the higher the total volume or value of transactions, the higher the total scheme revenues received from acquirers. While scheme fees in the PSR analysis are defined as the unit revenue (more details in section 2.1), which has taken into account total value of transactions, the unit revenue can still be lower for acquirers with higher total transactions due to some fees being tiered.
- **Change in transaction composition:** certain types of transaction would incur higher fees, such as card-not-present (CNP) versus card-present (CP) transactions, and inter-regional versus intra-EEA/domestic transactions. If the transaction composition in 2018 consists of more transactions with higher fees compared to 2014, then the total scheme fee revenues received from acquirers, as well as the unit revenue, would be higher as a result of this change in transaction mix, rather than any changes in the Mastercard fee schedule.
- **Change in the fee schedule:** this includes changes to existing fees and/or introductions of new fees between 2014 and 2018, that would affect the total scheme fee revenues and the unit revenues that Mastercard receives from acquirers.

The PSR notes that its analysis focuses on mandatory scheme and processing portions of the fees that are directly attributable to transactions. The analysis has also been done separately for Mastercard and Visa as their acquirers are subject to different fee schedules.

[redacted]

[2] [redacted]

[redacted]

[redacted]

1.3 Oxera's review—conclusions

The PSR's analysis suffers from several significant methodological issues. As a result, its finding that scheme fee revenues per unit have approximately doubled between 2014 and 2018 (after controlling for the relevant factors) is unlikely to be robust.

We discuss in detail the main issues from the PSR's analysis.

- the small sample size used by the PSR, given the number of control variables, means that the statistical inference power of the model is weak, leading to estimates not being statistically significant individually and jointly;
- the PSR focuses only on individual significance and not joint significance when determining relevant control variables;
- the PSR's preferred model also suffers from misspecification as it has failed to capture the non-linear relationship between unit revenue and its drivers;
- the PSR's approach of only including control variables that are individually statistically significant means that they may not have included all relevant factors that can affect the unit revenue. These include total value/volume and value/volume by transaction type, as well as acquirer specific fixed effects and year dummies. Only a subset of these are used at a time in various models considered by the PSR;
- the inconsistency between the PSR's annex and underlying analysis in how the PSR controls for changes in the transaction composition (using absolute level of transaction volume instead of share of transaction volume as indicated in the annex) indicates that this has not been controlled for appropriately;
- the PSR looks at scheme and switch fees separately in their analysis and overlooks the fact that part of the scheme fees changes in 2017 were driven by the scheme-switch separation.

[3] [redacted]

[4] [redacted]

[5] [redacted]

2 The PSR's methodology

2.1 How fees for scheme and processing services are defined

The total amount paid in fees for scheme and processing services depends on the volume and value of transactions.[6] The greater the number and value of an acquirer's transactions, the more it is expected to pay Mastercard for both services. [redacted]

To account for this relationship, the PSR considers the scheme and switch revenues per unit—i.e. as a percentage of GBP transacted—which is calculated based on the following formula:

$$Mastercard\ unit\ revenue\ , acquirer\ x\ in\ year\ y = \frac{total\ fees\ paid\ by\ acquirer\ x\ in\ year\ y}{total\ value\ of\ transactions\ from\ acquirer\ x\ in\ year\ y}$$

Using this definition, the PSR considers changes to the average unit revenue across all acquirers. [redacted]

2.2 Overview of the PSR's methodology

The PSR first presents the descriptive statistics on scheme revenues and the potential drivers of changes in scheme revenues (e.g. total volume and value of transactions, as well as value/volume of transactions by channel—CP vs CNP, and by location—inter-regional, intra-EEA, and domestic). This shows the developments in these variables over time during the 2014−18 period.

The PSR's finding on scheme revenues, however, relies on its econometric analysis. The analysis is based on regression modelling, which is a tool to decompose variation of the dependent variable into covariation with a set of covariates (or control variables).

Two key questions to consider when conducting a regression analysis are:

- What are the key relationships we are looking to understand?
- What do we need to control for?

A regression analysis has an **dependent variable**, which is the variable whose variation is to be explained, and **control variables**, which are the factors expected to affect the dependent variable.

In this case, the dependent variable is scheme revenue as a percentage of GBP transacted, and the key relationship we are looking to understand is whether and to what extent the increase in scheme revenue observed can be attributed to potential changes in the Mastercard fee schedule between 2014 and 2018, controlling for other factors.

[6] As mentioned above, the PSR focuses on mandatory fees that are directly attributable to transactions. This means that it has excluded 'on-us transactions', which are only relevant to two of the 14 acquirers in the sample.

[7] [redacted]

To answer this question, we need to control for and estimate the impacts of the following potential drivers of scheme revenues:

- total volume and value of transactions;
- transaction composition—CNP vs CP transactions; inter-regional vs intra-EEA vs domestic transactions.

[redacted]

2.3 Findings from the PSR's econometric analysis

First, the PSR considers a simple model containing only year dummies for the four years from 2015 to 2018. [redacted]

Second, the PSR individually tests each of the following factors to determine their effect on unit revenues and the significance of the effects: volume and value of purchase transactions; volume and value of CNP transactions; volume and value of domestic/intra-European/inter-regional transactions; and acquirer-specific fixed effects. Variables that are statistically significant are then included in the PSR's preferred model.[10]

[redacted].

3 Review of the PSR's analysis

3.1 Small sample size

The data sample analysed by the PSR contains only 70 observations due to the use of annual data (five observations for each of the 14 acquirers).

As discussed in section 2.2, there are several factors that affect scheme revenues and must, therefore, be controlled for in order to isolate any potential price effects. In addition to controlling for these factors, the model requires four dummies (to capture residual any price changes for the four years from 2015−18, compared to 2014), and a dummy for each acquirer to capture their

8 [redacted]

9 [redacted]

10 [redacted]

unique characteristics that may impact the amount paid in scheme fees.[11] These bring up the total number of variables to control for to more than 20 (depending on which and how many of the variables in total value/volume and value/volume for each transaction type are included).

Given the small sample size and the large number of control variables, it is unlikely that many variables will be statistically significant. As the degrees of freedom[12] are small, this implies that statistical inference in comprehensive specifications (i.e. those including the full set of control variables) is fragile because with fewer degrees of freedom, estimates are less precise and hence less likely to appear statistically significant, either individually or jointly.[13]

3.2 Individual significance versus joint significance

The PSR introduces the control variables one by one and only includes those that are individually statistically significant in its preferred model, which is the basis of its finding.

However, it is important to control for all the relevant factors to meaningfully estimate the change in revenue that can be attributed to changes in fee levels. The statistically insignificant coefficients may be due to the small sample size (especially given the number of control variables as discussed above), and individual insignificance is not a reliable indicator of whether a control variable is relevant in the model. While the PSR includes control variables that are individually statistically significant, it has not examined joint significance. Control variables can be jointly significant, even if they appear individually insignificant, which would provide a more complete and accurate picture of the impacts of these variables to the unit revenue of scheme fees.

The PSR's preferred model, by not controlling for all relevant factors, has failed to account for the specific characteristics of the data. We discuss these matters in turn in the following sections.

3.3 The non-linear nature of the relationship between unit revenue and its drivers

When conducting a regression analysis, it is important to understand the relationship between the dependent variable and control variables before deciding on the model specification. An ordinary least square (OLS) regression model that is used in the PSR's analysis, while being the most basic and standard model in econometrics, requires certain assumptions about the characteristics of the data. Notably, an OLS model assumes a linear relationship between the dependent variable (scheme revenue per unit) and the control variables.

To illustrate why this assumption is violated with this dataset, we first look at the distribution of scheme revenues both in GBP and as a percentage of GBP transacted. [redacted]

[11] We discuss the importance of these dummies in section 3.4.
[12] The number of degrees of freedom is the number of independent values a regression can estimate. It is calculated as the number of observations minus the number of estimated parameters, or variables.
[13] This is because the more precise an estimator, the smaller the confidence interval for a given level of confidence level (90%, 95%, and 99% are most often used in analysis).

Figure 3.1 Distribution of Mastercard scheme fees revenues in 2014−18

[redacted]

Source: Oxera analysis of Mastercard data.

[redacted] Indeed, the PSR acknowledges this point.[14]

> Scheme fees per GBP transacted would increase depending on the structure of scheme fees. The relationship may not be linear if the structure of scheme fees gives rise to economies of scale.

The PSR chooses to run a weighted regression, using the acquirer's share of transaction value in the total dataset as weight. Larger acquirers would then have a larger impact on the regression results. Weighting is a means to correct for heteroskedasticity and to provide correct standard errors.[15] Heteroskedasticity, however, is often the consequence of model misspecification. The PSR has not provided an explanation of why they use the acquirer's share of transaction value in the total dataset as weight, instead of including it in the main regression specification.

A better approach to address heteroskedasticity is to include the acquirer's share of transaction value as a control variable instead. This would allow us to examine the impact on unit revenues in an additional dimension and better

[14] PSR (2020), 'Market review into the supply of card-acquiring services: Interim report', September, Annex 4, para. 1.4, p. 3.
[15] This can be observed from examining the model errors, i.e. the difference between what values the model predicts and the actual data. If the variation in these errors is driven by the acquirer's share of transaction value, i.e. there is heteroskedasticity in the model errors, this can be adjusted for by using weights.

explore the non-linear relationship between unit revenue and size of acquirer. However, as discussed above, adding to the number of control variables in the model given the small sample size would mean that most of the variables are unlikely to be statistically significant.

[redacted]. However, this is an important variable that has been shown to be statistically significant across several model specifications considered by the PSR.[16]

Figure 3.2 Distribution of acquirers by value and volume of purchase transactions

[redacted]

[redacted].

Source: Oxera analysis of Mastercard data.

The best approach to model unit revenue is to use a fractional outcome regression, which not only ensures that the dependent variable is within the range of 0 and 1 but also captures particular non-linear relationships, especially when the dependent variable is near 0 or 1. [redacted]

Another approach would be to transform the data using logarithms to stabilise the variance. Alternatively, the non-linear nature of the relationship between the dependent variable and control variables can be further explored and addressed through quantile regressions, which would report estimates at

[16] PSR (2020), 'Market review into the supply of card-acquiring services: Interim report', September, Annex 4, Table 6, p. 22.

various positions along the distribution of the scheme fee variable instead of focusing only on the mean. However, quantile regressions have even larger sample size requirements for meaningful results because the estimator is only based on a subset of the sample.[17]

3.4 Heterogeneity across acquirers

The PSR's analysis pools together all observations in the five-year period for all acquirers (five observations per acquirer) to include in its regression models. This is called a 'pooled' OLS.

In this set-up, besides the control variables described above, each acquirer has its own set of characteristics, which is constant over time and can have an impact on its transactions and fees paid. This means that there is significant heterogeneity across acquirers that needs to be captured with acquirer-specific fixed effects, in the form of acquirer dummy variables.

OLS regression assumes that all error terms produced from the model are independently and identically distributed. This assumption may be violated when observations are pooled from multiple years across all acquirers. It is reasonable to expect that observations from the same acquirer, and thus the error terms, would not be independent of each other. Therefore, a pooled OLS needs to account for these fixed effects to produce robust results.[18]

[redacted];[19] however, not all of the models that it considers include the variables. To accurately estimate the change in unit revenues due to changes in fee levels, it is important that the regression model controls for all relevant factors. Failing to do so would result in a mis-specified model, and the resulting estimates would be biased and inconsistent.

3.5 Using absolute levels instead of shares of different transaction types

The PSR results in Annex 4, Table 5, state that it has controlled for the share of inter-regional transactions. [redacted]

This inconsistency between the PSR's Annex and underlying analysis makes it unclear how the PSR proposes to control for changes in the transaction composition. However, we were able to reproduce the PSR's reported estimates when following the PSR's underlying analysis, indicating that, indeed, absolute levels rather than shares of different transaction types have been used.

Absolute levels of the volumes of different transaction types are directly linked with the total volume of transactions (and similarly for the value of transactions). As a result, it is not possible to estimate the impact of changing, for example, the volume of inter-regional transactions, while keeping the total volume of transactions constant. It is therefore more appropriate to control for

[17] The entire sample is used, however, to determine which subsample is being used for any specific conditional quantile estimator.
[18] Additionally, the model should consider using cluster-robust standard errors on acquirers to address any clustering in the error terms.
[19] There are 13 acquirer-specific fixed effects, as one of the 14 acquirers would serve as the baseline case.

the share of different transaction types in order to control for changes in the transaction composition as discussed previously.

3.6 Scheme and processing fees being examined separately

The PSR analyses scheme and switch fee revenues separately and overlooks the fact that the scheme-switch separation was only implemented in 2017. Although before 2017, there were already specific fees related to scheme services and fees related to switch services, there were no separate fee schedules for the scheme and switch. These were only introduced in 2017 as a result of the regulatory requirement for a scheme-switch separation.

[redacted] This means that the increase in scheme fee revenues from 2016 to 2017 was not only a result of increases in scheme fees but also a result of the implementation of the scheme-switch separation. This can be observed in Figure 3.3 below. [redacted]

It would therefore be more appropriate to apply the analysis to both the scheme and switch fee revenues.

Figure 3.3 Scheme and processing revenues as a percentage of GBP transacted

[redacted]

Source: Oxera analysis of Mastercard data.

National Federation of Retail Newsagents (NFRN)

National Federation of Retail Newsagents

Supply of Card Acquiring Services

Response to Payment Systems Regulator

Introduction

1. The NFRN welcomes the opportunity to present its views to the government on the issue of card acquiring services.

About the NFRN

2. The NFRN was founded in 1919 and is one of Europe's largest employers' associations with the owners of over 15,000 independent retailer outlets in membership throughout the UK and Ireland.

3. We exist to help the independent retailer compete more effectively in today's highly competitive market by providing practical help and assistance, commercial support, deals and buying opportunities, training, expertise and services.

4. The NFRN also actively represents its members' interests at governmental and parliamentary level, and we are the official government referral body for the sector and are a powerful voice for the independent retailer.

5. Membership of the NFRN consists of a variety of independent retailers, including: newsagents, convenience stores, confectioners, florists, petrol forecourts, news deliverers, off-licences, post offices, coffee shops, and card & stationery shops.

Question 1. Do you have views on the provisional findings set out in this report?

6. With regard to small and medium size merchants, the NFRN broadly welcomes the provisional findings of your report.

7. The NFRN is aware of the tendency for busy retailers not to have the time to properly investigate the comparative costs of services from different acquirers and to allow their contracts to roll on without proper review and consideration.

8. The potential for retailers to save money through switching has been shown by retailers who have taken up an offer with a major acquirer negotiated by the Federation or its members. Members have seen saving of between £100 and £450 per month on the cost of services, including the costs of terminals. For an independent news or convenience store this is a significant benefit to their bottom line.

Question 2. Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

9. The NFRN agrees that automatically rolling over contracts is one of the issues that need to be addressed if the potential for greater movement between acquirers is to be achieved. Limiting the length of contracts and preventing their automatic renewal will provide retailers with the opportunity – and the reminder – to review the market to ensure that they are getting the best suitable offer.

10. The linking of contracts for acquirer services and those for POS terminals is a sensible move as it prevents confusion or differing contracts end dates being used as a backdoor lock in.

11. The final component of the PSRs proposals, the requirement to provide information so that retailers can shop around and make an informed choice, is key. Without this information, available in a comparable form, retailers will largely not be in a position to take advantage of the proposed changes to contract terms. However, information can be presented in different ways and the PSR will need to set the standards for what is reported and how it is measured to ensure that retailers are genuinely comparing like for like. Such transparency should then allow retailers to shop around without spending an inordinate amount of time researching and comparing prices and terms.

Question 3. Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?

12. The NFRN is not aware of any other remedies.

Question 4. How does COVID-19 impact on our review?

13. The NFRN does not believe that COVID-19 impacts on your review.

NFRN
Contact:

[redacted]

Nets

Payments Systems Regulator
12 Endeavour Square
Stratford
London E20 1JN
Sent by mail: cards@psr.org.uk

December 8, 2020

PSR's market review into the supply of card-acquiring services

This is Nets' response to the PSR's market review into the supply of card-acquiring services.

1. **Nets views on the provisional findings set out in this report**

   Nets welcomes many of the UK PSR's descriptions and findings. We find that the UK PSR's interim report shows a better understanding of the payments industry than we have seen by other authorities. We would like to note, however, that Nets is more optimistic with respect to the obstacles highlighted by the UK PSR.

1.1. Card acquiring services

Nets is very happy to read that the UK PSR acknowledges that card acquiring services are the same irrespective of where and how a payment card is used.

Payment card acquiring is a solution to an age-old problem – how does a seller decide to trust a purchaser that they do not know in the absence of cash? Historically, when most economies were local, this was rarely a problem for consumer purchases where seller and purchaser were usually known to each other. For wholesale transactions, the issue was solved through a complex set of banking counterparty relationships and letters of credit. In a globalised economy the seller and purchaser are rarely known to each other and payment cards, including the acquiring function, are a solution to this challenge.

The solution to the counterparty trust issue provided by payment cards is known as the "four-party model". This model entails that the cardholder has a relationship with their issuing bank (or issuer), the merchant has a relationship with their acquirer and the card scheme (e.g., Visa, Mastercard, Dankort, Carte Bancaire) connects all acquirers with all issuing banks. This network allows merchants and cardholders to transact in a way that removes the need for interpersonal trust.

The development of internet based commerce – or e-commerce – has not fundamentally altered the operation of the four-party model, which still underpins payments made over the internet. Although e-commerce payments have modified the way that payments are triggered – from a consumer device rather than a merchant terminal – and create different risks for acquirers and issuers the underlying payments processes and technologies remain the same. However, e-commerce is attracting a range of new payment providers in competition with card payments and acquirers.

The in-store and online card payments use cases use the same underlying four-party payments model and the same acquiring services albeit with different processes around the user experience. However, historically, many merchants have treated on-line and in-store payments separately to the point of having different acquirers for these services even though as mentioned the acquiring services provided for in-store and on-line are the same. However, the merging of the customer experience is changing this. For example, consumers increasingly order online and pick up in store or even order in store and receive their goods at home. This omnichannel approach is a major trend amongst merchants.

In parallel with this we are also seeing changes in the in-store experience. To date this has been built around the concept of the secure, payment scheme certified payments terminal which, in turn, has conditioned the retail shopping process – people line up to make a payment at a fixed device when they have completed their in-store shopping.

Recently we have seen a new form of payment terminal – the 'SoftPos'. A SoftPos is a payment terminal downloaded onto a standard mobile device – typically a tablet, although for micro-merchants it may be a smartphone. A SoftPos does not have the secure hardware common to a normal card payment terminal which means that much of the security must be provided in the back end by the provider of the SoftPos software.

SoftPos solutions, unlike most payment terminals, are by their nature mobile and mean that the in-store payment experience can be radically different as shop assistants can come to the customer rather than waiting for the customer to come to them. The payment process can be modified to suit the in-store experience that the merchant wants to present.

SoftPos also allows for the payments process to be radically different. The inherent flexibility of downloadable terminals means that adding new payment methods becomes trivially easy – to the point where the need to use a payment card disappears. Apple stores, for instance, use an Apple Id login to keep payment within the Apple ecosystem and Amazon has completely dispensed with a check-out process in their Amazon Go stores.

Increasingly the in-store experience mediated by SoftPos will look more like the online payment experience than a traditional card payments retail process. As the fixed acceptance infrastructure that has maintained card payments as the primary payment method in-store is replaced, then we will see a fragmentation of payment methods that are primarily determined by the retail experience and the demands of consumers.

As with the other trends, as card payment usage is reduced then the volume of transactions and revenue that acquirers can expect will also reduce. However, acquirers are in an excellent position to leverage their merchant relationships to provide SoftPos solutions along with the risk management to secure them. In this environment acquirers can also control the payment methods that merchants have access to and can support extended value added services such as point-of-sale lending, retailer loyalty or liquidity management services.

As in-store and online services increasingly merge, innovative acquirers have the opportunity to develop services across all of their merchant payment channels to extend their range of payment options – and therefore transaction revenues – while simultaneously building new revenue streams. This will, however, be happening in parallel with a decline in traditional revenue streams.

1.2. Alternatives to card acquiring

There is a growing reality of alternative payments solutions and infrastructures. This is not imaginary – it is already in development either due to direct regulation through PSD2, through direct intervention of the European Central Bank (ECB) or via support from both the European Commission and the ECB. There are currently three legs to this approach which are supported by private sector investment and initiatives.

The first leg is the PSD2 mandated implementation of Payment Initiation and Account Information APIs by all EEA payment institutions. This means that any accountholder with the EEA – both individual and corporate customers – can trigger a payment from their bank to a selected payee account. This payment initiation process is equivalent to the first leg of a standard card payment when a merchant sends the cardholder details to an acquirer and the acquirer onto the issuer via the payment scheme and receives the response that approves or declines the request.

The second leg is TIPS – the ECB's TARGET Instant Settlement System[1]. TIPS allows instant clearing and settlement of transactions between banks in Europe – currently this is focused on the Euro only but other currencies will be integrated in eventually. TIPS covers both clearing – the process where the paying bank confirms that they will transfer the money – and settlement – the process where the paying bank actually moves the money. Clearing may also be done locally to deal with specific local requirements and in the Nordics the P27[2] initiative is designed to provide a real-time clearing infrastructure that allows local requirements to be built out on top of it. This will modernise other types of payments such as direct debit (or direct bill payment) and will allow banks to create their own payment solutions for their own customers across the Nordics.

[1] What is TARGET Instant Payment Settlement?
[2] Nordic Payments EU

The third leg is the European Payment Initiative (EPI)[3], a pan-European payment scheme being developed by a number of the major banks in Europe with the explicit support of the European Commission and the European Bank as well as Nets and Worldline in their role as acquirers. The EPI will support both cards and mobile wallet payments and will be built on the PSD2 and TIPS infrastructure – and will therefore ensure that the entire European payment infrastructure is integrated and can be managed end-to-end. Payments running through EPI will need some level of traditional acquirer support but, for the most part, are likely to be push payments driven through the PSD2 APIs.

The overall aim of these initiatives is to create a single, integrated pan-European payments infrastructure that ensures that the liquidity remains within the European Union. If successful this would likely drive down costs as the scale of the underlying solution will be significant and can be directly regulated by the European Commission. Even if not directly successful it will likely depress prices for the existing card payment schemes as they face a new level of competition.

It should also be noted that this move to an Account-to-Account (A2A) infrastructure is not being ignored by the existing payment networks. Mastercard in particular have been very active purchasing both Vocalink, the UK Faster Payments (high speed ACH) provider and Nets' A2A business[4]. Mastercard have also won the contract to deliver the core technology for P27.

Many of the "new" mobile payment solutions already enable payments using both direct account-to-account payments as well as cards. For instance, the Danish (and Finnish) payment solution MobilePay is such a hybrid payment solution where the vast majority of the payments are made directly account-to-account.

1.3. Other relevant services

We note that the UK PSR states that there seems to be challenges for merchants when switching acquirers due to the technical set-up of their terminals. The UK PSR also states that it has observed that many merchants have more than 1 acquirer, which would indicate that the technical restrictions of the (POS) terminals is not an unsurmountable obstacle in switching acquirer.

With respect to the technical obstacles described by the UK PSR Nets is less concerned than the UK PSR. First, drawing on Nets experience in the countries where Nets has its primary business, there is acquirer and PSP agnostic processing and platforms and accordingly no technical obstacles when merchants want to change, add or remove acquirers. The

[3] The European Commission welcomes the initiative by a group of 16 banks to launch a European payments initiative (EPI)

[4] https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1487

processing platforms Nets operate or is connected to in continental Europe operate cross-border. Such cross-border functionality should be expandable even into the UK. [redacted]

Furthermore, looking at acceptance of payments, i.e. in-store via terminals or online via one payment gateway, the latter are for most acquirers and PSPs already operating on cross-border “rails”. As to the terminals in-store we are seeing the biggest changes as we are seeing “online” based terminals such as softPOS solutions as described above, where the acceptance of the payment in-store is actually done online. Even more changes come with the mobile in-app payments where the apps can circumvent the terminals altogether and “speak” directly to the till.

2. Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

Nets believes that the report accurately describes card payment acquiring services. However, Nets believes that the remedies may cause a range of unintended consequences.

In particular:

(i) tying contracts for acquiring services to contracts for POS device supply will lead to a significant increase in the cost of POS device supply;

(ii) the benefit of receiving the full cost saving of the IFR interchange fee capping alone is unlikely to justify the costs involved in switching for most merchants;

and

(iii) creating longer-term remedies involving fixed term contracts and pricing transparency may be less effective than desired due demanded supplier specific value-added services. If and when the value-added services differ – which they often do – demanding transparency will more likely create more confusion than the intended clarity.

3. Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?

The payments industry is still in the midst of intensive consolidation and the industry is subject to massive disruption from other parts of the payments industry and from tech (small tech, agile tech as well as big tech) as well as from mobile phone manufacturers. Although the it may be tempting to invent all sorts of regulation to prevent unwanted effects of the current and ongoing developments in the payments industry, Nets believes that the current tools under competition law are adequate to deal with the challenges ahead. At least for now and the near future. Developing new rules for an industry as dynamic as the payments industry may – whatever the intentions are – create unwanted effects. Just as the introduction of the EU's Interchange Fee Regulation has only increased the international cards scheme presence at the cost of the domestic schemes, which was not the intention.

4. **How does COVID-19 impact on our review?**
   Nets has seen an increase in the use of contactless and in app payments as well as an increase in the online trade.

[redacted]

[redacted]

North East Interiors

[redacted]

Date: 15 September 2020 12:10:52

Hi

I have read your interim report on card-acquiring services and find it does confirm our experience of merchant service charges and services as a small merchant and are glad that we highlighted this issue to you as your findings have shown we were not alone in our experiences.

Your proposals should make some improvements.

The stopping of long lease contracts for equipment is a good idea, we found ourselves at one point paying for a card terminal sitting in a box for around 2 years after we stopped using it, as it would have cost us even more to cancel the lease at the time we wanted to change provider than to continue paying the lease to the end due to early cancelation penalties and the savings in fees justified doing this rather than staying until the end of the lease, but it was a needless cost that we were tied into.

Although we have changed providers a few times in order to get a better deal, it is a time consuming and difficult task, so a more open and easier comparison system would make the process much easier. We have had experiences of being offered good rates to switch, only to then see rates jump after the initial contract term, so it would help if it was easier to shop around and move when necessary.

Regards

[redacted]

North East Interiors (Aberdeen) Ltd

Paypal/Zettle

PayPal

[redacted]

Thank you for the opportunity to comment on the Payment System Regulator's ("PSR") Interim Report on its market review into the supply of card-acquiring services. We have been engaged in the process since 2018 and responded to more than 30 requests for information and welcome the thorough review that was performed. We also appreciated the opportunity to discuss the report with you on 17 November 2020.

This response is provided on behalf of the PayPal group, including in respect of the iZettle brand.

The PSR has determined that: "Merchants with annual card turnover up to £50 million received, on average, little or no pass-through of the IFR savings – indicating that the supply of card-acquiring services may not be working well for these merchants. The evidence is slightly less clear for merchants with annual card turnover below £15,000."

The PSR has proposed three remedies and invited comment:

- First, ensuring there are fixed terms in contracts for card-acquiring services for both acquirers and payment faciliators. This proposed remedy would impact PayPal and our comments on it are below.
- Secondly, preventing long-term rental contracts for POS devices. This does not impact PayPal as devices are not rented but sold up front (for less than GBP60 typically) and so we have no comments on it.
- Thirdly, enhancing transparency and comparability of pricing for card acquiring services. This would not directly impact PayPal as it seems to be aimed at acquirers whose pricing is not public. Currently, as is demonstrated in the PSR's interim report, our pricing is generally publicly available and transparent. We support the PSR's measures to stimulate competition and promote the interests of UK businesses large and small, which PayPal have served since 2004.

We would like to draw the PSR's attention to the following in respect of the first remedy:

- PayPal serves millions of SMBs and has assisted them in making online and in-person sales which otherwise would not have occurred. This has taken on increasing importance due to Covid-19. A significant number of merchants using PayPal services would fall within the category of merchants with annual card turnover of less than GBP50m.
- The PSR's conclusion that IFR savings are not passed to SMBs is based on an analysis of acquirers' information, as opposed to payment facilitators' information. The report says:
  "The pass-through analysis is based on data from the five largest acquirers, so its conclusions do not apply to merchants who are customers of the largest payment facilitators, who serve nearly 80% of merchants with annual card turnover below £15,000 that only or mainly sell face-to-face. The entry and expansion of the largest payment facilitators may have delivered good outcomes for their customers, but it has not put sufficient competitive pressure on the largest acquirers to improve the pricing outcomes for their merchants".
- The pricing that payment facilitators provide is publicly available (unless bespoke arrangements are agreed) and transparent as is evident from the inclusion of

[redacted]

PayPal and other payment faciliator's pricing in the report, while pricing of the acquirer's is redacted in the interim report.

- Contracts between a merchant in the UK and PayPal essentially can be terminated at will by a merchant. The general PayPal User Agreement states that "You can close your account at any time." The process entails logging into the PayPal account and closing it. Products such as Braintree ("you may terminate this Agreement, without cause, by providing PayPal with one (1) day written notice") PayPal Here ("you may terminate your use of PayPal Here and uninstall the PayPal Here App at any time") and iZettle ("You may terminate these General Terms and Conditions and any Additional Terms at any time by closing your iZettle Account in accordance with the instructions available on our Website or in your iZettle Account ....") have similar provisions. Therefore, a PayPal merchant generally only is required to give at most one day's notice to terminate PayPal services.
- PayPal merchants are not constrained by ongoing rentals of POS devices. Therefore, merchants that want to switch provider, are able to switch away from PayPal easily. The proposed remedy would entail putting in place a process to inform merchants that their contracts are coming to an end and would not be renewed unless an active step were taken. Such requirements would come at an additional cost to PayPal. There would be the need to deal with many existing contracts, which would have to be re-negotiated. Fundamentally, imposing a date upon which contracts would end absent specific action by merchants also would risk service disruption. This is particularly so as some of PayPal's merchants are irregular users of our services and so may not need them continuously, therefore, requiring steps to renew the service may be inconvenient for them. Due to the factors above, imposing a fixed duration in a contract may have negative consequences for merchants. We believe that contracts that can be terminated by a merchant on one or a few day's notice (such as PayPal's) are adequate to enable merchant's ability to switch suppliers and facilitate customer choice. Accordingly, in our view, requiring fixed duration contracts should be excluded from the proposed remedies, particularly when pricing is transparent and POS devices do not require ongoing payments. There may be less intrusive options to have SMBs consider what service provider is best for them. [redacted] we look forward to considering the other options which you may be considering and would appreciate having the opportunity to comment on those along with the rest of the industry.
- We note, too, the PSR has provisionally found that "acquirer and gateway provider contracts for payment gateways are unlikely to restrict merchants' willingness and ability to search and switch acquirer." As mentioned above, PayPal merchants, for example using Braintree services, can terminate the services on one day's notice. Therefore, our understanding is that those contracts are not in scope of the proposed first remedy.

In respect of iZettle, we wish to clarify that there have been some changes since the responses provided to the PSR initially. We set out below the paragraph references in the draft report and some updated information.

1.246 iZettle has three pricing plans: iZettle Go, iZettle Go Plus and iZettle Pro

Comment: There are only 2 pricing plans now, we're not offering iZettle Go Plus plan anymore (https://www.izettle.com/gb/help/articles/2982482-changes-to-our-pricing-plans)
The two plans are named iZettle Go and iZettle Food & Drink (https://www.izettle.com/gb/pricing).

1.250 With the iZettle Go Plus pricing plan, the merchant pays 1.75% for all card-present transactions and 2.5% for all card-not-present transactions. There is also an additional charge of £29 per month. Merchants with the iZettle Go Plus pricing plan have access to a tool called iZettle E-com, which allows them to create a website and sell online. A payment gateway is included. As with the iZettle Go pricing plan, a free app is included.

Comment: We are no longer offering the iZettle Go Plus plan.

1.251 The iZettle Pro pricing plan is aimed at restaurants, bars and cafes. It charges 1.25% for all card-present transactions. Merchants also pay £39 per month per iPad that the iZettle Pro cloud-based app is used on. This app is different to that offered with the iZettle Go and iZettle Go Plus pricing plans because it includes features designed for restaurants (such as table management and bill splitting).

Comment: iZettle Pro has been replaced with iZettle Food & Drink, It also charges 1.75% like the iZettle Go plan and merchants pay an additional £29/month for the point-of-sale app that comes with additional specialised features designed to support food and drinks service.

Paytek

Paytek Administration Services Limited ("We, Us")

Executive Summary

We are the UK's leading provider of finance and support to Independent Sales Organisations ("ISO") offering Card Processing Services to small and medium sized businesses.

Commencing in 2002, this finance and support has enabled ISO's to bring real competition to the market through delivering competitive and innovative products and technology. In turn, this has driven down card acquiring rates and opened the UK market to a much greater choice of acquiring sources and terms.

We have provided more than £0.25bn of finance into the market, supporting more than 220,000 individual contracts for card services. Currently we have almost [redacted] active contracts with merchants, supporting more than 60 ISO's past and present (see Appendix 1) as well as device manufacturers such as [redacted] and others. Whilst predominantly SME's, the merchants we support include NHS hospitals, Local Government, Royal Estates, Arts and Cultural organisations and many major corporations, sporting venues and clubs.

In the following sections, we attempt to provide the history and background or our involvement and arguments why we do not believe there are grounds for added regulation in the spheres in which we operate. Finally, we must say that we find it quite extraordinary that the PSR has not had a single conversation with us, before publishing this review.

History & Background

We originally operated under the name of Virtual Lease Services Limited ("VLS"), a company set up in 1999 by a number of Banking and Finance professionals to provide outsourced lease management and funding services to the UK Asset Finance market.

In 2002, the UK card acquiring market was dominated by the four major clearing banks and their captive acquiring entities. Barclaycard, Streamline, Cardnet & HSBC. Merchants were generally 'obliged' to use these captive sources who provided them with a basic rented terminal at a high monthly cost and commission charges usually well in excess of 2%. Whilst there was an embryonic company called Cardsave Ltd who offered early ISO services, they were later acquired by Worldpay (in part to stifle the competition). Otherwise, there was very little choice. Like Banking generally at that time, there was limited movement of merchants from the franchise of the big four, so no distribution capacity for new acquirers or terminal solutions providers to enter the market.

However, this period also saw the emergence of the first GPRS enabled devices which were attractive both to existing merchants as well as opening up the ability to take card payments to a whole new range of mobile businesses. Things we take for granted today like 'pay at table' were rare.

Nat West Streamline (now Worldpay) were keen to offer GPRS terminals to their merchants, but nervous about supporting the technology and managing SIM card contracts and data usage in-house. Consequently, they offered a contract to a company called One Two Three Send Ltd "123", to provide the mobile terminal services to their merchants who needed them.

The cost of terminals is relatively high, as is the resource required to bill and collect the monthly charges, so 123 approached us to see if we could assist. Initially, we set up a conventional rental programme in order to provide the terminal to the merchant at an economic monthly rent, usually over a three-year term.

Whilst this served the immediate needs, it proved an inelegant solution as it required a rental contract for the terminal with a finance company, with separate contracts and terms for the Sim Cards, data usage, warranty and support provisions. In addition, merchants began to demand additional paid-for services such as 24/7 support, access to analytics portals, PCI services, Faster Payments and more.

To meet this demand, we worked with our partners to transition the contracts to a simple, flexible and easy to understand Services Agreement. In return for the basic monthly service charge, the merchant would be provided with a fully configured terminal, network & gateway access, help desk and guaranteed replacement service for any faults. The additional services (described above) could then be selected and added according to the merchant's needs and included within one simple contract and single monthly charge. The intention has always been to provide merchants with a 'sleepeasy' contract and a single source provision for simple problem resolution.

Inevitably, there is a minimum term commitment required ([redacted] months) in order to provide a monthly charge that is economic for the merchant [redacted] per month). Conversely, once established, the charges are fixed for the full term with no provisions for RPI increases, no annual additional administration charges and no penalty charges for late payment. Just a fixed monthly cost that aids budgeting and financial planning. Once the minimum term has expired, the merchant can cancel without further charge – there are no minimum 'rollover' provisions.

This contract format has served all parties well and has remained largely unchanged over the intervening period. It continues to underpin our support for the ISO community today.

With this programme, we went on to fund over [redacted] contracts for 123 before their acquisition by CR7 Services in 2015.

As the decade progressed, we began to manage similar programmes for other providers of Mobile Terminals such as [redacted] as well as more general terminal manufacturers such as [redacted].

2010 - 2015

By 2010, our funding programmes had begun to support the emergence of a number of new ISO's who brought innovation, more competition and significantly reduced costs to the SME community especially.

Some created alliances with new or fringe Acquirers who had no UK franchise and in turn, no distribution capacity. The ISO will typically market merchants directly and demonstrate significant savings by switching the merchant to the new acquirer. Such acquirers are able to offer 'wholesale' acquiring rates, much lower than the incumbents and despite paying a commission to the ISO, still deliver substantial savings to the merchant. Acquirers such as Elavon, Borgun, AIB, Truevo, E-Merchantpay, Valitor and Cashflows have all helped drive down the cost of acquiring services for merchants, which are now usually well below 1%.

We are grateful to one of our long-term ISO partners, [redacted] who have provided the analysis below of average card commission rates for their estate, a trend which is common to ISO's generally.

[redacted]

Other ISO's have a different USP by focussing on certain vertical sectors where service, device functionality and integration are key. Hospitality for example, may require multi-functional terminal devices to allow for both order and pay at tables, with integration to an EPOS or kitchen order processing system. Taxi operators are another similarly unique sector where fast, on-line settlements to individual drivers is key. Others may have added software capabilities that enable terminals to manage small-scale loyalty programmes, gratuity functionality or direct currency conversion.

Even the 'generalist' ISO needs to keep up with the changes in payment technology for Bluetooth, WiFi and Virtual Terminals and ensure their ability to accept new payment methods such as Apple or Google Pay, in order to properly advise the merchant on the best solutions for his business. It is the expertise and distribution capability that these ISO's possess, that cannot be easily replaced or provided by the acquirers themselves.

Another group of ISO's also maintain strategic alliances with Trade Bodies and Associations (FSB, Market Traders Association, British Curry Association to name but a few), to provide advantageous terms for their members. Similarly, some work with Franchise providers (Snap-on, Costcutter, Papa Johns) on the same basis.

One of the reasons acquiring rates and terms can differ widely, is the risk to the acquirer in different trades. Section 75 of the CCA gives chargeback rights to consumers for goods and services paid for by credit card. For example, a trader in white goods is a higher risk for chargebacks than say, a restaurant. Similarly, businesses that take deposits (travel, furniture, construction etc.) are also higher risk whereas money transfer agents, on-line betting are high-risk for fraud and money laundering. So, there are now some ISO's that target these higher-risk merchants to help them find suitable acquiring sources at reasonable terms.

2015 – 2020

Through all of these routes to market, the number of ISO's we support has grown throughout the current decade to the point where in 2015, the we took the decision to acquire the funding programme management from VLS and focus it into a dedicated entity, Paytek.

All of our management team have been directly involved in this market since inception in 2002. We are absolutely committed to ensuring that all merchants, (especially those small, new or inexperienced), receive fair and decent treatment. We have a simple philosophy that If our ISO partners and their merchants prosper, then so do we. To this end, we have expended huge efforts to promote and sharing best practice with all of our ISO's, imposing maximum pricing levels for terminals, resisting calls for longer minimum terms or extended 'rollover' periods. The documentation is simple and clear, with all important information clearly displayed on the front sheet and no hidden fees or onerous terms hidden in the one page of terms. See example in Appendix 2.

Consumer Credit Act

The Consultation Document rightly makes mention in section 6.78, that pure hire of terminals is regulated by the Consumer Credit Act 1974 (CCA) for certain small merchants (sole traders and partnerships). However, the inference that this gives them a right to terminate after 18 months is a common misconception but factually incorrect. Section 101 (7) (b) (i) of the CCA specifically provides an exclusion to this right for contracts entered into for business purposes.

From our understanding, this was a deliberate provision made by the drafters to ensure that Regulated Hirers were not disadvantaged or excluding from sources of funds readily available to incorporated businesses. It makes no sense if Jones the Butcher Ltd can lease a van over four years whilst Fred Jones and Co. cannot. Card processing services are unequivocally business assets, so the 18-month provision does not apply.

Alternate Solutions

The review points to some flexible, simple, low-cost solutions for merchants such as IZettle and Square. These are excellent alternatives for the occasional taking of card payments, but come at a cost. Transaction fees for such devices are significantly higher ([redacted]), so there quickly comes a point where higher usage overtakes the cost of a normal merchant account with a terminal. In addition, such devices are not really appropriate for retail environments with counters or employees as they require the use of the merchant's mobile phone to communicate.

They certainly have a place in the market, but not as a model for all other device types

Mischief Perceived

It is difficult to understand why the PSR considers that businesses, even micro-businesses, need statutory protection from what is perceived as the risk of a bad bargain.

A fundamental requirement for any business, no matter how small, is the need to invest in the assets and resources necessary to deliver the goods or services that it wishes to sell. This requires the business-owner to commit to a range of far more significant liabilities that it cannot control or walk away from. Premises Leases, Business Rates, employee obligations, fixtures and fittings, supply contracts, utilities, franchise commitments, telecoms and vehicle contracts are just a few examples.

Any one of these items is likely to require a significantly greater commitment and risk to the merchant than the cost of his Card Processing, yet there are no similar protections.

If a business buys an asset for cash for use in its business, it cannot take it back 18 months later and expect a refund, so why is it reasonable to expect a third party to invest time and money in providing such assets for the business and for the business-owner to simply to walk-away, just because a cheaper alternative may be available? A restaurant owner would not expect a customer to eat a meal and then only pay half the bill because he might have been able to get it cheaper elsewhere.

Basic Economics

The cost of the hardware elements required to provide any Card Processing Service are not insignificant. Depending upon the specification, the wholesale cost may be up to £800 – significantly more for the latest hybrid/epos versions. In addition, the ISO must provide the help desk resource, support/replacement facilities, data SIMS as well as the back-office, sales resource and some profit.

These are high-depreciation items as they will almost certainly require refurbishment (at least) and need to be data cleansed upon return. Acquirers are also reluctant to allow a used terminal to be logged in to their gateways, due to perceived security risks. Consequently, returned terminals have little value other than for spares.

If an ISO is to be able to offer an economic monthly charge for the services, it is clear that he needs to obtain some commitment in return. To try to amortise such costs over an 18-month term, simply cannot deliver an economic monthly charge. Typically, a simple single terminal over a 36-month minimum term would result in a monthly charge of [redacted]. The same terminal over an 18-month minimum term would be [redacted]. So unless the merchant closed his business after 18 months, he would continue to need a terminal and would consequently pay an extra [redacted] over the three year horizon.

In addition, having a commitment to utilise the card processing services for a minimum term, allows the ISO to offer the finest rates on the transaction charges. Good business for all parties.

Monthly 'Rolling' Contracts

In the review, you point to some terminal rental contracts which have a simple monthly rolling commitment. Our view is that these are a legacy from times when the big four dominated the market. With nowhere else to go (except another clearer offering similar terms), the risk of a merchant switching was low. There is no incentive for providers of such types of contract to ever promote upgrades or review, so merchants often end up paying the same amount for the same terminal for seven years or more, effectively re-paying the terminal cost several times over. The monthly commitment also enabled the providers to avoid CCA regulated hire contracts and all the added compliance that would entail.

However, we believe you will find that in the face of the much more competitive environment of today, (that the ISO community has helped to create), many such contracts now incorporate substantial 'hidden' charges in the small print terms. These may be variously described as 'Restocking

Fees' or 'Return Conditions' which may well amount to substantially the same cost to the merchant, as a fixed term contract settlement charge.

Unintended Consequences

Regulation to restrict commitments to a maximum 18-month term would give rise to numerous unintended consequences. Most obviously, monthly charges for the terminals and processing services would inevitably rise. In turn, technology choices would be limited to the most basic devices and service levels could be compromised as ISO's may no longer be able to provide the Help Desk and Support Services.

Alternatively, hidden charges may become more prevalent or acquirer charges rise.

We also believe that those who may be advocating the use of limited term contracts, are the one or two largest ISO's and certain acquirers. These tend to be the incumbent, well-established organisations with sufficient resources to provide the working capital necessary. Without access to the liquidity that our support of smaller ISO's provides, there would be a significant barrier to entry for smaller or new entrants (both ISO's and Acquirers) and a significant reduction in competition. It would suit the interests of such larger incumbents very well, to impede the competition in this way.

To survive, existing ISO's would have to turn to the external finance lease providers. This would still entail long term commitments for the merchant, but on a much less flexible basis. (see Finance Lease Alternative below).

Market Competition

In our view, it is the expansion of the ISO market that has brought real competition to this arena. Like many business services, it is the presence of such intermediaries that bring the expertise, choice and competition to the market. New ISO's approach us every month to expand the network.

Insurance Brokers, estate agents, finance brokers, utility switching agents, travel agents, mobile and telecoms ISO's and many more all compete with each other to guide any small business owner through the myriad of alternative products available. For the ISO's involved in Card Processing, they provide expertise in the rapidly changing card processing technologies, as well as the complexities of the merchant account charges.

Yes, they are trying to sell their services and may only be tied to a limited range of Acquirers, but around the corner is another ISO who can provide different choices of both technology and acquiring sources. More recently, we have seen the emergence of 'sub-ISO's' who have no direct Acquirer or technology relationships, but develop introducing relationships with a number of different ISO's and can help the merchant in deciding which will provide the best all-round deal for their business.

Switching

Notwithstanding commitments to existing contracts (if any), we find switching between ISO's is increasingly common. Where the savings from any new deal more than cover any settlement costs, then clearly there is an economic imperative for a merchant to do so. Indeed, some ISO's may provide some contribution to the costs of settlement in order to make the switch easier. If the savings are only marginal, then equally it makes sense for the merchant to stay with his existing provider and re-visit at a later date.

Whilst you may consider the current commitment periods to be long, best practice from the ISO's will entail keeping in regular contact with their merchant customers and particularly when approaching the end of term. Changes in the merchant's business, access to new acquirers or terms, availability of new technology or devices all present a good opportunity for an ISO to cement his relationship with a merchant as a trusted supplier, by 'upgrading' his contract. It is also in our interests to encourage such activity and so offer heavily discounted settlement costs for any existing contract upgraded in this way.

With ISO-originated acquiring charges at an historically low level, it can sometimes be difficult to demonstrate the level of savings which might justify a switch. Cognisant of the risk of (small merchants especially) over-committing, in 2019 we introduced a safeguard for merchants who already had a contract with us through a different ISO. This takes the form of a specific acknowledgement, separate from any new contract signed, reminding the merchant that he already has an existing commitment, allowing him an opportunity to reconsider before proceeding.

Finally in this section, your own IFF research suggests that 76% of merchants found it 'Easy' to switch their provider.

Features of Concern

In section 7.24 of your review, you highlight three areas of concern.

ISO and Acquirer Pricing

It is difficult to understand why you expect this to be the case. Technology type, merchant risk, business volumes, card types, card present/not present ratios and many other variables all dictate the final pricing formulas. There is no 'one size fits all' homogenous pricing structure. This is precisely why ISO's can provide such a valuable service to merchants.

Indefinite Duration

As discussed in the competition section above, we believe the ISO market serves the SME merchant community well in supporting them with their card processing needs and keeping them appraised of any improved or cheaper options.

The same argument exists for most services that any business may access and despite initiatives to encourage switching in certain sectors (such as utilities), most businesses still do not. Most merchants are too busy focussing upon their customers and other business priorities to spend valuable time on what are, in the greater scheme of things, marginal costs in relation to their business as a whole. They value their relationship with the ISO, as continuity and reliable card processing service is absolutely the key priority for most merchants. Many are not willing to risk potential disruption to their busines in changing without good reason.

POS Terminal Contracts

As outlined above, we believe there must be some minimum commitment in order to provide the services at an economic cost, particularly where complex or integrated devices are required. This is no different from any other capital expenditure that a business may incur when acquiring equipment on extended terms, such as leases for vehicles of HP on shop fittings etc.

We do agree however, that long successive fixed renewal terms are inappropriate. We do not support contracts with such provisions [redacted]. Our policy is [redacted] months preferred and [redacted] months maximum. If initial periods are limited to 18 months, then the prevalence of this type of hidden liability is likely to increase, as is the emergence of strict and unfair return conditions and costs.

Regulation

This is, by nature, predominantly a high volume, low value service provision. To deliver services economically, it has to be simple, quick and easy for a business to access with the minimum of fuss. ISO's have consistently worked to drive down the costs of provision by automating Acquirer applications (now instant rather than taking weeks), introducing simple e-signed contracts to minimise fraud or misunderstandings and procuring prompt equipment delivery and configuration. In turn this has enabled that new shop or restaurant to be able to take card payments on the day of opening rather than limp along until all is in place.

We entirely accept that some very small or new businesses may have inexperienced owners that may not fully understand all of the financial implications or alternatives available to them. However, if they need card payment services for their business, they will have to pay someone to provide them in one form or another. Most such businesses will require only a single device which even with a 48-month contract, will amount to little more than £1,000 over 4 years. Even for the smallest business, this is relatively insignificant when viewed against their other likely business expenses over the same period. The acquiring charges are likely to be equally modest if turnover is small. Consequently, any savings that you perceive may have been forgone, will be entirely at the margin.

Conversely, for the majority being more established and experienced owners, are we really saying that they need protection from a Regulator because they do not understand what they are doing? Introducing a layer of regulation seems entirely unnecessary and will add hugely to the administrative burden, slowing delivery and reducing flexibility.

Definition

Defining what types of relationships need regulation would also be hugely problematic. Is it all contracts, so that a recent contract we have completed for 216 integrated EPOS/Terminal devices into one of the UK's leading sporting venues needs regulating? Or is it just the smaller ones? If so, for one terminal or five or ten? Is it just sole traders or incorporated business too? The CCA does not regulate Ltd companies, no matter how small. If Gordon Ramsey sets up a new company for a new restaurant, does he need protecting?

Finance Lease Alternative

If ISO's are limited to offering 18-month maximum service contracts, they will simply revert to using conventional third-party lease finance to fund the expenditure. This will leave the merchants in a worse position, as they will still have a 48 month (or longer) lease contract (CCA rules do not apply), but with an unconnected lender that is unsympathetic to the wider needs of the merchant. Also, most such Lessors have minimum deal values which would exclude many single device contracts, will not accept new businesses and often demand personal guarantees. This will leave many small or new businesses with little choice but to purchase the devices and manage their own support needs.

Self-Regulation

From the forgoing, we have tried to make the case that there is no significant mischief to address, certainly within the business we undertake and ISO's we work with.

We are committed to ensure merchants are treated fairly and with compassion. The smallest or most naïve merchants have access to the Financial Ombudsman if they believe they have been unfairly treated, but only a handful have ever felt the need to do so over our 18-year history. Even in those few cases, the Ombudsman did not uphold any of the complaints.

Equally with debt enforcement. Although we are entitled to pursue the proprietors of businesses that fail for sums owing, we rarely do so unless there is clear evidence that they have the means. It seems unreasonable to heap more misery onto families that have already lost their livelihood. We never require directors' personal guarantees for the same reason. Similarly with merchants who die. It is part of the cost of doing business that we build into our economics.

There have been allegations and instances where unscrupulous sellers acting for ISO's deliberately mislead merchants about the contract terms or fraudulently alter documents. Whilst e-signing has helped eliminate most such behaviour, if this does arise, we work with the ISO concerned to exclude the particular seller or provide re-training. Our costs are recovered from the ISO and no debt is incurred by the merchant. We continue to work hard to stamp out such practice.

We also have firm policies in place with all our ISO's to limit the maximum monthly charge for a single device service [redacted] and a maximum term of [redacted] months. We also undertake regular dialogues with each, to encourage bringing the term down wherever possible. As a result, our average contract term is stable at [redacted] months.

We have also put in place the safeguards for merchants switching, referred to in the Market Competition section above. We also ensure than none of the contracts entered into with merchants, contain any penalty clauses for late payment or other hidden costs.

Finally, the current Covid crisis has proved a challenging time for us and many of our merchants. We did not require Government or a Regulator to tell us how to act. Working in partnership with our ISO's, we contacted every single merchant and unilaterally provided up to four-month pauses to their regular payments, for over 10,000 merchants affected during lockdown. We continue to extend such forbearance to those still affected today. We bore the entire cost of doing so without passing on any charges to the merchants concerned.

Best Practice - Code of Conduct

We believe that from our actions, we have demonstrated a responsible approach to this business and feel rightly proud of our contribution to the opening up of card processing to much wider competition and significantly better value for small businesses in particular.

We will gladly work with the PSR to produce a Code of Conduct and Best Practice that can be published for the future. We will happily sign up to such a reasonable code and ensure all of our ISO's do so before engaging in business with them.

We would strongly urge that you do not let perfection be the enemy of the good. There is a huge amount that is good about the way this industry operates and regulation should be the very last step.

[redacted]

Phoenix Edge

REPLY TO THE CONSULTATION ON THE PSR INTERIM REPORT INTO THE SUPPLY OF CARD ACQUIRING SERVICES

[redacted] Phoenix Edge Ltd

Phoenix Edge Ltd

Registered Address:

33a High Street, Stony Stratford

Milton Keynes, MK11 1AA

Company Registration Number: 6527212

DECEMBER 2020

[redacted]

Table of Contents

INTRODUCTION ... 4

About me ... 4

What prompted me to reply to this consultation ... 4

EXECUTIVE SUMMARY ... 5

ADDRESSABLE SPACE ... 7

Merchant Services Providers Assessed ... 7

Merchant Services Providers Models ... 10

Addressable Market ... 10

Merchants Acquired Directly by Acquirer ... 11

Merchants Acquired by an ISO ... 13

Merchants Acquired by a PSP ... 14

Telephone Payments ... 16

The Orphan Channel ... 16

Fraud & Liability ... 17

FEES & CHARGES ... 20

Understanding Fees & Charges ... 20

The Merchant Service Charge (MSC) ... 21

Interchange ... 21

Card Scheme Fees ... 21

Acquirer Margin ... 22

Payment Acceptance Merchant Rates ... 23

Interchange+ ... 23

Interchange++ ... 23

Blended or tiered ... 23

The difference between rates ... 23

Other Merchant Charges ... 27

Minimum Monthly Processing Fee ... 27

Early Termination Fee 27
Set-up Fees 27
Operational Fees 28
Value-Added-Services Fees 28
Assessments (aka "fines") 29
PCI DSS Related Fees 29
PCI DSS FEES 30
Introduction & History 30
The PCI DSS standard 30
Card Schemes Operating Regulations 30
Merchant Levels 31
The Acquirer Response 31
Merchant Terms & Conditions 31
Why and How the Fees were Introduced 32
Where We Are Now 33
Types of Fees 37
FURTHER CONSIDERATIONS 40
Underwriting 40
GDPR Compliance 41
CONCLUSION 42
ACKNOWLEDGEMENTS 43
Appendix 1: Merchant Validation Requirements 44

INTRODUCTION

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted].

EXECUTIVE SUMMARY

I commend the PSR for launching this review, and I have waited in anticipation for the results. This reply was finalised upon reading all related documentation published on the PSR website and drawing from public information sources.

The points summarised below are only some of the reasons that prompted my reply, and I hope this document will be of value for the final PSR report:

- The **merchant services providers** assessed do not seem to be representative of the UK market, and whilst some important players are included, the differences in their operating models make the merchant questionnaire difficult to answer and the replies misleading. With the pandemic driving many small businesses to digital, failure to include a representative sample of merchant services providers will leave out a large proportion of businesses that accept card payments and a large proportion of service providers that offer these services of. The scope of the review should be revisited, if only from a **fairness and competition** angle. (see ADDRESSABLE SPACE section).

- The **specific characteristics of a merchant must be taken into account** when crafting any assessment: what applies to a large retailer will generally not apply to a small ecommerce seller. (See Merchant Services Providers Models section)

- The **merchant questionnaire** seems to take a "one-size-fits-all" approach. The supply of merchant services is complex and depends on a number of factors, such as the size of the merchant. Perhaps due to its complexity, it increasingly lacks transparency. This means that SMEs would find it difficult, if not impossible, to give true answers to some of the survey questions as they have no visibility on the constituents of some elements (See FEES & CHARGES section). This should be examined further from a **transparency** angle.

- The PSR interim report suggests that the benefits of the Interchange Fee Regulation has only been passed on to larger merchants, but not to smaller merchants. This is easily explained as smaller merchants are not offered the transparency on fees that larger merchants benefit from. I suggest further analysis of **all the fees** that apply to the various commercial models, and not just interchange (See FEES & CHARGES section).

- The definition of value-added-services (VAS) is vague and should be considered for further investigation. For instance, PCI fees are charged, but the provision of a PCI portal is not a value-added service as it merely satisfies acquirers' card scheme reporting requirements (See PCI DSS Related Fees section) and merchants have no choice but to pay. The cost to SME merchants runs to tens of millions of pounds per annum.

- Given the current pandemic, the **telephone channel** should be specifically reviewed. In this channel, merchants do not get similar incentives as for other channels (face-to-face or e-commerce), and have to invest in extra fraud prevention capabilities to fulfil their obligations, or face negative financial impact if they don't. Given current trends, **this should be examined from a financial inclusion angle**. If merchants cannot invest in extra fraud prevention capabilities in the telephone channel, this means of interaction will not be made widely available to vulnerable segments. In addition, service providers find it difficult to offer their solutions, which stifles **innovation** in this space. (See Telephone Payments section).

- **Underwriting practices should be examined** from a **competition** and **innovation** angle (see Underwriting section).

Given the PSR's remit around improving **competition**, supporting **innovation** and **promoting end user interests** in payment systems a thorough review of the card market is welcomed. Reenforcing why the supply of card acquiring services is important to the economy and identifying what the industry and regulators need to do to ensure an effective market is key.

The card payments ecosystem is a complex one. In my response, I have taken great care to present an unbiased view of the card acquiring market and all references are from public sources. My aim is to highlight the issues that SMEs face in our constantly evolving and challenging world. It is my belief that the regulators are ideally placed to help them achieve better outcomes, ultimately to the benefits of the end customer. The PSR review is a good start. I also wish to highlight the challenges that other ecosystem players (e.g. PSPs, acquirers, issuers, schemes) are faced with, with the intention to advocate for more transparency in an ecosystem that is so fundamental to the economy.

This document provides a list of clear recommendations (highlighted in grey throughout) after the various problem statements and explanations. I appreciate that, bearing in mind the amount of change that is happening within the industry, any regulatory intervention has to be proportionate and prioritised appropriately. But it also needs to recognise that accelerating societal change is changing the shape of the market currently dominated by cards. With this in mind, the PSR may wish to consider **establishing a working group of experts** to help prioritise and establish a plan of activities to implement findings of the current review and to monitor the need for further action. I would be delighted to help.

I hope you find this report of use, and I remain at your disposal should you have any further queries.

[redacted]

ADDRESSABLE SPACE

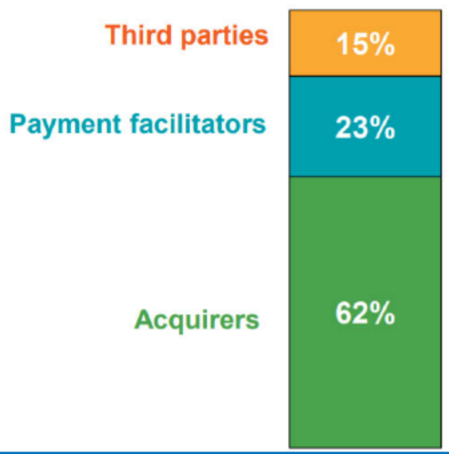
Merchant Services Providers Assessed

The interim report made the following selection as representative of the UK market:

Top 15 main providers identified

Barclaycard
Elavon
First Data
Global Payments
I-Zettle
Lloyds Cardnet
PaymentSense
PayPal
Payzone
Retail Merchant Services
Sage Pay
Square
Stripe
SumUp
Worldpay

Main providers identified by provider type



Merchant services providers can play various roles in the card payments ecosystem. It is dangerous when conducting any assessment of product & services provision (especially when in relation to fees and charges) to treat them equally. For example, the contract types and operational requirements will differ depending on which model is used. In addition, the same players can play various roles in the ecosystem, as illustrated below:

[redacted]

Whilst the Business Intelligence diagram on the previous page shows a majority of global and US players, it illustrates the point. For example, Adyen is both a PSP and an acquirer, so is Worldpay.

The merchant services providers assessed during the study were as follows:

- **Main stream acquirers** (6): Worldpay, Barclaycard, Elavon, Fiserv, Global Payments; Lloyds Cardnet (provided by Fiserv)
- **ISOs** (3): Payzone (now Take Payments), Retail Merchant Services[1], PaymentSense
- **PSPs** (6): Stripe[2], Paypal[3], Sumup, iZettle, SagePay, Square

It is acknowledged that the pandemic has driven payments digitisation much faster than predicted. SMEs have been forced into accepting payments digitally faster than they would have planned. In line with industry statistics, commercial models that facilitate SMEs digital payments adoption have become increasingly popular. These models can be broadly categorised under the banner of "Payments Aggregators". The PSR study included some of these under the generic banner of "PSPs". In addition, some increasingly popular players are not mentioned[4].

However, the payment aggregators come in many forms[5], notably:

- **Payment Facilitators (PayFacs)**: some were included (e.g. Stripe, Shopify)
- **Merchants of record**: none were included (e.g. Uber, Amazon, Paddle)

Many of the smaller SMEs are not able to use payment facilitators or ISOs (for risk & cost reasons), let alone direct acquiring services, and have no other option than to use merchants of record, a trend which can only increase.

In addition, the final study would not be complete if it limited itself to mainstream acquirers, as many smaller entities needing to accept payments, especially during the current economic crisis, would present a risk that mainstream acquirers are not prepared to take. Players such as Credorax, Paysafe, Bambora, checkout.com, Safecharge, trustpayments.com and Acquiring.com should not be ignored (not an exhaustive list), and none were considered in the interim study.

[1] RMS may also have an acquiring license.

[2] Stripe also has an acquiring license.

[3] Paypal now also has an acquiring license.

[4] https://go.forrester.com/blogs/merchant-payment-providers-key-takeaways-from-the-forrester-wave-q3-2020/

[5] See https://www.venable.com/-/media/files/publications/2018/10/identity-crisis-in-payment-aggregator-models/acheatsheetfordistinguishingaggregatormodels.pdf

In addition, the current assessment leaves out card schemes such as American Express and Discover who operate under the three party model. Whilst these card schemes are not dominant players in the UK, they have been left out of the assessment and this might render the final report incomplete, especially as such schemes are actively targeting the UK market. The decision was made not to include these in the final terms of reference but it might be advisable to revisit this.

CONSIDERATION FOR FINAL REPORT:

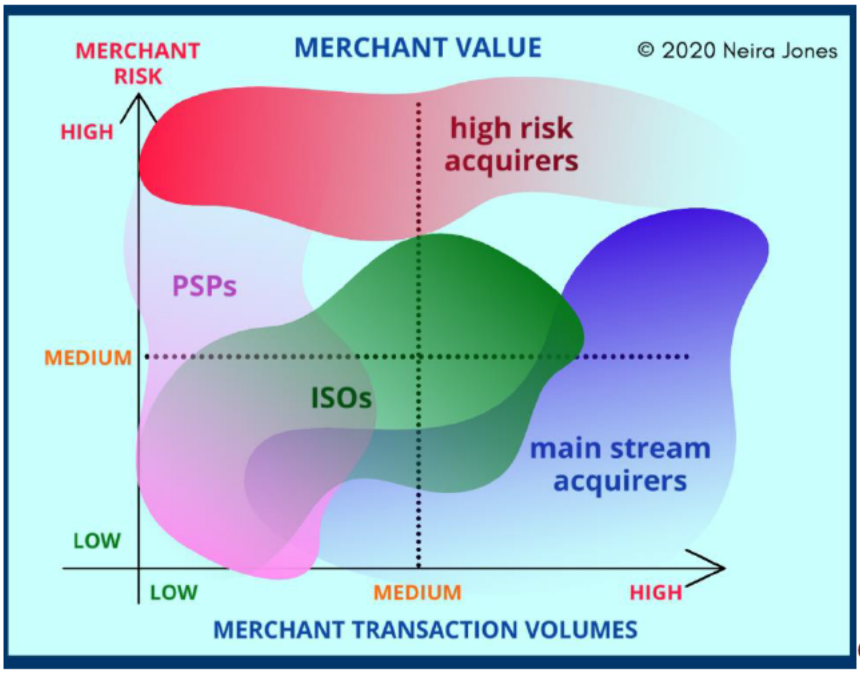
The current sample of service providers is not representative of the addressable market. With the pandemic driving many small businesses to digital, failure to do this will leave out a large proportion of businesses that accept card payments and a large proportion of service providers that offer these services.

In addition, attention should be paid to the fact that a "one-size-fits-all" approach to a merchant questionnaire will not give a true picture of the market. What applies to large merchants rarely applies to smaller ones.

Merchant Services Providers Models

Addressable Market

As explained in the previous pages, the supply of merchant services can be roughly divided as follows:



[6]

It is also worth noting that the "PSPs" category contains a number of different commercial models. Limiting the study to mainstream PSPs (e.g. Stripe) will leave a large part of the small trader population out, especially as these have no negotiating power.

The survey identified only three types of providers: acquirers, payment facilitators and third parties. It is not clear what is meant by "Third Parties" (this term is not defined in the glossary, and the terms of reference specify that these are "providers that do not also supply card-acquiring services", which is confusing) and even what entities are considered "Payment Facilitators".

CONSIDERATION FOR FINAL REPORT:

The current sample of merchants (and their service providers) is not representative of the addressable market. With the pandemic driving many small businesses to digital, failure to do this will leave a large proportion of small businesses (those who essentially have little choice or power to negotiate), in the same or a worse position than they are currently.

The following sections will examine the different commercial models.

[6] See Payments 101 – Part 2 – Card Payments Economics [redacted]

Merchants Acquired Directly by Acquirer

In this commercial model, the merchant has a direct contract with the acquirer for the provision of payment facilities. This model is illustrated below:

[redacted]

Understanding merchant needs is key when determining which payment facility is best for them. Determining factors for the fees charged include:

- Transaction volumes
- Merchant type/ industry sector
- Merchant risk profile
- Channels/ payment methods

Underwriting is a crucial stage for the acquirer, and full KYC, AML, and risk assessment will be performed. Some acquirers will specialise in high risk merchants, typically charging higher fees than mainstream acquirers. Acquirers will onboard merchants directly if the merchant value is worth the cost. Too many large volume/ low fee merchants would be detrimental to acquirers, which is generally why they have a cap on the number of large merchants they are prepared to have in their portfolio. Low/medium risk merchants will also bring volumes, but higher risk merchants may not be worth the cost for mainstream acquirers. Acquirers may partner with ISOs or PSPs to bring merchant volumes according to their risk appetite[7].

[7] For example, Take Payments (formerly Payzone) has a partnership with Barclaycard https://www.takepayments.com/

CONSIDERATION FOR FINAL REPORT:

Merchants onboarded directly by an acquirer will know about "card acquiring services" and therefore will be able to answer related questions. However, depending on their size, they may not have visibility of the fee structure (e.g. merchants on blended or tiered models). This means that some merchants, especially SMEs, may not be able to compare like-for-like easily. In addition, it is accepted practice for some providers that merchants might not see the T&Cs until they have signed a contract (or these may be included as a hyperlink in the merchant service agreement, which they generally overlook). **Transparency** is a very real issue.

In addition, the concept of "card acquiring services" is not introduced well in the questionnaire. Question A1 page 2[8] presents a lot of acronyms, even in the explanation. A more helpful question, to capture as much of the market as possible, would have been "Do you accept card payments from your customer? If so, who is responsible for making decisions on how you take these card payments?"

Note: whilst one would be forgiven for thinking that merchants offered a blended model are made aware of the other rates available (interchange + or ++), this is largely not the case. Whilst some of the smaller acquirers would make this reasonably clear, others would at worst not even talk about it, and at best would make some cursory mention of it in their Terms & Conditions (Worldpay, Clause 2.9[9]), whilst still contracting the merchant to a blended rate[10]. In the latter situation, it is understandable why small merchants would not even understand such a clause. It is also understood that some providers provide a link to their Terms & Conditions in the Merchant Service Agreement[11], merchants would actually rarely read these, let alone understand them. This answers the questions as to why merchants can generally not dedicate the time or resources to switch providers, as no information is available to make effective comparisons.

[8] https://www.psr.org.uk/sites/default/files/media/PDF/MR181.5_Consultation_on_our_merchant_survey_questionnaire.pdf

[9] Worldpay T&Cs https://www.fisglobal.com/-/media/fisglobal/worldpay/docs/general/merchant-services-agreement-standard-tscs.pdf?la=en-gb

[10] See Article 9 Interchange Fee Regulation https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015R0751

[11] https://www.fisglobal.com/-/media/fisglobal/worldpay/docs/general/merchant-services-agreement-standard-tscs.pdf?la=en-gb

Merchants Acquired by an ISO

In this commercial model, the merchant has a direct contract with the ISO, and also with the acquirer for the provision of payment facilities. This model is illustrated below:

[redacted]

Merchants onboarded by an ISO will generally pay lower fees than if they are directly onboarded by an acquirer. This is because acquirers will give ISOs wholesale rates so they can pass on savings to merchants. In this case the merchant will have a contract with both the ISO and the acquirer. ISOs can also partner with other providers (e.g. terminal providers or ecommerce payment gateways) and can be considered as a one-stop-shop for payment services for their market segments and generally offer a more personalised service.

ISOs add an extra layer between the merchant and the acquirer, as they take on additional risk. They will charge merchants for that additional risk, but this is compensated by their partner acquirers wholesale rates. This is why, generally, newly established merchants with little or no credit history are unlikely to interest ISOs. For these merchants, a "PSP" may be more suitable.

CONSIDERATION FOR FINAL REPORT:

Merchants onboarded by an ISO may know about "card acquiring services" and therefore might be able to answer related questions since they have a contract with the acquirer as well as the ISO. But as explained on the previous page, the fee structure will be different and they may not be aware of its detailed constituents.

Merchants Acquired by a PSP

In this commercial model, the merchant has a contract with the PSP only. Here, the term "PSP" is used in its loosest sense, as there are many commercial permutations depending on the type of merchant.

In addition, the acquirer will have a contract with the "PSP", as illustrated below:

[redacted]

As the merchant only has a contract with the PSP, the latter will have a number of responsibilities, as illustrated below:

[redacted]

Acquirers will contract with PSPs to bring internet volumes. The PSP isolates the acquirer from underlying merchant risk as they can aggregate a multitude of smaller entities.

PSPs generally have more flexible, light-weight systems optimised for dealing with large numbers of small merchants. To keep costs down, they must also deploy significant automation, and merchant self-provisioning.

CONSIDERATION FOR FINAL REPORT:

Merchants onboarded by a PSP may not understand the term "card acquiring services" and therefore might not be able to answer related questions since they only have a contract with the PSP (e.g. Stripe). They will only see one rate for the payment facility. For those merchants that have deliberately chosen this type of PSP (e.g. Stripe), they are generally more able to switch providers (depending on contract terms) as there are many reputable ones on the market (e.g. Braintree, Shopify, etc.).

Some of the "sub-merchants" acquired by PSPs can themselves be merchant aggregators for yet smaller entities (who would not otherwise be able to afford payment facilities because of their very low volumes).

CONSIDERATION FOR FINAL REPORT:

This type of situation happens at the lower end of the market, especially for very small merchants selling digital goods. In such instances, the provider of the payment facility will be a sub-merchant of a PSP themselves. This model is sometimes referred to as Merchant of Record (e.g. Paddle, Thinkific). As the pandemic is driving even more small businesses towards digital, ignoring this segment of the market is not advised. This type of model provides a low cost option for small merchants. Again, merchants in this situation are isolated from the basic card acquiring fee structure which the PSR interim report concentrates on.

Furthermore, the merchants using these types of services would have their primary interaction with the Merchant of Record, and whilst they may see an option to set-up the payment method (say, using Stripe or Paypal) which is done when the relationship is set up, they would not necessarily know, or even remember that they have done this.

PSPs provide one-size-fits-all pricing, and fees are generally higher than other options, which make them unappealing to larger merchants (who would choose to engage with an acquirer, either directly, or through an ISO). They are however very attractive to smaller merchants as they are relatively hassle free.

Telephone Payments

The current pandemic has driven increased digitisation. In the UK, a market already heavily digitised, the trend has been no less exacerbated by the crisis. The increase in contactless limits has driven increased use of cards in the face-to-face channel, and we are all familiar by the controversy around ATM closures, especially affecting rural areas and vulnerable segments of the population.

Whilst telephone payments do not traditionally represent a very large proportion of the overall payments landscape compared to other channels, current trends and statistics should not be ignored[12][13][14].

This drives me to point out that vulnerable segments that have traditionally relied exclusively on cash (either by preference or necessity), only have one other avenue familiar to them, and that is the telephone. Some organisations have recognised this, such as Morrison's, who made the telephone channel only available to vulnerable self-isolating segments via their Doorstep Delivery[15] service.

If we agree with the premise that payments over the telephone are set to increase, then we should consider some of the well known issues traditionally associated with the supply of card acquiring services in that channel.

For the purpose of this section, I will limit the analysis to the telephone channel (because of volume trends), but all my observations equally apply to mail order (so that the MOTO – Mail Order/ Telephone Order - channel is covered).

The Orphan Channel

Telephone payments, from a risk and liability angle, have never been treated in the same way as face-to-face and e-commerce payments.

The 2nd Payment Services Directive (PSD2) and subsequent European Banking Authority responses do not resolve this matter, leaving interested parties having to resort to direct specific questions through the EBA Single Rule Book, or best effort interpretation. This area is still confusing[16]. In any instance, and outside of PSD2, current card acquiring practices for this channel should be understood.

[12] https://thefintechtimes.com/six-ways-to-cope-with-the-huge-spike-in-customer-call-volume/

[13] https://www.iovation.com/blog/how-covid-19-is-causing-a-fraud-pandemic-in-call-centers

[14] https://www.clevelandfed.org/en/newsroom-and-events/speeches/sp-20200923-payments-and-the-pandemic.aspx

[15] https://my.morrisons.com/doorstep-deliveries/

[16] https://www.visa.co.uk/dam/VCOM/regional/ve/unitedkingdom/PDF/visa-preparing-for-psd2-sca-publication-version-1-1-05-12-18-002-final.pdf

Fraud & Liability

The concept of liability is well understood in the card acquiring space. From a merchant's point of view, the concept of **liability shift** is an important one. This is described below:

[redacted]

17

As described above, if fraud happens in the face-to-face channel (e.g. cloned card), the issuer bears the liability. This means that the merchant still gets paid, and the cardholder doesn't lose any money.

If fraud happens in the e-commerce channel, and the transaction has been authenticated with 3D Secure, the issuer bears the liability. This means that the merchant still gets paid, and the cardholder doesn't lose any money.

If fraud happens in the ecommerce channel, and the merchant hasn't deployed 3D Secure, the merchant bears the fraud risk. Simply put, depending on fraud levels and risk appetite, it is generally in the interest of ecommerce merchants to deploy 3D Secure, as they get a liability shift. This is an important fraud prevention incentive.

Merchants have no such choice or incentive in the telephone channel, as, regardless of extra fraud prevention measures deployed, they bear the fraud risk on any transaction through the MOTO channel. Merchants will probably not be aware of this risk and acquirers are unlikely to alert them. Especially for SMEs unaware of fraud or security risks, keeping

[17] [redacted]

written or recorded media that may include full PAN, CVV, address etc. could be a breach of PCI DSS requirements, which again might generate more fees.

To further the explanation, below are the tools available to merchants to prevent fraud in any channel:

[redacted]

The standard features in the face-to-face channel are well known and self-explanatory.

3D Secure and the use of the Card Verification Value (CVV) in the ecommerce channel are also well understood.

The Address Verification Service (AVS) is a service provided by major card schemes to enable merchants to authenticate ownership of a credit or debit card used by a customer in the card-not-present channel (AVS can also be used in the face-to-face channel, although this is not common/necessary in EMV Zone 1 & 2 countries). This will be included as part of **card scheme fees**, and depending on what contract a merchant has (see Merchant Services Providers Models section), merchants may not even be aware of this.

The main point to remember is that card scheme approved standard features are available that would give merchants the incentive of a liability shift in the ecommerce (3D Secure) and face-to-face (Chip, PIN, signature, visual checks) channels. No such incentives are available for the telephone channel.

For the telephone channel, equivalent protection for authentication and fraud prevention is an expense that needs to be considered carefully, as merchants can't justify this on the basis of any liability shift. PSD2 doesn't even help with this as requirements for Strong Customer Authentication for the telephone channel still remain vague.

CONSIDERATION FOR FINAL REPORT:

For e-commerce and face-to-face merchants, card scheme approved methods (e.g. 3D Secure) are available to give them the incentive of a liability shift. For provider of 3D Secure solutions, accreditation processes are available. But merchants are not free to select any equivalent (or potentially better) authentication measures, and authentication solutions providers wanting to offer solutions in that space must work to the 3D Secure specification. **This should be examined further from a competition angle**.

For the telephone channel, merchants will not get any liability shift and are confined to use standard features (e.g. CVV, AVS), and invest in extra fraud prevention capabilities. Given current trends, **this should be examined from a financial inclusion angle**. If merchants cannot invest in extra fraud prevention capabilities in the telephone channel, this option will not be made widely available to vulnerable segments. In addition, service providers find it difficult to offer their solutions, which stifles **innovation** in this space.

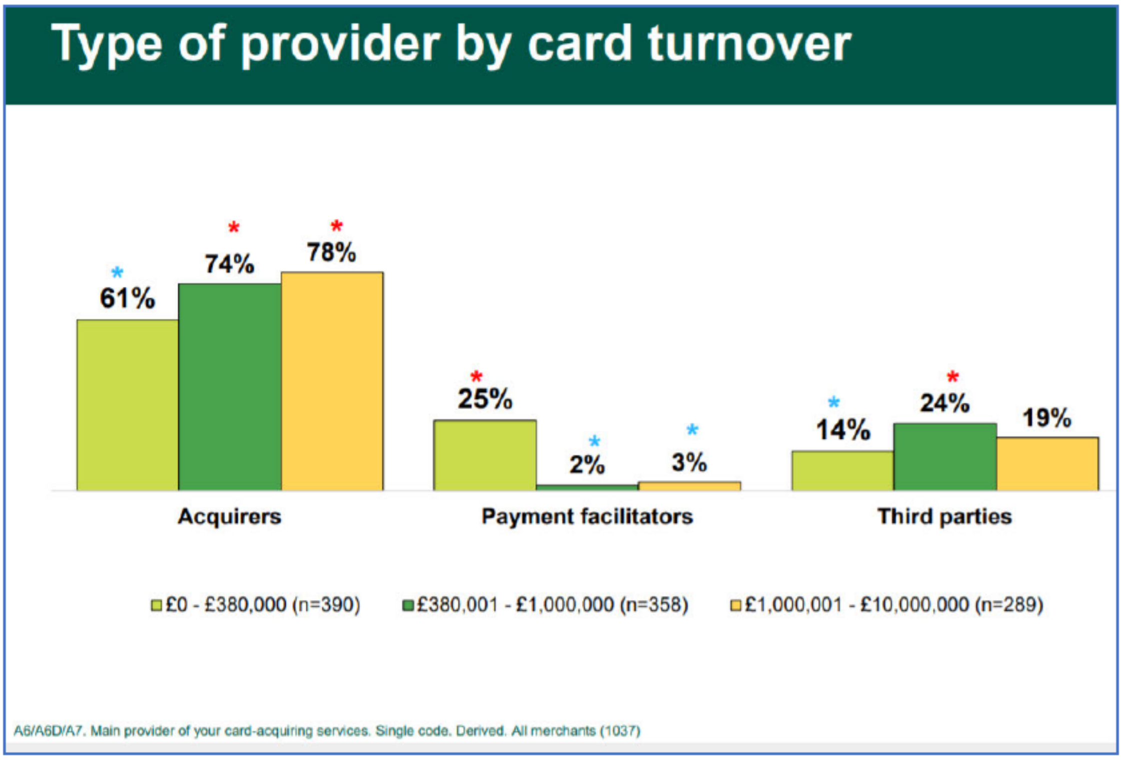
FEES & CHARGES

Understanding Fees & Charges

Understanding merchant service provider models is key to understand fees and charges levied on the various types of merchants.

The following sections will explain how fees and charges are calculated and how they apply to the various merchant models.

In the meantime, it becomes clear as to why the following diagram does not reflect a true picture of the UK market:



As previously mentioned, a number of factors will affect fees and charges:

- Merchant model, risk and size (transaction volume and value)
- Channel (Card Present, Card-Not-Present)
- Value-added-services (VAS) and other services
- Compliance related charges
- etc.

Typically, a merchant directly acquired by an acquirer will be charged the Merchant Service Charge (MSC) monthly for the provision of a payment facility or facilities. The merchant will also pay for other elements which will also be described in this section.

The Merchant Service Charge (MSC)

The MSC is calculated as follows:

[redacted]

Interchange

Interchange is a percentage of the transaction value. In the four party model, this amount flows from the acquirer to the issuer. It is the single largest cost to the acquirer. Depending on the card programme and product type, it may be the largest single income line item for issuers. Interchange rates vary depending on card type (e.g. debit, credit, consumer, commercial, etc.), channel and other factors.

Under the EU Interchange Fee Regulation (IFR), interchange is capped at 0.3% for consumer credit transactions and 0.2% for consumer debit transactions (higher rates apply for non-consumer cards).

Card Scheme Fees

These are not publicly disclosed, and they are unregulated. These can be rather obscure, and even acquirers don't completely understand the details and will generally only concentrate on items that stand out. The PSR makes some acknowledgement that these fees have gone up and it is generally accepted that they represent on average 0.03% of the transaction value, irrespective of card type.

[18] See Payments 101 – Part 2 – Card Payments Economics e-learning [redacted]

CONSIDERATION FOR FINAL REPORT:

I recommend that the card scheme fee manuals be reviewed and understood so the final report takes into account the details and implication of these fees and see if there could be any way of simplifying them so they could be better understood by all affected parties.*

As an example, the switch to make all contactless transactions have an online authorisation introduced an additional card scheme fee. With Covid 19 and the lift in contactless limits, the card schemes will experience a massive increase in revenues from this source and merchants have no choice but to pay.

As these fees generally get passed through to merchants, this has been a major contributing factor as to why merchants saw little benefit since the Interchange Fee Regulation came into play. The interim report seems to suggests that benefits have been passed on to merchants, but at the very same time, several trade associations complained very publicly[19].

*Note 1: as an example, one type of card scheme fee is the ATM locator fee charged by MasterCard, and all acquirers have to pay it. An intriguing factor is that this fee will be charged even if an acquirer only processes ecommerce transactions as it is applied by BIN. Note 2: Barclaycard publicly lists some of the scheme fees applied on transactions[20].

Acquirer Margin

Of course, the acquirer margin will depend on a number of factors, including the merchant's ability to negotiate. This will be explained in the next sections.

[19] https://www.bbc.co.uk/news/business-54606252

[20] https://www.barclaycard.co.uk/content/dam/barclaycard/documents/business/help-and-support/Interchange-Rates-and-Scheme-Fee-Guide.pdf

Payment Acceptance Merchant Rates

MSC = Interchange + Card Scheme Fees + Acquirer Margin

Interchange+

The merchant will see the interchange amount, and a fixed percentage will be added.

Interchange++

The merchant will see the interchange amount, the card scheme fees, and a fixed percentage will be added.

Blended or tiered

The merchant only sees one rate, with no contractual tie to interchange. This rate is generally the rate offered to SMEs, and also typically the structure used by PSPs.

The difference between rates

It is clear that Interchange+ and Interchange++ offer more fee transparency for merchants. These rates are reserved for the largest of merchants, who have the power to negotiate, because they bring volumes (or when they are available, it is generally not obvious for merchants to find them). These rates are generally not offered by default to SMEs, who will mostly be on a blended or tiered model (or if they are, merchants may not understand what this means to them, seemingly in direct contravention of Article 9 of the IFR[21]).

[21] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015R0751

This is illustrated below:

[redacted]

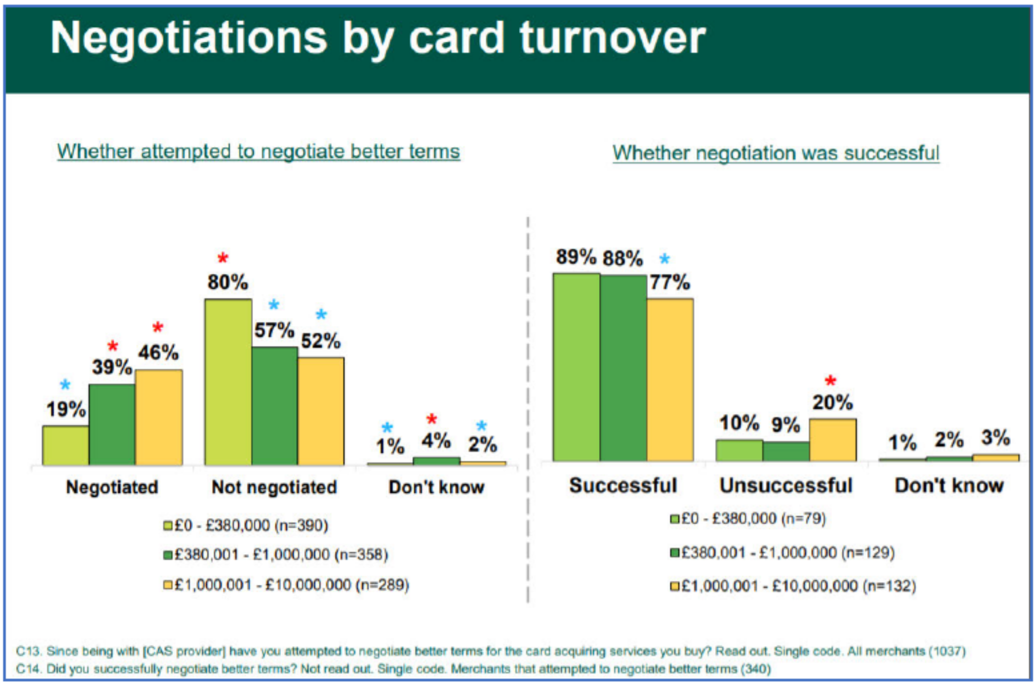
In addition, whilst for larger merchants (Interchange+ and ++), the acquirer will apply a fixed margin, for smaller merchant, because of the above model, the margin will typically be variable, as illustrated below:

[redacted]

This is further illustrated below, showing the different card transactions:

[redacted]

It is clear that when seeking merchant feedback on fees and charges, the questions must take into account the size of merchant and the commercial model used. For example, a merchant on a blended/tiered rate (who has no transparency as to margin applied) should not be asked the same questions in relation to MSC as a merchant on interchange++ (who has complete transparency and negotiating power). Consequently, the following diagram will be misinterpreted if the relevant factors are not taken into account:



In relation to the diagrams presented on the previous page, a diagram showing whether merchants' ability to negotiate depending on the type of provider would have been more helpful, but this wasn't provided in the study.

CONSIDERATION FOR FINAL REPORT:

A **merchant's ability to negotiate or switch is dependent on the commercial model used,** and therefore what type of provider has the main relationship for payment facilities. Questions related to commercial terms should not be the same for all payment facility providers as the terms can be vastly different.

In addition, taking a one-size-fits all approach will introduce **bias** in favour of larger merchants, leaving the SME segment no better than they were before.

Since this consideration was part of the Final Terms of Reference for this market review (section 3.5), it should be assessed accordingly.

Other Merchant Charges

The purpose of this section is not to present an exhaustive list of additional charges, but only the most notable ones.

Minimum Monthly Processing Fee

Typically, this is a fee that merchants will incur if they do not process a minimum level of transactions in a given month. This is a fee generally levied on small merchants by acquirers and some ISOs[22]. This fee is never levied on large merchants, for obvious reasons. (Also known as Minimum Monthly Service Charge [MMSC]).

CONSIDERATION FOR FINAL REPORT:

Monthly minimum processing fees are generally always declared, and therefore merchants entering in the commercial agreements that include it will generally do so in full knowledge.

Early Termination Fee

As the name suggests, smaller merchants may be locked into lengthy contracts because the early termination fee and notice period can be prohibitive (this wouldn't be an issue for larger merchants). This also further reduces any ability (if they have any in the first place) to negotiate.

CONSIDERATION FOR FINAL REPORT:

Early termination fees are generally always declared, but, whilst a merchant could technically terminate an acquirer agreement after 12-18 months, they might be locked in with their provider (e.g. ISO) if they have a 3-5 year terminal rental deal. This is a major source of complaints on TrustPilot[23]. I acknowledge that some remedies are suggested in the PSR Interim Review.

Set-up Fees

Set up fees, arrangement fees or joining fees are often charged for businesses that are new to cards. Years ago, these fees used to be charged as a matter of course and were typically £100 - £200. Smart business owners will negotiate them down, but others will just pay it. Some PSPs or ISOs may still have this practice. In addition, when the merchant is deemed high risk, the fees can go up a lot higher. In some instances, these fees could be refunded when the provider cannot place the business.

[22] See https://www.cardswitcher.co.uk/cheapest-merchant-services-for-small-businesses/

[23] See https://uk.trustpilot.com/review/worldpay.com?page=4&stars=1

Operational Fees

Here, the term “operational fees” is used as a catch all category reflecting that these are fees that are charged during the normal course of business. Therefore, a merchant may consider these as “operational” as they might not understand that the various fees are different in nature (e.g. a service, or a card scheme fee). They include terminal rental, payment gateway provision, chargeback fees, authorisation fees, any fees resulting from the merchant breaching any card scheme monitoring programme (e.g. excessive chargebacks, fraud to sales ratio, etc.). These fees are generally applied across the board by acquirers, regardless of merchant size.

CONSIDERATION FOR FINAL REPORT:

These types of fees are generally explained in the merchants’ Terms and Conditions. However, they may be described in very generic terms, and merchants may not realise that they could incur some of these when they sign a contract. More **transparency** and plain English should be recommended. I acknowledge that some remedies are suggested in the PSR Interim Review.

Value-Added-Services Fees

These are fees levied on merchants for the provision of VAS to enhance their payment acceptance environment (this is up-sell for an acquirer), such as mobile top-up, loyalty, dynamic currency conversion, factoring, etc.

CONSIDERATION FOR FINAL REPORT:

Merchants should be aware of these fees, as they are essentially paying for a service/product that they need or want as part of their business operations. These are generally clearly explained.

However, the provision of PCI DSS reporting portals to merchants is sometimes described as a VAS, but does not represent a value-added-service and the use of this term for that facility is misleading. (See PCI DSS FEES section).

Assessments (aka "fines")

There are many assessments that can be levied on merchants. Technically speaking, under EU law, the term "fine" has a specific meaning and its usage could lead to regulatory issues, but for this report, we will call them "fines" as the implications for merchants are the same. These "fines" relate to any breach of card scheme operating regulations, and these terms are always included in the merchants' terms and conditions for those that have a contract with an acquirer. For example, a merchant may suffer a payment security data breach (this is called a "data compromise"), in which case they could be liable for the following costs:

- Engagement with a forensic investigator and remediation costs
- Fines levied by the card scheme(s) on the acquirer
- Card fraud losses as claimed by the issuers affected.

CONSIDERATION FOR FINAL REPORT:

Acquirer's discretion governs whether fines/ losses are passed on to the affected merchant (this is not something the card schemes get involved in). This generally means that those merchants that have less negotiating power (SMEs) are generally more penalised, which becomes a fairness issue.

PCI DSS Related Fees

These are fees that started appearing in the card acquiring market around 2009-2010. The state of payment security was such that the card schemes were putting increasing pressure on acquirers to drive PCI DSS compliance in their merchant portfolios. This included fines from the card schemes levied on acquirers for not meeting portfolio PCI DSS compliance thresholds. The PCI DSS related fees are complex, which is why they require a section in their own right (See PCI DSS FEES section).

CONSIDERATION FOR FINAL REPORT:

Please note that PCI DSS related fees should not be considered as a "value-added-services". They are now essentially imposed on SMEs (these do not apply to large merchants), and should at least be investigated for transparency, purpose and fairness. Please see next section for details. In addition, PCI DSS fees are specifically included in the Final Terms of Reference of this market review, section 3.3[24], but no mention of them is made in the interim report.

[24] https://www.psr.org.uk/sites/default/files/media/PDF/PSR_MR18_1.2_card_acquiring_market_review_Final_terms_of_reference_January_2019_0.pdf

PCI DSS FEES

Introduction & History

The PCI DSS standard

The Payment Card Industry Data Security Standards has been around since 2004 to prevent card payment fraud. It is an excellent data security standard and applies to all entities that would process, store or transmit cardholder information, either electronically or manually. With the worldwide increase in digital payments, this standard was welcome (and still is). It is now a mature standard and has evolved drastically, in line with ever evolving cyber threats. We are now on version 3.2.1.

Card Schemes Operating Regulations

Compliance with the PCI DSS is clearly set out as a requirement in the card scheme operating regulations for card scheme members. This essentially means that a breach of PCI DSS requirements, as set out by the scheme via mandates (e.g. member letters), will attract an assessment fee (i.e. fine) from the card scheme on the member (e.g. an acquirer). What happens to that fine once it has been levied on a member (e.g. an acquirer) is entirely at the member's discretion.

In the early days (i.e. 2006 to 2015), the card scheme focus was on PCI DSS compliance given that PCI DSS industry compliance levels were low and fraud and data breach levels were high. As a result, the card schemes, given their role of preserving the integrity of the ecosystem, specified acquirer portfolio compliance thresholds, and deadlines by which to meet these thresholds. Failure from acquirers to meet those thresholds would attract fines.

The challenge for acquirers was to be able to manage the compliance status of their portfolios and to be able to report on that status to the card schemes. Reporting was usually done on a quarterly basis, and reporting spreadsheets were defined by the card schemes for that purpose.

Another challenge was to determine how to manage, and potentially re-distribute, the levied non-compliance fines to the merchant portfolio.

At that time however, it was clear that the justification for any re-distribution of non-compliance fines to the merchant portfolio (or part thereof) was on the basis of non-compliance fines that were levied on the acquirer by the card scheme.

Merchant Levels

An acquirer's merchant portfolio is categorised by "Merchant Levels". These are based on transaction volumes, not value. These are broadly defined below:

- Level 1: the largest merchants (more than 6 million transactions per year per scheme)
- Level 2: large merchants (between 1 and 6 million transactions per year per scheme)
- Level 3: large-medium ecommerce merchants (20,000 to 1 million)
- Level 4: small merchants (less than 20,000 ecommerce and up to 1 million transactions for all other merchants)

The compliance requirements by merchant levels are explained in Appendix 1: Merchant Validation Requirements.

The Acquirer Response

In order to fulfil the **compliance reporting requirement** imposed by the card schemes, and to avoid fines, acquirers needed to implement processes and systems. Smaller acquirers would manage this (if at all) through spreadsheets. Larger acquirers, with many thousands of merchants, deployed "PCI DSS Compliance Portals" as provided by suppliers such as Security Metrics, Trustwave, Sysnet, etc.

These industry compliance portals were specifically targeted at Level 4 merchants (i.e. SMEs) and essentially replicate the paper Self-Assessment Questionnaire (SAQ) in a digital form, as well as offering vulnerability scans for e-commerce merchants (where required).

Please take some time to look at https://www.pcisecuritystandards.org/documents/PCI-DSS-v3_2_1-SAQ-B.pdf for the simplest of these SAQs (SAQ B), which typically applies to small face-to-face merchants. It is apparent, when reading this SAQ, why small merchants would find it difficult to complete, whether on paper or digitally. The intention was that the PCI DSS compliance portals would enable acquirers to present a reflection of the compliance status of their merchant portfolio.

The way that acquirers managed the compliance of larger merchants (Levels 1, 2 and 3) varied across the board, generally either through spreadsheets or end-user technologies such as MS SharePoint.

Merchant Terms & Conditions

In order to cater for the usage of these portals, specific PCI DSS compliance clauses were introduced into merchants' Terms & Conditions.

Why and How the Fees were Introduced

Between 2006 and 2010, as PCI DSS compliance figures stagnated and fraud levels were high, most acquirers decided to introduce "Non-Compliance Fees", ramped up communications with merchants (via call centres and other means), to encourage them to become compliant and avoid the fees (and supposedly decrease the risk in their portfolio).

CONSIDERATION FOR FINAL REPORT:

PCI DSS became a major source of complaints for all acquirers, and was monitored at the highest level. These complaints ranged from not knowing who the call came from (when contacted directly by the compliance portal provider as part of the chasing activity), to not getting any help as to how to complete the SAQs, and of course complaining about the non-compliance fees, which they couldn't avoid since they were included in their terms and conditions. This resulted with merchants at best ticking boxes just to make it go away (thus defeating the original objective of getting a handle on compliance), and at worst not doing anything and seeing the fees pile up.

Where We Are Now

It has been long acknowledged in the industry that PCI DSS non-compliance fees have not achieved the objective they were supposed to fulfil.

The following report from Sysnet's 2nd Annual Acquirer PCI Sentiment Survey[25] says it all:

[redacted]

[25] https://sysnetgs.com/blocks/2nd-annual-acquirer-pci-sentiment-survey-home-banner-block/2nd-annual-acquirer-pci-sentiment-survey-ebook-image/

As compliance figures were still stagnating, the PCI Security Standards Council (PCI SSC, the industry body responsible for the development of the standard) and the card schemes decided to try a different approach. The fundamental principal of the approaches was to try and **get a handle on the risks posed by merchants by the way they deploy their payments infrastructure**. Notable initiatives include:

- In August 2018, the PCI SSC launched the **PCI Data Security Essentials Evaluation Tool for Small Merchants**[26], simplifying PCI DSS self-assessment by providing an easy to use visual tool, with plain English explanations and clearly highlighted risk factors.

PCI DATA SECURITY ESSENTIALS EVALUATION TOOL FOR SMALL MERCHANTS

Data Security Essentials Evaluation Tool

The PCI Data Security Essentials Resources for Small Merchants provides security basics to protect against payment data theft and to help small merchants simplify their security and reduce their risk. The Data Security Essentials Evaluation Tool provides an alternative for eligible small merchants to learn more about their security posture and perform a preliminary evaluation to understand how they are meeting these security basics for safe payments.

Each merchant's acquirer (merchant bank), in coordination with the applicable payment brands, determines which merchants are eligible to use Data Security Evaluation forms. We encourage small merchants to review Data Security Essentials Resources for Small Merchants, talk to your acquirers for instructions on how to complete and submit a Data Security Essentials evaluation, and start your path to better security and simpler validation today

For more information:

Acquirer Overview

Merchant Overview

LAUNCH DATA SECURITY ESSENTIALS EVALUATION TOOL

To date, no acquirer, to my knowledge, has communicated to their Level 4 (SME) merchants regarding the availability of this simplified tool and the merchants eligibility to use it. If these initiatives were implemented, PCI fees should largely fall by default.

- In October 2018, **Mastercard** launched their **PCI DSS Validation Exemption Program for Eligible Merchants Using Secure Technologies**[27]. Similarly, to my knowledge, no acquirer has communicated with merchants in respect to this tool.

[26] https://www.pcisecuritystandards.org/pci_security/small_merchant_tool_resources

[27] https://globalrisk.mastercard.com/wp-content/uploads/2018/10/PCI-Validation-Exemption-Program.pdf

In addition, in 2015, the **card schemes revisited their approach and decided to focus on portfolio risk rather than non-compliance**. Notable facts include:

- **Non-compliance portfolio fines removed** by card schemes on acquirers (effective 31st October 2015)
- **Quarterly reporting reduced and new targets set**. For acquirers not meeting thresholds, card scheme would require a remediation plan, and would potentially conduct an audit on the acquirer.
- **Data breach fine structure revisited** according to the knowledge the acquirer has on the merchant and their compliance status at the time of the breach (e.g. penalty reductions of between 25% and 100% in favour of acquirers will be applied based on self-notification of a breach and the PCI DSS compliance of the merchant). The intention here was to let acquirers manage the risk in their portfolio in a more flexible way, and this was welcomed by the industry.

CONSIDERATION FOR FINAL REPORT:

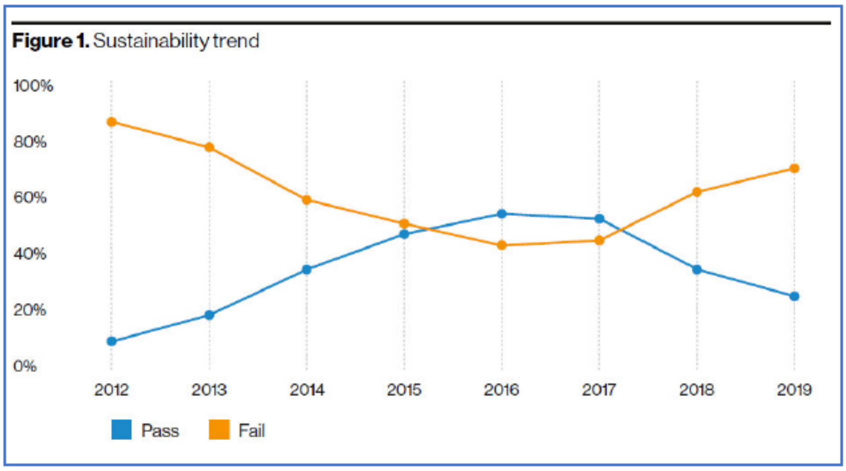
The original reason for levying non-compliance fines on small merchants (passing on PCI DSS card scheme portfolio non-compliance fines) **no longer exists**. Therefore, the purpose of these fees should be examined carefully. There are many ways merchants are charged for the risks they may bring to the ecosystem (see Merchant Services Providers Models and FEES & CHARGES), and remediation mechanisms are well understood. For cyber-risk (essentially payment security risk), fees should only be charged if it can be demonstrated that the risks are understood and that merchants can actually remediate them.

Some acquirers may argue that they deliver a service to their merchants for providing them with a portal to attest to their compliance. **The provision of a portal to attest to compliance is not a "service"**, it is solely for the benefit of the acquirer to fulfil their card scheme reporting obligations. Some acquirers, realising this, created enhanced offerings including further security products to help their Level 4 merchants towards compliance. The low take-up of these services suggests that merchants, as expected, do not understand these products.

Some acquirers deployed premium security products for SMEs (e.g. managed security services), to be used if they failed to meet certain compliance threshold. **Enrolment of merchants on these products should be investigated to determine whether they have given their consent to their purchase and are indeed able to use them**.

Alternative and easier methods for PCI DSS compliance validation have been available for a few years. The reasons why these methods have never been offered to merchants by acquirers should also be investigated.

Furthermore, the recent **Verizon 2020 Payment Security Report** highlights the following PCI DSS compliance trend:



This represents a systemic failure in PCI DSS compliance management, and clearly highlights that PCI DSS fines are not working.

These fees represent a **substantial amount of revenue for acquirers which can run into tens of millions of pounds per annum.**

The compliance (or non-compliance) trends above suggest that this revenue can only increase. Perversely, from a commercial point of view, **it is in the interest of acquirers who charge fees that their merchants remain non-compliant**. This however doesn't mean that 100% of non-compliant merchants present a risk to the ecosystem.

Further considerations:

- There is no evidence that PCI DSS fees (other than those related to data breaches) are ever levied on large merchants (Levels 1 and 2).
- Some acquirers also include Level 3 merchants in their compliance programmes.
- In some instances, **the total of PCI DSS related fees can amount to a higher amount than that paid for the card acquiring services themselves.**

CONSIDERATION FOR FINAL REPORT:

The FCA stated their objective[28] to "ensure fair treatment for consumers and small firms - making sure that firms give strong and clear support to customers, recognising challenges that everyone is facing".

In relation to PCI DSS related fees, **transparency and fairness should be investigated** thoroughly, as merchants of different sizes are treated differently. This could also be in breach of related regulations[29].

[28] https://www.fca.org.uk/news/press-releases/fca-sets-out-priorities-2020-21

[29] https://www.fca.org.uk/firms/fair-treatment-customers

Types of Fees

Since card schemes removed portfolio non-compliance fines, some acquirers started renaming the non-compliance fees as “admin/programme fees” or similar. It is however fair to say that there will be broadly speaking three types of fees: those related to non-compliance, those related to usage of the portal, and those related to security products.

Some examples are given below:

Acquirer	Public Information	Comments
Barclaycard	https://www.barclaycard.co.uk/business/help-and-support/accepting-payments/security-help/pci-dss/pci-dss-faqs https://www.barclaycard.co.uk/business/help-and-support/accepting-payments/security-help/pci-dss/becoming-compliant	It is known that programme fees are £4.80pcm (or £15 for the premium portal), non-compliance fee £25pcm, all per merchant ID. The fees for vulnerability scans are not listed.
WorldPay	(it is difficult to find these fees listed online with only the lowest fees published on the website, making it difficult for merchants to compare) website: https://www.fisglobal.com/en-gb/merchant-solutions-worldpay/products/safer-payments	[redacted]
Global Payments	(it is difficult to find these fees listed online with only the lowest fees published on the website, making it difficult for merchants to compare) website: https://cdn-gx.dataweavers.io/-/media/global-payments/uk-new-images/globalfortress/global_fortress_sales_sheet.pdf ([redacted] Old reprice letter ([redacted]) https://www.globalpaymentsinc.com/-/media/global-payments/files/uk-migration/resource-center-uk/card-processing/globalpayments_know_the_risks.pdf?la=en-gb	[redacted]

Acquirer	Public Information	Comments
Fiserv	Merchant agreement: https://www.firstdata.com/downloads/pdf/en_gb/First_Data_Merchant_Conditions.pdf website (no mention of fees): https://www.firstdata.com/en_gb/products/small-business/all-solutions/pci-dss-compliance.html	Non-compliance fee £35pcm, per merchant ID. Other fees are not listed.
Lloyds Cardnet	website: https://www.lloydsbankcardnet.com/Content/pdf/pci-dss-update.pdf	[redacted]
Elavon	website (no fees are mentioned): https://www.elavon.co.uk/solutions/security-and-pci-compliance/security.html Statement explainer (only best case presented): https://www.elavon.co.uk/content/dam/elavon/en-gb/documents/customer-centre/setting-up-your-account/Understanding_Your_Statement_vs2.pdf	Unable to find fees information

Some ISOs will also charge PCI DSS related fees:

- **PaymentSense** https://support.paymentsense.com/hc/en-us/articles/201239471-What-is-PCI-compliance-and-why-does-it-matter-

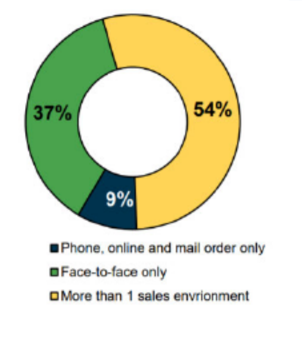
Some ISOs leave that to the acquirers:

- **RMS**: https://www.retailmerchantservices.co.uk/help-support/support-detail-pages/pci-compliance/how-do-i-become-compliant/

To my knowledge no payment facilitators, other merchant aggregators or merchants of records charge any PCI DSS related fees. This beggars the question as to why new entrants and smaller players see no need to charge these fees, yet the established players with the greatest knowledge and extensive resources do.

CONSIDERATION FOR FINAL REPORT:

It is fair to say that acquirers roughly charge similar levels of fees, [redacted].



It also must be understood that the charges stated are levied per merchant ID (MID).

This means there will be a **multiplier effect** if a merchant operates in more than one sales environment (i.e. each channel requires at least one separate MID, and PCI DSS fees are applied per MID).

Even confining ourselves to the PSR study data, this will affect 54% of the merchants that replied to the survey.

From the data on the previous pages, it will be apparent that, with the exception of Barclaycard, **there is a general lack of transparency in terms of PCI DSS related fees**. If I can't find them (and I know where to look), what chances do merchants have?

Whether such fees should be applied in the first place, and the conditions under which they could be legitimately applied should also be reviewed.

FURTHER CONSIDERATIONS

Underwriting

The Final Terms of Reference highlight Barriers to entry (sections 3.7 and subsequent of the original terms of reference) as an area in scope of the study.

It is a well understood fact that the time is takes to obtain payment facilities varies widely depending on the type of provider selected.

For example, getting a merchant account directly from an acquirer can take weeks, whereas getting a payment facility from a payment facilitator or aggregators can take less than an hour. This is primarily due to the structure of the commercial agreements explained in the previous sections.

However, there are some underwriting practices that are worthy of further examination.

For example, there has been an increased popularity of digital banks business accounts amongst the SME population because these seem to be more flexible and certainly more efficient than traditional incumbent banks.

However, SMEs (level 4 and level 3 merchants) seem to be penalised at underwriting stage because they use a digital only bank, such as Starling Bank or Monzo, as they are asked to provide substantially more information than those banking with traditional high street banks. Examples of extra information required include:

- Exterior photos of business premises
- Photos of stock
- Invoices for stock
- Advertising/social media links
- Order book, etc.

CONSIDERATION FOR FINAL REPORT:

Generally, **digital banks are classified as "high risk" by some acquirers**. Because digital banks have more efficient underwriting processes shouldn't mean that their business customers should be penalised for using them. Digital banks are regulated by the FCA just like any other bank and the practice of penalising their customers should be investigated.

In addition, **collateral requirements and settlement periods** should be further examined for consistency, fairness and competition.

GDPR Compliance

Whilst not directly related to the provision of card acquiring services, it should be noted that some providers include the implied consent to their privacy policy in their Merchant Service Agreement. This is a breach of the General Data Protection regulation, which specifies that consent to a privacy policy should be separate from any other consent given[30].

[30] https://www.fisglobal.com/-/media/fisglobal/worldpay/docs/general/merchant-services-agreement-standard-tscs.pdf?la=en-gb

CONCLUSION

Given the PSR's remit around improving **competition**, supporting **innovation** and **promoting end user interests** in payment systems a thorough review of the card market is welcomed. Reenforcing why the supply of card acquiring services is important to the economy and identifying what the industry and regulators need to do to ensure an effective market is key.

The card payments ecosystem is a complex one. In my response, I have taken great care to present an unbiased view of the card acquiring market and all references are from public sources. My aim is to highlight the issues that SMEs face in our constantly evolving and challenging world. It is my belief that the regulators are ideally placed to help them achieve better outcomes, ultimately to the benefits of the end customer. I also wish to highlight the challenges that other ecosystem players (e.g. PSPs, acquirers, issuers, schemes) are faced with, with the intention to advocate for more transparency in an ecosystem that is so fundamental to the economy.

This document provides a list of clear recommendations (highlighted in grey throughout) after the various problem statements and explanations. I appreciate that, bearing in mind the amount of change that is happening within the industry, any regulatory intervention has to be proportionate and prioritised appropriately. But it also needs to recognise that accelerating societal change is changing the shape of the market currently dominated by cards.

With this in mind, the PSR may wish to consider **establishing a working group of experts** to help prioritise and establish a plan of activities to implement findings of the current review and to monitor the need for further action. I would be delighted to help.

I hope you find this report of use, and I remain at your disposal should you have any further queries.

[redacted]

ACKNOWLEDGEMENTS

My sincere thanks go to the following people, who have freely given their time and expertise to review this document, and helped me make the final version as digestible and valuable as I hope it to be:

[redacted] InvestFem investfem.com

[redacted], Independent

[redacted], TwentyTwenty Payments Ltd

[redacted], The Best Sales Coach

[redacted]Blue Scorpion Limited www.bluescorpion.co.uk

Appendix 1: Merchant Validation Requirements

MERCHANT LEVEL	CRITERIA	VALIDATION REQUIREMENTS
LEVEL 1	(1). Any merchant, regardless of acceptance channel, processing more than 6,000,000 Visa transactions per year. (2). Any merchant that has had a data breach or attack that resulted in an account data compromise. (3). Any merchant identified by any card scheme as Level 1.	(1). Annual Report on Compliance ("ROC") by Qualified Security Assessor ("QSA") – also commonly known as a Level 1 onsite assessment – or internal auditor if signed by officer of the company. (2). Quarterly network scan by Approved Scan Vendor ("ASV"). (3). Attestation of Compliance Form
LEVEL 2	1 million – 6 million Visa or MasterCard transactions annually (all channels).	(1). Annual Self-Assessment Questionnaire ("SAQ"). (2). Quarterly network scan by ASV. (3). Attestation of Compliance Form.
LEVEL 3	Merchants processing 20,000 to 1 million Visa or MasterCard e-commerce transactions annually	(1). Annual Self-Assessment Questionnaire ("SAQ"). (2). Quarterly network scan by ASV. (3). Attestation of Compliance Form.
LEVEL 4	Less than 20,000 Visa or MasterCard e-commerce transactions annually, and all other merchants processing up to 1 million Visa or MasterCard transactions annually.	(1). Annual Self-Assessment Questionnaire ("SAQ"). (2). Quarterly network scan by ASV. (3). Attestation of Compliance Form. **Note: Ultimately, compliance validation requirements are set by the acquirer.**

Retail Merchant Services (RMS)

Retail Merchant Services response to PSR Market interim review into the supply of card-acquiring services (September 2020)

[redacted]

Following the publication of the Interim review into the supply of card acquiring services by the PSR in September 2020, Retail Merchant Services appreciates the opportunity to respond to this comprehensive report and conclusions.

We agree with the provisional finding that having indefinite durations for merchant contracts for card-acquiring services does not provide a clear trigger point for merchants to consider changing supplier. Feedback from our sales team would support this finding where prospective customers are keen to change provider, but only then subsequently discover there would be contractual penalties to do this. These potential penalty payments make the cost of switching prohibitive, and as such reduce the merchant's opportunity to lower their business costs.

We would be in favour of ending the practice of having automatically renewing clauses in merchant contracts and instead replacing with a monthly rolling clause upon expiration of the initial contract term. This is a remedy that RMS has already introduced as we recognised that many merchants would be unaware of when their contract expired and did not wish to penalise them through the imposition of long term financial commitments. In addition, from speaking to customers, we found that many thought this practice was not made explicitly clear in competitor's terms and conditions, and they did not receive clear notification that a renewal would happen. At RMS we believe in making our customers' lives easier, and so not automatically triggering a long term financial commitment, is consistent with this.

In addition we would support the POS terminal contracts being linked to the merchant acquiring contract term and so ensure that a merchant was not forced to renew an acquiring contract because they could not afford to change the POS terminal. Feedback from our sales team is that many potential customers are unaware that their POS terminal contracts are linked to the merchant acquiring contract, and so that while they think they have short term flexibility, the reality is that they are locked into for a longer period that they had envisaged.

Regarding the minimum length of contract, while we agree that a five year term is excessive, if the current recommendation of having an 18 month maximum term was adopted this could have potentially negative implications for SME merchants. In order to ensure a similar return on investment on the capital deployed, the monthly membership or rental charge would need to double compared to that of a three year term. This would impact the smaller merchants who would see this fixed element of their monthly bill increase significantly. We think that a workable solution would be cap the maximum term at three years and allow ISOs and acquirers to offer lower contract terms – this would give merchants the option of choosing a shorter but more expensive contract if they valued the optionality this would give them while also allowing the remaining merchant base to have a lower price offering. Currently at RMS we do offer merchants the option of shorter contracts in a bid to provide flexibility where it is required, although we still find that the vast majority of merchants opt for the [redacted] month contract as standard.

With regard to the impact of Covid-19 on the report's findings, we feel that the pressures on the small businesses in the high street, that make up the majority of our customer base, make it all the more urgent to make it easier for them to exit long term, expensive contracts and would help us deliver more value to them. In addition, as consumers become less willing to use cash, and the subsequent increase in card transactions, so the ability to accept card payments becomes more of an essential service to the customer base, and so there is a requirement to ensure that the provision of this service is done in a fair and transparent basis.

As a business which prides itself on being obsessed by the needs of the customer, we welcome measures that will make it easier for the merchant to fully understand their pricing and contract commitment.

Scottish Grocers' Federation (SGF)

PSR – MARKET REVIEW INTO THE SUPPLY OF CARD-ACQUIRING SERVICES: INTEIRM REPORT

RESPONSE FROM THE SCOTTISH GROCERS' FEDERATION

The Scottish Grocers' Federation (SGF) is a trade association for the Scottish Convenience store sector. There are 5,025 convenience stores in Scotland, which includes all the major symbol groups, co-ops and convenience multiples in Scotland.

SGF promotes responsible community retailing and works with key stakeholders to encourage a greater understanding of the contribution convenience retailers make to Scotland's communities. In total, convenience stores provide over 47,000 jobs in Scotland.[1]

Convenience stores trade across all locations (rural/ suburban/ urban) in Scotland, providing a core grocery offer and expanding range of services in response to changing consumer demands close to where people live. The valued services provided by local shops include mobile phone top-up (83%), bill payment services (73%), cashback (66%), and branches of the Post Office network (25%)[2].

Scottish convenience retailers also have EPoS (70%) and provide payment methods which respond to the needs of their customers with stores primarily offering the following payments methods: Cash (100%), Debit card (94%), Credit card (91%), Contactless payment (84%) and Mobile payment (75%)[3].

The average basket spend is £7.46 and access to cash remains a valued service for customers with Scottish convenience stores offering free-to-use cash machines (55%) and charged cashed machines (22%)[4].

Over the last year, the UK convenience sector contributed over £10.1.bn in GVA and over £8.9bn in taxes. The sector also invested £585m and is more relevant than ever to every type of customer and has key social benefits and is of key economic value to the economy.

SGF welcomes the opportunity to respond to the '*PSR – Market review into the supply of card-acquiring services: Interim report*'.

[1] Scottish Local Shop Report 2020
[2] Scottish Local Shop Report 2020
[3] Scottish Local Shop Report 2020
[4] Scottish Local Shop Report 2020

222 Queensferry Road, Edinburgh, EH4 2BN, Tel: 0131 343 3300, e-mail: info@sgfscot.co.uk

STAKEHOLDER QUESTIONS

Below are the SGF responses to the questions set out in Interim report.

Question 1 - Do you have views on the provisional findings set out in this report?

SGF welcome the provisional findings which we see as highlighting key issues of relevance for the Scottish convenience sector.

While using cash for payment transactions remains the main method of payment in convenience retail, the sector continues to adapt to meet the ever changing requirements of their customers and so being able to accept card payments is a key element of this. Our Scottish Local Shop Report 2020 highlights that, as percentage, Scottish stores in the convenience sector offer the following non-cash related payment services: Debit card (94%), Credit card (91%), Contactless payment (84%) and Mobile payment (75%). On top of this 33% of stores offer 'card not present' transactions.[5]

Given the growing trend towards accepting card payments it is more important than ever that small and medium sized merchants are able to secure card acquiring services and PoS terminals based on contracts and pricing which are competitive, flexible and based on transparent, easily accessible information.

We agree that in some instances ISO and acquirer pricing methods may create significant search costs for merchants due to, as the report highlights, the absence of published prices and the complexity of comparing pricing. Convenience retailers are working extended hours and any significant time taken for search activity could have a detrimental impact on the running their business be that financial or otherwise.

SGF concur that the indefinite duration of merchant contracts for card acquiring services is an issue which requires to be looked at. Given the ever-changing economic environment, it is important that retailers are able to adapt and respond in a timely manner in terms of how they run all aspects of their businesses so as to remain profitable, efficient and viable. This includes merchant contracts.

Likewise, the finding by PSR that the long length and apparent inflexibility of ISO and acquirer PoS terminal contracts is an important one which requires to be addressed to allow small and medium sized merchants to have the ability to get a better deal, one which suits the specific requirements of their business.

[5] Scottish Local Shop Report 2020

222 Queensferry Road, Edinburgh, EH4 2BN, Tel: 0131 343 3300, e-mail: info@sgfscot.co.uk

Question 2 - Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

SGF would offer the following points:

Contracts for card acquiring services

We would support the suggestion that these contracts for card acquiring services – for small and medium sized merchants up to annual card over of up to £50m – have an end date. This would allow merchants such as convenience retailers to be able to shop around for a competitive deal which might potentially be a better fit for their business rather continuing on in an indefinite contract which might not be working for them, with no triggers to remind them about considering a more competitive option.

ISO and acquirer POS terminal contracts

SGF would support the approach being put forward to limit the length and nature of these particular POS terminal contracts - for small and medium sized merchants up to an annual card turnover of up to £50m. Limiting the contract length to 18 months as is being considered here and ending POS terminal contracts that automatically renew for successive terms would, in our view, be a balanced and proportionate step. For those in the convenience sector that are small and medium sized merchants this would be of particular benefit allowing them as already mentioned, to be able to shop around and to get the best deals to suit their business model.

SGF also sees merit in the suggestion by PSR in relation to linking the contracts for card acquiring services and POS terminals where they are sold as a package. Being able - as is being suggested - to easily exit POS terminal contracts if the terms change in the card acquiring services contract without termination fees would increase fairness and flexibility. It will also enable the merchant not to be locked into a contract if the terms change and result in less beneficial conditions than those originally agreed to.

ISO and acquirer pricing of card-acquiring services

SGF agrees that there is a need for openness and transparency in relation to the pricing of card-acquiring services, one which improves accessibility to relevant pricing information and therefore encourages merchants to consider switching providers and so potentially see a direct benefit to their business.

222 Queensferry Road, Edinburgh, EH4 2BN, Tel: 0131 343 3300, e-mail: info@sgfscot.co.uk

The suggestions put forward by PSR about having enabling or enhancing tools to facilitate price comparisons and also that acquirers and ISOs provide price information in an easily comparable format, are in our view, both reasonable and necessary.

This would enable merchants such as busy convenience retailers to make highly informed decisions impacting on the successful operation of their business without it being a time consuming process. This would potentially encourage more merchants to consider switching if this price comparison and information sharing process worked well.

Question 3 - Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?

SGF has no specific suggestions however the engagement which PSR is conducting via webinars to discuss the findings with key stakeholders with a view to identifying appropriate actions going forward is a helpful approach and one which will help inform the work in this area as it progresses.

Question 4 - How does COVID-19 impact on our review?

SGF agree with the point put forward in the PSR report that COVID-19 may accelerate many well-established trends, such as the growth in card payments. For example, the use of cash has clearly been impacted by the emergence of the pandemic, with customers now considering - and using - other methods of payment.

Our Scottish Local Shop Report 2020[6] shows that as part of the in-store response to Covid-19, 69% of convenience stores are encouraging customers to pay with contactless payment. In addition, local shops are now providing over 600,000 home deliveries a week in their communities and 33% of Scottish convenience stores offering 'card not present' transactions. On top of this 16% of Scottish stores offer click and collect services for groceries, with 7% also offering self-service checkouts.

SGF recognise that given such trends it will be essential that the PSR review keeps a focus on the growing importance of card acquiring services for small businesses – which many Scottish independent retailers are - and that the associated contracts on offer to them are competitive, flexible and transparent.

Scottish Grocers' Federation - December 2020

[6] Scottish Local Shop Report 2020

222 Queensferry Road, Edinburgh, EH4 2BN, Tel: 0131 343 3300, e-mail: info@sgfscot.co.uk

Square

Square

November 27, 2020

[redacted]

Square UK
101 Cavendish Street
4th Floor
London,
W1W 6XH
United Kingdom

[redacted]

Payment Systems Regulator - Market review into the supply of card-acquiring services: Interim report (MR18/1.7)

Thank you for sharing the PSR's interim report on the supply of card acquiring services with us.

We have read the interim report with interest and welcome the PSR's interim findings. We would like to take a moment to thank you for such a thorough and in-depth review of the landscape.

It was also helpful to speak to you on the call on Nov. 19 and gain more insight into your approach. As discussed, we have some observations and feedback, which we have detailed below.

We would of course be happy to discuss these points with you in more detail. In addition if there is anything that we covered on the call with you which you feel is not captured here, please let us know.

Kind regards,

[redacted]

[redacted]

1. Contract terms

The PSR's initial findings note that contracts of "indefinite duration" don't provide a clear trigger point for merchants to search for other card acquiring service providers. While we acknowledge this concern, we believe that no merchant should be required to serve minimum contract terms.

At Square we do not require our merchants to enter fixed-term contracts for the use of either our software or hardware. This means that they are not forced into contract terms or charged early termination fees. This flexibility is important to our market of small to medium-sized merchants.

We serve many sellers who are just starting out and don't want to sign up for a fixed-term contract. We also have merchants who run seasonal businesses, such as the multi-location Christmas tree merchant who trades only in November and December, and for whom it is uneconomical to pay fees throughout the year.

During the pandemic, we have seen business owners pause trading or switch between card present and card-not-present. They benefit from not having to pay any fixed fees or hardware rental for services they may not be using during this challenging trading period.

The flexibility of having no fixed-term contract is clear and we are anxious that any proposed remedy does not unintentionally undermine this flexibility.

At Square we continually add new features and services for merchants at no extra cost. Recent examples include the ability to add QR code ordering, and the facility to sell via Instagram. Our merchants tell us that they derive additional value from our service over time and value the new features we add. We keep our merchants abreast of updates through a combination marketing channels including in-app notifications, and email communication, depending on the nature of the feature.

2. Pricing practices

Our pricing model is simple and transparent. The vast majority of our customers are charged a flat fee of 1.75% per transaction for card present transactions and 2.5% per transaction for card-not-present transactions. Merchants are not charged extra fees for activation, early termination, interchange, chargebacks, cash payments, refunds, inactivity or PCI compliance. All card fees are included in Square's fees and we deposit funds into the merchant's bank account next working day as standard.

Importantly, our fee structure ensures that our merchants are not forced into contract terms or charged early termination fees. It is simple, transparent and easy to understand.

Square fully supports the need for comparable card acquiring services. However, we believe that any intervention must be mindful of the benefits of simple and transparent pricing, and the additional services that come with using Square. This includes data and analytics from our Point of Sale app, no hardware rental fees, high quality customer support, access to both card-not-present and card present services, and API integrations.

We note the PSR's consideration that a remedy might include tools to facilitate price comparison for merchants. We believe there are already a number of comparison tools available to merchants at the payment facilitator end of the market (see for example this website). If the PSR takes the view that a new comparison tool requires development, we recommend that this should take into account all relevant features of card acquiring services, and should not be limited only to consideration of pricing - which would not reflect the full value that card acquiring services are capable of delivering to merchants.

3. Other

We would also like to take this opportunity to update you on a new development at Square. We note that at paragraph 4.73 of the interim report it is stated that "SumUp said it differentiates its offering by selling a card acceptance device that does not need to be connected to a mobile phone to operate." Since we submitted our original response to the PSR's market review we have launched Square Terminal, which does not require pairing with a mobile phone or tablet. Early feedback from customers suggests this has been well received and we continue to consider whether we can launch new products to best serve all types of customers.

Finally, we would draw your attention to our Cash and the Pandemic Report, which examines data from across the UK to determine how the pandemic has affected payment preferences.The key trends were a rise in omnichannel payments, an increase in the number of completely cashless businesses, and a decline in the amount of cash accepted. We looked at hundreds of Square merchants between March and July 2020. Please let us know if you would like to discuss our findings with us in more detail.

Stripe

PSR Card Acquiring Market Review - Response to Interim Report

About Stripe

Stripe is a global technology company that builds economic infrastructure for the internet. Businesses of every size - from startups, to scaleups, to public companies - use the company's software to accept online payments and simplify running their business online.

We partner with established financial institutions including banks, card schemes and payment methods. We are closely integrated with payment rails as a direct member of global card networks such as Visa, Mastercard and American Express, and through direct connections with national schemes including Bacs Direct Debit in the UK. Stripe provides regulated payment services to its business customers in the UK. In the UK, Stripe is regulated by the Financial Conduct Authority as an Electronic Money Institution, and merchant acquiring services are part of its suite of services.

Our role is to connect merchants to the payment methods that matter to their customers and thereby enable diversity and choice in payment options. We help businesses accept more than 25 different payment methods, including global and national card schemes, direct debits, credit transfers and digital wallets.

Stripe entered the UK - our first market outside North America - in 2013. Today our users in the UK range from tech-forward businesses, to established household names and non-profit organisations and government departments, along with many startups and SMEs.

We welcome the opportunity to engage with the PSR on its interim report on the card acquiring market and look forward to continued and productive engagement with the PSR going forward. We set out our comments on the provisional findings and provisional remedies below. We would be happy to discuss any aspect of our response with the PSR.

One practical point that we would like to note concerns the categorisation of Stripe throughout the interim report. At points we are grouped with other acquirers, and then at points with other payfacs (most of whom we note are card-present providers). We appreciate that this is due to us entering as a payfac and later becoming an acquirer, but it can be somewhat confusing given our current role as an acquirer. We would ask that the PSR consider how best to make this clearer where relevant in the final report.

Views on provisional findings

1/ The online world differs materially from the traditional (offline) acquiring segment.

In respect of acquiring, Stripe operates exclusively in *online* acquiring in the UK[1]. We believe the online-focused segment we operate in is, in many respects, different from the legacy offline acquiring segment. For example, the hardware/POS requirements and the range of distribution channels via ISOs are typical in the offline segment, but not in the online segment. Our response to the provisional report outlined below focuses on our experience in the online-focused space.

Our experience is that there is a very high level of competition in the online acquiring segment. SME merchants in the online space enjoy strong levels of competition from both technology-first providers as well as legacy acquirers. For example, there are notable new entrants in this online-focused acquiring segment who aren't mentioned in the interim report given their relatively recent entry. There are more than 20 full stack online payments options for SME merchants in the UK. We anticipate further new entrants in the coming years given the relatively low barriers to entry. The ability of online players to enter and win share in the market is clearly not indicative of an uncompetitive or poorly served market. The online segment is also characterised by high levels of innovation such as the ability to offer merchants additional payment methods, and software and services beyond "standard" acquiring (such as Stripe Radar, for fraud protection, and Stripe Connect, our platform product).

We appreciate that the PSR's analysis covers the overall market, rather than just online or offline segments. However, we would encourage the PSR to take the very different dynamics in the online segment into account when considering and implementing remedies and do additional analysis for its final report. We have some concern that the PSR, at points in its analysis, treats acquiring as a homogenous product, where merchant value is solely attributable to switching to the cheapest provider. In fact, differentiated technology helps merchants increase end customer conversion, expand into new customer segments, prevent fraud and reduce payments implementation and management costs.

It is also notable that Covid has accelerated the transition from offline to online (including through new online business models created as a result of lockdown restrictions) across the economy. We witnessed a notable uptick in UK businesses coming online with Stripe (and other payments providers) as lockdown restrictions came into force. Given the rate at which we sign up new merchants, we do not perceive a lack of engagement with merchants choosing to use our services. It is worth noting that we observe that even in the context of Covid, this is a competitive market in which many merchants choose Stripe competitors.

[1] Our Stripe Terminal product, which enables existing online businesses exploring complementary omnichannel capabilities to extend their online presence into the physical world by building their own in-person checkout, is not currently generally available in the UK.

2/ We agree with the PSR's finding with respect to large merchants.

We certainly agree with your finding that (very) large merchants do not experience any detriment. Our experience is that these merchants are highly engaged, knowledgeable and are able to exert significant downward price pressure in negotiations with their payment providers. The remainder of our analysis focuses on the cohort of merchants where the PSR has identified market detriment.

3/ However, the threshold for 'large merchants' is very high, and may be too high.

By the PSR's calculations (Table 1 at 4.4) 99.9% of merchants accept less than £50m in annual card payments. The PSR therefore finds that the market is not working well for 99.9% of merchants - which as we'll explain further below, is not a view we agree with based on our experience in the online segment, and don't believe is robustly supported by the data provided by the PSR. We have not reviewed the confidential data in the closed data-room and therefore base our views on the data and findings presented in the interim report. We understand from our trade associations that other parties will set out concerns on the validity of the underlying data. We do not seek to make such comments given that we have not reviewed the data.

We observe huge differences between merchants in the £0-50m annual card payment range, and we don't think it's proportionate or appropriate of the PSR to consider them as a homogenous group for the purposes of its findings and proposed remedies. If the PSR does consider that certain merchants are not sufficiently engaged (which we do not observe in our online segment) we suggest that the remedies are more targeted to achieve the desired outcomes. Our experience is that many merchants in that range, and particularly at the higher end of that range, are very engaged and knowledgeable in their evaluation and selection of payment providers.

4/ We do not recognise the PSR's view that SME merchants are poorly served and that the market for SME merchants does not work well.

In respect of small and medium-sized merchants, our experience is that the market is competitive and online-focused merchants do shop around and switch, potentially due to ease of price discovery, clear information about available features, switching and generally not requiring any form of hardware.

In this regard, we think the online-focused segment shows very different characteristics to the legacy acquiring segment and do not think that difference is adequately addressed in the interim report, or in its supporting data. We would be happy to discuss further with the PSR in preparation of the final report. We fully appreciate the situation may be different where, for example, a small merchant is tied into a lengthy hardware contract, but that is simply not applicable to our merchants and therefore we do not recognise the detriment identified by the PSR.

As noted by the PSR in its interim report, Stripe has signed up very large numbers of small and medium-sized merchants in the last number of years. This has accelerated due to Covid and is not indicative of an uncompetitive market. While some of these are net new merchants (i.e. merchants not previously using card acquiring services) many are switching to us from other providers on the basis of our ease of onboarding, pricing transparency and superior technology offering (both in respect of payments, but also in areas such as fraud monitoring). We have also experienced merchants "churning" away from Stripe to other providers, as well as failing to win business in competitive processes.

As regards price transparency (which we will also address in the context of the provisional remedies) we aim to be as transparent and straightforward as possible in our pricing. We provide both interchange plus-plus pricing along with a blended rate to provide certainty to those merchants who prefer that. The blended rate for UK merchants is publicly available on our website at https://stripe.com/gb/pricing and small and medium-sized merchants can start accepting payments using our advertised blended rate within minutes. In this regard, engagement is simply a click away in respect of merchants who seek blended rate pricing.

As the PSR notes "Stripe's pricing structure is simpler than most other acquirers" and that is our aim. We think that there are instances in the market where pricing is not as transparent as it could or should be, but it is also important to ensure that those merchants who prefer it have access to the granular interchange plus-plus pricing if it best suits their needs.

It is worth noting that online payments are inherently more complex than offline because of the cross-border nature (for example, more foreign-exchange aspects to consider, network fees become more complex with cross-border transactions). Therefore, we try and simplify as much as possible but complexity will be inherent where not blended for this reason.

5/ The PSR's analysis underestimates and doesn't meaningfully address the importance of non-price aspects of competition.

Non-price aspects of competition (e.g. technology quality, reliability, customer service and innovation) make up the overall value proposition of a payment provider and are hugely important to our merchants. Merchants do not switch solely due to core acquiring price. Our experience is that merchants sign up to Stripe for a broad range of factors, of which price is one. Other factors may include the ease of our onboarding, fraud capabilities, range of payment methods, ease of integration, higher authorisation rates, API uptime etc. As outlined above, we think that this could be an important distinction in the offline and online acquiring segments. While legacy POS terminals and offline acquiring technologies are (to our knowledge) relatively similar, we observe very considerable differences in the quality of offerings in the online space.

We do not consider that the PSR's relatively cursory analysis of non-price aspects (which focused solely on data from five large legacy acquirers) is sufficient to support the conclusions it has reached in this regard. Stripe exists because merchants who wanted to sell online did not have access to a technology-forward provider who easily enabled them to do so - price is rarely the main differentiating factor in the merchant's decision to use Stripe.

The potential issue is therefore that the PSR seems to limit its merchant detriment analysis to considering if merchants could save money by switching providers or renegotiating their rates. That is just one, albeit important, aspect of why a merchant selects a payment provider which fits their needs. Where small and medium-sized merchants appear in the PSR's analysis to not be engaged, it could be because they've holistically evaluated the offerings in the market (both price and non-price) and decided to remain with their incumbent provider. By not fully understanding and meaningfully addressing non-price competition, our concern is that the interim report does not fully consider the reasons merchants engage with their choice of payment provider. This may then have consequences for how any remedies are designed and ultimately the efficacy of those remedies.

Views on proposed remedies

6/ *If the PSR considers in its final report that remedies are required, it is vital that any unintended consequences and harm to merchants be avoided.*

In broad terms, even if we take issue with certain aspects of the PSR's analysis, we are always open to considering ways in which the market can work better for merchants. In principle, we are in favour of greater merchant engagement and pricing transparency. We urge the PSR to ensure that any remedies do not cause the consequence of any interruption to services to merchants, which would be catastrophic for small businesses and is a scenario we would wish to avoid in any circumstances.

Contract expiry:

We are not opposed to some form of prompt for merchants to periodically consider their current arrangements and be able to change them, but we do not think that mandating fixed term contracts or banning evergreen contracts is a proportionate or effective measure to achieve this. Furthermore, such a measure is not appropriate for the majority of our users (and particularly relevant for smaller merchants) who "self-serve" i.e. sign up via our website and accept our standard terms. Those users are not tied into any Stripe contract in terms of there being no minimum term, no subscription fees, no minimum volume. They simply integrate Stripe into their website/app and use it on a “pay as you go” basis on our standard terms, with standard pricing (clearly available on our website). They can cease using Stripe services at any time without penalty or contractual limitation. We welcome the interim report’s acknowledgement that this is to the benefit of some small and medium-sized merchants as regards convenience and continuity of service.

In that context, for those merchants there is no concept of a contract expiring and we envisage potential harm to our merchants by artificially imposing that concept. While our larger users tend to agree to negotiated contracts with a specified duration, we agree with the PSR that those merchants do not suffer detriment, and therefore this remedy is not required in respect of those merchants. There may be some merchants who would be classed as small and medium-sized businesses who are on negotiated, fixed term contracts. Generally, those contracts automatically renew on expiry in order to avoid sudden cessation of services. We think any remedy should not imperil auto-renewal, which is useful to merchants and avoids the potential for significant disruption to merchants where a contract ends without a new contract having been put in place. Merchants always have freedom to terminate by providing the agreed notice to Stripe.

In any case, if implemented, we would certainly want to ensure that no merchant contract expires by virtue of not engaging with renewal prompts. Our experience is that a material number of merchants may not respond to email/online prompts to engage. This would cause significant disruption to merchants, businesses (including ours) and consumers, and should be avoided at all costs. Therefore, the default of any lack of engagement should be that the contract continues without interruption. [redacted].

We agree that contract lengths, termination fees and other exit hurdles should not be used to unfairly prevent small and medium-sized merchants from switching and/or renegotiating their agreements.

In terms of potential alternative remedies, one option that could be considered further for rolling contracts of no fixed duration is a regular prompt (whether via email or in the merchant’s Stripe account dashboard) to remind merchants of the prices they pay (on a standardised basis) and plainly set out a statement that they may switch to another provider and are contractually free to shop around. However, in the online acquiring sector we note that a merchant generally has the ability to easily review standard prices on an ongoing basis. We would also ask the PSR to ensure that that the operational 'lift' of any such remedy should not disproportionately impact smaller and/or tech-forward players such as Stripe, by virtue of having many smaller merchants. The cadence of such prompts would also need to be considered - it is not clear to us that an annual prompt would be proportionate or necessary. Acquiring is not comparable to, for example, an insurance market, where prices may increase significantly on a yearly basis. Comparable services from our merchants' perspective may include services such as CRM software, data processing and storage, or cloud services.

Price transparency:

As the PSR recognises, pricing, given the huge range of scheme fees/interchange fees/card types, can be incredibly complex for merchants to understand. While larger merchants have the ability and resources to understand the complexity of pricing, and therefore generally seek interchange-plus/plus pricing, many merchants, especially those that are start-ups or new to accepting cards, wish for certainty of pricing. We provide both interchange-plus-plus pricing along with a blended rate to provide certainty to those merchants who prefer that. However, we think there is a good deal of confusing information in the industry and would be supportive of ways of making this clearer.

Our blended pricing is completely transparent and publicly available, with no hidden costs or ongoing maintenance fees. In our experience the vast majority of small and medium-sized merchants seek the clarity and certainty of blended rate pricing. Larger merchant pricing tends to be bespoke and negotiated on a contractual basis. In our experience there is no merchant desire to publish interchange plus-plus pricing: typically, merchants who want interchange plus-plus are knowledgeable and engage in discovery in the market. Exposing acquirer margins would also possibly lead to unintended consequences in terms of dampening pricing competition and is not appropriate in our view. However, we are supportive of blended pricing across the industry being more openly transparent, along with any extra fees or ongoing maintenance charges levied by other providers.

In terms of a remedy proposal, we would be supportive in principle of a standardised industry 'Key Facts' document, which would be provided by acquirers to new/prospective/renewing users, setting out pricing information. Detailed consultation would obviously be required on the specifics of what such a document would contain and we would be happy to discuss this with the PSR.

POS hardware:

We have no specific comments on the proposed remedy regarding POS hardware. As noted, we do not currently provide POS hardware to merchants in the UK [redacted]

7/ *We look forward to further consultation with the PSR regarding remedy design and implementation if it decides that remedies are required.*

We appreciate that the PSR is still early in its remedy design and implementation process. Given the potential consequences of certain aspects of remedies (as outlined above) we would urge the PSR to engage in detailed consultation on remedy design with stakeholders across the industry. We would also ask the PSR to consider some form of pilot or limited implementation of certain remedies to assess their efficacy in driving the desired outcomes, if appropriate. Any remedies will impose an operational cost on payment providers and other industry participants, and therefore the PSR should carefully consider the costs of remedies against the projected benefits arising from those remedies.

Stripe looks forward to engaging further with the PSR on remedy design and implementation as appropriate.

Stripe

Takepayments

1) **Feedback on interim report**

➔ Do you broadly agree with how we describe the industry? If not, why not?

- We disagree **that small & medium sized merchants got little or no pass-through benefit of the IFR savings**. We agree that they have not received all benefit because of increased scheme fees and increased acquirer revenues, most will have seen some benefit. Data may be impacted by the increase in number of micro merchants taking cards since 2015 and the high MSC rates that they pay. Data in figure 10 does not correlate with our experience of the sector

- We disagree that **Acquirer and ISO pricing creates significant search costs for merchants because of the absence of published prices and complexity of comparing prices.** The card acceptance sector has a very effective switcher market. Most businesses will have several approaches a year from the competition offering to switch. We called [redacted] different merchants last year. Merchants can easily access different providers through google search. All they have to do is to ask for a quote. They can ask for a quote showing their savings. Most providers will compare their MSC annual costs to the ones presently paid by merchant. We question the value of including very small merchants in survey. (definition of an active small and medium sized merchant to any that undertook at least 2 transactions). We would only be interested in merchants undertaking [redacted] spend per year. We also question the size of the sample- at1,037 seems very small
  - Survey may have included a disproportionate amount of micro merchants
  - Micro merchants – [redacted]
  - Merchants probably didn't switch because they didn't feel the value warranted the effort
  - 0-£380,000 covers a wide range

Our business experienced on average churn of [redacted] - includes going out of business churn.
ISO and acquirer pricings are complex because interchange fees and scheme fees are complex. Micro merchant payment facilitators are able to offer simplified pricing only because their MSC %s' are exceptionally high, creating large margins that are big enough to mop up variations in cost rates (interchange and scheme fees)
If ISOs and acquirers forced to publish pricing it is likely that pricing would still be complex. The only way that providers can make their pricing simpler would be by increasing margins which would not be in the merchants' best interests.
We support the suggestion of enabling or enhancing tools to facilitate price comparison for merchants and requiring acquirers and ISOs to provide pricing information in an easily comparable format

- **We disagree with the statement that the indefinite duration of merchant contracts for card-acquiring services doesn't provide a clear trigger point for merchants to think about searching for another provider and switching and, for this reason, isn't in merchant's interests**. -most contracts have definite end dates and just need to give notice following that date.

2) **Your feedback on the three potential remedies we propose in our interim report**
Any future remedies are contingent on the findings in our final report, but we're keen to hear any suggestions you have, even if these are high-level at this stage.

➔ What do you think the potential impact of the three potential remedies might be on your business?

1. **Limiting length of POS terminal contracts to 18 months**
   - It will not impact us as we have a [redacted]-month contract.
   - It will impact most ISOs and destroy their business model as they use the sale of their long- term contracts to fund

their business. This will likely reduce competition and set a high barrier to entry.
    - Reducing contract lengths may lead to less competition as most business models assume a tenure of 3 to 4 years to justify costs to acquire

2. **Ending POS terminal contracts that automatically renew for successive fixed terms**.
    - Document does not explain why the automatic renewal is an issue. [redacted].
    - Surely it also makes the contract term more important and more relevant, in that merchants have to provide sufficient notice before the contract end date to terminate. This seems to support your desire to have a more definite contract duration.
3. **Linking contracts for card acquiring services and POS terminal**
    - Not clear exactly what this would entail.
    - Agree with principle of allowing end of POS contracts if MSC rates are changed.
    - – will impact small ISO's greatly for reasons mentioned above.
    - How do propose this will work if card acquiring services can be terminated after 6 months?
4. **We're considering a remedy requiring all contracts for card-acquiring services to have an end date. This would apply to both acquirer and payment facilitator contracts**.
    - Not clear how this would work**.**
    - Adds much un-needed friction and cost into activity for acquirer which may need to be reflected in higher MSC charges
    - Adds much un-needed friction and cost into activity for merchants most of whom, report high levels of satisfaction with their provider, customer service and the information they receive

- Most operators need a minimum of 3 to 4 years average tenure to get sufficient return for costs of acquisition. Any change in average tenure may lead to either increase in MSC charges passed on to merchant or less competitive activity
- Not fair that payment facilitators are exempt from this change.

➔ Other information

1. Cost and period until obsolescence information on payment terminals:-

[redacted]

Tesco

TESCO

[redacted]
Payment Systems Regulator
12 Endeavour Square
Stratford
London
E20 1JN

04 November 2020

Dear [redacted]

I am writing to you with regard to the PSR's recently published report ***'PSR MR18/1.7 - Market review into the supply of card-acquiring services: Interim report'***. As a retailer that also supplies many small merchants through our wholesale business, we welcome the PSR's market review of card-acquiring services and the efforts to ensure that this market works well for all merchants.

We also appreciate that the PSR has examined the data on scheme fees paid to card scheme operators by merchants over recent years. The PSR's analysis has confirmed that scheme fees have approximately doubled between 2014 and 2018, and that acquirers have passed these increases fully to merchants. This finding is consistent with our experience. [Redacted], the scheme fees payable by our businesses have increased [Redacted] during this time period with no evidence to show the benefits that these cost increases deliver to our business, our retail customers or our business customers, who are all affected. [Redacted]

[redacted]. Given that your work has identified substantial increases in scheme fees paid by both large and small businesses, we ask that the PSR makes clear in its final report the steps you, or other regulatory authorities, plan to take to address this issue decisively.

We are keen to work with the PSR to promote competition and ensure good outcomes for all merchants in the payments market, both through this market review and via other engagements [Redacted].

If you would like to discuss any of the points in this letter, then please do not hesitate to contact me as we would be very happy to discuss this issue with you directly.

Yours Sincerely,

For and on behalf of
Tesco Stores Limited, Booker Group and One Stop Stores Limited

[redacted]

The Money Charity

The Money Charity Response to PSR Interim Report on the Supply of Card-acquiring Services
(December 2020)

The Money Charity is a financial capability charity whose vision is to empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.[1]

We welcome the opportunity to respond to the Payment Systems Regulator's Interim Report on the market review into the supply of card-acquiring services (MR18/1.7).

In this response, we set out our Key Points, make some overall comments on the issue then answer the questions posed in the Interim Report.

[1] See box on back page.

Key Points

1. We support the switching remedies proposed by the PSR as far as they go, but we doubt that these remedies alone will be sufficient due to the widely observed inertia among small economic units when it comes to switching service providers.

2. We would like the PSR to bottom out the apparently regressive charging structure that leads to a £5 minimum card payment rule being applied by many small merchants. We would like to see consumers able to make card payments with small merchants as easily as they do with large ones.

3. We would like to see the PSR directly regulate scheme fees, as these are the most monopolised part of the card payments system at the moment, with only two providers (Visa and Mastercard) controlling virtually the whole market.

Overall Comments

As a financial capability charity, we approach this review with the following concerns in mind:

1. For consumers, payments should be as easy, cheap and quick as possible with a minimum of overheads in the payments system. This means, for example, no artificial barriers such as the £5 minimum card payment rule applied by many small merchants.

2. The payments system should be as transparent as possible so it is clear what we are paying for the payments system, the various fees in the payments chain, how these fees change, whether there are cross-subsidies, whether there is monopoly or other forms of non-competitive pricing etc.

3. Appropriate consumer protections should apply, especially where people switch from established card systems to new forms of payment.

4. A multi-channel approach to payments should be maintained, for example ensuring that cash continues to be available alongside the expanding digital payments networks.

The issue of the £5 minimum card payment is one that we would particularly like the PSR to bottom out. A significant number of small merchants apply a £5 minimum payment rule (or ask for a payment surcharge, even though it is illegal) and have continued to apply such a rule, even during Covid-19, when generally there has been a large shift toward card payments. When we have asked merchants about this, we have been told that they face high per transaction charges (eg 30p to 50p) and that this makes small card payments uneconomic for them. High per transaction charges for small payments suggest that a regressive pricing system is in play. Whether this comes from card acquirers, card schemes or other sources, we are not clear, but we think it needs to be urgently investigated by the PSR and the appropriate regulatory response put in place.

Minimum payment rules do not apply at large merchants, eg supermarkets, so a different fee structure appears to apply in their cases. In our view, the policy objective should be that a small fee applies to small transactions at small merchants, so that no minimum payment rule need be applied and consumers can use cards as easily with small merchants as they can with large ones.

Answers to consultation questions

1. Do you have views on the provisional findings set out in this report?

We congratulate the PSR for producing a clear and insightful report into card-acquiring services. As we say above in our Opening Remarks, for most consumers – including charities such as ourselves – the payments system is non-transparent, and it is very helpful to see the system and its fee structure described clearly.

In our 2015 response to HMT's consultation on the Interchange Fee Regulation we suggested that regulating the interchange fee without regulating other aspects of the fee structure was unlikely to have the desired effect. We said:

> "Evidence from Spain and Australia suggests that consumers will not see the benefits of the fee capping passed on to them. Instead consumers may see increased costs resulting from card providers raising charges to cover the costs of interchange."[2]

Confirming this, the 2020 PSR Interim Report finds that:

> "Fees paid by acquirers to Mastercard and Visa for scheme services rose significantly from 2014 to 2018 and even after adjusting for changes in the volume, value and mix of card transactions, they approximately doubled over this period. For merchants in all turnover groups, the evidence available to us and our current analysis indicates that scheme fees were passed through by acquirers in full."[3]

This is an example of non-competitive (monopoly) pricing in which two dominant providers have been able to take a view of the demand curve as a whole and price

[2] The Money Charity 2015, *Response to HMT Consultation – Interchange Fee Regulation*. Available at: https://themoneycharity.org.uk/work/policy/consultation-responses/

[3] PSR 2020, *MR18/1.7*, *Interim report on the market review into the supply of card-acquiring services*, page 10.

along that demand curve to maximise profit. The capping of interchange fees released some economic rent which the card schemes were able to absorb.

The Interim Report finds that this effect was unequally distributed, with large merchants (turnover £50 million plus) receiving the benefit of the fee cap, while small and medium-sized merchants did not.

There are two remedies for monopoly. Either (a) introduce sufficient competition to break the monopoly, or (b) regulate the prices charged by the monopolists. The PSR's Interim Report relies on the potential of competition, but in our view, it is also necessary to consider direct regulation. It is too early to say that increased competition, including from new payments providers, will undermine the card schemes' market power to the extent that competitive pricing will be achieved.

2. Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

The potential remedies set out in the report focus on increasing competition among card-acquirers by reducing the barriers to merchants switching providers. The remedies do not directly address card scheme charges, only card-acquirer charges. While we support the remedies proposed, we think there are two problems which still need to be addressed:

> 1) The market power of the card schemes, which set a fee baseline above which card-acquirers compete.
>
> 2) The difficulty of encouraging switching by small economic units (consumers and small merchants). There is strong evidence from other markets (eg insurance, bank accounts, energy etc) that consumers have high inertia. Their search costs are large in relation to potential savings and the opportunity cost of their time. The proportion of any consumer group that switches never seems to rise above a minority, often a small minority. Indeed, an entire pricing strategy (price discrimination or price "optimisation") has been developed on the basis that most consumers seldom switch suppliers. The banking industry, for example, is fond of saying that "people are more likely to divorce their partner than change their bank."

The PSR's findings are consistent with this, showing a low switching rate among small and medium sized merchants and new customers paying less than existing customers.[4]

We do see potential for new payment providers using Open Banking to provide competition to the card schemes,[5] but we doubt that card-acquirer competition alone will have much impact on scheme fees and the overall cost of card payments.

---

[4] PSR, *Interim Report*, page 9.

3. Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?

There are two additional remedies we would like the PSR to consider:

1) Directly regulating the prices charged by the card schemes, to reduce or eliminate the monopoly rent secured by the schemes.

2) Addressing the structure of charges for small and medium merchants, to remove the apparent regressivity in charging that leads to a substantial number of merchants insisting on a £5 minimum card payment. The goal should be to have a pricing structure that makes it as easy for consumers to use cards with small merchants as they do with large merchants.

4. How does COVID-19 impact on our review?

We agree with the Interim Report that Covid-19 has accelerated established trends (page 6). LINK data show that in September 2020, ATM withdrawals were down by a third compared with the same month the previous year and the value of withdrawals was down by a quarter.[6] This must be putting great financial pressure on the cash distribution network, which was already under pressure before Covid-19. We support the Ceeney review and subsequent Government statements to the effect that a way must be found to sustain the cash network, while making it more efficient.

Two key reasons for maintaining the cash infrastructure are: (1) a substantial number of people still operate wholly or mainly in cash, even budgeting in cash, and many of these people are those in more vulnerable circumstances, and (2) switching to a system of electronic payments alone requires universal and reliable connectivity, which the UK does not yet have. Even with a complete electronic payments network, cash would have a back-up role, both for individuals and for the country (for example, in case of natural disaster). Currently most people are dual users of cards and cash.

Reduced use of cash increases the market power of card payment service providers, particularly the card schemes, so makes appropriate regulatory remedies for card-acquiring services and card scheme charges even more important.

---

[5] See HMT July 2020, *Payments Landscape Review*.
[6] The Money Charity, *The Money Statistics October 2020*, page 14.

The Money Charity is the UK's financial capability charity providing education, information, advice and guidance to all.

We believe that everyone achieves financial wellbeing by managing money well. We empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.

We do this by developing and delivering products and services which provide education, information and advice on money matters for those in the workplace, in our communities, and in education, as well as through influencing and supporting others to promote financial capability and financial wellbeing through consultancy, policy, research and media work.

We have a 'can-do' attitude, finding solutions to meet the needs of our clients, partners, funders and stakeholders.

Tel: 020 7062 8933

hello@themoneycharity.org.uk

https://themoneycharity.org.uk/

UK Finance

UK FINANCE

PSR Acquiring Market Review Interim Report (AMR)

UK Finance Response to AMR Consultation

Date: 5th February, 2021

Sent to: cards@psr.org.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

Our response to the AMR is made following detailed engagement with UK Finance's Payment Acceptance Policy Group (**PAPG**), which includes major UK banks, long established international payment services providers and newer entrants to the market.

Introduction

In this response we set out key impact statements in Part 1 and more detailed commentary in Part 2.

UK Finance welcomes the Interim Report and the continued positive engagement of the PSR in the consultation process.

The Interim Report accurately describes elements of the *card-acquiring* market, its operation, charging structure and overall importance to UK business.

We are pleased that the PSR concluded that the market is working well for larger merchants, and in the case of smaller merchants "*Most merchants reported high levels of satisfaction with their current provider"*[1].

[1] Paragraph 6.94, ibid

The Interim Report concludes that the card acquiring market may not be "working well" for some merchant segments; however, as this response will detail, our members express some material reservations on (a) the robustness and appropriateness of the pass-through data methodology and (b) the insufficient evidence used to formulate the conclusions. The material concern is the risk that remedies might be implemented founded upon a misunderstood and narrow appreciation of how merchants value the services the payments industry provides and how they choose their payments provider. In turn, our members are concerned that remedies should not create unintended and harmful consequences for the merchants that the payments industry serves.

Part 1 - Overview and Impact Statements

Impact Statement 1*:* Data

Members report significant concerns that the econometric pass-through analysis performed by the PSR is materially flawed in a number of respects. Members also report concerns as regards the merchant survey exercise, which whilst appearing to demonstrate broad satisfaction and ability to switch and negotiate better prices is also the foundation for proposed remedies. Members question the robustness of those foundations.

Impact Statement 2*:* The PSRs Findings

Members are concerned that the shortcomings with the pass-through analysis and other evidence means that the PSR incorrectly concludes that the "market is not working well" for those merchants with under £50m turnover.

Impact Statement 3: The Evolving Payments Market

Our members believe that a broader understanding of the overall payments market is required to develop a more forward-looking payments policy, reflecting the dynamic nature of payments (and payments innovation) and its evolution, beyond core acquiring. Price is an important element of the market but more emphasis should be given to other elements such as:

- ***the quality characteristics of the products and services provided by acquirers (such as speed of settlement, value-add services provided etc.)***
- ***the maintenance of liquidity and consumer protection (risk)***
- ***evolving and alternative payment types (such as direct bank payments being enabled by Open Banking and "Buy Now Pay Later" payment checkout options)***
- ***the evolution in how merchants choose, interact and contract with payments providers (such as integrated hardware, software, and gateway channels)***
- ***the breadth and pricing of other payment and related services offered by participants***

Acquiring is not a product in isolation and the approach of treating acquiring as similar to a binary and homogenous utility (e.g. electricity) is flawed.

Impact Statement 4: Covid-19

The payments market (and acquiring in particular) has rapidly evolved over the last five years and Covid-19 has provided some useful live examples of the risks and opportunities that the payments market presents for all participants. Our members believe that the payments industry met the challenges of Covid-19, providing a reliable and resilient service to the UK

economy, supporting the acceleration of on-line spending and increasing contactless payment acceptance by volumes and transaction amounts. Our members carry billions of pounds of retail insolvency risk and voluntarily implemented support packages, discounts, waivers and deferrals. The market not only served its clients well but also served consumers well by underpinning consumer protection in unprecedented times.

Impact Statement 5: Remedies

We are open to working with the PSR on consideration of potential interventions that improve the functioning of the market, but believe that the proposed transparency remedies are too narrowly focussed on price at the expense of other important considerations, such as card and non-card payment options for consumers, resiliency of platforms, speed of settlement, fraud tools, currency options and authentication processes, account management and servicing, reporting, billing, data analytics and integrations with specialist platforms (such as found in the hotel, travel, restaurant or leisure sectors).

Impact Statement 5A: Transparency and Comparability

Our members consider that additional transparency will be helpful but have reservations on comparability – the remedies should balance transparency with a clear articulation of what is being priced for and what are the comparable elements from a risk, servicing, other products, and merchant segment perspective. Acquiring is not a binary utility and transparency and comparability must be based upon a range of factors relevant to each individual merchant – a "one size fits all" approach will not be in merchants' interests.

Our members believe that there needs to be a clear statement of what metrics merchants want to compare (and a standard basis for comparison). All of this should be within a framework that does not add further complexity or friction to the merchant on-boarding, renewal or switching journey.

Members have also noted the inherent tension between (a) simple pricing packages as an aim, making it easier for merchants to compare prices and (b) the transparency requirements of the Interchange Fee Regulation, which are very prescriptive and are solely founded on a transaction-based pricing model. Not all merchants want a traditional pricing package – many would prefer certainty-based models, such as a fixed subscription based model or all-in pricing models including value added services and terminals. Transparency and comparability objectives should not overlook what many merchants want: certainty.

Impact Statement 5B: Contracts

There are already several prompts for merchants to consider their existing acquiring relationship (including regular billing, approaches from rival acquirers etc). However, our members are not opposed to exploring some form of additional prompt for merchants to periodically consider their current arrangements and potential alternatives. But, our members do not agree that fixed term contracts or banning evergreen contracts will achieve this. There is a place in the market for flexible contracts on evergreen terms that can be exited quickly. Also, there is a difference between an indefinite contract with a long exit period and an indefinite period with a short exit period. Our members express the view that short exit periods promote switching.

Our members concur that contract lengths, termination fees and other exit hurdles should not be used to unfairly prevent merchants from switching and/or renegotiating. Our members note that there is a place in the market for fair longer contract terms and fair and transparent termination fees where capital and set up costs need to be recovered or where longer contract terms offer more competitive rates.

Impact Statement 5C: Terminal Hiring Regulation is Not Fit For Purpose

It is noted that the Interim Report references the existing regulation of terminal hire under the Consumer Credit Act. To the extent that the PSR is considering remedies dealing with terminal hiring and practices, the Consumer Credit Act is not suitable for the modern market, is unnecessarily unwieldy, the documentary requirements create friction (and thus delay on-boarding and switching) and is not the right starting point for addressing market conduct. The Consumer Credit Act also makes it unnecessarily difficult to promote innovative pricing models for the whole suite of services.

Any remedies relating to terminal hiring should consider contracting and pricing practices as a whole, replacing the application of the Consumer Credit Act with specific and targeted objectives that do not differentiate between business models (sole traders vs out of scope limited companies) or legal forms of the applicable contract. To that end, in the remedies consultation phase, we recommend that the industry and the PSR consult with the FCA and HM Treasury on the regulation of terminals (it being acknowledged that the Consumer Credit Act is not within the regulatory perimeter of the PSR).

Impact Statement 5D: £50m turnover band

Our members do not agree with the £50m turnover band breakpoint. Any potential remedies should only apply at a much lower threshold.

Impact Statement 6: Remedies Design

It is acknowledged that the Interim Report is a "work in progress" and that a remedies consultation is expected to be issued in 2021. Our members believe that remedies design should not exclusively rely on the analysis or the findings in the Interim Report (because members find them unreliable sources upon which to base remedies) and that market relevant and merchant relevant factors should be taken into account in the remedies' intent and purpose.

Impact Statement 7: Remedies: Formulation, Validation and Implementation

We think the PSR needs to outline in its final report its approach as to how the remedies will be formulated, validated and implemented. We think the remedies should be formulated on a level playing field. Participants involved in the activity of selling acquiring services should be subject to the same legislative rules or codes of conduct and the remedies should not be imposed solely upon regulated entities. Acquirers should not have the responsibility for quasi-regulating ISOs, for example.

Part 2 – Detailed Commentary

1. THE PSR's FINDINGS, THE DATA AND THE EVOLVING PAYMENTS MARKET

1.1 Market Scope

1.1.1 The report provides a reasonable summary of some elements of the "*Competition between providers of card-acquiring services*". It identifies a number of behaviours and approaches which enable and drive merchant choice in the identified segments.

1.1.2 "Simple standard pricing", "low cost hardware" and "quick and simple onboarding process" are identified as good behaviours that enable merchants to make informed choices; this clarity and simplicity has underpinned the success of the new payment facilitators and simplified acquirer service offerings. However, we think that these behaviours need to be put in the context of PF, ISO and "simple" acquirer models and that the basis on which more complex service and hardware models operate should also be outlined.

1.2 Pass –Through Analysis

Those members who had access to the pass-through analysis data room express serious concerns about the analysis used by the PSR to validate and underpin the pass-through conclusions. We understand that a number of acquirers will make direct representations to the PSR about the analysis and the conclusions that the PSR has drawn from the pass-through data.

1.3 Focus on price

Our members do not believe that remedies founded solely on price will have significant impact on the competitive functioning of the payments acceptance market. It is not sufficiently clear or sophisticated enough to create a level playing field. There are other outcomes for merchants and consumers that need to be taken into account and incentivised which are discussed below and should be considered further in the final report and remedies phase.

1.4 Global Pandemic

1.4.1 The industry was able to respond to COVID-19 swiftly. It increased the contactless limit to £45, effected the switch to on-line shopping and granted considerable postponements or waivers of fees and charges (without any directions from the PSR or the FCA) and supported credit and liquidity stressed merchants (without any direct public guarantees). These factors do not represent a "market not working well" and the positive efforts of the industry are under-represented in the Interim Report.

1.4.2 The payments industry has always - and demonstrably during COVID-19 - supported consumers by underwriting their redress (through the possibility of chargeback) even when retailers were unwilling or not capable of doing so; this was particularly the case in the travel sector when responding to the travel restrictions placed on consumers by COVID-19.

1.5 Card-Acquiring vs Payment Acceptance

1.5.1 Whilst payment providers "touch the money" on behalf of merchants and therefore must be appropriately regulated, capitalised and be required to keep merchants' funds safe from payments provider insolvency, our members do not think that it is useful to base competition regulation in the payments market by reference to the "***card-acquiring***" market alone – traditional merchant acquiring no longer exists.

1.5.2 While the distinctions between cash, cheques, banking payments and cards are still generally relevant in the context of infrastructure, consumers now have an increasing number of "ways-to-pay". For example, if one looks at the modern checkout options available through a retailer's ecommerce website, one will find that the on-line checkout payment page may display many payment options: traditional cards, Applepay/Googlepay/Samsung pay options, bank account to bank account payment, buy now pay later, traditional instalment credit and e-money. As technology and innovation drive new ways to pay, retailers are no longer solely concerned with "acquiring" or payment cards but with the ability to maximise sales by accepting the widest range of payment methods possible with minimal consumer friction throughout the checkout stage. Physical in store (or off-line) payment options are likely to follow on-line developments and the distinctions between the two are narrowing. Moreover, the proliferation of payment options is not limited to the large retailers – many SMEs now offer their customers many ways to pay, accelerated by the Covid-19 pandemic. Whilst traditional acquirers are constantly innovating, the availability of the payment options are not solely driven by the acquirers – it is often driven by the ecommerce platforms and payment gateways. It is often the case that the merchant's primary choice is the functionality offered in the payments package as a whole, rather than the price of payment acceptance of one type of payment (cards).

1.5.4 Therefore, any competition policy focus should focus on **payment acceptance -** being on the one hand all the means by which a consumer transacts with a merchant at the point-of-sale as opposed by reference to one of the actual means that they use to "pay" the merchant, which seems an arbitrary distinction nowadays and on the other all the means by which a merchant transacts with its payment service providers.

1.6 Basis of Analysis

Too much reliance has been placed on theory, based upon an apparent assumption that the acquiring market can be compared to a consumer utility market such as gas or electricity where the unit of consumption and its delivery is homogenous. As this response explains, the market is complex (even in the SME segment), not homogenous and there are a multitude of offerings and channels, with providers competing on both price, functionality and quality.

1.7 Econometric Pass-Through Analysis

Whilst UK Finance has not had access to the data room, our members that have had access to the econometric pass-through data room (through their advisers) report material misgivings about the robustness of the methodology and analysis. A number of our members will provide their own commentary on the data exercise in their bilateral responses to the Interim Report.

1.8 "The Market Is Not Working Well"

1.8.1 Regardless of whether or not the analysis supports the finding of "*no evidence of pass-through"* (which many of our members dispute), the conclusion that the market is not working well is too binary. Our larger members point to a competitive environment witnessing a significant number of merchants switching to providers on more favourable terms. The data that they have demonstrates a market that is functioning well in terms of prices and quality of service choices that merchants are making.

1.9 Price vs Value

1.9.1 Merchants do not switch purely because of core acquiring *price* – they decide to switch because they may obtain better *value* elsewhere. The Interim Report does not address what merchants value and what they are willing to pay for that value. In our view the value is derived by others factors in addition to price (but of course acquiring price is relevant). All merchants require increasingly sophisticated offerings and have a wide variety of needs, including choice of terminals and industry specific point of sale hardware, software and gateway integrations, payment methods accepted and settlement times (and a variety of value-added propositions around data analytics). The acquirers have recognised that ease of integration with the merchant's wider requirements is fundamental to any payment proposition. New entrants have offered faster onboarding and less fixed pricing structures as a means of attracting merchants who just need the ability to take card payments quickly. Merchants value risk appetite, fraud tools, connected services, high card authorisation rates, data analytics, merchant portals, servicing, reliability, innovation and so on.

1.9.2 If there is no understanding of value and what drives merchants to switch or not switch providers, then the risk is that remedies will not change merchant or acquirer behaviour and may lead to unintended consequences of marginal gains for merchants on MSC when they switch, but a reduction in the total value derived from their choice of payments provider.

1.9.3 It is suggested that more thought needs to be applied with respect to merchants' payment acceptance needs:

- how they value those needs relative to the cost of acceptance
- how relevant this is to merchants' choice of provider

2. PROPOSED REMEDIES

2.1 Overview

2.1.1 Whilst members express reservations on the analysis and the findings, they are willing to positively engage on how the market can be improved for smaller merchants. Members are open to working with the PSR on potential interventions that improve the functioning of the market.

2.1.2 It is important that the PSR considers carefully whether the adoption of a utility-type approach (electricity, water etc) may lead to unintended consequences, that could stifle innovation and reduce merchant choice.

2.2 Context and Approach

The remedies should reflect our "broader market" and "value" observations in this response, and not be designed to solve the wrong problem.

Turning to the specific high-level approaches:

2.3 POS Contract Length

Any potential remedies regarding POS contract lengths must be balanced against other benefits:

- some merchants prefer contracts with flexible short exit periods whilst others prefer longer contracts (as lower transaction fees can be negotiated);
- for terminals, appropriate and fair termination fees support investment costs for new point of sale equipment that the market may be otherwise unwilling to invest in; and
- termination fees support low monthly payments – banning termination fees may end up in higher monthly costs for merchants or discourage investment.

2.4 Prompts to Consider Switching

There are already several prompts for merchants to consider their existing acquiring relationship (including regular billing, approaches from rival acquirers etc). However, our members are not opposed to exploring some form of additional prompt for merchants to periodically consider their current arrangements and potential alternatives. We and our members look forward to discussing potential options during the remedies consultation phase.

2.5 Terminal Contract Barriers

As a general principle it is agreed that merchants should not be locked into contracts because of onerous ancillary obligations that are disproportionate to the upfront investment costs borne by the payments provider. Regulation should focus on transparency and fairness and not dictate what commercial models should or should not be available. Again, we and our members look forward to discussing possible options in the remedies consultation phase.

2.6 Terminals Regulation

Our members think that the regulatory oversight of terminals should not distinguish between different legal models. If there are to be “protections” over terminal arrangements they should apply equally to sole traders, partnerships and limited companies. The Consumer Credit Act is not the place to regulate terminals and some other form of regulation is required that focuses on payments services and not on credit. The Consumer Credit Act itself has onerous requirements that appear to give very little benefit in a payments context and are more likely to hamper efficient switching than promote it and more likely to inhibit pricing models that merchants want.

2.7 ISO and Acquirer Pricing Transparency and Comparability

2.7.1 **Transparency** is a worthwhile goal and would be better expressed through a principle led market requirement (such as clearer information on key commercial terms and what (permissible) termination fees could apply), rather than achieved through a prescribed binary price for a single element of a total pricing and product package that does not capture **value.** To the extent that **comparability** is a desirable outcome then there needs to be some benchmarking and templating for information so that the comparison is feasible and effective. Given the vast array of risk profiles and transaction type profiles, a one size fits all “comparison” site or published pricing is neither workable, nor appropriate. The cost of acquiring for a travel company against a cash-and-carry is very different. Any comparison exercise needs to clearly define what "basic acquiring" looks like and prompt merchants to assess **value**.

2.7.2 **Non-Transaction Based Pricing Models**: Regulation should not determine commercial models. **Transparency** principles could work for distinguishing more clearly between pricing models such as pure transactional based pricing or “all-in” pricing or subscription style pricing. **Transparency** requirements should focus on a clear explanation of what is and is not included in non-transactional pricing models. Our members do think it is not necessary to break down all-in pricing models into a transaction-based pricing model – and their concern is that **comparability** will require this. The market should be free to offer different bases of pricing, as that is what merchants want.

2.7.3 **IFR/CCA**: We note that the Interchange Fee Regulation, alongside the Consumer Credit Act makes it very difficult to innovate on pricing models, such as offering a total fixed price package whilst complying with very technical requirements. Many merchants, especially those that are start-ups or new to accepting cards will wish for certainty and choice of pricing models over transaction based transparency as to how one element of the pricing package is calculated.

2.7.4 **Tariffs**: Consideration should be given as to how standard (usually non-negotiable) additional fees should be presented (such as requirements to publish standard tariffs for non-transactional items). Consideration should be given as to a requirement that the comparison methodology adopted (and any prompts) sets out the fees (and any termination fees) for additional services such as currency conversion, gateway, fraud tools etc.

2.8 Merchant Turnover "Breakpoint"

Our members express strong reservations that the remedies may apply up to turnover bands of £50m. This "breakpoint" is not supported by the evidence and is not recognised by the payments providers as the measure by which merchant sophistication or understanding is increased. Whilst it is accepted that there needs to be a level where the remedies do apply, the breakpoint should be at a much lower level. Further, the merchant survey did not consider merchants with a turnover over £10m. To the extent any remedies treat acquiring as a consumer-type utility, then it is submitted that the turnover level should be at the micro-merchant segment only.

3. REMEDIES DESIGN

Our members advocate that the PSR should take a fresh approach to the remedies design, that is not solely anchored on the analysis and the findings, nor takes a consumer utility approach, but instead focusses on what is required to promote a secure, open, transparent and competitive payments acceptance marketplace as a whole. UK Finance and its members would welcome a thorough remedies consultation process, in a collaborative effort with merchants, regulators and the payments industry to design workable and effective ways to ensure the payments acceptance market remains competitive and innovative.

4. REMEDIES IMPLEMENTATION

4.1 It is acknowledged that the "what" and the "how" of the implementation are dependent on the PSR's final findings, further consultation and merchant interaction. We would encourage the PSR to engage with our members and set out in the final report how the PSR foresees implementation.

4.2 UK Finance is particularly interested in how remedies will be imposed on non-regulated parties, such as ISOs or those that provide terminals or other payments services directly to merchants. What will be the legal basis for this?

4.3 UK Finance and its members think that assuming that the acquirers should "regulate" other industry players is not appropriate. Financial regulation policy at the *entity* level (capital, safeguarding, solvency) of card acquirers is an important and necessary regulatory imperative and is less of an issue for those providers that use an acquirer to collect merchant funds and settle transactions. However, when it comes to market conduct and transparency we advocate regulation policy at the *activity* level: all parties in the payments system, regardless of their current regulatory status, that contract with merchants for payments services should be bound directly by the same rules and be subject to the same consequences and enforcement processes.

5. NEXT STEPS

We and our members look forward to further engagement with the PSR and other stakeholders and are pleased to submit this response to the Interim Report. We look forward to discussing this response with you and to receiving the final report. We hope that the final report not only takes into account the contextual comments we make in this report but also sets out the direction of travel for the design and implementation of the remedies.

UTP Merchant Services

Market review into the supply of card-acquiring services- UTP's comments on the September 2020 interim report

1. Executive summary and background

UTP has been involved in the card-acquiring industry since 2013 as one of the UK's leading Independent Sales Organisations ("ISOs"). Before 2013 the management of UTP were involved in another leading ISO, Card Processing Solutions Limited ("CPS") which commenced operation in 2007. As such, the UTP team have a detailed, in-depth knowledge of the UK acquiring market from the perspective of the ISO participants. CPS was one of the first ISOs to operate in the UK and the UTP management team have been in a position to witness first-hand the development of the ISO market to where it is today.

This paper is intended to summarise UTP's comments regarding the September 2020 interim report and should be viewed in conjunction with the comments made in a conference call with the PSR held on 10th November 2020.

[redacted]

In summary and for the reasons highlighted below, UTP disagrees with the assertion (made in paragraph 7.26) that the supply of card-acquiring does not work well for small and medium sized merchants. Whilst this may have been true a decade ago before the existence of the ISO market, the healthy level of competition in the UK market is such that for those merchants who are interested in reducing their costs of card-acquiring, they can very easily contact a large array of providers in order to quickly assess whether it is commercially viable for them to switch to a new supplier. The statistics presented in the PSR Report support UTP's view that the market is working efficiently. For example:

- As per section 6.21, 76% of merchants found it easy to switch providers. This is further evidenced by the statistic that only 1% of respondents suggesting that they were unable to switch;
- Only 29% of respondents wanted to switch and of those, only 10% (i.e. 2.9%) suggesting they did not switch because they were tied into a contract;
- 90% of the merchants who tried to negotiate a new rate with their incumbent provider were successful.

UTP believes that attempts to regulate the market as proposed in the interim report e.g. restricting the use of long-term POS rental contracts, could result in a reduction in competition with the inevitable disadvantages that would bring.

2. Key high-level comments from UTP

The UK card-acquiring market is already highly competitive with a significant number of market participants competing predominantly on the basis of price. As such, it is very much a "buyer's market" and merchants who have a desire to reduce their cost of their card-acquiring are easily able to obtain pricing from a number of organisations to assess whether it is commercially viable for them to switch to a new provider. Putting the statistics presented in the PSR Report to one side, UTP believe this is evidenced by the following:

a. A review of customer attrition rates across the UK acquirers and ISOs will demonstrate that merchants are switching between providers at a fairly "healthy" rate. Controlling attrition caused by the ease with which merchants can switch is a major focus for most providers of merchant services.

b. An assessment of the rates merchants are paying for card-acquiring has dropped fairly steadily over the past 12+ years as highlighted in the table below:

[redacted]

[redacted] summarises the average rates paid by UK-based SME merchants for consumer credit cards. The fall from [redacted] to [redacted] represents a fall of [redacted] over the 12 years from 2008. This is relevant because it covers the period of time from present day back to when the ISOs first appeared over a decade ago.

The decrease in rates is evidence of the highly competitive nature of the market and highlights that (i) merchants are able to drive down their costs of card-acquiring and (ii) the market is efficient in passing benefits arising from cost reductions (e.g. interchange) through to merchants.

The development of the ISO market from the latter part of the last decade has seen significant benefits accruing to UK merchants. It is doubtful whether such benefits would have accrued to merchants without their involvement, particularly in relation to the flow-through of interchange cost reductions.

The five largest ISOs (of which UTP are one) are all well capitalised, profitable entities which are able to adapt to changes arising from the PSR Review. This is not however representative of most ISOs which are woefully under-capitalised. Many of the smaller ISOs rely heavily on the cash-flow generated by selling the income streams associated with longer terms POS terminal rental contracts. Any actions which limits the use of such contracts could result in a number of the smaller ISOs being forced out of the market.

3. Specific comments regarding the three conclusions reached by the PSR

a. Acquirer and ISO pricing

It is UTP's belief that the absence of published prices does not result in significant costs for merchants. The majority of a merchant's costs can be attributed to the rate charged for consumer debit cards and quotes for consumer debit can generally be obtained from one simple call to an acquirer or ISO. Imposing a requirement for acquirers and ISOs to publish pricing is unlikely to make a material difference to merchant behaviour.

b. Indefinite duration of merchant contracts for card-acquiring services

Whilst it is true that such contracts may have an indefinite duration, UTP do not believe this is a detriment to merchants. Many acquirers do not enforce exit penalties on merchants who want to move to an alternative provider and from this perspective, the merchant is currently getting a "good deal".

c. Acquirer and ISO POS terminal contracts

Auto-renewal of POS contracts

UTP agrees that the auto-renewal of long-term POS rental contracts is not in the interests of merchants. The rationale for a fixed term contract is to allow the ISO to recoup their costs of asset deployment and customer acquisition. This argument falls away when contracts automatically renew. A comparison can be drawn with mobile contracts where it is unreasonable for a mobile provider to continue charging for the cost of a phone if the cost has already been amortised over the length of the initial term.

Length of contract.

The length of a POS contract should not be longer than the expected life of the asset. By way of example, a five-year contract would be too long, particularly for a mobile device. Three and four year contracts however are reasonable based on UTP's experience of hardware reliability and performance.

The existence of long-term POS contracts.

The existence of long-term POS contracts undoubtedly discourages merchants from switching providers in the early years of such a contract. The following however is also true:

i. Long-term contracts enable many of the smaller, undercapitalised ISOs to operate. UTP believe that the benefits their existence in terms of promoting competition and driving down acquiring charges more than offsets the restrictions imposed by the long-term contract associated with the equipment.

ii. In a direct analogy with the mobile phone market, many merchants leave their rental contracts before the end of the minimum term if it is commercially beneficial for them to do so. It is also not uncommon for many ISOs provide incentives for merchants to switch providers and pay-off the remaining term of the contract. In so doing, the merchant may be able to reduce the cost of their card-acquiring which is likely to form a much larger component of their costs than the rental of the POS terminal.

iii. If the ISOs profit margin associated with acquiring a new customer and deploying a POS terminal is too small, ISOs may be more inclined to sell the cheapest device possible rather than a device likely to really add value to the merchant.

Visa

PSR market review into the supply of card-acquiring services

Visa Europe's response to the interim report

9th February 2021

Table of Contents

Executive summary....3
Overview....5
Answers to the PSR's questions....12
Technical Annex - Comments on the PSR's merchant survey....29

Executive summary

Visa welcomes the opportunity to respond to the PSR's interim report to the market review into the supply of card-acquiring services. We highlight three headline priorities for the remainder of the PSR's review:

1. Supporting the economic recovery should be the top priority for the sector

The COVID-19 crisis has been unprecedented in its scale and in the sobering impact it has had on businesses, economies and populations across the globe. Visa is committed to play its part in a successful, consumer-led recovery, applying its assets and expertise to support the global economy in getting back to business and commercial activity.

We see the focus of the year ahead as a return to stability for businesses across the globe, but significant commercial risks and uncertainty will remain for some time to come. The business community needs to know it is being supported by its partners, the Government and regulatory bodies. As the economy recovers, many businesses of all sizes will be fighting for their survival and, above all, they need the reassurance and confidence that they will be operating in an environment that is supportive to business growth. Visa is committed to play its part in a successful, consumer-led worldwide recovery.

2. The UK will continue to be a world leader in payments if outcomes are at the heart of regulatory decision-making

Over the past year, it is clear that the outcomes that merchants and consumers expect from digital payments have changed and new outcomes have emerged. The PSR has a unique opportunity to understand the key set of consumer and merchant outcomes it wishes the payments sector to deliver in a post COVID-19 and Brexit world. Having a granular understanding of the outcomes expected by the population of consumers and merchants is a critical step in establishing a clear vision for the UK payments sector.

In many ways, the interim report presents a cards market that is innovating, evolving at pace and delivering well for its merchants. The past year has further shown how capable the sector is of reacting to unknown and unfamiliar challenges. Where the PSR has identified concerns, we recommend it engages with merchants and the sector more widely to understand how these concerns align or rank against its vision of the sector and the consumer and merchant outcomes the PSR believes are important to deliver.

3. Remedies will need real-world trials and pilots before implementation.

Any regulation, no matter how minor, has consequences – including unintended ones. Visa supports positive change for consumers and merchants, but remains to be convinced that the proposed remedies are aligned with the right consumer and merchant outcomes.

Despite this, we recommend that, as far as possible, the PSR progresses an evidence-based approach into the next phase of the review. This would include articulating clearly the outcomes it is looking to promote in the sector; a robust analysis of the problems or obstacles to securing that outcome; developing a *range* of remedy proposals that clearly sets out the role regulation could play in solving that problem (or delivering better outcomes); and then testing the proposals to understand as far as is possible the costs, benefits and potential for unintended consequences of each one.

Remedy testing should involve developing impact assessments, performing behavioural experiments, undertaking small-scale direct merchant studies and performing real-world trials and ultimately pilots to understand the range of impacts of each remedy, until a front-runner emerges.

It is very important that the PSR, like regulators in other sectors, understands the full range of impacts of its remedies. Furthermore, we recommend the PSR collaborates closely with the sector throughout this process to ensure the desired merchant and consumer outcomes are achieved.

Overview

The payments sector has worked together, with the public sector, to respond to the crisis

The UK payments sector is a global success story that continues to support and enable businesses up and down the country, every single hour of every single day. Through the COVID-19 pandemic this has been more important than ever.

Throughout the past year, digital options and e-commerce have provided critical channels for consumers and merchants to endure the crisis. For millions of consumers and merchants, online purchases are no longer a convenience but a necessity. This is borne out in transactions figures where 15 countries in Europe had a 25% or higher increases in e-commerce transactions in September 2020 compared with the previous year[1]. We strongly believe a recovery that has digital as one of its foundations is likely to be a more inclusive as businesses can reach customers further away. We have been excited to see the level of innovation in this space as new players take shops and even whole high streets online.

We are proud to have been part of the response of the whole payments sector to the pandemic. Visa's systems have remained resilient throughout the crisis, managing significant increases in demand and allowing merchants and consumers to access vital e-commerce channels. Our cybersecurity centres have helped protect our system, our cardholders and our clients against security threats during this time, collecting and analysing on a real-time basis over nine billion security events each day[2]. Visa monitors and closely coordinates with our clients, ecosystem participants and international government stakeholders regarding other emerging threats.

In addition, working alongside the PSR, FCA and the Government, Visa was proud to play a leading role in the contactless limit increase to £45 in April. This type of initiative was policy-making at its best – collaborative and responsive to the needs of stakeholders. The result has been that UK cardholders can make larger purchases safely without entering a PIN and has led to shorter queuing times in stores – a critical necessity in the past year. In the UK, over [redacted] consumer 'touches' were avoided on Visa cards between April and December. [redacted] This change has been welcomed by consumers and merchants alike, and we are pleased to see new opportunities to further raise the limit in the near future.

However, Visa believes that consumers should continue to have multiple options for payments and access to cash remains an important goal for the business. We have worked closely with the Government and regulators on this issue and have been encouraged by HM Treasury's proposals announced on 15 October on introducing cashback without purchase, but more work in this area is needed.

1 VisaNet data (November 2020)

2 Visa Inc. (2020) - 'Investor Day, Corrected Transcript', February

The current landscape of payments in the UK

The digital payments sector is vibrant, highly competitive and one in which cards are only one player. [redacted].

Furthermore, the shift to open banking is further opening up the competitive map, where increasingly sophisticated merchants are looking across payment systems to determine the best solutions for their businesses. It is therefore no surprise that faster payments volumes are growing 19% annually (2019)[4], compared with 12% for debit cards[5].

London is leading Europe on fintech activity, housing 8 out of 12 of Europe's fintech unicorns[6] and over 20% of UK consumers – about a third of millennials in the UK – use a Challenger Bank as their primary bank[7].

Competition in cards is also delivering cutting-edge innovation for cardholders and merchants every single day and Visa continues to roll out new global innovations to the UK first. Examples include:

- **Secure Remote Commerce (SRC).** Rolling out globally, with the UK leading in Europe, Visa is moving to a high quality, easy and smart online checkout experience with Visa SRC, based on the EMV® SRC Specification v1.0. This enables ease of recognition for consumers, and signals that a consumer can confidently transact through an easy e-checkout, regardless of the payment card, digital channel or device they use.

- **Instalments.** Visa has selected the UK as one of three markets globally to launch its our instalments service. This service will give greater flexibility to consumers who want to use buy-now-pay-later (BNPL) services at checkout by supporting banks to underwrite the plan.

Furthermore, a host of new players and business models are serving changing merchant needs and tapping into previously underserved merchant segments and markets. For instance:

- **Technology is changing the way consumers pay for goods and services**. Merchants expect acquirers and payment facilitators to offer multiple acceptance solutions, which support different physical ways to pay (e.g. mobile, wearables and cards) as well as different payment channels (e.g. pre-paid wallets such as Revolut and closed-commerce ecosystems such as Alipay). Furthermore, the nature of POS terminals is changing rapidly, becoming increasingly mobile and software driven, allowing enhancements without replacing infrastructure and linking to software to offer value-added services such as accounting and business analytics.

- **There is an increasingly large and complex ecosystem**. For example, payment facilitators allow fast, simple and easy on-boarding for merchant segments that had previously been underserved by traditional acquiring businesses. This has seen a rapid increase in the number of small merchants accessing digital payment technologies.

---

3 [redacted].

4 Source: https://www.fasterpayments.org.uk/statistics.

5 UK Finance (2020) – 'UK Payments Market', June.

6 Tech unicorn are business with private market valuation of $1B+ Source: CBI Insights, State of Fintech Q1'20 Report: Investment and Sector Trends to Watch.

7 Finextra (2019): 'Third of millennial Brits say primary bank is a challenger', December.

Since the beginning of the crisis, we have seen rapid changes, such as e-commerce transaction numbers rising at an unprecedented pace – [redacted]. We have also witnessed a substantial rise in fintech businesses looking to provide for new consumer and merchant demands.

We encourage the PSR to continue to engage with the sector to understand developments closely as part of the next phase of the review. This is particularly relevant in payments, which is evolving quickly and already complex. Experience across sectors has been that it is particularly important to consider the likely impact of regulation and be mindful of the risk of unintended consequences when markets are dynamic and there are a range of sources for future innovations that will benefit consumers[9].

The importance of consumer outcomes and demands

We take it as given that understanding consumer and merchant demands and the outcomes they expect from digital payments should be at the top of the PSR's agenda. While the findings of the PSR's merchant survey provide a technical insight into the supply of card-acquiring services from a merchant point of view, we note the PSR failed to collect any observations on the views of consumers.

Innovation and operations at Visa will always be driven by a relentless focus on the outcomes we know our cardholders (and the merchants that serve them) want. For example, even before the pandemic our research showed that 68% of consumers believed preventing fraud should be one of the top priorities for card companies[10]. Rapidly innovating and operating our network to cater for new and changing demands allows us to know that whenever a consumer or merchant chooses Visa, they are choosing the best way to pay and be paid for them.

At Visa we have invested in a wide range of impactful initiatives to deliver on the outcomes we know consumers and merchants expect and demand of us:

- **Fraud monitoring:** We strive continuously to extend more robust fraud and risk management capabilities to our clients and their customers. In 2019 alone, Visa helped financial institutions prevent an estimated $25 billion in fraud using our AI-powered risk scoring engine. Our Visa Advanced Authorisation (VAA) and Visa Risk Manager (VRM) services use AI and machine learning to evaluate 500 risk attributes in each authorization request in real time. Today, more than 8,000 issuers in 129 countries receive VAA scores to help reduce fraudulent transactions[11].
- **Disputes management:** While disputes are extremely low relative to the number of transactions on Visa's network our dispute management solutions ensure that consumers and merchants can trust that they will be resolved as quickly and fairly as possible. Verifi at Visa enables disputes to be resolved quickly by connecting issuers to more than 25,000 merchants almost

---

[redacted]

9 The UKRN, for example, has a specific theme of 'innovation-friendly regulation' that aims to help regulators navigate these risks.

10 Research commissioned by Visa, quantitative fieldwork conducted by YouGov. October 2019.

11 Visa Inc. (2019) - Annual Report.

immediately when an account holder calls in with an issue. This reduces costs and friction for all stakeholders involved in disputed transactions.

- Technology: Before the pandemic, in the past five years, Visa had invested $9 billion globally in technology, including capabilities that detect, prevent, and mitigate security risks[12]. These investments ensure that Visa is the most secure, digitally advanced, and reliable network in the world. We have also transformed our proprietary technology network, VisaNet, into an open commerce platform. Visa Developer Platform (VDP) provides access to many of Visa's most in-demand products and services through an open network of Visa APIs, allowing anyone to transform great ideas into new digital commerce experiences.

However, no one entity in the ecosystem is ultimately responsible for protecting card users. As sophisticated cyber criminals, bad actors and petty fraudsters continue to find ways to misappropriate money, the ecosystem must continue to innovate and invest to stay ahead on this critical issue to our clients and cardholders.

Our commitment to merchants

Small businesses are the backbone of local economies in the UK. We recognise that digital payments play a critical role in supporting economic growth, and especially small businesses in the current circumstances. Visa understands this and this is why we continue investing in market-leading innovation to enable new ways to pay and be paid. We hope the PSR also puts Small and Medium-sized Enterprises (SMEs) at the heart of its thinking for the remainder of the review.

However, the increasing shift to digital payments creates difficulties for those businesses that are not ready or able to accept digital payments, or take full advantage of the benefits of such payments. The recent crisis has made digital access more important than ever and Visa is proud to be at the heart of facilitating SMEs in this space:

- Campaigns: For a number of years, Visa has been using its campaigns and advertising channels to create a rallying call for consumers to support small and independent merchants. Through our *Great British High Street*, *Love Your Local Market* and now our *Where You Shop Matters* campaigns, we have put a spotlight on merchants and their stories to inspire others to shop locally. And for the past two years, our high-profile and popular Christmas campaigns have asked people to support their local high streets.
- Small business toolkit: Visa has continued to expand its small business toolkit to provide a one-stop-shop for products and services to support merchants sell online and benefit from digital services. This includes tutorials to educate and help SMEs grow online and details of companies that can help SMEs with digital services such as: branding; social media access; website construction; taking bookings, and accounting services.
- Partnerships: Our partnerships include eBay, Down Your High Street and ShopAppy. Down Your High Street aims to help small merchants create a new digital identity for their businesses – literally a digital version of a high street that customers can "scroll" down – while ShopAppy's simple-to-use web portals are helping small businesses get online quickly and easily and share web space with other local businesses.

[12] Visa Inc. (2020) - 'Investor Day, Corrected Transcript', February

Even so, we recognise that merchants of all sizes face unprecedented challenges in the year ahead. This includes challenges that have been in place pre-pandemic such as complexities surrounding the implementation of Strong Customer Authentication (SCA), but also new and existential threats post-pandemic. How Government, regulators and the business community work together in the year ahead will be critical for the prosperity of millions of merchants across the country.

Looking to the future

We recommend the PSR continues to be mindful of the speed of change and future direction of travel of the UK payments sector as it concludes its market review. From a global Visa perspective, we strongly believe that the UK is a leader in payments innovation and FinTech growth.

Visa is deeply embedded in and committed to the FinTech ecosystem and we are excited about the opportunities ahead. For example, Fast Track is a global programme that speeds up the onboarding process with Visa, allowing nimble start-ups to easily leverage the reach, capabilities, and security that VisaNet provides. Some examples of our fast track partnerships include:

- [redacted].
- [redacted]
- [redacted]

In the years ahead, the UK will also experience further major changes. To ensure it has a clear picture and accurate outlook, the PSR must ensure these are reflected in its analysis in the market review. These developments include:

- **The New Payments Architecture (NPA)** will bring a new payments infrastructure to the UK's retail interbank payment systems by 2024. At the heart of the NPA will be a single resilient clearing and settlement core. NPA will significantly change the landscape for payments, and the PSR will need to work closely with the sector to develop a suitable regulatory framework for the NPA.

- **Post-Brexit:** All UK regulators will need to consider the implications of a post-Brexit world on their respective sectors. Payments, by its nature, involves cross-border transactions to a much greater extent than, say, utilities or even retail banking. At Visa, we see there being an important role for the PSR to contribute to mitigating the risks of Brexit and capitalising on the opportunities.

We highlight three headline priorities for the remainder of the market review:

1. Supporting the economic recovery should be the top priority for the sector

For the recovery to take shape, now is the time for all ecosystem participants – including public sector bodies, regulators and third parties – to focus efforts and help return the economy to long-term sustainable growth.

The problems businesses face are wide-ranging and complex. No single solution will work for all. The Government's wide ranging package of economic and fiscal support measures in response to COVID-19 – including, but not limited to, support for the self-employed, small businesses, training, tax measures, small and large loans, moratoria on debt repayments and furlough payments – is a strong example of the complexity of the problem the economy faces and the nature of the solutions needed.

We see the focus of the year ahead as a return to stability for businesses across the globe, but significant commercial risks and business uncertainty will remain for some time to come. The business community needs to know it is being supported by its partners, the Government and regulatory bodies.

2. The UK will continue to be a world leader in payments if outcomes are at the heart of decision-making

Significant shifts in consumer behaviour are requiring businesses of all sizes to reconsider their business models. It is therefore clear that the outcomes that merchants and consumers expect from digital payments have changed and new outcomes have emerged in the past year.

Furthermore, following Brexit the PSR has a unique opportunity to understand the specific outcomes that UK consumers and merchants are looking for. Having a more granular picture of the outcomes and needs of the population of consumer and merchants is a critical step in establishing a clear vision for the UK payments sector. We are excited about this work and believe it aligns closely with the PSR's Future Strategy work and the Payments Landscape Review.

In many ways, the interim report presents a cards market that is innovating and evolving at pace, delivering well for its merchants. Where the PSR has identified concerns, we recommend the PSR engages with merchants and the sector more widely to understand how these concerns align or rank against its vision of the sector and the consumer and merchant outcomes the PSR believes are important to deliver. This vision can then form the basis of the PSR's future priorities.

3. Remedies will need real-world trials and pilots before implementation

Any regulation, no matter how minor, can have potential negative consequences. Visa supports positive change for consumers and merchants but remains to be convinced that the proposed remedies are aligned with the right merchant and consumer outcomes.

No one knows how merchants and consumers will react to a new product or service (or indeed to regulatory intervention). When developing new products and services, many businesses will take a *fail fast* approach. This involves progressing and testing a wide range of ideas, discounting those ideas that are not generating the desired impacts and moving ahead with the remainder. These tests become increasingly more sophisticated the fewer options remain, until a front-runner emerges.

We recommend the PSR takes elements of this approach and begins the next phase of the review by considering a wide range of remedies that could each deliver its objectives and then tests the proposals to understand the costs, benefits and unintended consequences of each one. Remedy testing should involve developing impact assessments, performing behavioural experiments, undertaking small-scale direct merchant studies and performing real-world trials and ultimately pilots to understand the range of impacts of each remedy, until a front-runner emerges.

Circumstances in the past year have made it even more important the PSR understand the costs, benefits and unintended consequences of its remedies. Furthermore, we recommend the PSR collaborates closely with industry throughout this process to ensure the desired merchant and consumer outcomes are achieved.

The remainder of this document responds to the specific questions the PSR has asked, but we of course are ready to assist further in any way we can.

[redacted]

Answers to the PSR's questions

Question 1. Do you have views on the provisional findings set out in this report?

The UK payments sector is a global success story that continues to support and enable businesses up and down the country every single day. Throughout the COVID-19 pandemic this has been more important than ever. The sector understands its responsibilities and demands in the years ahead – it will continue to support consumers and merchants to the very end of the crisis and ensure that the ecosystem delivers seamless and secure services for the millions of consumers and merchants that rely on them.

Many of the PSR's findings present a cards market that is working well, innovating and evolving at pace and delivering for its merchants and consumers. The past year has further shown how capable the payments sector is of reacting to unknown and unfamiliar challenges. As part of the next phase of the review, we recommend the PSR carefully consider the current status of the market and ensure it has updated observations in areas most impacted by the COVID-19 crisis.

In this section, we comment in turn on the following:

- The PSR's merchant survey findings.
- The PSR's comments on market structure.
- The PSR's econometric exercises.

The PSR's merchant survey findings

The findings of the PSR's merchant survey undertaken by IFF research provide a technical insight into the supply of card-acquiring services from a merchant point of view. Many of the PSR's survey results suggest that the status quo is working well for merchants. For example:

- The most common reason for merchants not to switch acquirer (after considering it), was that they decided their current deal was the best option, or because their existing provider offered a better deal[13].
- When merchants were asked what would have helped them feel more confident in making a decision about switching, nearly half of merchants said "nothing"[14].
- Of those merchants who had recently switched, 76% said they found it easy, while only a fifth found it to be difficult[15].

However, we believe there are three key oversights in the PSR's merchant survey work:

- First, the PSR's research is focused on face-to-face payments. We note below that e-commerce has substantially increased in importance for many merchants in the past year and therefore should be represented as such in merchant research work.

[13] PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 27.
[14] PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 30.
[15] PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 27.

- Second, the PSR's questions provide limited insight on the value merchants receive from their acquirers, or the range of additional services offered, and
- Third, the PSR fails to collect any observations on the outcomes or views of consumers, despite the PSR's stated aim of the review being the determination of whether the card-acquiring market system is working well for merchants, and ultimately consumers.

We comment on each area below:

E-commerce payments

E-commerce has been a highly important channel for many merchants for some time, but during the past year, circumstances have changed dramatically. The crisis has seen a rapid shift to e-commerce (card-not-present) transactions by consumers and merchants. [redacted]

Given the rapid and unprecedented rise in e-commerce transactions, many merchants would have seen substantial increases in this payment channel and many others would have used e-commerce for the first time. We recommend the PSR works to understand this critical and valuable channel and the interlinkages between merchant acquirers, gateway service providers and ISOs as part of further merchant research. Understanding and removing barriers to adoption is likely to benefit all stakeholders.

A broader picture – value provided and consumer perspectives

At a similar time to the PSR's work, we conducted both qualitative and quantitative research with merchants and consumers. The qualitative research involved focus groups and discussions and the quantitative work was conducted online by YouGov with representative samples of merchants and consumers of approximately 2,000 respondents in each. The merchant sample was representative of UK SMEs (1 to 249 employees) that accept card payments. The consumer sample was weighted according to age, gender, social grade and ethnicity.

Our work has identified useful findings to complement the PSR's thinking.

First, the PSR's research presents limited insight on the value received from acquirers or the range of additional services offered. The PSR find that 82 per cent of all merchants are happy with the customer service they receive, but the research does not go further to understand the dimensions of customer service that merchants value. Our research found that merchants value reliability more than any other acquirer attribute. Reliability was also the attribute that acquirers were performing best at. Beyond reliability, the cost of accepting card payments and the transparency of fees ranked second and third most important attributes. In both cases, acquirers scored well with 64% of merchants reporting their acquirers perform very or quite well on the costs of acceptance and 71% of merchants reporting that acquirers perform very or quite well on the transparency of fees. We also found that the cost of taking payments was not a significant determinant in explaining the difference between merchants who would consider switching and those who would not.

[redacted] [redacted]

On additional services, our research also provided useful insights. The service considered most important by merchants is fraud protection (71%). Issuing invoices, data and analytics on payments and e-commerce gateways are all reported as important or quite important by over half of merchants surveyed.

Second, our research gives some insight into consumer attitudes to digital payments. Our findings demonstrate consumer experience of cards is very positive, with most consumers welcoming the perceived move towards digital payments. Fraud prevention is critical for consumers with 68% agreeing that preventing fraud should be a top priority for card scheme companies and their investments. Indeed, consumers believe it is in card companies' interests to protect them and businesses from fraud – all stakeholders benefit from a safer ecosystem.

We provide further details in our technical Annex.

Owing to the timing of both pieces of research, the impacts of the coronavirus pandemic are not reflected in the findings. However, given the varied nature of the PSR's merchant survey findings, combined with the substantial and ongoing impacts to the sector in the past year, we recommend that the PSR revisits elements of its merchant survey as part of its work on analysing the impact of different remedies.

The PSR's comments on market structure

A number of the PSR's findings give testament to the speed and scale of the evolution of the UK cards market in recent years. These include:

- **The vast number of options that UK merchants have available for their digital payments offerings**. The PSR state that in 2018 there were over 100 acquirers and over 50 payment facilitators providing card-acquiring services to UK merchants[17].
- **The declining market share of the five largest acquirers.** Between 2014 and 2018, both the volume and value of card transactions acquired by the five largest acquirers in the UK fell by approximately 10 percentage points[18].
- **The rapid increase in merchants using payment facilitators**. Between 2014 and 2018, the number of UK merchants using payment facilitators increased seven-fold, from around 200 thousand to 1.4 million[19].

These observations demonstrate an evolving market with trends suggesting further increase in competition in acquiring services over time and this is before open banking and faster payments are considered. We believe the speed of these changes in the acquiring market is also borne out in our onboarding data on acquirers. [redacted]

17 PSR (2020) – 'Market review into the supply of card-acquiring services', Interim report, paragraph 3.44.
18 PSR (2020) – 'Market review into the supply of card-acquiring services', Interim report, figures 2 and 3.
19 PSR (2020) – 'Market review into the supply of card-acquiring services', Interim report, paragraph 4.19.

Visa has also welcomed a huge number of fintech businesses aiming to provide merchants and cardholders with new and innovative solutions in the payment ecosystem. [redacted]

The PSR references the blurring of business models in the report, with acquirers moving down the value chain and payment facilitators and gateways moving up. The PSR quotes Elavon's purchase of Sage Pay – a gateway service provider – in 2019[21]. Other substantial mergers and acquisitions in this space include: Worldline and Ingenico's business combination, and Global Payments acquisition of TSYS in May 2019. In reference to the latter, at the time Jeff Sloan, chief executive of the combined company said: *"The reason I think [the consolidation] is accelerating now is that the pace of innovation is accelerating"*[22].

In the other direction, the PSR quotes Paysafe and Nuvei (previously SafeCharge), two payment gateway providers, that both began providing card-acquiring services to UK merchants in 2015[23]. We also note the following:

- [redacted].
- [redacted]
- [redacted].

Finally, the pace of change in payments in the past year is also being reflected in global financing. In the third quarter of 2020, payments companies raised almost $4 billion across over 100 deals, comfortably above any other fintech sector[25].

These statistics point towards the continuing rapid evolution of digital payments in the UK, which the past year has only accelerated. This dynamism is a critical feature of the market under review, and must be kept in the PSR's thinking in testing the impact of any remedies. We encourage the PSR to continue to monitor and understand these developments closely, particularly as part of the next phase of the review.

[redacted] [redacted]

21 PSR (2020) – 'Market review into the supply of card-acquiring services', Interim report, paragraph 3.40.

22 FT (2019) – 'Global Payments buys TSYS in $21.5bn all-stock deal'.

23 PSR (2020) – 'Market review into the supply of card-acquiring services', Interim report, paragraph 3.41.

[redacted] [redacted]

25 Bank of England (2020): "Seizing the Opportunities from Digital Finance – Speech by Andy Haldane", November.

The PSR's econometric exercises

Pass-through analysis

The PSR's findings place substantial weight on its econometric pass-through analysis. However, given the complexity of this analysis and the known limitations of econometrics, particularly when dealing with small sample sizes, we encourage the PSR to keep an open mind to alternative data-points and approaches proposed by the sector. We also note that this analysis is based on data from the five largest acquirers and therefore excludes the pricing approach of a significant number of smaller acquirers from the analysis.

On the evolution of scheme fees within the pass-through analysis, we agree directionally with the PSR's finding that scheme fees for a typical merchant are very low. In this context, we think there is a labelling error in Figure 5 of Annex 2 that needs to be corrected.

Scheme fee analysis

As part of the scheme fee analysis the PSR identified an increase in card scheme fees between 2014 and 2018.

For a typical domestic transaction, Visa's charges to acquirers remain very low, despite the range of benefits merchants receive – including system resilience, fraud monitoring and swift refunding. This is particularly important as small and medium sized merchants will deal predominately with domestic transactions. Indeed, the Visa fees that a merchant pays to accept a typical transaction equate to [redacted] for a £30 transaction[26].

However, and importantly for Visa, the period of the PSR's analysis represents a highly atypical phase for the company. First, in 2016, Visa Europe was acquired by Visa Inc. The acquisition created a special set of circumstances for Visa Europe and led to a substantial transformation for the company, moving the business from being a member-owned organisation to a commercial entity for the first time in its 60-year history.

Second, with this transition, the relationship between Visa and its acquirers changed fundamentally, with acquirers moving from being effective owners of Visa and contributing to the decision-making processes of the company, to holding a commercial relationship with Visa.

[redacted]

[redacted]

26 [redacted]

[redacted]

[redacted]

Question 2. Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

Any regulation, no matter how minor has consequences, including unintended ones. Visa supports positive change for consumers and merchants, but remains to be convinced that the PSR's proposed remedies are the most appropriate way forward and are clearly aligned with the right merchant and consumer outcomes.

As discussed in Question 1, many of the PSR's findings present a cards market that is working well for merchants and consumers with trends pointing towards more competition between acquirers and choice for merchants over time. We believe the PSR should consider carefully the dynamic nature of the market as part of the next phase of the review. We particularly urge the PSR to ensure that any remedy it is considering has clearly identifiable and quantifiable benefits; that the PSR identifies possible negative consequences arising from the remedy, and that the PSR conducts analysis to conclude that the benefits outweigh the costs and risks of unintended consequences that the remedy may introduce to the market.

As we set out in the introduction to this response, no one knows how merchants and consumers will react to a new regulatory intervention. We therefore recommend that, as far as possible, the PSR progresses an evidence-based approach. This could involve progressing and testing a wide range of ideas, discounting those ideas that are not generating the desired impacts and moving ahead with the remainder. These tests become increasingly more sophisticated the fewer options that remain, until a front-runner emerges. This approach would ideally include progressing the following steps:

- First, we recommend the PSR articulates clearly a vision for the UK payments sector and the merchant and consumer outcomes this vision would deliver.
- Second, the PSR should consider what it finds to be the main obstacles or problems that stand in the way of achieving this vision. The more specific the PSR can be about the problems, the greater the likelihood that it will design regulation that can secure meaningful change, and that minimises the risk of unintended harm or distortions of competition.
- Third, through engagement with the sector, the PSR develops a range of remedy proposals that sets out clearly the role that regulation could have to address these obstacles or problems, and hence to deliver better outcomes[27].
- Fourth, the PSR produces a regulatory impact assessment on each remedy, to identify at a high-level the benefits and costs, including the potential for unintended consequences of each remedy. Part of this work would include performing behavioural experiments or small-scale direct merchant studies to bolster desk-based research on the impacts of the remedies. We recommend these impact assessments are published to further facilitate conversation with the sector.
- Fifth, once a small number of options emerge that appear most likely to meet the objectives the PSR seeks to achieve, the PSR should employ real-world trials, to test a selection of remedies in real-world environments. This could involve trialling the selection of remedies in selected cities. These trials would determine, in a real-world environment, what the costs,

[27] We note that step 2 is not dissimilar to the approach the PSR is taking with Remedy 3, although as we explain below, we are not clear whether the PSR has sufficiently understood or identified the outcome it is looking to deliver.

benefits and unintended consequences of each remedy would be. They would make it clear to the PSR which remedies are preferred by merchants and which ones are not. Once again, we recommend that the PSR publish these findings for public consultation.
- The final stage would be a large pilot of the remedy of choice. The purpose of the pilot is to learn from a small-scale implementation before attempting a national roll-out. This experience will give the PSR real-world experience to learn from application in the field.

This approach will provide the PSR with a clear and evidence-based understanding of the costs, benefits and wider impacts of the remedies it is proposing. This is significantly preferable to an approach that relies primarily upon regulatory conjecture to assess the impact of its proposals. As noted, such an approach risks undermining a fast moving, dynamic and innovative payment sector ultimately to the detriment of merchants and customers. For the same reason, we also recommend the PSR does not work in isolation, but as a collaborative effort with the sector.

Circumstances in the past year have made it even more important that the PSR fully understands the implications of its remedies before introducing them to the merchant community. In this context, there is likely to be merit in taking an incremental approach to introducing remedies and not deploying them as a package. The most significant proposals might usefully be introduced with a long lead time, to keep the costs of implementation as low as reasonably possible. This would avoid creating excessive burdens on the sector and merchants during implementation and give the PSR the opportunity to review and understand the isolated impacts (both positive and negative) of each remedy before continuing with the next.

One of the areas that the PSR will need to consider is how to limit the risk of unintended consequences. The following section provides some initial thoughts on the potential consequences of the proposed remedies from the PSR. However, we invite the PSR to bolster these and other views from the sector with its own first-hand research.

Remedies on contracts for card-acquiring services and ISO and POS terminal contracts will likely give rise to costs and unintended consequences

The PSR has proposed a number of remedies on contracts for card-acquiring services and ISO and POS terminal contracts, in particular:

a) Requiring all acquirer and payment facilitators' contracts to have an end date.
b) Limiting the length of POS terminal contracts.
c) Ending POS terminal contracts that automatically renew for successive fixed terms.
d) Linking contracts for card-acquiring services and POS terminals, ensuring POS terminal contracts can be exited with no termination fees if acquiring contracts change.

We appreciate the PSR acknowledges that these remedies may have unintended consequences and costs that need to be considered. In particular on the remedies proposed, we note the following:

- Higher prices for merchants: The PSR's remedies could result in higher prices for merchants, with the impacts particularly felt by those who do not actively switch or contact their provider on an annual basis. If the PSR's remedies increase the probability *on average* that an acquirer could lose a customer in a particular year, acquirers may be required to revise their pricing models. Circumstances for merchants vary widely and some merchants may, reasonably, conclude that it is unnecessary to engage with their acquirer on a more regular basis than they currently do. It is not clear that simply increasing the 'loyalty premium' (as is it termed in other sectors) will necessarily be a fair or reasonable way to increase engagement and thus promote effective competition. To avoid replicating the expensive lessons learned in other sectors about the limits of such an approach (for example, in relation to energy consumers), we recommend the PSR understands more clearly the factors that influence merchant engagement with acquirers before progressing any remedy in this space.

- Additional costs to merchants: Creating a more regular renewal process will introduce additional *search and switching* costs for merchants. These costs might be particularly problematic for SMEs who have small staff numbers with multiple responsibilities. The PSR should be particularly mindful of these potential consequences and costs, and consider whether they are worth the benefits that might be derived, especially taking into account the unprecedented challenges merchants are facing due to the COVID-19 crisis.
- Risk of merchant confusion: Particularly given the lack of evidence that merchants are dissatisfied with the market as a general matter, any lack of clarity on the changes to the process around contracting may create confusion for some merchants, which could risk potential disruptions. Increasing the frequency or renewals is also likely to increase the frequency of mistakes. The risks and the costs of these mistakes are largely borne by merchants and, ultimately, by consumers. We invite the PSR to be particularly mindful of these risks when defining the remedies.
- Preventing merchant disruption: [redacted] However, under the proposed remedies, we can envisage instances that could result in these circumstances arising. For example, if a merchant forgot or was unaware that their acquiring or POS terminal contract was due to end. Or, as noted above, more renewals are likely to lead to more mistakes, particularly when merchants have so little time to dedicate to this activity. Therefore, the PSR will need to explain how it would avoid disconnection in the event a merchant does not renew.

Proposals on ISO and acquirer pricing of card-acquiring services require further work before it will be possible to comment on benefits, challenges and unintended consequences

We understand the objective of the PSR on ISO and acquirer pricing of card-acquiring services is to:

- Facilitate shopping around and increase customer awareness of the prices and offerings of different firms; and
- Enable easier comparison of acquirer prices.

However, we question the size and detail of the evidence base the PSR has used to underscore these objectives. For example, the PSR states that:

- One acquirer and one ISO said that comparing headline rates can be misleading because this ignores the additional fees that acquirers apply for card-acquiring services.
- The same ISO also said that merchants often do not understand the quotes they receive.
- One acquirer said that some of its rivals promote a low headline rate and then have significant additional fees.

- Another party said merchants can find it difficult to work out what they are paying for card-acquiring services from the statements they receive from their provider[28].

These statements may be true, but seemingly represent a very small sample size. Furthermore, the PSR's own survey contradicts these assertions, where only 1% of merchants who do not shop around (from a sample size of 348) said it was because it was too difficult or complicated to compare providers' pricing[29].

It is also important that the PSR understands that achieving different objectives will require quite different measures. For example, increasing customer *awareness* of prices and offerings will require different remedies to enabling easy *comparison* of firms' prices. There may be trade-offs between the different policy objectives, and it is critical that these are understood and set out transparently for consultation before any final decision to impose remedies is taken.

Therefore, before further work is done in this area we recommend the PSR clearly identifies the central objective it is trying to achieve and links it closely to the desired outcomes for consumers and merchants it wants the payment system to deliver. It would also be important for the sector to have the opportunity to review the supporting evidence behind the PSR's central objective in more detail.

The PSR should take into account lessons learnt from other regulators when introducing remedies for acquirers

As noted above, a significant part of the next phase of the review should be testing the proposals in real-world environments. This would involve trialling a selection of remedies to determine what the costs, benefits and the potential for unintended consequences of each remedy would be. These trials would make it clear to the PSR which remedies are preferred by merchants and which ones are not. We recommend that the PSR publish these findings for public consultation and that the regulator closely collaborates with the industry in this process.

We encourage the PSR to engage with its regulatory counterparts to gain insight into good practice in this space. We highlight some of these lessons below.

---

[28] PSR's Market review into the supply of card-acquiring services, Interim Report, September 2020, paragraph 6.54.

[29] PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 40.

Case Study 1 – Lessons from Ofgem's Retail Market Review

In 2013, following Ofgem's Retail Market Review, the regulator introduced the four-tariff rule which limited suppliers to four core tariffs per fuel. Ofgem did not trial (in real world settings) or pilot this remedy before implementation. The remedy led to the Six Large Energy Firms withdrawing a number of tariffs and discounts and changing their tariff structures. In 2016, following the Energy Market Investigation by the Competition and Markets Authority (CMA), the CMA concluded that the introduction of the four-tariff rule could have made some customers worse off and reversed its introduction, after only three years of operation.

In addition, the CMA required Ofgem to introduce a new licence condition requiring suppliers to participate in trials. To assist with this, the regulator established an in-house behavioural insights unit and embarked on a programme of work to develop and test new ideas to prompt consumers to increase their levels of engagement with the energy market.

The trials included over 1.1 million energy customers and resulted in over 94,000 switches to new energy tariffs. Of note, Ofgem began its trials by testing interventions that the CMA had recommended as part of the Energy Market Investigation, but the approaches evolved over time.

The programme tested a variety of prompts to encourage engagement, including different types of letters and emails sent to customers on default energy tariffs. Each of the trials tested the impact of the communication against a control group. The prompts trialled were:

- Better Offer trials - a single letter signposting customers to three personalised, cheaper tariffs, highlighting the potential savings and summarising the information the customer needed to switch. The customer would then need to contact a supplier, or search for a better deal, themselves.
- The Collective Switch trials – three letters, each signposting customers to a single cheaper, exclusive tariff, highlighting the potential savings and summarising the information the customer needed to switch. The letters suggested the customer contact a named third-party switching service who would search the market for them and facilitate the switch.
- The remainder of the trials were part of the 'prompts to engage' work stream which focused on increasing engagement among all default tariff customers and maintaining engagement among previously engaged customer groups.

Each trial built on the learnings from the previous set. For example, the trials provided clear evidence that correspondence from a customer's own supplier were <u>more effective</u> than Ofgem-branded letters in prompting engagement.

Source: Ofgem (2019), Insights from Ofgem's consumer engagement trials

The FCA's approach to trialling and testing

The FCA has undertaken trialling and testing of remedies on many occasions. We invite the PSR to leverage the FCA's experience in this space and work closely with the regulator on developing behavioural experiments and trials.

In particular, the FCA asks three questions when deciding whether to complete field trials[30]. We consider each question in the context of the acquiring services market review:

Question	Description	Visa's view
Is a field trial possible and appropriate?	For example, does it test consumer behaviour in a representative setting and a timely fashion?	The proposals being considered by the PSR are highly suited to field trials and will complement desk-based research well.
Is evidence from a field trial important for the policy decision?	The FCA is likely to consider a field trial an important part of the evidence base when there is little existing evidence, when other methods are less suitable and when the proposed intervention would pose high costs.	The PSR has limited experience of designing remedies for the merchant community and has had only limited engagement with merchants (and the sector more widely) during the market review to date. Progressing trials will contribute greatly to the PSR's understanding of merchant circumstances and the outcomes they are looking for.
Is a field trial proportionate?	The FCA will only conduct field trials when it means the use of resources is in an efficient and economical way.	At a time of significant economic uncertainty, there are substantial risks of creating additional costs and unintended consequences to UK merchants. Reducing this risk via field trials would be a highly effective use of the PSR's resources.

Source: FCA (2018) "When and how we use field trials", and Visa

We have provided an example below of one of many FCA case studies the PSR should consider before embarking on the next phase of the review.

[30] FCA (2018) "When and how we use field trials", July

Case Study 2 - FCA's trial of default credit card repayment options

In 2016, the FCA identified that a quarter of credit card repayments were at, or close to, the minimum payment amount due. As a result, customers tended to pay off their debt more slowly and incur high interest costs.

In exploring how to improve outcomes for indebted credit card customers, the FCA ran a trial with 40,000 newly issued credit cards to customers of a large UK lender. The trial varied the repayment options shown to customers on the direct debit sign-up screen to explore whether different options could increase consumers' repayment levels and reduce debt faster.

Participants were randomly allocated to either the **treatment group** or the **control group**. The control group was shown three payment amount options: 1) the minimum payment, 2) the full amount, and a 3) free-form box to manually insert an amount. The treatment group only saw two options: the full amount and another for the free-form box.

The results of this trial were highly informative. First, the results showed that 1 in 5 fewer people set up direct debits for the minimum payment in the treatment group and, on average, the value of these were higher than the minimum amount. However, the results also unexpectedly found that there was no reduction in the overall level of debt of customers in the treatment group. This was because the treatment group also reduced the value of any additional manual payments they made over the time of paying the debt off.

This example shows how a trial can reduce the risk of implementing remedies that miss securing the outcome sought. In fact, following the results of this trial, the FCA chose not to implement the remedy and introduced other remedies such as customer prompts to change repayment speeds.

Sources: Ofcom (2019), Trialling consumer remedies, September. FCA (2018), Occasional Paper 45, July.

Finally, an important part of the next phase of this review will be the publication of a regulatory impact assessment on proposed remedies. Regulatory impact assessments should identify the benefits and costs, including unintended consequences of each remedy and give the sector an opportunity to comment on them. Part of this work should include performing behavioural experiments or small-scale direct merchant studies to bolster desk-based research on the impacts (both positive and negative) of the remedies.

We recommend the PSR refers to the Treasury's Green Book for a standard framework for regulatory impact assessments. In particular, Box 2 from the Green Book identifies the standard stages in policy appraisals. There are also guidelines for specifically regulatory impact assessments that have been adopted by other economic regulators that represent best practice and would be useful starting points for the PSR in designing its own approach:

- Ofgem's Impact Assessment Guidance[31], and
- Ofcom's guidelines, 'Better Policy Making : Ofcom's approach to Impact Assessments[32].

---

31 See link: https://www.ofgem.gov.uk/system/files/docs/2020/05/impact_assessment_guidance_1.pdf

32 See link: https://www.ofcom.org.uk/consultations-and-statements/category-1/ia_guidelines

[redacted]

The Green Book – Central Government Guidance on Appraisals and Evaluation

Box 2: The key steps in the appraisal process are:

- The first step in appraisal is to provide the **rationale for intervention**. This should be used to **identify the objectives or outcomes** the government wishes to meet through intervention.
- The next step is to consider how best to meet the government's objectives by considering **a long-list of options**, including a wide range of possible approaches. These should be assessed for viability and filtered down to a short-list.
- **Short-list appraisal** follows and is at the heart of economic appraisal where expected costs and benefits are estimated and the trade-off is considered. This is done using Social Cost Benefit Analysis (CBA) or Social Cost-Effectiveness Analysis (CEA).
- **Identification of the preferred option** is based on the detailed analysis at the short-list appraisal stage. It involves determining which option provides the best balance of costs, benefits, risks and unmonetisable factors.
- **Monitoring** is the collection of data, both during and after implementation to improve current and future decision making. **Evaluation** is the systematic assessment of an intervention's design, implementation and outcomes. Both monitoring and evaluation should be considered before, during and after implementation.

Question 3. Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?

We have combined our answers to Questions 3 and 4 below.

Question 4. How does COVID-19 impact on our review?

We have combined our answers to Questions 3 and 4 below. We have not proposed additional remedies at this stage, as the acquiring and merchant community are better placed to identify ideas in this space. For further details on how the COVID-19 crisis has impacted the payments sector, see our answer to Question 1 above.

In addition to completing the market review, we encourage the PSR to consider its priorities in the 24 months ahead. These include:

1) Supporting the economic recovery post-COVID-19;
2) Supporting the payments sector to manage Brexit and take advantage of post-Brexit opportunities; and
3) Establishing a clear vision for the sector that is based on consumer and merchant outcomes and that provides a clear blueprint for the sector for future competition and policy initiatives.

We discuss each of the following in turn below.

Supporting the economic recovery post-COVID-19

Many businesses and, in particular, small merchants will find the next year very difficult. Our research shows that the top goals for small businesses are to increase revenue (68%) and grow their online presence (26%). We believe there are a number of areas on which the PSR should focus its attention in support of the economic recovery.

First, we encourage the PSR to monitor closely the evolving state of the economy. This includes monitoring the categories of businesses and merchants that are being most impacted by the crisis, their locations and sizes. Having a more granular understanding of the businesses and merchants that are facing the greatest risks will contribute to a wide range of PSR activities, including its Strategy workstream; any work the PSR undertakes on establishing merchant and consumer outcomes; its work on developing remedies within the current market review, and identifying future areas of focus.

Second, and as part of this, we recommend the PSR considers its resource allocation across its programmes of work, to confirm this allocation is aligned with the highest priority areas for the organisation's stakeholders. In the past year, every business in the country has had to reconsider its resource profile, with many being forced into furloughing workers or putting additional responsibilities onto existing roles. Such challenges are necessary to ensure organisations can continue to deliver the products and services to the quality their clients expect. Similarly, policy-makers and regulators have a responsibility during crises to review workloads and responsibilities against the key outcomes their stakeholders expect of them.

Third, and as we note in detail in our response above, in any year the PSR has a responsibility to explain how it is evaluating the costs, benefits and unintended consequences of its initiatives (including the current market review remedies). This past year has made this responsibility more important than ever. We encourage the PSR to clearly set out its impact assessment framework, including the criteria it plans to use in this assessment (see also our answer to Question 2). We also encourage the PSR to give the sector the opportunity to comment on the results of completed impact assessments before making final decisions between different remedy options. As we set out in Question 2 above, a key part of completing good impact assessments should be real-world testing. We therefore also encourage the PSR to share its testing approach with the sector. Finally, the PSR should consider how its initiatives interact with other workloads and responsibilities to ensure key outcomes expected by stakeholders are prioritised.

Fourth, the PSR should continue to communicate with the sector throughout the crisis. We believe a more regular flow of communication between the PSR and the sector would assist the PSR in understanding the progress of the crisis and the challenges its stakeholders are under.

Finally, the PSR has not sought views from the sector on what more it could be doing as a regulator during the crisis, in contrast to regulators in other sectors. The items listed above provide some examples of what the PSR could be doing differently, but the sector will have different views that the PSR should consider as part of its work for the year ahead.

Supporting the payments sector manage Brexit and take advantage of post-Brexit opportunities

In addition to the economic recovery, the UK is facing a second structural impact in the form of Brexit. While the UK's legal and regulatory landscape post Brexit continues to evolve, there remains an important role for the PSR to contribute to mitigating the risks and capitalising on the opportunities in this regard.

First, having left the EU UK regulators and policymakers can now focus on the specifics of the UK payments sector, including understanding the specific outcomes that UK consumers and merchants expect from digital payments. Having a more granular picture of the outcomes and needs of the population of consumers and merchants in the UK is a critical step in establishing a clear vision for the UK payments sector (see also below).

Second, the PSR should be using its understanding of consumer and merchant outcomes to consider where regulatory divergence from European law could result in benefits to UK merchants and consumers. There have been a number of instances already in the past year where the UK has either successfully diverged from other EU countries to deliver specific and positive outcomes for UK consumers and merchants:

- SCA timescales: the FCA is providing UK merchants an additional nine months to implement SCA for e-commerce. The new timeline to 14th September 2021 replaces the previous 14th March 2021 date, which contrasts significantly with the European Banking Authority's approach of maintaining a 31st December 2020 deadline. This is despite evidence of market participants struggling with its implementation[33] and the challenges that merchants across Europe are facing due to the impact of the Coronavirus.

- **Contactless limit increase to £45:** A clear UK success story. The increase has allowed UK cardholders to make larger purchases without entering a PIN and to drastically cut queuing times in shops – a critical necessity in the past year. In the UK, over [redacted] consumer 'touches' were avoided on Visa cards between April and December, as a result of the increase and the FCA's relaxation of step-up requirements. [redacted] The FCA is currently consulting on raising the contactless limit further, having observed no increase in fraud rates after raising the contactless limit to £45. We continue to think that there is a strong case for the UK government revisiting legislation to put in place more flexibility on the overall limit and also on the approach to step up.

In addition to the timelines discussed above, we believe the PSR has a significant opportunity to support the FCA in assessing how SCA requirements may be reassessed in the UK context.

Finally, given the fundamental shifts in the market as a result of COVID-19 since the start of the review, we encourage the PSR:

- to be open to additional evidence as part of this consultation, as well a broad range of results from experiments on remedies implementation given potential changes in the market; and
- to minimise the disruption or unintended consequences to merchants at this time, as merchants of all sizes continue to face unprecedented challenges. This is achievable if the PSR engages substantially with the sector, and undertakes experiments, trials and tests to develop specific solutions that drive the best outcomes for merchants and consumers.

Establishing a clear vision for the sector that is based on consumer and merchant outcomes

Over the past year, it is clear that some outcomes that merchants and consumers expect from digital payments have changed and new outcomes have emerged. The PSR therefore has a unique opportunity to understand the key set of consumer and merchant outcomes it wishes the payments sector to deliver in a post COVID-19 and Brexit world, the obstacles that prevent those outcomes from being secured, and the role that regulation might play in addressing those obstacles. Having a more granular picture of the outcomes and needs of the population of consumers and merchants is a critical step in establishing a clear vision for the UK payments sector.

In many ways, the interim report presents a cards market that is innovating and evolving at pace, delivering well for its merchants and capable of reacting at pace to unknown and unfamiliar challenges. Where the PSR has identified concerns, we recommend the PSR engages with merchants and the sector more widely to understand how these concerns align or rank against its vision of the sector and the consumer and merchant outcomes the PSR believes are important to deliver. This vision can then form the basis of future regulatory priorities.

[33] https://www.pymnts.com/news/regulation/2019/deep-dive-merchant-smb-retail-sca/

Technical Annex - Comments on the PSR's merchant survey

The findings of the PSR's merchant survey undertaken by IFF research provide a technical insight into the supply of card-acquiring services from a merchant point of view. However, we believe there are three key oversights in the PSR's merchant survey work:

- First, the PSR's research is focused on face-to-face payments. We note below that e-commerce has substantially increased in importance for many merchants in the past year and therefore should be represented as such in merchant research work.
- Second, the PSR's questions provide little insight on the value merchants receive from their acquirers, or the range of additional services offered.
- Third, the PSR fails to collect any observations on the outcomes or views of consumers, despite the PSR's stated aim of the review being the determination of whether the card-acquiring market system is working well for merchants, and ultimately consumers.

At a similar time to the PSR's work, we conducted both qualitative and quantitative research with merchants and consumers. The qualitative research involved focus groups and discussions and the quantitative work was conducted online by YouGov with representative samples of merchants and consumers of approximately 2,000 respondents in each. The merchant sample was representative of UK SMEs (1 to 249 employees) that accept card payments. The consumer sample was weighted according to age, gender, social grade and ethnicity.

Owing to the timing of the research, the impacts of the coronavirus pandemic are not reflected in either the PSR's or our own work. As we note above, the ways in which merchants and consumers are engaging with the payment system has changed dramatically over the past 12 months. Taking account of this changing landscape and consumer behaviour will be important as the proposed remedies are finalised.

Interpretation of the PSR's results

Many elements of both the PSR's and our own research identify that the status quo is working very well for merchants in the context of the 'three-As' framework. This framework is typically used by regulators and competition authorities and identifies whether merchants (and consumers) face barriers to searching and switching according to their ability to:

- *Access* information on the price and quality of card-acquiring services;
- *Assess* their own requirements and then compare different offerings of card-acquiring services, and
- *Act* on the information based on a comparison of different offers by staying with their current provider of card-acquiring services or switching to a different one.

The following sections analyse these elements in turn for the PSR's survey results:

Access

If 'Access' to information on the price and quality of card-acquiring services was a problem, we would expect the PSR's findings to show merchant concerns in *finding* information on their acquirers. However, this is not the case from the PSR's merchant survey:

- 89% of merchants agreed that they receive enough information from their acquirers to help understand the price paid for card-acquiring services[34].
- When asked about the reasons why some merchants that have been with the same provider for more than two years, did not consider other providers before choosing their current one, only 5% said the reason was the lack of information about other providers[35].

Furthermore, the PSR's findings suggest that many merchants have made an active choice not to engage or switch acquirer, due to high levels of satisfaction with the current circumstances:

- Satisfaction with their existing acquirer was the number one reason provided by merchants who had not considered switching acquirer in the last two years (64% of merchants)[36].
- When asked why merchants decided not to switch their provider after they considered switching, the most common reasons were that they decided their current deal was the best option or because their existing provider offered a better deal[37].

Assess

A problem in the 'Assess' dimension, would imply that merchants struggle to understand or compare different offerings of card-acquiring services. Again, this is situation is not supported by the PSR's findings:

- Almost three-quarters of merchants had shopped around for providers when they considered switching in the last two years[38].
- Four-fifths of new merchants found shopping around to be easy[39].
- Across all merchant sizes surveyed, a majority found shopping around "easy", with the smallest merchants (up to £380k) finding it easier than medium sized merchants (£1m to £10m)[40].
- Only 1% of merchants who do not shop around (a sample size of 348) said it was because it was too difficult or complicated to compare providers' pricing[41].

---

34 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 17.
35 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 84.
36 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 25.
37 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 27.
38 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 34.
39 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 38.
40 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 85.
41 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 40.

- When asked what would have helped them feel more confident in making their decision about switching, nearly half of merchants said "nothing"[42].

Act

Finally, concerns in the 'Act' dimension would imply very low levels of switching or reports from merchants that they had not considered switching their acquirer, or reports that a complicated switching process was thwarting their desire to find a new acquirer. However, the PSR's research finds the contrary:

- The majority of merchants (58%) had switched or considered switching their acquirer in the past two years[43].
- Of these, 16% had switched card-acquiring services in the last two years. A further 29% hadn't switched but had considered switching, and the remainder were new merchants who had started accepting card payments in the last two years[44].
- 76% of merchants who recently switched found it easy, while only a fifth found it to be difficult[45]. Only five merchants of the sample that considered switching in the last two years didn't switch because they were unsuccessful in carrying it out[46].
- Merchants who negotiate with their providers appear to be generally successful. Of the 21% of merchants that did negotiate with their provider, nearly 90% were successful in negotiating better price or non-price terms[47] with merchants with card turnover between £0 and £1,000,000 being relatively more successful in negotiations than larger merchants[48].

Visa's merchant research

Many of the PSR's findings chime with our own research completed at a similar time:

- **Switching current services:** The PSR's research found that 16% of merchants have switched card-acquiring services in the last two years[49]. Our own research found that 17% of merchants had switched in the past two years.
- **Ease of switching:** The PSR's research found that 76% of merchants who had switched found it easy to switch card-acquiring services [50]. Our own research found that 75% of all merchants found their own provider easy and quick to sign up with.

However, our own research also presented some additional important observations. In addition to the PSR's work, we found that:

- Of merchants who had switched in the last two years, 42%, would consider doing it again.

---

42 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 30.
43 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 22.
44 Ibid.
45 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 29.
46 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 27.
47 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 15.
48 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 71.
49 Ibid.
50 PSR's Card-Acquiring Market Review: Merchant survey results, September 2020, slide 29.

- Merchants value reliability more than any other acquirer attribute. Reliability was also the attribute that acquirers were performing best at.
- The cost of taking payments was not a significant determinant in explaining the difference between merchants who would consider switching and those who would not.
- In the round, merchants do not consider payment processing as a significant cost. Only 9% of merchants reported processing payments at all when asked what items impact their ability to make a profit. Furthermore, in focus group discussions merchants said that acquiring costs matter less because they are largely a small, marginal cost, not an overhead.
- In terms of the main challenges facing their business - merchants cited Brexit uncertainty (37%) and changing customer behaviour (27%) as their most pressing concerns.
- On value added services, our research also provides useful insights. The service considered most important by merchants is fraud protection (71%). Issuing invoices, data and analytics on payments and e-commerce gateways are all reported as important or quite important by over half of merchants surveyed.

Visa's consumer research

Consumers' experience of cards is very positive, with a focus on protection from fraud, trust and speed of payments:

- Most consumers welcome the perceived move towards digital payments. Most consumers are happy with the transition and believe it is being driven by their own preferences. Consumers generally think the increasing use of cards to make payments is a positive change.
- General consumer attitudes to cards are related to protection from fraud and trust. Consumers believe it is in card companies' interests to protect consumers and businesses from fraud, and that using a debit or credit card means the business they are buying from can be trusted.
- Fraud is the top priority for consumers. 68% of consumers agree that preventing fraud should be a top priority for card scheme companies and their investments.
- In addition, consumers expect there to be continuing innovation, partly to combat fraud, partly to continue making payments more efficient and informative. 63% of consumers in our research agree that new technologies for making payments are broadly a good thing, whereas 37% of consumers agree that the greater use of technology in making payments makes fraud less likely.

Worldpay

worldpay
from FIS

PSR MARKET REVIEW INTO THE SUPPLY OF CARD-ACQUIRING SERVICES

Worldpay response to the Interim Report

9 February 2021

Confidential version

[redacted] [redacted]

Contents

Introduction and summary 3

1. Market structure and competition in the supply of card-acquiring services 20

2. Worldpay's response to the intense levels of competition in the supply of card-acquiring services 45

3. Pass-through of savings from interchange fee caps under the IFR 57

4. Merchants search and switch between providers of card-acquiring services 93

5. Merchants are contractually free to search and switch 112

6. Worldpay's response to the Interim Report's proposed remedies 130

INTRODUCTION AND SUMMARY

Introduction

1. On 15 September 2020, the PSR published an interim report (the "**Interim Report**") setting out the preliminary findings from its market review into the supply of card-acquiring services in the UK ("**Market Review**"), which had the purpose of determining whether the supply of card-acquiring services was working well for merchants, and ultimately consumers.

2. The Interim Report provisionally finds that certain features of the supply of card-acquiring services are "*causing harm to small and medium-sized merchants with annual card turnover up to £10 million and large merchants with annual card turnover up to £50 million*".[1] The Interim Report also outlines high-level approaches that are being considered to remedy the features that it considers "*restrict those merchants' willingness and ability to search and consider switching provider*".[2] The PSR has invited stakeholder feedback on the interim findings and potential remedies.

3. Worldpay has appreciated the opportunity to engage fully and proactively with the PSR throughout the Market Review, including responding to requests for information, participating in the virtual data rooms via its external advisers and attending meetings with the PSR. Worldpay looks forward to continuing to engage in a proactive and positive fashion, including throughout any remedies consultation process.

4. However, based on the content and analysis contained in the Interim Report, and along with the additional materials that have been made available to Worldpay and its expert advisers, Worldpay respectfully disagrees with a number of the preliminary findings and conclusions set out in the Interim Report, as described in paragraph 5 below. In this respect, Worldpay has concerns relating to preliminary findings in the Interim Report that appear to be based on the following factors:

   (a) an econometric analysis of pass-through;

   (b) a financial review analysis;

   (c) evidence relating to merchant searching and switching; and

   (d) evidence linked to differences in outcomes for new and existing customers.

5. Whether considered individually or together, these factors do not support a finding that the supply of card-acquiring services is not working well, particularly when contrasted with evidence demonstrating that the retail payments market is highly competitive. Worldpay's concerns regarding each of these factors are set out in detail in this response to the Interim Report (the "**Response**"), and summarised further below in the context of the specific chapters of this document. However, by way of initial remarks, taking each of these in turn:

---

1 Interim Report, paragraph 7.34. The Interim Report defines small and medium-sized merchants as businesses with annual card turnover up to £10 million ("**SME Merchants**"). [redacted]

2 Interim Report, paragraph 7.35.

(a) The analysis of pass-through

(i) It is not correct to state that: "[m]*erchants with annual card turnover up to £50 million received, on average, little or no pass-through of the* [Interchange Fee Regulation ("**IFR**")] *savings*", as the Interim Report and associated publicity did.[3]

(ii) In fact, the data obtained from operators when assessed using a more conventional methodology that captures pass-through of changes in interchange fees demonstrates very high levels of IFR pass-through (see paragraph 23(a) – 23(b) below).

(b) Financial review analysis

(i) The Interim Report's preliminary finding that "*acquirer net revenue*"[4] as a percentage of card turnover increased between 2014 and 2018 for the five largest acquirers does not provide a reliable evidential basis to conclude that "*acquirers may not have fully passed on the IFR saving to merchants*".[5] It is widely accepted that acquirer net revenue is a partial measure and will not provide a complete measure of acquirers' costs, revenues or profits. [redacted]

(ii) There would in any event be numerous explanations for any increase in acquirer net revenue unrelated to the introduction of interchange fee caps. These include: (a) changes to operating and capital expenditure costs (which have increased since 2014); (b) investments in measures designed to increase choice, quality and innovation; (c) changes in acquirers' business and pricing strategy; and (d) changes in demand trends and other external factors (such as the impact of economic cycles). The Interim Report does not consider or control for these factors and, consequently, the analysis is not capable of demonstrating on a reliable basis a causal link between acquirer net revenue and the introduction of interchange fee caps under the IFR.

(c) Evidence relating to merchant searching and switching

(i) Contrary to the conclusion reached in the Interim Report, levels of switching observed in the data used to support the Interim Report's preliminary findings are substantial, both in absolute and relative terms across the categories of merchants assessed. Evidence supporting this is set out in detail in chapter 4 (and summarised in paragraphs 25 - 29 below).

(ii) [redacted]. Providers of card-acquiring services aggressively compete for the custom of merchants, and merchants experience no difficulty identifying when

3 Interim Report, page 56 and PSR Press Release, 'PSR announces provisional findings of card acquiring market review' (15 September 2020).

4 Interim Report, paragraph 3.14. The Interim Report defines acquirer net revenue as the costs acquirers incur (other than interchange fees and scheme fees) to provide card-acquiring services, plus the acquirer's margin.

5 Interim Report, paragraph 5.11.

they might switch, shopping around to explore and compare their options and, unless satisfied with their current provider, switching to a rival provider. This is also consistent with the results of evidence taken from the 'PSR Card-Acquiring Market Review: Merchant survey results, September 2020' (the "**IFF Survey**").

(iii) Similarly, as explained in chapter 5 of this Response, evidence provided by the IFF Survey does not suggest that contractual terms gives rise to barriers to searching and switching. [redacted]

(d) Evidence linked to differences in outcomes for new and existing customers

(i) The Interim Report finds that new customers pay less than longstanding customers, i.e. merchants can benefit from a lower merchant service charge ("**MSC**") when switching their provider of card-acquiring services. However, analysis carried out by Worldpay's external advisers of the data provided in the virtual data room suggests that the Interim Report's analysis has materially overstated the extent to which merchants can pay lower MSCs after switching.

(ii) In this regard, section 5 of the technical annex to this Response (the "**Technical Annex**"), shows that the Interim Report methodology is not robust to minor changes in specification. In particular, controlling for trends in MSCs over time and adopting a start-year control variable instead of age control variable significantly lowers the estimated benefits of switching. As a result, Worldpay considers that the new versus longstanding regressions results referenced in the Interim Report cannot be used to support switching remedies.

Contrary evidence confirming competitive market conditions

6. It is noted that the specific evidence and analysis that has been relied on for the purposes of the Interim Report's preliminary findings is largely retrospective, whereas careful thought needs to be given to trends and developments impacting card-acquiring services that are either yet to occur or whose effects are yet to be fully realised. The retail payments market is going through a particularly intensive period of competition and other competition regulators that have recently examined competition in retail payments, including the UK Competition and Markets Authority ("**CMA**") and the European Commission, have found competitive conditions in this market. In particular, those regulators have identified the "*fast-moving and dynamic*" competition and innovation taking place in the sector[6] and the potential for so-called "**Big Tech**"[7] firms to disrupt the traditional card payments model through the "*the emergence of innovative, instant means of payments*".[8] Indeed, these findings emphasise the challenges faced by traditional providers, such as Worldpay, from technological disruption and new entry by Big Tech firms: for example, a market study published by the Dutch competition authority in December 2020 has noted the role of Big Tech firms acting "*as a driving force behind*

6 CMA, Final report in relation to 'Completed Acquisition by PayPal Holdings, Inc. of iZettle AB' (12 June 2019) ("**Paypal/iZettle**"), paragraph 10

7 The phrase "**Big Tech**" is generally used to describe a small group of global IT firms, including Facebook, Amazon, Apple and Google, many of whom have started expanding into the provision of retail payments services in recent years.

8 European Commission, 'Report on the application of Regulation (EU) 2015/751 on interchange fees for card-based payment transactions' (the "**IFR Report**"), (29 June 2020) pages 3-4.

competition and, by extension, behind innovation" and has recommended changes at the EU level to ensure payment services are not "*dominated by one or several major* [Big Tech] *competitors*".[9]

7. The procompetitive features that Worldpay respectfully suggests are present in this market include:

   (a) new entry, including by completely new categories of provider and fast paced technical innovation, is constantly changing the way consumers pay for things. Indeed, with the possible exception of smart phones, it is difficult to think of a market that has been subject to more innovation than payments in the last five years and where that innovation continues apace. Consistent with economic principles, the degree of innovation across all aspects of payment services reflects robust competition in retail payments and will continue to enhance it;

   (b) despite intensive investment, the share of supply of the leading acquirers has declined steadily in the last three years, as their merchant customer base seeks out and takes advantage of new competitive options; and

   (c) there is no evidence, and no analysis has been advanced, to suggest that acquirers or other competitors are earning supra-competitive returns on capital in this market.

8. It is important that a holistic and forward-looking approach to the examination of competition is taken in this Market Review, as other competition regulators have done in recent cases involving payment services. As explained in further detail below, Worldpay does not consider that upcoming market developments have been sufficiently taken into account in the context of this analysis, for example:

   (a) the pace of technical and competitive change noted above, which is transforming acquiring into a broader payments solutions industry serviced by a plethora of new and previously unrecognisable competitors; and

   (b) the host of pro-competitive regulatory initiatives, including the IFR business rules, PSD2 and the New Payments Architecture ("**NPA**"); some of which are in place but whose effects are still being worked through, others of which are yet to arrive.

9. This wider evidential context of competitive conditions in the sector as a whole is inconsistent with a conclusion that the supply of card-acquiring services is not working well. Moreover, these observable competitive conditions are, it is suggested, clearly distinguishable from a situation of market failure or adverse market features that would otherwise conventionally be required to justify market interventions of the type being considered in the Interim Report. Given this, Worldpay considers that there is no evidential basis to support a conclusion that the supply of card-acquiring services is not working well, and therefore no justification or legal basis upon which to impose the proposed remedies.

10. In light of the points above, Worldpay emphasises that the potential for any remedy to be ultimately unnecessary and thus disproportionate is high. Substantive remedies may also give rise to unintended negative consequences, including higher transaction costs, reduced choice and potentially chilling effects upon competition. This is particularly the case given competition in the supply of card-acquiring services is currently delivering positive merchant outcomes,

9 Authority for Consumers & Markets, '[Big Tech and the Dutch payment market: tightening of rules needed to maintain a level playing field]' (1 December 2020).

including high levels of choice, customer service, quality and innovation, and competitive prices.

11. Notwithstanding the above, Worldpay will continue to engage proactively and constructively with the PSR, including during the course of any remedies consultation. Worldpay supports the PSR's objectives to deliver better outcomes for users of payments systems and is also supportive of efforts to secure access, particularly of microbusiness merchants, to a wide range of competitive payment products. Worldpay looks forward to a continuing dialogue with the PSR in this regard.

12. The points set out above and supporting evidence are developed in further detail in this Response, which consists of six chapters. These six chapters are summarised in the remainder of this 'Introduction and summary'.

Summary

Chapter 1 – market structure and competition in the supply of card-acquiring services

13. The structures and features of the retail payments market and the conduct of market participants are both conducive to and evidence of intense competition for the supply of card-acquiring services. These features, as well as increasing levels of choice, customer service, quality and innovation to the benefit of service users, indicate healthy competition. However, Worldpay submits that these factors should have been given considerably more weight in the Interim Report's assessment of whether the supply of card-acquiring services is working well, and that there are a number of elements which have not been taken sufficiently into account.

14. In this chapter, Worldpay agrees with the preliminary findings in the Interim Report that there are no significant barriers to entry and expansion, as demonstrated by significant entry of new players and erosion of the share of supply of established players. For example, the Interim Report acknowledges that the overall share of supply of four of the five largest acquirers has steadily declined in recent years.[10]

15. Worldpay also agrees that there are a large number of active players in the supply of card-acquiring services. The Interim Report identifies more than 100 acquirers and 50 payment facilitators that already supply card-acquiring services in the UK[11] (in addition to more than 60 ISOs[12] and a similar number of retail banks that could, in principle, enter the supply of card-acquiring services as others have successfully done in the recent past). This is evidence of a dynamic and competitive retail payments market, in which acquirers are competing to supply card-acquiring services with a vast array of traditional and new players, which has and will continue leading to innovation and positive outcomes for merchants.

16. This chapter highlights a number of market structure features and elements that Worldpay considers have not been sufficiently taken into account in the Interim Report. In particular:

(a) firstly, for the purposes of its analysis, preliminary findings, and potential remedies, the Interim Report has segmented merchants into different categories based on annual card turnover (e.g. SME Merchants with turnover below £10 million; large merchants with turnover between £10 million and £50 million; and the largest merchants with

---

10 Interim Report, paragraphs 3.48 – 3.49.

11 Interim Report, paragraph 3.44.

12 Interim Report, paragraph 3.80.

turnover above £50 million). However, as explained throughout this Response, merchants of different sizes within these broad categories have materially different requirements (for example, based on their need for terminals, online and/or card-present transactions, and customer and transaction mix).[13] It is not appropriate to consider and impose remedies on the basis of preliminary findings that adopt the segmentations currently set out in the Interim Report;

(b) secondly, the Interim Report does not sufficiently take into account the importance of non-price elements of competition in the supply of card-acquiring services, such as offering merchants choice, customer service, quality, and innovation across a range of products. Significant competition takes place between providers based on these parameters, leading to positive merchant outcomes, and in many cases driven specifically by merchant demand. Worldpay has submitted evidence providing examples of its initiatives to compete on the basis of non-price factors, such as the introduction of various new tariffs, card-acceptance products and quality enhancements. It is important that this is recognised and appreciated in any final conclusions drawn in this Market Review;

(c) thirdly, omnichannel services and integrated payments are areas of intense competition within the card-acceptance value chain, which means that providers of card-acquiring services face actual and potential competition from an increasingly broader set of firms than traditional providers; and

(d) fourthly, significant technological and regulatory changes are having a material impact on the market and the way competition works. The Interim Report's analysis is largely retrospective, whereas careful thought needs to be given to trends and developments that are either yet to occur or whose effects are yet to be realised. The importance of taking a forward-looking assessment has been recognised by both the CMA and the European Commission in their recent examinations of card payments.[14] Similarly, there is significant innovation and transformation occurring in the payments industry, such as: the emergence of new methods of payment acceptance and new cryptocurrencies; the expansion of Big Tech firms into the payment sector (such as Amazon, Google, Alipay, and Facebook); the entry and expansion of Fin Tech firms; and a new regulatory environment (for example, due to PSD2 and the introduction of Open Banking) which will further stimulate innovation and competition in the retail payments market.

17. Finally, this chapter explains the impact that COVID-19 has had to date on the payments sector, which is likely to have longer term implications in this market. Worldpay has been working throughout the pandemic to support customers and assist in helping businesses return to business as usual during the initial phases of lockdown. COVID-19 has also accelerated the consumer and merchant demand for new technology and alternative payment methods,

---

13 This is most notably the case in the Interim Report's examination of the IFF Survey, which surveyed 1,037 merchants and summarised the results across three SME segments. However, the Interim Report reaches its preliminary findings and identification of potential remedies without meaningful consideration of the differences between these customer groups, in most cases reporting the outcomes of the survey in aggregate across all segments of SME merchants.

14 The CMA described the payment services industry as "*a fast-moving and dynamic market*" in PayPal/iZettle and commented on the "*rapid growth*" and potential for "*disruption to the current state of competition*" in light of technological and commercial developments (paragraph 10). Similarly, in the IFR Report, the European Commission referred to shifting competitive dynamics arising from "*the emergence of innovative, instant means of payments*" (page 3) and "*entry of innovative suppliers of financial services, such as FinTechs and BigTechs*" (page 4).

which will further increase innovation and competition in card-acquiring and between payment systems going forward.

Chapter 2 – Worldpay's response to the intense levels of competition

18. Chapter 2 of this Response provides further information on how Worldpay itself has driven, adapted to and responded to this intense, and increasing, competition, in particular since 2014.

19. In this regard:

(a) Worldpay has driven and responded to an increasingly competitive environment for the supply of card-acquiring services in a number of ways, such as offering merchants greater choice in terms of pricing proposition, product offering and add-on services, an improved card-acquiring service and a higher quality card-acceptance proposition overall. [redacted] and

(b) since 2014, Worldpay has expanded its service provision across the card-acceptance value chain, including the launch of new card-acceptance products, omnichannel services and value-added products. Worldpay has also entered into new innovative partnerships with providers of complementary payments and business services, such as independent software vendors ("**ISVs**"), which has resulted in merchants receiving new and innovative collaborations.

20. [redacted]

21. Finally, as explained in chapter 1 of this Response, the COVID-19 pandemic has had an unparalleled impact on the UK economy and the payments sector as a whole. Chapter 2 explains Worldpay's specific response to this pandemic, and the actions taken to support smaller merchants that have been affected by business disruption as a consequence of the UK Government's 'lockdown' policy. These initiatives illustrate the role that acquirers are expected to perform by merchants as trusted providers of payment services and highlights the importance of understanding and assessing the provision of these services in a way that fully captures non-price factors, including the quality of service provision.

Chapter 3 – Pass-through of Savings from Interchange Fee Caps under the IFR

22. As noted above, one of the areas of concern raised in the Interim Report is that "[m]*erchants with annual card turnover up to £50 million received, on average, little or no pass-through of the IFR savings*".[15] This conclusion is based on: (i) an econometric analysis of pass-through rates; (ii) financial data on "*acquirer net revenue*"; and (iii) an analysis of internal survey metrics and unit cost data. However, as set out in detail in chapter 3 of this Response, the conclusions reached in the Interim Report as to the low rate of pass-through are not in fact supported by the evidence cited connection with the analysis carried out in the Interim Report. Modelling Worldpay and its external advisers have conducted using a more conventional

15 Interim Report, page 56.

methodology to measure rates of pass-through, and correcting for errors in the PSR's analysis, reaches the opposite conclusion to the Interim Report.

23. In particular:

(a) at the outset we would note that the methodology employed to assess pass-through for the purposes of the analysis in the Interim Report differs from the more conventional methodological approaches that were initially identified and consulted upon by the PSR in February 2019 (the "**Pass-through Consultation Paper**"). For the reasons set out in more detail in chapter 3 of this Response, the adopted methodology does not follow a conventional approach as would be required to provide a robust evidential foundation and as a result does not measure rates of pass-through in any meaningful sense;

(b) in contrast, the results revealed by the analysis undertaken by Worldpay's external advisers is based upon a more robust and conventional methodology and provides a more accurate measure of pass-through compared to the approach adopted in the Interim Report. Importantly, on the basis of this methodology, there is no evidential basis on which to conclude that merchants with annual card turnover of less than £50 million received little or no pass-through. Moreover, this analysis records a clear finding that merchants with annual card turnover above £1 million received very high levels of pass-through, of over 80%;

(c) the Interim Report has also departed from the profitability analysis that was originally consulted on by the PSR in July 2019 (the "**Profitability Consultation Paper**"). Instead, a partial measure of "*acquirer net revenue*" (as a percentage of card turnover) has been adopted that does not enable reliable conclusions to be reached on the impact of interchange caps under the IFR on the costs, revenues, or profits of card-acquiring services. There would in any event be numerous explanations for any increases in acquirer net revenue, unrelated to the introduction of interchange fee caps, as the Interim Report itself recognises.[16] By failing to consider and control for these factors, the analysis is not capable of demonstrating on a reliable basis a causal link between acquirer net revenue and the introduction of interchange fee caps under the IFR, or whether acquirers have passed on any savings following implementation of the IFR;

(d) [redacted]; and

(e) the analysis in the Interim Report has not considered improvements in choice, quality or innovation.[18] In particular, it has only looked at a limited subset of internal service metrics [redacted] which does not capture the full array of product developments that have taken place, [redacted] The Interim Report's

[16] Annex 3 to the Interim Report, paragraph 1.51 ("*there could have been other factors that may have led MSC and acquirer net revenue to vary over the five years, including: changes to operating costs, changes in the volume and value of transactions acquired, changes in services and changes in the business environment*").

[17] Interim Report, paragraph 3.53.

[18] Specific examples Worldpay's product developments are provided in chapter 2 of this Response.

assertion that an absence of unit cost increases – based on partial cost data submitted by two acquirers – provides evidence of a lack of non-price pass-through is fundamentally flawed,[19] both as a matter of economic theory and in practice. Quality, choice and innovation have all improved over the five-year period considered by the Interim Report, in a sector that is undergoing a period of rapid and unprecedented change, as set out in the previous chapters.

24. In any case, as previously explained to the PSR, it is not possible to conclude on a reliable basis what level of pass-through rate is consistent with limited competition for the supply of card-acquiring services.[20] There is no meaningful benchmark against which to compare the pass-through rate. It is widely recognised that lower pass-through rates can be found in more competitive industries and higher ones in less competitive ones.

Chapter 4 – Merchants search and switch between providers of card-acquiring services

25. The Interim Report states that its preliminary finding regarding pass-through "*suggests there may be features in the supply of card-acquiring services that restrict merchants' willingness and ability to search and switch*".[21] However, as explained in detail in chapter 4 of this Response, Worldpay considers that there is no evidential basis for this conclusion. Indeed, under the position taken in the Interim Report regarding pass-through and competitive intensity, the very high rates of pass-through, as calculated by Worldpay, are consistent with a market where merchants have no difficulty in exploring alternative options.

26. Firstly, the evidence demonstrates that merchants search for and switch to alternative providers in significant numbers consistent with a competitive market, under the position taken in the Interim Report regarding search, switching and competitive intensity. This is confirmed by evidence from the IFF Survey and additional survey data. [redacted] In relation to frequency of merchant searching and switching, the IFF Survey found that of 1,037 merchants:

(a) 29% of respondents had either switched provider within the last two years or had started accepting card payments (i.e. were new merchants)[22]; and a further 29% of respondents had considered switching in the last two years. This means that at least 58% of merchants could be considered as marginal consumers (i.e. merchants that acquirers could compete for);

(b) moreover, in relation to the remaining 42% of respondents (i.e. those that responded that they have not considered switching in the last two years): 64% of those merchants stated that this was because they were satisfied with their current provider and a number of merchants specifically noted that they were happy with the price of their current provider;[23] and

19 Interim Report, paragraph 5.37. The Interim Report even recognises that "*care needs to be taken in generalising*" on the basis of the unit cost data examined.

20 See Worldpay's response to the PSR's pass-through methodology consultation (March 2019), paragraphs 2.6-2.14 and 2.33-2.41.

21 Interim Report, paragraph 6.2.

22 16% of respondents had switched and 13% were new merchants.

23 Other survey respondents gave a variety of reasons for not considering switching in the last two years, including 8% of merchants that responded they "*hardly use card services*". Only ten merchants (out of 448 respondents) suggested that it would cost them too much to switch (IFF Survey, slide 25). Other

(c) the IFF Survey confirms that there are no material barriers to switching. The results confirm that the vast majority of merchants that have switched found the process of switching easy, and there were very few responses that referred to either impediments to switching or the cost of switching as the reason for not considering switching. Moreover, around 40 per cent of merchants that have been with their acquirer for more than two years have tried to negotiate better terms, which provides further evidence of effective competition in the market.

Further evidence is set out in detail in chapter 4 of this Response.

27. Secondly, there is considerable evidence that competitors are competing strongly for merchants, and indeed one of the main that reasons merchants may choose not to switch is due to satisfaction with their current provider. This is confirmed by various results of the IFF Survey. For example, 82% of respondents that contacted their main provider in the last year were satisfied with the customer service received and, as noted above, of merchants that have not switched or considered switching in the last two years, 64% responded that they were satisfied with their current provider, and other merchants specifically noting that they were happy with the price of their current provider.

28. Customer satisfaction is driven by the significant product development and customer engagement that takes place in response to merchant demands and competition. [redacted] Worldpay also notes the finding from the IFF Survey that of the merchants who had attempted to negotiate better terms with their provider, 88% had been successful, and of those that did not, 51% said this was because they were happy with their current terms.

29. Thirdly, this chapter sets out Worldpay's position that the features identified in the Interim Report, including the variability in pricing structures, the absence of published prices, and restrictions in contracts for card-acquiring services and POS terminal hire, do not constitute barriers to searching and switching. The Interim Report has specifically identified "*the absence of published prices, and the complexity of comparing prices quoted by different firms due to the variation in pricing structure*, [creating] *a search cost*…". However, various providers of card-acquiring services have introduced simplified pricing structures in response to merchant demand, whilst still maintaining and protecting the existing degree of merchant choice. In addition, the evidence from the IFF Survey does not support the position that availability of published prices or complexity of comparability are a problem for merchants:

(a) 89% of respondents said that they receive enough information in order to understand the price they pay for card-acquiring services;

(b) 76% of respondents that had switched within the last two years said that the switching process was easy; and

(c) in relation to merchants that stated that they never shop around, 54% of respondents said that this was because they were satisfied with their current provider (other merchants responded that they: hardly use card services; are approached by third parties with offers so do not need to shop around; have only recently joined their provider or have not been with them for that long; and are happy with the price of their

---

positive responses included, for example, that the provider has a good reputation; ease of use of current system / uncomplicated; it was not the respondent's decision; the innovative payment products they offer; and client / customer lead decision.

current provider). Only 1% of respondents said that this was because it was too difficult or complicated to compare providers.

Other features identified in the Interim Report are addressed further in chapter 5 of this Response.

30. Finally, the statements in the Interim Report suggesting that because prices may in some instances be lower for new customers, higher switching levels are necessary to demonstrate that the market is working well, are misconceived. The presence of low prices for new customers demonstrates that the market is working well, with providers competing strongly to attract new merchants. Conversely, as explained above, analysis carried out based on the material in the virtual data room indicates that [redacted]

Chapter 5 – Merchants are contractually free to search and switch providers

31. As explained in chapter 4 of this Response and referenced above, Worldpay does not agree with the preliminary findings in the Interim Report regarding merchant searching and switching. In this context, the Interim Report has sought specifically to assess whether contractual provisions in contracts for card-acquiring services and POS terminal hire could contribute to these searching and switching interim findings.

32. The results of the IFF Survey do not suggest that existing contractual arrangements are a barrier to switching. For example, only 4% of merchants that were asked to explain why they had never considered switching indicated that they felt they could not switch provider as they were currently in a contract, and when merchants were asked what would make them consider switching in the future, only 1% of merchants said that the expiry of a contract would make them consider switching in the future (of whom, only "*a few*" of these 1% of merchants stated that this was in relation to a contract with a provider of card-acceptance products).

33. However, despite the IFF Survey confirming that merchants do not consider there to be contractual barriers to searching and switching, the Interim Report has identified a number of contractual features of concern, i.e.: (i) the "*indefinite*" duration of card-acquiring contracts, with an absence of so-called "*trigger points*" meaning merchants do not think to switch; and (ii) features of ISO and acquirer POS terminal hire contracts, in particular which automatically renew for successive fixed terms. These concerns are addressed in detail in chapter 5 of this Response, and summarised below.

34. In relation to the "*indefinite*" duration of card-acquiring contracts:

(a) the analysis in the Interim Report is premised on a link between trigger points and merchants' interests in searching and switching; however, Worldpay does not consider that there is any evidence in the Interim Report to support this premise;

(b) in any event, merchants of all sizes encounter a number of different trigger points throughout their relationship with providers of card-acquiring services, such as monthly invoices, price change notifications, contact by rival providers and their representatives, competitor advertising, change or expansion of card-acceptance services, and relationship management and other customer service interactions between providers and their merchants. All these examples, which are discussed in detail in chapter 5, provide merchants with the opportunity to reflect on the service received from their provider of card-acquiring services, and to consider whether their provider is able to meet their needs going forward; and

(c) there are material benefits arising from the current arrangements that must also be taken into account. In particular, the availability of evergreen contracts provide merchants with more comfort and security in terms of operational continuity.

35. [redacted] Finally, as recognised in the Interim Report, it is important that the benefits to merchants of any contractual arrangements are taken into account. In this regard, the automatic renewals for merchants provide guarantees in terms of operational continuity.

Chapter 6 – Worldpay's response to the proposed remedies

36. As noted above, on the basis of the preliminary findings in the Interim Report, Worldpay does not consider there to be a robust evidence base to conclude that the supply of card-acquiring services does not work well for merchants with annual card turnover below £50 million. Worldpay therefore does not consider the remedies in the form currently contemplated in the Interim Report to meet the legal requirements of proportionality and, in particular, believes that their implementation could lead to a number of unintended consequences. These concerns are explained in detail in chapter 6 of this Response.

37. Notwithstanding these concerns, Worldpay will engage constructively and in open dialogue with the PSR and the payments industry as a whole throughout any subsequent consultation process. In this regard, Worldpay sets out below its comments on the types of measures that may be appropriate to consider in further detail, in particular, by focussing on and limiting their application to the smallest merchants. However, as explained in chapter 6:

(a) evidence gathered primarily from merchants with annual card turnover below £10 million, and which does not take account of the significant differences between merchant segments, cannot be used to justify remedies imposed on merchants in larger turnover categories, including merchants with annual card turnover between £10 and £50 million;

(b) Worldpay does not understand the legal or evidential basis to impose remedies that are effectively akin to consumer protection measures in respect of merchants exceeding the smallest turnover categories. In particular, there is no basis for the imposition of such remedies upon merchants with annual card turnover above £1 million (and more specifically turnover equating to the category of the smallest merchants with turnover that does not exceed say £380,000[25]) and £10 million and, in turn, of up to £50 million; and

---

24 [redacted]

25 The Interim Report introduces £380,000 as its definition of the "*smallest merchants*", which account for 90% of the overall merchant population (paragraph 1.13).

(c) in any event, the remedies that have been proposed in the Interim Report would not fulfil the legal requirements of proportionality, especially if implemented in their current form. There are more appropriate and less onerous alternatives to the remedies outlined in the Interim Report, which in Worldpay's view should be limited to merchant segments below the £380,000 annual card turnover threshold.

Proposed remedy 1: requiring all contracts for card-acquiring services to have an end date

38. Worldpay would have significant concerns with the imposition of a contractual end date for card-acquiring services that could potentially result in any interruption to merchants' provision of payment services at the end of their contract, which could significantly affect their business and operational continuity and merchants' overall revenue. [redacted]. Nevertheless, Worldpay would reiterate that such a remedy could have unintended consequences for merchants, and that there is no evidence to support the fact that a contractual end date would improve upon the levels of switching (which are, in any event, high in comparison to a number of other industries) given, for example, the numerous 'trigger points' that already exist (as explained in chapter 4 of this Response).

39. In light of this, there are likely to be more effective and proportionate measures other than imposing a contractual end date, that could be considered. For example, it is noted that in some consumer markets, annual communications have been used to promote consumer switching behaviour. In this context, similar type of communications to those currently sent to regulated merchants under terminal rental hire agreements ("**RHA**") under the Consumer Credit Act 1974 ("**CCA**"), i.e. in order to remind or 'prompt' customers to consider their current relationship with their provider of card-acquiring services, may be appropriate for the smallest merchant segment. Worldpay would welcome the opportunity to discuss the possibility of this type of remedy with the PSR during any remedies consultation process.

Proposed remedies 2 and 3: limiting the length of POS terminal contracts, for example to align with the 18-month limit set in the Consumer Credit Act 1974; and ending POS terminal contracts that automatically renew for successive fixed terms

40. Worldpay provided an overview of its existing business practices with respect to POS terminal hire during the 30 November Meeting, and these are also summarised in chapter 5 of this Response. [redacted] Given these circumstances, imposing an 18-month term limit on POS terminal hire contracts for SME Merchants, and preventing the "*automatic renewal*" of successive fixed terms in these contracts, may be technically feasible [redacted]

41. However, it would be necessary to discuss further the operational aspects of these proposals during any remedies consultation to fully understand the impact to acquirers, ISOs and merchants. The following considerations, among other things, would need to be fully taken into account in the design of this remedy:

(a) the Interim Report does not explain why it is necessary to limit the choice available to merchants, who may have legitimate business reasons to enter into longer contractual arrangements to suit their individual business needs and requirements, for reasons including negotiating lower prices, to ensure business continuity or to minimise administrative cost. It is important that any proposed remedy relating to POS terminal hire contracts does not have the unintended consequence of increasing terminal hire prices, reducing merchant choice and undermining merchants' freedom to choose the contractual arrangements best-suited to their business needs; and

(b) the Interim Report has not explained why preventing contractual renewals or setting contract term limits for POS terminals to align with consumer credit legislation would be proportionate or effective, particularly in circumstances where SME Merchants do not consider the duration of contractual terms to be a material factor when making switching decisions, and where SME Merchants already have opportunities to switch their providers of POS terminal hire during their contractual term.

Proposed remedy 4: linking the contracts for card-acquiring services of POS terminals (for example, by making it easy to exit POS terminal hire contracts if terms change in the card-acquiring services contract without incurring termination fees)

42. [redacted]

43. [redacted] In particular, the Interim Report does not establish an evidential basis that early termination fees in these circumstances represent a barrier to searching and switching to justify the imposition of a remedy linking these contracts in this manner.

44. As a related point, Worldpay would note that there are numerous justifications for the application of legitimate early termination fees by acquirers and ISOs in appropriate circumstances, such as the recovery of fixed costs associated with the provision of POS terminals. There is a risk that interfering with the ability of acquirers and ISOs to implement early termination fees may have adverse consequences for merchants, requiring such fixed costs to be recouped by increased charges to all merchants. It is therefore important that any remedies considered that would impact the application of early termination fees take into account legitimate and justifiable reasons for their use.

A requirement that standalone POS terminals are interoperable between acquirers

45. [redacted]

46. The Interim Report does not, in the first place, provide any justification for an interoperability POS terminal remedy, nor does it identify any features that such a remedy is intended to address. As such, Worldpay would have serious concerns were such a fundamental intervention to be considered further.

47. In any event, [redacted], there are range of issues that would need to be considered in detail before a remedy requiring POS terminal interoperability could be proposed, which would require cross-industry support and may create significant costs for market operators. These issues are detailed further in chapter 6 and summarised below:

(a) **Technical interoperability**: Although there are varying degrees of standardisation within the POS terminal ecosystem, in practice, implementations vary between acquirers, terminal manufacturers, and other parties. Enabling terminal interoperability between acquirers would require a large programme of standardisation across the POS terminal ecosystem, for example, in respect of the terminal management software that acquires use to remotely manage their POS terminal estates.

(b) **Security**: Detailed consideration would need to be given to how the necessarily high level of security and encryption in today's POS terminals would be maintained in an environment where terminals are interoperable between acquirers, including processes to ensure that existing encryption keys can be securely and easily updated when merchants switch between acquirers.

(c) **Terminal addressing**: To enable widespread terminal portability, an industry-wide system would need to be developed whereby unique identifiers, known as Terminal IDs, could be managed and migrated between different acquirers on a large-scale.

(d) **Commercial implications**: The introduction of terminal interoperability would likely have significant commercial implications, including additional costs, for the provision of POS terminals. These costs could impact the prices merchants face for POS terminal provision, which must be carefully balanced against any perceived benefit merchants may gain from terminal portability.

(e) **Merchant convenience**: it is important that merchants do not risk losing many of the benefits of having a "*one-stop shop*" provider of card-acquiring services and POS terminals, which the Interim Report acknowledges is important to merchants.[26]

Proposed remedy 5: Comparable pricing information and tools facilitating price comparison

48. Finally, the Interim Report provides limited information as to what types of remedies or comparison tools it may consider appropriate to address its preliminary findings regarding unavailability or complexity of pricing information. [redacted]

49. The IFF Survey evidence does not support any preliminary finding that lack of comparability is a problem for merchants requiring the imposition of market remedies; as noted above, 89% of merchants responded that they receive enough information in order to understand the price they pay for card-acquiring services. Worldpay supports the principle that merchants should understand the prices they pay for card-acquiring services. However, it is also important that merchants can choose between acquirers on the basis of other non-price factors, such as settlement speed, resilience, security and account support. Worldpay currently has concerns as to how any 'overall rate' would adjust for these non-price factors. There is a significant concern that such a rate may operate in practice as a price floor and/or lead to a reduction in the range of price and non-price competition. Prior regulatory experience also illustrates the pitfalls of comparison rates, such as the provision of a 'Tariff Comparison Rate' for domestic energy consumers, which was removed by Ofgem in 2017 following a consultation demonstrating it had limited impact and potentially adverse consequences for consumers.

50. There are various practical considerations that also require further examination before an overall comparison rate could realistically be considered as a potential remedy outcome. In particular, it must be clear which prices are proposed to fall within the comparison rate, whilst

26 Interim Report, paragraph 3.53.

ensuring that the rate remains relevant to merchants and existing pricing structures. Merchants would also need to understand that the comparison rate may not actually reflect their overall card-acceptance costs, for example, due to variations in customer or transaction mix (i.e. a comparison rate is unlikely to have any relevance for merchants that do have a simple 'use case' scenario for card-acquiring services). Finally, it is important that any comparison rate does not undermine existing pro-competitive developments, such as the introduction of alternative pricing structures, by incentivising providers of card-acquiring services to compete across a narrower range of price-based variables.

51. In a competitive environment that is driven by quality, choice and innovation, in addition to price, it is unlikely that any remedies that seek to unduly prescribe the provision of information that merchants receive, such as a comparison rate, would be effective. This is because, as noted above, providers of card-acquiring services compete across a wide range of price and non-price factors to satisfy merchant demand and there is a high risk of unintended consequences. Worldpay would have serious concerns with a remedy that attempts to prescribe the format, content or presentation of the tariff information provided to merchants in the form of a common product.

52. In contrast, Worldpay would welcome the opportunity to discuss the option of principle-based rules that ensure merchants are provided with the 'key information' required to understand card-acquiring services against a high-level standard set of criteria. For example, requirements that merchants are provided with certain comparable pre-contractual information that accurately describes the price and non-price components for each tariff for card-acquiring services and explains the circumstances where additional fees may apply would be a more suitable and proportionate alternative to a comparison rate. However, it would still be necessary to ensure, through industry-wide consultation, that any standard criteria is designed ensure that it is relevant to the information merchants require and sufficiently flexible so that providers of card-acquiring services are not constrained in their ability to offer merchants greater choice and innovation.

53. The approach outlined above would be consistent with the steps taken by other competition regulators that have recently sought to implement information remedies using principle-based rules, which establish the type of information that should be provided to customers, rather than seeking to prescribe a common approach to customer communications. It should also be noted that information remedies of this nature have previously been introduced almost exclusively within the context of consumer-facing markets. As noted above, Worldpay considers there to be only narrow justification for the introduction of any consumer protection-style remedies in a business-to-business context, for example, in respect of the smallest merchants with annual card turnover below £380,000.

Worldpay welcomes further opportunities for an industry-led response

54. By way of conclusion, Worldpay does not consider the Interim Report's preliminary findings to provide a sufficient legal or evidential basis upon which to introduce market interventions, especially if implemented in the form currently proposed.

55. However, Worldpay would be open to engaging with the PSR and the payments industry to consider the implementation of non-binding industry guidelines or voluntary standards of conduct as an alternative to the imposition of remedies. A non-binding voluntary solution would be consistent with a principles-based approach to regulation and, in Worldpay's view, would ensure greater flexibility in how measures are implemented and reduces the risks of unintended consequences (through listening and responding to feedback from customers).

56. Worldpay would welcome the opportunity to discuss these proposals further with the PSR as an alternative to any remedies imposed using statutory powers, whether on a bilateral basis or through the relevant industry associations in which Worldpay participates, such as UK Finance.

1. MARKET STRUCTURE AND COMPETITION IN THE SUPPLY OF CARD-ACQUIRING SERVICES

Introduction

1.1 The Interim Report provisionally finds that "*the supply of card-acquiring services does not work well for small and medium-sized merchants*"[27] and does not work well for "*large merchants with annual card turnover between £10 million and £50 million*".[28] Worldpay and its external advisers disagree with the evidential factors upon which this conclusion is drawn, including the preliminary findings in the financial review; on the level of pass-through of the interchange fee reduction under the IFR; on merchant searching and switching rates; and on the level of price differential between new and existing customers, all of which are considered in detail in the following chapters of this Response.

1.2 However, in the first instance, Worldpay considers that there are a significant number of industry features and developments in the retail payments market which have not been sufficiently taken into account in the Interim Report, and which support the conclusion that there is intense competition for the supply of card-acquiring services, which is working well for merchants and consumers. These features, and supporting evidence, is summarised in this chapter.

1.3 In summary, this chapter explains that:

(a) the features of the supply of card-acquiring services and the conduct of market participants are both conducive to, and evidence of, intense competition. In particular, as confirmed in the Interim Report:

(i) there are no significant individual barriers to entry and expansion, and Worldpay submits that barriers to entry and expansion are also jointly low, as demonstrated by the following points;

(ii) new entrants are taking share of supply from traditional providers of card-acquiring services; and

(iii) there are a large number of active players, and intense competition across the value chain and between different types of provider;

(b) although one of the objectives behind the Market Review was to "*provide the first holistic overview of this sector*",[29] in a number of important respects the analysis in the Interim Report is partial or incomplete. For example, the analysis has not fully taken into account:

(i) the changing nature of merchant preferences, and the differences between different segments of "*SME merchants*", which may have fundamentally different business requirements for payments services;

(ii) the importance of choice, customer service, quality (including security/reliability) and innovation, and how providers of card-acquiring services compete on the basis of non-price factors (the Interim Report acknowledges that non-price

[27] Interim Report, paragraph 7.26.

[28] Interim Report, paragraph 7.30.

[29] Interim Report, paragraph 1.3.

factors are important, however almost no meaningful analysis has been undertaken);

(iii) the importance of omnichannel services and integrated payments as an area of increasingly intense competition within the card-acceptance value chain, which means that card-acquiring providers face actual and potential competition from a broader set of firms than simply other providers of card-acquiring services; or

(iv) the wider trends and developments that are shifting the competitive dynamics in the payments sector as a whole. In particular, new technology and regulation is exposing providers of card-acquiring services to competition from new entrants and rivals that offer alternative payment methods; and

(c) finally, this chapter explains how the impact of COVID-19 is accelerating these trends and developments.

(a) Card-acquiring services are supplied within a competitive market structure

1.4 Structural features of a market, such as barriers to entry and expansion, are often examined by competition authorities as a starting point to determine whether competition is functioning well and in the interest of consumers.[30] Indeed, the PSR has acknowledged that the "*prospect of entry and expansion*" by rivals is an important source of competitive constraint that can lead to more competitive outcomes, including lower prices, more innovation, better quality of services and greater choice for customers.[31]

1.5 In particular, Annex 5 to the Interim Report sets out the preliminary findings on barriers to entry and expansion, focussing on SME Merchants. In summary, the PSR:

(a) has not found any evidence of significant barriers to entry and expansion for providers serving merchants with less than £50 million annual card turnover;[32]

(b) has identified direct evidence of competitors that have either successfully entered into or expanded within the supply of card-acquiring services. This is supported by a declining share of supply of the traditional providers of card-acquiring services; and

(c) provides evidence of a large number of active players, and intense competition across the value chain, and between existing and new suppliers of card-acquiring services.

No evidence of significant barriers to entry and expansion

1.6 In order to assess whether there are barriers to entry and expansion in the supply of card-acquiring services, the Interim Report considers numerous issues identified by respondents to the Market Review. In particular, it has been found that:

(a) collateral requirements imposed by Mastercard and Visa are not used frequently and are not a significant barrier to entry and expansion;

30 CMA, 'Guidelines for market investigations: Their role, procedures, assessment and remedies, CC3 (Revised)' ("**CC3 Guidelines**"), (April 2013), paragraph 99.

31 Interim Report, Annex 5, paragraph 1.2.

32 Interim Report, paragraph 4.82.

(b) the structure of Mastercard and Visa scheme fees do not create significant barriers to entry, as they are unlikely to affect providers serving SME Merchants and most large merchants;[33]

(c) economies of scale exist within the supply of card-acquiring services, but do not act as a significant barrier to entry and expansion, as smaller acquirers have access to IT platforms through outsourcing to third parties. This means that new and/or smaller acquirers are able to benefit from economies of scale;

(d) neither small acquirers nor new entrants have deemed the costs of compliance with regulation to be a barrier to entry and expansion. Moreover, smaller acquirers and new entrants can use third party acquirer processors to assist with regulatory compliance requirements;

(e) bank referrals are not significant barriers to entry and expansion and account for less than 10% of all new customers of acquirers; new providers have been able to expand without relying on bank referrals. ISO relationships are readily available and do not represent a significant barrier to entry and expansion; and

(f) Mastercard and Visa scheme rules do not affect payment facilitators' ability to onboard merchants and therefore do not act as a significant barrier to entry and expansion.[34]

1.7 In addition, the Interim Report has specifically identified low barriers to entry and expansion for providers who target merchants new to card payments.[35] The identification of entry and expansion in both the SME Merchant segment and large merchants segment since 2014 is indicative of strong competition from new and existing market participants. This is consistent with the competitive environment within which Worldpay operates, and Worldpay agrees with the Interim Report's overall conclusion that no significant barriers to entry or expansion exist.[36]

1.8 However, there is also additional evidence that has not been taken into account that confirms that there are low barriers to entry and expansion and that new entry is a significant reality in this expanding and dynamic market place. These themes are discussed further below, and in particular:

(a) merchant demand for omnichannel services and integrated payments has increased the competitive opportunities available to new and existing providers of payment services across the card acceptance value chain (see paragraphs 1.38 to 1.39); and

(b) regulatory change in the payments sector has increased the competitive opportunities available for entry and expansion (see paragraphs 1.56 to 1.64).

---

33 Interim Report, paragraph 4.82. The Interim Report also states that stepped scheme fees are "*more likely to affect competition between acquirers for the largest merchants with an annual turnover over £50 million*" (Annex 5, paragraph 1.41), but does not conclude that this gives rise to barriers to entry and expansion as the Interim Report reaches the preliminary finding that the supply of card-acquiring services works well for these merchants.

34 Interim Report, paragraphs 4.80 – 4.82 and Annex 5, paragraphs 1.25 – 1.63.

35 Interim Report, paragraphs 4.78 and 7.13.

36 Interim Report, paragraph 4.78 and Annex 5, paragraph 1.3.

Direct evidence of actual entry and expansion by competitors in recent years

1.9 The Interim Report identifies numerous examples of successful (i) entry and (ii) expansion, for the supply of card-acquiring services in recent years.[37] These findings are important, and support the PSR's provisional findings that there are no significant barriers to entry, as evidence of past entry and expansion can be helpful in assessing the significance of any barriers to entry and expansion that exist within a market.[38]

1.10 In terms of market entry, there are numerous examples of successful entry by providers from different backgrounds, including:

(a) SumUp, iZettle, Square and Stripe entering as payment facilitators between 2012 and 2013, with iZettle having done so "*without scale or brand recognition*";[39]

(b) Adyen starting to supplying card-acquiring services to UK merchants in 2015.[40] During the same year, Paysafe and Nuvei also began providing card-acquiring services to UK merchants, having previously provided payment gateway services;[41]

(c) Square starting to provide card-acquiring services to UK merchants in 2017 (having previously provided card-acquiring services as a payment facilitator);[42]

(d) RBS announcing its re-entry into the provision of card-acquiring services under the NatWest Tyl brand in 2019;[43]

(e) EVO Payments starting to supply card-acquiring services to SME Merchants in recent years;[44] and

(f) Revolut starting to provide card-acquiring services to merchants in 13 European countries, including the UK, as recently as December 2020.[45]

1.11 In addition, the identification in the Interim Report of more than 100 acquirers and 50 payment facilitators that already supply card-acquiring services in the UK[46] (in addition to more than 60 ISOs[47] and a similar number of retail banks that could, in principle, enter the supply of card-acquiring services as others have successfully done in the recent past) further indicates that barriers to entry are low.

---

37 Interim Report, paragraph 4.78 and Annex 5, paragraph 1.3.

38 CC3 Guidelines, paragraph 234.

39 Paypal/iZettle, paragraph 10.3; and Interim Report, paragraph 3.42, 4.32, 4.34, and 4.77.

40 Interim Report, paragraph 4.14.

41 Interim Report, paragraph 3.41.

42 Interim Report, paragraph 3.42.

43 Interim Report, paragraph 3.41.

44 Interim Report, paragraph 4.90.

45 City AM, 'Revolut expands business offering with digital payments service' (4 December 2020).

46 Interim Report, paragraph 3.44.

47 Interim Report, paragraph 3.80.

1.12 In terms of evidence of expansion, it is emphasised that:

(a) Adyen now serves [5-10%] of large merchants and its overall share of card transactions (in volume and value) increased by [0-5]% between 2015 and 2018;[48]

(b) the rapid expansion of the payment facilitators in recent years sees them now serve nearly 80% of the smallest merchants, namely those that only or mainly accept card-present transactions with annual card turnover up to £15,000;[49]

(c) Stripe started supplying card-acquiring services in 2013 as a payment facilitator and has subsequently established itself as an acquirer, having "*expanded significantly in recent years*", particularly through offering merchants integrations with ISVs;[50] and

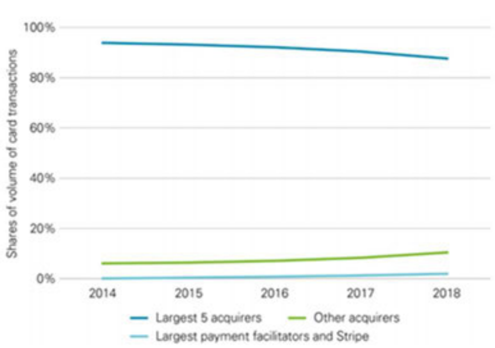
(d) EVO Payments and Tyl by NatWest have also expanded their supply of card-acquiring services to SME merchants.[51]

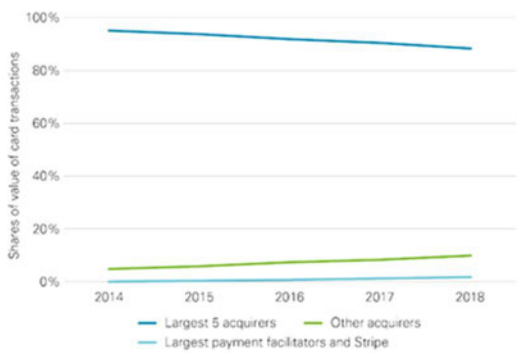
Increasing market size and declining market share of traditional players

1.13 The increase in both entry and expansion in recent years should also be understood in the context of a market for retail payments that is growing in size, which provides new opportunities for acquirers and other market players to recruit businesses that are new to card payments. For example, within the supply of card-acquiring services, the Interim Report finds that the total number of SME Merchants served by acquirers increased by over 7% between 2014 and 2018.[52]

1.14 The consequence of increased entry and expansion can also be seen in the Interim Report's evidence that the overall shares of supply of four of the five largest acquirers has steadily declined in recent years, as evidenced by the aggregated figures seen in Figures 1 and 2 below:[53]

Figures 1 and 2: Volume and value of card transactions acquired for merchants by providers of card-acquiring services from 2014 to 2018





48 Interim Report, paragraph 4.14.

49 Interim Report, paragraph 4.77.

50 Interim Report, paragraphs 4.32 to 4.34, and 4.77.

51 Interim Report, paragraph 7.14.

52 Interim Report, paragraph 4.19.

53 Interim Report, paragraphs 3.48 to 3.49.

1.15 The steady decline in aggregated share of supply of four of the five largest acquirers (the dark blue line) is consistent with intense competition for card-acquiring services and confirms the Interim Report's provisional findings that there are no significant barriers to expansion. [redacted] This significant and steady loss of share of supply by historically the four largest operators is inconsistent with a theory that competition for the supply of card-acquiring services is anything other than fully functioning and intensive.

Intense competition across the card-acceptance value chain and between new and existing providers

1.16 Card-acquiring services form part of an ecosystem of payment services. Worldpay has made numerous submissions emphasising the importance of taking into account the competitive interactions that take place between different providers of payment services.[54]

1.17 In particular, Worldpay has previously explained that competitive opportunities are increased by the fact that parties' business models may incorporate various combinations of the services in the card-acceptance value chain and can independently contract with merchants to do so.[55]

1.18 Many parties choose to only provide a limited number of these services but remain essential in the provision of card payment acceptance services to merchants. For example, both ISOs and ISVs will directly compete with acquirers to recruit merchants that wish to accept card payments. Gateway services, similarly, may be offered separately from traditional card-acquiring services, but provide important capability in the capture of the transaction.

1.19 As previously submitted, this means there are numerous entry points at which merchants can purchase services within the card-acceptance value chain, which is reflected by the different business models used by Worldpay's competitors.[56] This is further evidence of flexibility in terms of the options for market entrants and low barriers to entry. The different business models that can provide card-acquiring services include, among others:

(a) integrated providers (such as Worldpay);

(b) ISOs that supply POS terminals for the capture of transaction data, which are often the entry-point for SME Merchants when looking to accept card payments but do not provide all aspects of card-acquiring services;

(c) payment facilitators and other intermediaries, who will in turn sub-contract or refer other elements of the card-acceptance value chain;

(d) retail banks that offer card-acceptance services as part of a wider commercial banking relationship, either providing card-acquiring services as part of an integrated business model or sub-contracting those services; and

(e) hardware providers that provide the POS terminals required to physically accept card payments.

54 Worldpay response to Draft Terms of Reference (September 2018), paragraphs 2.3 - 2.8.

55 Worldpay response to Draft Terms of Reference (September 2018), paragraph 2.7.

56 Worldpay response to Draft Terms of Reference (September 2018), paragraph 1.10.

1.20 The Interim Report merely notes and accepts that there are a variety of "*third parties*" that help merchants accept card payments and provide an "*important entry point*" to merchants that want to purchase card-acquiring services. However, whilst these parties do not perform all of the functions that constitute card-acquiring services, they currently and increasingly compete directly with providers of card-acquiring services for the recruitment of merchants and the supply of other retail payment services. They include ISOs, gateway providers, ISVs and third-party POS terminal providers.[57]

1.21 Although the Interim Report provides a description of the services that are provided by other parties in the card-acceptance value chain, the competitive constraint that those providers impose on the supply of card-acquiring services has not been fully taken into account. For example, the Interim Report has recognised that there are more than 60 ISOs operating in the UK, the majority of whom compete against providers of card-acquiring services to recruit smaller merchants, and especially smaller merchants with revenue below £1 million.[58] The Interim Report also observes that ISOs will work with multiple acquirers in order to "*create some competitive tension between acquirers*".[59] However, it does not appear to take this information into account when conducting its assessment and in reaching its preliminary finding that the supply of card-acquiring services is not working well for SME merchants.

1.22 As explained above, from the perspective of the merchant, their entry point into the card payment value chain may not necessarily be their provider of card-acquiring services. In practice, this means that the primary relationship with the merchant may be another provider of payment services.[60] Moreover, from the perspective of merchants, there will normally be a vast array of alternatives providers offering retail payment services tailored to their specific needs.

1.23 In summary, the Interim Report does not sufficiently acknowledge the features of this market that demonstrate that competition is intense, such as low barriers to entry and expansion, the large number of active players and different types of provider, and the fact that there is direct evidence of a decline in share of supply of traditional market players.

(b) The Interim Report does not sufficiently take into account the fact that merchants of different sizes have different requirements, and providers of card-acquiring services cater to the needs of different merchant segments

1.24 The analysis in the Interim Report does not sufficiently take into account the fact that merchants of different sizes have different requirements and expectations from their providers of payment services. This is recognised to a certain extent, however for the purpose of its analysis, the Interim Report refers primarily to two broad merchant segments. These are:

(a) SME Merchants with annual card turnover up to £10 million; and

(b) large merchants with annual turnover above £10 million ("**Large Merchants**").[61]

1.25 The Interim Report uses this broad categorisation, but also adopts narrower annual card turnover bands, for example, in respect of SME Merchants for the purpose of the pass-through

57 Interim Report, paragraph 3.78.

58 Interim Report, paragraph 3.80 and 4.40

59 Interim Report, Annex 1, paragraph 1.141.

60 Worldpay response to Draft Terms of Reference (September 2018), paragraphs 2.20-2.23.

61 Interim Report, paragraph 4.2.

analysis. These include merchants with less than £15,000 annual card turnover, between £15,000 and £180,000 annual card turnover, between £180,000 and £380,000 annual card turnover and between £380,000 and £1 million annual card turnover.

1.26 It is important to note that merchants within each of these narrower annual card turnover bands will typically have fundamentally different requirements and expectations from their providers of card-acquiring services. By way of example, a sole trader operating an independent convenience store with an annual card turnover of less than £180,000 using a standalone POS terminal will have materially different requirements from a retailer with multiple outlets and annual card turnover of around £5 million, operating multiple card terminals, a website accepting online payments (potentially in multiple currencies) and a delivery service that processes refunds.

1.27 The Interim Report appears to recognise that providers of card-acquiring services adopt different business strategies in order to tailor their services to different merchant segments.[62] For example, the Interim Report explains that the largest payment facilitators serve nearly 80% of merchants that only or mainly sell face-to-face with annual card turnover below £15,000, but their share of supply decreases sharply above this level.[63] The Interim Report also observes that the majority of merchants referred by ISOs have an annual card turnover of less than £1 million.[64]

1.28 However, with the exception of the pass-through analysis (which is addressed in chapter 3 of this Response), the Interim Report attempts no meaningful analysis of competition that distinguishes between each of these merchant segments. This is most notably the case in the examination of the IFF Survey, which surveyed 1,037 merchants across numerous annual card turnover bands and summarised the results across three SME segments.[65] However, the Interim Report reaches its preliminary findings and identification of potential remedies without meaningful consideration of the differences between these customer groups, in most cases reporting the outcomes of the survey in aggregate across all segments of SME Merchants with annual card turnover between £0 and £10 million.[66]

1.29 This approach to the examination of SME Merchants is fundamentally at odds with, for example, the CMA's recent assessment of offline payment services (which examined competition by reference to, among other things, merchants with annual card turnover below £21,000; between £21,000 and £160,000; and between £160,000 and £380,000).[67]

The Interim Reports shows that Large Merchants have bespoke requirements

1.30 As noted above, the Interim Report confirms that the supply of card-acquiring services is working well for merchants with annual card turnover above £50 million. In particular, the Interim Report identifies the following evidence that acquirers cater to the specific needs of this merchant segment:

---

62 Interim Report, paragraph 4.1.

63 Interim Report, paragraph 4.88.

64 Interim Report, paragraph 4.91.

65 These were merchants with: (i) £0 - £380,000 annual card turnover; (ii) £380,001 - £1,000,000 annual card turnover; and £1,000,001 - £10,000,000 annual card turnover.

66 See, for example, paragraphs 6.22-6.23, 6.26-6.27, 6.29-6.30 and 6.35-6.36 of the Interim Report.

67 PayPal/iZettle, paragraph 6.12.

(a) some acquirers predominantly serve Large Merchants, for example, Adyen focusses its offering on large enterprise merchants and Chase Paymentech mostly provides card-acquiring services to large multinational merchants;[68]

(b) other acquirers refine their target customer base further by focussing on specific types of Large Merchants.[69] [redacted]; and

(c) there are providers with differentiated services tailored to merchants of different sizes, for example, PayPal's Braintree product which is targeted at Large Merchants.[70]

1.31 Whilst Worldpay agrees with the Interim Report's preliminary finding that the supply of card-acquiring services works well for the "largest" merchants with an annual card turnover above £50 million (the "**Largest Merchants**"), it is noted that Large Merchants (i.e. with annual card turnover between £10 million and £50 million) largely benefit from the same competitor set. In particular, this is evidenced by:

(a) providers of card-acquiring services that serve the Largest Merchants are more likely to also serve Large Merchants than providers that primarily focus on the smallest merchants (such as payment facilitators and ISOs);[71]

(b) Large Merchants will often receive comparable contractual terms to the Largest Merchants. For example, [redacted][72]

(c) Large Merchants will usually have similar requirements and exhibit similar behaviour when compared to the Largest Merchants, which is evidenced by the fact that:

(i) as the Interim Report observes, merchants with annual card turnover above £10 million are more likely to buy only card-acquiring services from their acquirers and source card-acceptance products from third parties;[73]

(ii) Large Merchants are more likely to have complex card-acceptance and integration requirements, including an online sales presence, as well as multiple site locations;

(iii) Large Merchants possess and use their bargaining power and will therefore negotiate more aspects of their contracts with acquirers;

(iv) Large Merchants are more likely to have a volume of commerce that may make it more cost effective for them to negotiate bespoke tariff options; and

68 Interim Report, paragraph 4.12.

69 Interim Report, paragraphs 4.12 – 4.13.

70 Interim Report, paragraph 4.37.

71 Interim Report, paragraphs 3.41, 3.46, 3.49, 4.14, 4.77 and 4.86.

72 [redacted]

73 Interim Report, paragraph 3.52.

(v) Large Merchants will normally receive more tailored relationship management services. [redacted][4]

SME Merchants are diverse and receive the widest choice between available providers

1.32 As noted above, the Interim Report amalgamates numerous SME Merchant segments within its analysis. However, evidence in the Interim Report demonstrates that there are significant differences between the demands of different SME Merchant segments:

(a) SME Merchants with annual card turnover below £380,000 are more likely to contract with payment facilitators than merchants with higher card revenue (payment facilitators, for instance, supply nearly 80% of merchants with annual card turnover below £15,000).[75] The Interim Report acknowledges that payment facilitators have different business strategies from other providers of card-acquiring services and generally focus on merchants with less than £380,000 annual card turnover, by offering such merchants:

(i) simplified pricing structures and certainty around fixed fees;

(ii) cheap card-acceptance hardware (e.g. mPOS card readers); and

(iii) fast onboarding using digitalised, automated programmes to determine whether to accept the merchant as a new customer;[76]

(b) SME Merchants with annual card turnover below £380,000 – representing more than 90% of merchants[77] – exhibit different switching behaviour compared to merchants with higher annual card turnover (see chapter 4 of this Response);

(c) SME Merchants with annual card turnover below £1 million are more likely to be recruited by ISOs, which accounted for the majority of customer acquisitions for merchants selling face-to-face below this threshold. This is in contrast to payment facilitators, which tend to supply the very smallest merchants, or acquirers, who supply to merchants of all sizes[78];

(d) SME Merchants with annual card turnover above £1 million are more likely to contract for card-acquiring services directly with acquirers (i.e. they are less likely to contract with a payment facilitator or be referred by an ISO).[79] [redacted][80]

(e) [redacted] merchants between £1 million and £10 million annual card turnover [redacted]

74 [redacted]

75 Interim Report, paragraph 4.77.

76 Interim Report, paragraph 4.20 and 4.62.

77 Interim Report, paragraph 1.77.

78 Interim Report, page 35.

79 Interim Report, page 35.

80 Worldpay response to Draft Terms of Reference (September 2018), paragraphs 2.3 - 2.8.

[redacted] are more likely to:

(i) (re)negotiate elements of their card-acquiring services, which may include negotiating lower prices or demanding higher levels of service quality (e.g. faster settlement times). The IFF Survey finds that 21% of SME merchants have tried renegotiating with their current provider of card-acquiring services.[81] However, the breakdown of survey responses disclosed in the second virtual data room (the "**Merchant Survey Data Room**") also reveals that:

(A) around 40% of merchants with annual card turnover between £380,000 and £1 million have attempted to renegotiate with their current provider;

(B) around 47% of merchants with annual card turnover between £1 million and £10 million have attempted to renegotiate with their current provider.

In contrast, only 19.5% of merchants with annual card turnover below £380,000 have tried renegotiating with their current provider of card-acquiring services;

(ii) demand sophisticated card-acceptance requirements, including omnichannel services. [redacted];

(iii) demand greater relationship management services. [redacted][82]; and

(iv) demand more value-added services, including data analytics services [redacted]

1.33 In summary, the Interim Report has accepted that there are different merchant segments within the broad category of "*SME merchants*", which have been considered individually for the purpose of the PSR's pass-through analysis. However, the broader analysis on competition for the supply of card-acquiring services makes insufficient distinction between these distinct merchant segments, each of which have different requirements for card payments, different preferences, and will tend to contract with different types of providers. This approach to merchant segmentation has significant implications for the provisional findings, including regarding potential remedies, which are discussed in chapter 6 of this Response.

(c) The Interim Report does not sufficiently take into account the levels of competition on the basis of non-price factors

1.34 It is the standard approach by competition regulators to examine competition in markets having regard to elements such as service, choice, innovation or quality ("**non-price factors**"), in

81 As explained in chapter 4 below (paragraph 4.43(a)(ii)), Worldpay has concerns with this finding in general, which is likely to understate the number of merchants that have tried to negotiate better terms by including a large number of merchants that have been with their current acquirer for less than two years.

82 [redacted]

addition to price.[83] Throughout the Market Review, Worldpay has submitted evidence and internal documents to the PSR designating the importance of non-price factors to the supply of card-acquiring services (see also paragraphs 2.12 – 2.35 of chapter 2 below).[84]

1.35 The Interim Report acknowledges that acquirers compete on the basis of non-price factors, including: authorisation performance; customer service and support; ease and speed of onboarding and set up; fraud detection and reduction; geographic reach; integration with other products/software; omnichannel services; quality and range of value-added services; reliability and stability; settlement speed; and supporting merchants with regulatory change and changes to scheme rules.[85] The Interim Report also recognises that the relative importance of these non-price factors will often vary, for example, by size of merchant or geographic presence. For example, a Large Merchant operating in multiple jurisdictions is more likely to value multi-currency settlement compared to an SME Merchant with one outlet in the UK.[86] In contrast, it is observed in the Interim Report that, for SME Merchants, "*the quality and range of card-acceptance products is likely to be more important than for the largest merchants*", as SME Merchants will often expect to receive card-acceptance products from their provider of card-acquiring services.[87]

1.36 The IFF Survey provides further evidence confirming the importance of service quality, choice and innovation. The three most important factors referred to by merchants when choosing their provider of card-acquiring services are: (i) the price of card-acquiring services; (ii) the payment methods available; and (iii) settlement times. Set up speed, range of products offered, innovative payment solutions and awareness of the provider were also other important factors identified by merchants as being relevant.[88]

1.37 Whilst the Interim Report accepts that non-price factors are important to merchants that use card-acquiring services, there is no meaningful analysis of whether competition on the basis of choice, customer service, quality or innovation is working well for merchants. The analysis of competition is almost exclusively based on the prices that merchants receive. This issue is discussed in further detail in relation to the Interim Report's analysis on pass-through in chapter 3 of this Response (paragraphs 3.116 – 3.115) and in connection with the proposed remedies, which are discussed in chapter 6 of this Response (paragraphs 6.47 – 6.55).

(d) The Interim Report does not take sufficient account of the fact that omnichannel services and integrated payments are growing areas of importance

1.38 The Interim Report acknowledges that omnichannel services are an "*emerging trend*" within card payments and that acquirers and payment facilitators are looking to build and strengthen these propositions to merchants.[89] This includes the provision of integration with ISVs, which the Interim Report notes is an increasing focus of acquirers and payment facilitators. The

---

83 CC3 Guidelines, paragraph 103. The CMA will often examine "PQRS" (Price, Quality, Range and Service) when examining mergers in retail markets. See generally CMA, 'Retail Mergers Commentary (CMA62)' (10 April 2017).

84 Worldpay response to Draft Terms of Reference, page 16. See also Worldpay's response to General RFI 2, Annex B, Annex C (question 2) and documents submitted thereto.

85 Interim Report, paragraph 4.65.

86 Interim Report, paragraphs 4.46 – 4.68.

87 Interim Report, paragraph 4.73.

88 IFF Survey, slide 33.

89 Interim Report, paragraphs, 3.40, 4.38, 4.69.

Interim Report additionally recognises that omnichannel services and integration are among the "*non-price factors*" on which firms compete.[90]

1.39 Worldpay agrees that omnichannel services and integrated payments are increasing in demand and of importance to merchants. However, Worldpay also considers that their emergence is itself a manifestation of the competitive and innovative process working well, which the Interim Report does not sufficiently take into account when examining the benefits that these trends and developments are having on competition for the supply of card-acquiring services. In particular:

(a) although ISOs were the "*most important source of merchants*" for acquirers in 2018, the Interim Report notes that an increasing number of acquirers are now focussing on ISVs as a customer acquisition channel.[91] In turn, this increases the competitive pressure between ISOs and ISVs for the recruitment of merchants;

(b) the CMA has previously considered the likelihood of future entry in respect of omnichannel services and had identified "*evidence of likely entry coming from <u>a variety of providers with different backgrounds</u>*". This is likely to have effects on the provision of card-acquiring services as more providers seek to recruit merchants;[92] and

(c) a number of acquirers, payment facilitators and ISOs are investing in their own omnichannel and integrated software solutions, which the Interim Report has acknowledged are important non-price factors.[93]

1.40 Chapter 2 of this Response provides evidence of the steps Worldpay has taken to expand its provision of omnichannel services, integrated payments and other value-added services (see paragraphs 2.28 - 2.35).

(e) Rapid and unprecedented technological and regulatory change is shifting the competitive dynamics in the payments sector and challenging the traditional card payment model

1.41 Finally, in terms of market and industry features to be taken into account going forward, Worldpay emphasises the importance of the significant technological and regulatory changes which are having a material impact on the market and the way competition works. In particular, in this regard it is noted that:

(a) the Interim Report's analysis is largely retrospective;

(b) there is significant innovation and transformation in the payments industry;

(c) Big Tech and Fin Tech firms are disrupting the traditional card payment model;

(d) there is a new regulatory environment fostering greater innovation and competition, for example, PSD2, and the IFR; and

(e) the market is also being impacted by Brexit considerations, and COVID-19.

---

90 Interim Report, paragraph 4.65, 4.93

91 Interim Report, paragraph 4.46.

92 PayPal/iZettle, paragraphs 47 and 10.13. Emphasis added.

93 Interim Report, paragraphs 4.74 – 4.76.

1.42 These points are discussed in further detail below.

(i) The Interim Report is largely retrospective

1.43 The Interim Report's preliminary findings are largely based on evidence that has been collected in relation to card-acquiring services up to and including 2018. On the basis of this evidence, the Interim Report acknowledges that there have been developments in card payments caused by "*rapid growth in adoption of contactless card payments*", "*new ways of paying by card*", "*changing shopping preferences*" and "*increasing levels of card-acceptance among businesses (particularly among smaller businesses)*".[94] Some of these developments are attributed to "*regulatory changes; divestments, mergers and acquisitions; and entry by new providers*".[95]

1.44 However, the Interim Report is largely retrospective in its approach and fails to consider evidence "*on any likely trends and developments*" arising from the technological and regulatory changes that will have an impact on card-acquiring services in the near future.[96] This raises significant concerns as to the probative value of the interim findings, which do not sufficiently take into account future developments, and are predominantly based on evidence that is now at least two years out of date and in many cases considerably older, particularly in a market where the pace of change (including market structure changes) is taking place so quickly.

1.45 Worldpay's previous submissions emphasised the importance of adopting a forward-looking assessment and giving careful thought to (i) imminent regulatory and (ii) technological and industry changes that are either yet to occur or whose effects are yet to be fully realised.[97]

1.46 In this regard, it is noted that the CMA recently emphasised the importance of taking a forward-looking assessment in its recent examinations of card payments. In *PayPal/iZettle*, the CMA took into account "*a range of forward-looking evidence*" in order to "*form expectations about future competition*". The CMA went on the explain that, "[i]*n markets characterised by rapid growth and a significant degree of product development and innovation (which can be either incremental and drastic), the CMA is aware that the competitive constraint posed by a firm may not be captured by a 'snapshot' of its market position at any one time. For that reason, a fuller assessment is liable to provide greater insight on how the market dynamics will continue to develop over time*".[98]

1.47 Worldpay notes that in a different consultation, the PSR has accepted that emerging payment services "*could make competition between separate infrastructure/service combinations* […] *more substitutable from the perspective of payers and payees*"[99] and that "[t]*he competitive landscape* […] *between the NPA and payment card systems will continue to evolve*".[100]

94 Interim Report, paragraphs 3.2 – 3.3 .

95 Interim Report, paragraph 3.34.

96 The Terms of Reference at paragraph 4.6 stated that the Market Review would take into account any "*likely trends and developments*", for example arising from PSD2, technological changes, the European Commission's review of the IFR or Brexit. However, there is no evidence of any meaningful analysis in this regard being undertaken in the Interim Report.

97 Worldpay response to the Draft Terms of Reference (10 September 2019), paragraphs 1.16-1.22.

98 PayPal/iZettle, paragraph 5.4. Emphasis added.

99 PSR, 'Competition and Innovation in the UK's New Payments Architecture: Call for input (CP20/2)' (January 2020), paragraph 2.6.

100 PSR, 'Consultation on delivery and regulation of the New Payments Architecture (CP21/2)', (February 2021), paragraph 6.32.

However, the Interim Report does not sufficiently consider the impact of non-card-based payments on the supply of card-acquiring services or the implications that this may have on any interim findings or possible remedies.

(ii) There is significant innovation and transformation in the payments industry

1.48 The Interim Report provides no analysis on the current rate of innovation in the provision of card-acquiring services, or across any other retail payment methods. Indeed, it is noted that the word 'innovation' does not appear in the Interim Report, other than brief references to the fact that innovation is one of the PSR's statutory objectives.[101]

1.49 It is emphasised that other regulatory bodies have repeatedly identified innovation as being a defining characteristic of the payments industry, which is changing competitive dynamics within the sector. For example:

(a) in January 2019, the FCA published its views that the retail banking and payments sector is "*in transition as new entrants and incumbent firms look to develop new propositions to meet consumers' changing preferences*". As such, the FCA noted that "[t]*he way in which payments are made is evolving*";[102]

(b) in June 2019, the CMA described the payment services industry as "a fast-moving and dynamic market" that can be "*distinguished by rapid growth in a relatively short period of time and notable technological and commercial developments that often result in disruption to the current state of competition and how consumers interact*";[103]

(c) in June 2020, the European Commission found that "[c]*ompetitive dynamics are shifting with the emergence of innovative, instant means of payments" and "the rise in digital payments has spurred the entry of innovative suppliers of financial services, such as FinTechs and BigTechs*";[104]

(d) in July 2020, HM Treasury variously described the "*pace of change and transformation*" of the payments landscape over the last ten years as "*astonishing*", "*evolving quickly*" and "*continuing to evolve*".[105] The Bank of England similarly observed the importance that any changes to the regulatory framework for payments "*keep[s] pace with innovation*";[106]

(e) in July 2020, the independent PSR Panel described changes in the payments landscape as "*fast-paced*" and the risk that "*the findings* [in the PSR's Market Review] *would be overtaken by developments in the market*", particularly following the implementation of PSD2;[107] and

---

101 Interim Report, paragraphs 1.2, 1.3, 2.6 and 7.1.

102 FCA, 'Sector Views' (2019). This was followed, in February 2020, by further commentary observing that "[r]*egulatory changes continue to transform the sector*", including PSD2 and open banking, which "*are embedding both in the UK and internationally*" – see FCA 'Sector Views' (2020) pages 15 and 18.

103 Paypal/iZettle, paragraph 10.

104 IFR Report, pages 3-4.

105 HM Treasury, Payments Landscape Review: Call for Evidence (July 2020), ("**Payments Landscape Review: Call for Evidence**") paragraphs 1.2, 2.47 and 3.1.

106 Bank of England, 'Financial Policy Committee, Financial Stability Report' (December 2019), page 82.

107 Payment Systems Regulator Panel, 'Annual Report 2019-20', (September 2020), page 6.

(f) in August 2020, the CMA described PIS-enabled payments in the UK as "*dynamic and rapidly evolving*" whilst recognising that "*consumers and merchants increasingly perceive PIS-enabled payments to be a viable alternative to card-based payments for C2B* [consumer-to-business] *payments*" and that "*PIS-enabled payments will compete more closely with card-based payments in future*".[108]

1.50 The pace of change in the payments sector is exemplified by the fact that, even since the PSR announced its Market Review in July 2018, there have been further industry-wide developments to payments innovation.[109] A few notable examples include:

(a) the emergence of new methods of payment acceptance and authentication. For example, scheme operators including Mastercard, Visa and American Express are trialling biometric payment cards in jurisdictions around the world.[110] Worldpay has developed support for payment authentication using biometric techniques (such as face scanning and fingerprints);[111]

(b) the announcement of new cryptocurrencies and technology, including:

(i) Facebook's announcement in 2019 that it plans to launch a cryptocurrency ('Libra') and a new digital wallet ('Novi', formerly 'Calibra') that will enable both cryptocurrency and government-backed currency payments through WhatsApp and Facebook Messenger;[112] and

(ii) the Bank of England's announcement in relation to a potential new Central Bank Digital Currency ("**CBDC**"), that would enable households and businesses for private use, enabling them to directly make payments using central-bank issued money;[113] and

(c) the launch of the European Payments Initiative ("**EPI**") in July 2020, represented by a coalition of 16 European banks, seeking to challenge national networks for card and mobile based payments using the Single European Payments Area infrastructure, which has widely been reported in the press as a challenger to traditional card scheme operators.[114] Similar initiatives are also expected to follow in the UK, following the

108 CMA, 'Anticipated acquisition by Visa International Service Association of Plaid Inc: Summary of the CMA's decision on relevant merger situation and substantial lessening of competition', (5 October 2020), paragraph 12.

109 See paragraphs 1.52 – 1.55 on the impact of Big Tech and Fin Tech firms on the traditional card payments model.

110 A study by Visa shows that 88% of participants surveyed in Singapore had used a form of biometric payment. Visa Press Release, 'Nine in 10 Singaporeans interested in biometrics authentication and payments' (20 March 2018). Amazon and Alipay are also reported as exploring biometric face scanning as a method to increase payment acceptance – see Finance Digest, 'The Future of Biometrics in Payments'.

111 FIS Press Release, 'FIS Enables Secure Seamless Online Payments with New Worldpay 3DS Flex Solution' (5 March 2020)

112 Facebook Press Release, 'Welcome to Novi' (26 May 2020)

113 Bank of England, 'Discussion Paper: Central Bank Digital Currency - Opportunities, challenges and design' (March 2020)

114 See, for example, City AM, 'EU banks take on Visa and Mastercard with 'truly European' payments system' (2 July 2020); Reuters, '*EU banks to take on Visa, Mastercard with new payments system*' (2 July 2020)

increase uptake of Open Banking solutions and the launch of the UK's New Payments Architecture.

1.51 These industry developments have emerged in an environment where there is already a diversity of payment methods, including more than 300 different types of eCommerce payment methods alone. But the pace of innovation in payment acceptance is likely to continue accelerating, driven by a number of technological breakthroughs such as distributed ledger technology and cheap, cloud-based computing. These changes will not only improve the services merchants and, ultimately, cardholders receive, but will also impact the underlying business models of firms and the economics of payment acceptance.

(iii) Big Tech and Fin Tech firms are disrupting the traditional card payment model[115]

1.52 The Interim Report does not sufficiently consider the full extent of both potential, as well as actual, competition that takes place in the payments industry. As set out in Worldpay's submissions to the PSR, providers of card-acquiring services compete with known and unknown payment methods, including global technology firms on the brink of expansion into the payments industry.[116]

1.53 Other competition and financial regulators have emphasised the challenges faced by traditional providers such as Worldpay from technological innovation and new entry by integrated providers, including the potential competitive constraint that Big Tech firms in particular impose on card payments:

(a) the European Commission recently noted that Big Tech firms active in the payment industry have the "*capacity to benefit from large existing customer networks, proprietary data, financial resources, technological capabilities and established reputation when introducing new services and entering new markets*";[117]

(b) the Bank of England has made similar remarks on the ability of 'Big Tech' firms to "*use their global customer base and brand to attract customers and launch new propositions*";[118] and

(c) following a recent market study into payment services, the Dutch national competition authority concluded that, "*Big Tech companies can act as a driving force behind competition and, by extension, behind innovation* […]. *It would be good if the European*

115 As noted above, the phrase "**Big Tech**" is generally used to describe a small group of global IT firms, including Facebook, Amazon, Apple and Google, many of whom have started expanding into the provision of retail payments services in recent years. "Fin Tech" is generally used to describe firms that specialise in the application of new and emerging technology to disrupt traditional financial services models, including within the retail payments market.

116 Worldpay response to General RFI 1, Annex B (10 June 2019), paragraphs 19.2-19.5.

117 IFR Report, page 5. The Commission went on to state that "[t]*he increasing reliance of consumers on digital devices and the concomitant rise in digital payments has made the wallet products offered by new players including Big Techs a significant point for attention*" (IFR Report, page 15).

118 Bank of England, Huw van Steenis, 'The future of finance report: review on the Outlook for the UK Financial System: what it means for the Bank of England' (20 June 2019) ("**The Future of Finance Report**"), page 104. Similar statements were made in the van Steenis Report, commissioned by the Bank of England, which noted that the success of new payment systems "*shows that the traditional link between consumers and banks can break down*" (The future of finance report, page 30).

rules regarding this issue were tightened, before the market is dominated by one or several major competitors".[119]

1.54 There is already evidence that Big Tech firms are seeking to expand their entry into the payments sector:[120]

(a) Amazon, Google and Alipay are registered as payment institutions in the UK and/or Europe, and Facebook is authorised as an e-money firm under PSD2;[121]

(b) Facebook has confirmed that its entry into the payments industry will form part of its vision for the next decade. As noted above, Facebook intends to launch a new cryptocurrency and a new digital wallet to handle crypto-based payments;[122]

(c) Amazon has developed a range of retail payment propositions including payments, cash, lending, credit and prepaid cards;[123]

(d) Apple recently announced its acquisition of start-up Mobeewave, which would give it the capability to offer an Apple mPOS product;[124] and

(e) Big Tech firms have already expanded into card issuing and retail banking, which may provide further opportunities to expand into retail payments.[125]

1.55 Similarly, Fin Tech firms have demonstrated increasing success entering and expanding into retail payments. For example:

(a) established providers of peer-to-peer payments, including PayPal, have successfully demonstrated their ability to use established brand recognition and customer bases in the peer-to-peer payments market in order to expand their presence in retail payments (including card payments); and

(b) smaller Fin Tech firms have demonstrated their potential to disrupt the payments industry. The UK's first physical peer-to-peer-based credit card was launched in July

119 Authority for Consumers & Markets, 'Big Tech and the Dutch payment market: tightening of rules needed to maintain a level playing field' (1 December 2020).

120 The competitive practices of Big Tech firms in the payments sector has also come under scrutiny by competition regulators. The European Commission commenced antitrust proceedings in June 2020 into Apple's practices in connection with Apple Pay in case AT.40452 – Mobile Payments. Google's practices in relation to Google Pay is also currently under investigation by the Competition Commission of India (see Case No. 07 of 2020).

121 Compact, 'Will Bigtechs change the European payments market forever?' (2020).

122 Mark Zuckerberg, Facebook Post, (9 January 2020).

123 The Future of Finance Report, page 28.

124 PracticalEcommerce, 'Is Apple Entering the Payment Acceptance Business?' (11 August 2020)

125 Notable market entries including the launch of Apple's credit card in the US in collaboration with Goldman Sachs and Marcus in 2018, Google's launch of consumer bank accounts in the US in partnership with Citibank in 2019. See Financial Times, 'What the Apple Card gets right, and wrong'(13 August 2019); Financial Times, 'Google in talks to move into banking' (13 November 2019).

2020[126] and there are multiple examples of peer-to-peer firms entering and expanding into retail payments in jurisdictions across Europe.[127]

(iv) A new regulatory environment is fostering greater innovation and competition

1.56 The Interim Report accepts that regulatory change has been one of the factors impacting the supply of card-acquiring services.[128] There are numerous past examples where regulation has enabled competition in retail payments, including:

(a) PSD1 which, as noted above, has contributed to a payments landscape in the UK where there are more than 100 acquirers currently active;[129]

(b) many respondents to the European Commission's consultation on retail payments have agreed that PSD2 has "*facilitated the access to the market for payment service providers other than banks, facilitated innovation, allowed open banking to develop, increased competition and the level of security for payments*";[130] and

(c) the European Commission has recently concluded that, "*major positive results have been achieved through the implementation of the IFR*".[131]

1.57 Worldpay's previous submissions highlighted a number of areas where forthcoming changes are being made to the regulatory environment for payments in the UK and EU.[132] These regulatory changes also have the potential to stimulate innovation and competition in the payments sector and, in many cases, their effects are yet to be fully realised.

1.58 The Terms of Reference indicated that the Market Review would take into account "*any likely trends and developments*" arising from such regulatory changes, including PSD2 and the introduction of Open Banking, and Brexit.[133] However, the Interim Report has not addressed these developments; there is no reference to the potential impact of Brexit and PSD2 is only described in an annex,[134] and there is no analysis of how these changes are likely to impact competition for the supply of card-acquiring services in the future. This section explains in further detail:

(a) the implications of PSD2, including:

(i) Open Banking and inter-bank payments enabled by the UK's NPA; and

---

126 Altfi, 'New P2P lending credit card aims to shake up the industry' (1 June 2020).

127 Tikkie, for example, has recently launched in the Netherlands and Germany and is currently trialling physical in-app store purchases. Similar initiatives are also being pursued by Twyp and Bizum (Spain), MobilePay (Denmark) and Payconiq (Belgium and Holland) – see Oxera, 'The competitive landscape for payments: a European perspective' (March 2020), pages 43 - 47.

128 Interim Report, paragraph 3.34.

129 Interim Report, paragraph 3.44.

130 European Commission, Consultation on a new retail finance strategy - summary of responses, (24 September 2020) page 10.

131 IFR Report, page 2.

132 See, for example, Worldpay's response to General RFI 1, Annex B (10 June 2019), paragraphs 8.1 - 8.9 and documents submitted thereto.

133 Terms of Reference, Annex 2, paragraphs 2.26-2.29.

134 Interim Report, Annex 1, paragraph 1.305.

(ii) the rules on Strong Customer Authentication ("**SCA**"); and

(b) the potential implications to the UK's regulatory framework for payments as a consequence of Brexit.

PSD2 and inter-bank payments enabled by the New Payments Architecture

1.59 The adoption of Open Banking solutions under PSD2 is expected to increase competition both within card payments, as well as between card payments and other payment methods. The UK is currently the leading jurisdiction in Europe in terms of the maturity of its Open Banking system, which has been driven by work undertaken by the CMA following its retail banking market investigation in 2016 and the establishment of the Open Banking implement Entity (the "**OBIE**").

1.60 These factors, taken together with the emergence of Payment Initiation Service Providers and the enhanced infrastructure to be introduced by the New Payments Architecture ("**NPA**") to support account-to-account bank transfers, has the potential to revolutionise how merchants and consumers make payments in the future. These services, combined with lower costs of card-acceptance, means that merchants and consumers will increasingly view card payments and non-card digital payments as substitutable payment options. The NPA in particular is anticipated to be the most significant change to the UK's payment infrastructure since the 1960's,[135] which the PSR itself has described as a "*generational change in UK payments*".[136]

1.61 The Interim Report does not consider the competitive constraint that Open Banking solutions or the NPA is likely to have on card-based payments in the future. However, a number of competition authorities and financial services regulators have recently acknowledged the potential for inter-bank payment systems to challenge and compete with card-based payments, for example:

(a) the Bank of England has recognised the potential for the NPA "*to increase competition and resilience as well as enhance innovation across the payments and banking industry*";[137]

(b) HM Treasury has similarly recognised the capability for the NPA to "*catalyse innovation in a variety of payment services*";[138] and

(c) as noted above, the PSR has itself acknowledged that:

(i) "*the second Payment Services Directive (PSD2) and Open Banking will facilitate the emergence of new services which could make competition between separate infrastructure/service combinations increasingly possible by making them more substitutable from the perspective of payers and payees*"; and[139]

135 Pay.UK, 'New Payments Architecture Programme'

136 Letter from Hannah Nixon, Managing Director at PSR to Mr Paul Horlock, CEO of NPSO Limited (18 January 2018), page 1.

137 Bank of England, Consolidation of three UK Payment System Operators, (1 May 2018). Emphasis added.

138 Payments Landscape Review: Call for Evidence, page 3. Emphasis added.

139 PSR, 'Competition and Innovation in the UK's New Payments Architecture: Call for input (CP20/2)' (January 2020), paragraph 2.6. Emphasis added.

(ii) "[t]*he competitive landscape* […] *between the NPA and payment card systems will continue to evolve*".[140]

1.62 These statements are supported by evidence that an inter-bank payment system is now already on the verge of driving change through the payments industry. For example:

(a) there is already growth in the uptake in Open Banking-based technology. The OBIE reported an increase in successful API calls by third parties using account providers, from 1.9 million successful calls in June 2018 to 694.4 million successful calls in December 2020;[141]

(b) Mastercard's acquisitions of VocaLink in 2017 and Nets in 2019, and the introduction of its Pay-by-App offering, demonstrate a clear shift in strategic focus towards account-to-account payments. Similarly, Visa's proposed acquisition of Plaid provides evidence that established industry payment providers are shifting their attention towards account-to-account payments delivered, among other things, through Open Banking solutions; [142]and

(c) strategic investments into Open Banking technology have also been announced by global Fin Tech firms, including PayPal,[143] and retail banks, including HSBC.[144] Worldpay has also launched an account-to-account payments proposition in partnership with Sentenial (Open Banking Hub), which is described in chapter 2.

Strong Customer Authentication

1.63 Annex 1 of the Interim Report notes that the deadline for implementation of SCA in the UK has now been extended to 14 September 2021 by the FCA to 14 September 2021 in response to the COVID-19 health crisis.[145] The Interim Report does not take into account the impact that SCA will have on the supply of card-acquiring services. However, the implementation and roll-out of SCA is likely to have a material impact on acquirers, merchants, and cardholders because:

(a) as the proportion of consumers using shopping online continues to increase, merchants and consumers are more likely to adopt electronic payment methods that are subject to SCA; and

(b) acquirers are already launching new and innovative solutions to ensure that merchants and their consumers are able manage SCA in as frictionless a manner as possible. For example, Worldpay has recently launched a new Exemptions Engine product that enables merchants to leverage SCA exemptions to limit friction in the payments journey.

140 PSR, 'Consultation on delivery and regulation of the New Payments Architecture (CP21/2)', (February 2021), paragraph 6.32.

141 Available at: Open Banking APIs Performance.

142 Visa Press Release, 'Visa and Plaid Announce Mutual Termination of Merger Agreement' (12 January 2021).

143 Tink, PayPal and Tink expand partnership across Europe, (3 June 2020).

144 City AM, 'HSBC signs global deal with City fintech startup Bud' (11 December 2019).

145 FCA, 'Strong customer authentication and coronavirus' (30 April 2020).

1.64 It is also important to note the potential for SCA to have cost implications to acquirers, merchants and consumers during a period of adjustment. This would have the potential of making card-based payments less attractive compared to the cost of rival payment methods (such as account-to-account payments).

The potential implications of Brexit have not been considered in the Interim Report

1.65 As noted above, the Interim Report makes no reference to the future impact of Brexit, except for one descriptive mention to the end of the transition period (in Annex 1).[146] The regulatory framework for payment services has already changed as a consequence of Brexit during this Market Review, and further developments are likely to materialise in the future that may have implications to the conclusions in the Final Report and any potential remedies.

1.66 Payment service providers invested significant time and resource in preparation for the end of the transition period on 31 December 2020 and are continuing to seek clarification on the future direction of regulation of UK payment services. The EU-UK Trade and Cooperation Agreement does not provide equivalences for financial services and it remains the case that, despite high-level statements previously made by the UK Government,[147] there is considerable uncertainty on aspects of the future regulatory status of card payments in the UK. By way of example:

(a) cross-border payments between the UK and the EEA are no longer subject to the interchange fee caps under domestic legislation.[148] This has opened up the possibility for increased interchange fees in respect of cross-border transactions, which could impact the cost structures for acquiring certain transactions. For example, on 24 January 2021, Mastercard announced an increase to its interchange fees for consumer card transactions between the UK and the EU, which have increased to 1.5% for credit transactions (from 0.3%) and to 1.15% for debit transactions (from 0.2%);[149] and

(b) whilst the UK has been granted permission to remain as a participating country in the Single Euro Payment Area after the transition period, the UK's continued membership is predicated on continued adherence to the same or equivalent EU financial services regulations.[150]

1.67 Apart from the significant regulatory uncertainty to which Brexit has given rise, payment service providers will also be exposed to yet unknown economic implications. Further economic disruption and uncertainty resulting from Brexit exacerbate these challenges for both acquirers and merchants, which are likely to impact the analysis in the Interim Report in at least two ways:

(a) as explained in chapter 3 of this Response (paragraphs 3.102 – 3.115), economic downcycles are relevant to the Interim Report's financial review of acquirer net revenue. By focussing on a period of relative economic wellbeing, the analysis has not taken into

146 Interim Report, Annex 1, paragraph 1.305.

147 HM Treasury, 'Chancellor statement to the House – Financial Services' (9 November 2020) and Government news story: 'Chancellor sets out ambition for future of UK financial services' (9 November 2020).

148 Explanatory Memorandum to the Interchange Fee (Amendment) (EU Exit) Regulations 2019 No. 284, paragraph 2.8.

149 Financial Times, 'Mastercard to increase fees for UK purchases from EU' (24 January 2021).

150 European Payments Council Decision on Brexit and UK PSPs' Participation in SEPA Schemes, (7 March 2019).

account acquirers' underwriting risk that is more likely to materialise during periods of economic decline; and

(b) changes to the trading relationship between the UK, the EU and non-EU countries are likely to impact the types of cross-border payments made by consumers and merchants. This could, in turn, affect merchant preferences and transaction mix, which may ultimately affect the costs associated with providing card-acquiring services.

1.68 Given the proximity of this significant period of regulatory and economic change, it would be inappropriate for the Market Review to ultimately propose further disruption by imposing unjustified remedies or unnecessary compliance costs upon the industry. Adding greater uncertainty in a regulatory environment that is already uncertain could have the unintended effect of chilling innovation and risking the UK's position as a leading jurisdiction for investment in payments technology.

(v) COVID-19 is disrupting the payments sector and accelerating changing payment trends

1.69 The COVID-19 pandemic has had an unparalleled impact on both how payments are made and on the payments sector as a whole. When the UK Government introduced 'lockdown' restrictions in March 2020, businesses across the UK were disrupted, and payment service providers were exposed to a record decline in consumer spending. [redacted]

1.70 The payments industry performed an important role in helping businesses return to business as usual during the initial phases of the UK Government's lockdown. This included measures to accelerate the increase in maximum contactless payments from £30 to £45 and assisting merchants with accepting payments in accordance with social distancing guidelines. Further information on Worldpay's response to provide merchants with relief and support in set out in chapter 2 of this Response.

1.71 However, COVID-19 is also likely to have longer term implications to the payments sector as a whole. The Interim Report acknowledges the "*extraordinary impact*" that COVID-19 is having on the UK's economy, its effect on merchants and suppliers of card-acquiring services, and that it:

> "*may accelerate many well-established trends, such as the growth in card payments, changing shopping preferences (including the shift to online spending), and increasing levels of card-acceptance amongst businesses (particularly small businesses)*".[152]

1.72 Worldpay agrees that COVID-19 is likely to accelerate established trends within card payments, such as increases in online and other remote methods of payment. In this regard, it is noted that fundamental shifts in consumer behaviour are expected to persist in future. In particular, there is widespread expectation that 'lockdown' restrictions will "*accelerate*[…] *the shift to digital payments*", and in particular online payments, resulting in permanent shifts to

151 [redacted]

152 Interim Report, paragraphs 1.4 and 1.5.

buying patterns in the medium- to long-term future, as merchants and consumers adopt new technology enabling and other remote payments.[153] In this connection:

(a) the European Commission's Executive Vice-President, Valdis Dombrovskis, recently stated in a letter to the e-commerce industry that "*the COVID-19 pandemic has increased the volume of e-commerce and consequently of online payments. It can be expected that many EU consumers will maintain these new payment habits*";[154]

(b) the FCA's Head of Payments recently stated that "*[t]he social distancing and lockdown rules have accelerated existing trends toward digital, in particular electronic payments*" that are "*unlikely to return to pre-COVID-19 levels*";[155]

(c) the European Commission's IFR Report published in June 2020, accepted that as many as 10% of users may "*permanent*[ly] *shift*" from cash-based payments towards contactless and electronic payments methods due, in particular, to the reduction in in-store physical interactions;[156]

(d) research commissioned by Visa shows that 41% of customers are shopping online more frequently than before the COVID-19 pandemic, of whom 74% will continue to do so in the future;[157] and

(e) an estimate by Bain on the impact of COVID-19 predicts that digital payments will increase to 67% of transaction values by 2025 (compared to a previous estimate pre-COVID-19 that digital payments will reach 57% by 2025).[158]

1.73 Consumer and merchant demand for new technology and alternative payment methods is also increasing. In particular, underlying shifts in consumer preferences between payment methods have practical consequences for both merchants and their providers of card-acquiring services. Many merchants, and in particular smaller merchants, have been pushed to adopt new technology and alternative payment methods, not only as a matter of public safety, but to keep pace with changes in consumer demand. For example:

(a) the rapid adoption of contactless card payments[159] compared to Chip & PIN cards, which has been further accelerated by the permanent increase to the maximum spending limit for contactless payments in the UK from £30 to £45 on 1 April 2020. UK Finance data shows that the value of contactless spending was 18.1% higher in September 2020 compared to September 2019, as the proportion of contactless

153 On the shift from cash to digital payments prior to the Covid-19 crisis, data from UK Finance shows that card payments have become the most payment method of choice in recent years, with 51% of all payments made using card for the first time in 2019, and 41% of debit card transactions made using contactless technology. See UK Finance 'Cards used for half of payments for first time last year' (3 June 2020).

154 Edgar, Dunn & Company, 'Update on SCA (SCA) Enforcement Dates' (2 July 2020).

155 PYMNTS, 'UK Financial Authority On The COVID-19 Pandemic's Impact On Open Banking' (30 June 2020).

156 IFR Report, page 1. Emphasis added.

157 Visa, 'New lockdown habits here to stay: Majority plan to keep spending more frequently online' (3 June 2020).

158 Bain & Company, 'The Covid-19 Tipping Point for Digital Payments' (29 April 2020).

159 Interim Report, paragraphs 3.3 and 3.85.

payments continues to increase.[160] On 27 January 2021, the FCA announced its plans to launch a consultation seeking views on whether to increase the limit for contactless card payments to £100;[161]

(b) [redacted] and

(c) demand for integrated payment technology is expected to rise, as businesses seek to provide seamless choice between multiple payment methods (such as "pay at table" solutions that are increasing in demand).[162]

160 UK Finance, 'News in brief' (16 December 2020).

161 FCA, 'Update on mortgages, consumer credit, banking and payments during coronavirus' (27 January 2021).

162 McKinsey, 'How payments can adjust to the coronavirus pandemic—and help the world adapt' (31 March 2020) ("*Companies that provide viable options for integrated and contactless payments, to both customers and merchants, will probably have a distinctive edge over competitors*.").

2. WORLDPAY'S RESPONSE TO THE INTENSE LEVELS OF COMPETITION IN THE SUPPLY OF CARD-ACQUIRING SERVICES

Introduction

2.1 As explained in chapter 1, there are a significant number of industry features and developments supporting the position that the supply of card-acquiring services is intensely competitive and working well for merchants and consumers. Worldpay also considers that this is reflected and demonstrated by how Worldpay itself has adapted to this intense competition in recent years.

2.2 This chapter therefore focusses on how Worldpay has driven and responded to the increase in competition for the supply of card-acquiring services since 2014, including providing further context to evidence submitted previously to the PSR on the new products and propositions that Worldpay has launched over the same period, including the benefits that merchants have received in the form of greater choice, customer service, quality and innovation, as well as competitive prices.

2.3 In particular, this chapter explains:

(a) the impact that increased competition has had [redacted];

(b) how Worldpay has driven and responded to increased competition for card-acquiring services by offering merchants greater choice, customer services, quality and innovation;

(c) the steps Worldpay has taken to expand the provision of its products across the card-acceptance value chain, which has included the launch of new card-acceptance products, omnichannel services and value-added products;

(d) the new innovative partnerships that Worldpay has entered into with providers of complementary payments and business services, including independent software vendors; and

(e) Worldpay's response to the COVID-19 pandemic, which demonstrates the role that acquirers perform as trusted providers of payment services.

[redacted]

2.4 The Interim Report identifies Worldpay as one of the five largest acquirers in the UK measured by volume and value of card transactions.[163] However, as discussed in chapter 1, the shares of supply of four of the largest five suppliers of card-acquiring services has been steadily declining between 2014 and 2018, as is shown in Figures 1 and 2 in the Interim Report.

2.5 Even on the basis of this artificially narrow view of competition for the supply of card-acquiring services (i.e. which excludes all other payment services and payment types), the steady decline in share of supply of four of the five largest acquirers is consistent with intense competition for card-acquiring services and confirms the Interim Report's findings that there

163 Interim Report, paragraph 3.45.

are no significant barriers to expansion. This is demonstrated by the corresponding growth of rival acquirers and payment facilitators supplying card-acquiring services to UK merchants over the same period.

2.6 When the European Commission examined competition for the provision of card-acquiring services in 2019, it concluded that Worldpay faces "*strong competition from several players*" in the UK.[164] [redacted]

2.7 [redacted]

(a) [redacted]

(b) [redacted]

Table 1: [redacted]

[redacted]

2.8 [redacted]

164 European Commission, Case M.139/2004 - *FIS/Worldpay*, paragraph 83(a).

165 [redacted]

166 [redacted]

167 [redacted]

168 [redacted]

[redacted]

2.9 Many of the market characteristics identified in the Interim Report, and discussed further in chapter 1 of this Response, have directly impacted how Worldpay must adapt to competition in order to win and retain merchants. For example, Worldpay must respond to:

(a) low entry barriers and more than 100 rival providers of card-acquiring services with licences to operate in the UK.[173] [redacted]

(b) the emergence of rival providers of card-acquiring services and third parties, including payment facilitators and ISOs, which have brought new technology and different business models to offer SME Merchants with card-acquiring services.[174] [redacted]

(c) the rapid growth in demand for online payment gateways, which the Interim Report has found is working well for merchants.[175] As payment gateways are increasingly offered to smaller merchants in combination with card-acquiring services at the point of sale (a trend that has accelerated due to COVID-19), [redacted] and

(d) new and innovative partnerships between providers of business software services. The Interim Report acknowledges that ISVs are an increasingly important customer acquisition channel, which has been an important factor in the growth of rival payment facilitators.[176] [redacted]

169 Interim Report, Annex 1, paragraph 1.79 (citing UK Finance, UK Payment Markets 2020 (June 2020), Chart 1.1 and page 11).

170 Interim Report, paragraph 4.19.

171 Interim Report, Annex 1, paragraph 1.79

172 Interim Report, paragraph 7.11.

173 Interim Report, paragraph 3.44.

174 Interim Report, paragraph 3.33.

175 Interim Report, paragraph 6.98.

176 Interim Report, paragraph 4.46.

2.10 As a consequence of these developments the largest acquirers, including Worldpay, have been under greater competitive pressure than ever before to offer merchants greater choice, higher quality services, innovation and competitive prices.

2.11 [redacted]

(b) Worldpay has driven and responded to increased competition for card-acquiring services through offering greater choice, customer service, quality and innovation

2.12 The Interim Report acknowledges that providers of card-acquiring services have "*varied business models*"[177] and will adopt "*different business strategies*" when competing for merchants.[178] It is implicit in these statements that providers of card-acquiring services will also have varied and different approaches to pricing, quality, customer service, innovation and the degree of choice that they offer to merchants. [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

2.13 However, the Interim Report adopts an almost exclusive focus on the level of prices paid by merchants for card-acquiring services. As explained in chapter 3 of this Response (paragraphs 3.116 – 3.155), this has resulted in a fundamentally flawed approach to the PSR's econometric and financial review analyses. The Interim Report contains almost no substantive analysis of the level of innovation, customer service, quality or the degree of choice that different providers of card-acquiring services offer to their merchants.

2.14 Further information on the steps that Worldpay has taken to increase innovation, choice and service quality is set out below.

177 Interim Report, paragraphs 3.33 and 3.46.

178 Interim Report, paragraphs 4.1.

Worldpay has increased the choice of payment options available to merchants

2.15 Worldpay has previously submitted evidence that different merchants prefer different pricing options.[179] Therefore, offering customers a choice between tariff structures enables them to choose a plan according to their individual business needs, their risk appetite, and their preferences in terms factors such as simplicity and predictability. [redacted]

[redacted]

[redacted]

[redacted]

2.16 The CMA noted in *PayPal/iZettle* that Worldpay was among the first traditional POS terminal providers to offer merchants the choice of simplified contracts that compete with the pricing structures offered by payment facilitators.[181] [redacted]

2.17 However, Worldpay continues to offer merchants of all sizes the ability to choose traditional 'Custom' tariffs, [redacted]. In addition, as explained in chapter 1 of this Response (paragraphs 1.16 – 1.23), merchants increasingly perceive card-acquiring services as but one component of a payment acceptance solution. In this regard, [redacted] (see paragraphs 2.23 - 2.35 below).

Worldpay has made investments to offer merchants higher levels of customer services, innovation and to enhance the overall quality of its card-acquiring services

2.18 [redacted]

179 See Worldpay's response to General RFI 1, Annex B, question 18. Also see Worldpay's response to General RFI 2, Annex C.

180 [redacted]

181 PayPal/iZettle, Appendices and Glossary (Appendix G10), paragraph 57.

2.19 The importance of these non-price related factors to merchants' choice between providers of card-acquiring services is confirmed by the IFF Survey, which found that slower settlement times, service outages and poor customer service were among the most frequently cited reasons for merchants that decide to leave their current provider.[182] Settlement times were also regularly mentioned as one of the main factors considered by merchants when shopping around (in addition to, among other things, price levels).[183]

2.20 [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

2.21 [redacted].[185]

2.22 [redacted] The IFF Survey confirms that 82% of merchants that contacted their provider of card-acquiring services within the

182 IFF Survey, slide 31.

183 IFF Survey, slide 34.

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

previous 12 months were satisfied with the customer service they received (only 8% said they were dissatisfied).[187] The importance of customer service is also confirmed by the IFF Survey, as the fourth most frequently cited reason for merchants that switched within the last two years was to receive better customer service.

(c) Worldpay has driven and responded to increased competition across the card-acceptance value chain, including for the supply of new card-acceptance products, online payment gateways, omnichannel services, and value-added products

2.23 As explained in chapter 1 of this Response, competition for card-acquiring services takes place across the card-acceptance value chain ((paragraphs 1.16 – 1.23). This means that providers of card-acquiring services, providers of card-acceptance products and providers of other value-added services will all compete to secure the merchant relationship.

Card-acceptance products and online payment gateways

2.24 [redacted]

- [redacted]
- [redacted]
- [redacted]

[redacted] [redacted]

[redacted] [redacted]

2.27 [redacted]

- [redacted]

187 IFF Survey, slide 16.

188 [redacted]

189 [redacted]

190 Interim Report, paragraph 6.98.

[redacted]

[redacted] [redacted]

Omnichannel and value-added services

2.28 The Interim Report has acknowledged that SME Merchants "*prefer to one-stop-shop*" (i.e. to source their card-acceptance requirements from a single firm)[192] and that Large Merchants also demand omnichannel services, which may include the provision of payment services through multiple channels.[193] However, whilst the Interim Report recognises that omnichannel services are an "*emerging trend in payments*", it does not go far enough to identify omnichannel services more broadly as a feature of the retail payments market and evidence of intense competition between rival payment service providers. These trends are closely linked to developments in integrated payment services that provide an opportunity for new entrants to develop software-focussed products, in respect of which acquiring services are just one element. Such products support the merchant's business across a wide range of areas, enriching information flows in areas such as transactional activity, customer base and enabling efficiencies to be achieved across their payments architecture and new technologies to be adopted as they evolve.[194] As explained in chapter 1, this trend is expected to continue to grow following the COVID-19 pandemic.

2.29 [redacted]

2.30 Merchants benefit from a fully integrated payment acceptance system, provided by one party and where all component services and products are designed to work seamlessly with each other. Overall, this can provide an ongoing benefit to merchants through a higher quality service, and ease of operation, by avoiding the possibility of any gaps in payment acceptance that may otherwise arise (for example, in relation to issues with fraud detection, or with difficulties processing certain payment types).

2.31 [redacted]

191 [redacted]

192 Interim Report, paragraph 6.72.

193 Interim Report, paragraph 4.65.

194 Interim Report, paragraph 4.69.

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

(d) Worldpay integrates its products with complementary service providers, which results in merchants receiving new and innovative collaborations

2.32 The Interim Report acknowledges the growing demand from merchants for products and services from ISVs, which it also attributes to the "*rapid growth*" of Stripe through offering merchants the ability to build websites and sell online.[195] The Interim Report also notes that

[195] Interim Report, paragraph 4.34.

iZettle, Square and SumUp offer merchants similar integrations with ISVs (and are seeking to build their omnichannel offerings in general).

2.33 Acquirers are also referred to in the Interim Report as focussing on building and improving their integrations with ISVs as a priority.[196] Since 2014 Worldpay has continued to develop software integration with a wide range of technology partners and now offers integration with approximately 250 software products across a wide range of business applications, including (among others):[197]

(a) digital accounting, bookkeeping and invoicing tools;

(b) booking, ticketing and travel software;

(c) commerce platforms, including customer relationship management services and shopping carts;

(d) EPOS systems that are tailored to specific industry sectors (e.g. retail, hospitality and travel); and

(e) a range of other software tools including subscription management, form/template builders, transaction analytics and logistics.

2.34 Additionally, Worldpay has partnered with technology providers to give merchants access to new alternative payment methods, including account-to-account transfers. In particular, Worldpay announced the launch of Open Banking Hub in June 2020, which has been established through a commercial partnership with Sentenial. The Open Banking Hub provides a single API integration to all enabled UK banking providers, which enables consumers making purchases to pay directly from their bank account at checkout. Consumers can also see their bank account balance during online checkout, offering greater control and transparency over their finances. The Open Banking Hub also enables merchants to credit refunds in real time.

2.35 Finally, Worldpay has partnered with other commercial providers to enhance its offering of value-added services to merchants, such as Worldpay Business Finance, a partnership with Liberis, which gives merchants access to cash advances (based on the sale of future receivables) to merchants [redacted]

(e) Worldpay's response to COVID-19

2.36 As noted in chapter 1 above (paragraphs 1.69 – 1.72), the COVID-19 pandemic has had an unparalleled impact on the UK economy and the payments sector as a whole, which inevitably includes individual acquirers. Worldpay's response to the COVID-19 pandemic, and in particular Worldpay's actions to support smaller merchants that have been affected by business disruption as a consequence of the UK Government's 'lockdown' policy, is explained below. These initiatives, which were voluntarily undertaken by Worldpay, illustrate the role that acquirers are expected to perform by merchants as trusted providers of payment services.

COVID-19 support campaign

2.37 [redacted]

196 Interim Report, paragraph 4.36.

197 A list of applications that have been integrated to work with Worldpay can be found here.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

198 [redacted]

2.38 During a period of significant business disruption, it was incumbent on Worldpay to proactively communicate with merchants and encourage them to assess the services that they currently receive from Worldpay (and to consider whether there is more that Worldpay could do to assist). These steps were necessary both in order to protect the financial position of Worldpay's merchants, but also to respond to intense competitive pressure from rival providers of payment services. [redacted]

The continuing impact of COVID-19 on Worldpay's business

2.39 [redacted]

2.40 Worldpay is also continuing to support merchants as they adapt to changes in consumer demands for payment methods as a consequence of the COVID-19 pandemic. As explained in chapter 1, many of these developments in consumer preferences are expected to persist. [redacted]

(a) [redacted]

(b) [redacted]

(c) [redacted]

2.41 It is important that the Final Report fully takes into account the range of assistance provided by card-acquiring service providers to merchants in times of difficulty (not limited to price-related aspects), and the wider role performed by providers in supporting merchants to accept payments.

3. PASS-THROUGH OF SAVINGS FROM INTERCHANGE FEE CAPS UNDER THE IFR

Introduction and summary of the Interim Report's preliminary findings on pass-through

3.1 The press release that accompanied the Interim Report states that many SME Merchants may not be getting a good deal from their provider of card-acquiring services.[199] The pass-through analysis is a central piece of analysis that is used to underpin this preliminary finding in the Interim Report. In particular, the Interim Report states that the introduction of the interchange fee caps under the IFR were used "*as an indicator for how well the supply of card-acquiring services is working*", by investigating the extent to which savings acquirers realised were passed-through to merchants. The Interim Report asserts that "[l]*imited or slow pass-through is one indicator that competition is weak*".[200]

3.2 The Interim Report's chapter on pricing and quality outcomes draws three key conclusions to support an interim finding that the supply of card-acquiring services may not be working well:

(a) merchants with annual card turnover of up to £50 million received "*on average, little or no pass-through of the IFR savings*". In contrast, merchants on IC++ tariffs, which are typically the largest merchants, received full pass-through of the IFR savings;[201]

(b) results obtained from analysis that "*didn't find evidence of improved quality of service in the period*",[202] which the Interim Report suggests implies that pass-through of the IFR savings did not take place in the form of higher quality of services to merchants; and

(c) for merchants in all turnover groups, analysis indicating that scheme fees were passed-through by acquirers in full. The Interim Report states that, "[i]*f acquirers passed these increases on to merchants, while at the same time holding on to IFR savings – that is, they passed through cost increases and decreases asymmetrically – this could constitute further evidence that the supply of card-acquiring services is not working well*".[203]

3.3 The pass-through analysis relied upon in the Interim Report to justify these preliminary findings involved an estimation of the rate at which interchange fee reductions (and scheme fees) were passed-through to merchants in the form of a reduced MSC, based on data submitted by the five largest acquirers. The Interim Report's pass-through analysis has three limbs:

(a) an analysis of descriptive statistics of the data that is presented to support the position that on average: (i) interchange fees decreased after the implementation of interchange fee caps under the IFR; and (ii) the MSC stayed relatively constant before and after the introduction of the interchange fee caps;

(b) an econometric model that seeks to estimate the change in the interchange fee margin (MSC less interchange fees) before and after the introduction of the interchange fee

199 PSR Press Release, 'PSR announces provisional findings of card acquiring market review' (15 September 2020).

200 Interim Report, paragraph 5.2.

201 Interim Report, page 56, second and third bullets.

202 Interim Report, paragraph 5.36.

203 Interim Report paragraph 5.6.

caps, after controlling for scheme fees and, to a degree, transaction mix and merchant risk. The output of this modelling concludes that the interchange fee margin increased after the introduction of interchange fee caps, which the Interim Report attributes to acquirers not passing through reductions in the MSC; and

(c) a review of annual financial data on "*acquirer net revenue*" from the five largest acquirers. The Interim Report concludes that this review shows that acquirer net revenue (as a percentage of card turnover) increased between 2014 and 2018, and claims that this indicates that "*acquirers may not have fully passed on the IFR savings to merchants*".[204]

3.4 Additionally, the Interim Report reaches the preliminary finding that the lack of pass-through cannot be explained by increased scheme fees or increases in the quality of service. In order to reach this view, a review of quality of service metrics and unit cost data was undertaken, and a separate econometric regression was undertaken in order to model the pass-through of scheme fees, which the Interim Report claims showed that "*acquirers passed-though scheme fees in full*".[205]

3.5 Worldpay and its external advisers have reviewed both the Interim Report's analytical approach in relation to the pass-through analysis, and the conclusions reached from that analysis. In summary, that review shows that the preliminary findings reached in the Interim Report as to the low rate of pass-through are not in fact supported by the evidence cited in connection with the analysis undertaken, and are also rebutted by the modelling Worldpay's external advisers have conducted using a conventional methodology to measure rates of pass-through. In particular:

(a) at the outset, it is noted that the methodology employed to assess pass-through for the purposes of the analysis in the Interim Report differs from the more conventional methodological approach that was initially identified and consulted upon by the PSR in the Pass-through Consultation Paper. For the reasons set out in more detail below, the methodology adopted in the Interim Report does not follow a conventional approach as would be required to provide a robust evidential foundation and as a result does not measure rates of pass-through in any meaningful sense. The results revealed by the analysis undertaken by Worldpay's external advisers is based upon a more robust and conventional methodology (which is similar to the approach in the Pass-through Consultation Paper) and provides a more accurate measure of pass-through compared to the approach adopted in the Interim Report.[206] In particular, this analysis records a clear finding that merchants with annual card turnover of over £1 million received very high levels of pass-through, of over 80%;

(b) as regards the Interim Report's financial review analysis, the Interim Report has also departed from the profitability analysis that was originally consulted on by the PSR in June 2019. Instead, a partial measure of "*acquirer net revenue*" (as a percentage of card turnover) has been adopted that does not enable reliable conclusions to be reached on the impact of interchange caps under the IFR on the costs, revenues, and profits of card-acquiring services. There would in any event be numerous explanations

[204] Interim Report, paragraph 5.11.

[205] Interim Report, Annex 2, paragraph 1.99.

[206] In any event, as explained in paragraphs 3.50 – 3.57 below, it is not possible to conclude on a reliable basis what level of pass-through rate is consistent with limited competition for the supply of card-acquiring services, particularly in circumstances where this is no meaningful benchmark against which to compare the pass-through rate observed.

for any increases in acquirer net revenue, unrelated to the introduction of interchange fee caps, which is recognised in the Interim Report. [redacted] By failing to consider and control for these factors, the analysis is incapable of demonstrating on a reliable basis a causal link between acquirer net revenue and the introduction of interchange fee caps under the IFR; and

(c) the Interim Report does not examine improvements in quality correctly. In particular, only a very limited subset of service metrics have been considered, which do not capture the full array of product developments that have taken place, and the assertion that an absence of unit cost increases provides additional evidence of a lack of non-price pass-through is fundamentally flawed. It is implausible to suggest that quality, choice and innovation has not improved, over a five year period, in a sector that is undergoing a period of rapid and unprecedented change, both in terms of innovation and the development of new payment technologies, and which has attracted new entry (as explained in chapter 1 of this Response).

3.6 In order to address the issues raised by Interim Report's pass-through analysis in detail, this chapter is split into three sections:

(a) **section (a)** provides detailed comments on the econometric methodology for assessing pass-through in the Interim Report, and reflects comments by Worldpay's external advisers based on their review of the data and analysis disclosed within a virtual data room established by the PSR in October 2020 (the "**Confidentiality Ring**");

(b) **section (b)** provides comments on the financial review analysis set out in the Interim Report, which is used to support the Interim Report's preliminary finding on pass-through; and

(c) **section (c)** provides comments in relation to the Interim Report's conclusions on non-price pass-through, which Worldpay believes has been incorrectly dismissed.

(a) Econometric analysis of pass-through

Introduction

3.7 As noted above, the Interim Report states that merchants with annual card turnover of less than £50 million received "*on average, little or no pass-through of the IFR savings*", which it suggests provides evidence that the supply of card-acquiring services is not working well. This interim finding relies upon econometric analysis of data provided by each of the five largest acquirers.

3.8 The econometric approach to estimating pass-through presented in the Interim Report is unconventional, and differs substantially from the methodology set out in the Pass-through Consultation Paper. To reach the conclusion that there was little or no pass-through of the IFR savings, the Interim Report compares:

(a) **IFR savings**: an estimate of the extent to which interchange fees declined as a result of the interchange fee caps implemented under the IFR. The estimate is based on a comparison of the weighted average interchange fee before and after the introduction of the interchange fee caps in December 2015; and

(b) **IFR effect**: an estimate of the change in the interchange fee margin as a result of the IFR, estimated using an econometric model. Under the Interim Report's analysis, an IFR effect close to zero indicates that the interchange fee margin remained flat following the interchange fee caps coming into force. On the other hand, a positive IFR effect would indicate that the interchange fee margin increased.

3.9 The Interim Report suggests that a comparison of the IFR savings and the IFR effect demonstrates the extent to which pass-through occurred. Specifically, the Interim Report states that, "[i]*f the IFR effect is bigger than or equal to the IFR savings, it indicates little or no pass-through; if it is less than the IFR savings, it indicates partial pass-through*".[207]

3.10 The Interim Report splits merchants into seven groups based on annual card turnover.[208] The pass-through rate for each of these groups is considered separately. Merchants on IC++ pricing, irrespective of annual card turnover, are also considered separately.

3.11 However, for the reasons set out in this section, the approach adopted in the Interim Report is fundamentally flawed. In particular:

(a) the methodology does not measure pass-through; it measures the difference in the interchange fee margin in the period after the interchange fee caps under the IFR compared to the period before the interchange fee caps. There are a range of reasons why the interchange fee margin could have changed between the two periods which are unrelated to changes in interchange fees;

(b) the Interim Report departs from the methodology set out in the Pass-through Consultation Paper without any justification;

(c) the Interim Report's own results, when correctly interpreted, show that pass-through rates are between 75% and 95%. The existence of this analysis and results cannot on any reasonable basis be used to support a statement that there was "*little or no pass-through of the IFR savings*";

(d) these results are robust to other specifications. Worldpay's own analysis shows that the pass-through rate is greater than 70% across all merchant groups and more than 80% for merchants with an annual turnover above £1 million; and

(e) in any case, it is not possible to conclude on a reliable basis what level of pass-through rate is consistent with competition problems.

3.12 Each of these points is considered in further detail below.

(i) The Interim Report's approach does not measure pass-through

3.13 The PSR's econometric approach is set out in Annex 2 of the Interim Report. The IFR effect is estimated using a fixed effects panel model where the interchange fee margin (MSC minus

207 PSR Interim Report, paragraph 5.27.

208 Up to £15,000 (Group 1); £15,000 to £180,000 (Group 2); £180,000 to £380,000 (Group 3); £380,000 to £1 million (Group 4); £1 million to £10 million (Group 5); £10 million to £50 million (Group 6); and more than £50 million (Group 7).

interchange fees) is the dependent variable. This is described as model (2) in Annex 2 of the Interim Report; the three models considered are reproduced below:

$$MSC_{it} = \alpha_i + \beta_1 IFR_t + \beta_2 IF_{it} + \beta_3 SF_{it} + \sum_k \gamma_k x_{kit} + \varepsilon_{it} \qquad (1)$$
$$MSC_{it} - IF_{it} = \alpha_i + \beta_1 IFR_t + \beta_3 SF_{it} + \sum_k \gamma_k x_{kit} + \varepsilon_{it} \qquad (2)$$
$$MSC_{it} - IF_{it} - SF_{it} = \alpha_i + \beta_1 IFR_t + \sum_k \gamma_k x_{kit} + \varepsilon_{it} \qquad (3)$$

3.14 Model (2) includes a dummy variable (IFR_t) for the introduction of the interchange fee caps under the IFR, the dummy variable takes a value of zero before December 2015 and one after December 2015. The coefficient on this dummy variable (β_1), provides the estimate of the IFR effect, which is the basis for the pass-through conclusions.

3.15 The Interim Report's suggestion that this provides a measure of pass-through is fundamentally flawed. The analysis is attempting to measure the extent to which changes in interchange fees were passed-through to merchants in terms of changes to the MSC. However, by focussing on the interchange fee margin as the dependent variable, the Interim Report assumes that all changes in interchange fees are fully passed through to merchants. Annex 2 of the Interim Report makes this clear (paragraph 1.13, emphasis added):

> "*Moving from model (1) to model (2) imposes the restriction that the coefficient on interchange fees is equal to one. This would hold under <u>full pass-through of interchange fees</u>.*"

3.16 What the Interim Report describes as the IFR effect is actually the change in the interchange fee margin following the introduction of interchange fee caps under the IFR. There are a range of reasons why the interchange fee margin could have changed which are unrelated to changes in interchange fees. The fact that the coefficient on the IFR dummy is positive does not provide a measure of the rate of pass-through. Rather, the relevance if any, of the resulting observation is limited to the suggestion that the interchange fee margin has increased on average since the interchange fee caps came into effect.

3.17 As set out in more detail in the financial information section below, there are a number of reasons why the interchange fee margin may have increased since December 2015, for example:

(a) increased operating and capital expenditure costs and investments that have increased service quality and choice for merchants of all sizes;

(b) increased demand for card-acquiring services generally could give rise to increasing prices, even in a competitive market; and

(c) changes in the transaction mix over time (e.g. a higher proportion of online transactions) could affect the average interchange fee margin.

3.18 The Interim Report claims that the regression results are robust to changes in the model specification.[209] However, the limited scenario testing described in Annex 2 involves only minor adjustments to the model that are incapable of addressing the fundamental concern, namely that the coefficient on the IFR dummy does not measure pass-through. As shown below, changes to the Interim Report's modelling to align it with a more conventional

209 PSR Interim Report, paragraph 5.24.

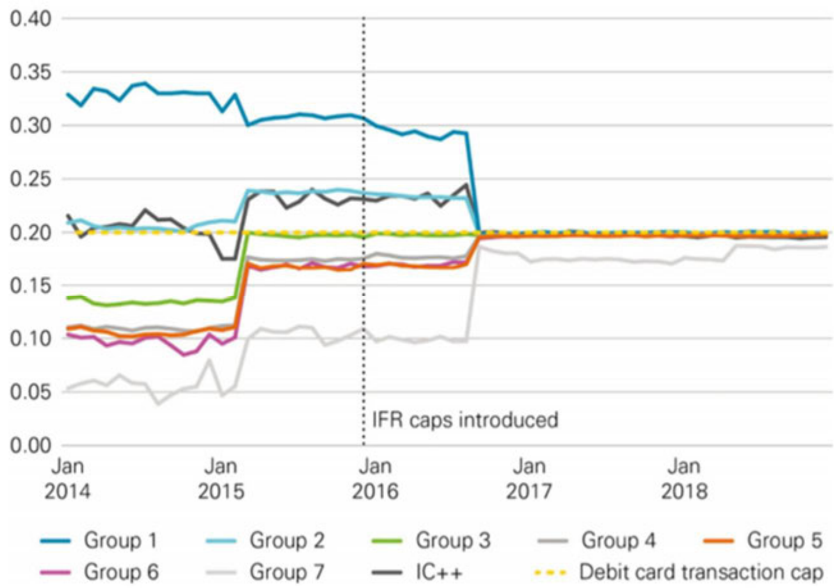
methodology, and also the approach set out in the Pass-through Consultation Paper, show that pass-through is significantly higher than suggested by the Interim Report.

3.19 The comparison of the IFR effect with the IFR savings is also not meaningful. The IFR effect measures the change in the interchange fee margin after controlling for changes in interchange fees, whereas the IFR saving measures the change in the interchange fee before and after the introduction of interchange fee caps. The two measures are unrelated and a comparison of them does not provide any indication of pass-through rates.

3.20 Moreover, the Interim Report's approach of using a dummy variable to measure pass-through would only be valid if there was a change in interchange fees across all transaction types in December 2015. Whilst this was largely the case for capped credit card transactions (see Figure 3 in Annex 2 of the Interim Report), it is clearly not the case for capped debit card transactions.

3.21 As explained in paragraph 1.40 of Annex 2, interchange fees on debit card transactions changed in March 2015 and in September 2016 following changes by Visa to its interchange fee rates. These changes are illustrated in Figure 4 of Annex 2, reproduced below.

Figure 3: Monthly average interchange fees on capped debit cards, by merchant group (Figure 4 in Annex 2)



3.22 The figure above clearly demonstrates that interchange fees on capped debit cards remained stable in and around December 2015, but there were sizeable changes in March 2015 and September 2016.

3.23 Capped debit card transactions account for [redacted]% of all transactions and therefore have a significant impact on the Interim Report's overall analysis. The analysis introduces a further distortion in this regard by the fact that it also includes commercial card transactions, which were not within scope of the IFR.

3.24 As a result, a dummy variable approach is not measuring pass-through, as over [redacted]% of transactions (capped debit card and non-capped card transactions) in the Interim Report's analysis experienced no change in interchange fees in December 2015 (i.e. the month of the dummy variable). Instead the dummy variable is picking up other structural changes in the interchange fee margin unrelated to changes in the interchange fee.

(ii) There has been no consultation on the methodology presented in the Interim Report

3.25 The approach adopted in the Interim Report, and explained above, departs from a conventional methodology, in that it fails to properly isolate and test the factor under investigation, namely the pass-through rate. As far as Worldpay is aware, a similar approach of using a dummy variable has not been used in any other market reviews or by any other competition regulators to estimate pass-through.

3.26 As noted above, this methodology also differs substantially from the methodology consulted upon in the Pass-through Consultation Paper. In particular, the Interim Report uses the coefficient on the IFR dummy as its measure of pass-through, rather than the coefficient on the interchange fee variable. The approach to assessing pass-through in the Pass-through Consultation Paper proposed three different methodologies to estimating the pass-through rate:

(a) a reduced-form panel model that would model the MSC as a function of current and historical fees, merchant characteristics, acquirer characteristics, and market-wide characteristics;

(b) a difference-in-difference style regression with IF++ tariffs as the comparator; and

(c) a difference-in-difference style regression with the MSC for commercial cards as the comparator.

3.27 Whilst Worldpay had concerns about the proposed approaches set out in the Pass-through Consultation Paper (as set out in Worldpay's response dated March 2019), each of the approaches consulted upon did, at least in principle, measure pass-through.

3.28 The approach ultimately adopted in the Interim Report differs significantly from all three of the approaches in the Pass-through Consultation Paper, but is closest to the reduced form panel model (approach (a) above). However, even in relation to the reduced form panel model proposed in the Consultation Paper, there are fundamental differences compared to the approach ultimately adopted in the Interim Report. In particular:

(a) the proposed methodology had the MSC as the dependent variable, whereas the adopted approach in the Interim Report uses the interchange fee margin as the dependent variable;

(b) the proposed methodology did not include a dummy variable for the introduction of interchange fee caps under the IFR. This is a significant change given the Interim Report uses the coefficient on the IFR dummy variable as its measure of pass-through;

(c) the Interim Report's adopted approach does not allow for any differences between "*long-term pass-through*" and "*short-term pass-through*", unlike the reduced-form panel model in the Pass-through Consultation Paper; and

(d) a number of variables included in the reduced-form model in the Pass-through Consultation Paper have not been included in the model adopted in the Interim Report, including: (i) all of the transaction mix controls; (ii) the period-specific fixed effects; (iii) demand controls; and (iv) cost measures.

3.29 The Interim Report also departs from using three independent models, each one estimating a pass-through rate, to an approach that relies on a single model that does not estimate a pass-through rate. As a result, the Interim Report's econometric results are not founded upon a robust methodology and are susceptible to model mis-specification.

3.30 The Interim Report sets out no clear justification as to why it was necessary to depart from the approaches set out in the Pass-through Consultation Paper. The response to feedback set out in box 1 of Annex 2 addresses specific points of detail, but does not address the fundamental changes that have been made compared to the originally proposed approach that was consulted upon with industry stakeholders.

3.31 As a result of the significant differences listed above and the fact this radically different methodology was introduced without consultation, neither Worldpay nor any other party has had the opportunity to meaningfully engage with the PSR in regards to the adopted methodology. The differences listed above represent fundamental changes to the pass-through analysis and must be considered carefully. It may also have been preferable to collect different data or use a different approach to sampling had a consultation taken place with respect to the adopted approach before the data collection stage.

3.32 Moreover, the Pass-through Consultation Paper considered the use of econometric analysis in relation to the pass-through rate of interchange fees. There had been no suggestion prior to publication of the Interim Report on using econometrics to assess the separate topic of prices paid by new versus longstanding customers. As explained in chapter 4 of this Response (and in further detail in section 5 of the Technical Annex), Worldpay has significant concerns about the methodology adopted in respect of this analysis.

(iii) The Interim Report's alternative specifications show pass-through is high

3.33 As explained above, the Interim Report's adopted methodology does not properly assess the pass-through rate. However, one of the alternative specifications presented in Annex 2 to the Interim Report does directly measure pass-through.

3.34 Table 20 of Annex 2 shows the results of a regression with the MSC as the dependent variable and with the interchange fee and a number of controls as the independent variables (similar to model (1) in paragraph 3.13 above). The estimated coefficient on the interchange fee variable in this regression can be interpreted as the pass-through rate, i.e. the expected change in the MSC that arises as a result of a change in the interchange fee after controlling for various other factors.

3.35 The regression set out in Table 20 of Annex 2 is also closest in structure to the reduced form model in the Pass-through Consultation Paper. In particular, the dependent variable is the MSC and the interchange fee is one of the independent variables. In this regard, it is also clear from the consultation that the PSR had proposed to interpret the coefficient on the interchange fee variable as the pass-through rate.[210]

3.36 The coefficient on the interchange fee variable in Table 20 of Annex 2 provides, on any conventional methodology, a more accurate measure of pass-through than the coefficient on the IFR dummy relied upon in the Interim Report. In particular, the coefficient on the

210 The Interim Report's proposed reduced form model included multiple lagged interchange fee variables and the sum of the coefficients on the interchange fee variables would have represented the long-run pass-through rate. The regression reported in Table 20 of Annex 2 to the Interim Report includes a single interchange variable and therefore the coefficient on this variable represents the contemporaneous pass-through rate.

interchange fee variable provides a direct measure of how changes in interchanges fees impact on MSCs (i.e. pass-through).

3.37 Table 2 shows the estimated pass-through rate from the regression results in Table 20 of Annex 2 (i.e. the coefficient on the interchange fee variable).

Table 2: Pass-through rates estimated in the Interim Report

Merchant Group	1	2	3	4	5	6	7	IC++
Merchant turnover (£)	<15k	15k-180k	180k-380k	380k-1m	1m-10m	10m-50m	50m+	NA
Pass-through rate	76.4	89.6	98.3	94.5	79.2	79.0	76.9	100.0

Source: Table 20 of Annex 2

3.38 The pass-through rates estimated above clearly contradict the Interim Report's preliminary findings of "*no or little pass-through of IFR savings*"; indeed pass-through rates for all categories of merchants are above 75%.

3.39 In addition, it is clear from this analysis that merchants with annual card turnover less than £50 million (groups 1 - 6) do not achieve outcomes sufficiently different when compared to merchants with annual card turnover greater than £50 million (group 7) as would justify adverse findings. These clear results are also contrary to the Interim Report's further preliminary finding that merchants with annual card turnover less than £50 million received little or no pass-through, whilst merchants above £50 million annual card turnover were not adversely affected.

3.40 The Interim Report also concludes that acquirers passed-through increases in scheme fees in full to merchants in all groups and that this could constitute further evidence that the supply of card-acquiring services is not working well. However, it is clear from the above results that interchange fees were passed on in full, or nearly in full. Moreover, the results in Table 20 of Annex 2 show that the pass-through rate for scheme fees is broadly similar to (and for some merchant groups lower) than the pass-through rate for interchange fees.[211] Therefore, there is no basis to conclude that pass-through of interchange fees and scheme fees has been asymmetric.

(iv) Worldpay's own analysis shows the pass-through rate is high

3.41 The coefficients on the interchange fee variable in Table 20 of Annex 2 provides a more meaningful measure of pass-through than the baseline results reported in the Interim Report. However, there remain issues with the specification of the regression model underpinning this regression. In particular, Worldpay has the following concerns with the specification of the regression model reported in Table 20:

(a) the Interim Report's analysis combines data on consumer card transactions with data on commercial card transactions. However, commercial card transactions have significantly higher interchange fees (that were not subject to the IFR) and are outside

211 Interpreted as the coefficient on the scheme fee variable and interchange fee variable respectively.

the scope of this Market Review. Including commercial card transactions therefore risks distorting the pass-through results; and

(b) the Interim Report's analysis only includes a contemporaneous interchange fee variable and therefore fails to measure long-run pass-through. It would be incorrect to assume that all changes in interchange fees are passed through immediately, e.g. for some customers MSCs may be set in contracts and will not change until the contract is renegotiated.

3.42 In addition, Worldpay has concerns regarding the data used in the Interim Report's analysis, including:

(a) the approach to excluding outliers results in a very large number of observations being dropped that are not obviously outliers, including more than [redacted] observations that have been dropped because of a rounding error; and

(b) using the proportion of chargebacks as a control in the analysis is a poor proxy for merchant risk. In particular, more than [redacted]% of observations and more than [redacted]% of merchants show no chargebacks.

3.43 The above issues are discussed in more detail in the Technical Annex to this Response.

3.44 One of the key challenges of measuring pass-through rates in the supply of card-acquiring services is the presence of mix effects, i.e. the MSC can change from month-to-month due to changes in transaction mix rather than changes in interchange fees. By aggregating together all card transactions, the Interim Report's adopted model is particularly susceptible to mix effects and this issue is only partially controlled for by including transaction share variables in the regression model.

3.45 To account for these shortcomings, Worldpay's external advisers have undertaken an updated regression analysis to assess pass-through. The changes include:

(a) focussing on consumer card transactions only (i.e. excluding commercial card transactions and other MSC charges[212]) which helps to reduce the mix effects issue outlined above, as well as focussing on card transactions within the scope of the Market Review;

(b) including lagged variables to assess long-run pass-through rates;

(c) updating the approach to cleaning the data provided by acquirers including: (i) refining the approach to dropping outliers; and (ii) not relying on imputed data; and

(d) removing the IFR dummy. As explained above the coefficient on the interchange fee variable (including lagged variables) provides a more meaningful measure of pass-through.

212 As explained in the Technical Annex, the other MSC charge variable disclosed within the Confidentiality Ring includes charges with fixed price elements (i.e. that do not vary based on transaction values or volumes). The inclusion of these charges, without the ability to control for differences in pricing structure or tariff type, gives rise to a large number of outliers that risk significantly distorting the results of the analysis.

3.46 As the model is based on consumer card transactions, it is based on data for the three acquirers that provided MSC data split between consumer and commercial cards [redacted].

3.47 The results for this regression model are set out in Table 3 below. The long-run pass-through rate measures the total pass-through rate in the six months after any change to interchange fees.[213]

Table 3: Pass-through rates estimated by Worldpay

Merchant Group	1	2	3	4	5	6	7	IC++
Merchant turnover (£)	<15k	15k-180k	180k-380k	380k-1m	1m-10m	10m-50m	50m+	NA
Long-run pass-through rate	79.9	75.0	70.9	70.5	82.7	85.8	94.5	104.1

Note: For IC++ merchants lagged variables were not included in the regression model as IC++ tariffs should pass- hrough any changes in interchange fees and scheme fees immediately, i.e. the contemporaneous pass-through rate should equal the long-run pass-through rate.

3.48 The results above show that the long-run pass-through rate is greater than 70% across all merchant groups. Notably, merchants with an annual card turnover above £1 million (groups 5 – 7) had a pass-through rate of more than 80%.

3.49 These results provide a more accurate and robust measure of pass-through compared to the approach adopted in the Interim Report and show that there is no basis on which to conclude that merchants with annual card turnover less than £50 million received little or no pass-through.

(v) It is not possible to conclude what level of pass-through rate is consistent with competition problems

3.50 The results above show that the pass-through rate is high and for many merchant groups in excess of 80%. Moreover, these results are likely to underestimate the true pass-through rate, as they do not take into account pass-through that did not occur in the form of a reduced MSC.

3.51 In addition to reductions in the MSC, merchants benefited from price reductions on related transaction fees (e.g. [redacted]), abolishing or reducing joining fees, and investments in increased choice, customer service, quality and innovation as a result of IFR savings (e.g. [redacted]). This is discussed in more detail in the next section.

3.52 In any case, it is not possible to conclude on a reliable basis what level of pass-through rate is consistent with limited competition for the supply of card-acquiring services. In particular, there is no meaningful benchmark against which to compare the pass-through rate. As is widely recognised, it is possible to find lower pass-through rates in more competitive industries and higher ones in less competitive ones.[214] This illustrates the fundamental difficulty presented

213 In the regression model this corresponds to the coefficient on the interchange fee variable in the current month plus the sum of coefficients on the weighted interchange fee in the previous six months.

214 The extent of industry-wide pass-through typically depends on the elasticity of demand relative to the elasticity of supply. The curvature of demand also plays a key role in determining the magnitude of pass-through. Depending on the relevant elasticities and the curvature of demand, it is possible to find lower

by the Interim Report's econometric analysis of the pass-through rate used as an indicator of the intensity of competition. The Interim Report has also not set out an indication of the level pass-through rate it expects to see in an industry that is working well.

3.53 In addition, even if the Interim Report had set a benchmark pass-through rate that could be expected in a competitive market, the adopted methodology would prevent meaningful comparison to that benchmark. As noted above, the PSR has not calculated a pass-through rate, as a result it is impossible to compare the estimated IFR effect to a benchmark or other markets.

3.54 As mentioned in Worldpay's response to the Pass-through Consultation Paper, there are very few studies that shed light on the relationship between pass-through, market structure and the intensity of competition. Indeed, the RBB Economics report on pass-through prepared for the Office of Fair Trading (OFT) notes the following:

> "*Empirical work on cost pass-through issues in industrial organisation settings is relatively new, and analysis that attempts to quantify pass-through rates in this context is scarce. Most notably, we have identified few studies that shed light on the relationship between cost pass-through and market structure and competition. Moreover, the pass-through measures reported in the empirical literature, notably pass-through elasticities, are often difficult to interpret and compare…* [I]*mportantly, <u>no clear evidence emerges as to how cost pass-through is linked to market concentration measures</u> such as a firm's market share or the market HHI level.*"[215]

3.55 Moreover, as set out further below, where both price and non-price factors are relevant to competition in practice, as they are in relation to card-acquiring services, (which is accepted in the Interim Report[216]) focussing only on the pricing dimension of competition will significantly understate the actual pro-competitive pass-through to customers.

3.56 Importantly, the Interim Report also claims that it has identified different pass-through rates for different merchant groups. To the extent that these groups and products have different elasticities of demand relative to supply, one would expect their pass-through rates to be different even if the intensity of competition is similar across these groups or products. It is clear that the PSR has not taken such factors into account when interpreting the results of its analysis.

3.57 Accordingly, Worldpay is concerned that too much weight has been applied to the results of the pass-through analysis in the Interim Report, which only examines the link between interchange fees, scheme fees and the MSC, and which cannot be used to provide any meaningful insight as to the intensity of competition for card-acquiring services.

pass-through rates in more competitive industries and higher ones in less competitive ones. This illustrates a fundamental difficulty in the PSR's intention to use a calculated pass-through rate as an indicator of the intensity of competition; it is unclear what a relevant competitive benchmark is.

215 RBB Economics, 'Cost pass-through: theory, measurement, and potential policy implications, A Report prepared for the Office of Fair Trading', (February 2014).

216 Interim Report, paragraph 4.59 ("*most acquirers report that they differentiate their card-acquiring services offering mainly based on quality and other non-price factors. In addition, most do not identify price as a key consideration in how they plan to develop their offering,* […]").

(b) The PSR's financial review analysis

Introduction

3.58 The five largest acquirers were asked to provide a substantial volume of financial information during the Market Review. On the basis of this information, the Interim Report observes that:

(a) average interchange fees as a percentage of card turnover "*fell significantly*" between 2014 and 2016 and then remained approximately constant;

(b) average scheme fees as a percentage of card turnover more than doubled over the period from 2014 to 2018, with most of this increase occurring between 2016 and 2018. In addition, the proportion of the MSC relating to scheme fees has increased;

(c) average MSCs fell as interchange fees fell between 2014 and 2016. However, average MSCs increased after 2016 "*mainly driven by a rise in scheme fees*"; and

(d) average acquirer net revenue as a percentage of card turnover (i.e. after deducting the interchange fee and scheme fees) rose between 2014 and 2016 "*at the same time as interchange fees fell*", then flattened off.[217]

3.59 Annex 3 to the Interim Report concludes that the decrease in average MSCs was less than the decrease observed in interchange fees, "*resulting in a higher acquirer net revenue*". The Interim Report seeks to draw a further conclusion based on the same financial analysis stating that the results "*<u>indicates acquirers may not have fully passed on</u> the IFR savings to merchants*".[218]

3.60 According to Annex 3 to the Interim Report, the value of the financial review analysis is to provide additional information on some of the issues covered in the pass-through analysis by "*describing the aggregate results and with an acquirer-centric view*". On the basis of this additional analysis, it is claimed that the results of the financial review are "*consistent with* [the] *pass-through analysis*" (i.e. that there was limited or no pass-through of the benefits of interchange fee caps to merchants with less than £50 million annual card turnover).[219]

3.61 Worldpay strongly disagrees that such conclusions can be reached purely from an assessment of acquirer <u>net</u> revenue. In particular:

(a) identifying variations in acquirer net revenue does not enable any meaningful conclusions to be reached on the impact of interchange fee caps under the IFR on acquirers' profitability (which is acknowledged at paragraph 1.39 of Annex 3). It is widely accepted that acquirer net revenue is a partial measure and will not provide a complete measure of acquirers' costs, revenues or profits, and therefore cannot be used to support conclusions around an acquirer's profitability. It would be against conventional and accepted principles to do so. Notably in this regard, the adopted approach which seeks to rely upon acquirer net revenue is a fundamental departure from the methodological proposals set out in the PSR's Profitability Consultation Paper;

(b) [redacted]

217 Interim Report, paragraph 5.10.

218 Interim Report, paragraph 5.11.

219 Interim Report, Annex 3, paragraph 1.4.

[redacted]

(c) there would in any event be numerous explanations for any increases in acquirer net revenue unrelated to the introduction of interchange fee caps under the IFR, which is recognised at paragraph 1.51 of Annex 3.[220] By failing to consider and control for these factors, the analysis is incapable of demonstrating on a reliable basis a causal link between acquirer net revenue and the introduction of interchange fee caps; and

(d) a five-year period between 2014 and 2018 has been used to undertake the financial review analysis. However, as Worldpay submitted in response to the Profitability Consultation Paper, a five-year period does not cover the business cycle for card-acquiring services. Any analysis of acquirer net revenue must take into account that variations may be driven by wider market conditions, including changes to acquirers' exposure to risk or the impact of economic downturns (e.g. as a consequence of the COVID-19 pandemic).

Acquirer net revenue does not assist with measuring the impact of interchange fee caps under the IFR

The "financial review" analysis is a fundamental departure from the 2019 consultation

3.62 The proposal to undertake a financial review analysis that examines variations in acquirer net revenue measured as a percentage of card turnover did not appear in the Profitability Consultation Paper, which set out the proposed approach to assessing profitability during this Market Review. This Response is therefore the first opportunity that Worldpay has had to submit any representations on the meaningfulness of the new methodology.

3.63 The Profitability Consultation Paper proposed an analysis that would use two different measures of profitability: Return on Capital Employed ("**ROCE**") and gross profit margins ("**GPMs**"). The PSR announced in September 2019 that it did not intend to pursue its ROCE analysis further, but instead to rely on GPMs.[221] The intended uses for the GPMs analysis was communicated on the PSR's website, [redacted][222]

3.64 Worldpay welcomed the decision to discontinue the ROCE analysis proposed in the Profitability Consultation Paper. However, Worldpay's response to that consultation also raised concerns about relying on GPMs as a measure of profitability. In particular, Worldpay's submission emphasised that a significant proportion of acquirers' fixed and common costs (including technology spend) would have been excluded from the GPMs analysis.[223]

220 Interim Report, Annex 3, paragraph 1.51.

221 PSR Press release, 'PSR update on its approach to the profitability analysis for its market review into card-acquiring services' (18 September 2019).

222 [redacted]

223 See Worldpay's response to the PSR's Profitability Consultation Paper, paragraph 3.6.

3.65 The concerns raised by Worldpay in relation to the use of GPMs as a measure of profitability are even more acute in relation to acquirer net revenue, which only takes account of interchange fees and scheme fees and therefore excludes all other costs. It is concerning that the Interim Report has fundamentally departed from any meaningful calculation of profitability of card-acquiring services, such that the analysis carried out is largely meaningless. As Annex 3 confirms, the calculation of GPMs has been abandoned and replaced with a "*financial review of the evolution over time of the MSC by merchants to the five largest acquirers and its components*".[224]

3.66 A further consequence of the revised methodology has been changes to the questions that are intended to be addressed through this exercise. In particular, instead of considering how acquirers may have reacted to the introduction of interchange fee caps through variations in their profitability, the Interim Report examines acquirer behaviour solely by reference to variations in acquirer net revenue. In this regard, the Interim Report acknowledges that, "*since we are considering acquirer net revenue, which is before the deduction of costs (other than interchange fees and scheme fees), we are unable to conclude on profitability*".[225]

3.67 The Interim Report attributes the decision to use acquirer net revenue to the unavailability of cost information required from acquirers to undertake a GPM analysis,[226] but no explanation has been provided as to why acquirer net revenue should be considered an adequate substitute to GPMs in the first place. In particular, no explanation has been provided for how acquirer net revenue allows for the issues originally contemplated in the Profitability Consultation Paper to be addressed, nor is there any explanation for why acquirer net revenue can be used to draw inferences about the impact of interchange fee caps under the IFR.

Acquirer net revenue is an inadequate substitute for measuring the impact of the IFR

3.68 In the information request issued to Worldpay on 18 October 2019, GPMs were defined as revenue less Directly Attributable Costs, and the request went on to explain that Directly Attributable Costs may be categorised as either "*direct selling costs or other relevant direct costs*".[227] The information request gave examples of direct selling costs, including: sales staff; commissions paid to ISOs and other third parties; and marketing costs. Other relevant direct costs were defined to include all direct costs other than direct selling costs, including bad debts; computing and processing costs; support desk costs; management; and accommodation and property costs.

3.69 Worldpay's response to the Profitability Consultation Paper explained that GPMs would not provide a reliable basis on which to identify patterns of profitability across different periods of time. In particular, a significant proportion of fixed and common costs (including technology spend) would have been excluded from the profitability analysis. Changes in these costs would need to be controlled for, in order to separate their impact from changes in GPMs resulting from the introduction of interchange fee caps under the IFR.

3.70 Annex 3 to the Interim Report accepts the limitations of using GPMs when stating that, "*we acknowledge the challenges in establishing causal links between changes in GPM and*

224 Interim Report, Annex 3, paragraph 1.2.

225 Interim Report, Annex 3, paragraph 1.39.

226 Interim Report, Annex 3, paragraph 1.34.

227 Profitability Consultation Paper, paragraph 2.21.

changes in the levels of interchange fees and scheme fees".[228] It goes on to explain that there are "*many other factors that could influence the level of GPM, such as changes in costs (other than interchange fees and scheme fees) and other operating conditions*".[229]

3.71 Worldpay agrees with the Interim Report's identification of this general issue; however, after acknowledging this limitation in the context of GPMs, the Interim Report then proceeds to focus solely on acquirer net revenue for the purpose of the financial review analysis. This is despite the fact that the same difficulties establishing causality are even more acute when considering variations in acquirer net revenue, as even more costs are excluded from the analysis. This is implicitly recognised in Annex 3 to the Interim Report, which notes that:

> "*there could have been other factors that may have led MSC and acquirer net revenue to vary over the five years, including: changes to operating costs, changes in the volume and value of transactions acquired, changes in services and changes in the business environment*".[230]

3.72 However, nowhere in Annex 3, nor elsewhere the Interim Report, are the implications of this methodological issue addressed. The implications of this are clear: there is no basis to conclude from the financial review analysis that, "*acquirers may not have fully passed on the IFR savings to merchants*" or that the analysis is "*consistent with* [the] *pass-through analysis*", as the Interim Report does not establish causality (i.e. by controlling for all other factors that may have impacted on the MSC and acquirer net revenue over time).

3.73 The approach adopted in the financial review analysis is especially surprising given that there is an even weaker causal link between changes in interchange fees, MSC and the acquirer net revenue of acquirers compared to GPMs. For example, whereas the proposed measure of GPMs in the Profitability Consultation Paper would have taken into account some additional directly attributable costs, the Interim Report's measure of acquirer net revenue makes no attempt to separate between variations in costs except for interchange and scheme fees. Therefore, the financial review analysis of acquirer net revenue is even more sensitive than GPMs to variations in costs (other than interchange and scheme fees).

3.74 As a consequence, the absence of any or adequate measures to control for other factors that may have impacted the acquirer net revenue of acquirers during the same period means that the financial review analysis is incapable of demonstrating on a reliable basis a causal link between acquirer net revenue and the introduction of interchange fees. Despite acknowledging that other factors may impact the MSC and acquirer net revenue, there is no evidence in the Interim Report that attempts have been made to control for these factors.

There are numerous explanations for increases in acquirer net revenue

3.75 Chapter 1 of this Response describes the industry-wide changes that have been taking place within the payments sector, which have been driven by changes in innovation and technology, a wider choice of service providers, changes in the regulatory environment, and the internationalisation of payment services. Before drawing any conclusions from changes in acquirer net revenue over time, it is important to consider the numerous dynamic changes that have also taken place during the same period. These include changes to:

---

228 Annex 3 to the Interim Report, paragraph 1.18.

229 Annex 3 to the Interim Report, paragraph 1.18.

230 Annex 3 to the Interim Report, paragraph 1.51.

(a) operating and capital expenditure costs, which have generally increased since 2014;

(b) investments that have enhance the levels of choice, customer service, quality and innovation across card-acquiring services (and related card-acceptance products);

(c) changes in demand trends (e.g. product, transaction and customer mix) and other external factors (including differences in the risk profile of merchants); and

(d) changes in acquirers' business and pricing strategy.

3.76 Acquirer net revenue may also fluctuate in accordance with the business cycles of acquirers (e.g. reductions in pricing to attract and retain new customers may be more likely to take place during economic recessions), which means that it is necessary to take into account the full economic cycle in order to draw any conclusions on overall trends in acquirer net revenue.

3.77 Each of the factors set out above, which the Interim Report acknowledges may impact acquirer net revenue, will often be independent of the level of interchange fees and scheme fees. Therefore, before drawing any conclusions from whether trends in acquirer net revenue can be attributed to interchange fee caps, it is necessary to identify the extent to which other plausible factors are driving these results. Again, this analysis has not been undertaken in the Interim Report.

Acquirer net revenue ignores variations in key business costs

3.78 The absence of the financial review methodology to measure the wider cost base is not a theoretical issue; it has material consequences, [redacted]. As noted above, Annex 3 to the Interim Report acknowledges that changes in operating costs (other than interchange fees and scheme fees) may impact the variation of MSC and acquirer net revenue from year-to-year. Respondents to the Profitability Consultation Paper, including Worldpay, raised similar concerns in the context of the profitability analysis that had been originally proposed.

3.79 [redacted]

3.80 [redacted]

231 [redacted]

[redacted]

Table 4: [redacted]

[redacted]

3.81 Any changes to the MSC in order to cover increases in costs over time will impact directly on acquirer net revenue. The PSR has correctly acknowledged that changes to operating costs could be one of the factors that may have led MSC and acquirer net revenue to increase over the five years, and therefore such changes will not be a consequence of the interchange fee caps introduced under the IFR.

3.82 [redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]

232 [redacted]

[redacted]

3.83 Accordingly, without considering the potential impact of changes [redacted] on the MSC and acquirer net revenue, it is not possible for the Interim Report to conclude that any such changes observed are as a result of interchange fee caps under the IFR.

Acquirer net revenue ignores investments that increase choice, customer service, quality and innovation

3.84 Worldpay has previously submitted evidence that competition for card-acquiring services takes place across many different dimensions, including choice, customer service, quality, innovation, and price.[234] [redacted]

3.85 The Interim Report confirms that most acquirers aim to "*differentiate their card-acquiring services offering mainly based on quality and other non-price factors*".[235] In particular, the Interim Report accepts that acquirers compete for both Large Merchants and SME Merchants based on non-price factors including customers service, omnichannel services, quality and range of card-acceptance products, ease of speed of onboarding, faster settlement and offer of business management software.

3.86 It is important that any relationship between the prices merchants pay for card-acquiring services takes into account variations in the quality and choice of those services over time. Acquirers will seek to recover investments made to improve the quality, resilience and speed of their IT platforms, [redacted] Similarly, acquirers may use revenues received from card-acquiring services to launch new tariffs, card-acceptance products or value-added services and expand their overall product offering to merchants.

3.87 [redacted]

3.88 [redacted] it must also take into account all other costs that have been incurred over the same period, which could be impacting on the net revenue observations. This would require an analysis of acquirers' overall costs across a representative period of time, which takes into account all direct costs (i.e. not limited to interchange fees and scheme fees) and fixed and common costs (including any investments that have been undertaken).

233 The Interim Report accepts that the increases in scheme fees "*isn't negligible*" (Annex 3, paragraph 1.46).

234 See Worldpay's response to General RFI 2, Annex C (7 October 2019).

235 Interim Report, paragraph 4.59.

Acquirer net revenue does not take account of demand changes and other external factors

3.89 In addition to changes that have been introduced within the businesses of acquirers, acquirer net revenue is sensitive to demand changes and other external factors that vary from year-to-year. These include the following:

(a) variations in the mix of merchants supplied with card-acquiring services, which have continued to change between 2014 and 2018 as traditionally cash-based businesses start to accept card payments or when acquirers are successful in persuading merchants to switch (or unsuccessful in retaining existing merchants). [redacted]

(b) variations in the portfolio mix of merchant transactions over time, which may attract different levels of interchange fees and scheme fees. There have been a number of contributing factors that have driven such changes between 2014 and 2018, including (among other things):

(i) an increase in the proportion of card payments made using contactless technology;

(ii) an increase in the proportion of consumer debit card payments (relative to other card payment types);

(iii) an increase in average transaction values for card payments in general;

(iv) an increase in the proportion of online payments (driven, in part, by an increase in the number of merchants that now accept online payments);[236] and

(c) other changes in market conditions, such as the timing of business cycles and the wider macroeconomic environment within which acquirers operate (see below).

3.90 As explained above, any conclusions drawn from variation in acquirer net revenue would need to take account of changes to other factors that may explain those trends, including changes to merchant and transaction mix. The growth in small businesses accepting card payments, for example, may increase the risk exposure of acquirers and justifiably attract higher acquirer net revenue to offset greater risk. The financial review analysis does not consider the possible impact of such payment trends on the acquirer net revenue.

Acquirer net revenue does not take account of variations in business and pricing strategy

3.91 The financial review analysis measures acquirer net revenue by subtracting interchange and scheme fees from the MSC, which is defined as "*the total amount merchants pay to acquirers*

236 More recently, as explained in chapter 1 of this response, the COVID-19 pandemic has also accelerated existing trends in transaction mix changes; following a sudden decline in POS transactions by bricks and mortar businesses. This has subsequently increased the number and proportion of card-not-present transactions, in particular, through mail order/telephone order and online payment methods.

for card-acquiring services".[237] However, in practice, the fees that acquirers charge to merchants from year-to-year will be established by reference to many factors that are independent to the level of interchange and scheme fees.

3.92 [redacted]

(a) [redacted]

(b) [redacted]

(c) [redacted]

(d) [redacted]

(i) [redacted]

(ii) [redacted]

---

237 Interim Report, paragraph 3.13 and Annex 3, paragraph 1.2.

238 [redacted]

239 [redacted]

[redacted]

(iii) [redacted]

(iv) [redacted]

(e) [redacted]

3.93 [redacted] Any identification of industry-wide variation in acquirer net revenue could be attributed to a combination of the above factors.

[redacted]

3.94 As explained above, the financial review analysis of acquirer net revenue does not control for variations in business and pricing strategy across the totality of the card-acceptance products and/or value added services that acquirers provide. This is despite the Interim Report acknowledging that such products and services accounted for a significant proportion (approximately 38%) of the revenues of the five largest acquirers between 2014 and 2018.[241] [redacted]

3.95 [redacted]

(a) [redacted]

240 [redacted]

241 Interim Report, paragraph 3.58.

242 [redacted]

[redacted] [redacted]

[redacted] [redacted]

3.96 [redacted]

Figure 4: [redacted]

[redacted]

3.97 [redacted]

3.98 [redacted]

Figure 5: [redacted]

[redacted]

3.99 [redacted]

Figure 6: [redacted]

[redacted]

3.100 [redacted]

[redacted]

3.101 It is clear, therefore, that the financial review analysis misinterprets the results from the increase in acquirer net revenue by attributing that increase to the imposition of interchange fee caps under the IFR. However, [redacted] there are more plausible explanations for the changes that are observed when the prices of other products are taken into account. [redacted]

The five-year period does not cover the full business cycle

3.102 The financial review analysis of acquirer net revenue examines a five-year period from 2014 to 2018. In the Profitability Consultation Paper, the PSR explained that, "*the five-year period we have selected for our analysis straddles the introduction of interchange fee caps* […] *in December 2015 and should therefore enable us to identify the effects of the change in interchange fee levels on costs, revenues and profitability*".[243]

3.103 Respondents to the Profitability Consultation Paper, including Worldpay, argued that it would be necessary to consider a period of more than five years in order to understand the impact of the interchange fee caps. In particular, a longer period would be necessary in order to:

(a) account for the fact that interchange fees and prices for card-acquiring services had already started reducing before the interchange fee caps came into force on 9 December 2015;

(b) to measure the impact of the interchange fee caps over a sufficiently long period of time after 9 December 2015 to determine the long term impacts; and

(c) take into account the impact of business cycles for providers of card-acquiring services, during which costs, revenues and margins are likely to fluctuate.

3.104 Annex 3 to the Interim Report states that, "*having almost two years' worth of data prior to the IFR caps coming into force would be sufficient to assess their impact*". The annex also acknowledges that the results from the analysis "*should be considered alongside other evidence collected as part of the market review*", including changing market conditions. However, the Interim Report does not actually address any of the objections relating to business cycles for card-acquiring services raised in response to the Profitability Consultation Paper for the purpose of the financial review analysis.

The financial review analysis ignores businesses cycles and variations in acquirer risk over time

3.105 As set out in Worldpay's response to the Profitability Consultation Paper, it is important that any financial assessment takes account of long term trends, and in particular the impact of the full business cycle.[244] The period between 2014 and 2018 only captures a period of economic

243 Profitability Consultation Paper, paragraph 1.15.

244 This is widely recognised in the literature on profitability analyses. See, for example, OECD, 'Policy Roundtables – Excessive Prices' (2011), page 390 ("*we need to look at longer term patterns of profitability, ideally over the length of an economic cycle*").

growth, during which there are a greater number of competitive opportunities for acquirers to provide card-acquiring services. It would, therefore, be reasonable to expect acquirer pricing, revenues and profits to be different during periods of recession compared to periods of growth.

3.106 As previously explained to the PSR, a significant factor that affects acquirers and their revenues is their exposure to risk.[245] The risks facing acquirers (including Worldpay) in providing card-acquiring services to UK merchants can be broadly separated into two categories:

(a) merchant-specific risks (i.e. acquirers are accountable for financial losses of cardholders through chargebacks and acquirers must also assume settlement risk and refund risks). Any downturn in the economy increases the credit risk of many businesses, and increases Worldpay's exposure to risks resulting from merchant failure; and

(b) wider business risks that could impact on the ability of Worldpay to provide card-acquiring services, which include wider macroeconomic risks from economic downturns. As previously mentioned, Worldpay is exposed to general economic conditions that affect consumer confidence, consumer spending, and consumer discretionary income.

3.107 These risks are more likely to materialise during periods of economic downturns, which may manifest through higher levels of bad debt, an increase in merchant defaults, and lower levels of overall card turnover.[246] It is therefore necessary to account for these differences over the course of a business cycle in order to understand the financial performance of acquirers, and which may also feed through to pricing. It is obvious, for example, that [redacted]

3.108 Worldpay's response to the Profitability Consultation Paper emphasised that the 2014 to 2018 period would not cover the full duration of Worldpay's business cycle and therefore fails to consider the longer term patterns of profitability. It further emphasised Worldpay's concerns that there were no proposals to make any adjustments to take account of the impact of economic downturns and other long term trends within the business cycle that would have a direct impact on Worldpay's financial performance.

3.109 Annex 3 of the Interim Report confirms that no adjustments have been made to account for the business cycle for card-acquiring services (despite having accepted that evidence on "*changing market conditions*" should be taken into account[247]), nor has the time period for the financial review analysis been extended, as respondents to the Profitability Consultation Paper submitted would be necessary.

3.110 [redacted]

245 See Worldpay's response to General RFI 2, Annex A (3 September 2019) paragraphs 2.1 – 2.26.

246 These risks vary from year-to-year and can have a significant impact on financial performance [redacted].

247 Interim Report, Annex 3, paragraphs 1.15 and 1.21.

[redacted] As the financial review analysis does not consider the impact of the full business cycle for card-acquiring services, the Interim Report cannot draw any meaningful conclusions on the basis of that analysis to assess the extent of pass-through of any IFR savings.

COVID-19 demonstrates the impact of business cycles

3.111 The Interim Report states that the PSR is aware of the impact that COVID-19 is having on the UK economy, including upon providers of card-acquiring services and their merchants. The PSR has requested feedback from respondents on how COVID-19 impacts the Market Review.

3.112 As noted above, the revenues and margins that acquirers receive for card-acquiring services will vary across the business cycle, and periods of economic downturn will generally impact the financial performance of acquirers. As noted in chapter 1, when the UK Government introduced 'lockdown' restrictions in March 2020, [redacted]

3.113 Moreover, many merchant businesses have continued to experience financial hardship as a consequence of the COVID-19 pandemic. This, in turn, has numerous implications to their providers of card-acquiring services, including:

(a) an increase in bad debts as merchants have experienced declines in consumer spending across various sectors;

(b) a growing number of merchant defaults, [redacted] in addition to the permanent loss of card-acquiring revenue in respect of those customers; and

(c) increased demand from existing merchants to re-negotiate existing contracts for card-acquiring services or from new merchants that are looking to reduce the prices that they pay for card-acquiring services.

3.114 The factors identified above (which are commonplace during economic downturns) will impact the financial performance of acquiring businesses generally. However, as explained above, the Interim Report's financial review analysis has focussed exclusively on the period between 2014 and 2018 (a period of economic growth) and has not examined the economic consequences that are more likely to materialise during economic downturns.

3.115 [redacted]

(c) The Interim Report incorrectly dismisses non-price pass-through

Introduction

3.116 The Interim Report's preliminary findings on pass-through focus on the relationship between changes in interchange fees and the MSC. The methodology adopted therefore only captures the extent to which there was pass-through in relation to costs onto prices (i.e. price competition).

3.117 The Interim Report adopts an econometric analysis that does not measure all aspects of pass-through, and therefore is likely to underestimate pass-through to merchants (Worldpay previously raised this concern in response to the Passthrough Consultation Paper). In particular, the analysis does not capture: (i) any savings in reduced costs that were subsequently invested in the business in the form of enhanced choice, customer service and quality (e.g. investments in new and improved products and services); (ii) changes to pricing structures and tariff types, such as reductions in non-MSC charges; and (iii) wider changes to the mix of card-acquiring services and card-acceptance products (e.g. the provision of terminals and aspects of card-acquiring services).

3.118 In response to the comments from Worldpay and other acquirers that an analysis of pass-through of the IFR savings must also take into account non-price pass-through, the Interim Report states that "*the five largest acquirers* [were asked] *to provide us with information on their quality of service metrics over time*".[248] The Interim Report then concludes that "[o]*ur assessment showed a mixed picture of the quality of service and, overall, we didn't find evidence of improved quality of service in the period* [2014 to 2018]."[249]

3.119 Worldpay does not agree with these conclusions. It is implausible to suggest that the quality or variety of service offerings have not required extensive investments over a five year period. This is particularly striking in a sector that all stakeholders and regulators, including the European Commission, accept is undergoing a period of rapid and unprecedented change as explained in chapter 1, both in terms of innovation and the development of new payment technologies, and which has attracted new entry and expansion. In this regard, the Interim Report:

(i) confirms that quality, choice and innovation are important aspects of competition for card-acquiring services, and that acquirers seek to differentiate their service offering on the basis of non-price factors (i.e. that dynamic competition on quality, choice and innovation is taking place);

(ii) fails to consider non-price pass-through correctly. In particular, the Interim Report examines a limited subset of internal service metrics, which does not capture the full array of product developments that have taken place. [redacted]

(iii) incorrectly asserts that a decline in unit costs is not consistent with investments in quality of service over the period 2014 to 2018. This is fundamentally incorrect. The Interim Report's unit cost analysis also fails to take into account [redacted]; and

(iv) fails to control for changes in pricing structure and tariff type (such as reductions in non-MSC charges), and other related acquiring services and acceptance products, that have changed over the last five years (i.e. pass-through in relation

248 Interim Report, paragraph 5.34.

249 Interim Report, paragraph 5.36.

to other aspects of price competition and competition in the wider payments sector).

3.120 Each of these points is considered in further detail below.

(i) Quality, choice and innovation are important characteristics of competition

3.121 As explained in chapter 1 of this Response (paragraphs 1.34 – 1.37), competition for card-acquiring services takes place across many different dimensions, including quality, choice, innovation and price, and chapter 2 of this Response illustrates the steps Worldpay has taken to expand improve product quality and expand choice i[redacted]

3.122 The existence of quality of service, choice and innovation as factors that affect competition between acquirers is acknowledged in the Interim Report, albeit not properly taken into account in the concluding analysis:

> "*most acquirers report that they differentiate their card-acquiring services offering mainly based on* <u>*quality and other non-price factors*</u>"[250]
>
> "*For small and medium-sized merchants,* <u>*the quality and range*</u> *of card-acceptance products is likely to be more important than for the largest merchants*"[251]
>
> "*Firms also seek to compete for large merchants and small and medium-sized merchants based on a* <u>*range of non-price factors*</u>*, including customer service, omnichannel services, quality and range of card-acceptance products, ease and speed of onboarding, faster settlement and offer of business management software*".[252]

3.123 The Interim Report also states that, for Large Merchants, acquirers compete on a range of non-price factors.[253] These findings are also supported by evidence obtained from the IFF Survey in respect of SME Merchants.[254] As set out further below, it is clear that the Interim Report's analysis of non-price pass-through is deficient and does not fully consider non-price factors correctly (that the Interim Report accepts are of importance to merchants).

3.124 As explained in chapter 1 (paragraphs 1.41 – 1.73) and submissions made throughout this Market Review, the payments industry is undergoing rapid and unprecedented change driven by the introduction of new technologies that have increased the competitiveness, dynamism and innovation in retail payments. In order to respond to such changes, and given the importance of competing on choice, quality and innovation, different acquirers will have

250 Interim Report, paragraph 4.59.

251 Interim Report, paragraph 4.73.

252 Interim Report, paragraph 4.93.

253 These include authorisation performance, customer service and support, ease and speed of onboarding and set up, fraud detection and reduction, geographic reach, integration with other products, omnichannel services, the quality and range of value-added services sold alongside card-acquiring services, reliability and stability of the service, settlement speed, and support in relation to regulatory changes. The Interim Report acknowledges at paragraph 4.67 that some of these factors are also relevant to SME Merchants.

254 The three most important factors referred to by SME merchants when choosing their provider of card-acquiring services are: (i) the price of card-acquiring services; (ii) the payment methods available; and (iii) settlement times. Set up speed, range of products offered, innovative payment solutions and awareness of the provider were also other important factors identified by merchants as being relevant.

adopted different strategies to passing through any IFR savings. It is clear, therefore, that there are a number of fundamental flaws in the Interim Report's analysis.

(ii) The Interim Report does not consider quality of service, choice and innovation aspects correctly

3.125 The Interim Report's statement that, "*we asked the five largest acquirers to provide us with information on their quality of service metrics over time*",[255] does not acknowledge that the analysis was clearly incomplete, as it only covered a limited range of internal service metrics, [redacted].[256] The Interim Report also states that, "[w]*e reviewed the metrics over the period 2014 to 2018 and compared them against the acquirers' own targets and external benchmarks*". However, no further details are provided in the Interim Report as to how these quality metrics were assessed, and which quality metrics specifically were considered. The PSR has not accepted Worldpay's request for disclosure of further information on the analysis that was undertaken in relation to quality metrics, other than to explain that "[t]*he assessment carried on acquirers' quality metrics is purely qualitative*" [redacted].[257]

3.126 [redacted]

3.127 [redacted]

3.128 [redacted]

255 Interim Report, paragraph 5.34.

256 Interim Report, paragraph 5.35.

257 [redacted]

258 [redacted]

259 [redacted]

260 [redacted]

261 One of the 22 individual service metrics commenced in 2016.

[redacted]

It is inaccurate to focus only on service quality metrics

3.129 As set out above, the Interim Report reaches its conclusions on non-price pass-through based on information submitted by acquirers relating to "*their quality of service metrics over time*", which was examined on a "*purely qualitative*" basis. There is no further mention in the Interim Report as to any further factors taken into consideration other than quality of service metrics.

3.130 Worldpay does not consider that focussing solely on a narrow subset of quality of service metrics provides any meaningful basis for assessing the overall improvements in quality, choice and innovation in this sector. [redacted] Moreover, any 'scores' identified in quality of service metrics must be interpreted in a context where the experiences and expectations of merchants are constantly shifting over time, and as technology and innovation gives rise to new challenges and demands. These types of metrics are better understood as a 'health check' to ensure that any issues raised by customers are not left unresolved.

3.131 [redacted]

3.132 [redacted]

3.133 The Interim Report does not take such investments or product developments into account, nor does it consider improvements in the functionality of the products and services offered. [redacted]

262 [redacted]

263 [redacted]

264 [redacted].

[redacted] None of these factors are measured in the quality of service metrics examined in the Interim Report.

3.134 [redacted]. To conclude that quality has not increased over a five year period is implausible and inconsistent with the findings of other competition and financial services regulators that have repeatedly emphasised the pace of innovation within the card payments industry (see paragraph 1.49 of chapter 1). The more likely conclusion to be drawn is that the Interim Report fails to assess non-price pass-through correctly.

There are more reliable sources of evidence of non-price pass-through

3.135 In addition to the pass-through of prices received by merchants following introduction of the interchange fee caps under the IFR, Worldpay has driven and responded to increased competition for the supply of card-acquiring services [redacted] that have enabled the provision of improved products, and wider range of choice and better service quality for its merchants. These products and service quality improvements are summarised in chapter 2 of this Response (paragraphs 2.12 – 2.35).

3.136 [redacted]

(iii) A reduction in unit costs does not mean a lack of investment

3.137 Paragraph 5.37 of the Interim Report states that, "*the information available from the acquirers on costs – which would be an important indicator of increased spending on quality of service – suggested that over the period, unit costs fell*". The Interim Report then concludes that this "*is not consistent with rising unit costs due to investments in quality of service over the period*", and refers to Annex 3 for further details.

3.138 Annex 3 states that, "[w]*e examined the cost information we received to see if this indicated that acquirers were making investments to enhance quality of service*".[265] More specifically, paragraph 1.64 states that, "*we compared the* <u>*total cost*</u> *(both direct and non-attributable) reported by these two acquirers in their responses, for each year, against the* <u>*volume and value*</u> *of transactions acquired*" (emphasis added). The analysis is therefore based on the assertion that if there had been increased spending on quality of service, then it would be reflected in higher unit costs, which the Interim Report claims is not the case. Worldpay disagrees with this proposition both as a matter of economic theory and fact.

3.139 Firstly, as a matter of economic theory, the proposition that more investment would be reflected in unit cost increases is not correct. For example, in circumstances where there are economies of scale (which the Interim Report confirms is relevant for the provision of card-acquiring services[266]), unit cost reductions from increases in output may offset any increase in costs as a result of additional investment. Moreover, businesses will often invest in order to produce

265 Interim Report, Annex 3, paragraph 1.63.

266 Interim Report, Annex 5 paragraphs 1.42 - 1.45.

products and develop processes more efficiently (i.e. to benefit from unit cost savings). In such cases, merely observing a reduction in unit costs does not provide any meaningful information about the level of investment undertaken.

3.140 [redacted]

3.141 [redacted]

Table 5: [redacted]

[redacted]

3.142 [redacted]

3.143 [redacted]

267 [redacted]

3.144 Secondly, it is clear from Annex 3, [redacted] that a full and detailed assessment of unit costs as would permit evidenced preliminary findings has not been undertaken. In particular:

(a) paragraph 1.64 of the Interim Report acknowledges that the PSR obtained "*limited cost information from acquirers*" and goes on to state that it nevertheless carried out a high-level review of the total cost information provided by just two acquirers [redacted] and

(b) paragraph 1.64 of the Interim Report also acknowledges a limitation in the unit cost analysis that, "*this calculation does not strictly provide a unit cost that relates purely to card-acquiring services, since acquirers offer other products and the costs of providing these could be included in total costs*". The costs of providing "*other products*" should not be underestimated in circumstances where the Interim Report also provisionally finds that 38% of acquirer revenue (after deduction of interchange and scheme fees) relate to card-acceptance devices, payment gateways or other products.[268]

3.145 [redacted]

3.146 [redacted]

3.147 Third, despite the Interim Report asserting that a reduction in unit costs is an indicator that a business has not increased spending on the quality of service, there is no actual analysis of the amount of investment and capital expenditure incurred by acquirers. To suggest that

268 Interim Report, Annex 3, paragraph 1.56.

269 [redacted]

270 [redacted]

271 [redacted]

investment has not increased without actually looking at the level of capital expenditure incurred within the business highlights a fundamental flaw in the Interim Report's analysis.

3.148 [redacted]

Table 6: [redacted]

[redacted]

3.149 [redacted]

3.150 [redacted]

3.151 [redacted]

3.152 [redacted]

- [redacted]
- [redacted]

3.153 Accordingly, Worldpay strongly disagrees with both the Interim Report's methodology for assessing the level of investments (and improvements in quality) in its business, and the conclusions that have been reached on the basis of the Interim Report's unit cost analysis.

(iv) Pass-through via changes to pricing structures, tariff types and other related products and services

3.154 Worldpay has previously submitted that in addition to assessing pass-through of the IFR savings onto the MSC, pass-through can also take place in a number of other ways, including in relation to the following:

(a) the provision of ancillary card-acquiring services, either in relation to reductions of the charges for those services, or where those services become integrated within the core card-acquiring service. [redacted] It is clear that the Interim Report does not control for such changes in its pass-through analysis (including its econometric analysis, its financial analysis and its assessment of quality of service metrics);

(b) changes to pricing structures and tariff types, such as reductions in non-MSC charges (including, among other things, joining fees, PCI non-compliance fees, MMSCs and [redacted]). Where these charges have reduced since the IFR, the measurement of pass-through that focusses solely on the MSC would understate the pass-through effect of the interchange fee caps. [redacted] and

(c) changes in the overall card-acceptance proposition. For example, as acknowledged in the Interim Report (and confirmed in the IFF Survey), many SME Merchants prefer to "*one-stop shop*".[272] In such situations, it is rational for acquirers to set prices to take account of the inter-related nature of all the products and services provided. Accordingly, savings from the interchange fee caps under the IFR could be passed-through in other ways (e.g. by reducing prices for terminals or online payment gateways). By focussing narrowly on the MSC, the Interim Report's analysis would fail to pick up such effects. [redacted]

3.155 As the Interim Report only considers the impact of changes in the interchange fee on the MSC, it has failed to take into account reductions in other price-related factors (such as joining fees) and other related products and services, which provides further confirmation that the Interim Report's preliminary findings on pass-through are substantially understated.

272 Interim Report, paragraph 3.53.

4. MERCHANTS SEARCH AND SWITCH BETWEEN PROVIDERS OF CARD-ACQUIRING SERVICES

Introduction

4.1 Paragraphs 6.1 and 6.2 of the Interim Report state:

> "*…on average merchants with annual card turnover up to £50 million received little or no pass-through of the IFR savings – indicating that the supply of card-acquiring services may not be working well for these merchants. Our analysis also shows that, on average, merchants who have switched their provider of card-acquiring services get a better deal.*
>
> *This suggests there may be features in the supply of card-acquiring services that restrict merchants' willingness and ability to search and switch. If merchants face barriers to searching and switching, providers will face fewer incentives to compete for these merchants – for example, through lower prices – resulting in worse outcomes for merchants*."

4.2 As explained in chapter 3, the data does not support the preliminary findings in the Interim Report that there has been little or no pass-through of the IFR savings for merchants with annual card turnover of up to £50 million. Therefore, the preliminary finding that the supply of card-acquiring services is not working well for these broad categories of merchants is based upon a flawed premise. As such, there is no evidential basis to find that there may be features restricting merchants' ability to search and switch. Indeed, the high rates of pass-through, as calculated by Worldpay, are consistent with the alternative premise of intense competition, where merchants have no difficulty in exploring alternative options and accessing competitive solutions.

4.3 This alternative premise is consistent with a review of the evidence on switching behaviour accompanying the Interim Report, which confirms: high levels of switching; survey responses from merchants indicating they can and do switch (and if they choose not to, do so for good reason, e.g. because they receive a competitive offer from their current provider); and, finally, an absence of material barriers to switching, i.e. technical or other barriers that could inhibit switching behaviour. This evidence is explored further below.

4.4 Worldpay also notes that the package of remedies being considered are all intended to promote and facilitate switching by merchants (e.g. by providing pricing information in an easily comparable format, amending POS terminal contracts which are identified as being a barrier to switching, and requiring all contracts for card-acquiring services to have an end date in order to encourage merchants to shop around and switch). However, the assumption that there is a competitive problem impacting upon shopping around and switching is not supported by the evidence.

4.5 This chapter will demonstrate that:

(a) merchants do, in fact, search for and switch to alternative providers in significant numbers, consistent with high levels of competition, and this is confirmed (in respect of the merchants covered by the IFF Survey, see further below) by the evidence taken from the IFF Survey and [redacted];

(b) there is considerable evidence to support the position that competitors are competing intensely for merchants, indeed one of the main reasons merchants may not switch, including after specifically considering switching, is due to satisfaction with their current provider. The supply of card-acquiring services is working well in offering merchants choice, and developing solutions to suit their needs;

(c) the specific features identified in the Interim Report, i.e. variability in pricing structures and absence of published prices; and restrictions in merchant contracts for card-acquiring and POS terminal hire contracts, do not constitute material barriers to searching and switching. Contractual restrictions will be discussed in detail in chapter 5 of this Response, and chapter 6 will discuss Worldpay's response to the proposed remedies relating to these market features; and

(d) the claims in the Interim Report that because prices may in some instances be lower for new customers, higher switching levels are necessary to demonstrate that the market is working well are misconceived. In fact, the presence of low prices for new customers demonstrates that the supply of card-acquiring services is working well, with providers competing strongly to attract new merchants. Conversely, there is no evidence to support a theory of harm that the existence of promotional pricing translates to the exploitation of existing customers, [redacted]

4.6 These points are explored in turn below.

(a) Merchants do search for, and switch to, alternative providers

4.7 Contrary to the assertions in the Interim Report, the provision of card-acquiring services is dynamic and competitive, with higher levels of searching and switching observed in the data than suggested in the Interim Report. In this regard:

(a) this is confirmed by slide 10 of the IFF Survey, which makes clear that SME Merchants have a significant amount of choice in relation to the provision of card-acquiring services (i.e. merchants identified 66 different providers when asked to name their main provider of card-acquiring services, with the top 15 providers being listed on slide 10). Moreover, 38% of respondents named either a payment facilitator or a third-party (e.g. an ISO) as their main provider. Such results are consistent with the findings that barriers to entry are generally low and the increasingly wide categories of suppliers that merchants are able to access;

(b) the existence of a dynamic, innovative and competitive industry is also supported by the general comments set out in chapters 1 and 2 above regarding the significant developments in the payments space, and the growth and advances of other market participants. Indeed, there is a strong argument that acquiring services is a case study of a sector that has experienced significant and successful new entry, by different and diverse types of provider, most of whom are exploiting technological and financial innovation to enter with a range of differentiated products; and

(c) this is also supported by the following points, which are considered in further detail below:

(i) the findings in the IFF Survey;

(ii) the lack of detail provided regarding the "other survey" results relied upon in the Interim Report;

(iii) additional survey evidence;

(iv) [redacted] and

(v) lower levels of switching found in the context of market investigations by other regulators / in other sectors.

(i) The IFF Survey data does not support the provisional findings in the Interim Report regarding switching

4.8 The Interim Report relies upon the IFF Survey as a principal evidential basis to support its detailed conclusions as to switching behaviour. For example, paragraph 6.5 of the Interim Report states that: "*the results of the merchant survey show that many small and medium-sized merchants do not regularly search for other providers or consider switching their provider. We also consider where large merchants with annual card turnover between £10 million and £50 million may share characteristics with small and medium-sized merchants*".

4.9 Firstly, the IFF Survey does not shed any light on whether the concerns identified in the Interim Report arise in relation to merchants with annual card turnover of between £10 million and £50 million, as these merchants were not included in the IFF Survey.[273] Therefore, the Interim Report does not include any evidence to support the position that the preliminary findings regarding searching and switching also apply to merchants within this category.[274] Similarly, as explained in detail in chapter 6, based on analysis carried out by Worldpay's external advisers on the data contained in the Merchant Survey Data Room 94.4% of IFF Survey respondents had an annual card turnover of below £3 million. Therefore, this is also not a sufficient evidential basis to support the preliminary findings in the Interim Report in relation to merchants with turnover above that level.

4.10 Secondly, Worldpay considers that the presentation and interpretation of the results in the Interim Report is open to considerable challenge. In fact, the evidence in the IFF Survey, when considered as a whole, is actually supportive of the conclusion that merchants do search and switch, and the results properly considered (as set out in detail in this Response) actually demonstrate highly competitive search and switching behaviour. For example:

(a) in relation to frequency of searching and switching:

(i) the Interim Report references the results on slide 39 of the IFF Survey, and in particular, that 43% of merchants reported that they never search for providers, as evidence that searching levels are low. However, even if this evidence is considered as presented on slide 39:

(A) this result implies that 57% of SME Merchants do shop around different providers at some point,[275] with 37% of them doing so at least once every

273 This is confirmed on slide 4 of the IFF Survey, which states "*IFF research conducted a quantitative telephone survey with 1037 small and medium-sized merchants that use card-acquiring services*", and goes on to explain that "*small and medium-sized merchants are defined as those that took less than £10 million in turnover from card payments in the calendar year in 2018*". Accordingly, slide 4 confirms that merchants with card turnover of between £10 million and £50 million were not included in the survey, and therefore any findings do not apply to merchants within this range.

274 The Interim Report also fails to substantiate its claim that SME merchants "*share characteristics*" with merchants in larger turnover categories above £10 million annual card turnover, for the reasons explained in chapter 6.

275 This includes 3% of merchants who responded "*Don't know*".

3 years.[276] In addition, as explained below, a number of the merchants who responded that they did not shop around, stated that this was because they were approached by third parties and therefore did not need to, and therefore can still be considered to be searching / choosing between providers (see below); and

(B) even of the 43% of merchants who reported that they never shop around: 55% of those merchants reported that this was because they are satisfied with their current provider and/or happy with the price of their current provider[277]; 10% stated this was because they hardly use card services; and 4% stated that they are approached by third parties with offers so they don't need to. A small number (i.e. 1%) also stated that this is because they only recently joined the provider, however, Worldpay's external advisers have some concerns regarding the accuracy of this number, given based on the data in the Merchant Survey Data Room, nearly 27% of the merchants that responded that they never shop around have been with their acquirer for less than two years;[278]

(ii) in addition, when the results on slide 39 are considered on a category basis (i.e. by turnover band), the results are materially different for certain merchant categories. As can be seen from Figure 12 in the Interim Report:

(A) only 26% of merchants with annual card turnover of £380,000 - £1 million responded that they never shop around, and only 24% of merchants with annual card turnover of £1 million - £10 million; and

(B) over 40% of merchants with annual card turnover of £380,000 - £1 million shop around at least every two years, and 47.0% of merchants with annual card turnover of £1 million - £10 million shop around at least every two years,

(C) as explained in further detail in chapter 6, these percentages suggest that the Interim Report does not have sufficient evidence to impose switching-related remedies in relation to merchants with annual card turnover of above £380,000;

(iii) the Interim Report goes on to reference slide 22 of the IFF Survey in support of an argument that "*many small and medium-sized merchants do not often consider switching their provider*".[279] However, slide 22 of the IFF Survey in fact confirms the high level of switching and natural churn that takes place for card-acquiring services, which is not consistent with the provisional findings that there are barriers to switching that result in muted competitions. In particular:

---

276 IFF Survey, slide 39.

277 This was a multicode response, and therefore merchants were able to provide more than one response. In this respect, it is highly likely that a merchant who responded "*satisfied with current provider*", would not feel compelled to provide other responses which also covered positive aspects of the service they received, and therefore this casts doubt on the appropriateness of displaying the responses in the format on slide 40.

278 IFF Survey, slide 40.

279 Interim Report, paragraph 6.19.

(A) 29% of respondents had either switched provider within the last two years or had started accepting card payments (i.e. were new merchants) (16% had switched and 13% were new merchants); and

(B) a further 29% of respondents had considered switching in the last two years;

(C) this means that 58% of merchants could be considered to be marginal consumers (i.e. merchants that acquirers could compete for). Moreover, in relation to the remaining 42% of respondents (i.e. that responded that they have not considered switching in the last two years), 64% of those merchants stated that this was because they were satisfied with their current provider, and a number of merchants also specifically responded that they were happy with the price of their current provider.[280] Clearly, high levels of customer satisfaction cannot be viewed as an impediment to switching. This is explained in further detail in paragraphs 4.29 - 4.32 below;

(iv) slide 68 of the IFF Survey suggests that 39% of merchants have used different providers. However, based on the data in the Merchant Survey Data Room, if this is broken down by the length of time a merchant has been accepting card payments, it can be seen that for merchants that have accepted card payments for more than two years, around 55% have previously had a different provider;[281] and

(v) slide 33 of the IFF Survey provides evidence on the factors most commonly considered by merchants in choosing the provider of card-acquiring services. The three most important factors are: (i) the price of the card-acquiring service (mentioned by 74% of respondents); (ii) the payment methods available (mentioned by 48% of respondents); and (iii) settlement times (mentioned by 44% of respondents). Set up speed, range of products offered, innovative payment solutions and awareness of the provider were also other important factors identified as being relevant. This demonstrates that price and quality are important factors that create the competitive dynamics in the provision of card-acquiring services;

(b) in relation to ease of searching and switching, as is acknowledged in the Interim Report:

(i) "*the IFF Survey showed that 76% of merchants who recently switched found it easy. And only around 1% of merchants that considered switching in the last two years didn't switch because they were unsuccessful in carrying it out*";[282] and

280 IFF Survey, slide 25. This question was multicode and slide 25 suggests the options were not specifically read out. It seems likely that a merchant who responded that they were satisfied with the current provider may not specifically list other positive points, if they consider this to be covered by their initial broad response.

281 Excluding "*Don't know*" responses. (Unweighted responses).

282 Interim Report, paragraph 6.21.

(ii) "*the results in Figure 14 and Figure 15 show that most small and medium-sized merchants that search and switch don't report facing difficulties doing so*".[283] In this regard:

(A) slide 34 confirms that it is easy to shop around. In particular, of those merchants that considered switching in the last two years, 70% had shopped around and the key factors taken into account when shopping around were: (i) the price of card-acquiring service; (ii) the price of other products; (iii) settlement times; and (iv) payment methods available. Of note, 65% of respondents said that it was easy to shop around, with only 22% saying that it was difficult; and

(B) as set out on slide 36, of those merchants that had switched, 57% had shopped around before switching and 51% reported that the shopping around was easy, with only 26% saying it was difficult.

(c) This provides further evidence that there are no material barriers to switching; and in relation to the reasons merchants report for not searching and switching, and merchants' ability to negotiate a better deal, see paragraphs 4.29 - 4.32 and 4.43 respectively.

(ii) The Interim Report contains insufficient details regarding the "other surveys" referenced

4.11 In relation to other survey data referenced in the Interim Report, paragraph 6.4 states that other sources of evidence have also been considered, including:

(a) "*survey research submitted to* [the PSR] *by parties in response to information requests*"; and

(b) "*responses to* [the PSR's] *information requests from various parties, including a section of large merchants (nearly all of whom had an annual card turnover above £50 million)*".

4.12 In this connection, Worldpay notes that the Interim Report does not include details regarding these surveys and their results, such as: the number of surveys being considered; the authors; the survey size (i.e. how many merchants participated); the merchant demographic (i.e. their sector and turnover); or the specific questions asked or responses given. Therefore, [redacted] it is not possible for Worldpay to test the findings and reliance on evidence from the other surveys in any detail.

4.13 Notwithstanding the above, based on the relatively small amount of information that has been provided regarding these surveys, it is noted that the Interim Report states that the results from the other surveys "*suggest that anywhere between 15% to 25% of small and medium-sized merchants switched in the last two years*".[285] Without being provided with any of the underlying information regarding these surveys, it is not possible for Worldpay to comment on these findings. However, when placed in the context of the answers to the IFF Survey, which demonstrate that (i) merchants have limited switching costs; (ii) there are a sizeable number of merchants who search; (iii) there is high awareness of information and options available;

283 Interim Report, paragraph 6.25.

284 [redacted]

285 Interim Report, paragraph 6.18.

and (iv) there are a significant number of customers who self-identify as being satisfied with their acquiring services, levels of switching of up to 25% in the last two years represents a high level of switching, and demonstrates high levels of customer engagement.

4.14 In relation to reasons merchants report for not searching and switching, the Interim Report relies on findings from another survey, i.e. that merchants do not switch because "*they're locked into contracts*" and "*it would cost too much*".[286] However, the Interim Report provides no further details regarding the survey or whether these comments are representative of other views. The Interim Report should not place any weight upon evidence that has not been disclosed in order that it might be properly understood and tested.

4.15 Finally, in relation to the responses to requests for information, the Interim Report specifically acknowledges that the majority of the Large Merchant respondents had card turnover above £50 million a year.[287] Therefore this does not appear to provide any supporting evidence in respect of Large Merchants with card turnover below £50 million.

(iii) Other survey / analysis evidence also contrasts with the Interim Report's findings

4.16 [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

286 Interim Report, paragraph 6.31.

287 Interim Report, paragraph 6.4.

[redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

(iv) [redacted]

[redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

Table 7: [redacted]

[redacted]

4.20 [redacted]

4.21 [redacted]

4.22 [redacted]

4.23 [redacted]

(v) Contrast with lower levels of switching in other markets

4.24 As explained in detail in chapter 6 of this Response, the Interim Report contains a number of proposed remedies to try to address the provisional findings, and in particular to increase switching levels. However, remedies should only be imposed when it is proportionate to do so.

4.25 In this respect, as noted above:

(a) based on the IFF Survey, the Interim Report's analysis found that 29% of respondents had either switched provider within the last two years or had started accepting card payments (i.e. were new merchants) (16% had switched and 13% were new merchants), and a further 29% of respondents had considered switching in the last two years;[288]

(b) according to the Interim Report, other surveys indicate a switching level of between 15 – 25%, although the Interim Report does not contain details to place these results in context;[289]

(c) [redacted] and

(d) this is in the context of a situation where the evidence suggests merchants have limited switching costs; there are a sizeable number of merchants who do search; there is high awareness of information and options available; and there are a significant number of customers who self-identify as being satisfied with their acquiring services.

4.26 These figures represent high levels of switching. It is noted that in other recent market investigations and market studies, levels of switching giving rise to remedies have been found to be several orders of magnitude lower than those set out in the Interim Report in relation to card-acquiring services. For example:

(a) in the FCA's Investment Platforms Market Study (2019), the FCA found low levels of direct-to-platform (non-advised) consumer switching, based on switching rates of around 3% per year;[290]

(b) in the Retirement Outcomes Review (2018), the FCA found there to be low levels of switching in respect of non-advised pension draw downs, where nearly 90% of consumers did not switch to another provider. The FCA also acknowledged that "[i]*n any market, the level of switching is only one factor when considering how well it is functioning. Good value products for consumers do not necessarily require high levels of switching*";[291] and

(c) in its investigation into the Retail Banking Market (2017), the CMA compared switching rates for personal current accounts ("**PCAs**") to switching rates in other sectors. It deemed switching rates of PCAs in the past three years (being around 8%) to be materially lower than those in other sectors, such as, 13% in savings products and over 30% in energy. The annual switching rates of business current accounts ("**BCAs**") were found to be only around 4% in 2014.[292]

4.27 In contrast, the levels of switching set out in the Interim Report are similar to those found in the CMA's investigation into the Investment Consultants Market (2019). However, in this

288 IFF Survey, slide 22.

289 Interim Report, paragraph 6.18.

290 FCA, 'Investment Platforms Market Study: Final Report', (March 2019) paragraph 4.2.

291 FCA, 'Retirement Outcomes Review: Final Report' (June 2018), , paragraphs 4.5 and 4.7.

292 CMA, 'Retail Banking market investigation: Final Report' (2016), paragraphs 65, 66 and 8.36.

investigation, the CMA found that the average rates of switching in investment consultancy of 27% did not raise concerns about lack of competition in the market.[293]

4.28 In summary, the switching figures in this context represent a significant rate of switching and natural churn in respect of the provision of card-acquiring services, which is considerably higher than has been evident in a number of markets. While it is understood that there are differences across markets / sectors, Worldpay considers that this is supportive of its comments regarding remedies set out in chapter 6.

(b) The provision of card-acquiring services is working well, with high satisfaction levels, and product development in response to merchants' demands

The evidence suggests that merchant satisfaction levels are high, supporting the position that the provision of card-acquiring services is working well

4.29 In addition to the IFF Survey demonstrating that searching and switching levels are higher than suggested in the Interim Report, the IFF Survey also confirms that there are pro-competitive reasons for some merchants deciding not to switch, such as merchant satisfaction. In this regard, it is clear that searching levels can be more relevant than switching levels, if the reason customers ultimately decide not to switch is because they realise their current provider is the best option, or if they are offered an incentive to remain.

4.30 While it is acknowledged in the Interim Report that merchant satisfaction results are high, the Interim Report does not acknowledge that this provides a positive explanation for why merchants may choose not to switch, and this has not been taken sufficiently into account when considering whether remedies to promote switching are required.

4.31 It is clear from the evidence that merchant satisfaction is high. For example:

(a) as noted in paragraph 6.27 of the Interim Report, slide 16 of the IFF Survey confirms the very high satisfaction rates amongst merchants with the customer service of their current providers. In particular, 82% of respondents that contacted their main provider in the last year were satisfied with the customer service received[294];

(b) as referenced in paragraph 6.29 of the Interim Report, slide 25 confirms that, of the merchants that responded that they have not switched or considered switching in the last two years, 64% specifically stated that they were satisfied with their current provider and a number of merchants additionally specifically mentioned that they were happy with the price of the current provider. 8% were infrequent users that hardly use card services; and a number of responses also included other positive reasons, such as the reputation of the provider; the ease of use of the current system; and the innovative payment products they offer.[295] Only 4% referred to a contract as being a reason from preventing them switching or considering switching, and less than 3% (just 10 merchants) said that it would cost too much to switch (i.e. that it would take time to arrange and implement a switch). These results are not consistent with the findings in

[293] CMA, 'Investigation into the Investment Consultants Market: Final Report' (2018), paragraphs 6.82 and 9.70.

[294] Slide 16 suggests that 38% of merchants had contact with their provider in their last year, noting that this is excluding renegotiation of contractual terms.

[295] As noted above, this question was multicode and slide 25 suggests the options were not specifically read out. It seems likely that a merchant who responded that they were satisfied with the current provider may not specifically list other positive points, if they consider this to be covered by their initial broad response.

the Interim Report that there are barriers to searching and contractual restrictions that are preventing merchants from switching provider of card-acquiring services; and

(c) slide 27 of the IFF Survey indicates that of those that considered switching within the last two years but decided not to switch, 35% thought that the current provider still provided the best option (e.g. after shopping around), a further 25% said that their current provider gave them a discount / better offer, and 8% said they were "in the process of switching / had already switched".[296] Only 10% referred to being "*tied into a contract*" as a reason for not switching,[297] which does not provide statistically significant evidence to support the conclusions reached in the Interim Report that contractual restrictions are preventing switching, particularly in respect of merchants with annual card turnover above £1 million, of whom only two merchants referred to their contractual status. The largest proportion of merchants that referred to being tied into a contract had annual card turnover below £380,000. Only five merchants attempted to switch but were unable to because the cost of terminating the contract with their existing provider was too high.

4.32 In light of these findings, it is clear that merchant satisfaction is generally high, which cannot be considered to be a market failing. In addition, as innovation and products develop, merchant satisfaction is likely to increase further going forward, and Worldpay considers that protecting merchant choice is an important aspect of keeping satisfaction levels high. It is important that this is taken sufficiently into account when any potential remedies are considered.

Industry developments / innovation in response to merchant demands

4.33 As explained in previous submissions, the industry has been developing (and is continuing to develop) innovative solutions in response to merchants' demands. These have occurred without directions being imposed by the PSR, and have been introduced in order to respond to merchants' requirements for less complexity, whilst protecting merchant choice.

4.34 [redacted]

(a) [redacted] and

(b) [redacted]

4.35 [redacted]

296 Slide 27 of the IFF Survey describes this as "still considering switching", however the terminology in the Merchant Survey Data Room suggests it may be more definitive than this.

297 Based on the data in the Merchant Survey Data Room, this 10% falls to 6.5% when the IFF weighting is removed.

[redacted]

4.36 These developments occurred in addition to innovative strategies being implemented by other providers of card-acquiring services, and disruptors / new providers (for example, Stripe) entering the market, as explained in detail in chapters 1 and 2.

4.37 As noted above, this innovation took place, and is continuing, without directions from the PSR, and this demonstrates that the provision of card-acquiring services is working well (including self-correcting where necessary). Regulatory intervention should not be undertaken absent a clear need for it, both on the grounds it would be disproportionate, impose unnecessary additional transaction costs (which may ultimately be paid by consumers) and give rise to the risk of unintended consequences that may ultimately have negative effects for competition. These points are explored in further detail elsewhere in this Response.

[redacted]

4.38 [redacted]

4.39 [redacted]

4.40 [redacted]

(a) [redacted]

(b) [redacted]

(c) [redacted]

(d) [redacted] and

(e) [redacted].

298 [redacted]

4.41 [redacted]

Negotiations between merchants and acquirers

4.42 The Interim Report briefly considers the ability of merchants to negotiate with providers of card-acquiring services in paragraphs 6.34 – 6.36 of the Interim Report.

4.43 [redacted]

(a) Worldpay notes that as referenced in the Interim Report:

(i) slide 15 of the IFF Survey suggests that:

(A) 88% of merchants that had attempted to negotiate better terms with their provider had been successful; and

(B) of those that did not, 51% said this was because they were happy with their current terms; and

(ii) in relation to the statement on slide 15 that "*only a fifth of merchants had tried to negotiate better terms with their main provider in the past*", Worldpay has some concerns with this statement, given that slide 11 of the IFF Survey confirms that 28% of the merchant sample had been with their main provider less than two years, and it is unlikely that such recent customers would have tried to negotiate better terms with their provider. Therefore, these new customers should be excluded from the population of merchants for whom provider negotiations are considered. Based on the data in the Merchant Survey Data Room, if these responses are broken down by length of time a merchant has been with an acquirer, of merchants who have been with their acquirer for more than two years, around 40% have tried to negotiate better terms, with this proportion being even higher for those that have been with their acquirer for more than five years;[299] and

(iii) as referenced above, according to slide 27 of the IFF Survey, 25% of merchants who considered switching in the last two years responded that they ultimately decided not to because "*my current provider gave me a discount/better offer*" (along with 35% who considered that their current provider was still the best option). This suggests that card-acquiring providers are having to negotiate and compete strongly in order to retain merchants.

299 Excluding "*Don't know*" responses. (Unweighted responses).

(c) The features identified in the Interim Report do not constitute material barriers to searching and switching

4.44 The Interim Report suggests that the following specific features may make it difficult for merchants to search and switch:

(a) ISO and acquiring pricing creating significant search costs for merchants because of the absence of published prices and the complexity of comparing pricing;

(b) indefinite duration of merchant contracts for card-acquiring services; and

(c) ISO and acquirer POS terminal contracts with long initial terms or which automatically renew for successive fixed terms.[300]

4.45 However, Worldpay considers that there are few restrictions (whether legal, contractual, technical or otherwise) that might otherwise limit a merchant's ability to search and switch provider of card-acquiring services. Rather, the evidence points to barriers to searching and switching being low, and Worldpay does not consider that the Interim Report has demonstrated that the features listed above constitute barriers to switching.

Pricing

4.46 In relation to pricing (i.e. feature (a) above), this is discussed in paragraphs 6.42 – 6.58 of the Interim Report, resulting in the conclusion in paragraph 6.58 that "*the absence of published prices, and the complexity of comparing prices quoted by different firms due to the variation in pricing structure, creates a search cost for small and medium-sized merchants that restricts their willingness and ability to search and switch, or negotiate a better deal*."

4.47 In this regard, Worldpay notes that:

(a) as explained above in paragraphs 4.33 - 4.37 and in detail in previous submissions, there have already been many developments by a number of players relating to simple pricing structures. These developments show that the provision of card-acquiring services is / has already been adapting to merchant demands, whilst maintaining and protecting merchant choice, without directions from the PSR; and

(b) the evidence does not support the position in the Interim Report that complexity of pricing and lack of comparability are a problem for merchants. For example:

(i) slide 17 of the IFF Survey confirms that the vast majority of merchants felt that they received enough information to understand the cost of card-acquiring services and are provided with enough support to comply with requirements. In particular:

(A) 89% of respondents said that they agreed that they receive enough information in order to understand the price that they pay for card-acquiring services. This percentage is broadly the same across different turnover bands,[301] and these high levels are not consistent with the

[300] Interim Report, paragraph 6.97.

[301] Based on breakdowns by card turnover band, when considering the data in the Merchant Survey Data Room.

conclusion that there are issues with the complexity and comparability of pricing that is impacting on competition; and

(B) 92% of respondents said that they agree that they receive enough support from the provider of card-acquiring services to help comply with the requirements to accept card payments (and again, this is broadly consistent across different turnover bands). Again, this confirms that the information provided is not seen as being a problem in this context;

(ii) slide 29 of the IFF Survey provides evidence as to the ease of switching. In particular, 76% of respondents that had switched within the last two years said that the switching process was easy,[302] with only 19% saying that it was difficult. This provides further evidence that there are no material barriers to switching;

(iii) moreover, slide 30 of the IFF Survey asked those merchants that had switched within the last two years, what would have helped them feel more confident in making the decision about switching. A number of points and concerns have been identified in relation to this question:

(A) of note (and as recognised in paragraph 6.24 of the Interim Report), just under half of merchants (46%) replied "nothing";

(B) on the basis of slide 30, only 10% of respondents said "more comparable / standard pricing information", only 6% referred to "better quality information", 6% stated "more accessible / easy to find information", and just 7% stated that they wanted to know more about the provider. These are low percentages even on their face. In addition, based on the data in the Merchant Survey Data Room, it is not appropriate for these figures to be collated to the 30% referenced in paragraph 6.24 of the Interim Report, given these were multicode answers. In particular, only 52 out of the 181 merchants specifically stated one of these four responses. Once the sample-size weighting is applied, this means that only 23.2% of merchants said that one of those four things would make them feel more confident with switching, rather than the 30% referenced in paragraph 6.24;

(C) the data in the Merchant Survey Data Room indicates that responses were not coded according to whether the merchant said "knowing more about the provider" would help them feel more confident about switching, but rather the "reputation of the provider", which has no bearing on the complexity of pricing or price comparison; and

(D) it is also observed that the framing of this question (i.e. "*what would have helped [merchants] feel more confident in making their decision about switching*") is likely to cause merchants to feel obliged to provide a reason, notwithstanding that they may also have had a very good switching experience;

(E) this evidence does not support the proposed remedies in the Interim Report in relation to increasing the comparability of prices;

302 An additional 4% of respondents were indifferent (IFF Survey, slide 29).

(iv) slide 38 of the IFF Survey further confirms that shopping around is easy. Of those merchants that started accepting card payments within the last two years (i.e. that are new merchants to card payments) just under 60% said that they had shopped around and 80% reported that the shopping around experience was easy; and

(v) as set out on slide 40 of the IFF Survey, in relation to merchants that responded that they never shop around, 55% said that they were satisfied with their current provider and/or were happy with the price of their current provider (and other positive responses included, for example, that they hardly ever use card services; that they are approached by third parties and therefore do not need to; or that they only recently joined their provider). Moreover, only 6% said that they were tied into a contract and just 1% said it was too difficult / complicated to compare providers. This evidence clearly does not support the findings in the Interim Report that remedies should be aimed at addressing contractual restrictions and easing comparison of card-acquiring services between providers.

(c) The findings in the Interim Report regarding pricing comparability and the proposed remedies are discussed in further detail in chapter 6 below.

Contractual restrictions

4.48 In relation to the Interim Report's provisional findings regarding contractual restrictions (i.e. features (b) and (c) above), the Interim Report claims that the indefinite duration of card-acquiring service contracts do not provide a clear 'trigger point' for merchants to think about searching or switching, and that renewable fixed-term POS terminal hire contracts make it difficult for merchants to terminate these contracts and switch to an alternative provider.

4.49 However, the Interim Report does not provide evidence to support the claim that trigger points play a causal role in merchants' searching and switching behaviour. Furthermore, the Interim Report does not take into account IFF Survey evidence that in fact points to a number of such trigger points during the merchants' contractual relationship for card-acquiring services. The Interim Report's claims regarding the effects of standalone POS terminal hire contracts are also not supported by the IFF Survey; ignore the benefits of automatically renewed fixed-term contracts for merchants in terms of operational continuity; and overstate the possible impact of early termination fees on merchants' behaviour. These points are considered in further detail in chapter 5 below.

(d) The Interim Report has over-estimated the need for, and benefits of, increasing switching levels, and has failed to take into account relevant factors explaining new and longstanding price differentials

4.50 Finally, the Interim Report relies heavily upon a preliminary finding set out at paragraphs 5.38 – 5.41 that: "*in general, regardless of merchant size, new customers pay less … This shows that when merchants switch provider of card-acquiring services, they can secure better prices in the form of lower MSCs.*"

4.51 Firstly, analysis carried out by Worldpay's external advisers of the data provided in the Confidentiality Ring suggests that the Interim Report has materially overstated any differential between prices paid by new and existing merchants. In this respect, any observable disparity may be explained by, among other things, promotional offers made to attract new customers. The latter is a feature of competitive markets where operators compete hard to win new merchants, whilst there is no evidential basis to assert that this market suffers from structural deficiencies that permit long term customers to be charged uncompetitive prices. Worldpay's analysis, set out in section 5 of the Technical Annex to this Response, shows that the methodology in the Interim Report is not robust to minor changes in specification. In particular, controlling for trends in MSCs over time and adopting a start-year control variable instead of age control variable significantly lowers the estimated benefits of switching. As a result, the new customer versus longstanding customer regression results referenced in the Interim Report cannot be used reliably or otherwise as a robust evidential basis as would be necessary to justify the implementation of switching remedies.

4.52 Secondly, Worldpay considers that the analysis in the Interim Report also fails to take into account a number of market features which explain price differentials for new customers and, far from evidencing market failure, are a feature of a competitive dynamic to win market share. For example:

(a) it is clear that offering promotions and discounts in order to attract new customers confirms the fact that providers of card-acquiring services are operating in a competitive market and are required to compete strongly in order to gain new merchants. Examples of specific sales promotions are set out at paragraph 4.40 above;

(b) [redacted] and

(c) these offerings may also be proactively offered to existing customers. [redacted]

4.53 Accordingly, the existence of promotional time-limited pricing policies for new customers is a feature of a competitive market. Whilst it may introduce a differential in pricing between new customers and some existing customers, it is not in any way an observation that justifies the conclusion of a competitive issue due to a lack of switching.

4.54 Moreover, there are many valid reasons why existing customers, as they maintain their relationship with an acquirer, decide to pay more for the service they receive, receiving greater value in return. [redacted] This will result in a higher overall price for the totality of the services offered, as potentially observed in the Interim Report, but a greater commercial benefit received by the merchant.

4.55 Conversely, the Interim Report does not include any evidence that existing customers are the subject of exploitative pricing due to a lack of switching options. Such a theory of harm would be completely inconsistent with the evidence of:

(a) the fact the vast majority of merchants either do switch or remain because they are satisfied with the service, including pricing, that they receive;

(b) the fact that high levels of switching are actually observed in this market, in absolute terms or relative to other markets;

(c) the ease reported by merchants with which they are able to implement switching;

(d) steps that an operator [redacted] has taken to offer existing customers who request it the benefit of certain promotions that are being offered to new customers at the time;

(e) objective reasons why existing customers may choose to purchase ancillary services from an acquirer as they obtain more value from their relationship; and

(f) the fact that in many instances, it is not possible for merchants to accurately estimate the volumes of transactions they will be making when they first join [redacted]

5. MERCHANTS ARE CONTRACTUALLY FREE TO SEARCH AND SWITCH

Introduction

5.1 As set out in chapter 4, Worldpay disagrees with the findings in the Interim Report regarding the levels of and reasons for merchants switching to alternative providers. As explained above, contrary to the Interim Report's findings, the evidence presented does not support the finding of obstacles materially preventing merchants from searching for and switching to other suppliers.

5.2 In this context, the Interim Report has also sought specifically to assess whether contractual provisions in contracts for card-acquiring services and POS terminal hire could contribute to its provisional findings in relation to merchant searching and switching behaviour.

5.3 Whilst Worldpay considers this analysis to be based on a flawed premise, this chapter sets out Worldpay's submissions in response to the assessment of the contractual restrictions in the Interim Report. In particular, this chapter:

(a) briefly summarises the relevant findings / concerns raised in the Interim Report;

(b) sets out a brief overview of Worldpay's contractual arrangements with its merchants;

(c) assesses the basis for the Interim Report's statements concerning the impact of trigger points in card-acquiring contracts on merchants' searching and switching behaviour; and

(d) considers the evidence supporting the interim findings on the impact of POS terminal hire provisions on merchants' searching and switching behaviour.

(a) The Interim Report's provisional findings relating to contractual restrictions

5.4 As set out in chapter 4 of this Response:

(a) the Interim Report's provisional findings are that SME Merchants tend not to regularly search for alternative card-acquiring service providers, nor to consider switching from, nor negotiating with, their current provider;

(b) it has found that the smallest merchants, with annual card turnover up to £380,000 are the least likely to search and consider switching compared to merchants with higher annual card turnover; and[303]

(c) the Interim Report also states there are some potential barriers to searching and switching to a different provider, including being locked into contracts.[304]

5.5 For the reasons set out in this Response, Worldpay does not accept the findings the Interim Report has sought to draw from the survey evidence. In particular, the sources of survey evidence reviewed in fact revealed high levels of switching and merchant satisfaction.

303 Interim Report, paragraph 6.39.

304 Interim Report, paragraph 6.40.

5.6 The Interim Report's analysis of contracts between merchants and providers of card-acquiring services has focussed on the duration of these contracts (including any initial term, renewal and early termination fees) as well as the interaction between contracts for card-acquiring services and POS terminal hire contracts.[305] In summary, the principal contractual concerns the Interim Report has identified are:[306]

(a) the "indefinite" duration of contracts for card-acquiring services. The Interim Report alleges that these contracts do not provide a clear 'trigger point' for merchants to think about searching for and switching to another provider, and therefore are not in the merchants' best interests; and

(b) renewable fixed-term POS terminal hire contracts. In particular, the Interim Report alleges that: the initial terms of three to five years; the fact that contracts are renewed for successive fixed terms in the absence of notice to terminate; and the use of early termination fees, make it difficult for merchants to end these contracts. The Interim Report claims that these difficulties affect merchants' searching and switching behaviour in relation to card-acquiring services, as merchants will generally need to terminate POS terminal hire contracts in order to switch card-acquiring services provider.

5.7 The Interim Report also asserts that many of the contractual arrangements with Large Merchants (with card turnover of up to £50 million a year) for both card-acquiring services and POS terminal hire, are similar to those applicable to SME Merchants. On that basis, the Interim Report has also concluded that features that restrict SME Merchants' ability and willingness to search and switch will also affect many Large Merchants.[307]

5.8 In order to address these concerns, the Interim Report considers, in respect of merchants with annual card turnover of below £50 million:[308]

(a) a remedy requiring all contracts for card-acquiring services to have an end date;

(b) limiting the length of POS terminal contracts, for example to align with the 18-month limit set in the Consumer Credit Act 1974 ("**CCA**");

(c) ending POS terminal contracts that automatically renew for successive fixed terms; and/or

(d) linking the contracts for card-acquiring services and POS terminals, where they are sold together as a package by acquirers or ISOs.

5.9 The remedies that the Interim Report proposes are addressed in chapter 6 below, while this chapter responds to the preliminary findings in relation to contracts for card-acquiring services and POS terminal hire. By way of context, this chapter will first provide a brief overview of Worldpay's contractual arrangements with merchants.

305 Interim Report, paragraph 6.60.

306 Interim Report, paragraph 6.97.

307 Interim Report, paragraph 6.99.

308 Interim Report, paragraphs 1.19 and 1.22.

(b) Overview of Worldpay's card-acquiring and POS terminal hire contracts

[redacted]

5.15 In addition, as explained in chapter 4, the IFF Survey did not cover merchants with annual turnover above £10 million (and as explained in chapter 6, based on the Merchant Survey Data Room, it is clear that the number of respondents to the IFF Survey with annual turnover above £3 million was very low). Therefore, the Interim Report does not provide any evidence to support its findings regarding the searching and switching behaviour of merchants with annual card turnover above £10 million, and very little for merchants with annual card turnover above £3 million. Similarly, there is no evidential basis to support the provisional position that merchants with these levels of turnover should be included within the possible contractual

[redacted]

provisions-related remedies. This is also in line with Worldpay's experience, which indicates that there are significant differences between these merchant categories.

5.16 The sections that follow set out Worldpay's responses to the specific issues identified in the Interim Report in relation to the contracts for card-acquiring services and POS terminal hire.

(c) "Indefinite" duration of card-acquiring contracts / 'trigger points'

5.17 The Interim Report's analysis of card-acquiring service contracts concludes with the following statement:[313]

> "*The indefinite duration of contracts for card-acquiring services doesn't provide a clear trigger point for merchants to think about searching for another provider and switching and, for this reason, isn't in merchants' interests. This feature explains, at least in part, why we find many merchants don't consider switching or searching for other providers regularly, if at all.*"

5.18 However, contrary to this statement:

(a) there are, in fact, a number of 'trigger points' during a merchant's contractual relationship for card-acquiring services;

(b) there are benefits to the current duration of contracts which mitigate the perceived concerns; and

(c) the Interim Report contains no evidence to support a link between the absence of trigger points and merchants' interests in searching and switching to another provider.

5.19 These points are assessed in turn below.

The purported lack of clear trigger points during the merchants' contractual relationship for card-acquiring services

5.20 The Interim Report does not clearly set out what constitutes a 'trigger point', nor has Worldpay been asked any questions during the Market Review in relation to what trigger points merchants may be subject to during their contractual relationship with providers of card-acquiring services.

5.21 Assuming that a 'trigger point' should be understood as any event 'prompting' a merchant to search for and consider switching to another provider, merchants in fact encounter a number of trigger points during their relationship with their provider of card-acquiring services.

5.22 The IFF Survey clearly shows that in practice, SME Merchants receive many prompts to search and consider switching. Although this survey does not cover Large Merchants, many of the same prompts will have equal relevance to these merchants. For example, as set out on slide 26 of the IFF Survey, merchants who considered switching over the last two years but ultimately decided not to switch stated a variety of responses for thinking about switching. These include wanting to find a better deal, price increases, being approached by a provider with better terms, better settlement terms, wanting better customer service, and wanting to accept new payment methods.

313 Interim Report, paragraph 6.68.

5.23 In addition, Worldpay merchants are subject to at least the following prompts, and Worldpay understands that other providers of card-acquiring services are likely to have at least some similar measures in place:

(a) invoices that are sent to merchants [redacted]

(b) price change notifications;

(c) contact by rival providers and their representatives;

(d) competitor advertising;

(e) change or expansion of card-acceptance services; and

(f) relationship management / ongoing interaction between Worldpay and merchants.

Invoices

5.24 The IFF Survey indicates that the price merchants pay for card-acquiring services (among other things) is a factor that influences SME Merchants' searching and switching behaviour. The leading response to questions about why merchants had either considered switching or actually switched was that they wanted to pay a lower price or find a better deal.[314]

5.25 [redacted] Invoices therefore provide a clear and significant series of trigger points for SME Merchants, as well as Large Merchants, in order to prompt them to engage in searching and switching behaviour.

Notifications regarding changes in terms and conditions

5.26 [redacted].[315] This includes changes to the prices paid by merchants for those services.

5.27 The IFF Survey confirms that price increases are a relevant prompt for SME Merchants to search for and switch to alternative providers. In particular, changes in price terms were the second most significant factor motivating merchant decisions to consider switching card-acquiring services provider and to actually switch provider.[316]

5.28 Changes to price terms therefore provide a further periodic trigger point for all merchants to engage in searching and switching behaviour.

314 IFF Survey, slides 26 and 28.

315 [redacted]

316 IFF Survey, slides 26 and 28.

Contact by rival providers and their representatives

5.29 [redacted]

5.30 The IFF Survey confirms the significance of contacts with rival providers and their representatives. Approaches by providers with terms that were perceived to be better than those offered by the merchants' current providers was the third most significant factor motivating merchants' decisions to consider switching card-acquiring services providers and actually switching providers.[318]

5.31 [redacted]

5.32 Contacts by competitors thereby provide another consistent trigger for small and medium sized merchants, as well as Large Merchants, to engage in searching and switching behaviour.

Competitor advertising

5.33 Merchants are likely to encounter both online and offline advertisement from rival service providers on a very regular basis. The results of the IFF Survey confirm that these act as relevant trigger points for merchants to consider searching and switching.

5.34 In the IFF Survey, merchants pointed to considerations such as improved payment settlement times, presumably advertised by rival providers and competitor advertisement, as factors motivating their decision to search and switch.[319] As noted above, seeing a better deal being advertised was the third most significant factor merchants considered likely to affect their future switching behaviour.[320]

5.35 Worldpay considers that merchants of all categories are likely to frequently encounter advertisements from rival providers, [redacted]

5.36 As such, competitor advertising and broader marketing strategies comprise a further consistent trigger point for merchants to engage in searching and switching behaviour.

---

317 [redacted]

318 IFF Survey, slides 26 and 28.

319 IFF Survey, slides 26 and 28.

320 IFF Survey, slide 31.

321 [redacted]

Merchant contacts with acquirer customer service teams

5.37 Merchants contact the customer services departments of acquirers for a variety of reasons, such as to enquire about desired changes to the scope of services provided or to report technical issues.

5.38 The IFF Survey indicates that these interactions with the acquirers' customer service teams are an opportunity for merchants to evaluate the service received from the acquirer as well as any improvements to the service offering the acquirer may be able to provide, and to consider searching for and switching to find better service elsewhere.[322]

5.39 [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Change or expansion of card-acceptance services

5.41 The IFF Survey indicates that some SME Merchants considered searching and then switched providers when seeking to make changes to the way they use card-acquiring services. Merchants cited their desire to accept a new payment method as one of the factors influencing their decision to consider switching, as well as their decision to switch. Merchants also cited a change of software and a desire for better integration with that software as a factor motivating their decision to switch.[326]

322 IFF Survey, slides 26, 28 and 31.

[redacted]

[redacted]

[redacted]

326 IFF Survey, slides 26 and 28.

5.42 This shows that changes to or expansion of card-acceptance services provides merchants with a relevant trigger point to engage in searching and switching behaviour. This is likely to apply to both SME Merchants and Large Merchants.

5.43 As discussed in chapter 1 the market is moving towards a retail payments market where merchants seek a range of omnichannel services from an increasingly diverse range of providers. Merchants will interact with different parts of the card-acceptance value chain as part of this process, for instance when:

(a) adding new terminals, to accommodate increased footfall;

(b) adding new outlets, when opening a new store in a chain;

(c) adding online payments, when launching or expanding a website;

(d) providing other remote payment options, when opening delivery or click and collect services (e.g. over the phone, or other e-Commerce alternative payment methods); or

(e) adding other value-added services that customers might demand (e.g. dynamic currency conversion).

5.44 The IFF Survey results confirm that each of these interactions with the value chain act as a potential trigger point for SME Merchants and Large Merchants to consider changing their card-acquiring service provider.[327] Given the market developments set out in chapter 1, these factors are likely to increase in relevance, and therefore lead to a greater increase in the number of trigger points in the future.

Relationship management / ongoing interaction between Worldpay and merchants

5.45 The Interim Report's findings regarding the lack of trigger points also fails to take into account the numerous other instances of contact Worldpay has with its customers as part of their contractual relationship, which will be relevant to switching levels (as explained above). For example:

[redacted] [redacted]

[redacted] [redacted]

[327] IFF Survey, slides 26 and 28.

[328] See Worldpay's response to General RFI 2, Annex C (7 October 2019), paragraph 1.15.

[329] See Worldpay's response to General RFI 2, Annex C (7 October 2019), paragraph 1.17.

[redacted]

5.46 These contacts provide all-sized merchants with the opportunity to reflect on the service received from Worldpay, and to consider whether Worldpay is able to meet their needs going forward or whether their needs may be better satisfied elsewhere. These instances therefore constitute additional trigger points for SME Merchants, as well as Large Merchants, to engage in searching and switching behaviour. [redacted]

The benefits of the current contractual duration

5.47 There are a number of benefits of evergreen contracts for card-acquiring services. In particular, the current contractual arrangements provide merchants with more comfort and security in terms of operational continuity. They know they will not need to worry about the contract coming to an end at an inconvenient time, and having to deal with renewing their contract and potentially facing additional and unnecessary inconvenience if they are perfectly happy with their current provider.

5.48 It is important that these benefits are sufficiently taken into account when considering potential remedies, which are discussed in chapter 6. [redacted]

The link between 'trigger points' and merchants' searching and switching behaviour

5.49 The Interim Report's analysis is premised on a link between trigger points and merchants' interest in searching and switching. However, there is nothing in the Interim Report to support this premise. In particular:

(a) for the reasons explained above, it is not accepted that there is a lack of trigger points in relation to the contracts concerned. It is also not accepted that the nature or duration of the contracts concerned impede or otherwise disincentivise switching as would warrant, exceptionally, the imposition of remedies in this regard. Moreover, the Interim Report does not meaningfully analyse the significance of trigger points or their relationship with merchants' interests.[331] In fact, the Interim Report only contains one reference to the term 'trigger point' in its analysis of contracts for card-acquiring services, i.e. in the paragraph concluding its analysis of these contracts;[332]

(b) in the only paragraph discussing trigger points, the Interim Report simply states that "*the indefinite duration of contracts … doesn't provide a clear trigger point for merchants to think about searching for another provider…*" and "*for this reason*", are not in merchants' interests. [redacted]

330 See Worldpay's response to General RFI 2, Annex C (7 October 2019), paragraph 1.18.

331 The term is used a total of 7 times in the Interim Report: once in the conclusion of the analysis of card-acquiring service contracts (paragraph. 6.68), once in the concluding paragraph of its analysis of payment facilitator contracts (paragraph 6.71) and on all other occasions in paragraphs summarising its conclusions in relation to these two sections (paragraphs. 1.14, 1.17, 6.97, 7.24 and 7.37).

332 Interim Report, paragraph 6.68.

[redacted]

(c) moreover, the Interim Report appears to assume a causal relationship between trigger points and the merchants' interests. However, this assumption is not accepted in a context where (i) there is no evidential basis to conclude that levels of switching are abnormal for a competitively functioning market of this type; and (ii) there are many other reasons why merchants retain their existing provider. In particular as emphasised throughout this chapter, merchants can benefit significantly from the convenience of having the continuity of service provided by the current contractual arrangements;

(d) in contrast, the assumption that a lack of trigger points inhibits switching to an abnormal level is simply not supported by the overall analysis or the items of evidence contained in the Interim Report, including through the IFF Survey. In particular, as discussed in detail in chapter 4, there are many other reasons (other than the absence of a trigger point) why a merchant may take an active decision to retain its existing provider. The IFF Survey, for example (as explained above), shows that the primary reason merchants do not consider switching provider is satisfaction with their current provider. Such an answer is completely inconsistent with a theory of harm predicated upon inability (through incentives or otherwise) to switch. In this regard, see paragraphs 4.29 – 4.32 in chapter 4 above, relating to slides 25 and 27 of the IFF Survey;

(e) this evidence, properly considered, is fundamentally inconsistent with a conclusion that there is a switching issue in this market that would require the exceptional step of the imposition of remedies:

(i) the majority of merchants with contract terms exceeding two years have either switched or considered switching;

(ii) of this cohort, even of those who decided not to switch, the vast majority chose to remain either because they compared the market and preferred to remain or obtained better terms with their existing provider;

(iii) even in respect of the remaining providers who had not considered switching (42%), the significant majority (64%) considered there was no need to do so, because they were happy with their existing provider (with a number of other positive responses being provided – see chapter 4 above). There is no basis to conclude that even in respect of this minority there is any basis to impose a remedy;

(iv) even in respect of the minority who responded that they had not considered switching and were not happy with their existing provider, the reasons given in response to the IFF Survey questions posed do not indicate a serious competition issue in this market. More specifically, there is no evidence to suggest any issue relating to a lack of trigger points, or to a suggestion that it had not occurred to merchants to consider switching due to a lack of prompts encouraging them to do so. Indeed, of the merchants who answered that they did not shop around for providers, only 2% stated that they had no particular reason or hadn't thought to shop around;[333]

333 IFF Survey, slide 40.

(v) in relation to future switching behaviour, according to the IFF Survey, when asked what would make merchants consider switching in the future, only 1% of merchants said that the expiry of a contract would make them consider switching in future;[334] and

(vi) the Interim Report does not explain how these results, which as explained in chapter 4 do not support any preliminary finding that merchants do not consider switching, support a theory that a perceived lack of trigger points affects merchants' interest in switching, or that switching would increase if the contract terms were amended; and

(f) finally, as explained above, Worldpay considers in any event that the levels of movement and switching in the market are significantly higher than as suggested in the Interim Report, notwithstanding the existence of the current contract provisions.

5.50 In light of these considerations, the Interim Report's findings in respect of the need for further switching incentives in the market, including so called trigger points, appears to be largely if not wholly unsupported, both by the evidence given by merchants themselves to the survey questions or the conventional levels of switching that are in fact observed in relation to the provision of card-acquiring services.

(d) Standalone POS terminal hire contracts

The findings in the Interim Report

5.51 The Interim Report identifies and acknowledges some important aspects of the services acquirers provide to merchants. In particular, the Interim Report highlights the importance from a merchant's perspective of the wide range of suppliers of card-acquiring services providing a 'one-stop-shop', covering both card-acquiring services and POS terminal hire, particularly for small and medium-sized merchants.

5.52 POS terminals provide a reliable and secure means for merchants selling face-to-face to capture card details and process payments at the point of sale. POS terminals differ considerably from card readers in terms of the volume of transactions that can be processed and other capabilities (e.g. user functionality and ability to provide printed receipts). These additional features necessarily have implications on the cost of POS terminals, as contrasted with card readers.

5.53 Merchants are free to acquire POS terminals separately from card-acquiring services (and the Interim Report sets out a number of commercial arrangements available to merchants, which are discussed in further detail below). This freedom to obtain POS terminals independently from acquiring services should at the outset raise strong doubts as to any potential theory of harm that commercial arrangements concerning the former have any capacity to impact negatively upon competition for acquiring services.

5.54 As such, a decision to acquire both products as a one-stop-shop is a matter of positive customer choice, reflecting the fact that such a choice provides distinct advantages to merchants. [redacted]

334 IFF Survey, slide 31. (According to this slide, out of the 1%, for most, this was in relation to the contract held with their provider of card-acquiring services. According to the data in the Merchant Survey Data Room, only 6 merchants said this was in relation to a contract held with a provider of card acceptance products (e.g. POS terminals).

[redacted]

5.55 However, the conclusion in the Interim Report on the impact of POS terminal hire contracts in chapter 6 is summarised in the following statement:[335]

> "…*Long initial terms, of three to five years, or contracts that automatically renew for successive fixed terms, where the merchant cannot terminate before the end of the minimum or renewal term without incurring early termination fees, affect merchants' willingness to search for other providers and switch and are not in merchants' interests. Some merchants will be prevented from switching to a different provider because the financial cost of doing so is too high. Some merchants may be able to absorb this cost, but many will be unwilling to do so*."

5.56 The Interim Report therefore identifies three features which it claims impede merchants' interest in searching and switching to alternative providers:

(a) the long initial terms of POS terminal hire contracts;

(b) the automatic renewal of POS terminal hire contracts for fixed successive terms; and

(c) terminations fees applicable to POS terminal hire contracts.

5.57 Worldpay does not recognise this theory of harm. It is not applicable at all to the Worldpay merchants that benefit from separate regulatory protection under the CCA, [redacted] In addition, larger merchants are demonstrably capable of assessing the benefits of a shorter or longer POS contract and choosing the one that best meets their needs. Interference with this freedom of choice is both unjustified on the evidence and likely to give rise to negative consequences for competition. These identified 'features' are assessed in turn below.

Longer term POS terminal hire contracts

5.58 In relation to the interim findings that longer term POS terminal hire contracts represent a barrier to switching, as explained in this section:

(a) the Interim Report contains insufficient evidence to support the interim findings in respect of SME Merchants, based on the IFF Survey. In addition, the IFF Survey does not apply to larger merchants, and therefore the Interim Report contains no evidence at all to support the findings in relation to this category of merchant. However, even if some of the characteristics were similar, the IFF Survey does not support the Interim Report's preliminary findings;

(b) [redacted]

335 Interim Report, paragraph 6.68.

(c) [redacted] and

(d) there are a number of benefits of longer-term contracts, and Worldpay considers that it is important these benefits are sufficiently taken into account, and that merchant choice is protected.

The Interim Report lacks evidence supporting the claims of a barrier to searching and switching

5.59 The evidence set out / referenced in the Interim Report does not support the claim that the duration of POS terminal hire contracts represents an obstacle to searching and switching. For example, the IFF Survey confirms that contractual restrictions are a negligible factor when it comes to merchants' switching decisions:

(a) only 4% of merchants who were asked to explain why they had never considered switching in the IFF Survey indicated that they felt that they could not switch provider as they were currently in a contract;[336]

(b) of those merchants who responded that they had considered switching, but had decided not to, only 10% reported that this was because they were tied into a contract;[337]

(c) as mentioned above, when merchants were asked what would make them consider switching in the future, only 1% said that the expiry of a contract would make them consider switching in the future (with only 6 of these merchants referring to a contract with a provider of card-acceptance products (e.g. POS terminals);[338] and

(d) of the merchants who responded that they did not shop around for different providers, only 6% of these merchants stated that this was because they were tied into a contract.[339]

5.60 These are very low percentages in the context of the full IFF Survey results, and this evidence is not sufficient to support the findings that contracts of a longer duration represent a barrier to switching that requires the imposition of market remedies. In addition, as noted previously, the IFF Survey did not apply to merchants with annual card turnover over £10 million, and as explained in chapter 6, the IFF Survey only received a very small number of responses from merchants with annual card turnover of greater than £3 million, as such, it is not accepted that there is a sufficient evidential basis to support the provisional findings in respect of POS terminals and the merchants in these categories.

5.61 Finally, in relation to initial term duration, paragraph 6.97 of the Interim Report states that "*long initial terms, of three to five years … affect merchants' willingness to switch*". However, this general statement does not accurately reflect the wide range of choice available to merchants when selecting between different initial term lengths for POS terminal hire. [redacted]

336 IFF Survey, slide 25.

337 IFF Survey, slide 27.

338 IFF Survey, slide 31.

339 IFF Survey, slide 40.

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

5.62 However, the Interim Report makes no attempt to differentiate between these initial terms, nor does it set out the impact that longer initial terms have on switching behaviour.

[redacted]

5.63 As explained above at paragraphs 5.26– 5.28, [redacted] This covers both the price at which these services are provided and other material terms.

5.64 [redacted]:

(a) [redacted] and

(b) [redacted]

5.65 These notifications provide merchants with a trigger point to consider switching. [redacted]

The merits of longer term POS terminal hire contracts

5.66 From a Worldpay perspective, as a general point, it is important to note that merchants are free to choose whether to obtain POS terminals from Worldpay, (and indeed the Interim Report sets out a number of commercial arrangements available to merchants – see paragraph 6.75). [redacted]

[redacted] [redacted]

[redacted] [redacted]

5.67 [redacted]

(a) [redacted] and

(b) [redacted]

5.68 The ability to choose between different POS terminal hire options, [redacted], is advantageous to merchants as it allows for the possibility of the cost of the terminal as well as the costs associated with setting up terminals to be spread out over a longer term. This means that longer term contracts can result in a lower per unit monthly cost of the POS terminal to the merchant.[345]

5.69 [redacted], longer term contracts provide merchants with the option to obtain a lower price as the fixed cost of the terminal(s) can be spread over a longer duration whilst also guaranteeing continuity of service over the extended period. Some merchants value the ability to benefit from lower monthly POS terminal costs using these longer term contracts.

5.70 The PSR should therefore ensure that it pays due regard to the advantages longer term contracts can offer merchants and preserves their freedom to choose the rental terms most suited to them. [redacted] Such an intervention would also interfere with freedom to choose contractual arrangements where such freedom, presumptively, should support competitive outcomes.

Renewal of POS terminal hire contracts

5.71 In relation to the Interim Report's preliminary findings that the so-called "automatic renewal" of POS terminal hire contracts for fixed successive terms represent a barrier to switching, as explained in this section:

(a) the Interim Report contains insufficient evidence to support its interim findings in respect of SME Merchants, based on the IFF Survey, whilst the IFF Survey does not apply to larger merchants;

(b) [redacted]

342 [redacted]

343 [redacted]

344 [redacted]

345 See in this regard, Worldpay's response to General RFI 2, Annex A, (3 September 2019), paragraph 3.11.

[redacted]

(c) the ability and exercise of renewal terms provides numerous benefits to the merchants concerned, no doubt forming the basis for the decision to renew.

The Interim Report lacks evidence supporting claims of a barrier to searching and switching

5.72 As explained in paragraphs 5.59 above, the evidence gathered in the context of the IFF Survey provides no support for the claim that the duration of POS terminal hire contracts represents a material obstacle to searching and switching. This lack of evidence is therefore equally applicable to the arguments regarding the duration of a POS rental contract through automatic renewal.

5.73 As noted above, the IFF Survey did not cover merchants with annual card turnover above £10 million. However, even if it could be demonstrated that the findings of the IFF Survey are equally applicable to Large Merchants (which is not accepted[346]), the available evidence provides no support to the claim that the automatic renewal of POS terminal hire contracts represent a barrier to switching for merchants of any size.

Merchants are able to terminate POS hire contracts before the end of the renewal term

5.74 The Interim Report does not sufficiently recognise that in practice merchants may have numerous opportunities to terminate their POS terminal hire contract prior to the end of the renewal term. [redacted]

5.75 [redacted]

The merits of automatic renewal of POS terminal hire contracts

5.76 As with longer contract terms, contract renewal provisions provide merchants with the assurance that they will not experience service interruption in the event that they fail to renew

346 See chapter 6.

347 [redacted]

their POS terminal hire contract, whilst preserving their freedom to exit the agreement if necessary.

5.77 As explained throughout this Response, protecting merchant choice is important to Worldpay, as Worldpay considers this to be in its customers' interests and therefore beneficial to its relationship with merchants. It is therefore crucial that the PSR takes into account all the benefits and positive elements of the current arrangements in the context of its assessment.

Early termination fees applicable to POS terminal hire contracts

5.78 In relation to the interim findings that early termination fees applicable to POS terminal hire contracts represent a barrier to switching, as explained in this section:

(a) the Interim Report contains insufficient evidence to support the interim findings in respect of SME Merchants, based on the IFF Survey, whilst the IFF Survey does not apply to larger merchants;

(b) there are objective reasons justifying the imposition of termination fees, [redacted] nd

(c) [redacted].

The Interim Report lacks evidence supporting its claims of a barrier to searching and switching

5.79 The Interim Report provides no factual support for the claim that early termination fees represent a barrier to switching to another provider. Indeed, early termination fees are not referenced at all in the IFF Survey results, and the Interim Report does not provide any analysis or further evidence at all examining the impact of early termination fees on switching levels in respect of any size of merchant.

There are justifications for early termination fees; [redacted]

5.80 There are objective and justifiable reasons for the imposition of early termination fees, as this enables providers to recover the costs of the POS terminal hire, as well as set up costs, such as support and manufacturer costs.

5.81 [redacted]

5.82 [redacted]

[redacted]

5.83 [redacted]

348 [redacted]

349 [redacted]

6. WORLDPAY'S RESPONSE TO THE INTERIM REPORT'S PROPOSED REMEDIES

Introduction

6.1 The Interim Report proposes remedies to address features of the supply of card-acquiring services that have been provisionally identified as restricting merchants' willingness and ability to search and consider switching. The PSR expects to "*carry out further detailed work to consider the most effective way to design and implement any remedies*" and any remedies considered will be contingent on conclusions in the Final Report.[350]

6.2 This chapter sets out Worldpay's views on the proposed remedies that have been outlined in the Interim Report, and during the 30 November Meeting. In particular, this chapter explains that:

(a) any remedies considered in the Final Report must fulfil the legal requirements of proportionality. In each case, it must be demonstrated that remedies are appropriate, necessary, the least onerous between a choice of alternative effective measures and not disproportionate to the aim pursued;

(b) evidence gathered primarily from merchants with annual card turnover below £10 million, and which does not take account of the significant differences between merchant segments, cannot be used to justify remedies imposed on merchants in larger turnover categories, including merchants with annual card turnover between £10 million and £50 million;

(c) Worldpay does not understand the legal or evidential basis used to justify remedies that are effectively akin to consumer protection measures in respect of merchants exceeding the smallest turnover categories. In particular, there is no basis for the imposition of such remedies upon merchants with annual card turnover between £1 million (and more specifically turnover equating to the category of the smallest merchants with turnover that exceeds say £380,000[351]) and £10 million and, in turn, of up to £50 million;

(d) the remedies that have been proposed in the Interim Report would not fulfil the legal requirements of proportionality, especially if implemented in their current form. There are more appropriate and less onerous potential alternatives to the remedies outlined in the Interim Report, which should in Worldpay's view be limited to merchant segments below the £380,000 annual card turnover threshold; and

(e) in respect of each category of remedies proposed in the Interim Report, it is important that any future remedies consultation gives industry stakeholders adequate opportunity to fully engage on the design of any remedies at an early stage. Worldpay has identified particular concerns with the remedies are proposed:

(i) [redacted] However, it remains unclear whether such a remedy would be proportionate in circumstances where merchants are

350 Interim Report, paragraph 7.36.

351 The Interim Report introduces £380,000 as its definition of the "*smallest merchants*", which account for 90% of the overall merchant population (paragraph 1.17).

already subject to numerous opportunities to consider their existing relationship with their provider of card-acquiring services;

(ii) [redacted] the Interim Report has not demonstrated why restricting merchant choice through prohibiting longer POS terminal hire contracts or successive fixed terms would be proportionate in the context of any preliminary findings. In addition, measures intended to "*link*" contracts for card-acquiring services and POS terminal hire by prohibiting early termination fees require further investigation, as there are many legitimate and proportionate reasons for termination fees to be applied that are ultimately in merchants' interests; and

(iii) there are likely to be adverse consequences arising from information or comparison remedies that focus solely on the prices for card-acquiring services. Any prescriptive requirements to provide merchants with information, for example in the form of a comparison 'rate', is highly unlikely to take account of non-price factors, such as choice, customer service, innovation and quality, which are important to merchants. Worldpay would respectfully submit that a standard set of information criteria, based on high-level principles, is a more proportionate alternative to any remedies that seek to establish a common comparison rate.

6.3 Finally, Worldpay submits that it would be more proportionate to include as an alternative approach measures seeking voluntary commitments from industry to comply with standards of conduct using a principles-based regulatory approach. Worldpay is fully prepared to work closely with the PSR and the wider payments industry to identify potential objectives that could be pursued.

The potential remedies proposed in the Interim Report

6.4 The Interim Report sets out three categories of remedies that are intended to address features that have provisionally been identified as restricting merchants' willingness and ability to search and consider switching. These are:

(a) a remedy requiring all contracts for card-acquiring services to have an "*end date*", which would apply to both acquirer and payment facilitator contracts;

(b) remedies that would apply to POS terminal hire contracts supplied by acquirers and ISOs, such as:

(i) "*limiting the length of POS terminal contracts, for example to align with the 18-month limit set in the Consumer Credit Act 1974;*

(ii) *ending POS terminal contracts that automatically renew for successive fixed terms; and*

(iii) *linking the contracts for card-acquiring services and POS terminals, where they are sold together as a package by acquirers or ISOs. For example, by making it easy to exit POS terminal contracts if terms change in the card-acquiring services contract (including price) without incurring termination fees*";[352] and

352 Interim Report, paragraph 7.44.

(c) a remedy designed to complement existing regulatory requirements to provide information to merchants on their prices, which "*could take several forms*", such as:

(i) "*enabling or enhancing tools to facilitate price comparison for merchants; and*

(ii) *requiring acquirers and ISOs to provide pricing information in an easily comparable format*".[353]

6.5 The remedies outlined above are proposed on the basis of a preliminary finding that merchants with an annual card turnover below £50 million face barriers which restrict their willingness and ability to search and consider switching, and that merchants that have switched their provider of card-acquiring services "*get a better deal*".[354] The remedies that the Interim Report outlines above are, therefore, intended to promote and facilitate switching by merchants.

(a) Any remedies considered in the Final Report must be proportionate

6.6 Chapters 4 and 5 of this Response address the Interim Report's preliminary findings on searching and switching, concluding that these preliminary findings are based on a series of flawed premises. Given the concerns raised in respect of the evidential basis supporting those preliminary findings, Worldpay considers there to be no sufficient legal basis for the imposition of remedies based on the preliminary findings set out in the Interim Report.

6.7 In any event, it would remain necessary to demonstrate in each and every case that remedies proposed to address any identified market features fully satisfy the legal requirements of <u>proportionality</u>. In particular, any remedies must:

(a) take into account the regulatory principles under section 53 of FSBRA, including the proportionality principle, which requires that:

"*a burden or restriction which is imposed on a person, or on the carrying on of an activity, <u>should be proportionate to the benefits</u>, considered in general terms, which are expected to result from the imposition of that burden or restriction*";[355] and

(b) be in accordance with principles on proportionality derived from EU law. In *Tesco plc v Competition Commission* [2009] CAT 6, the Competition Appeal Tribunal summarised the four requirements of proportionality in the context of remedies imposed following a market investigation as follows:

"*(1) must be effective to achieve the legitimate aim in question (appropriate), (2) must be no more onerous than is required to achieve that aim (necessary), (3) must be the least onerous, if there is a choice of equally effective measures, and (4) in any event must not produce adverse effects which are disproportionate to the aim pursued*".[356]

---

353 Interim Report, paragraph 7.52.

354 Interim Report, paragraphs 6.1, 6.2, and 7.35.

355 Section 53(b), Financial Services (Banking Reform) Act 2013. The PSR is also required to have regard to the efficiency principle and the "*need to use the resources of the Payment Systems Regulator in the most efficient and economic*[al] *way*".

356 <u>*Tesco plc v Competition Commission*</u> [2009] CAT 6 at paragraph 137 citing the European Court of Justice's judgment in Case C-331/88 *R v Ministry of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte Fedesa* [1990] ECR I-4023, paragraph 13.

6.8 The remedies proposed in the Interim Report would not satisfy the legal requirements of proportionality if pursued in their current form, whether or not the provisional findings in the Interim Report were accepted at face value. In particular, the proposal to implement all three categories of proposed remedies (summarised in paragraph 6.4 above) without distinguishing between the very different categories of merchants – each with very different characteristics and requirements[357] - found within the very broad cohort of merchants with annual card turnover of up to £50 million, demonstrates this point. As explained below:

(a) evidence gathered primarily from merchants with annual card turnover below £10 million, and which does not take account of the significant differences between merchant segments, cannot be used to justify remedies imposed on merchants in larger turnover categories, including merchants with annual card turnover between £10 million and £50 million; and

(b) Worldpay does not understand the legal or evidential basis to impose remedies that are effectively akin to consumer protection measures in respect of merchants exceeding the smallest turnover categories. In particular, there is no basis for the imposition of such remedies upon merchants with annual card turnover above levels such as £380,000, above which their information and other needs vary considerably.

(b) Evidence gathered primarily from SME Merchants cannot be used to justify remedies being imposed in larger merchant segments with annual turnover above £10 million

6.9 The Interim Report makes the preliminary finding that the supply of card-acquiring services does not work well for 'SME Merchants' (defined by the Interim Report as merchants with annual card turnover up to £10 million) and 'Large Merchants' (merchants with annual card turnover between £10 million and £50 million). However, the Interim Report's analysis of barriers to searching and switching is accepted by the PSR as having a "*focus*" on SME Merchants.[358] Similarly, the Interim Report states that the remedies proposed are intended to address "*a combination of features that restrict* [SME Merchants'] *willingness and ability to search and switch*", although in practice merchants above the £10 million annual card turnover threshold remain within contemplation of remedies in the report.[359]

6.10 Worldpay would respectfully suggest that no real evidential basis has been provided for issues of switching and searching concerning merchants above the £10 million annual card turnover category. In particular, the IFF Survey, which the Interim Report cites in support of its preliminary findings on searching and switching, did not interview merchants with annual card turnover above £10 million at all (and, as explained below, 94.4% of survey respondents had an annual card turnover below £3 million).[360] The lack of evidential foundation for remedies in respect of the £10 million to £50 million category is compounded by the fact that "*nearly all*" of the merchants that responded to the PSR's information requests had annual card turnover above £50 million.[361]

357 See paragraphs 1.24 – 1.33 of chapter 1 for a further explanation.

358 Interim Report, paragraph 6.5.

359 Interim Report, paragraph 7.26.

360 IFF Survey, slide 4.

361 Interim Report, paragraph 6.4.

6.11 The Interim Report provides no direct evidence concerning searching and switching in respect of Large Merchants with annual card turnover between £10 million and £50 million (let alone evidence supporting the implementation of remedies). Instead, the Interim Report states that these merchants "*share characteristics*" with SME Merchants.[362] But the Interim Report fails to substantiate this assertion, other than to claim that SME Merchants and "*many*" Large Merchants with annual card turnover between £10 million and £50 million have:

(a) "*the same contracts for card-acquiring services*";

(b) the "*same terms when contracting for POS terminals*"; and

(c) "*the same pricing options*".[363]

6.12 On the basis of these claimed "*share*[d] *characteristics*", the Interim Report then provisionally concludes that "*the features that restrict* [SME] *merchants' ability and willingness to search and switch will affect many large merchants with annual card turnover between £10 million and £50 million*".[364] This provisional conclusion is flawed in a number of respects. In particular:

(a) as noted above, there is no direct evidence in the Interim Report on searching and switching in relation to merchants with annual card turnover between £10 million and £50 million. Such evidence cannot be assumed by simply extrapolating from one broad merchant segment to another;

(b) as explained in chapter 1, (paragraphs 1.24 – 1.33) merchants within different customer segments have fundamentally different requirements and expectations from their providers of card-acquiring services, which the Interim Report acknowledges.[365] It is flawed, therefore, to suggest that a merchant with an annual card turnover of £200,000 "*may share characteristics*" with a merchant with an annual card turnover of £40 million, merely on the basis that they may contract under a similar pricing structure (which in any event is not the case, as explained below);

(c) it is incorrect to state that Large Merchants and SME Merchants "*share characteristics*" on the basis of their contractual terms and pricing options for card-acquiring services and POS terminals. [redacted]

(i) [redacted]

(ii) [redacted]

(iii) [redacted]

362 Interim Report, paragraph 6.10.

363 Interim Report, paragraph 6.99.

364 Interim Report, paragraph 6.99.

365 Interim Report, paragraph 4.1.

[redacted]

(d) as explained in section 5 of the Technical Annex, there is no basis for the Interim Report's provisional finding that merchants with an annual card turnover below £50 million that switch their provider of card-acquiring services "*get a better deal*".[366] However, even if this preliminary finding were maintained in the Final Report, it would not provide a substitute for direct evidence identifying market features giving rise to barriers to those merchants' ability and willingness to search and switch providers.

6.13 The Interim Report also notes that many Large Merchants are "*clustered towards the lower end of this turnover range*" and that "*35%* [of Large Merchants] *have an annual card turnover between £10 million and £15 million*". However, this observation does not support a proposal to adopt a threshold of £50 million annual card turnover for the implementation of remedies; on the contrary, it makes the identification of a £50 million threshold even more disproportionate and arbitrary.

6.14 It is therefore not appropriate to consider remedies that would apply to merchants with annual card turnover between £10 million and £50 million in the Final Report. The Interim Report provides no sufficient evidential basis, and in many respects no evidential basis at all, as would be needed to demonstrate that remedies are necessary or proportionate in relation to Large Merchants falling into this category.

(c) There is no legal or evidential basis to impose remedies on merchants with annual card turnover above £380,000

Acquirers, payments facilitators and ISOs are operating within a business-to-business environment when contracting and negotiating prices and service offerings with merchants. However, the remedies proposed in the Interim Report can be more aptly described as consumer protection measures, typically found in business-to-consumer markets. The Interim Report even applies the "*three-As framework*", which is taken from a document published by the CMA and the FCA on "*consumer facing remedies*".[367]

6.15 As explained in chapter 1 (paragraphs 1.24 – 1.33), there are important differences between merchant segments falling within the Interim Report's very broad definition of SME Merchants with annual card turnover below £10 million. The distinctions between these segments must inform the scope of any potential remedies. For example, sole traders with levels of turnover below £50,000 may share characteristics with consumers. In contrast, larger organisations with higher annual card turnovers including above £1 million are likely to have structures and processes which leads them to clearly operate as businesses capable of in nearly every scenario negotiating outcomes in their best commercial interests.

6.16 The Interim Report does not undertake sufficient analysis to adequately distinguish between the differences between these merchant segments and had it done so, the scope of any remedies proposed would have been more narrowly defined. In particular:

366 Interim Report, paragraphs 6.1, 6.2, and 7.35.

367 Interim Report, footnote 86 citing CMA and FCA, 'Competition and Markets Authority and Financial Conduct Authority, Helping people get a better deal: Learning lessons about consumer facing remedies' (October 2018).

(a) the IFF Survey found that switching concerns – to the limited extent that any concerns are identified – were by and large focussed upon the smallest merchants, namely those with annual card turnover below £380,000. For example:

(i) "*merchants in the lowest turnover group* [£0 - £380,000] *were the most likely to have never shopped around*";[368] and

(ii) merchants with annual card turnover below £380,000 were the least likely to have switched provider.[369]

To the extent that the Final Report concludes there is evidence of a lack of searching and switching for card-acquiring services (which is not well-founded for the reasons explained in chapter 4), then any remedies, if pursued, would need to be targeted towards merchants with annual card turnover below £380,000;

(b) merchants with annual card turnover below £380,000 are more likely to behave similarly to consumers (and many of the smallest merchants, such as sole traders, are already subject to consumer protection measures under the CCA). As noted below, the remedies proposed in the Interim Report would be more consistent with measures introduced by other regulators in the context of consumer-facing markets;

(c) remedies applied to merchants with less than £380,000 annual card turnover are less likely to give rise to unintended consequences than remedies imposed on merchants in larger turnover segments. For example, a smaller merchant is more likely to have basic card-acceptance requirements, including standalone POS terminals and/or card readers, whereas merchants with £1 million or £10 million annual card turnover have increasingly bespoke requirements and it is more difficult to predict the impact of remedies on those customer groups; and

(d) a remedy that applies to merchants with annual card turnover up to £380,000 would apply to 93.7% of merchants that accept card payments in the UK.[370] Therefore, if the Final Report were to propose remedies to this merchant segment, the impact would still affect most UK merchants that contract for card-acquiring services.

6.17 Moreover, the conclusions drawn from the IFF Survey rely primarily on evidence obtained from the smallest merchant groups, including a large proportion of merchants with annual card turnover significantly below the £380,000 threshold.[371] From a sample of 1,037 survey participants:

(a) 38% of merchants had an annual card turnover of less than £380,000, of whom approximately 87% had an annual card turnover below £160,000;

(b) 72% of merchants had an annual card turnover of less than £1 million, of whom approximately 83% had an annual card turnover below £600,000;

368 IFF Survey, slide 79.

369 IFF Survey, slide 23 and Interim Report, paragraph 6.39.

370 Interim Report, Annex 1, Table 1.

371 IFF Survey, slide 54.

(c) the available evidence for merchants with annual card turnover between £1 million and £10 million is more limited and less likely to be reliable, particularly from merchants in the higher annual card turnover categories:

(i) 5.6% of survey participants (58 merchants) had annual card turnover between £3 million and £10 million, of whom only 31 merchants accepted card-present transactions;

(ii) 1.6% of survey participants (17 merchants) had an annual card turnover between £6 million and £10 million, of whom only seven merchants accepted card-present transactions.[372]

The limited number of survey responses from merchants with annual card turnover between £3 million and £10 million, whether as a proportion of total responses or in absolute numbers, further suggests that the IFF Survey provides no evidential basis to impose remedies on merchants within these segments.

6.18 Moreover, as explained in chapter 4 and at paragraphs 6.9 – 6.13 above, the Interim Report provides no evidence that considers barriers to searching and switching in respect of merchants with annual card turnover between £10 million and £50 million. Therefore, there are no preliminary findings on barriers to searching and switching that can be reached in respect of this group of merchants in any event, including with regards to the imposition of any remedies.

6.19 In summary, Worldpay has not identified a legal or evidential basis as would justify the imposition of remedies for merchants with annual card turnover above £380,000. In particular, the remedies that have been proposed in the Interim Report are essentially suitable for consumer-type transactions and would not meet the legal requirements of proportionality in the context of business-to-business contracts.

6.20 The remarks set out below focus upon the detail of the remedies proposed in the Interim Report, including in respect of small merchants with turnover levels below thresholds such as £380,000.

(d) Worldpay's response to the approaches to remedies proposed in the Interim Report

6.21 As noted above, the Interim Report proposes the three categories of remedies set out above in paragraph 6.4.

Remedy category 1: Requiring an "*end date*" for card-acquiring services contracts

6.22 The Interim Report states that the "*indefinite*" duration of contracts for card-acquiring services do not provide a clear trigger point for merchants to think about searching for another provider and consider switching.[373] In order to address this concern, and to "*encourage merchants to*

[372] A number of the remedies outlined in the Interim Report relate specifically to POS terminal contracts. However, merchants that do not accept card-present transactions do not contract for POS terminals and, therefore, responses from such merchants cannot be used to support the imposition of remedies relating to POS terminal contracts.

[373] Chapter 5 at paragraphs 5.49 - 5.50 explains that the Interim Report's assumed causal link between "*trigger points*" and merchants' interests in searching and switching is based on a false premise, which is not supported by the IFF Survey or Worldpay's submitted evidence.

shop around more regularly", the Interim Report proposes a remedy "*requiring all contracts for card-acquiring services to have an end date*".[374]

6.23 As a preliminary observation, [redacted] Any interference with cardholders' ability to make card payments or merchants' ability to accept card payments – even for a short period – would likely cause harm that is disproportionate to any perceived benefits.

6.24 [redacted] In particular:

(a) as explained in chapter 5 (paragraphs 5.49 - 5.50), the Interim Report provides no supporting evidence that the absence of a "*trigger point*" has an adverse impact on merchants' interests in searching and switching or that a contractual end date, specifically, would increase merchants' propensity to search and switch;

(b) chapter 5 (paragraphs 5.20 - 5.46) also explains that merchants are already presented with a numerous prompts from their provider of card-acquiring services to search or consider switching. Therefore, even if the implementation of a contractual end date, in principle, were to increase the likelihood of searching and switching, the Interim Report does not explain why one additional prompt, in the form of a contractual end date, would be appropriate or necessary to increase the existing levels of searching and switching;

(c) the Interim Report acknowledges that "*contracts with no end date may provide benefits for some merchants*" and may "*protect merchants by providing continuity of service for those who have forgotten to renew*".[375] Merchants receive comfort and security in the knowledge that they do not need to worry about their contract coming to an end at an inconvenient time, and having to deal with renewing their contract and potentially facing additional and unnecessary inconvenience in circumstances where they are satisfied with their current provider.[376]

6.25 [redacted] there are likely to be more effective and less onerous measures than a contractual end date remedy that would address the Interim Report's provisional findings on contracts for card-acquiring services. In some consumer markets, for example, annual communications have been used to promote consumer switching behaviour. In this context, communications similar to those currently sent to regulated merchants under RHAs (pursuant to the CCA) may be appropriate for further consideration, such as a reminder or 'prompt' for merchants to consider their current relationship with their provider of card-acquiring services.

6.26 However, as explained above, it is unlikely that remedies intended to "*nudge*" or "*prompt*" customers would be effective or proportionate in the context of business-to-business contracts. This is with the possible narrow of exception of the smallest merchants, such as merchants with annual card turnover below £380,000 (which includes some merchants, such as sole

374 Interim Report, paragraphs 7.38-7.39.

375 Interim Report, paragraph 7.41.

376 Interim Report, paragraph 7.41.

traders, that are already regulated under the CCA), who are more likely to be prompted by consumer-facing remedies. Worldpay would welcome the opportunity to discuss the possibility of this type of remedy in further detail.

Remedy category 2: Remedies relating to POS terminal contracts

6.27 The Interim Report reaches preliminary findings on three features relating to POS terminal contracts that are claimed to impede merchants' interest in searching and switching. These are: (i) "*long initial terms, of three to five years*"; (ii) POS terminal contracts that "*automatically renew for successive fixed terms*"; and (iii) termination fees that apply during the initial or renewal term.[377]

6.28 To address these features, the Interim Report proposes a set of three remedies that would apply to such contracts entered into between merchants and acquirers or ISOs, as set out in paragraph 6.4 above. [redacted]

6.29 The Interim Report proposes each of these potential remedies with respect to "*POS terminals*", i.e. card-acceptance devices that accept card-present transactions "*without the need to connect to a smartphone or tablet*".[378] It is therefore understood that these remedies would not apply to payment facilitators, who sell card readers to merchants upfront,[379] nor would they apply to pin entry devices ("**PEDs**") that are used to support the capture of card-present transactions for integrated payment solutions (i.e. PEDs that cannot function independently of an internet-connected device, such as a tablet with POS software installed or a standalone EPOS terminal).

6.30 In addition, as explained above at paragraphs 6.9 – 6.14, there is no adequate legal or evidential basis at all to impose remedies on merchants with annual card turnover of between £10 million and £50 million that, among other things, did not participate in the IFF Survey.

6.31 To the extent that remedies relating to POS terminals are contemplated for SME Merchants specifically, Worldpay submits that it would not be proportionate to impose such remedies for merchants with annual card turnover above £380,000. For the reasons set out above, merchants above these thresholds will carefully consider and negotiate terminal requirements, often on a bespoke basis. Care needs to be taken to ensure that any remedy employed in response to any concerns perceived, essentially in respect of the very smallest merchants, are not employed so as to interfere with the freedom to contract and exercise choice currently enjoyed by merchants more appropriately categorised as medium and large businesses.

(a) Limiting the length of POS terminal contracts

6.32 During the 30 November Meeting, Worldpay explained that there are justifications and benefits that merchants receive when contracting for POS terminal contracts for longer terms. [redacted]

377 Interim Report, paragraphs 1.20 and 7.42. Responses to each of the Interim Report's preliminary findings in respect of POS terminal hire contracts are set out in chapter 5 of this Response.

378 Interim Report, Annex 6 (Glossary), page 5.

379 As confirmed by the Interim Report, paragraph 7.45.

[redacted]

6.33 In particular, any remedy imposing limits on the length of POS terminal contracts would need to carefully take into account the following factors:

(a) as explained in chapter 5 (paragraphs 5.59 - 5.62), the Interim Report does not explain why longer contractual terms are a barrier to searching and switching. On the contrary, the IFF Survey confirms that the duration of contractual terms is a negligible factor when it comes to merchants' switching decisions. Therefore, there is limited evidence that imposing a maximum contractual term would have any impact on levels of searching and switching;

(b) limiting the term length of POS terminal hire contracts would limit the choice and contractual freedom of merchants. Merchants may have a legitimate business interest to enter into longer POS terminal contracts for reasons including negotiating lower prices, to ensure business continuity (in terms of prices price and services received) or to minimise administrative costs. [redacted]

(c) merchants are currently free to choose the length of POS terminal hire that suits their requirements. The Interim Report acknowledges that acquirers and ISOs that offer merchants POS terminal contracts with longer term lengths will "*simultaneously present the merchant with the option to choose an initial term of less than 3 years (between 12 and 24 months depending on the firm)*".[380] In circumstances where merchants are presented with the option to enter into POS terminal contracts with shorter term lengths, and must make an <u>active</u> choice to enter into a longer contractual term, a remedy limiting the length of POS terminal contracts would constrain this choice; and

(d) merchants may have numerous opportunities to terminate their POS terminal contracts during the course of their contractual term, irrespective of the term length. [redacted]

6.34 For the reasons explained above, Worldpay does not consider there to be a sound basis to remove choice from merchants that prefer longer POS terminal hire contracts. However, as explained in chapter 5 (paragraph 5.13), merchants regulated under the CCA already contract for POS terminals under RHAs for maximum terms of 18 months. Therefore, it would be more proportionate for any remedies imposing a maximum term on POS terminal contracts to focus upon merchants that are similar in character to consumers (such as sole traders that contract under RHAs), but fall outside the current statutory definition of an "*individual*" under the CCA (e.g. incorporated businesses). Worldpay would respectfully suggest the annual card turnover amount of £380,000 as an appropriate threshold to cover the types of merchants that are likely to fall within this description.

380 Interim Report, paragraph 6.81.

(b) Ending "*automatic renewal*" of successive fixed terms in POS terminal contracts

6.35 [redacted]

6.36 However, it would be necessary to discuss further the operational aspects of this proposal during any remedies consultation to fully understand the impact to acquirers, ISOs and merchants. The following considerations, among other things, would need to be fully taken into account in the design of this remedy:

(a) as explained in chapter 5 (paragraphs 5.59 to 5.62), the Interim Report provides no evidence that the duration of POS terminal hire contracts represents a genuine obstacle to searching and switching. On the contrary, the IFF Survey confirms that the duration of contractual terms is a negligible factor when it comes to merchants' switching decisions. Therefore, there is no evidence that a prohibition of contracts that renew for successive fixed terms would increase levels of searching and switching;

(b) merchants may have a legitimate interest to enter into POS terminal contracts with successive terms, for example, to ensure business continuity (in terms of prices paid and services received).[381] A prohibition on renewals for successive fixed terms would have an adverse impact on merchants that prefer those contracts and restrict their freedom of choice;

(c) merchants that are regulated under the CCA are already notified in advance of renewal terms coming into effect, which provides those merchants with an additional reminder of their opportunity to terminate the contract prior to the renewal date. [redacted] As noted above, Worldpay would propose that communications similar to those currently sent to regulated merchants under RHAs may be appropriate for the smallest merchants, and in particular those merchants with annual card turnover below £380,000, as opposed to an outright ban on successive contract terms; and

(d) POS terminal contracts that contain renewal provisions for successive fixed terms do not prevent merchants from switching following variations in, for example, price. [redacted]

(c) "*Linking*" the contracts for card-acquiring services and POS terminal hire

6.37 The Interim Report proposes a remedy "*linking*" contracts for card-acquiring services and POS terminal hire when they are sold together as a package by acquirers or ISOs, for example, by making it easier to exit POS terminal hire contracts if contractual terms change, without incurring termination fees.

6.38 [redacted]

381 Interim Report, paragraph 7.41.

[redacted]

6.39 In particular, the Interim Report does not establish an evidential basis that early termination fees represent a barrier to searching and switching to justify the imposition of any remedies. As explained in chapter 5:

(a) early termination fees are not referenced at all in the IFF Survey results and no analysis on the impact of early termination fees on switching levels has been undertaken as part of this Market Review; and

(b) the Interim Report acknowledges that "*several acquirers*" said they do not have and/or may waive termination fees[382] [redacted].

6.40 In contrast, Worldpay would note that there are numerous legitimate justifications for the application of legitimate early termination fees by acquirers and ISOs in appropriate circumstances. If providers of POS terminals are prohibited from recovering fixed costs through early termination fees, this could lead to unintended and adverse consequences for merchants, requiring such fixed costs to be recouped by increased charges to all merchants. It is therefore important that any remedies considered that would impact the application of early termination fees must take into account legitimate and justifiable reasons for their use.

Interoperability for standalone POS terminals

6.41 [redacted]

6.42 [redacted] In addition, the Interim Report provides no justification for such a remedy and Worldpay is not in a position to assume what the motivations behind such a remedy would be. As such, Worldpay would have serious concerns were such a fundamental intervention to be considered further.

6.43 In any event, [redacted], there are range of issues that would need to be considered in detail before such a remedy was proposed. In particular:

(a) **Technical interoperability**: Although the different elements of the POS terminal ecosystem – such as messaging formats and terminal functionality – are to varying degrees standardised, in practice implementations vary between acquirers, terminal manufacturers, and other parties. For example, terminal management software (software that enables parties' acquirers to remotely manage their POS terminal estates e.g. provide firmware and security updates) is typically provided by terminal manufacturers, and generally is only able to manage terminals from that specific manufacturer. To enable straightforward and uniform portability of terminals from different manufacturers between different acquirers would require a large program of standardisation across the POS terminal ecosystem. The potential significant cost of

382 Interim Report, footnote 64.

such industry-wide standardisation would require further investigation and cross-industry support.

(b) **Security**: Detailed consideration would need to be given to how the necessarily high level of security and encryption in today's POS terminals would be maintained in an environment where terminals are interoperable between acquirers. For example, POS terminals are loaded with encryption keys that are specific to the merchant's acquirer, such that only that acquirer can decrypt communications from that terminal. To enable interoperability, an industry-wide system would need to be developed whereby existing encryption keys could be securely and easily updated with those from the acquirer the merchant is migrating to. The potential significant cost of such a program would require further investigation and cross-industry support.

(c) **Terminal addressing**: To function correctly, each POS terminal requires an industry-unique identifier (known as a Terminal ID or "**TID**"). Allocation of such identifiers is currently coordinated and managed by UK Payments. To enable widespread terminal portability, an industry-agreed system would need to be developed whereby TIDs could be managed and migrated between different acquirers on a large-scale. The potential significant cost of such a system would require further investigation and cross-industry support.

(d) **Commercial implications**: The introduction of terminal interoperability would likely have significant commercial implications for the provision of POS terminals. For example, the generation of additional costs relating to enabling, administering, and managing incoming and outcoming POS terminal transfers. These costs could then in turn impact the prices merchants face for POS terminal provision; this would have to be carefully balanced against any perceived benefit merchants may gain from terminal portability.

(e) **Merchant convenience**: it is important that merchants do not risk losing many of the benefits of having a "*one-stop-shop*" provider of card-acquiring services and POS terminals, which the Interim Report acknowledges is important to merchants.[383] For example, if merchants have separate providers of card-acquiring services and POS terminals, it is important that merchants know who to contact in the event of technical difficulties.

6.44 In summary, whilst the full costs and implications of an interoperability remedy for standalone POS terminals would require further investigation (including the potential involvement of global POS terminal manufacturers), there are clear preliminary indications that the costs associated with introducing such a remedy are likely to be disproportionate to any potential benefits. Therefore, to the extent that the Final Report considers a remedy in relation to POS terminal contracts, Worldpay submits that a contractual solution (such as linking contracts, subject to the comments at paragraphs 6.38 – 66.40 above) would be more proportionate than a technical remedy seeking to make POS terminals interoperable.

Remedy category 3: Provision of comparable pricing information and tools to facilitate price comparison

6.45 The Interim Report sets out the preliminary finding that "*the absence of published prices, and the complexity of comparing prices quoted by different firms due to the variation in pricing*

383 Interim Report, paragraph 3.53.

structure" gives rise to search costs for SME Merchants that restrict their ability and willingness to search and switch, or to negotiate a better deal.[384] As explained in chapter 4, (paragraph 4.47), the IFF Survey evidence does not support any preliminary finding that merchants find an absence of information or lack of comparability to be a problem requiring the imposition of market remedies; on the contrary, 89% of respondents said that they receive enough information in order to understand the price they pay for card-acquiring services.[385]

6.46 The Interim Report also provides limited information as to what types of remedies or comparison tools may be considered appropriate to address the unavailability or complexity of pricing information claimed in the provisional findings.[386] [redacted].

Any information or comparison remedies should not focus solely price information

6.47 Worldpay would welcome the opportunity to engage with the PSR and the payments industry to discuss in further detail whether there are measures that would assist small merchants with their understanding of payment services, the features of these services, the terms on which they are provided, and how they compare between providers. However, as explained in chapter 1 (paragraphs 1.34 - 1.37), the Interim Report appears to focus disproportionately on the price elements of information provision and comparison, and makes no suggestion that any information remedies would also take account of non-price factors (which are acknowledged as important elsewhere in the Interim Report).[387]

6.48 It is important to emphasise that any remedies focussing wholly or predominantly on the price factors of card-acquiring services are likely to have unintended consequences and result in a 'race to bottom' in terms of how providers compete. For example, if merchants rely solely on price information when choosing between providers of card-acquiring services, this could create less incentive for providers to compete on the basis of non-price factors, such as settlement speed, resilience and security, to enhance their provision of customer service, and to offer merchants a choice between tariff options. In an industry that is driven by choice, customer service, quality and innovation, such an outcome would have adverse implications to merchants, cardholders and the card payments system as a whole.

6.49 [redacted] Worldpay supports the principle that merchants should understand the prices they pay for card-acquiring services. However, as noted above, Worldpay currently has concerns as to how any "*overall rate*" would adjust for the non-price factors discussed above and there is a significant concern that such a rate may operate, in practice, as a price floor and/or lead to a reduction in the range of price and non-price competition.

6.50 Prior experience by competition regulators seeking to introduce a comparison rate also illustrates the pitfalls of comparison rates. In 2014, Ofgem introduced a "*Tariff Comparison*

384 Interim Report, paragraph 6.58.

385 The Interim Report also refers to other surveys submitted by acquirers reporting high levels of satisfaction with the information that merchants received from their providers (see paragraphs 4.11 to 4.15 of chapter 4).

386 The Interim Report notes that such a remedy "*could take several forms*" at paragraph 1.27.

387 Interim Report, paragraph 4.64 – 4.70.

Rate" (the "**TCR**") in order to facilitate comparison between domestic consumer gas and electricity supply contracts. Ofgem launched a review to examine the Tariff Comparison Rate (among other things) following recommendations made during the CMA's energy market investigation in 2016. Ofgem's consultation subsequently found that there was "*near unanimous*" agreement by stakeholders that the TCR should be removed, citing evidence that the TCR "*has not proved to be particularly useful to consumers*" and that there was "*limited awareness and understanding*" of the TCR. Ofgem subsequently removed supplier licence conditions requiring that consumers are presented with TCRs in 2017.[388]

6.51 There are various practical challenges and potentially unintended consequences that require careful further examination before an overall comparison rate could realistically be considered as a potential remedy outcome. In particular:

(a) it must be clear which prices are proposed to fall within the comparison rate. It would be necessary for merchants to understand, for example, whether the rate they are comparing incorporates any MMSC, or includes fees for premium transactions, authorisations, fraud management, PCI non-compliance and/or chargebacks;

(b) a balance would need to be achieved between, on the one hand, a comprehensive comparison rate and, on the other hand, the appropriateness of including each individual fee within the overall rate. For example, incorporating all fees for card-acquiring services within a comparison rate would be operationally complex, require merchants to provide more information at the pre-contractual stage, and may not be relevant to the business requirements of merchants or the pricing structures currently offered by providers of card-acquiring services. In contrast, a comparison rate that includes too few prices within the rate would still require merchants to consider the application of additional fees, and could give rise to unintended consequences such as higher prices outside of the comparison rate;

(c) there is a risk that a comparison rate might undermine the degree of choice between alternative tariff structures. [redacted] It is important that any remedies do not undermine these pro-competitive market developments. However, the introduction of an industry-wide comparison rate may result in existing tariffs needing to be removed or redesigned in order to compete more effectively on the basis of the prescribed rate; and

(d) merchants must understand that an *ex-ante* comparison rate would be illustrative and would not reconcile with *ex-post* prices actually paid. In practice, there are a number of factors that determine the overall cost of card-acceptance, including card revenue, transaction mix and customer mix. These factors are difficult for merchants or their acquirers to predict in advance, which means that there is an inherent degree of uncertainty that a comparison rate is unlikely to address. This could result in the comparison rate being irrelevant or potentially highly misleading, or may even encourage providers of card-acquiring services to advertise a higher comparison rate to ensure that the higher costs associated with more expensive transactions are recovered on the basis of the prescribed rate.

6.52 Worldpay would welcome the opportunity to discuss these matters further, including whether there are potential alternative information remedies available that would include non-price

388 Ofgem, 'Statutory Consultation: Enabling consumers to make informed choices' (30 January 2017).

factors, such as choice, customer service, quality and innovation. As explained below, a principles-based remedy that seeks to establish a standard set of criteria relating to information provision would be a more suitable and proportionate alternative to a comparison rate.

Principle-based criteria are more suitable for information remedies in payments markets

6.53 In a competitive environment that is driven by choice, customer service, quality and innovation, in addition to price, it is unlikely that any remedies seeking to unduly prescribe the provision of information that merchants require would be effective. As noted above, merchants are better served by the right mix of product and service characteristics that meet their needs, and the information that they require will vary accordingly.

6.54 Worldpay would therefore welcome the opportunity to discuss a principles-based approach to potential information remedies that provides the smallest merchants with certain standardised 'key information' against a high-level standard set of criteria. For example, requirements that merchants receive pre-contractual information that accurately describes the price and non-price components for each tariff for card-acquiring services, explains the circumstances where additional fees may apply, and is presented in a format that is transparent and not misleading would be a more suitable and proportionate alternative to a prescribed comparison rate. However, it would still be necessary to ensure, through industry-wide consultation, that any standard criteria is made relevant to the information merchants require and designed to be sufficiently flexible so that providers of card-acquiring services are not constrained in their ability to offer merchants greater choice and higher levels of customer service, quality and innovation.

6.55 The approach outlined above would be consistent with recent approaches that competition regulators have adopted to implement information remedies. For example, in 2018 Ofgem published a decision removing a large number of prescriptive rules relating to domestic supplier-customer communications. In the context of that review, Ofgem stated that a principle-based approach to regulation "*can deliver better outcomes for consumers*" and "*provide room for innovation*" by placing the responsibility on suppliers "*to understand and deliver what is right and fair for their customers and enables comprehensive consumer protection*".[389]

Information remedies would only be relevant to the smallest merchants

6.56 Competition regulators have previously implemented information remedies primarily in the context of consumer communications. Similarly, statutory rules on the provision of pre-contractual information, such as APR in the context of consumer credit agreements, are primarily aimed at communications with consumers. In contrast, there is limited justification for the imposition of information remedies in the context of business-to-business communications, with the possible exception of the smallest categories of merchants, such as merchants with annual card turnover below £380,000.

6.57 As noted above, Worldpay would welcome the opportunity to discuss a remedy that seeks to establish a standard set of criteria for information provision. However, the information provided to merchants must be relevant to their requirements. In practice, this means that for merchant segments with annual card turnover exceeding £380,000, there is an increased risk that customers will have fundamentally different business requirements for payment services, and significant variations in their customer mix and transaction mix that may not be adequately represented by a requirement to provide them with a default set of information. A comparison

389 Ofgem, 'Future of retail market regulation' (2017).

rate in particular, as noted above, is highly unlikely to be relevant to merchants that fall outside of a narrowly defined average 'use case' scenario.

Worldpay welcomes further opportunities for an industry-led response

6.58 By way of conclusion, Worldpay does not consider the Interim Report's preliminary findings to provide a sufficient legal or evidential basis upon which to introduce market interventions (and especially if implemented in the form currently proposed). As explained in chapters 4 and 5, the Interim Report does not demonstrate that merchants face barriers that restrict their willingness and ability to search and consider switching.

6.59 However, Worldpay is open to engaging with the PSR and the wider card payments industry on the potential development of an industry led-approach – such as through implementing industry guidelines – in order to pre-emptively address potential concerns identified in the Interim Report. In effect, this might involve payment service providers committing to meet certain non-binding voluntary standards, such as requirements that merchants are provided with certain comparable information at the pre-contractual stage that is complete and accurate.

6.60 There are advantages to an industry-led approach, such as a greater degree of flexibility that enables better merchant outcomes to be achieved. In turn, there would be reduced risk of unintended consequences, as providers of card-acquiring services will have greater visibility on the impact of any new measures that have been introduced through feedback from customers.

6.61 Worldpay would welcome the opportunity to discuss these proposals further with the PSR as an alternative to any imposed using statutory powers, whether on a bilateral basis or through the relevant industry associations in which Worldpay participates, such as UK Finance.

worldpay
from FIS

[redacted] [redacted]

Worldpay Technical Annex

ashurst

PSR MARKET REVIEW INTO THE SUPPLY OF CARD-ACQUIRING SERVICES

WORLDPAY RESPONSE TO INTERIM REPORT - TECHNICAL ANNEX

09 February 2021

1. INTRODUCTION AND SUMMARY

1.1 Ashurst LLP ("**Ashurst**") has been instructed by Worldpay (UK) Limited ("**Worldpay**") to prepare this technical annex (the "**Technical Annex**") as part of Worldpay's response (the "**Response**") to the PSR's interim report published on 15 September 2020 (the "**Interim Report**").

1.2 The findings presented in this Technical Annex include analysis undertaken by Ashurst, acting as legal and economic advisers on behalf of Worldpay, in the virtual data room established by the PSR on 14 October 2020 in connection with the PSR's econometric analysis on pass-through of savings following the introduction of interchange fee caps under the Interchange Fee Regulation (the "**IFR**").

1.3 This Technical Annex is structured as follows:

(a) section 2 explains that methodology used in the Interim Report to assessing pass-through is not robust to changes in the model specification. Small changes to the model specification show that the Interim Report's conclusions of little or no pass-through are unsupported;

(b) section 3 provides a detailed critique of the Interim Report's pass-through analysis, and highlights a number of fundamental errors in the approach adopted. In particular, the analysis has:

(i) incorrectly <u>dropped over **[✂]** per cent of the data as outliers</u>, which heavily distorts the dataset;

(ii) included <u>commercial card transactions, which are not impacted by the IFR, as well as ancillary charges</u> without being able to control for differences in tariffs and fee structures (which creates significant variation in the data); and

(iii) included the <u>value of chargebacks</u> as a proxy of merchant risk, which is an inappropriate proxy;

(c) section 4 describes the methodology and results of the model adopted by Worldpay's advisers, which addresses many of the failings in the Interim Report's pass-through model and clearly demonstrates that pass-through rates are high; and

(d) section 5 considers the analysis in the Interim Report in relation to new versus longstanding customers. Our analysis shows that the Interim Report's results are not robust to specification changes.

2. THE INTERIM REPORT'S RESULTS ARE NOT ROBUST TO CHANGES IN SPECIFICATION

2.1 As explained in the Response, the methodology used in the Interim Report for estimating pass-through rates compares the IFR savings and the IFR effect. This methodology is fundamentally flawed.

2.2 Notwithstanding the concerns with this methodology set out in the Response and below, the model used for the purposes of the Interim Report analysis (the "**Interim Report Model**") is also not robust to minor changes in specification. This section explains that relatively minor changes to the Interim Report Model result in a significantly higher level of pass-through than set out in the Interim Report. As a result, the econometric results in the Interim Report cannot be considered robust and used to support the preliminary findings.

The IFR effect and IFR savings are not comparable

The IFR savings excludes commercial cards but the IFR effect does not

2.3 The IFR savings is the difference between the weighted average of interchange fees post-IFR cap and pre-IFR cap. However, in calculating the IFR savings, the Interim Report analysis has only considered interchange fees on consumer cards and ignored interchange fees on commercial cards. On the other hand, the IFR effect is measured across both consumer and commercial cards.

2.4 Given that the IFR only applied to consumer cards, a more assessment of pass-through rates would consider the effect the IFR had on consumer cards only. By including commercial cards the Interim Report analysis risks distorting the results.

The Interim Report analysis has calculated the IFR savings on inconsistent basis

2.5 Paragraph 1.62 of Annex 2 to the Interim Report explains that the IFR savings are calculated as: *"the differences between average interchange fees on capped transactions before and after the IFR caps came into force are then weighted by the post-IFR caps shares of domestic and intra-EEA consumer debit and credit card transactions"*.

2.6 **[✂]**. This has the effect of underestimating the IFR savings.

2.7 Table 1 below shows the impact of correcting this inconsistency.[1]

Table 1: Impact of calculating the IFR savings on a consistent basis

	1	2	3	4	5	6	7	IF++
IFR saving as calculated by PSR	0.17	0.13	0.11	0.12	0.11	0.10	0.00	0.09
Corrected IFR saving	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**	**[✂]**

Source: Interim Report, Annex 2, Table 8 and Worldpay adviser's own calculations

2.8 The table above demonstrates the extent to which the IFR savings have been underestimated. Once the inconsistent treatment of commercial cards is addressed, **[✂]**.

[1] For example the change in capped debit interchange fees is weighted by the value of capped debit transactions post IFR as a share of the total value of capped transactions post IFR (excluding non-capped transactions).

As a result, the Interim Report analysis has artificially underestimated pass-through using its methodology.

The Interim Report's results are sensitive to change in the specification

2.9 The Interim Report suggests that the pass-through analysis is robust to changes in the specification.[2] However, our analysis of materials disclosed within the data room suggests that this is not the case, as relatively minor changes in the specification can result in substantially higher pass-through rates. To illustrate this, we considered the following changes to the methodology for estimating the IFR effect and IFR savings:

(a) for the reason set out in the Response and explained in more detail below, the IFR effect should be estimated by reference to consumer card transactions only. This can be done by including an IFR dummy in Worldpay's consumer card specification explained below (this produces results equivalent to the Annex 2, Table 20 specification). In this case it is also necessary to re-estimate the IFR savings to only include data for **[✂]** (the **[✂]** acquirers for which consumer card data is available) so that the IFR consumer savings and IFR consumer effect are comparable; and

(b) the Interim Report's analysis does not include a time trend and therefore changes in the supply of card-acquiring services over time (e.g. increasing demand for card payments) are partially captured by the IFR dummy even if they are unrelated to the IFR. Therefore, Worldpay's advisers submit that a time trend should be included in the analysis alongside an IFR dummy variable.

2.10 In order to demonstrate the extent to which the Interim Report Model is sensitive to minor specification changes, Worldpay's advisers have re-estimated interchange fee pass-through rate with the above specification changes. The table below compares the IFR savings and IFR effect in three scenarios:

(a) the IFR effect is estimated using the Interim Report's baseline model, i.e. the IFR effect is estimated across all five card acquirers for consumer and commercial card transactions and the IFR saving is estimated for both consumer and commercial card transactions (including the change explained in paragraph 2.7 above);

(b) the IFR effect is estimated using a consumer card model excluding a trend variable, i.e. the IFR effect is estimated across **[✂]** acquirers for consumer card transactions only (not including a trend variable in the regression) and the IFR savings are re-estimated for these **[✂]** acquirers; and

(c) the IFR effect is estimated using a consumer card model including a trend variable, i.e. the IFR effect is estimated across **[✂]** acquirers for consumer card transactions only (including a trend variable in the regression) and the IFR savings are re-estimated for these **[✂]** acquirers.

Table 2: [✂]

[✂][3][4]

---

2 See paragraphs 1.71-1.78 of Annex 2 of the Interim Report

3 **[✂]**.

4 **[✂]**.

2.11 The Interim Report states that, "[i]*f the IFR effect is bigger than or equal to the IFR savings, it indicates little or no pass-through; if it is less than the IFR savings, it indicates partial pass-through*"[5]. **[✂]**.

2.12 **[✂]**.

2.13 **[✂]**. As recognised in the Interim Report, this is consistent with full pass-through[6].

2.14 A more conventional approach to assessing pass-through, as explained in section 4 below, provides a more reliable measure of pass-through rates in the supply of card-acquiring services. Nonetheless, the results in Table 2 show that even using the flawed methodology in the Interim Report, relatively minor changes to the specification can produce results that are consistent with full pass-through.

---

5 Interim Report, paragraph 5.27.

6 Interim Report, paragraph 5.27.

3. THERE ARE FUNDAMENTAL ERRORS IN THE PASS-THROUGH ANALYSIS

3.1 The Interim Report's data cleaning and econometric model gives rise to a number of significant concerns, which are detailed in this section. In particular, the Interim Report's analysis has:

(a) dropped over **[✂]** per cent of the data as outliers, yet the final dataset is still noisy;

(b) included commercial card transactions and ancillary charges in its analysis; and

(c) used the value of chargebacks as a proxy of risk, which is an inappropriate proxy.

3.2 These points are addressed in detail below.

The approach to outliers heavily distorts the dataset

3.3 Before undertaking the Interim Report analysis, the PSR has performed a number of data cleaning steps with a view to identifying and removing outliers from the dataset. Removing outliers from the data is necessary in order to ensure that the data is error-free and the results are not skewed by extreme observations. However, the approach used to identify and remove outliers gives rise to a number of serious concerns that risk creating a biased dataset.

3.4 The outlier identification and removal was carried out in two steps:

(a) **Outlier Drop 1**: this involves dropping observations that are (i) negative; (ii) missing; or (iii) in the 99th percentile within each merchant group for either: (i) the total interchange fee as a proportion as transaction value; or (ii) the total merchant service charge ("**MSC**") as a proportion of transaction value;[7] and

(b) **Outlier Drop 2**: this involves dropping observations that are (i) negative; or (ii) in the 99th percentile within each merchant group for a specified variable.[8] This process is repeated for nine variables.[9]

3.5 In total, the approach adopted results in **[✂]** observations being dropped as outliers, which removes a total of **[✂]** merchants from the data – this accounts for **[✂]** per cent of all observations in the pre-cleaned dataset. This approach to identifying outliers is flawed and creates distortions and potential biases in the dataset. Specifically, this approach has:

(a) **[✂]**; and

(b) **[✂]**.

Over* [✂] *observations are dropped unnecessarily

3.6 An error has been made in the approach to data cleaning that results in a significant number of observations being incorrectly removed due to a rounding error.

A rounding error results in **[✂]** observations being excluded from the data

3.7 As part of Outlier Drop 2, **[✂]** observations and **[✂]** observations that are negative for the variables *iff_otherall_p* and *iff_otherall_p2* respectively have been dropped. **[✂]**.

---

7 Lines 219-232, Stata do file 6 append and transform.

8 Lines 235-253, Stata do file 6 append and transform.

9 *msc_cm, msc_con, sf_sum, iff_creidomcon_p, iff_debidomcon_p, iff_otherall_p, iff_creidomcon_p2, iff_debidomcon_p2*, and *iff_otherall_p2*

3.8 **[✂]**[10] **[✂]**.

3.9 When the inconsistencies in rounding are corrected,[11] the outlier approach that has been adopted would drop **[✂]** fewer observations; there is no reason to drop these observations from the dataset.

3.10 **[✂]**.

<u>Outliers are identified using variables not used in the analysis</u>

3.11 In addition to the rounding error described above, Outlier Drop 2 drops outliers on the basis of nine different variables. This results in **[✂]** observations being removed from the dataset (once the rounding error above has been corrected). This step was undertaken despite the fact that seven of the nine variables are not used further in the analysis. By identifying outliers on the basis of variables not used in the later analysis, a number of observations are dropped which are unlikely to meaningfully distort the results. There is no need to drop these observations from the dataset; and by doing so the dataset has been both unnecessarily and artificially distorted.

<u>The impact of the Interim Report's approach to removing outliers</u>

3.12 To demonstrate the impact of the adopted approach to removing outliers as part of the data cleaning methodology, the scatter plot below shows the MSC as a proportion of transaction value (the "**MSC percentage**") on the vertical axis and interchange fee as a proportion of transaction value on the horizontal axis.

Figure 1: [✂]

[✂]

3.13 **[✂]** shows the observations dropped by the rounding error described above, and **[✂]** shows the observations that have been dropped, separate to the rounding error. **[✂]** This suggests that the approach that has been adopted drops too many observations from the dataset.

3.14 The PSR's Stata code also ensures that outliers identified within the second outlier treatment (i.e. observations within the 99th percentile) are dropped before the next variable is considered (i.e. the approach to cleaning applies the 99th percentile sequentially across multiple different variables). As a result the adopted approach does not allow for "overlap" between the 99th percentile in each group and drops many more observations than necessary. A more robust approach would not drop outliers until they are identified across all variables in order to avoid unnecessarily dropping observations.[12]

3.15 As explained below, a more conventional approach is an outlier approach that is based only on variables that are used in the analysis, therefore keeping more observations in the dataset. This results in over **[✂]** fewer observations being dropped from the dataset and is explained in more detail below (paragraph 4.5 onwards).

The Interim Report's approach fails to remove a significant number of outliers

3.16 The purpose of removing outliers from the data is to arrive at a dataset that has fewer data errors and extreme observations that may distort the results. However, despite dropping

---

10 **[✂]**

11 i.e. *iff_otherall_t, sf_otherall_t* and *valtxn_otherall_t are* rounded to 2 decimal places (i.e. rounded to the closest pence) before *iff_otherall_p* and *iff_otherall_p2* are calculated.

12 More specifically, the outlier drop should be moved outside the loop in the Stata code.

over **[✂]** observations, the PSR's dataset still contains a significant number of outliers for key variables (i.e. observations which exhibit significant variation).

3.17 The scatter plot below shows the MSC percentage on the vertical axis and interchange fee as a proportion of transaction value on the horizontal axis. Each point represents a merchant from group 1 in a given month; outliers have been removed using the PSR's approach.

Figure 2: [✂]

[✂]

3.18 **[✂]**.

3.19 **[✂]**.

3.20 **[✂]**.

3.21 **[✂]**.

3.22 Figure 3 below provides a comparison of the MSC and interchange fee (as a proportion of transaction value) between the **[✂]** acquirers that provided a breakdown of the MSC, both including and excluding the *msc_other* component. The top **[✂]** charts include *msc_other* (and are the same as in Figure 2 above); the bottom **[✂]** charts exclude *msc_other*.

Figure 3: [✂]

[✂]

3.23 **[✂]**.

3.24 **[✂]**.

3.25 In summary, **[✂]** of the dataset has been dropped as outliers, despite many having no justifiable reason to be dropped. In addition, despite this unjustified approach to cleaning of the data, this has not resulted in a sufficiently "clean" dataset that is not distorted by outliers (e.g. as a result of including the msc_other variable in the regression).

Commercial card transactions should be excluded

3.26 The econometric analysis in the Interim Report has only considered the aggregate MSC, which includes the MSC charged with respect to transactions made on both consumer and commercial cards (as well as the variable *msc_other*). **[✂]**. The inclusion of commercial card transactions in the pass-through analysis gives rise to significant concerns:

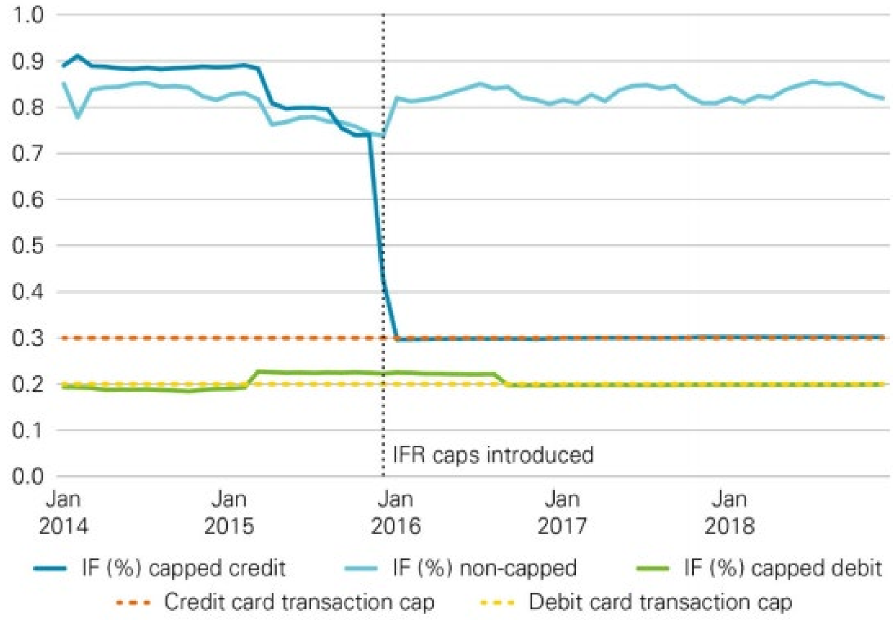
(a) First, the IFR does not apply to commercial cards, and therefore there is no pass-through effect to assess with respect to the impact of the IFR on commercial card transactions. As a result, the approach of assessing an IFR-specific pass-through rate including commercial card transactions may underestimate the pass-through rate of interchange fees.

(b) Second, interchange fees and MSCs are significantly higher on commercial card transactions compared to consumer card transactions. For example, interchange fees on commercial cards are typically between **[✂]** per cent and **[✂]** per cent of transaction value, whilst they have been capped at 0.2 per cent and 0.3 per cent for consumer debit and credit respectively. These differences can further distort the results of the econometric analysis.

(c) Third, the market dynamics in relation to commercial card transactions and consumer card transactions are markedly different. Specifically, interchange fees and MSCs on commercial cards follow different trends when compared to consumer cards. As a result, the level and speed of pass-through may be expected to differ significantly between commercial and consumer cards.

3.27 It is clear that the interchange fees on commercial cards should be considered entirely separately from the interchange fees on consumer cards, which follow different trends. For example, Figure 4 below is a copy of Figure 2 from Annex 2 to the Interim Report, which shows interchange fees by card type over time.

Figure 4: Interchange fees by card type over time



3.28 It is evident from Figure 4 above that the interchange fees on commercial cards (non-capped interchange fees) have followed different trends since 2014.[13] In particular:

(a) the IFR had no effect on non-capped transactions (the light blue line);

(b) there has been no significant change in commercial card interchange fees over time; and

(c) as explained above, the level of interchange fees on commercial/non-capped transactions is much higher than on capped transactions.

3.29 **[✂]**.

Table 3: [✂]

[✂]

[✂]

3.30 **[✂]**.

---

13 Over **[✂]** per cent of non-capped transactions in the dataset relate to commercial cards.

3.31 Accordingly, in light of the factors set out above, there is no basis for the inclusion of commercial cards in the Interim Report's pass-through analysis.

Value of chargebacks is not an appropriate measure of risk

3.32 The Interim Report analysis has adopted an approach that uses the value of chargeback (as a proportion of transaction value) as a measure of merchant risk. Notwithstanding its inclusion, the Interim Report acknowledges the fact that the value of chargeback is an imperfect measure of risk:

> *"it should be noted that in some cases a merchant may show no or few chargebacks until it is insolvent, and proportion of chargebacks is therefore an imperfect proxy."*[14]

3.33 Whilst it may be the case that merchant riskiness can affect the level of pricing the merchant pays, and should therefore be controlled for in any econometric regression, Worldpay's advisers have significant reservations regarding the use of chargebacks as a proxy for risk.

A merchant fixed-effect captures some aspects of merchant risk

3.34 The PSR estimates all regression models using a fixed effects panel model. As a result, any merchant characteristics that do not vary over time are controlled for by including the merchant fixed-effect in the regression model. Given that an element of risk is merchant specific, the merchant fixed-effect will control for large elements of a merchant's risk profile.

3.35 For example, one of the key drivers of a merchant's risk profile is the sector that the merchant operates in. This is a time-invariant characteristic, i.e. it is constant across all time periods. Accordingly, the merchant-fixed-effect will control for the element of risk associated with the merchant's sector. The merchant fixed-effect will also control for other risk characteristics that are constant over time. Therefore an additional variable to capture risk should only be included if it is capturing <u>changes</u> in the risk profile of merchants over the sample period, which are not picked up by the fixed effects.

Chargebacks represent the realisation of risk, not a change in risk

3.36 There is also likely to be a mis-match between the underlying level of riskiness of a merchant and the value of chargebacks in a given month. Risk is inherently a measure of the acquirer's <u>potential</u> loss associated with a specific merchant, whilst the value of chargebacks is a measure of <u>actual</u> loss associated with a merchant.

3.37 Merchants are deemed riskier because they expose acquirers to greater <u>potential</u> losses (e.g. through chargebacks or default) and this will to some extent be captured by the inclusion of a merchant fixed-effect. Naturally, risky (but also less risky) merchants will incur chargebacks, e.g. as a result of fraudulent transactions. This is not necessarily a change in the risk profile of that specific merchant, only that the potential loss of a risky merchant has been realised.

3.38 **[✂]**[15] **[✂]**.

3.39 **[✂]**.

3.40 If the value of chargebacks was measuring changes in the risk profile of a merchant, there would be sustained increases in the value of chargebacks, not just a single month where chargebacks occur.

---

14 Page 7, Annex 2 of the Interim Report.

15 **[✂]**

4. **WORLDPAY'S REVISED MODEL**

4.1 As noted in chapter 3 of the Response, Worldpay has instructed Ashurst to prepare an analysis on the data provided in the data room in order to estimate the rate of pass-through in response to changes in the interchange fees (the "**Revised Model**"). This Revised Model addresses some of the fundamental shortcomings of the methodology used in the Interim Report, and applies an approach that is similar to the methodology set out in the PSR's pass-through consultation document published in February 2019 (the "**Pass-through Consultation Paper**").

4.2 This section describes the Revised Model and is broken down into three sections:

(a) a description of how the PSR's dataset has been amended so as to arrive at a robust and reliable dataset. The approach adopted addresses a number of the concerns set out above in relation to the Interim Report's approach to cleaning the data;

(b) a description of the econometric model used to estimate the rate of pass-through as a result of changes in the interchange fee; and

(c) the results of the Revised Model and specification, which demonstrate that the rate of pass-through are very high.

Preparing a dataset ready for analysis

4.3 The PSR has taken a number of steps to prepare the raw data submitted by acquirers for econometric analysis. The Revised Model departs from the PSR's approach in two key areas: (i) the approach to outliers; and (ii) the use of imputed data.

4.4 This sections outlines how the Revised Model differs from the PSR's approach.

Corrections have been made with respect to identifying outliers

4.5 As outlined above in section 3 of this Technical Annex, the Interim Report's approach to outliers gives rise to serious concerns. Of particular note is the fact a large number of observations which are not outliers have been unnecessarily dropped. Accordingly, the Revised Model adopts an alternative approach that seeks to address some of the flaws and errors in the PSR's methodology.

4.6 Under this alternative approach, observations have been identified as outliers if they are: (i) missing values; (ii) negative (after taking account of the identified error as regards rounding); or (iii) in the 99th percentile for four key variables:[16]

(a) MSC as proportion of total transaction value;[17]

(b) interchange fees as a proportion of total transaction value;[18]

(c) MSC on consumer cards as a proportion of consumer card transaction value; and

(d) interchange fees for consumer cards as a proportion of consumer card transaction value.

---

16 It is noted that the Revised Model's approach to outliers does not drop any observations until outliers have been identified across all four variables. As a result, there is the possibility for that an observation falls in to more than one of four categories.

17 This is the variable *msc_p*: this variable was created by the PSR and used in its outlier approach.

18 This is the variable *iff_sum_p*; this variable was created by the PSR and used in its outlier approach.

4.7 The four variables selected are integral to the analysis. The MSC and interchange fee on consumer card transactions have been selected because they are the dependent variable and variable of interest respectively.

4.8 The result of the Revised Model's outlier approach is that **[✂]** fewer observations are dropped (**[✂]** in total) **[✂]**. **[✂]**. Figure 5 plots all the observations dropped as part of this outlier treatment.

Figure 5: [✂]

[✂]

4.9 **[✂]**.

The Revised Model does not rely on imputed data

4.10 The Interim Report has relied on imputed data in its analysis for eight different variables.[19] The majority of the missing data that was required to be imputed was **[✂]** scheme fee data for 2014 and 2015, as well as the **[✂]** transaction shares and interchange fees for 2014 and 2015.[20]

4.11 The Revised Model does not use imputed data to estimate pass-through rates. Instead, the Revised Model uses the average scheme fee as a proportion of transaction value for the other four acquirers in the years 2014 and 2015, in place of the missing data.

4.12 In the case of scheme fees, taking an average across the other four acquirers (within merchant turnover groups) for the years 2014 and 2015 is the optimal solution to the problem of missing data. The reasons for this are:

(a) **[✂]**

(b) **[✂]**

(c) **[✂]**

4.13 Notwithstanding the reasons above, as an additional robustness check the Revised Model also imputes scheme fee values for **[✂]** in the years 2014 and 2015.[21] The pass-through results below are robust to the method used for estimating **[✂]** missing scheme fee data (i.e. the pass-through rate does not change significantly irrespective of how missing scheme fee data is estimated).

4.14 With regards to the other seven variables (excluding scheme fees) that the PSR imputed data for, these have not been used in the Revised Model. Only the variables that are important to explaining variation in the dependent variable (MSC on consumer cards) were selected; the remaining seven variables were not considered necessary (see below for a full explanation on why the Revised Model adopts the chosen control variables).

The Revised Model adopts a more robust and conventional methodology

4.15 As explained in the Response, Worldpay's advisers consider that the Interim Report's approach to assessing pass-through is fundamentally flawed and does not measure the

---

19 *sf_sum_p, sf_con_p, iff_credidomcon_p2, iff_debidomcon_p2, s_valtxn_credidomcon, s_valtxn_debidomcon, s_valtxn_f2f* and *valchargeb_p*

20 **[✂]** the PSR use imputed values for **[✂]** transaction shares and interchange fee values for all of 2015. The data was available for October 2015 onwards and therefore should have been used.

21 The same imputation method adopted by the PSR was adopted on total consumer card scheme fees as a proportion of transaction value.

pass-through rate of interchange fees. The Revised Model addresses this issue and is closely aligned to the original methodology in the Pass-through Consultation Paper. The Revised Model has the following structure:

(a) the MSC on consumer transactions is the dependent variable;

(b) the model includes both contemporaneous and lagged interchange fees on consumer card transactions as independent variables. The sum of the coefficient on these variables is used to estimate the long term pass-through rate; and

(c) a number of control variables and a merchant fixed effect to control for other factors which may explain the MSC charged to specific merchant in a specific month.

4.16 A separate regression for each merchant group based on annual card turnover (using the same definition as the PSR) has been estimated. As a result, a pass-through rate has been estimated for each merchant group. The rest of this section outlines more detail on the Revised Model.

The Revised Model focusses on consumer cards only

4.17 For the reasons outlined in section 3 above, it is incorrect to analyse pass-through rates on commercial and consumer transactions combined. Accordingly, the Revised Model assesses the pass-through rate on consumer transactions only.

4.18 In order to achieve this, the Revised Model relies on the MSC that is attributable to consumer cards (variable *msc_con_p* in the PSR's analysis) as the dependent variable. On the "right hand side" of the regression, the Revised Model includes the interchange fee attributable to consumer card transactions as a proportion of consumer transaction value (both contemporaneous and lagged) as well as other control variables.

4.19 By using consumer card transaction-only values for the MSC, interchange and scheme fee, the Revised Model excludes commercial cards from the pass-through equation. This focusses the analysis on the set of transactions to which the IFR applied and where pass-through can be expected. By including commercial cards, the Interim Report analysis has included transactions where the interchange fee remained approximately constant and where no pass-through can be expected.

4.20 Focussing on consumer card transactions only has the added benefit of partially addressing the mix effects problem described in the Response. Part of the reason MSCs change from month to month is due to changes in the transaction mix, but it is only possible to partially control for this in the regression model. Using consumer card transactions only reduces the variation in the transaction mix over time and therefore reduces the mix effect problem.

4.21 Due to the fact that **[✂]** acquirers (**[✂]**) were unable to provide the MSC split between consumer and commercial cards, the Revised Model excludes these **[✂]** acquirers. **[✂]**.

The Revised Model estimates the long term pass-through rate

4.22 The Interim Report's approach to estimating pass-through, using a pre/post IFR dummy variable does not consider that pass-through of the IFR is likely to be gradual for all merchants that are not on an IF++ tariff. It also provides no information with regards to the speed of pass-through.

<u>Six months is the optimal length of time to allow pass-through over</u>

4.23 In order to effectively control for full pass-through of interchange fees, the Revised Model includes lagged interchange fees. This allows for changes in interchange fee to effect the

MSC for a period of time following any change in interchange fee.[22] This approach is a more realistic reflection of how the market for card-acquiring operates given that non IF++ customers do not receive automatic pass-through of interchange fees and merchants are not re-priced on a monthly basis.

4.24 In Worldpay's baseline model, six months of lagged interchange fees are included as independent variables. This is a reasonable amount of time to expect pass-through to occur **[✂]**. **[✂]**. Accordingly, six months of lagged interchange fees are considered to be the optimal length of time to include lagged values for the interchange fee.

<u>The Revised Model controls for changes in the transaction mix of interchange fees</u>

4.25 When considering lagged interchange fees it is important to distinguish between the "mix effect" and the "price effect". Interchange fees may vary from month to month because the mix of transactions is different, e.g. a higher proportion of credit card transactions (the mix effect);[23] or because of a change in the underlying interchange fees (the price effect).[24] To accurately measure the pass-through rate it is important that the lagged variables focus on the price effect, rather than the mix effect.

4.26 Accordingly, the Revised Models weights lagged interchange fees with the contemporaneous transaction mix. This means that there is no change in transaction mix between the contemporaneous interchange fee and the lagged interchange fee. This is consistent with the Pass-through Consultation Paper, which noted that *"the equation should use weighted average of historic Interchange Fees, weighted by current number of transactions in each category of transaction"*.[25]

4.27 The Pass-through Consultation Paper suggested that in practice using weighted or unweighted lagged interchange fee variables would not matter if the mix of transactions does not vary too much from one period to the next (i.e. if the mix effect was limited). However, our analysis shows the importance of controlling for mix effects.

4.28 **[✂]**. To illustrate this, the figure below shows the share of credit card transactions as a proportion of the total of value of transactions over time for a random sample of five merchants.[26]

Figure 6: [✂]

[✂]

4.29 **[✂]**.

4.30 **[✂]**. Accordingly, it is necessary to account for changes in the transaction mix when using lagged interchange fees. If not, the lagged variables will not necessarily reflect the transaction mix in the current period and could bias the results.

The Revised Models controls for a number of important determinants of consumer MSC

---

22 The long term pass-through rate can be estimated by summing the estimated coefficient on the contemporaneous and lagged interchange fee variables.

23 For example, an increase in credit transactions will likely increase interchange fees because interchange fees charged on credit transactions are typically higher than non-credit interchange fees.

24 For example, if interchange fees on a specific transaction type changed from 0.1% to 0.15%.

25 Pass-through Consultation Paper, footnote 9.

26 Five merchants were randomly selected from Ashurst's cleaned dataset using the runiform() function on Stata. To be selected a merchant must: (i) be **[✂]**; and (ii) have at least 24 months of data. **[✂]**.

[✂]

4.31 In any econometric analysis it is important to include additional independent control variables that explain variation in the dependent variable. By doing so you reduce the risk of creating bias estimates. However, including unnecessary variables that do not explain variation in the MSC risk biasing the estimated pass-through rate and making the estimated coefficients inefficient (i.e. large standard errors). This section explains the controls included in the model which are closely related to the controls included in the PSR's base model.

4.32 First, the Revised Model includes a merchant fixed effect, which controls for any merchant specific characteristics that do not vary over time, e.g. the merchant's sector.

4.33 Second, the Revised Model includes scheme fees attributable to consumer transactions as a control variable. As noted above, for the years 2014 and 2015 the missing **[✂]** data has been replaced with the average of the other four acquirers.

4.34 Third, the transaction mix of a merchant will affect the price paid by a merchant, however this must be a distinct effect from the effect that the transaction mix has on the interchange fee. In this regard, the Revised Model includes the merchants' share of consumer transactions and the share of debit transactions but does not include the share of face-to-face transactions. **[✂]**. This also has the advantage of not requiring data imputation for **[✂]**.

4.35 Fourth, the Revised Model includes the volume of consumer transactions as an independent variable to control for differences in the size of merchants within a group.

4.36 For the reasons outlined in Section 3 above, the Revised Model does not included the value of chargebacks as a proxy for risk, as including a merchant fixed effect is sufficient and the value of chargebacks adds no additional value.

The Revised Model's results show high pass-through

4.37 The results of the Revised Model set out below provides a more accurate and robust measure of pass-through compared to the Interim Report analysis. **[✂]**:

(a) **[✂]**

(b) **[✂]**

(c) **[✂]**

(d) **[✂]**

(e) **[✂]**.

4.38 The table in Appendix 1 shows the full results from the Revised Model's baseline regression.

4.39 By summing the coefficients on the interchange fee variables, it is possible to estimate the long term pass-through rate of interchange fees. The long term pass-through rates are shown in the table below for each merchant group.

[✂]

Table 4: The Revised Model's estimate for long term pass-through

Merchant Group	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**IF++**
Merchant turnover (£)	<15k	15k-180k	180k-380k	380k-1m	1m-10m	10m-50m	50m+	NA
Long-run pass-through rate	79.9	75.0	70.9	70.5	82.7	85.8	94.5	104.1

Note: For IC++ merchants lagged variables were not included in the regression model as IC++ tariffs should pass through any changes in interchange fees and scheme fees immediately, i.e. the contemporaneous pass-through rate should equal the long-run pass-through rate.

4.40 The results above show that the long-run pass-through rate is greater than 70 per cent across all merchant groups. Notably, merchants with an annual turnover above £1 million (groups 5 – 7) had a pass-through rate of more than 80 per cent.

5. **LONGSTANDING CUSTOMERS DO NOT PAY A HIGHER MSC THAN NEW CUSTOMERS**

5.1 The Interim Report states that regardless of merchant size, new customers pay less than merchants who have been with their acquirer for several years[27]. This preliminary finding is then used to support the Interim Report's conclusions that merchants can secure better prices (in the form of lower MSCs) by switching provider.[28] This claim is based on analysis of the same data used to assess the rate of pass-through and is set out in detail in Annex 2 to the Interim Report.

5.2 In order to test whether new customers pay less than longstanding customers, the Interim Report has applied an econometric approach, based on a model similar to that applied in the pass-through analysis.[29] In particular, the Interim Report analysis has applied two different specifications of the model (set out in Tables 12 and 13 of Annex 2 to the Interim Report) that include dummy variables to control for the time (in years) a merchant has been with its current acquirer.[30] The coefficients on the dummy variables measure the estimated difference in the MSC between new and longstanding customers.[31]

5.3 As explained in the Response, the fact that new customers pay less than longstanding customers does not provide evidence of a competition problem. If anything, this may provide evidence of promotional pricing for new customers, which in itself is a feature of a market that is working effectively (i.e. where competitors are competing aggressively for new customers).

5.4 In any case, as set out in detail below, Worldpay's analysis does not support the conclusions that longstanding customers pay significantly higher prices than new customers. It is also evident that the results and analysis referenced in the Interim Report are not robust to changes in the model specification, and therefore cannot be relied upon.

The Interim Report's preliminary findings can be explained by a time trend

5.5 The Interim Report's model has failed to take into account any long run trends that have occurred in the card payments industry, which may have impacted on the MSC.[32] By ignoring such long run trends, the Interim Report's model assigns all changes in the MSC over time that are not controlled for by other explanatory variables (e.g. changes in interchange fees are controlled for by the interchange fee variable) to the merchant's length of tenure with their acquirer, which results in a significantly biased estimate of the impact of merchant's tenure on the MSC.

5.6 It is particularly important to include a time trend in any model specification considering the impact of merchant age, as the impact of merchant age on the MSC is closely correlated to the trend in the MSC over time, and therefore by excluding the time trend the estimated coefficient on the age variable is biased (creating an omitted variable bias).

5.7 The table below compares the results from Annex 2 of the Interim Report to the Revised Model's analysis which includes a time trend variable. The values reported in the table are the coefficients on the dummy variable for merchants that have been with their acquirer for three or more years. Hence, in all regressions the value reported can be interpreted as the

---

27 Tables 12 and 13, Annex of the Interim Report.

28 Paragraphs 5.40-5.41 of the Interim Report.

29 Described as a reduced form panel model.

30 In Table 12 MSC is the dependent variable and the model does not include an IFR dummy. Whereas in Table 13 the interchange fee margin is the dependent variable and an IFR dummy is included.

31 After three years all merchants are treated the same.

32 More specifically, the PSR has not included a time trend or a time-specific fixed-effect in the panel regression model.

expected difference in MSC between a new merchant and a longstanding merchant (i.e. a merchant that has been with their acquirer for more than three years). **[✂]**.

Table 5: Comparison of estimated of price differential for new versus longstanding customers

	1	2	3	4	5	6	7	IC++
Table 12								
PSR results	1.33 ***	0.30 ***	0.17 ***	0.14 ***	0.12 ***	0.07 ***	0.05 ***	-0.06 *
Trend included	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Table 13								
PSR results	1.31 ***	0.21 ***	0.09 ***	0.07 ***	0.08 ***	0.04 *	0.01	-0.05
Trend included	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Note: *** p<0.001, ** p<0.01, * p<0.05

5.8 As set out in the table above, the PSR's results show that for all merchants in groups 2-7, longstanding merchants pay between up to 0.3 percentage points more than new merchants. **[✂]**.[33]

5.9 **[✂]**.

5.10 It is further noted that the PSR's methodology (which excludes a time trend) generates results (in Table 12 and Table 13) that vary significantly. For example, for Group 4 merchants the price differential in Table 12 (0.14) is twice the price differential in Table 13 (0.07). This indicates that there is a lack of robustness in the PSR's methodology, given that the changes in the specification between Table 12 and 13 are relatively minor. **[✂]**. Accordingly, the inclusion of a time trend captures unexplained variation that is unrelated to merchant tenure, and therefore significantly improves the robustness of the model.

Controlling for start year shows there is no price differential

5.11 An alternative way of measuring the price differential between new and longstanding merchants is to assess whether the year in which a merchant joined an acquirer effects the MSC that they pay. If new merchants pay less than longstanding merchants, it would be expected that merchants with older sign-up dates would pay a higher MSC compared to merchants who signed up to their acquirer more recently.

5.12 In this regard, the dataset provided to the PSR records the merchant's sign-up date, and the date in which an account was closed if the merchant has since left the acquirer. Therefore, the Interim Report's model to control for the start year that a merchant joined an acquirer, instead of relying on the PSR's age variable (i.e. which only categorises merchants into one of four categories based on length of tenure; 0 years, 1 year, 2 years, and 3 or more years).[34] This approach allows us to consider at a more granular level

[33] **[✂]**. However, as recognised by the PSR and for the reasons outlined in section 3, the results for this group are not reliable when including the *msc_other* element of the MSC.

[34] Instead of including a dummy variable for the age of a merchant, a dummy variable corresponding to the year a merchant signed up with their acquirer has been included in the regression instead.

whether the MSC continues to increase for longer-standing merchants (i.e. those that have been aggregated together in the three or more years category in the Interim Report's analysis).

5.13 Table 6 below shows the results from an updated regression model that includes a dummy variable for each start year in the data, but is otherwise the same as the Interim Report's model presented in Table 12 of Annex 2 to the Interim Report. The coefficient on each dummy variable shows the estimated difference in MSC compared to the base year of 2004.[35] If new merchants paid a lower MSC than longer standing merchants, then the coefficients on the dummy variables in the following table would be negative, and decreasing in value for merchants that have signed up more recently (i.e. newer customers).

5.14 It is noted that due to the fact **[✂]** was unable to provide start dates prior to 2013, **[✂]** merchants have been dropped from the analysis.

Table 6: [✂]

[✂]

5.15 Table 6 above shows that:

(a) **[✂]**;[36] and

(b) **[✂]**.

5.16 These results further demonstrate that the new versus longstanding customer analysis is not robust to changes in the specification, and there is no evidence to support the Interim Report's preliminary finding that longstanding customers pay significantly higher prices than new customers.

---

35 **[✂]**.

36 **[✂]**.

APPENDIX 1 - WORLDPAY'S BASELINE REGRESSION RESULTS

Table 7: [✂]

[✂]

APPENDIX 2 - IFR EFFECT ON CONSUMER CARDS (NO TREND)

Table 8: [✂]

[✂]

APPENDIX 3 - IFR EFFECT ON CONSUMER CARDS (TREND INCLUDED)

Table 9: [✂]

[✂]