



Harriett Baldwin MP
Chair
Treasury Select Committee
House of Commons
SW1A 0AA

31 May 2023

Dear Harriett

In recognition of the Committee's continued interest in the PSR's work on card fees, I am pleased to provide a progress update on our cross-border interchange fees and scheme and processing fees market reviews.

Background

Cards are the most popular way for people to make payments in the UK. Visa and Mastercard account for around 99% of all UK debit and credit card payments, both by volume and value.

Reflecting this, the PSR has been taking steps to improve how this market works for consumers and businesses. In particular, we recently concluded a review into card acquiring services (the services merchants need to accept card payments). This review resulted in interventions, implemented through our statutory powers of direction, that will improve merchants' ability to shop around for a better deal.

In addition, we launched two further market reviews, to consider whether card payments are working well for merchants and, ultimately, consumers: one on UK-EEA consumer cross-border interchange fees and one on scheme and processing fees.

These reviews consider the following fees:

- Cross-border interchange fees refer to the interchange fees on cross-border consumer transactions between the UK and EEA. Following the UK's withdrawal from the EU at the end of 2020, the EU Interchange Fee Regulation no longer applies to UK domestic and cross-border transactions between the UK and EEA. Shortly after EU withdrawal, Mastercard and Visa increased interchange fees for card-not-present (CNP) transactions using consumer debit and credit cards from 0.2% and 0.3% to 1.15% and 1.5% respectively.
- Scheme fees are those charged by scheme operators to participate in the scheme, while processing fees are those charged for the authorisation, clearing and settlement of payments.

Both reviews focus on the two largest – and so called 'four-party' – card schemes (Mastercard and Visa).

Following the announcement of our review of card fees in November 2021, we sent Mastercard and Visa initial information requests in January 2022. These informed the draft terms of reference for both reviews, published in June 2022, and our final terms of reference, published in October 2022. Work continues to progress both market reviews, as we outline below.

Objectives of the market reviews

In time, account-to-account payments should encourage wider innovation and provide greater competition for card payments. In the meantime, these market reviews will ensure that we understand how competition between schemes is working, and whether this is resulting in reasonable prices for the services that consumers and businesses receive.

We have clear objectives for each market review:

- On both market reviews we are assessing the factors that may influence and constrain how Mastercard and Visa set different card fees, and the impact of this. Such factors may include the extent of any barriers to entry or network effects involved in setting up and running card payment systems, and whether Mastercard and Visa have a 'must take' status for merchants.
- On scheme and processing fees, we are also considering the differences in the structure and/or levels of scheme and processing fees charged to different participants (including issuers and acquirers), and their impact on competition, innovation and service-user interests.
- On cross-border interchange fees, we want to understand the impact of and rationale for the increases in interchange fee levels for UK-EEA card-not-present (CNP) consumer debit and credit transactions.

We are concerned that the extent of Visa's and Mastercard's increase of these fees is an indication that one or more aspects of market(s) is not working well for service users, which could result in higher prices paid by UK merchants and consumers. The scheme operators have provided some explanation for the increases to us, and also to the TSC, and we are exploring their reasons further in our market review.

Progress update

We launched an extensive programme of work to identify and gather evidence about how the market is operating. We are engaging with key stakeholders across the market including the card schemes, Mastercard and Visa, merchants, card acquirers and card issuers. This includes through information requests (using our statutory information gathering powers), voluntary questionnaires, roundtable discussions and bilateral meetings.

Since December 2022, we have published three working papers across both market reviews¹, consulting on our initial thinking on key topics and offering an opportunity for stakeholders to provide their views to us.

Scheme and processing fees market review

Following the issue of our draft terms of reference, we issued further draft information notices to Mastercard and Visa. This request covered: cross-border interchange fees (discussed separately below), and, in respect of scheme and processing fees:

1. competitive and market context,
2. financial analysis,
3. fees and transaction data,
4. fee change events.

Following extensive discussions with the schemes, including workshops, conference calls and consideration of written submissions, these requests were issued in autumn 2022 (October and November) as five separate notices.

It was our intention that by May 2023 this data gathering would have been concluded and we would have been consulting on working papers with a view to completing the further analysis required before issuing an interim report.

This was always an ambitious goal. We continue to prioritise our resourcing of this work, so as to make progress as quickly as we can. However, it is also important to make sure that we proceed in a way that is thorough and robust.

Against this backdrop, it has proven incredibly challenging to gather the full evidence we need from the card schemes, and this may ultimately impact our ability to meet our published timetable. The challenges encountered have included:

1. the Interchange Fee Regulation (IFR) separation requirements, which have required us to send parallel requests to each of the card schemes' scheme and processing businesses,
2. personnel changes at the schemes, which mean that some of the relevant individuals involved in making the decisions of interest to us are no longer employed by Mastercard or Visa. This has contributed to the difficulties in identifying and retrieving information, noted below,
3. the lack of UK specific financial information for the schemes (as noted below in regard to our February 2022 profitability analysis working paper), and
4. the inability of the schemes to retrieve or access all the requested data in the timescales originally envisaged.

This has required further work to discuss and identify appropriate ways to obtain the information we need. While we always recognised that the collection of information would be a challenging

¹ [MR22/1.4: Competitive constraints in card payment systems call for evidence](#), [MR22/1.5: Approach to profitability analysis working paper](#) and [MR22/2.4 Impact of the UK-EEA cross-border interchange fee increases working paper](#)

and time-consuming exercise, it has proven to be more difficult than we originally envisaged. There has been a mismatch between the evidence we need to discharge our statutory role and the schemes' ability to provide us with this evidence in line with our original plans.

Reflecting this, we have set out plans for improvements to the routine collection of information from the two card schemes, supported by the creation of a new division within the PSR – our Supervision and Compliance Monitoring division – that will improve the availability of this information going forward.

Notwithstanding these challenges, we have continued to progress our market review. In February 2023, we published two working papers for consultation:

- *Competitive constraints*²: a call for views as to which factors influence and constrain the card schemes in setting their fees, and the impact of those factors.
- *Profitability analysis*³: considering how to assess the UK profitability of the schemes, including an initial view of their profitability based on Visa and Mastercard's published European and Global statutory financial statements. We also noted that it took longer than we expected to collect UK financial reporting evidence as Mastercard and Visa's international commercial and accounting structures do not report UK-specific information. As noted above, separate to our market reviews, we are taking steps to improve the availability of information going forward.

We have received 20 responses to these working papers and will publish the non-confidential responses in due course. We also held stakeholder roundtables on these working papers (one each for acquirers, issuers and merchants) attended by 41 stakeholders from 31 organisations and we will publish a summary of what we heard at these roundtables soon.

Later this year (starting with 'Event analysis' in June) we plan to publish 3 further working papers, setting out what we have seen on:

- *Event analysis*, examining the most significant fee changes in recent years, the background to these changes and what factors the schemes considered when setting their fees,
- *Quantitative data analysis* of the fees charged by card schemes (and the payments they make to customers) and how they have changed in recent years, and
- The *relationship between card schemes and their customers*.

Our working papers, the consultation responses received, outcomes from stakeholder engagement, and information received from the schemes will feed into the production of our interim report. This report will set out our provisional findings about whether the market(s) in connection to scheme and processing fees are working well and, if not, potential measures we

² <https://www.psr.org.uk/publications/market-reviews/mr22-1-4-competitive-constraints-in-card-payment-systems-call-for-evidence/>

³ <https://www.psr.org.uk/publications/market-reviews/mr22-1-5-approach-to-profitability-analysis-working-paper/>

are considering to tackle any problems identified. We will use the interim report process to consult on our provisional findings and potential measures for intervention.

Cross-border interchange fees market review

As per our terms of reference, we are prioritising outbound cross-border IFs (fees paid by UK acquirers to EEA issuers).

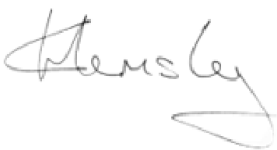
In December 2022 we published a working paper on our initial thinking of the impact of the UK-EEA cross-border interchange fee increases on UK service users, including SMEs. This paper showed a significant increase of between £75m and £100m in the UK-EEA cross-border interchange fees that UK merchants were charged on CNP transactions in H1 2022. This was despite a decline in the volume and value of transactions over the same period.

We received eight stakeholder responses to our working paper which we have reviewed and analysed, alongside reviewing the other information we have gathered. We intend to publish a paper summarising these stakeholder responses in the summer, including an annex containing the non-confidential responses we received.

The challenges in obtaining information from the card schemes outlined above have also affected our work on cross-border interchange fees. However, notwithstanding these challenges, we continue to work towards the publication of our interim report in Q3 2023, followed by our final report in Q4 2023. This is in line with our target timeline set out in our October 2022 final terms of reference.

I look forward to keeping the Committee updated as this work progresses.

Yours sincerely



Chris Hemsley
Managing Director