

Market review into the supply of card-acquiring services

Final terms of reference

January 2019

Contents

1	Introduction	3
2	Scope of the market review	7
3	Our approach	18
4	Next steps	22
	Annex 1 Respondents to the consultation	25
	Annex 2 Main points raised in responses	27
	Annex 3 Roles of acquirers and payment facilitators	33
	Annex 4 Indicative timetable of work	36

1 Introduction

- 1.1** This document sets out our final Terms of Reference (ToR) for a market review into the supply of card-acquiring services in the UK. It follows our consultation on the draft ToR published on 24 July 2018. The aim of our market review is to consider whether the supply of card-acquiring services is working well for merchants, and ultimately consumers.
- 1.2** Market reviews are one of our tools for investigating how well the market for payment systems, or the markets for services provided by payment systems, are working for service-users¹ in line with our statutory competition, innovation and service-user objectives. We will conduct this market review using our general powers under the Financial Services (Banking Reform) Act 2013 (FSBRA).
- 1.3** We publish this ToR to explain the scope of our review, what issues we will be initially considering, what the potential outcomes are and to provide some explanation of the work we anticipate conducting. This scope sets out the supply of services and/or goods that we are examining when considering whether the market is working well.

Why card acquiring matters

- 1.4** Card payments are critical to the smooth running of the UK economy. In 2017, there were 13.2 billion debit card payments totalling £523 billion. Credit card payments in the same year numbered 3.1 billion and amounted to £168 billion.²
- 1.5** Card use is high and has been growing strongly in recent years. Between 2007 and 2016, the number of card payments in the UK more than doubled.³ In 2017, debit cards overtook cash as the most frequently used payment method for the first time.⁴ Reasons for this include higher online spending and a significant increase in contactless payments.
- 1.6** The number of merchants (retailers or service providers) accepting card payments has also grown. In 2017, 1.38 million outlets accepted card payments.⁵ Over the last five years the number of point-of-sale (POS) terminals has increased by half.⁶
- 1.7** Card payment systems enable people to make payments using debit, credit, charge and prepaid cards. These systems are administered by card scheme operators.

1 By service-users, we mean the people and organisations who use, or are likely to use, services provided by payment systems.

2 UK Finance, *UK Payment Statistics 2018* (2018), tables 6.2 and 6.3.

3 PSR analysis based on UK Finance, *UK Payment Statistics 2018* (2018), table 6.2.

4 UK Finance, *UK Payment Markets Summary 2018* (2018), page 3.

5 UK Finance, *UK Payment Statistics 2018* (2018), table 15.1.

6 PSR analysis based on UK Finance, *UK Payment Statistics 2018* (2018), table 15.1.

- 1.8** To accept card payments, merchants need to buy card-acquiring services. These are services to accept and process 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. Unless otherwise stated, when we refer to card-acquiring services in this document we mean card-acquiring services provided by acquirers and payment facilitators.
- 1.9** The costs merchants incur for such services may ultimately be reflected in the prices they charge or the services they provide to their customers.
- 1.10** Similarly, the service merchants receive from an acquirer or payment facilitator may affect the experience they can offer to customers paying for goods and services by card.

Why we are carrying out this market review

- 1.11** Before we published our draft ToR, various stakeholders had raised concerns with us about card payments.
- 1.12** A number of these concerns indicated that the supply of card-acquiring services may not be working well for merchants, and ultimately consumers. This included concerns that:
- acquirers have not passed on to smaller merchants the savings they made from the interchange fee caps introduced by the Interchange Fee Regulation (IFR)⁷
 - there is a lack of transparency around the fees merchants pay to accept card payments
 - there are barriers that make it hard for merchants to compare and switch acquirers, and they tend not to shop around
 - there are barriers to offering services that would help merchants to compare and switch between acquirers
 - the fees that card scheme operators charge to acquirers (called 'scheme fees'), and the rules they set, favour larger acquirers
 - the scheme fee portion of the fees that merchants pay to acquirers is increasing significantly
- 1.13** Many stakeholders raised these same concerns in their responses to the draft ToR and some supported our intention to carry out a market review into the supply of card-acquiring services.

⁷ The IFR is an EU regulation that aims to reduce the costs of card payments for merchants and consumers, and strengthen competition.

- 1.14** Some respondents asked us to focus on or carry out a review of the level of scheme fees that card scheme operators charge to acquirers. They said these scheme fees have increased significantly in recent years. One respondent explicitly asked us to consider whether scheme fees are excessive. We acknowledge these concerns and note that since their nexus is in the upstream market – namely the supply of services provided by the card scheme operators – we could have chosen to examine them through a separate exercise. This exercise would consider whether the supply of services provided by card scheme operators is working well for the users of card payment systems.
- 1.15** However, we have limited resources and we therefore need to prioritise our work. Consequently, we have decided not to examine whether the supply of services provided by card scheme operators is working well for the users of card payment systems while also carrying out a market review into card-acquiring services. We have decided to prioritise the latter for two reasons.
- 1.16** Firstly, as we describe in paragraphs 1.11 to 1.13, stakeholders including respondents to the consultation on the draft ToR, have raised concerns with us that indicate the supply of card-acquiring services is not working well. The Payment Systems Regulator (PSR) Panel (our independent advisory body) has also raised these concerns.⁸
- 1.17** We note particularly the concerns raised with us (before and in responses to the draft ToR) that acquirers are holding on to the savings they made from the IFR interchange fee caps. The IFR aimed to reduce the costs for merchants of accepting card payments by capping the interchange fees that acquirers pay to issuers on certain consumer debit and credit card transactions. Interchange fees typically make up the largest portion of the fees that merchants pay to acquirers. The IFR did not cap the fees that merchants pay to acquirers. It relied on competition between acquirers to ensure that the benefits of the interchange fee caps flowed through to merchants, and ultimately consumers. If the benefits are not being passed on to merchants, this could indicate that some merchants – especially smaller merchants – are suffering harm because competition in the supply of card-acquiring services is not working well.
- 1.18** Secondly, we would expect any problems relating to card payment systems that affect merchants to materialise largely through the fees and services they receive from acquirers and payment facilitators. Therefore, prioritising work to examine card-acquiring services is an appropriate first step in examining stakeholders' concerns about card payments.

⁸ For an overview of the issues raised by the PSR Panel, see here: <https://www.psr.org.uk/psr-publications/annual-plans-and-reports/psr-panel-annual-report-2017-2018>

- 1.19** For the reasons explained above, we are assessing whether the supply of card-acquiring services is working well for UK merchants, and ultimately consumers. This includes considering any effects of the supply and acquisition of related goods and services on the supply of card-acquiring services. For example, we will consider any effects of the services provided by card scheme operators. For the sake of clarity, we are interested in these related goods and services to the extent that:
- they are relevant to understanding how the supply of card-acquiring services operates; and/or
 - they may adversely affect the supply of card-acquiring services
- 1.20** If we identify that the supply and acquisition of related goods and services cause harm to the supply of card-acquiring services, we will consider what action (if any) to take.
- 1.21** As explained in Chapter 2 (paragraph 2.30), we will also 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).
- 1.22** We may identify issues that sit outside the scope of our market review. If so, we will consider undertaking further work to investigate these issues separate to this market review. Chapter 3 (paragraph 3.20) provides further information on the possible outcomes of the market review.

Stakeholder input to the Terms of Reference

- 1.23** We received 35 responses to the consultation on the draft ToR from a variety of stakeholders. Annex 1 lists those who responded. Alongside the final ToR, we are publishing the non-confidential versions of the responses.
- 1.24** We summarise and respond to stakeholders' main comments on our proposed scope in Chapter 2, and to other aspects of our draft ToR in Annex 2.
- 1.25** The remainder of this document is structured as follows:
- In **Chapter 2** we summarise the comments we received on the proposed scope described in the draft ToR, set out our response and confirm the scope of our market review.
 - In **Chapter 3** we describe our approach to the market review, identify some specific issues of interest and outline the possible outcomes.
 - In **Chapter 4** we set out our next steps, invite evidence and summarise our approach to disclosure of information provided to us. This chapter should be read alongside Annex 4, which lists the indicative milestones for our market review.

2 Scope of the market review

- 2.1** Our market review will examine the supply of card-acquiring services. This chapter sets out our scope. It also explains how we took account of respondents' views on the proposed scope set out in our draft ToR.

Background

- 2.2** Consumers commonly use credit and debit cards to pay for goods and services online, by phone or mail order, or in store. There are six card payment systems operating in the UK: American Express, Diners Club International, JCB International, Mastercard, UnionPay International and Visa.
- 2.3** To accept card payments, merchants need to buy card-acquiring services. One option is to contract with an acquirer (who in some circumstances may also be the card scheme operator).⁹ The acquirer allows a merchant to access a card payment system. The acquirer is also responsible for making sure the merchant complies with the rules set by the card scheme operator. These rules govern how card payments are made.
- 2.4** Acquirers use a variety of channels to gain customers, including face-to-face sales, their own websites and call centres. An acquirer may also engage third parties such as independent sales organisations (ISOs) to sell their services and procure new merchant relationships.
- 2.5** Rather than contract with an acquirer, merchants – typically smaller merchants – can buy card-acquiring services from a payment facilitator. The payment facilitator contracts with one or more acquirers who retain responsibility for allowing merchants to access the card payment systems.
- 2.6** Annex 3 provides more information on the roles of acquirers and payment facilitators.
- 2.7** To accept card payments, merchants also buy goods or services in addition to card-acquiring services, which we refer to as “card acceptance products”. These include, for example, point-of-sale (POS) terminals and gateways.¹⁰ Acquirers and payment facilitators typically offer these card acceptance products. Third parties such as ISOs also offer these products. Merchants can buy card acceptance products from their provider of card-acquiring services or from a third-party provider.

⁹ In a three-party card payment system, the card scheme operator generally performs the issuing and acquiring functions itself. See Annex 3 for more information.

¹⁰ In its most basic form, a gateway is software that helps a merchant accept card payments through a website by capturing the card details and translating them into a message that can be sent to and understood by the acquirer's systems.

Respondents' views on our proposed scope and our response

2.8 The draft ToR described the proposed scope of the market review. Respondents' main suggested changes to our proposed scope were:

- We should change or clarify our definition of card-acquiring services.
- We should expand our proposed scope to include all card acceptance products.
- We should expand our proposed scope to include the card scheme operators.
- We should not limit our focus to the supply of card-acquiring services for Mastercard and Visa.
- We should expand our proposed scope to examine acquiring services for all digital (i.e. non-cash) payment methods not just card payments.

2.9 Below we summarise our proposals in the draft ToR and respondents' views. We also provide our response.

Definition of card-acquiring services

2.10 In our draft ToR, we described card-acquiring services as services to accept and process card payments on behalf of a merchant resulting in a transfer of funds to the merchant.

Respondents' views

2.11 Of the respondents that commented on our proposed description of card-acquiring services, around half agreed with it.

2.12 Of the remainder, around half said that merchants buy products other than card-acquiring services to accept card payments. They also said that these card acceptance products can be bought from the merchant's provider of card-acquiring services or from third parties. Given this, some respondents sought clarity on which specific products and market participants are covered by our proposed description or asked that we expand our proposed description to include card acceptance products.

2.13 Among other comments on our proposed description, one respondent suggested that we align it with the definition of acquiring of payment transactions set out in the Payment Services Regulations 2017 (PSRs 2017).¹¹ Another respondent said that our proposed description was inconsistent with the way the European Commission has described acquiring services in merger decisions.

¹¹ The PSRs 2017 transposed the revised Payment Services Directive (PSD2) into UK law. PSD2 aims to create a more integrated and efficient European payments market, encourage innovation, and make payments safer and more secure.

Our response

- 2.14** As proposed in the draft ToR, for the purposes of our market review we define card-acquiring services as services to accept and process card payments on behalf of a merchant resulting in a transfer of funds to the merchant.
- 2.15** Card-acquiring services are one of the products that merchants buy to accept card payments. Other card acceptance products – such as POS terminals and gateways – are not covered by our definition. As we explain in paragraph 2.21, we will consider any effects of the supply and acquisition of card acceptance products on the supply of card-acquiring services.
- 2.16** Our definition of card-acquiring services uses as a starting point the definition of acquiring of payment transactions set out in the PSRs 2017. However, the PSRs 2017 definition also covers acquiring services for non-card digital payments, which are outside our scope. In any case, our definition does not need to replicate any legislation or merger decision – it was created solely for the purposes of our market review. Our definition of card-acquiring services does not prejudge the process of defining any relevant market(s).

Card acceptance products

- 2.17** In our draft ToR, we proposed that the supply of products and services that are related to card-acquiring services would not be in scope except insofar as they affect the supply of card-acquiring services. We said the supply of POS terminals would be an example of a service that could affect the supply of card-acquiring services.

Respondents' views

- 2.18** Some respondents argued that we should expand our proposed scope to include some or all card acceptance products that merchants buy.
- 2.19** These respondents argued that we would not be able to understand the supply of card-acquiring services in isolation. They said that card acceptance products can be the entry point for merchants buying card-acquiring services or may be bundled with these services. Respondents also emphasised the influence of third-party providers of card acceptance products, which they said can be unregulated. Respondents argued that these third-party providers may influence merchants' choice of acquirer, create barriers to switching or control the price of card-acquiring services (and hence influence whether the savings acquirers realised from the IFR interchange fee caps are passed on).
- 2.20** Several respondents also argued that by examining card-acquiring services only, we would not be able to understand the overall costs for merchants of accepting card payments.

Our response

2.21 We will consider any effects of the supply and acquisition of card acceptance products on the supply of card-acquiring services. This means we will consider many of the issues raised by respondents including:

- the extent to which card acceptance products are the entry point for card-acquiring services and may affect the ease with which merchants can switch
- whether third-party providers of card acceptance products control the price of card-acquiring services
- how third-party providers of POS terminals, gateways and other card acceptance products can influence merchants' choice of provider of card-acquiring services and the ease with which they can switch

2.22 We do not see a need to examine the overall costs for merchants of card acceptance products. This is because the concerns raised with us mainly relate to card-acquiring services or how card acceptance products may affect the supply of these services.

Card scheme operators

2.23 In our draft ToR, we proposed that the supply of products and services that are related to card-acquiring services would not be in scope except insofar as they affect the supply of card-acquiring services. We said services provided by card scheme operators would be an example of a service that could affect the supply of card-acquiring services. We also proposed to gather detailed data on scheme fees (and interchange fees) and explore the factors that determine the level of scheme fees.

Respondents' views

2.24 As described in paragraph 1.14, some respondents asked us to focus on or carry out a review of the level of scheme fees that card scheme operators charge to acquirers.

2.25 Some respondents wanted us to include card scheme operators within the scope of the market review. They said that the rules card scheme operators set and the fees they charge to acquirers impact the supply of card-acquiring services. A small number of respondents argued scheme fees or the rules set by card scheme operators favour larger acquirers. Several identified specific rules set by card scheme operators that we should examine including those relating to collateral requirements. One respondent said the rules set by card scheme operators cause harm to merchants.

2.26 By contrast, one respondent asked for clarity on why obtaining data on scheme fees would be relevant to the market review, and about our proposal to explore what determines the level of these fees. This respondent also said we must identify now the specific services provided by card scheme operators that would be considered as part of the market review and explain why they are relevant to our work.

Our response

- 2.27** For the reasons explained in paragraphs 1.15 to 1.18, this market review will not examine whether the supply of services provided by card scheme operators is working well for the users of card payment systems. This means we will not review the fees that card scheme operators charge to acquirers to determine whether they are excessive.
- 2.28** We note respondents' views that card scheme operators impact the supply of card-acquiring services through the rules they set and the fees they charge. As set out in paragraph 1.19, we will consider these scheme fees and rules to the extent that they are relevant to understanding how the supply of card-acquiring services operates and/or may adversely affect the supply of card-acquiring services.
- 2.29** This work will be mainly informed by stakeholders' concerns. We will examine any concerns raised and decide what action to take (if any) on a case-by-case basis. It would not be appropriate for us to provide a definitive list of issues we will examine now as this would prejudice any concerns that stakeholders may raise during the market review or issues we identify through our work. However, for the avoidance of doubt, we will not carry out a wholesale review of the rules that card scheme operators set or the scheme fees they charge to acquirers, and whether these are excessive or justifiable.
- 2.30** We 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). This is a relevant consideration for our market review given the concerns raised about acquirers holding on to the savings they made from the IFR interchange fee caps and significant increases in the scheme fees portion of the fees that merchants pay to acquirers. Therefore, we will gather detailed data on scheme fees (and interchange fees) and how they have changed. We will also examine how merchants' transactional activity (for example, the number and types of transactions they accept) determine the scheme fees component of the fees that they pay to acquirers.

Focus on Mastercard and Visa

2.31 In our draft ToR, we proposed to focus on the supply of card-acquiring services for Mastercard and Visa for the following reasons:

- Mastercard-branded cards and Visa-branded cards accounted for over 98% of all UK debit and credit card payments in 2017, both by volume and value.¹²
- The concerns that stakeholders have raised with us about card-acquiring services largely relate to Mastercard and Visa.
- Our current understanding is that most merchants are unlikely to see card-acquiring services for other card payment systems as alternatives to card-acquiring services for Mastercard and Visa. This is because it is the customer who decides which payment instrument to use, and 98% of cards in issue in the UK in 2017 were Mastercard-branded or Visa-branded cards.¹³

Respondents' views

2.32 Of the respondents that commented on this point, a majority supported our proposal to include acquiring services for all card payment systems in scope but focus on card-acquiring services for Mastercard and Visa. Some of these respondents noted that Mastercard-branded and Visa-branded cards account for nearly all UK debit and credit card payments.

2.33 One respondent argued that American Express differs from the Mastercard and Visa payment systems – for example, because it does not have interchange fees. Therefore, the respondent argued that the concerns that prompted the market review do not apply to American Express. This respondent also argued that no merchant needs to accept American Express cards.

2.34 Some respondents queried our proposal or disagreed. Their arguments included that:

- card payment systems other than Mastercard and Visa are widely accepted by some types of merchants and are growing in importance
- many of the concerns raised in the draft ToR (e.g. in relation to pricing transparency and barriers to switching) would apply to all card payment systems
- acquiring services for card payment systems other than Mastercard and Visa may be more expensive or serve as a point of differentiation for acquirers

2.35 One respondent asked that we expand our proposed scope to include LINK. LINK is the interbank payment system that enables people to take cash out of bank accounts (and carry out other activities) using its network of ATMs in the UK. This respondent argued that the reduction of LINK's interchange fees for cash withdrawals is causing harm to consumers and merchants.

¹² PSR analysis based on UK Finance, *UK Payment Statistics 2018* (2018), tables 10.1 and 10.2.

¹³ Excluding ATM-only cards. PSR analysis based on UK Finance, *UK Payment Statistics 2018* (2018), table 7.1.

Our response

- 2.36** We will focus on the supply of card-acquiring services in relation to Mastercard and Visa. We consider this is an appropriate approach and a good use of our resources. While other card payment systems are accepted by merchants, Mastercard and Visa-branded cards account for the vast majority of card payments overall and the bulk of merchants' expenses for card-acquiring services.¹⁴ Therefore, our work will have the greatest potential to make a positive difference for UK merchants overall by ensuring that card-acquiring services for Mastercard and Visa are working well.
- 2.37** While our focus will be on card-acquiring services for Mastercard and Visa, card-acquiring services for other card payment systems will be in scope. We explain in Chapter 3 (paragraphs 3.16 to 3.19) what this means for our approach to the market review.
- 2.38** We currently have a significant programme of work on both LINK and access to cash more generally. We expect this to continue through 2019 and expect that this programme of work is the best place to consider any issues relating to the reduction of interchange fees for cash withdrawals rather than through work on card-acquiring services.

Acquiring services for non-card digital payments

- 2.39** Merchants may buy acquiring services for digital (i.e. non-cash) payment methods other than card payments – for example, for payment methods that enable them to be paid using the interbank payment systems. In the draft ToR, we proposed to limit our scope of work to card-acquiring services. We also said that testing whether merchants have credible alternatives to card-acquiring services would be part of the market review.

Respondents' views

- 2.40** A small number of respondents commented on our proposal to limit our scope of work to card-acquiring services. Some said that we should expand our scope to include acquiring services for non-card digital payments. One reason given was that some merchants use such payment methods extensively. Another was that the second Payment Services Directive (PSD2) aims to help promote alternatives to card payments for merchants and consumers. A third reason was that offering acquiring services for non-card payment methods may allow an acquirer to differentiate itself. However, no respondents raised specific concerns about acquiring services for non-card digital payment methods.

14 Mastercard-branded cards and Visa-branded cards accounted for over 98% of all UK debit and credit card payments in 2017, both by volume and value. PSR analysis based on UK Finance, *UK Payment Statistics 2018* (2018), tables 10.1 and 10.2.

- 2.41** Two respondents said our proposal to test whether merchants have credible alternatives to card-acquiring services must consider emerging or possible future alternatives. Their reasons included the pace of innovation in payments, and the potential for PSD2 to facilitate offer of payment methods that do not rely on card payment systems.
- 2.42** A small number of respondents said we should examine interactions between card payments and other payment methods. They were concerned that the latter are not good substitutes for the former and that there are barriers to this changing. Two respondents wanted us to consider how we might remove any barriers that exist. Another wanted us to explore why Mastercard and Visa – in the respondent’s view – have a dominant position in retail payments.

Our response

- 2.43** The concerns that respondents raised relate to acquiring services for card payments. Given we have not heard concerns about acquiring services for other digital payment methods, our market review will not examine whether the supply of these services is working well.
- 2.44** However, we note the comment that providers of card-acquiring services may seek to differentiate themselves by offering non-card-acquiring services. This is a relevant consideration for our market review. We will consider any effects of the supply and acquisition of acquiring services for non-card digital payments on the supply of card-acquiring services.
- 2.45** We will also consider whether acquiring services for non-card digital payments imposes a competitive constraint on card-acquiring services. We recognise that we may find that the extent to which card-acquiring services can be wholly or partially substituted for acquiring services for non-card digital payments may differ by type of merchant.
- 2.46** We note respondents’ views that our work to consider whether acquiring services for non-card digital payments impose a competitive constraint on card-acquiring services must consider emerging or potential alternatives. Our analysis of whether the supply of card-acquiring services is working well and consideration of any potential remedies will be based on all types of evidence available to us including on likely trends and developments.
- 2.47** Our market review is not the appropriate way to consider and address concerns about potential barriers to uptake of non-card digital payment methods. We will take account of these concerns in developing our work programme for 2019/20.

Other comments

Respondents' views

- 2.48** Some respondents commented on the geographic scope of our work. Two respondents said we should look at acquirers based outside the UK that offer card-acquiring services to UK merchants. One respondent said that our market review must take account of how acquirers compete for merchants that operate in multiple jurisdictions.
- 2.49** A small number of respondents said that card issuers should be within scope. One reason given was that some acquirers are also issuers, which in turn affects their card-acquiring services offering. Another reason was that card issuers contribute to the harm to merchants caused by – in the respondent's view – abuse of a dominant position by Mastercard and Visa.
- 2.50** One respondent said we should limit our scope of work to acquiring services for in-store card payments. This respondent argued that there are material differences between in-store and online card payments and that the concerns raised with us appear to be more relevant to the former. They also said that new technology is bringing about major changes to acquiring services for card payments made online.
- 2.51** One respondent asked us to include interchange fees within scope and to consider intervening to lower these fees. It said that UK merchants pay higher interchange fees than merchants located elsewhere in the EU because other countries have chosen to lower the IFR caps on interchange fees.¹⁵ This respondent and one other also said we should examine interchange fees applied to commercial cards, which were not capped by the IFR.

Our response

- 2.52** Our market review will consider whether the supply of card-acquiring services is working well for UK merchants, and ultimately consumers. This is line with our role as the regulator of the UK payments industry. We will not limit our scope of work to any particular types of UK merchants. Our work will also consider how conditions of supply may differ between broad types of merchant – for example, between UK merchants operating across multiple jurisdictions and those that do not. For clarity, all providers of card-acquiring services to UK merchants (regardless of where the provider is located) are in scope as are all types of card payments that merchants accept.¹⁶

¹⁵ The IFR offers national discretions to Member States in several areas including the option to implement lower caps for domestic consumer credit and debit card transactions.

¹⁶ Rules set by card scheme operators require acquirers to assign an outlet location to each merchant including those that only operate online. For the purposes of our market review, our initial view is that we will treat the population of UK merchants as all merchants assigned a UK outlet by their acquirer.

- 2.53** We note the comment that where a firm is a card issuer and an acquirer, this may impact on its card-acquiring services offering. We agree this is a relevant consideration for our market review. We will consider any effects of the supply and acquisition of issuing services on the supply of card-acquiring services.
- 2.54** Our market review is not investigating card scheme operators or issuers for an alleged potential abuse of a dominant position in breach of the antitrust rules. We will consider what, if any, further action we might take in respect of any information received in the course of conducting this market review – for example, evidence suggesting anti-competitive conduct. We would also consider how, if at all, we take such information into account in our market review.
- 2.55** In the main, stakeholders’ concerns are not limited to card payments made in store. Therefore, our market review will cover acquiring services for card payments made online, over the phone, by mail order or in store. We note the point that conditions of supply may differ between these different types of card payment. Our work will consider this.
- 2.56** The IFR already caps interchange fees on certain consumer credit and debit card transactions. The European Commission is currently undertaking a review of the IFR, which will cover the application of the interchange fee caps. This could lead to changes to the IFR that may apply in the UK subject to the UK's withdrawal from the EU. In relation to domestic transactions, the power to reduce the level of the caps sits with the Treasury.

Our decision on our scope of work

- 2.57** We will examine the supply of card-acquiring services in our market review. Card-acquiring services are services to accept and process card payments on behalf of a merchant resulting in a transfer of funds to the merchant. Our definition of card-acquiring services does not prejudge the process of defining any relevant market(s) (see paragraphs 2.14 to 2.16).
- 2.58** We will examine the supply of card-acquiring services by acquirers and payment facilitators. We will also consider the role that third parties such as ISOs have in the supply of card-acquiring services – for example, as channels through which acquirers sell their services (see paragraphs 2.4 and 2.5).
- 2.59** In assessing card-acquiring services, we will focus on the supply of these services in relation to Mastercard and Visa. This is a non-exclusive focus. We will also consider card-acquiring services for other card payment systems operating in the UK (see paragraphs 2.36 to 2.38).

- 2.60** We will consider the supply of card-acquiring services to UK merchants. We will not limit our scope of work to any particular types of merchant (see paragraph 2.52).
- 2.61** We will consider any effects on the supply of card-acquiring services of the supply of related goods and services. This includes:
- card acceptance products (see paragraphs 2.21 and 2.22)
 - services provided by card scheme operators (see paragraphs 2.27 to 2.30)
 - acquiring services for non-card digital payments (see paragraphs 2.43 to 2.47)
 - acquiring services for non-card digital payment (see paragraphs 2.43 to 2.47)
- 2.62** As explained in paragraph 1.19, we are interested in the supply and acquisition of these goods and services to the extent that:
- they are relevant to our understanding of how the supply of card-acquiring services operates; and/or
 - they may adversely affect the supply of card-acquiring services
- 2.63** As our market review evolves, we may obtain new information that means we examine the effects of the supply of goods and services that are not listed in paragraph 2.61.

3 Our approach

3.1 This chapter sets out our approach to the market review including three specific issues we will examine. Annex 2 sets out how we took account of respondents' views on the proposed approach set out in our draft ToR.

Our approach

3.2 We will consider how competition is working in the supply of card-acquiring services and whether there are aspects of the market(s) that adversely affect competition in the supply of those services. These aspects of the market(s) may either be intrinsic to the structure of that market(s) or arise from the conduct of any market participant (whether or not in the market(s) concerned). If we consider that competition in the supply of card-acquiring services is not working well for merchants, and ultimately consumers, we will consider what action, if any, we should take. For the purposes of this market review, the relevant market participants will include:

- acquirers and payment facilitators
- card scheme operators
- merchants
- third-party providers of card acceptance products (that is, providers that do not also supply card-acquiring services)

3.3 We will examine how competition in the supply of card-acquiring services operates. This includes examining:

- the nature and characteristics of card-acquiring services and developments in the supply of these services
- who provides card-acquiring services and how the supply of these services has developed historically
- how providers of card-acquiring services compete for merchants, including whether other goods or services are tied or bundled with the supply of card-acquiring services
- how the supply of card-acquiring services may differ across broad types of merchants
- the scope for differentiation and innovation in the supply of card-acquiring services
- whether there are credible alternatives to card-acquiring services for some or all merchants (that is, merchants' demand side substitutes for these services and supply side substitutes)
- how merchants buy card-acquiring services
- the fees merchants pay for card-acquiring services including how the level of these fees has responded to changes in the fees acquirers pay to card scheme operators (scheme fees) and card issuers (interchange fees)

- what support merchants receive from their acquirer or payment facilitator to comply with the rules set by the card scheme operators (including PCI DSS requirements), and any fees or fines associated with such compliance¹⁷
- the quality of service that merchants receive from their provider of card-acquiring services – including how quickly they receive the funds paid by customers using cards, the resilience of the services and the support provided where there are issues accepting card payments
- the regulatory and legal framework that applies to the supply of card-acquiring services

3.4 We will also examine whether these and any other considerations might affect innovation in the supply of card-acquiring services, as well as the interests of service-users.

3.5 We will examine whether conditions of supply (including the fees merchants pay for card-acquiring services) differ across broad types of merchants – for example, depending on a merchant’s size, when they last switched or the risks that an acquirer or payment facilitator carries in serving them.

3.6 Within our scope of our work, we will initially examine the three specific issues of interest outlined below. These issues were identified based on stakeholders’ concerns, and desk-based research and analysis. We do not yet have a view on what impact, if any, these issues might have on the supply of card-acquiring services. We may identify other issues during the market review that we decide to examine.

Specific issues of interest

Barriers to entry or expansion in card-acquiring services

3.7 Barriers to entry or expansion can make it difficult to start offering card-acquiring services or grow as a provider of these services. Such barriers could therefore result in less competitive pressure on established providers. Barriers could also make it difficult for a new provider to launch innovative products.

3.8 We want to understand if there are any barriers to entry or expansion for providers of card-acquiring services and, if so, the nature and extent of these. These could include technical, contractual, legal or regulatory barriers, economies of scale, or something else. For example, we will consider concerns that scheme fees and the rules set by card scheme operators may create or exacerbate barriers to entry or expansion.

Barriers to searching or switching that merchants face

3.9 Barriers to searching or switching can make merchants less responsive to price increases or reduced quality of service. As a result, prices may be higher or quality of service lower than would have been the case if searching and switching had been easier.

¹⁷ The Payment Card Industry Data Security Standard (PCI DSS) is a set of standards designed to protect the security of card payments and reduce fraud.

- 3.10** We would like to find out how merchants choose between providers of card-acquiring services so that we can understand what barriers they face (if any) to searching or switching.
- 3.11** For example, merchants could face barriers:
- when they gather information about card-acquiring services
 - when they compare card-acquiring services (for example, if fees are not transparent)
 - when they switch between card-acquiring services, including technical and contractual barriers
- 3.12** We will also consider whether market participants behave in ways that make any such barriers worse.
- 3.13** We will take account of existing regulatory obligations on providers of card-acquiring services to provide information to merchants about their services. This includes the obligations in the IFR that require acquirers to provide specific information to their merchants about the costs of accepting card payments.

Availability of services that facilitate merchant decision-making

- 3.14** Services that help merchants make better choices about card-acquiring services could deliver better outcomes for them. This would particularly be the case if merchants face barriers to searching.
- 3.15** We want to consider the availability of such services and whether there are factors that prevent them from emerging or growing. This includes any restrictions on independent sales organisations (ISOs) or others that could prevent them from helping merchants make better choices.

Focus on Mastercard and Visa

- 3.16** We explain in Chapter 2 (paragraph 2.59) that while our focus will be on card-acquiring services for Mastercard and Visa, card-acquiring services for other card payment systems will be in scope. This means we will, in relation to card-acquiring services for Mastercard and Visa, fully implement the approach set out in paragraphs 3.2 to 3.6 and explore the specific issues described in paragraphs 3.7 to 3.15.
- 3.17** Our work is expected to be more limited in relation to card-acquiring services for card payment systems other than Mastercard and Visa. In the first instance:
- We will explore the extent to which card-acquiring services for other card payment systems compete with card-acquiring services for Mastercard and Visa, respectively.
 - We will aim to form a high-level understanding of the competitive process in respect of card-acquiring services for card payment systems other than Mastercard and Visa. This includes looking at who provides these services and how they compete for merchants.
 - We will not assess the outcomes of the competitive process (such as the fees merchants pay for card-acquiring services) for card payment systems other than Mastercard and Visa or merchants' views of these outcomes.

3.18 We are open to exploring any concerns we hear in relation to card-acquiring services for card payment systems other than Mastercard and Visa. This may mean we adapt the approach described in paragraph 3.17.

3.19 In reaching our findings, we will take account of anything we learn about competition in card-acquiring services for card payment systems other than Mastercard and Visa.

Possible outcomes of the market review

3.20 We will consider what actions, if any, we should take if we find that the supply of card-acquiring services is not working well. For example, we might:

- make new or amend existing general directions
- make new specific directions
- require the operator of a regulated payment system to establish or change their operating rules, to tell us of rule changes or to seek our approval before making rule changes
- make recommendations for industry initiatives or enhanced industry self-regulation
- make proposals to the Financial Conduct Authority (FCA), which regulates payment service providers including those providing card-acquiring services
- publish guidance
- investigate a potential breach of the Competition Act 1998
- make a market investigation reference to the Competition and Markets Authority (CMA) to investigate a market or a feature of several markets
- undertake further work in relation to specific issues

3.21 Where we have reasonable grounds to suspect that any feature, or combination of features, of a market or markets are adversely affecting competition, we can refer a market or a feature of several markets to the CMA for an in-depth investigation, or accept undertakings in lieu of making a reference.

3.22 We aim to ensure that any action we take is effective and proportionate to any harm we identify.

4 Next steps

4.1 Publication of the final ToR marks the launch of the market review into the supply of card-acquiring services. Annex 4 sets out an indicative timetable for our work. We plan to publish a report setting out our interim conclusions on the supply of card-acquiring services in Q4 2019 and a final report in Q2 2020.

4.2 We will now begin gathering evidence and information from a range of stakeholders using a variety of methods. This includes:

- issuing information requests to stakeholders, including:
 - providers of card-acquiring services (acquirers and payment facilitators)
 - other parties that help merchants accept card payments including independent sales organisations and gateway providers
 - card scheme operators (Mastercard, Visa and the operators of the other card payment systems in the UK)
 - large merchants
- carrying out a survey of small and medium-sized merchants
- holding meetings with various parties

4.3 As we progress our market review, we may also seek information and evidence from other parties or use methods not listed in paragraph 4.2.

4.4 We intend to seek views at an early stage on some of the analysis we propose to carry out. We plan to do this by publishing methodology or approach papers in Q1 and Q2 2019 covering:

- our proposed methodology for assessing how the level of fees that merchants pay have responded to changes in the fees that acquirers pay to card scheme operators and card issuers (the pass-through analysis)
- our proposed approach to carrying out the survey of merchants
- our proposed methodology for assessing the profitability of a subset of acquirers

4.5 We will continue to liaise with other authorities as we progress our work. These include the FCA, which regulates payment service providers including those providing card-acquiring services, and the Bank of England, which supervises Visa. We will also continue to liaise with the European Commission as it progresses its review of the IFR.

4.6 We recognise that our market review will run in parallel to the implementation of PSD2 and ongoing technological developments. Our analysis of whether the supply of card-acquiring services is working well, and consideration of any potential remedies, will be based on the evidence available to us, including on any likely trends and developments arising from PSD2, and any technological changes. We will also take account of the European Commission's review of the IFR and the UK's withdrawal from the EU.

We welcome input to this market review

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

Card-acquiring market review team
Payment Systems Regulator
12 Endeavour Square
London
E20 1JN

Disclosure of information

4.8 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 and
- exercising our functions as transparently as possible

4.9 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.

4.10 We may nonetheless be required to disclose information marked as confidential in order to meet legal obligations.

4.11 This would be the case, for example, if we are asked to disclose confidential information under the Freedom of Information Act 2000. We will endeavour to consult you if we receive such a request under the Freedom of Information Act 2000. Any decision we make not to disclose information can be reviewed by the Information Commissioner and the Information Rights Tribunal.

4.12 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.

- 4.13** 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.
- 4.14** We have statutory powers under FSBRA to require a person to provide information or documents which we require in connection with our functions. In such circumstances, you should note that there are serious consequences for you if you provide false or misleading information or fail to comply with such a request, in particular:
- Sections 90(1) and (2) FSBRA state: “A person who fails to comply with a requirement imposed, without reasonable excuse, including a requirement to provide information, may be dealt with as if he or she were in contempt of court, which may result in imprisonment or a fine.”
 - Section 90(6) FSBRA states: “It is a criminal offence, when, in response to a written requirement to provide information under section 81(1) FSBRA, a person either provides information which he or she knows is false or misleading in a material particular or recklessly provides information which is false or misleading in a material particular.”
- 4.15** Participants we regulate under FSBRA are also required to have an open and cooperative relationship with us and disclose relevant information to us pursuant to our General Direction 1. Breaching a general direction is a compliance failure, which makes a participant liable for regulatory sanctions.
- 4.16** We take our data protection responsibilities seriously and will process any personal data that you provide to us in accordance with the Data Protection Act 2018, the General Data Protection Regulation and our PSR Data Privacy Policy. For more information on how and why we process your personal data, and your rights in respect of the personal data that you provide to us, please see our privacy policy on our website, available here: <https://www.psr.org.uk/privacy-notice>.

Annex 1

Respondents to the consultation

American Express

Association of British Travel Agents

Association of Convenience Stores

Association of Independent Risk & Fraud Advisors

British Airways

British Retail Consortium

Cardswitcher

Ciceroni

CMSPI

Ecommpay

Edgar, Dunn & Company

Elavon

Electronic Money Association

Emerging Payments Association

EuroCommerce

Federation of Small Businesses

First Data

Global Payments

Gradeon

HSBC

iZettle

Lloyds Banking Group

Mastercard

North East Interiors

Onestopmoneymanager Ltd

Paysafe

PSI-Pay

Secure Trust Bank

Stripe

Transport for London

UK Finance

Vanquis Bank

Visa Europe

Which?

Worldpay

Annex 2

Main points raised in responses

2.1 In Chapter 1 of the final ToR (paragraphs 1.14 to 1.18) and Chapter 2 (paragraphs 2.8 to 2.56), we address the main points raised by respondents to the consultation on the draft ToR in relation to the proposed scope of our work set out in that document. This annex summarises the other main points raised by respondents, and our response.

Our proposed approach

Respondents' views

2.2 Some respondents commented on how we would engage with stakeholders. They asked for clarity on our timescales, sought details of who we would engage with and how, and urged us to seek information from a variety of stakeholders. A subset of these respondents particularly emphasised that we must engage with acquirers to understand the issues they face and the risks they carry.

2.3 A small number of respondents said we should specify the criteria we will use to assess whether the supply of card-acquiring services is working well.

2.4 Some respondents asked us to consider how supply of card-acquiring services may differ by type of merchant. Several respondents said that our work should consider how a merchant's risk categorisation might impact on their choice of provider of card-acquiring services or the price they pay. Respondents also suggested we might consider how prices differ for large and small merchants, and for those that have switched recently versus those that have not.

2.5 One respondent said its understanding was our powers are limited to payment systems. It also noted the FCA regulates the activities of acquirers. It therefore asked on what basis the PSR is conducting a market review into card-acquiring services.

Our response

2.6 Chapter 4 addresses respondents' requests for more information on how we will engage with stakeholders. As set out in Chapter 4 (paragraphs 4.1 to 4.4) we intend to gather information and evidence from a range of stakeholders – including acquirers – using a variety of methods. Annex 4 addresses respondents' requests for more details on the timetable for the market review.

2.7 We note the request for us to specify the criteria we will use to assess whether the supply of card-acquiring services is working well. Our approach to this assessment is set out in Chapter 3 (paragraphs 3.2 to 3.4).

- 2.8** We also note respondents' views that the prices merchants pay, and their choice of provider, may vary depending on their risk categorisation, size or how often they switch. As set out in Chapter 3 (paragraph 3.5), these are relevant considerations for our market review. We will examine how the supply of card-acquiring services may differ between broad types of merchant.
- 2.9** We will conduct this market review using our general powers under the Financial Services (Banking Reform) Act 2013 (FSBRA). We have a function under FSBRA to keep the markets for payment systems and services provided by payment systems under review. Market reviews are one of our tools for investigating how well the market for payment systems, or the markets for services provided by payment systems, are working for service-users (i.e. the people and organisations who use, or are likely to use, services provided by payment systems) in line with our statutory competition, innovation and service-user objectives.
- 2.10** Under FSBRA, we have the power to request information from any person (not only persons we regulate). At the end of the market review, as we explain in Chapter 3 (paragraph 3.20), one of the potential outcomes of the market review is to make a market investigation reference to the CMA under the Enterprise Act 2002. Other possible outcomes involve us using our other FSBRA powers in relation to participants in designated payment systems. Participants are defined in FSBRA as the operator of the payment system, any infrastructure provider and any payment service provider. As set out in Chapter 4 (paragraph 4.5), we will liaise closely with the FCA as we progress our work.

Specific issues we plan to examine

Respondents' views

- 2.11** Some respondents highlighted the barriers to switching that merchants face including from the complexity and lack of transparency of fees they pay, point-of-sale (POS) terminal rental contracts, Payment Card Industry Data Security Standard (PCI DSS) compliance requirements and the cost of making IT changes. Two respondents said that some acquirers spread their costs of onboarding a merchant over the life of the contract, which avoids the merchant incurring costs upfront that might deter switching. Commenting on potential barriers to entry and growth, two respondents raised concerns that the process for certifying new POS terminals is expensive and can delay bringing new products to market.
- 2.12** One respondent suggested we might delay our assessment of barriers to switching because PSD2 has the potential to enable development of services that could help merchants choose between providers of card-acquiring services.

- 2.13** Commenting on our intention to consider the availability of services that facilitate merchant decision-making, one respondent was concerned that this could prejudice our work to consider what barriers, if any, merchants face to searching and switching. It suggested we should not examine the availability of services that facilitate merchant decision-making until we have reached a view on whether merchants face barriers to searching and switching. One respondent said we should assess the usefulness of services that facilitate merchant decision-making that are already available to merchants and another said those services that exist may not be helpful. Another respondent said it can be difficult for merchants to access services that help decision-making.
- 2.14** One respondent queried our intention to examine whether scheme fees and the rules set by the card scheme operators create or exacerbate barriers to entry or expansion. It said that card scheme operators have obligations under the PSRs 2017 relating to their access rules or conditions including that these must be proportionate, objective and non-discriminatory. The respondent requested more clarity on our concerns.

Our response

- 2.15** We welcome input on the specific issues of interest that we plan to examine through the market review. The concerns that stakeholders have raised about barriers to switching and certification of POS terminals will help guide our analysis.
- 2.16** We note the comment that PSD2 has the potential to help merchants compare card-acquiring services. Our analysis of whether the supply of these services is working well, and consideration of any potential remedies, will be based on the evidence available to us, including on any likely trends or developments arising from PSD2. However, we do not consider we should delay our work to examine barriers to switching until any changes brought about by PSD2 materialise. This is because the concerns raised with us about barriers to switching are not limited to merchants' ability to compare card-acquiring services.
- 2.17** We also note the comments about our intention to consider the availability of services that facilitate merchant decision-making. We are not persuaded it is necessary to delay consideration of this issue until after we have assessed any barriers to searching and switching that merchants face. We will take account of any such barriers in coming to a view on the issue relating to availability of services that facilitate merchant decision-making. As suggested by one respondent, we will also take account of any decision-making services that exist today.
- 2.18** As set out in Chapter 2 (paragraph 2.29), we will examine any concerns that scheme fees and the rules set by card scheme operators adversely affect the supply of card-acquiring services. For example, stakeholders have raised concerns, before and in responses to the draft ToR, that the rules set by card scheme operators and the fees they charge may favour larger acquirers. This could potentially create a barrier to entry or expansion. If we find any issues that may relate to the PSRs 2017, we will take this into account in deciding what action (if any) to take.

Other comments

Respondents' views

- 2.19** Some respondents said that the supply of card-acquiring services has evolved significantly in recent years. These and other respondents also emphasised the ongoing pace of change driven by one or all of PSD2, open banking and the UK's withdrawal from the EU, as well as changing shopping preferences, shifts in merchants' needs and technological developments. Some of these respondents emphasised that PSD2 aims to promote alternatives to card payments and increase the number of market participants. One respondent asked that we consider how the ban on surcharging has affected merchants. Given the possible changes being brought about by regulatory and technological changes, a small number of respondents concluded that we must take a forward-looking approach to analysing the supply of card-acquiring services.
- 2.20** A small number of respondents asked us to consider the impact of the IFR on the supply of card-acquiring services. They particularly asked us to consider the impact of the business rules on the transparency of the fees merchants pay to acquirers or argued these rules may help to address some of the concerns raised with us. Several others said we should check whether acquirers have complied with these rules.
- 2.21** A small number of respondents queried the timing of our market review given the European Commission's IFR review, potential changes from PSD2 and the uncertainty caused by the UK's withdrawal from the EU. One respondent wanted information on how we would ensure any action we may take would work with any interventions that the European Commission might consider following its IFR review.
- 2.22** One respondent said that the market review would not assess the impacts of the IFR on all parties involved in a card payment. It said this was a significant omission because the PSR has said in the past that this should precede consideration of any further interventions in relation to card payments. This respondent also said that it did not have the opportunity to provide input during the development of the draft ToR. It expressed concern that we were drawing conclusions in the draft ToR based on engagement with a small number of stakeholders whose views may not reflect those of the diverse range of merchants that accept card payments. It said we must engage more widely and be more transparent about who we are hearing views from.
- 2.23** A small number of respondents said we should examine the fees that acquirers charge to merchants in relation to PCI DSS compliance.
- 2.24** A small number of respondents said we cannot assume that benefits to merchants will automatically translate into benefits for consumers and that we must assess whether this is the case.
- 2.25** One respondent asked us to clarify what we mean by "larger acquirers" and "smaller merchants".

Our response

- 2.26** We note the comments about the pace of change in card-acquiring services and agree with respondents that PSD2 has the potential to promote non-cash alternatives to card payments. Our analysis of whether the supply of card-acquiring services is working well, and consideration of any potential remedies, will be based on the evidence available to us including on any likely trends and developments arising from PSD2, open banking and any technological changes.
- 2.27** We will also take account of any changes brought about by the IFR impacting the supply of card-acquiring services and the UK's withdrawal from the EU. For example, in exploring barriers to searching or switching, as set out in Chapter 3 (paragraph 3.13) we will take account of the obligations in the IFR that require acquirers to provide specific information to merchants about the costs of accepting card payments. Separate to the market review, we are already monitoring compliance with the IFR including the business rules.
- 2.28** We do not consider that the potential changes brought about by PSD2, the European Commission's review of the IFR and the UK's withdrawal from the EU should delay our market review given the concerns that stakeholders have raised about card-acquiring services. The aims and scope of the European Commission's work are different from our market review. The IFR review will look at a wide range of issues relating to card payments¹⁸ whereas our aim is to examine whether the supply of card-acquiring services is working well. We will liaise closely with the European Commission and we will take account of the developments and the findings of that review.
- 2.29** Although the purpose of this market review is not to examine the impacts of the IFR, we will take account of changes brought about by this regulation if relevant to our work. Our market review is prompted by stakeholders' concerns. A number of these concerns are unlikely to be fully addressed by the IFR. Moreover, they have been raised consistently by stakeholders for some time. For these reasons, we decided to revisit our view that the impacts of the IFR should be understood before considering further interventions in relation to card payments. We considered a range of options on how to proceed and discussed card-related issues with the PSR Panel, whose membership is drawn from payments system operators, payments service providers, infrastructure and technology providers and service users. We also chaired a discussion on the future of card payments at the launch event for our 2018/19 annual plan that was open to all stakeholders. We also published the draft ToR to give all interested parties the opportunity to comment on our plans and we have taken account of the feedback we received in preparing this document. As described in Chapter 4 (paragraphs 4.1 to 4.4), we will engage with a wide range of parties to inform our market review including through a survey of merchants. We also welcome any input from stakeholders who wish to engage with us on the subject matter of this review. We approach the market review with an open mind and will seek to understand how the supply of card-acquiring services operates and examine whether it is working well for merchants, and ultimately consumers.

18 See Article 17 of the IFR: <https://eur-lex.europa.eu/legal-content/EN/TXTHTML/?uri=CELEX:32015R0751&from=ENhtmlfile\Shell\Open\Command>

- 2.30** The acquirer is ultimately responsible for allowing a merchant to access the card payment systems and hence making sure it complies with the rules set by the card scheme operators including PCI DSS requirements. The payment facilitator also has a role in monitoring a merchant's compliance. Therefore, as set out in Chapter 3 (paragraph 3.3), we will examine what support merchants receive from their acquirer or payment facilitator to comply with the rules set by the card scheme operators, and any fees or fines associated with such compliance.
- 2.31** We also note the suggestion that we must assess whether benefits for merchants translate into benefits for consumers. Savings to merchants' card-acquiring fees that are ad valorem or paid on a per-transaction basis represent savings to merchants' variable costs, and such cost savings would affect all merchants who accept card payments. Economic theory predicts that such a reduction would be passed on to consumers in a competitive market – but the extent of pass-through depends on the details of supply and demand in the market.¹⁹ Therefore, we do not consider it necessary to assess whether benefits for merchants translate into benefits for consumers.
- 2.32** Our use in this document of the terms “larger acquirers” and “smaller merchants” reflects the language stakeholders used to articulate their concerns to us about the supply of card-acquiring services.

¹⁹ RBB Economics, *Cost pass-through: theory, measurement, and potential policy implications – a report prepared for the Office of Fair Trading* (2014), section 1.5.1.

Annex 3

Roles of acquirers and payment facilitators

3.1 This annex summarises the roles of acquirers and payment facilitators as defined by the rules set by card scheme operators. It does not define what we mean by card-acquiring services. See Chapter 2 (paragraph 2.57) for the definition of card-acquiring services we will use for the purposes of our market review.

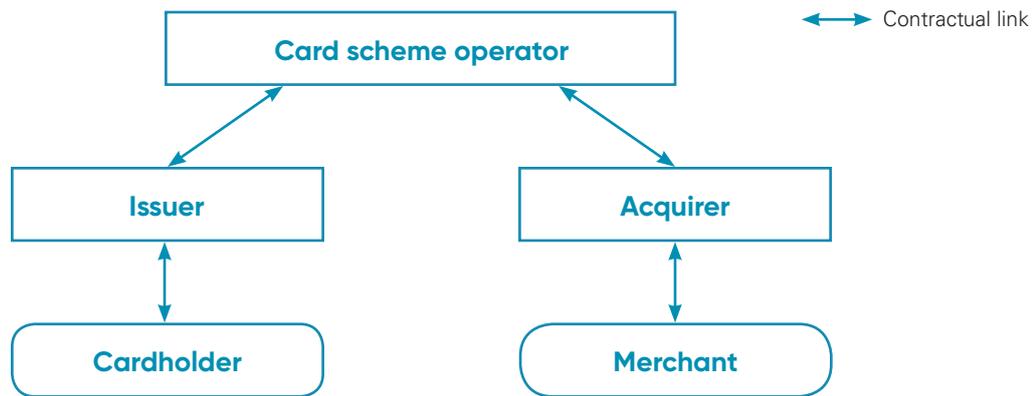
Role of acquirers

3.2 Acquirers generally perform three core functions:

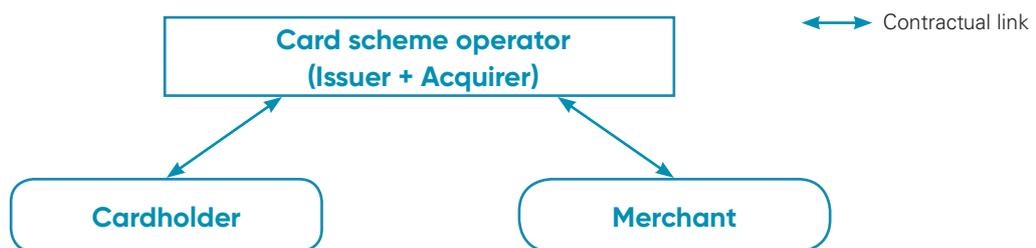
- recruiting merchants to accept card payments, and underwriting them
- facilitating the authorisation, clearing and settlement of transactions through the card payment system
- ensuring merchants comply with the rules set by the card scheme operator that govern how card payments are made

3.3 Generally, when a card is presented to pay for goods or services, the merchant sends an authorisation request to the acquirer. (In some cases, however, the transaction does not need to be authorised.) The acquirer then forwards this request to the issuer via the card scheme operator. The issuer decides whether to approve or decline the transaction including by checking that the cardholder has enough money in their account to make the payment and that the card has not been reported lost or stolen. If the transaction is authorised and once the merchant has received the issuer's response, the sale can proceed. Later, the acquirer receives the funds from the issuer and credits the merchant's account through the clearing and settlement processes. The merchant receives the value of the transaction less the fees that the acquirer charges for its services. The issuer debits the cardholder's account.

3.4 In a four-party card payment system, the card scheme operator has no direct contractual relationship with the merchant. It licenses acquirers to manage these relationships. Similarly, the card scheme operator has no direct contractual relationship with cardholders. It licenses issuers (often banks) to issue cards to customers and to manage those relationships. Figure 1 shows a simplified structure of a four-party card payment system.

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

3.5 In a three-party card payment system, the card scheme operator generally performs the issuing and acquiring functions itself. Figure 2 shows a simplified structure of a three-party card payment system.

Figure 2: Simplified structure of a three-party card payment system

3.6 Acquirers may choose to outsource some of their core functions to third parties. Where an acquirer outsources its functions, it retains responsibility for allowing the merchant to access the card payment system and for making sure that third parties perform these functions in accordance with the rules set by the card scheme operator.

3.7 Acquirers may offer other services beyond the core functions, such as:

- leasing point-of-sale terminals
- offering credit facilities
- providing payment gateways

3.8 Third parties can also provide these services directly to merchants.

Role of payment facilitators

- 3.9** Rather than contract directly with an acquirer, merchants – typically smaller merchants – can contract with a payment facilitator. 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.

Annex 4

Indicative timetable of work

4.1 The table below shows the indicative milestones for our market review.

4.2 In the event of substantive changes to this timetable, we will publish a revised version on our website.

Phase	Activity	Timing
Launch	Publish final ToR	January 2019
Information gathering and analysis	Publish working paper on pass-through analysis	February/March 2019
	Publish working paper on profitability analysis	February/March 2019
	Collect evidence and information from market participants	February to July 2019
	Publish working paper on merchant survey	April/May 2019
	Conduct merchant survey	May and June 2019
	Analysis of evidence and information gathered	May to October 2019
Interim report	Publish interim report for consultation	Q4 2019
Final report	Conduct hearings	Q1 2020
	Publish final report	Q2 2020

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