

Rt Hon Mel Stride MP
Chair, Treasury Select Committee
Committee Office
House of Commons
London
SW1A 0AA

17 December 2021

Dear Mel

Thank you for your letter dated 2 December on card payment fees. We understand the concerns that retailers have about how well the cards industry is working. We are currently finalising our plans to continue work addressing issues in this industry, and what follows sets out more information about what we propose to do.

Before turning to your specific questions, I have outlined some background context which I hope will be helpful.

Card payments are a crucial part of the UK economy and enable consumers and businesses to pay for goods and services. There are around 157 million cards in issue in the UK and 20 billion card transactions in 2020¹. As the UK's regulator of payment systems, we want there to be effective competition in the market, sufficient choice and payment systems that work well for everyone. This includes working to make sure that the cards industry delivers good outcomes for people and businesses, recognising that the fees merchants pay to accept cards can, ultimately, be passed on to consumers by way of increased prices.

Earlier this year, I set out our view that there are real questions about how well the cards industry is working.² Our proposed Strategy (final version due to be published in January 2022) sets out our broad approach to tackling this issue and highlights how we will deliver through specific pieces of work. Our approach is focused on promoting competition between payment systems by unlocking the longer-term potential of different ways to make payments, whilst keeping in mind the ongoing need to protect users until competition has time to take effect.

We have work underway on interbank payments (sometimes called 'account to account' payments), which will support alternative ways to make and receive payments in the future. This will promote competition in the long term, which we expect will increase the commercial pressure to lower fees, raise service quality and continue to innovate.

Additionally, we announced in November that we are also taking forward a piece of work to examine the basis for card scheme fees and cross-border interchange fees. We provide more detail on our concerns with these fees below. This work will consider the range of tools available to us to protect users and also consider whether shorter-term measures such as caps for scheme fees or cross-border interchange fees might be appropriate. Any such action would not be a 'quick fix', as these are complex issues that need thorough investigation.

1 <https://www.ukfinance.org.uk/sites/default/files/uploads/SUMMARY-UK-Payment-Markets-2021-FINAL.pdf>

2 https://www.psr.org.uk/news-updates/speeches/speeches/pay360_chris-h_oct-2021/

But, if put in place, these measures could protect users in the intervening period until we develop and implement any longer-term measures to introduce more competition. Of course, we would welcome the opportunity to provide more information on this work when our Strategy is published in the new year.

And there is, of course, the work we have been doing to date relating to card acceptance and certain card fees. This includes our work to enforce the regulatory caps on interchange fees, and to improve how this industry works for retailers and other merchants. Indeed, as part of this work, we recently published analysis that shows how they have risen significantly (you rightly point to our Card Acquiring Market Review Final Report – chapter 5). We will publish our remedies consultation in early 2022 which focuses on improving choice, to support greater competition and, ultimately, to achieve a better deal for their card acquiring services.

The cards industry is complex with a number of different parties involved and fees being charged along the value chain. In addition, there is also a complex arrangement of caps applying to interchange fees. I have set out more information on the industry and these fees in Annex 1.

We have observed increases in two different types of fees set by Visa and Mastercard and charged to acquirers.

1. Scheme fees, which the Schemes receive and are not currently capped under any regulatory regime in the UK or EU.
2. Some cross border interchange fees, which are received by Issuers and have seen changes to the capping arrangements following the UK's withdrawal from the EU (set out in Annex 1)

Our Card Acquiring Market Review (CAMR), which you referred to in your letter, examined increases to scheme fees paid by acquirers. Evidence presented in our CAMR final report showed that average scheme fees more than doubled over the period between 2014 to 2018 with most of this increase occurring between 2016 and 2018, after the IFR caps came into force.³ Our analysis indicates a substantial proportion of these increases were not explained by changes in the volume, value or mix of transactions.⁴ Our ongoing engagement with merchants suggests that they have continued to significantly increase since then.

Following the changes in caps that accompanied the UK's withdrawal from the EU, both Mastercard and Visa announced proposed increases to the interchange fees on purchases UK consumers make at EEA merchants, made online or over the phone with consumer debit and credit card payments from 0.2% and 0.3% to 1.15% and 1.5% respectively. In addition, both Visa and Mastercard have announced increases to interchange fees on purchases made online or over the phone by EEA issued cards at UK merchants to the same levels as cross-border transaction going the other way. We are monitoring this closely.

3 See Figure 2 in Annex 1.

4 See paragraph 1.16 CAMR Final Report <https://www.psr.org.uk/media/p1tlg0iw/psr-card-acquiring-market-review-final-report-november-2021.pdf>

Your specific questions

1. **What have been the changes to debit and credit card UK scheme fees over the last five years and cross-border interchange fees more recently? What research has the PSR done to look at the underlying reasons for these changes?**

As noted above, scheme fees increased substantially between 2014-2018 (see Figure 2 in Annex 1) and our ongoing engagement with merchants suggests that they have continued to significantly increase since then.

Some cross-border interchange fees have also increased more recently.⁵ As noted above, there have been changes in the applicable regulatory regimes which has increased the level that some interchange fees are capped at and removed the caps on other fees – see Tables 1 and 2 in Annex 1.

We have not seen evidence that shows that there have been significant changes in the costs for issuers of enabling online transactions via EEA-issued cards in the UK, or UK-issued cards in the EEA, nor following the UK's withdrawal from the EU. Our proposed work will be looking more closely at the reasoning behind the recent increases and whether this indicates any themes or concerns that warrant action from us.

2. **What impact does Mastercard's and Visa's dominance have on competition and pricing within the card acquiring services market, in particular for smaller firms?**

The increases in card fees noted in the introduction to this letter, pose important questions as to whether there are sufficient competitive constraints on card schemes.

We set out in our proposed Strategy that retail transactions are largely made by debit and credit card payments. The use of cash, the main alternative to card payments in retail settings, has been in decline in recent years; a trend which has been accelerated by the pandemic.

On the face of it, the two largest card schemes enjoy a strong position in retail payments. In 2020, Visa provided over 90% of debit cards in circulation in the UK. Mastercard provided two thirds of credit cards. Between them, the two card schemes accounted for 99% of all card transactions.

Both interchange fees and scheme fees are set by the card schemes. While interchange fees for domestic debit and credit card transactions are capped at 0.2% and 0.3% respectively, following the UK's withdrawal from the EU, the regime capping interchange fees paid on purchases made with non-UK issued cards (including EEA Issuers) at UK merchants no longer applies (see first column of table 2 in Annex 1). Similarly, while there is still a cap on interchange fees paid on transactions made by UK issued cards at EEA merchants, due to a change in the regime capping the fee after the UK withdrawal from the EU, the effective cap increased for purchases made online or over the phone. Acquirer scheme fees are also uncapped.

In October this year, both Mastercard and Visa increased cross-border interchange fees on purchases made online or over the phone by UK consumers at EEA merchants with consumer debit and credit card payments from 0.2% and 0.3% to 1.15% and 1.5% respectively. In addition, both Visa and Mastercard have announced increases to interchange fees on purchases made online or over the phone on EEA issued cards at UK merchants to the same levels as cross-border transaction going the other way.

5 Specifically the fees that have increase are payments made online or over the phone using (i) UK-issued cards to EEA merchants; and (ii) EEA issued cards to UK merchants

These higher fees feed into the price which acquirers charge merchants (the Merchant Service Charge, or MSC). All firms (including smaller firms) that accept card payment are likely to face higher prices as a result of the recent increases in the fees set by the large card schemes. Those firms that have larger amounts of cross-border payments are likely to face higher increases in the MSC they pay. Our work on card acquiring did, however, identify that while competition between acquirers (as opposed to between the schemes) was generally working well for large merchants, there were issues faced by a range of smaller merchants. We will set out our proposals on remedies early in the new year.

- 3. To what extent does the PSR believe that the increases in interchange fees that Visa and Mastercard are charging on cross-border activities (reported as coming into force in October 2021) are justified on the grounds of increased costs? In addition, has the PSR done any work to consider whether domestic interchange fees set by the UK Interchange Fee Regulation are appropriate in current market conditions, or whether there is scope to reduce them still further?**
- 4. What future work does the PSR intend to carry out to look at whether the overall levels of UK scheme fees, as well as the level of interchange fees when goods are bought overseas, are justifiable or excessive?**

(Answer to both Q3 and 4) We will examine the issue of increasing card fees as part of the additional work we announced recently⁶. In addition to the material set out above, we plan to set out further information on this work alongside our final Strategy. This work is likely to consider some of the issues above. We will publish further details of the scope of this work early in 2022.

- 5. What action can the PSR take within its current remit to regulate both scheme fees and interchange fees for goods bought overseas, and in what circumstances would it expect to intervene in the future?**

There are a number of regulatory regimes which apply caps to interchange fees. However, after the UK withdrawal from the EU, the scope and level of some of the caps has changed. We are also the main authority for the IFR, which regulates domestic interchange fees for credit and debit cards.⁷

The PSR is the authority responsible for monitoring the interchange fee caps set out in the IFR. In addition, in relation to Visa and Mastercard the PSR has a variety of tools at its disposal to address potential concerns. These result from our regulatory powers (under Financial Services (Banking Reform) Act 2013 and Payment Services Regulations 2017) and concurrent competition law powers (Competition Act 1998 and market studies under the Enterprise Act 2002). For example, we may give directions to participants in regulated payment systems, impose requirements on the operator of a regulated payment system concerning the rules of the system, amend agreements relating to regulated payment systems (including fees and charges), open investigations (both into potential breaches of regulatory requirements, and market reviews) and act where we see anti-competitive behaviour in relation to participation in payment systems (alongside the Competition & Markets Authority).

⁶ <https://www.psr.org.uk/news-updates/latest-news/news/psr-statement-on-card-scheme-fees/>

⁷ Domestic fees are those where issuer, acquirer and point of sale are all in the UK.

Decisions on whether to act and which powers to use will depend on the circumstances of each case. In this context, we will have regard to a number of factors including the impact on advancing our statutory objectives, functions and duties, resource implications for the PSR, likelihood of success and the strategic importance of the action taken.⁸

As you might expect, our Strategy will guide how we prioritise work. Indeed, one of our strategic priorities is to promote competition between and within payment systems and protect users where that competition is not sufficient. As noted above we recently announced an additional project that will consider how well the cards services is working, including the issue of card fees.

6. How does the PSR’s new 5-year Strategy incorporate continued examination of whether debit and credit card interchange fees and scheme fees are proportionate, and how does it continue to test the level of competition within the card acquiring services market?

The PSR’s proposed Strategy sets out that one area of focus is promoting competition between payment systems by unlocking the longer-term potential of different ways to make payments. This approach would unlock the potential of account-to-account payments, including through initiatives such as Open Banking, and bring additional competition and choice in how payments are made.

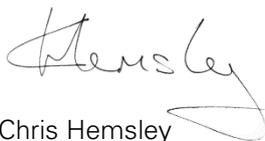
However, as set out above, in addition to work focused on improving competition, we may need to act to protect users until competition has had time to take effect. Our recent announcement of new work to examine card scheme fees and cross-border interchange fees – including considering whether shorter-term measures would be appropriate – is a good example of this. More generally, if we don’t see real prospects for improvements in competition, we do not rule out the possibility of regulating in more detail in order to protect consumers and businesses.

Our next steps on the card acquiring market review will be to publish our remedies consultation in early 2022, with a provisional decision on remedies later next year.

In addition, as noted in our proposed Strategy we intend to measure whether we are achieving our strategic priorities. This includes looking at metrics such as the degree of competition in the market, but also assessing changes in key price indicators over time. Card acquiring services will be considered as part of our wider monitoring of our Strategy.

I will, of course ensure the Committee is kept updated in the new year once our plans are published, alongside our Strategy.

Yours sincerely



Chris Hemsley
Managing Director

8 See PSR’s administrative Priority Framework <https://www.psr.org.uk/media/gtagmkqg/psr-administrative-priority-framework.pdf>

Annex 1

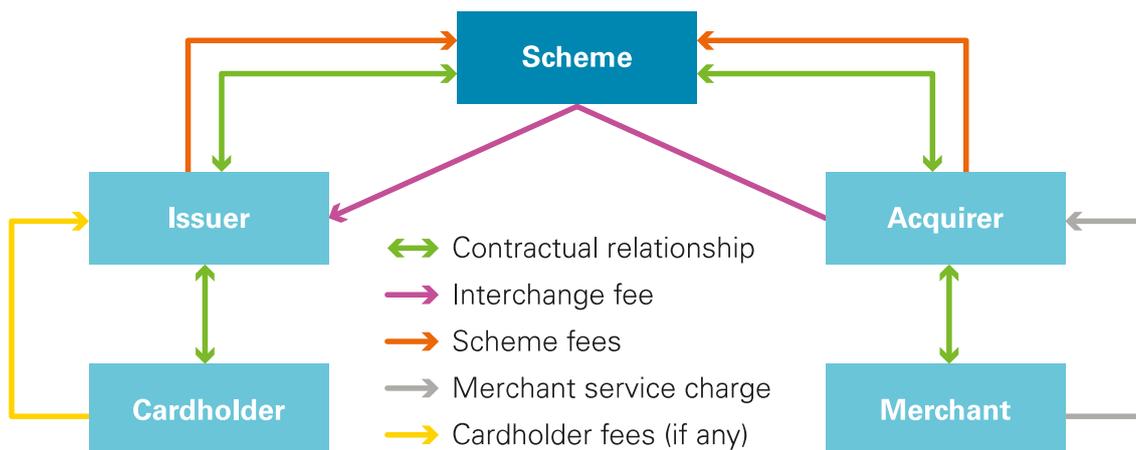
Card Industry

When a card payment is made, interchange fees are paid by the acquirer to the card issuer; scheme fees are paid by both acquirers (and issuers) to the operator of the card payment system. These fees are either charged directly or re-charged back to the merchant selling the goods or services through the merchant service (MSC).

Figure 1 below shows the main flow of fees between parties in a four-party card payment system, specifically:

- interchange fees, which acquirers pay to issuers each time a card is used to buy goods or services
- scheme fees, which acquirers and issuers pay to the operators of card payment systems for their services
- merchant service charge (MSC), which is the total amount merchants pay to acquirers for card-acquiring services
- cardholder fees, which cardholders may pay to issuers

Figure 1: Main fees flowing between parties in a four-party card payment system



The MSC comprises interchange fees, scheme fees and acquirer net revenue.

Interchange fee cap and levels

The Interchange Fee Regulation (EU IFR, imposed in December 2015) capped interchange fees on domestic and cross border EU-UK consumer debit and credit card at 0.2% and 0.3% respectively (See light grey shaded area in Table 1). Following the UK’s departure from the EU, the regime capping interchange fees paid on purchases made with non-UK issued cards (including EEA Issuers) at UK merchants no longer apply (see first column of table 2 in). Similarly, while there is still a cap on interchange fees paid on transactions made by UK issued cards at EEA merchants, due to a change in the regime capping the fee after the UK withdrawal from the EU the effective cap increased for purchases made online or over the phone⁹.

⁹ The specifics of the cap relate to Card not present transactions (CNP). Throughout this letter we have referred to CNP transactions as those made online or over the phone, but it does also include card payments made by post.

Domestic interchange fees remain capped at 0.2% for debit cards and 0.3% for credit cards under UK law under made online or over the phone The Interchange Fee (Amendment) (EU Exit) Regulations 2019.

Inbound cross-border interchange fees (on payments for goods and services made into the UK) are constrained by undertakings made by Visa and Mastercard to reduce their multilateral interchange fees for payments in the EEA with consumer cards issued elsewhere. The European Commission made these commitments legally binding under EU antitrust rules in 2019. Following the UK's departure from the EU, the caps on interchange fees paid to non-UK issuers by acquirers of UK merchants no longer apply (see areas shaded orange in Table 2) while the cap applying to interchange fees paid by acquirers of EEA merchants to UK issuers for purchases made online over the phone has increased.

Following the changes in caps, both Mastercard and Visa announced their intention to increased interchange fees on purchases made online or over the phone by UK consumers at EEA merchants with consumer debit and credit card payments from 0.2% and 0.3% to 1.15% and 1.5% respectively. These increases were due to come into effect in October 2021. In addition, both Visa and Mastercard have announced increases to interchange fees on purchases made online or over the phone by EEA issued cards at UK merchants to the same levels as cross-border transaction going the other way, namely consumer debit and credit card payments from 0.2% and 0.3% to 1.15% and 1.5% respectively.

Table 1: Interchange fee caps before UK withdrawal from EU

| Payment to¹⁰ | UK | EEA | RoW¹¹ |
|--------------------------------|---|---|-------------------------|
| Payment from | | | |
| UK | EU IFR Debit card 0.2% Credit card 0.3% | EU IFR Debit card 0.2% Credit card 0.3% | No cap |
| EEA | EU IFR Debit card 0.2% Credit card 0.3% | EU IFR Debit card 0.2% Credit card 0.3% | No cap |
| RoW | EU Commitments <i>Debit cards</i> CP ¹² : 0.2% CNP ¹³ : 1.15% <i>Credit cards</i> CP: 0.3% CNP: 1.5% | EU Commitments <i>Debit cards</i> CP: 0.2% CNP: 1.15% <i>Credit cards</i> CP: 0.3% CNP: 1.5% | No cap |

10 Note the interchange fee goes in the opposite direction to the payment.

11 Rest of the world

12 Card-present (CP) transactions are where the consumer uses their physical card or uses a mobile wallet such as Apple Pay or Google Pay that uses an NFC chip on a Point of Sale terminal.

13 Card-not-present transactions (CNP) are all transactions other than card-present transactions, namely purchases made online or over the phone.

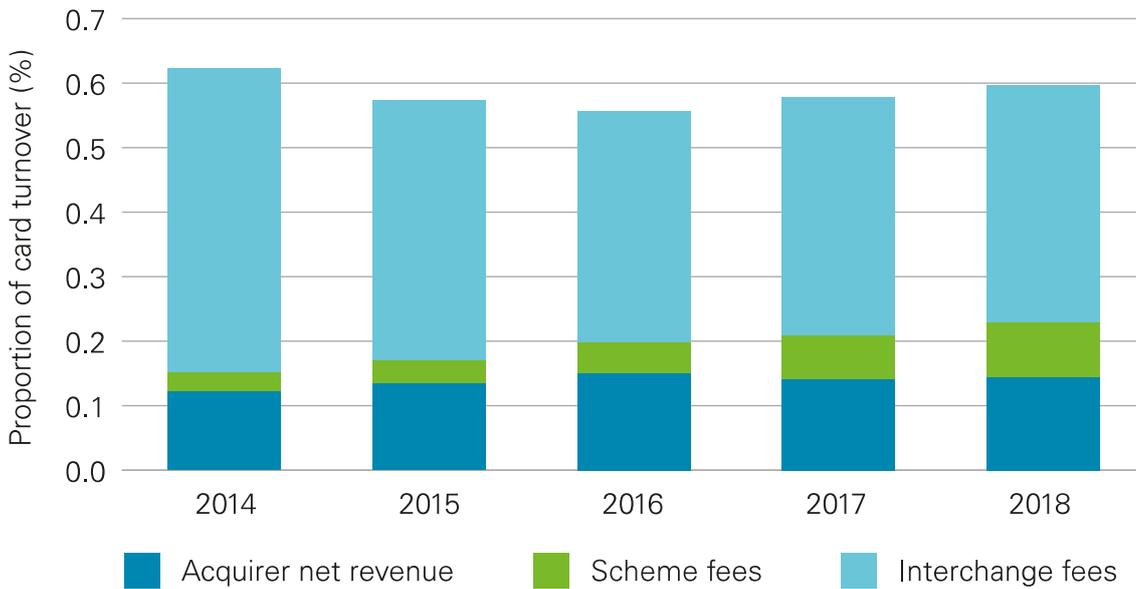
Table 2: Interchange fee caps after UK withdrawal from EU

| Payment to | UK | EEA | RoW |
|---------------------|--|---|--------|
| Payment from | | | |
| UK | UK IFR Debit card 0.2% Credit card 0.3% | EU Commitments <i>Debit cards</i> CP: 0.2% CNP: 1.15% ↑ <i>Credit cards</i> CP: 0.3% CNP: 1.5% ↑ | No cap |
| EEA | No cap ↑ | EU IFR Debit card 0.2% Credit card 0.3% | No cap |
| RoW | No cap ↑ | EU Commitments <i>Debit cards</i> CP: 0.2% CNP: 1.15% <i>Credit cards</i> CP: 0.3% CNP: 1.5% | No cap |

Changes in the Merchant Service Charge (MSC)

Figure 2 sets out the changes in average MSC at the 5 largest acquirers between 2014-2018.¹⁴

Figure 2: Average MSC as a percentage of card turnover split by interchange fees, scheme fees and acquirer net revenue (2014-2018)



Source: PSR analysis of data provided by the five largest acquirers. Weighted average of the five largest acquirers (weighted by card turnover) expressed as a percentage of card turnover from 2014 to 2018.

14 This is also found in Figure 11 CAMR Final Report <https://www.psr.org.uk/media/p1tlg0iw/psr-card-acquiring-market-review-final-report-november-2021.pdf>