

Call for evidence

Market review of scheme and processing fees

Competitive constraints in card payment systems

February 2023

We welcome your views on this call for evidence. If you would like to provide comments, please send these to us by **5pm on Tuesday 11 April 2023**.

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

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

We will consider your comments when preparing our response to this consultation.

We will make all non-confidential responses to this consultation available for public inspection.

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You can download this paper from our website:

www.psr.org.uk/scheme-and-processing-fees-competitive-constraints-paper/

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1 Introduction

- 1.1** We are conducting a market review of the scheme and processing fees associated with Mastercard and Visa, the two largest card payment system operators in the UK. We published the final terms of reference (ToR) on 27 October 2022.¹
- 1.2** The market review of scheme and processing fees is motivated by two main factors. First, our findings – in our earlier card-acquiring market review² – of increases in fees that acquirers paid to card scheme operators over the period 2014 to 2018.³ Second, the concerns various stakeholders have raised with us about increasing scheme and processing fees since 2018. The aim of our market review is to understand whether the supply of scheme and processing services is working well with regard to competition, innovation and protection of service users.
- 1.3** Some stakeholders have argued that the current outcomes are a consequence of competition not working well.⁴ As an economic regulator, we are interested in promoting competition in the interest of service users. To assess whether competition is working well, we therefore need to understand how the competitive constraints on card scheme operators work in practice given the factors discussed above. The final ToR of our market review set out that we would examine, among other things:
- the services Mastercard and Visa provide and the associated scheme and processing fees, including how and why these differ between individual service users
 - the factors Mastercard and Visa consider when setting the levels, structures and types of scheme and processing fees
 - the competitive constraints Mastercard and Visa face when setting scheme and processing fees
 - whether and how the competitive constraints faced by Mastercard and Visa differ for the services provided to issuers and acquirers
 - how much Mastercard and Visa are perceived as ‘must-take’ payment methods and merchants
 - whether service users are able to assess which services they need and decline those they do not, and whether there are any constraints on their ability to do this

1 MR22/1.2, [Final terms of reference for scheme and processing fees market review](#) (October 2022).

2 MR18/1.8, [Market review into the supply of card-acquiring services: Final report](#) (November 2021).

3 Key findings on scheme and processing fees from our card-acquiring market review are repeated in paragraph 1.10 of MR22/1.2.

4 So far, we have heard views from a number of card scheme operators (including Visa and Mastercard), acquirers, merchants, issuers and consumer representatives. Views and perspectives may differ both across groups of stakeholders and within each group. In the rest of the paper, when we refer to stakeholders’ views, we mean views that have been, in general terms, expressed to us by two or more stakeholders. No inference should therefore be drawn as to the relative number of stakeholders who have indicated any of the points set out in this paper.

- 1.4** This paper sets out a summary of what we have heard so far regarding the competitive constraints Mastercard and Visa face when setting scheme and processing fees, and seeks further views and information to help us develop our thinking. In particular, this paper seeks views and evidence related to all the above points mentioned in the previous paragraph.
- 1.5** Understanding the competitive constraints and broader competitive dynamics⁵ will help us decide whether action is required to promote our statutory objectives. In parallel, we have also published our thinking on analysing Mastercard and Visa's profitability in the UK, and some initial analysis of their global and European profitability based on public financial statements.⁶
- 1.6** As part of our review, we have been engaging with various stakeholders.⁷ We have gathered views on price, quality and innovation in card payment services and have also asked stakeholders to explain how, in their view, those outcomes relate to the prevailing competitive dynamics with respect to Mastercard and Visa. In response to these questions, we have received a range of different perspectives. In Chapter 3, we provide a brief overview of the various themes that have been brought to our attention.
- 1.7** We are keen to hear further views and to receive evidence, including documents, research reports, studies or data, that could provide inputs to our ongoing analysis of the views represented in this paper. We have included some questions on specific areas of interest, and we would welcome responses.
- 1.8** We launched this market review due to concerns that current arrangements may not be delivering good outcomes for users of payment services, and that this could be the result of competition not working well. At present, we have not yet reached a view on the nature and strength of the competitive constraints Mastercard and Visa face. We expect our thinking to develop further over the course of the market review as we continue to gather evidence, including through responses to this document.
- 1.9** The remainder of this document is set out as follows:
- In **Chapter 2** we provide some background on four-party card payment systems and the economics of setting scheme and processing fees.
 - In **Chapter 3** we provide a brief overview of what we have heard to date from various stakeholders about the competitive constraints that Mastercard and Visa face when setting scheme and processing fees.
 - In **Chapter 4** we set out next steps.

5 Throughout the document, we use the expression 'competitive dynamics' to refer to the interactions between and among the parties of four-party card payment systems (including the schemes themselves) as well as their competitors. When looking at these interactions, we are interested in both the actions taken and the responses elicited.

6 See www.psr.org.uk/scheme-and-processing-fees-approach-to-profitability-analysis-paper

7 So far, we have received stakeholders' submissions in reply to requests for information, gathered comments on our ToR and held meetings with selected stakeholders. We are continuing our engagement activities.

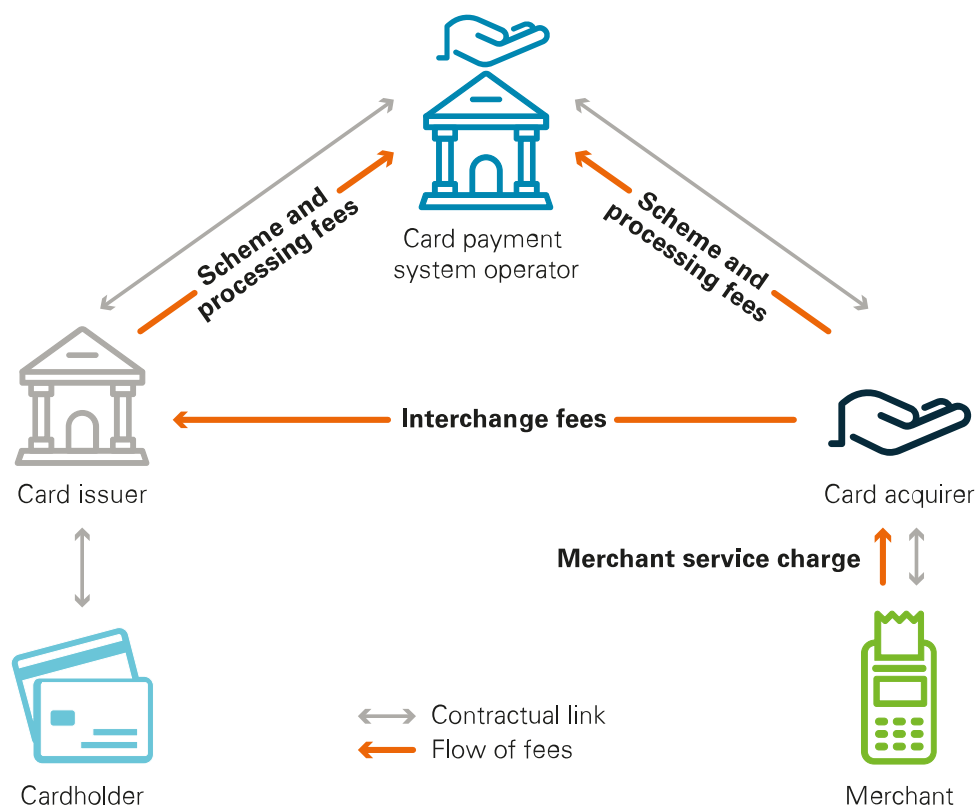
2 Background

Four-party card payment systems

2.1 As set out in Figure 1, card payment systems enable people and organisations to make payments by card by providing a network that joins up the following:

- **Cardholders:** Individuals or businesses that use cards to make payments.
- **Issuers:** Banks or other organisations licenced by operators of card payment systems to provide cards to cardholders.
- **Merchants:** Organisations that accept payments by card.
- **Acquirers:** Banks or other organisations licenced by operators of card payment systems to recruit merchants to accept card payments. Acquirers provide card-acquiring services to merchants.

Figure 1: Simplified structure of a four-party card payment system⁸



⁸ Figure 1 is a simplified diagram. It offers a stylised representation of a four-party card scheme, showing the contractual links and revenues flowing within it. It does not reflect, in full, the different roles required to be performed by payment card schemes and processing entities pursuant to the separation requirements set out in Article 7 of the UK Interchange Fee Regulation (IFR). Similarly, we use simplified language throughout the document to illustrate some of the aspects that may matter for the analysis of the competitive constraints. The choice of language does not reflect, in full, the different roles required to be performed by payment card schemes and processing entities pursuant to the separation requirements set out in Article 7 of the UK IFR.

- 2.2** Card payment systems are administered by card scheme operators. Card scheme operators set the rules and technical requirements for participating in the card scheme and for processing card transactions. They also supply a range of services that are required by participants (issuers and acquirers) to comply with the rules they set, and to process transactions. In addition, card scheme operators offer a range of optional services that – while ancillary to the core payments functions – increase the value of the scheme to users and/or may be important inputs into the distinct products that issuers and acquirers offer to cardholders and merchants.
- 2.3** To accept card payments, merchants also need to purchase card-acquiring services from acquirers or payment facilitators.⁹ To pay by card, customers need to obtain a debit, credit, charge or prepaid card from an issuer. Acquirers and issuers make payments to card payment system operators for scheme and processing services, as well as for other services.¹⁰

Economics of setting scheme and processing fees

- 2.4** For cardholders, the value of having a payment card increases with the number of merchants that accept that card. Merchants have a greater incentive to accept a card if there are many cardholders who are willing to use it for making payments.¹¹ The operator of a card scheme therefore has an incentive to structure its fees across the two sides of the transaction to optimise the number of issuers and acquirers that are part of the scheme and to maximise its own profits.¹²
- 2.5** With respect to card payments, competition may influence the level of fees on each side of the transaction (issuers and acquirers). For example, if scheme operators compete more strongly for issuers than for acquirers (and hence need to offer the former greater incentives to join their scheme), the balance of fees would tend to be higher for acquirers and lower for issuers, and vice versa. That is, the fee structure of scheme operators will tend to be influenced by the competitive dynamics and constraints on both sides of a card transaction.

9 Card-acquiring services are services involved in accepting and processing card payments on behalf of a merchant, resulting in a transfer of funds to the merchant. Merchants can contract with acquirers or payment facilitators to obtain these services. A payment facilitator is a payment service provider (PSP) that enables merchants to accept card payments via a payment gateway. The payment facilitator contracts with an acquirer who retains responsibility for allowing merchants to access the card payment systems. The acquirer is also liable for the merchant's and the payment facilitator's compliance with the rules set by the card scheme operator.

10 For further details about how a card payment works, and associated definitions, see Annex 1 of MR22/1.2, [Final terms of reference for scheme and processing fees market review](#) (October 2022).

11 Economists would describe card payment systems as platforms operating in a two-sided market and would refer to the fact that the value of a card payment system depends on the number of users as a network effect.

12 In more detail, optimal pricing by a platform operator depends on how price sensitive users are on both sides. A commercial, profit-maximising card scheme operator has two incentives: first, to set network rules and fees so as to optimise network use, in view of the inherent network effects; second, to maximise its own profits, in view of the benefits it gives to both consumers and merchants and the degree of market power it has over them.

2.6 Acquirers and issuers then contract with merchants and cardholders, respectively. The fees that Mastercard and Visa levy on issuers and acquirers for providing scheme and processing services represent costs to these businesses. Issuers and acquirers will seek to recover these costs in different ways. A possible way is by increasing the prices they charge for the services they provide to their customers (cardholders for issuers and merchants for acquirers).

3 Views from stakeholders

- 3.1** In this chapter, we provide a brief overview of what we have heard to date from various stakeholders about the competitive constraints that Mastercard and Visa face when setting scheme and processing fees. The purpose of presenting this summary is to stimulate further discussion. We are actively seeking the views of all parties involved (including card scheme operators, issuers, acquirers, merchants and consumer representatives) and would welcome responses to the questions set out at the end of each subsection below.
- 3.2** Each subsection contained in this chapter represents the synthesis of views expressed by stakeholders, grouped under a common heading. We have termed these as ‘themes’ and they are intended to capture the range of views we have received to date. While we have not captured every detail and nuance, we have summarised the range of views in order to provide a basis for seeking further input from stakeholders on how we should view the competitive constraints.
- 3.3** These themes are intended as a way of identifying some of the key points that have been presented to us. They are a way of helping stakeholders understand the different perspectives put forward so far, so they can set out their own views on the degree to which we should focus or rely on different pieces of evidence when reaching our conclusions on competitive constraints.
- 3.4** No single theme provides a complete description of all the competitive dynamics that are relevant to our review. Furthermore, the views and topics summarised under each theme are not necessarily mutually exclusive. As a consequence, the four themes should not be treated as a set of propositions that can be agreed with or disproved in a binary way.
- 3.5** We intend to use the views and evidence gathered in response to this call for evidence to inform our overall assessment, rather than select a single or preferred theme from those set out below. We plan to reach an evidence-based view which may include elements from some or all of these individual themes.
- 3.6** In the rest of this chapter, we present the following four themes:
1. The intensity of competition and innovation in the payments ecosystem.
 2. Differences in the competitive dynamics on the issuing and acquiring sides.
 3. The impact of transparency on competitive pressure at all levels of the value chain.
 4. The ‘must-take’ status of Mastercard and Visa-branded cards (in many retail environments).

3.7 Across most of the subsections below, we have not attributed views to specific stakeholders. However, the description of a thriving payments ecosystem characterised by intense competition, innovation and positive outcomes for service users (as reflected in Theme 1) emerged primarily in representations made to us by Mastercard and Visa, whose scheme and processing fees are the subject of our market review. Conversely, views primarily expressed by other stakeholders (including acquirers, merchants and merchant representative associations) tended to raise concerns about market outcomes under current arrangements. For example, they placed more emphasis on the perceived differences in competitive dynamics on the issuing and the acquiring side (as reflected in Theme 2), the potentially negative competitive effects of complex fees (as reflected in Theme 3), and/or favour close scrutiny of fees given the importance that Mastercard and Visa-branded cards have for acquirers and merchants (as reflected in Theme 4).

3.8 After each subsection below, we have set out specific questions on which we are inviting views, in particular:

1. how accurately the views discussed represent the actual competitive dynamics
2. what additional evidence we should seek or consider when making our assessment as part of our market review

3.9 We invite you to answer all questions, including areas of both agreement and disagreement. We have also set out two initial questions below to allow you to express a view on the overall status of competition in card payment systems and what theme – if any – may be closest to your position. We have not yet formed a view on the extent to which any of these themes faithfully represent how competition currently works, and our final view may incorporate aspects of one or more of these themes. It is also possible that we identify, through our analysis and responses to this call for evidence, relevant aspects of the competitive constraints which are not currently captured in any of these themes.

Questions

Question 1: Do you think competition in card payment systems is working well? If not, what would it look like if it did?

Question 2: What key aspects of the four themes in your view most accurately capture how competition affects the setting of scheme and processing fees?

Theme 1: The intensity of competition and innovation in the payments ecosystem

- 3.10** Some stakeholders – primarily Mastercard and Visa¹³ – described major international four-party card payment networks as ecosystems characterised by intense competition and thriving innovation. In their view, wide acceptance of Mastercard and Visa-branded cards is a key driver of the value that such schemes create in the payments sector. Mastercard and Visa each said that the card schemes’ practice of sharing standards and protocols enables other businesses to enter the payments sector. They noted that wide acceptance of cards, combined with open standards, has enabled the development of many alternative payment methods. They also argued that competition from other card schemes, existing alternative payment systems and emerging payments technologies shapes and ultimately constrains the commercial strategies of Mastercard and Visa, including with respect to service features and associated pricing.
- 3.11** The same stakeholders also noted that card payments deliver significant positive outcomes for end-users (both merchants and consumers) of card payment systems. These stakeholders highlighted that such positive outcomes include but are not limited to: the low cost of making and receiving payments; the ubiquitous acceptance network offered by card payment systems; the security and resilience of payments supported by card payment networks; and the range of services which benefit merchants and consumers by providing a high quality and seamless payment experience.
- 3.12** Proponents of this view emphasised the following key aspects:
- Competition in payments is about the choices that different participants in the value chain can make, which may involve an initial funding stage before the payment stage.
 - The payments value chain has multiple different levels: from banks to payment intermediaries, to end users (both consumers and merchants). There are multiple choices at each different level – for example, when issuers choose a scheme, when merchants choose which payment methods to accept, and when stakeholders across the value chain choose different payment services and different service providers.
 - While issuers’ choice of card scheme may be fixed over a certain period, other choices, such as a consumer’s choice over which method of payment to use, can (and often do) vary between each transaction (and merchants may try to influence this).
 - Recent market trends and technological innovation have greatly increased the range of methods that consumers and merchants can use to pay or be paid.

13 As noted above, the arguments set out in this subsection are primarily informed by Mastercard’s and Visa’s representations to the PSR. However, none of the views reported can be interpreted as fully representative of the position of either Mastercard or Visa. In addition, for brevity, in this subsection we typically refer jointly to Mastercard and Visa, given the degree of overlap between the views they have expressed separately to the PSR. However, this should not be interpreted as indicating that Mastercard and Visa have expressed identical views.

- Payment schemes are the result of coordination of the activities and incentives of many specialised functions that interact in complex ways.
- Pricing as a whole is set in order to encourage activities that are beneficial for all users of the system (such as fraud prevention for individual customers/businesses or system-wide improvements and innovation).

3.13 Stakeholders that support this view highlighted the following:

- Consumers decide which payment methods they want to adopt (for example, which card brands to carry, which payment apps to register with) and which one to use for a specific transaction.
- Merchants choose which payment methods they are willing to accept and may try to steer customers towards the ones they would prefer to be used. For instance, an e-commerce website can add support for many different payment methods and make some more prominent than others at checkout. Merchants may choose their preferred payment methods based on the expected additional sales of goods or services, the general type of customer experience they want to provide, and the cost of accepting different payment methods.

3.14 Proponents of this view noted that before consumers can make payments, there is a funding stage that is important for competition. For card payment systems, funds are drawn from a bank account or credit account. Banks choose which payment methods to offer to their account holders, potentially influencing customers' choice to participate in different payment systems. Existing payment intermediaries (e.g. PayPal) can offer non-card-based methods to fund digital or mobile wallets,¹⁴ and then allow consumers to pay by drawing from those wallets. Some e-commerce platforms have been experimenting with 'closed' payment systems.¹⁵ Mastercard and Visa each stated that they compete against each other and against these alternative payment systems to secure access to sources of funds.

3.15 Some stakeholders, including Mastercard and Visa, highlighted that the choice between payment methods for both merchants and consumers is influenced by the requirements of the specific payment transactions. Different types of transaction – for example, supermarket or convenience store retail transactions, cross-border payments, purchase of travel or holiday packages, recurring payments for subscriptions, and large payments towards a car or jewellery – all have certain different requirements. As a result, competition differs depending on the payment type, and competition in payment services is based on multiple product dimensions alongside price, including security, convenience and consumer protection considerations.

14 See www.psr.org.uk/information-for-consumers/ways-of-paying/

15 Closed payment systems or closed-loop payment systems are payment systems that can only be used within specific environments after being pre-funded. Examples include store-specific payment systems like gift cards or vouchers.

- 3.16** Mastercard and Visa each stated to us that competitive dynamics are complex also due to the range of specialised activities that form part of a payment system. They explained that the role of the payment system operator in a four-party card scheme is wide-ranging, encompassing activities such as:
- speeding up transaction times and improving the convenience around payment methods
 - reducing frictions during customer authentication
 - managing settlement, fraud, cyber and operational risks
 - working with others to promote the adoption of new technologies
 - working with the standard-setters in the payments industry to drive forward innovation
- 3.17** In each of the Mastercard and Visa payment card schemes, certain activities are offered by it directly (that is, when a card payment system operator acts as a supplier of a specific service – for instance, fraud detection), others are offered indirectly (that is, when a card payment system operator sets a requirement that other participants then have to enforce – for example, merchant verification requirements imposed on acquirers), and others may be offered either directly or indirectly.
- 3.18** Mastercard and Visa each stated that many of the services offered by a specific card scheme are also offered by others, including providers of alternative card schemes, providers of alternative payment methods (for example, real-time account-based payment systems), and a broad range of distinct specialised suppliers (for example, clearing houses or providers of digital identity solutions or network capabilities). Mastercard and Visa both indicated that there is increasing availability of these alternatives and therefore consider card payment systems to be characterised by increasing optionality of services.
- 3.19** Those supporting this view identified four-party card schemes as a particularly effective way of facilitating coordination between parties to a transaction, by creating confidence and trust in a common set of rules and standards. Under such a view, four-party card payment schemes are a key enabler of further innovations that – in some cases – present a competitive threat to the card schemes themselves. For example, various digital and mobile wallets and buy-now-pay-later (BNPL) providers have successfully entered and acquired consumers and merchants in the UK, leveraging the infrastructure created by either Mastercard or Visa (or other international card schemes).
- 3.20** As some of these payment methods have started using alternative payment rails (for example, Faster Payments), stakeholders sharing this view argued that merchants are being offered new payment products that compete with card schemes. Examples include Klarna Pay Now, Pay With Bank Transfer (developed by American Express) and GoCardless. Similarly, they argue that mobile wallet operators (for example, Revolut, Monzo, Apple Pay, Google Pay and Samsung Pay) have developed increasingly strong relationships with final consumers, to the extent that they are seen to ‘own’ the customer relationship. While currently these intermediaries have mainly acted in partnership with card payment systems, they are well positioned to switch between payment systems with relative ease and little impact on the end-user experience, or to start operating as payment systems themselves.

3.21 In this context, Mastercard and Visa argued that pricing for scheme and processing fee services would be constrained by the competitive pressure Mastercard and Visa exercise on each other, by competition from existing operators in the payment services industry (including competing card payment schemes), and by potential entry and growth from new operators. Stakeholders sharing this view described a dynamic sector characterised by wide availability of alternatives, highlighting that card schemes' pricing for new scheme and processing services, as well as the adjustments to existing scheme and processing fees, remains largely reflective of the value created by card schemes for all users of their respective payment systems.

Questions

Question 3: Are there specific elements described under Theme 1 that you think are factually correct (or incorrect), and what evidence do you have to support your view?

Question 4: Please provide evidence and/or views on the extent to which Mastercard and Visa are currently competitively constrained (or likely to be competitively constrained in the near future) in their ability to set their scheme and processing fees (in general or for certain services), on either the issuing or acquiring side, by:

- other card payment systems
- other payment systems (please identify)
- other payment intermediaries who use Mastercard and Visa infrastructure (please identify)
- other third parties – for instance, providers of specific services such as authentication, clearing or fraud detection (please identify), and/or
- the existence of shared standards and protocols between or within schemes

Question 5: Do you agree that users have different payment options, which can reflect either the requirements for specific transactions or the characteristics of the available payment methods? In particular, it would be helpful if you could reference the choices available to different groups of users (consumers, merchants, issuers and acquirers) and expand on:

- a. the needs of those who want to make payments and of those who want to receive payments, and how issuers and acquirers cater for those needs
- b. the circumstances in which, or the types of payment transactions for which, you consider that card-based payment systems have few alternatives
- c. the circumstances in which, or the types of payment transactions for which, you consider that card-based payment systems would be easier to substitute with other payment systems
- d. any studies you are aware of on the relative frequency and importance of the different types of payment transactions

- Question 6:** What are the main factors that limit the entry and/or expansion of payment schemes other than Mastercard and Visa? To what extent do those factors result in limited entry or expansion and how does limited entry or expansion affect the competitive constraints on Mastercard and Visa in setting the level of scheme and processing fees?
- Question 7:** To what extent do you agree with the view that the fees Mastercard and Visa charge to issuers and acquirers for scheme and processing services are 'largely reflective of the value' of those services? To what extent do you consider fees for scheme and processing services to be reflective of the costs of providing those services? Please provide examples and explain to what extent you think 'being reflective of the value' or 'cost-orientation' are relevant criteria in assessing the competitiveness of such fees.

Theme 2: Differences in the competitive dynamics on the issuing and acquiring sides

- 3.22** In representations to the PSR, some stakeholders highlighted how current market outcomes are driven by the different competitive dynamics on the issuing and acquiring sides of card transactions. While they acknowledged the ongoing innovation in the payments sector, they suggested that Mastercard and Visa continue to be in a particularly strong bargaining position with respect to acquirers and merchants in the UK. In contrast, they suggested that such card scheme operators might have to make concessions in negotiations with issuers, to grow their cardholder base.
- 3.23** They also argued that the UK is a mature market for card payment systems. On the issuing side, they highlighted high penetration by Mastercard and Visa, with limited penetration by other card schemes and – in contrast to many other countries – no UK domestic card payment system. On the acquiring side, they claimed that there is near-universal acceptance of Mastercard and Visa by merchants, while substitution from cash payments to card-based payments has been accelerated by the COVID-19 pandemic and the continued growth of online sales. In addition, they identified alternative payment methods as either relying on Mastercard and Visa as a scheme operator (for example, PayPal, Apple Pay, Google Pay and Samsung Pay) or still being in their infancy (for example, Pay by Bank).
- 3.24** In their view, cardholders do not exhibit strong brand preferences – that is, consumers see Mastercard and Visa-branded cards as interchangeable, and just accept the one offered by the institution they have decided to bank with (for debit cards) or get credit from (for credit cards).
- 3.25** In a context of near-universal acceptance by merchants and accelerated decline in cash use, supporters of this view argued that to further increase transaction volumes (and therefore revenues), established card payment schemes such as Mastercard and Visa mainly compete for the same pool of cardholders. That is, the focus of card schemes' competitive efforts is on attracting issuers, by granting issuers various incentives so they offer a specific brand of card to their own customers.

- 3.26** Conversely, on the acquiring side, they argued that there is no real competition between the card payment schemes: merchants need to accept both major card brands (given their widespread penetration among consumers) and acquirers therefore must join both schemes. They also argued that, in such circumstances, acquirers have limited incentives (and for the smallest acquirers, even limited ability) to exercise buyer power against Mastercard and Visa. In their view, this helps to explain the observed increase in scheme and processing fees paid by acquirers in the UK identified by the PSR in the card-acquiring market review, in addition to increased fees in other countries.
- 3.27** However, some stakeholders argued that acquirers remain largely unaffected by fee increases, as they are generally able to pass them through to merchants. In their view, merchants, particularly smaller merchants, would bear the impact of higher scheme and processing fees charged by card schemes due to a combination of factors, including:
- consumer expectations that both major card brands would be almost universally accepted
 - their limited ability to negotiate directly with Mastercard and Visa
 - limited transparency around scheme and processing fees
- 3.28** Finally, some stakeholders argued that the higher degree of competition on the issuing side (that is, for cardholders) creates powerful incentives for the card schemes to organise financial flows from the acquiring side to the issuing side. To the extent that Mastercard and Visa face weak competitive constraints, they may be able to increase the aggregate fees charged across both sides of the market and offset the increase for some issuers by offering rebates and incentives. The same stakeholders noted that the interchange fee cap introduced through the Interchange Fee Regulation (IFR) constrained the ability of card scheme operators to divert funds from the acquirer side to the issuer side, arguing that increases in scheme and processing fees (combined with rebates and incentives for issuers) could effectively amount to a circumvention of the IFR.

Questions

- Question 8:** Are there specific elements described under Theme 2 that you think are factually correct (or incorrect), and what evidence do you have to support your view?
- Question 9:** How would you describe the nature and intensity of competition between Mastercard and Visa for issuers and cardholders? In particular:
- a. What are the dimensions or features on which Mastercard and Visa compete?
 - b. Do Mastercard and Visa offer bespoke deals, rebates or discounts to issuers?
 - c. Do issuers currently have credible alternatives to Mastercard and Visa? How quickly could they effectively adopt alternative card (or non-card) payment schemes?
 - d. Does the intensity of competition between Mastercard and Visa differ between issuers? For example, does the negotiating power of issuers vary with certain characteristics?

- e. Does the intensity of competition between Mastercard and Visa differ depending on the specific services procured by issuers, or for specific requirements of different transaction types?

Question 10: How would you describe the nature and intensity of competition between Mastercard and Visa for acquirers and merchants? In particular:

- a. What are the dimensions or features on which Mastercard and Visa compete?
- b. Do Mastercard and Visa offer bespoke deals, rebates or discounts to acquirers and merchants?
- c. Do acquirers and merchants currently have credible alternatives to Mastercard and Visa? How quickly could they effectively adopt alternative card (or non-card) payment schemes?
- d. Does the intensity of competition between Mastercard and Visa differ between acquirers? For example, does the negotiating power of acquirers vary with certain characteristics, including the types of merchants they cater to, or particular use cases?
- e. Does the intensity of competition between Mastercard and Visa differ depending on the specific services procured by acquirers, or for specific requirements of different transaction types?

Question 11: Can you describe, to the extent you consider that scheme and processing fees can be raised to either issuers or acquirers, who you think would ultimately bear those higher costs compared to a better functioning market?

Theme 3: The impact of transparency on competitive pressure at all levels of the value chain

3.29 Some stakeholders suggested that scheme and processing fee can be complex, and are not always transparent. The same stakeholders noted that these factors lead to higher costs in various parts of the card payments value chain, and reduce competitive pressure on the card schemes. The reasoning varies slightly between stakeholders. Some mentioned lack of price transparency as a symptom of competition not working well; others claimed complexity of scheme and processing fees is directly causing a reduction in competitive pressure.

3.30 Such stakeholders argued that the complexity of fees translates into higher operational costs, diverting issuers' and acquirers' resources from more productive uses and ultimately increasing the overall cost of doing business with card scheme operators. They also stated that the lack of transparency around financial flows reduces competitive pressure in various parts of the card payments value chain. In particular:

- The complexity of scheme and processing fee structures can limit the degree of competition between card schemes, insofar as it makes it difficult for market participants to assess the expected cost of participating in each scheme.

- The lack of transparency around incentive payments from card scheme operators to issuers can reduce the competitive tension between the card schemes.
- The complexity of scheme and processing fee structures can make it difficult for acquirers to anticipate their own costs and set their own margins. Consequently, acquirers may then compete less fiercely for new merchant customers. Furthermore, given the potential for acquirers to have a stronger bargaining position with some merchants, acquirers are likely to factor in the above uncertainty when pricing downstream, leading to higher prices for merchants.
- Merchants have poor visibility of the specificity of scheme and processing fees that they are paying. Where acquirers don't clearly present scheme fees, processing fees and their own fees separately to their customers, merchants may struggle to exercise choice about potential alternative suppliers of scheme, processing or acquiring services, to bring down their own costs.

Questions

Question 12: Are there specific elements described under Theme 3 that you think are factually correct (or incorrect), and what evidence do you have to support your view?

Question 13: Do you think lack of transparency around financial flows is an obstacle to effective competition? If so, why and for which group(s) of users (issuers, acquirers, merchants and consumers)?

Question 14: Do you think the complexity of scheme and/or processing fees is an obstacle to effective competition? If so, why and for which group(s) of users (issuers, acquirers, merchants and consumers)? If fees were made less complex, do you think the overall cost of participating in card schemes would change?

Theme 4: The 'must-take' status of Mastercard and Visa-branded cards (in many retail environments)

3.31 Some stakeholders said that Mastercard and Visa were 'must-take' payment types and therefore the fees they charge to issuers and acquirers need close scrutiny.

3.32 Some stakeholders said that Mastercard and Visa-branded cards have long been defined as 'must-take' for merchants, within the established case law that led to the introduction of the IFR.¹⁶ Once a merchant starts accepting card payments, they are unlikely to stop as that would put them at a disadvantage against competing merchants and risk them losing sales.

¹⁶ We note that within the context of the IFR, must-take has a precise meaning: that the merchant accepts the card even when an alternative payment method would be cheaper for them. The notion has been used within the framework of the merchant indifference test (MIT). The cheaper alternative considered in the MIT has historically been cash.

- 3.33** Some stakeholders put more emphasis on the nature of competition between acquirers for merchant customers – that is, that acquirers compete against each other by offering merchants a ‘bundle’ of payment methods. Due to their ‘must-take’ status, both Mastercard and Visa must be included in the bundle. An acquirer only able to offer one of Mastercard or Visa card services would not represent a compelling proposition for any merchant, and merchants are unlikely to want to contract with different acquirers for different card brands due to associated transaction costs. Hence, Mastercard and Visa are both effectively ‘must-take’ payment types for acquirers.
- 3.34** Some stakeholders suggested the existence of brand-specific card-acquiring markets – that is, that Mastercard and Visa each effectively act as monopolists when setting the conditions to access their own networks, and the associated fees. They argued that, as UK merchants have little choice but to accept both Mastercard and Visa card brands, acquiring services for the different card brands are not substitutable. An acquirer wishing to offer acquiring services for Visa card payments would therefore have no alternative but to participate in the Visa scheme and pay the fees imposed by Visa, and similarly for Mastercard.
- 3.35** While different stakeholders explained the ‘must-take’ status differently, the point they all made was that Mastercard and Visa each leverage their ‘must-take’ status to charge high fees to acquirers and/or issuers, unless constrained by other factors.
- 3.36** Some stakeholders emphasised that this ability to leverage a ‘must-take’ status to charge high fees remains even in the context of alternative payment methods (either card-based or not) growing in importance, and where regulatory and technological changes have introduced greater optionality along the value chain (for example, the IFR requiring a separation of scheme and processing services).
- 3.37** While card scheme operators offer a broad range of services, at least some of which acquirers could possibly procure from alternative suppliers, stakeholders suggested that some services (and their associated fees) remain unavoidable. For instance, even though processing of transactions could be performed using competing networks (although schemes also require participants to have a processor of last resort), some scheme services and related fees remain unavoidable. Stakeholders suggested that an increase in such ‘unavoidable’ fees set for the effective participation in the card system would therefore signal the absence of strong competitive constraints.
- 3.38** Some stakeholders suggested that an increase in such ‘unavoidable’ fees could be achieved either directly (for example, by increasing existing fees) or indirectly (for example, by altering the requirements to participate in the scheme, the associated fees or the penalties for non-compliance in a way that temporarily creates additional, unavoidable costs for issuers or acquirers). Secure authentication-related services, reporting services and market development funds (allocated at the sole discretion of scheme operators) were also mentioned as possible examples of ways that Mastercard and Visa have adopted to extract additional profits. This contrasted with alternative perspectives on this issue, which framed those services and fees as essential to the maintenance and development of the payment ecosystem.¹⁷

¹⁷ See the discussion under Theme 1.

- 3.39** Some stakeholders also stressed the self-reinforcing nature of this problem. In their view, card scheme operators that have 'must-take' brands are in a strong position to potentially hamper the development of alternative payment types that could – in the long run – exercise a competitive constraint on them, even if just in some particular use cases or for specific groups of users.

Questions

Question 15: Are there specific elements described under Theme 4 that you think are factually correct (or incorrect), and what evidence do you have to support your view?

Question 16: Would you describe Mastercard and Visa as 'must-take', and if so for whom (for example, merchants, acquirers or both)? Please describe in detail what you mean by 'must-take' and the evidence on which you base your views. In particular:

- a. Do merchants have any alternatives to accepting both Mastercard and Visa-branded cards if they decide to accept cards? In what situations or under what conditions is it a viable option for a merchant to refuse particular card types, either in full or for specific transactions?
- b. Do acquirers need to sign up with both Mastercard and Visa to have a viable business model? In what situations or under what conditions is it a viable option for an acquirer to sign up with just one of these two? What would be the consequences for the acquiring services offered to merchants?

Question 17: How do you think that the optionality of different services related to Mastercard and Visa payments has changed in recent years? When answering, please also consider and provide specific examples on the following aspects:

- a. Which of the services offered (and fees charged) by Mastercard and Visa are unavoidable for issuers (and cardholders) and/or for acquirers (and merchants) that want to participate in the Mastercard and Visa schemes?
- b. Which services can instead be procured from third parties (or simply rejected)? Who are these third-party providers and, if you have used these, what has been your experience with their services?
- c. How does the situation regarding the optionality of services affect the ability of different users to optimise their costs?

4 Next steps

- 4.1** We welcome responses to the questions set out throughout this paper. We repeat the questions that are included in each earlier chapter below in a consolidated list.
- 4.2** You can provide your responses in writing until **5pm on Tuesday 11 April 2023**.
- 4.3** **We're planning opportunities for stakeholders to engage with us during the call for evidence period.** We'd like everyone with an interest to provide their feedback and help us shape our understanding. Further details of the engagement events will be provided to participants in due course.
- 4.4** Views and evidence gathered through this call for evidence will inform the interim report of our scheme and processing fees market review. Publication of the interim report for consultation is currently planned for Q4 2023.

List of questions

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

Question 1: Do you think competition in card payment systems is working well? If not, what would it look like if it did?

Question 2: What key aspects of the four themes in your view most accurately capture how competition affects the setting of scheme and processing fees?

Question 3: Are there specific elements described under Theme 1 that you think are factually correct (or incorrect), and what evidence do you have to support your view?

Question 4: Please provide evidence and/or views on the extent to which Mastercard and Visa are currently competitively constrained (or likely to be competitively constrained in the near future) in their ability to set their scheme and processing fees (in general or for certain services), on either the issuing or acquiring side, by:

- other card payment systems
- other payment systems (please identify)
- other payment intermediaries who use Mastercard and Visa infrastructure (please identify)
- other third parties – for instance, providers of specific services such as authentication, clearing or fraud detection (please identify), and/or
- the existence of shared standards and protocols between or within schemes

Question 5: Do you agree that users have different payment options, which can reflect either the requirements for specific transactions or the characteristics of the available payment methods? In particular, it would be helpful if you could reference the choices available to different groups of users (consumers, merchants, issuers and acquirers) and expand on:

- a. the needs of those who want to make payments and of those who want to receive payments, and how issuers and acquirers cater for those needs
- b. the circumstances in which, or the types of payment transactions for which, you consider that card-based payment systems have few alternatives
- c. the circumstances in which, or the types of payment transactions for which, you consider that card-based payment systems would be easier to substitute with other payment systems
- d. any studies you are aware of on the relative frequency and importance of the different types of payment transactions

Question 6: What are the main factors that limit the entry and/or expansion of payment schemes other than Mastercard and Visa? To what extent do those factors result in limited entry or expansion and how does limited entry or expansion affect the competitive constraints on Mastercard and Visa in setting the level of scheme and processing fees?

Question 7: To what extent do you agree with the view that the fees Mastercard and Visa charge to issuers and acquirers for scheme and processing services are 'largely reflective of the value' of those services? To what extent do you consider fees for scheme and processing services to be reflective of the costs of providing those services? Please provide examples and explain to what extent you think 'being reflective of the value' or 'cost-orientation' are relevant criteria in assessing the competitiveness of such fees.

Question 8: Are there specific elements described under Theme 2 that you think are factually correct (or incorrect), and what evidence do you have to support your view?

Question 9: How would you describe the nature and intensity of competition between Mastercard and Visa for issuers and cardholders? In particular:

- a. What are the dimensions or features on which Mastercard and Visa compete?
- b. Do Mastercard and Visa offer bespoke deals, rebates or discounts to issuers?
- c. Do issuers currently have credible alternatives to Mastercard and Visa? How quickly could they effectively adopt alternative card (or non-card) payment schemes?
- d. Does the intensity of competition between Mastercard and Visa differ between issuers? For example, does the negotiating power of issuers vary with certain characteristics?

- e. Does the intensity of competition between Mastercard and Visa differ depending on the specific services procured by issuers, or for specific requirements of different transaction types?

Question 10: How would you describe the nature and intensity of competition between Mastercard and Visa for acquirers and merchants? In particular:

- a. What are the dimensions or features on which Mastercard and Visa compete?
- b. Do Mastercard and Visa offer bespoke deals, rebates or discounts to acquirers and merchants?
- c. Do acquirers and merchants currently have credible alternatives to Mastercard and Visa? How quickly could they effectively adopt alternative card (or non-card) payment schemes?
- d. Does the intensity of competition between Mastercard and Visa differ between acquirers? For example, does the negotiating power of acquirers vary with certain characteristics, including the types of merchants they cater to, or particular use cases?
- e. Does the intensity of competition between Mastercard and Visa differ depending on the specific services procured by acquirers, or for specific requirements of different transaction types?

Question 11: Can you describe, to the extent you consider that scheme and processing fees can be raised to either issuers or acquirers, who you think would ultimately bear those higher costs compared to a better functioning market?

Question 12: Are there specific elements described under Theme 3 that you think are factually correct (or incorrect), and what evidence do you have to support your view?

Question 13: Do you think lack of transparency around financial flows is an obstacle to effective competition? If so, why and for which group(s) of users (issuers, acquirers, merchants and consumers)?

Question 14: Do you think the complexity of scheme and/or processing fees is an obstacle to effective competition? If so, why and for which group(s) of users (issuers, acquirers, merchants and consumers)? If fees were made less complex, do you think the overall cost of participating in card schemes would change?

Question 15: Are there specific elements described under Theme 4 that you think are factually correct (or incorrect), and what evidence do you have to support your view?

- Question 16:** Would you describe Mastercard and Visa as ‘must-take’, and if so for whom (for example, merchants, acquirers or both)? Please describe in detail what you mean by ‘must-take’ and the evidence on which you base your views. In particular:
- a. Do merchants have any alternatives to accepting both Mastercard and Visa-branded cards if they decide to accept cards? In what situations or under what conditions is it a viable option for a merchant to refuse particular card types, either in full or for specific transactions?
 - b. Do acquirers need to sign up with both Mastercard and Visa to have a viable business model? In what situations or under what conditions is it a viable option for an acquirer to sign up with just one of these two? What would be the consequences for the acquiring services offered to merchants?
- Question 17:** How do you think that the optionality of different services related to Mastercard and Visa payments has changed in recent years? When answering, please also consider and provide specific examples on the following aspects:
- a. Which of the services offered (and fees charged) by Mastercard and Visa are unavoidable for issuers (and cardholders) and/or for acquirers (and merchants) that want to participate in the Mastercard and Visa schemes?
 - b. Which services can instead be procured from third parties (or simply rejected)? Who are these third-party providers and, if you have used these, what has been your experience with their services?
 - c. How does the situation regarding the optionality of services affect the ability of different users to optimise their costs?

How to provide comments

- 4.6** Please send your comments by **5pm on Tuesday 11 April 2023**. You can email them to cardfees@psr.org.uk or write to us at the following address:

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

Disclosure of information

- 4.7** Generally, we will seek to publish views or submissions in full or in part. This reflects our duty to have regard to our regulatory principles, which include those in relation to:
- publication in appropriate cases
 - exercising our functions as transparently as possible
- 4.8** We will not accept blanket claims of confidentiality. If you wish to claim confidentiality over specific items in your submission, you must identify those specific items which you claim to be confidential, and explain the basis on which confidentiality is sought. If you include extensive tracts of confidential information in your submissions, we will ask you to submit non-confidential versions.
- 4.9** We may nonetheless be required to disclose information marked as confidential in order to meet legal obligations.
- 4.10** This would be the case, for example, if we were asked to disclose confidential information under the Freedom of Information Act 2000. We will endeavour to consult you if we receive such a request under the Freedom of Information Act 2000. Any decision we make not to disclose information can be reviewed by the Information Commissioner and the Information Rights Tribunal.
- 4.11** In accordance with the legal framework in the Financial Services (Banking Reform) Act 2013 (FSBRA), we will not disclose confidential information that relates to the business or affairs of any person that we receive for the purposes of our functions under FSBRA, unless:
- we have the consent of the person who provided the information and, if different, the person to whom it relates, or
 - there is a 'gateway' permitting such disclosure. One of the gateways is the 'self-help' gateway whereby the PSR will be able to disclose confidential information to third parties to enable or help the PSR to perform its public functions. Where we disclose confidential information to a third party, we may impose restrictions on the further disclosure or use of the information by such parties
- 4.12** You should note that information that is already lawfully publicly available or in such a form that it is not possible to ascertain from it information relating to a particular person (for example, if it is summarised, anonymised or aggregated) is not confidential information for the purposes of FSBRA.
- 4.13** We take our data protection responsibilities seriously and will process any personal data that you provide to us in accordance with the Data Protection Act 2018, the General Data Protection Regulation and our PSR Data Privacy Notice. For more information on how and why we process your personal data, and your rights in respect of the personal data that you provide to us, please see our privacy policy on our website, available here: www.psr.org.uk/privacy-notice.

PUB REF: MR22/1.4

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