Market review into the supply of card-acquiring services

Responses to draft Terms of Reference

January 2019

Contents

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

American Express

American Express's response to the PSR's consultation on comments on the PSR's draft terms of reference for a review of card acquiring services

14 September 2018

Non-confidential version

American Express welcomes the opportunity to provide feedback on the PSR's draft terms of reference for a review of card acquiring services.

A. American Express in the UK

American Express issues cards and acquires American Express transactions in the UK. American Express currently has a very small share of the cards sector contrasting sharply with the dominant duopoly of Mastercard and Visa (as the PSR concludes in its draft terms of reference, Mastercard-branded and Visa-branded cards accounted for over 98% of UK debit and credit card payments in terms of value and volume in 2017). Since its entry in the UK in 1963, American Express brought effective competition and increased consumer choice.

American Express operates probably the best-known proprietary card system worldwide. The system is proprietary because American Express itself operates the network and typically acts as both issuer and acquirer, in contrast with the association-based, inter-bank network models used by Visa and Mastercard.

In particular, the vast majority of American Express-branded cards worldwide, and the vast majority of transactions on these cards, are issued and acquired by American Express itself. By contrast, neither Visa nor Mastercard issues cards or acquires transactions; rather, they perform a network function linking and co-ordinating among thousands of independent issuing and acquiring institutions.

As the issuer and acquirer of card transactions on the American Express network, American Express contracts directly with cardholders and merchants. With respect to card issuing, it bears responsibility for providing the payer with a payment instrument and for processing and authorising transactions made using the card; it bears the cost of funds, operating expenses and all other expenses relating to the card; it bears all the credit and other risks associated with issuing; and it remains responsible for compliance with all applicable laws and regulations. With respect to merchant acquiring American Express pays the sums due to the merchant for the transaction in which it has accepted payment by card; it agrees the price that the merchant will pay; it bears the risk associated with credit and fraud losses; it bears the cost of processing the transaction; and it remains responsible for ensuring compliance with all applicable laws and regulations.

American Express does not compete - and could not compete - on the basis of ubiquity. It has to prove its value to both consumers and merchants every day and must rely on a highly differentiated, niche business model in order to compete with Visa and Mastercard. American Express cards are not a "must carry" commodity. Nearly every American Express cardholder carries and uses at least one (often more than one) Visa or Mastercard product. The reverse is not true: most Visa and Mastercard cardholders do not have an American Express Card. Since consumers and merchants do not have to carry or accept American Express cards, American Express can compete only if its customers see a benefit from using or accepting American Express cards. American Express focuses on providing superior customer service, as well as differentiated value to both cardholders and merchants. It is notable that merchants will not accept the payment products of a discretionary network like American Express unless they find value in doing so. For merchants, a big component of that value is the incremental spend that American Express is able to deliver as a result of its investments and efforts in targeted marketing, business building initiatives, rewards and other cardholder and merchant benefits and services.

In an effort to improve geographic coverage and market relevance, American Express has established licensing relationships with approximately 150 partner payment providers around the world. In all cases, American Express negotiated terms on an arm's length, confidential and bilateral basis. There are no interchange fees paid between licensees. American Express is careful and limited in its selection of partners in order to maintain the integrity of the American Express brand and to ensure that the benefits to consumers and merchants of the "closed loop" are not compromised. In Europe, historically, these partnerships enabled American Express to offer competitive choice in Eastern and Southern Europe, where it was not viable for it to issue or acquire itself.

Unlike Visa and Mastercard, none of American Express's licensees owns shares or otherwise controls or assumes any governance role, directly or indirectly, in American Express. American Express is a fully publicly traded company. There are no concepts of "association" or "membership" in American Express. American Express's licensees do not collectively agree on any of the rules or fees under which the American Express network operates; nor is there any forum through which they could do so. [CONFIDENTIAL].

As the PSR is aware, American Express is no longer able to operate its licensing business in the EU. The EU Payments Package imposes a cumulative regulatory burden on our licensing business that renders this no longer viable. American Express is therefore discontinuing its licensing arrangements in Europe.

The key differences between American Express on the one hand and Visa and Mastercard on the other are summarised in Table 1.

Table 1: Key differences between Visa/Mastercard and American Express in the UK

	Visa/Mastercard	American Express
Association based	✔	-
Interchange fees	✔	-
Scheme fees	✔	-
Must-carry	✔	-

B. American Express's comments on the draft terms of reference

As a general comment, we note the proposed study is referred to as a "market" review. Market definition has a specific meaning for the purposes of competition law. American Express kindly asks the PSR to treat its review as a sector review in order to avoid unintended consequences from a market definition perspective.

1. Do you agree with our description of card-acquiring services?
If not, please explain:
a. how our description should be altered
b. why you think the description should be altered in this way
Please include any evidence you think is relevant to your response.

American Express partially agrees with the PSR's description of card-acquiring services in paragraph 1.7. As defined in PSD2 (Article 4(44)), card acquiring services are services to accept and process card payments *for* the merchants, resulting in a transfer of funds to the merchant.

American Express agrees it is fundamental to draw a distinction between acquirers and payment facilitators. In the UK, only American Express acquires transactions on American Express cards. [CONFIDENTIAL]

In addition, payment facilitators do not have the same regulatory and commercial obligations and responsibilities as an acquirer. Where a payment facilitator interacts with merchants, the acquirer continues to carry the relevant acquiring-related risks and responsibilities from a regulatory perspective for acquiring those merchants. [CONFIDENTIAL]

2. Do you agree with the proposed scope of the market review?
If not, please explain:
a. how the proposed scope should be altered
b. why you think the proposed scope should be altered in this way
Please include any evidence you think is relevant to your response.

American Express broadly agrees with the proposed scope of the PSR's review, including the focus on the supply of card acquiring services for Visa and Mastercard on which we will comment in more detail in response to question 3.
American Express agrees that the focus should not be limited to particular categories of merchants.

[1] [CONFIDENTIAL]

[2] [CONFIDENTIAL]

3. Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?
If not, please explain:
a. how the focus should be altered
b. why you think the focus should be altered in this way
Please include any evidence you think is relevant to your response.

American Express agrees that the focus of the analysis should be on the supply of card-acquiring services for Mastercard and Visa for the reasons set out in this section.

[CONFIDENTIAL]

First, as the PSR concludes in its draft terms of reference, Mastercard-branded and Visa-branded cards accounted for over 98% of UK debit and credit card payments in terms of value and volume in 2017.

Second, the concerns the PSR intends to analyse relate to Visa and Mastercard. Further to the explanations provided under point A, American Express's business model operates differently from the association-based, inter-bank network models used by Visa and Mastercard. Therefore, the concerns identified by the PSR notably in point 1.11 relating to merchant pricing and transparency do not apply to American Express for the following reasons:

- ***American Express does not have interchange fees.*** Therefore, the concern that smaller merchants have not benefitted from cost savings expected to arise due to regulated interchange fees is not a concern that applies to American Express. [CONFIDENTIAL]
- ***American Express has dedicated initiatives that benefit small merchants.*** Another reason why the concern with regards to smaller merchants does not apply to American Express is the following: [CONFIDENTIAL] We have also been running a so-called "shop-small" campaign once a year for the last 6 years. This marketing campaign incentivises American Express cardholders to spend at participating small merchants through dedicated marketing and with the offer of statement credits[3]. [CONFIDENTIAL]

- [CONFIDENTIAL] The concern regarding a lack of transparency around the fees merchants pay to accept card payments does therefore not apply to American Express.
- [CONFIDENTIAL] The PSR's concerns with regards to scheme fees do therefore not apply to American Express.

[3] Statement credit means that an amount is credited to a cardholders statement, reducing the overall sum due to American Express by that amount.

Third, as set out in further detail under point A, three party schemes such as American Express (with less than 2% of card share in the UK) are a choice, not a must-have. Nearly every American Express cardholder carries and uses at least one (often more than one) Visa or Mastercard product. The reverse is not true: Visa and Mastercard cardholders do not need to carry an American Express Card. As a result, American Express can compete only if its customers (cardholders and merchants) see a benefit from using or accepting American Express cards.

As American Express acceptance is a choice and no merchant needs to accept American Express, [CONFIDENTIAL]

4. **Do you agree with our proposed approach?**
   If not, please explain:
   a. how proposed approach should be altered
   b. why you think the proposed approach should be altered in this way
   Please include any evidence you think is relevant to your response.

American Express would like to make the following observations with regards to the proposed approach.

- The EU payments package has led to asymmetric regulation of surcharging practices, with some card transactions being surchargeable and others not. American Express's position on this is simple – surcharging is harmful to consumers and should be prohibited. We urge the PSR to consider this issue and call on HMT to implement a full ban on surcharging of all payment types.

- We also note that a payment facilitator is different to an acquirer, as the payment facilitator [CONFIDENTIAL] the acquirer continues to carry the risks and responsibilities from a regulatory perspective for the payment facilitator. [CONFIDENTIAL]

- We agree it is important for the PSR to assess recent fee changes introduced by Visa and Mastercard and to focus on whether greater transparency should be provided to merchants concerning these fees.

- As explained in detail in response to question 3, American Express's pricing for merchants [CONFIDENTIAL]

- It is right that the review should look at barriers to switching for merchants and the means available to merchants to calculate whether they are receiving the services that are right for them. In this regard, we note that the new payment service of account information services under PSD2 ("AIS") is expected to result in the development of a number of such information and comparison services that will allow a merchant to see if he is getting value for money in relation to acquiring fees. We suggest that the PSR may wish to delay their consideration of these issues until the new legal regime has had time to bed in and for these new services to come to market. In particular, requirements for acquirers to enable access to payment accounts by Account Information Service Providers do not have full effect until the EBA RTS enter into force.

5. Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?
If not, please explain:
a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions)
b. why you think these additional issues have the potential to be relevant to the market review
c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review
d. why you think those issues do not have the potential to be relevant to the market review
Please include any evidence you think is relevant to your response.

- N/A

Association of British Travel Agents

Payment Systems Regulator:

Market Review into the supply of card-acquiring services

ABTA response – September 2018

This response is submitted on behalf of ABTA – The travel association.

ABTA was founded in 1950 and is the largest travel trade association in the UK, with almost 1,200 members operating from over 4,500 locations. Our Members range from small, specialist tour operators and independent travel agencies specialising in business and leisure travel, through to publicly listed companies and household names.

Annually, ABTA Members' turnover is in excess of £37 billion. ABTA's focus is ensuring that Members can operate their businesses in a sustainable and successful manner, enabling their customers to travel with confidence.

Introduction: existing regulation and the travel industry

In recent years, ABTA has proactively engaged with officials at HM Treasury and the PSR in relation to the problems caused for travel businesses by the UK's implementation of the Interchange Fees Regulation (IFR) and the second Payment Services Directive.

The IFR, which was introduced in 2015, was designed to cap interchange fees for card payments - at 0.3% for credit cards (previously at 0.8%) and 0.2% for debit cards (previously charged on a pence per transaction basis). The theory was that this move would reduce the cost of taking card payments across the board, as the interchange fee is the largest of the three component charges within the Merchant Service Fee. The other two charges are those paid to the acquirers, and the scheme fees due to Visa and MasterCard. The IFR was intended as a path-clearing regulation, which would lower the cost to businesses (merchants) of taking card payments. Policymakers explained that, by lowering of the costs associated with taking consumer card payments, the IFR would reduce the impact of the latter regulation, PSD2, which prohibits surcharging when taking consumer card payments.

However, the IFR has failed to reduce the cost of taking card payments within the UK, and HM Treasury acknowledged as much when implementing PSD2. As a result, the cost to businesses associated with the implementation of the surcharging ban has been greater than expected, especially for SMEs and those who experience high average transaction values – both characteristics common in the UK travel industry. As ABTA outlined in a recent letter to Treasury Minister, John Glen, the combined impact of the IFR and PSD2 on the travel industry can be summarised as follows:

- The PSD2 prohibits surcharging for all consumer card payments;
- As a result of the ban on surcharging the comparative attractiveness of paying on cards is increased, and many travel businesses are reporting a significant shift towards increased usage of cards for payment;

- However, travel businesses still face sizeable costs for the processing of card payments. Research conducted by ABTA demonstrates that more than half of travel companies are facing higher costs than they were in 2015;
- For tour operators, especially SMEs, this leaves little choice but to increase headline prices across the board;
- However, retail travel agents – the vast majority of whom are SMEs – do not control the price of the product they sell (set by the tour operator or travel service provider). Agents earn commission on completed sales, which will typically be around 10%. Card fees typically account for 2-3% of the cost of a holiday, and make up a significant proportion (20-30%) of an agencies retained revenue. This leave travel agencies facing a variety of unattractive options:
    - Absorbing the cost, which is unlikely to be viable for many businesses;
    - Adding a booking fee to all bookings, which will make the product less attractive, and penalises all consumers - not just those that pay by card;
    - Refusing to take card payments, which leaves the business less appealing to consumers and reduces their competitiveness.

We believe the impact on travel businesses is exacerbated by gold-plating undertaken by the UK government. The UK government has opted to extend PSD2 into areas not directly covered by the EU legislation, including the banning of discounting, and has also included premium card brands, such as Amex, within the scope of the surcharging ban.

ABTA research revealed that more than half of travel companies are now facing higher costs for card payments than in 2015, and very few are making any notable savings. It is clear to us that those smaller businesses, which are less able to negotiate with acquirers for better deals, are being hit particularly hard by the regulation. Further, ABTA has uncovered a serious lack of transparency throughout the payments chain relating to the different charges applied by acquirers, particularly in relation to information made available to merchants.

As a result, ABTA warmly welcomes the announcement by the PSR that a Market Review will be conducted into the card-acquiring marketplace, as well as the opportunity to provide feedback on the terms of reference proposed for this review. We look forward to engaging in a constructive manner with the Market Review once published.

Responses to consultation questions

Question 1: Do you agree with our description of card-acquiring services?

ABTA agrees with the description of card-acquiring services.

Question 2: Do you agree with the proposed scope of the market review?

ABTA agrees with the proposal to focus on how card-acquiring services are working for merchants. We believe the failure to adequately consider the perspective of merchants, and particularly SME businesses, when legislating in this area over recent years has been a major factor in the creation of a non-competitive marketplace for card-acquiring services, which has failed to meet the needs of merchants and ultimately also fails to serve the best interests of consumers by keeping costs for payments artificially high.

ABTA also agrees with the intention to focus the review on an analysis of card-acquiring services for Mastercard and Visa. These companies are by far the largest scheme providers, as ably demonstrated by the statistic provided within the paper that these schemes accounted for over 98% of all card payments in 2017.

A number of ABTA Members have reported increases in scheme fees in recent years. However, it is very difficult for merchants to assess the rationale for these increases, or indeed to understand the level of increase in terms of precise impact on their costs, as acquirers are not currently obliged to set these out fees – or their own acquirer fees - in a clear, unambiguous manner. We believe an effective review should consider the entire payments chain, including how each element of the merchant service charge interacts.

While we welcome that the review will examine how scheme fees are calculated, ABTA also believes that an assessment of whether existing levels of fees are justifiable will also be an important part of any longer-term solution. If the PSR maintains the view that an analysis of scheme fees is out of scope for this review, ABTA believes urgent consideration must be given to bringing forward a review to examine scheme fees as a standalone, but closely connected, matter, alongside that of acquiring services.

Question 3: Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

As referenced in response to question 2, above, ABTA agrees with this proposal.

Question 4: Do you agree with our proposed approach?

Taking account of the comments made in response to question 2, around the inadequacy of the existing scope of the Review, ABTA agrees with the proposed approach.

Question 5: do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant for the market review?

ABTA does not wish to make any additional comments on the review at this time.

More information:

[redacted]

Association of Convenience Stores

ACS Submission: Card-Acquiring Market Review: Draft Terms of Reference

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

We welcome this market review to ensure the supply of card-acquiring services is competitive for all merchants. Only 11% of convenience retailers have seen reductions in the cost of processing card payments since 2016, compared to 57% having increases in their Merchant Service Charges (MSCs)[1]. There is a possibility that the benefits of the EU Interchange Fee Regulation (IFR) capping interchange fees are not being past on to convenience retailers and significant increases in card scheme fees from Visa and Mastercard have escalated card acquiring costs for retailers since January 2017.

We are concerned that the complexity of bills can undermine confidence from retailers to accurately compare card acquirers' offer. Some smaller retailers are still receiving 'blended' bills with no breakdown of costs, while retailers receiving 'interchange ++' pricing can struggle to forecast acquirer bills or account for costs outside the MSC when comparing acquirers. Poor transparency about costs and changes in MSC bills can act as a barrier to retailers understanding bills and comparing the wider acquiring market. Switching card acquirers can also be a burdensome process for retailers when handling possible changes in acquirer-supplied payment terminals and auditing PCI DSS compliance. These factors should be in scope of the review for their impact on merchant switching behaviour.

We have answered the relevant consultation questions below.

1. Do you agree with our description of card-acquiring services?

The description of card acquiring services provided is accurate and we have no suggested changes to make. Acquirers recruit merchants, including retailers, to accept card payments. An acquirer's core service is to authorise and settle transactions through the card scheme and ensure merchants comply with rules set by the card scheme. Acquirers can offer services beyond this, often leasing payment POS terminals to merchants. The provision of terminals influence merchant decisions on choosing or switching acquirers and are a valid consideration for the review, as detailed further at Q5.

[1] ACS Voice of Local Shops Survey: May 2018

2. Do you agree with the proposed scope of the market review?

There has never been a more volatile period in the costs of payments for retailers and we broadly welcome the scope of this review, which we support focusing on acquirers and payment facilitators. Most retailers will negotiate deals with acquirers that pass on other costs from along the supply chain. Payment facilitators are only used by a very small proportion of convenience retailers.

We understand the need for a focused remit and the indirect coverage of card scheme fees in the scope of this review as a fee passed onto merchants by acquirers. The draft Terms of Reference acknowledges that card scheme fees favour larger acquirers after Visa raised its pence per transaction fees this year[2]. Card scheme fees have risen significantly since January 2017, causing a shift in the proportion of fees included in the MSC for merchants after the interchange fee cap. The Regulator should analyse evidence it receives on card scheme fees through this review and be prepared to use its regulatory powers to remedy potential harm to merchants.

Only 11% of convenience stores have seen reductions in the cost of processing card payments since 2016 meaning it is unlikely cost savings from the IFR have been passed onto retailers[3]. Although the interchange fee cap has been implemented successfully retailers report this has often failed to result in lower MSCs per transaction, indicating that cost savings are either being retained by acquirers or not being passed onto smaller merchants.

Acquirers have continued to use ‘blended’ billing for some retailers processing a relatively low volume of transactions, which has prevented some retailers from observing caps in interchange fees as part of their MSC. These retailers can be told that providing an MSC breakdown or ‘interchange ++’ pricing model is cost-prohibitive. Blended billing is an existing barrier to transparency on fees, making it more difficult for these retailers to compare acquirers. The review should look at whether Article 9 of the IFR on billing is being applied appropriately and if further action is required.

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

3. Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

We agree with the proposal to focus on card acquiring services from Mastercard and Visa specifically. This approach is sensible with 98% of transactions going through Visa or Mastercard and a non-exclusive focus will allow significant evidence on other card schemes

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[2] Merchants set to suffer as Visa announces increases to scheme fees CMPSI. 12 September 2017
[3] ACS Voice of Local Shops Survey: May 2018

to still be considered. There is no realistic alternative to accepting Visa and Mastercard cards due to their duopoly in the card schemes market, all merchants are impacted by the fees they pass onto acquirers.

4. Do you agree with our proposed approach?

We support the approach outlined in the draft Terms of Reference to examining competition in the acquiring market. We are not aware of many alternatives to card acquiring services used in the convenience sector.

The Review should also examine how the fees charged by acquirers have changed since the IFR, including fees outside the MSC. Interchange fees have been capped but card scheme fees are increasing significantly, and retailers are not seeing reductions in the cost of processing card payments. Fees outside the MSC are adding to these costs, ranging from new acquirer authorisation fees, payment gateway fees, PCI compliance fees, setup fees, chargeback fees and minimum MSCs. These costs make it harder for merchants to compare the acquiring market and will influence how acquirers compete for merchants.

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

Switching acquirers is especially complex for unaffiliated independent retailers. These retailers cannot draw on payments expertise or symbol group oversight when comparing the acquirer market. The complexity of fee structures and switching acquirers makes it difficult for retailers to find the best deal for them. ACS conducts a quarterly survey of 1,210 independent retailers, which we will use to gather more data on independent retailers' approach to card acquirers.

5. Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

We welcome the review's specific focus on barriers to switching and comparison for merchants. There are barriers for merchants to compare and switch acquirers which can prevent retailers from getting the most competitive deal. For example, retailers often lease POS equipment from their card acquirer as an additional service in their contract. The IT processes needed to switch POS equipment without restricting the use of card payments for consumers is complex and a material consideration for switching acquirers for retailers.

Switching also requires merchants to ensure they remain compliant with PCI DSS (Payment Card Industry Data Security Standard). Retailers must organise a PCI compliance assessment and self-assess the validation requirements they must achieve to be compliant.

The IT changes needed to be compliant can be substantial and discourage switching acquirers, for example installing firewalls ant anti-virus software, encrypting cardholder data and monitoring networks. The Review should consider these barriers to switching acquirers for merchants, especially in relation to additional services that can be provided by the acquirer.

Retailers will often only consider changing acquirer when their existing contract ends. Fees outside the MSC are not always transparent and can discourage switching and gaining an accurate quote from an alternative acquirer is difficult due to the complexity of fees according to card used. The complexity and poor transparency of merchant bills for card acquiring services means price increases rarely precede market comparison behaviour.

[redacted]

Annex A

ABOUT ACS

The Association of Convenience Stores lobbies on behalf of around 50,000 convenience stores across mainland UK on public policy issues that affect their businesses. ACS' membership is comprised of a diverse group of retailers, from small independent family businesses running a single store to large multiple convenience retailers running thousands of stores.

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

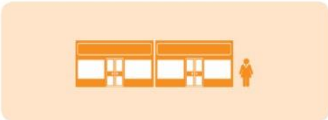
WHO WE REPRESENT

INDEPENDENT RETAILERS

ACS represents 22,397 independent retailers, polling them quarterly to hear their views and experiences which are used to feed in to Government policy discussions.

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

SYMBOL GROUPS AND FRANCHISES



ACS represents 14,659 retailers affiliated with symbol groups. Symbol groups like SPAR, Nisa, Costcutter, Londis, Premier and others provide independent retailers with stock agreements, wholesale deliveries, logistical support and marketing benefits.

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

MULTIPLE AND CO-OPERATIVE BUSINESSES

ACS represents 12,862 stores that are owned by multiple and co-operative retailers. These businesses include the Co-Operative, regional co-operative societies, McColls, Conviviality Retail and others.

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

THE CONVENIENCE SECTOR

In 2017, the total value of sales in the convenience sector was £38bn.

The average spend in a typical convenience store transaction is £6.28.

There are 49,918 convenience stores in mainland UK. 74% of stores are operated by independent retailers, either unaffiliated or as part of a symbol group.

The convenience sector provides flexible employment for around 370,000 people.

24% of independent/symbol stores employ family members only.

20% of shop owners work more than 70 hours per week, while 19% take no holiday throughout the year.

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

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

79% of independent/symbol retailers have engaged in some form of community activity over the last year.

Between August 2016 and May 2017, the convenience sector invested over £858m in stores.

The most popular form of investment in stores is refrigeration.

OUR RESEARCH

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

ACS VOICE OF LOCAL SHOPS SURVEY

Regular quarterly survey of over 1200 retailers, split evenly between independent retailers, symbol group retailers and forecourt retailers. The survey consists of tracker questions and a number of questions that differ each time to help inform ACS' policy work.

ACS INVESTMENT TRACKER

Regular quarterly survey of over 1200 independent and symbol retailers which is combined with responses from multiple businesses representing over 3,000 stores.

ACS LOCAL SHOP REPORT

Annual survey of over 2400 independent, symbol and forecourt retailers combined with responses from multiple businesses representing 6,291 stores. The Local Shop Report also draws on data from HIM, IGD, Nielsen and William Reed.

BESPOKE POLLING ON POLICY ISSUES

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

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

Association of Independent Risk & Fraud Advisors

From: AIRFA
To: cards@psr.org.uk

Subject: Re: Payment Systems Regulator (PSR) Draft Terms of Reference: Market review into the supply of card-acquiring services

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Having read the consultation ToR document, we provide the following initial feedback.

IN THE FOLLOWING SECTION 1.11, we have added (**in blue bold**) additional comments/concerns for consideration / addition.

1.11 A number of these concerns indicate that the supply of card-acquiring services may not be working well for merchants and ultimately consumers. This includes 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)
- **smaller value debit-card transactions actually incurred higher interchange fees and the new regime introduced in 2015, but any savings in interchange fees have in many cases been offset by increased or new acquiring fees and/or increased or new card scheme fees**
- **acquirers have inconsistently applied interchange++ pricing, in many cases the calculation process and reporting are still manual - making it prone to error and harder to track/validate; in other cases acquirers have not fully implemented and/or committed to selling or implementing 'interchange ++ pricing**
- **debit/credit commercial card interchange rates fell outside of the IFR, so remain at much higher levels that the merchants have to pay - often unknowingly. These vary by product type and acquirer, and reporting typically lacks transparency and granularity**
- there is a lack of transparency around the fees merchants pay to accept card payments**, in terms of interchange - what should be and is applied, acquirers' own processing fees, acquirers' exception items and sundry fees (including but not limited to disputes, chargebacks, reporting, POS terminals and PCI protection).**
- there are barriers making 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
- **comparison sites can be misleading and represent an acquirer**
- **merchants are required to engage various service providers and vendors to support the card transaction capture process, e.g. authentication, anti-fraud tools that add to their costs**
- the fees that card scheme operators charge to acquirers (called 'scheme fees'), and the rules they set, favour larger acquirers **(this assumes tiered card scheme pricing, which used to be the case, but also means that new and smaller acquirers may be disadvantaged and less competitive.**
- the scheme fee portion of the fees that merchants pay to acquirers is increasing significantly **and is often simply passed through by the acquirer**
- **acquirers often provide limited customer service support, additional data detail, explanation of service fees; and in general bundle-together all fees for the merchants. This can often appear to merchants to be hiding fees: especially when the acquirer, the merchants and often the card schemes do not understand the fees, when the fees have unclear and complex names and where the fees charged are neither published or readily available.**
- **PCI compliance creates huge overhead for merchants, significant deployment and ongoing costs. Typically, many acquirers have added a PCI compliance/non-compliance fee that is paid to an acquirer for what are 'unclear reasons' and unsubstantiated merchant benefit. These PCI fees appear to be an additional charge that provides no protection and add no further work / effort or service from acquirers. (NOTE: We would contend that these PCI fees will become 'the new PPI' and as such should be investigated; as, a) in the event of a data breach, the consequences for the merchant will be no less harsh and: b) the merchants are led to believe that they are in some way protected from a PCI DSS data security breach and thereby may assume that they need not give appropriate attention to any data security weaknesses).**

1.13 In this section particular attention needs to be made to:

a) Standalone POS terminal/device procurement, pricing, volume discounts, deployment and estate management, insurances, etc.

b) Pricing will often be justified based upon (i) risk costs, (ii) higher sector fraud costs, (iii) chargeback costs - often these are not realised and/or are also charged for separately e.g. chargeback processing costs and/or fines for breaches of fraud and chargeback acceptance thresholds.

IN THE FOLLOWING SECTIONS 2.2, 2.5, 2.11, 2.13, 2.15: we have added (**in blue**

bold) additional comments/concerns for consideration / addition.

2.2 Customers commonly use credit and debit cards to pay for goods and services online, over the phone, by mail order or in store. There are six card payment systems operating in the UK: American Express, **Discover/**Diners Club International, JCB International, Mastercard, UnionPay International and Visa. **Other payment brands also exist and are commonly accepted by merchants and offered in a suite of alternative and emerging payment options (e.f. Alipay / Digital currency acceptance, and other local market schemes).**

2.5 Rather than contract with an acquirer, merchants – typically smaller merchants or in specialist business sectors – can buy card-acquiring services from a payment facilitator. The payment facilitator contracts with **one or more** acquirers who, **through some delegated responsibilities**, retains responsibility for allowing merchants to access the card payment systems.

2.11 In assessing card-acquiring services, we propose to 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. **These are typically contracted separately by the merchant with the individual card payment system, but increasingly are included as part of the same acquirer/merchant contract.**

2.13 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. However, we propose to limit our scope of work to card-acquiring services. It appears likely that, for many merchants, accepting other types of digital payments is not currently a good alternative to accepting card payments. Testing whether merchants have credible alternatives to card-acquiring services will be part of the market review, **especially where the provision of such non-card alongside card payment services presents an uncompetitive advantage for an individual .**

2.15 To do this, we propose to examine how competition in the supply of card-acquiring services operates. This includes examining:

- the nature and characteristics of card-acquiring services
- whether there are credible alternatives to card-acquiring services for some or all merchants (i.e. what are merchants' demand side and supply side substitutes for these services?)
- who provides card-acquiring services and how their market shares have developed historically **(including both UK domestic organisations and those operating cross-border into the UK in accordance with payment scheme rules)**
- how providers of card-acquiring services compete for merchants, and how this process affects merchants
- how merchants buy card-acquiring services**, including the rate cards applied and additional pricing approaches**
- the regulatory and legal framework that applies to the supply of card-acquiring services
- the scope for differentiation and innovation
- **How the PSR / NPSO may wish to encourage and supplement the facility for faster adoption of PSD2 'open-banking' / PISP solutions to develop innovation and competition for the sector: and/or whether there might be sufficient opportunities within these initiatives to commercially (and quickly) evolve more competition and innovation.**

Turning to the specific questions that you posed, albeit there could be further questions and evolution of these questions:

3.6 Question 1

We agree. The market overall is quite complex with many other parties involved, and various parties merging into one another, acquiring businesses in adjacent sectors etc. The question is however, rather academic. One might also assess the risk based functions of an acquirer here to pre-empt defences that you will receive and add that the acquirer also:
- Advances funds to the merchant, prior to settlement being received from the cardholder / issuer (which often the acquirer will mitigate with delayed funding themselves).
- Carries a credit risk that is realised upon failure of merchants when there are pre-payments/ delayed delivery of services (that acquirers and payment facilitators mitigate through retaining deposits from merchants).
- Carries a capital cost that regulators require from the contingent liability rules in Basle III : which applies to banks and is often a) Overlooked/not formalised by bank acquirers in the UK even though it is enforced by many regulators across the EU more assertively; or b) has led to non-bank acquirers emerging. (NOTE: this is a risk based / collapse of market capital adequacy that should also be considered by the PSR / FCA (and enforced) for all acquirers to avoid market failures and unfair competition to arise from new entrants that do not understand the risks that they are carrying.
- Manages customer disputes (chargebacks)
- Manages frauds and potential frauds
- Risk assesses transactions in real time at the point-of-purchase to avoid / deter frauds
- Protects the payment systems from illegal spending, money laundering and other abuses on cards

3.7 Question 2

The focus here is upon Visa and Mastercard for all the reasons explained elsewhere; but other payment schemes need to be included even though they form a small part of the engagement today, the PSR should plan for a wider audience and not allow the other parties to operate outside the oversight of any regulators (NB China Union Pay is the worlds largest processor of card transactions - volumes).

PCI compliance creates huge overhead for merchants/retailers, significant deployment and ongoing maintenance costs, as well as a key and expensive part of third party independent relationships. Additionally, there is typically a PCI compliance/non-compliance fee that is paid to an acquirer - which we are unclear as to what the work carried out is, what the return on this revenue is nor what the real or actual merchant benefit is, It often appears that this is an added overhead from an acquirer that is not something that can be opted-out from or that is understood by merchants. It is very unclear what PCI fees protect, whom they protect or from what. PCI fees are the new PPI and should be investigated as such as a part of this review.

3.8 Question 3

Focus should be on Visa and Mastercard due their dominant market share, but other payment schemes need to be clearly included in any findings even if they are not so involved in the reviews.

3.9 Question 4

Include UK domestic acquirers and those identified as 'licensed cross-border acquirers' as defined by the card scheme rules.

Include an assessment of the 'unique selling points' for each acquirer, including underwriting/onboarding, securitisation/guarantees, pricing model, systems/operations, innovation, payment options, service levels, operational performance, fraud/risk tools, contract terms, etc.

3.10 Question 5

Consideration needs to be given to the full spectrum of acquirer/payment facilitator pricing. Some acquirers will 'lead' their sales / market proposition with 'apparently' competitive 'per-transcation' processing fees; but are then less transparent on periodic charges, sundry/exception item charges, and e.g. POS terminal related fees and charges.

There is a lot more that can be asked, but at this stage this should provide you with a good 'flavour' for some of the things to be investigated; and that we can help you investigate.

Kind regards

[redacted]

British Airways

British Airways - RESPONSE TO PSR CONSULTATION - September 2018

Background

British Airways welcomes this review into card acquiring services and we submit our responses to the consultation questions in **blue** below.

PSR TOR - Consultation Questions

Question 1 Card Acquiring Services

We describe what we mean by card-acquiring services in Chapter 1, paragraph 1.7.

Do you agree with our description of card-acquiring services? YES
If not, please explain:
a. how our description should be altered
b. why you think the description should be altered in this way
Please include any evidence you think is relevant to your response.

Question 2 Scope

We set out in Chapter 2, paragraphs 2.7 to 2.13, the proposed scope of the market review.

Do you agree with the proposed scope of the market review?
YES subject to comment at question 4.

If not, please explain:
a. how the proposed scope should be altered
b. why you think the proposed scope should be altered in this way
Please include any evidence you think is relevant to your response.

Question 3 Mastercard and Visa

We explained in Chapter 2, paragraphs 2.11 and 2.12, that we propose to focus on card-acquiring services for Mastercard and Visa.

Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa? YES
If not, please explain:
a. how the focus should be altered
b. why you think the focus should be altered in this way
Please include any evidence you think is relevant to your response.

Question 4 Our Proposed Approach

We set out in Chapter 2, paragraphs 2.14 to 2.27, our proposed approach to understanding whether the supply of card-acquiring services is working well for UK merchants and, therefore, ultimately consumers.

Do you agree with our proposed approach? YES but we would like to see a focus on card scheme fees (paragraph 2.17) as we believe that this is an area where our MSC costs have escalated in a manner which we cannot easily explain and control. We recommend that scheme fee calculation and reporting are included within the review.

If not, please explain:
a. how proposed approach should be altered
b. why you think the proposed approach should be altered in this way
Please include any evidence you think is relevant to your response.

Question 5 Specific Issues of Interest
We also set out in Chapter 2, paragraphs 2.20 to 2.27, a list of specific issues of interest.

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? NO subject to comment at question 4

If not, please explain:
a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions)
b. why you think these additional issues have the potential to be relevant to the market review
c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review
d. why you think those issues do not have the potential to be relevant to the market review
Please include any evidence you think is relevant to your response.

British Retail Consortium

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BRC response to PSR consultation: Market review into the supply of card-acquiring services – Draft ToR

September 2018

Introduction

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

0.2 All BRC members have an interest in the payment system as end users, in fact retailers are one of the most significant end user groups, processing more than 50 million transactions per day and around £366 billion per year for products & services sold in store, online & over the phone. A priority for the BRC has therefore been to ensure an innovative, transparent and competitive payments market for all retail end users and their customers.

0.3 The BRC produce a Payments Survey on an annual basis measuring the sales volumes and values of different payment channels employed by retailers across the UK. The results from the BRC Payments Survey conducted for the 2017 calendar year, published in September 2018, was completed by retailers that represent almost half of UK retail annual sales turnover (£366 billion in 2017).

Card-acquiring services

Question 1: Do you agree with our description of card-acquiring services?

1.1 Yes.

Scope

Question 2: Do you agree with the proposed scope of the market review?

2.1 No.

If not, please explain: a. how the proposed scope should be altered;

2.2 The market review should be wider in its scope to include card scheme operators, without condition, and to include card issuers.

2.3 In addition to competitiveness within each aspect of the card industry, the market review should consider the impact of the card industry and its relationship with alternative payment methods on competitiveness of the payments industry as a whole.

b. why you think the proposed scope should be altered in this way. Please include any evidence you think is relevant to your response.

2.4 Governments and regulators are rarely quick to respond to market failure.

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2.5 Retailers are today suffering harm from market failures that exist within the card payments industry. At the same time, card payments have become a necessity for most businesses to function day to day, accounting for 76% of all retail sales.

2.6 If the harms of the card payment industry are to be adequately addressed, and in a timely fashion, then this market review must capture all aspects of the card payments industry that contribute to those market failures and the harms they bring.

2.7 There is sufficient evidence today of harm emanating from card scheme operators and card issuers for the PSR to include them within the scope of any market review of the card payments industry.

Card-acquiring services

2.8 The BRC fully support the PSR plans to carry out a market review into the supply of card-acquiring services for all the reasons stated in Chapter 1 of the PSR consultation document under paragraphs 1.11 and 1.14 to 1.16.

Card scheme operators

2.9 The BRC understand the rationale put forward by the PSR to focus "first" on the supply of card-acquiring services, and that card scheme operators have been designated as conditionally "in scope if affect supply of card-acquiring services". The BRC also notes the prospect of a separate market review into "harm that do not relate to the supply of card-acquiring services", that could well indicate a subsequent market review into card scheme operators, as cited in paragraph 1.17 of the consultation document.

2.10 The BRC do not believe that this will facilitate timely regulatory action to address the harms being felt by retailers today from market failures in the card payment industry emanating from card scheme operators.

Pecuniary harms

2.11 The BRC's last annual Payment Survey published in September 2018, covering the 2017 calendar year, shows that card costs began to rise again in 2017 as the benefits of the Interchange Fee Regulation (IFR) have been eroded by increases in other card fees. Retailers spent an additional £170 million to process card payments in 2017, reaching almost £1 billion (£970m). These costs are borne by businesses, large and small, and add to the pressure on companies during a time of industry transformation.

2.12 Our results show that the £170 million increase in Debit Card costs and Credit and Charge Card costs, shouldered by the retail industry, have been driven entirely by increases in scheme fees. Scheme fees increased by 39% in 2017 measured as a percentage of turnover, or by 34% measured by pence per transaction. In fact, the adverse impact of these scheme fee increases has been partly hidden by savings in other aspects of the Merchant Service Charge – possibly down to retailers negotiating better terms with card acquirers following the IFR (many retailers reporting into the Payments Survey report only acquirer fees whereby a breakdown of card fees has not been provided by their card acquirer).

	Pence per transaction			% of turnover		
	2016	2017	Increase	2016	2017	Increase
Interchange fees	9.11	9.05	-1%	0.41%	0.41%	0
Acquirer fees	1.48	1.45	-2%	0.08%	0.07%	-9%
Scheme fees	0.57	0.76	34%	0.023%	0.032%	39%

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2.13 This year's survey also asked BRC members to report the impact of further scheme fee increases that have come into effect in 2018, based on communications received from card acquirers. The table below shows the percentage increase in scheme fees measured in pence per transaction across a range of card categories. The projected scheme fee burden to retailers from domestic transactions alone for 2018 range between 30% and 100%.

	Scheme fees increases 2018 (projected, %)		
	Domestic	**Intra**	**Inter**
Credit Mastercard	69	105	8
Credit Visa	120	273	87
Debit Mastercard	58	518	19
Debit Visa	103	3	101

2.14 Since December 2015, when EU legislation was introduced to regulate interchange fees, card scheme fees have increased by £1bn in the UK (CMSPI) and there has been a proliferation in the range of fees themselves. Regulatory action is needed now to address the problem of soaring scheme fees, which come at a time when the retail industry is facing acute cost pressures elsewhere.

2.15 Card scheme fees – like any other cost of doing business – are ultimately paid for by the consumer. As card fees have increased, retailers are faced with a choice of increasing prices or absorbing costs to remain competitive – which for smaller retailers could mean going out of business.

Non- pecuniary harms

2.16 As stated in the consultation document in Chapter 2, paragraph 2.3, "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." The exercise of these rules by card scheme operators, and their enforcement by card-acquirers, can impose harm on merchants.

2.17 Such rules come in many forms such as PCI-DSS compliance, branding guidelines, equipment checks, or other rules, practices or compulsory operations. A number of BRC members have reported that these rules can be spurious in nature; appear to do little to enhance the operation of the card payment system or the interests of its users; carry unreasonable timetables for implementation; and/or strike a poor a poor balance in the imposition of liability.

2.18 Merchants have no direct relationship with the card schemes, who only contract with acquirers. In this way, merchants are forced to agree to rules that card schemes can change at will, without giving merchants the ability to negotiate rules directly. In turn, card acquirers have arguably developed the fines associated with non-compliance of scheme rules into a pernicious but lucrative revenue stream.

2.19 As an example, in 2017, the BRC expressed concern to the PSR about reports from retailers of rules pushing merchants to accept NFC payments through mobile and other devices. Our members contest that these are in fact different payment propositions to contactless cards, and that merchants must retain the right to refuse mobile payments (which themselves raise new issues for merchants regarding data, refunds, the application of potential new fees, etc).

2.20 In 2015, EuroCommerce expressed concern to the PSR regarding rule changes by Mastercard in which the card scheme imposed a cap on the interchange fee rebate given to merchants following a refund. EuroCommerce provided details of the impact these caps have on merchants and the additional income received by card Issuers in these circumstances. EuroCommerce understand that this practice is ongoing despite its direct contravention of Article 5 of the Interchange Fee Regulation.

The role of card scheme operators in card fees negotiations

2.21 Larger merchants typically negotiate on an Interchange plus+ basis (interchange fee + scheme fee + acquirer fee) where the interchange fee and scheme fee are both set by the respective card schemes (and therefore beyond the control of either the merchant or the acquirer) and the only 'negotiation' revolves around the acquirer fees. However, more recently (typically within the last two years), a host of additional fees have been introduced by the card schemes and acquirers. Some of these fees are mandated by the card schemes, such as caps on the MIFs associated with refunds. Most acquirers pass them on to their merchant customers, so merchants have no leverage.

2.22 Fees vary depending on the type of card, where it's issued, where it's used, and how it's used, with other fees charged or about to come into effect including:

- Authorisation fees (for both sales & refunds)
- PCI non compliance fees
- Minimum activity fees
- Joining fees
- Chargeback fees
- Non Secure transaction fees (eg. MOTO, e-commerce without 3DS and mag stripe)
- Terminal rental fees

2.23 Card schemes have developed new fees as revenue generators that bear little or no relationship to the risk to the network, or the value to the merchant, and arguably circumvent the IFR – primarily cross-border fees.

2.24 For larger merchants, some of these new fees may be negotiable, however smaller merchants or trade associations trying to negotiate a better offer on behalf of their SME base would have little room to negotiate.

2.25 Smaller merchants tend not to negotiate on an interchange plus+ basis preferring instead to agree a 'blended' rate for card-based payment transactions with their card acquirer. They tend to believe it simplifies the reconciliation process and they know in advance exactly how much they will have to pay to accept any given card type (credit, debit etc.), though we believe some merchants on a 'blended rate' still have commercial and international fees separated from their 'headline' rates.

2.26 Occasionally, larger merchants are approached by Visa or MasterCard (normally via their card acquirer) and offered financial incentives. These are typically one-off payments, to participate in marketing promotions or the adoption of new technology such as implementation of fraud prevention measures.

2.27 Another key element arising from any negotiation is when settlement finally takes place. For the larger merchants, settlement is typically made the following day, however for smaller merchants, settlement can be delayed until several days later. Part of this delay or withholding of payment can be attributed to the risk associated with the merchant by the acquirer who may hold back several days value as collateral in case a merchant got into financial difficulty or has a long lead time between taking payment (or a deposit) and fulfilling the final order. This practice is quite common with furniture retailers.

2.28 For 3 party schemes, such as American Express, there is quite a lot of negotiation available. American Express is not as widely accepted as Visa & MasterCard and merchants are able to exploit Amex's objective to increase acceptance and therefore market share, to drive down their cost of acceptance. For a lot of retailers American Express is still considered a discretionary product and not a 'must have' which helps their negotiation tactics. One advantage of American Express acceptance is that once a rate has been agreed it applies to all transactions irrespective of type. No distinction is made between domestic, inter or intra-regional or consumer, commercial or corporate cards.

2.29 Some larger merchants will typically agree a headline 'discount rate' with American Express. This may be higher or comparable to an inter-regional MIF rate set by Visa or MasterCard. However, they could then also negotiate further. For instance, a value rebate based upon the volume and level of completed sales or agree 'marketing contributions' which, when considered alongside the headline discount rate, have the effect of significantly reducing the overall cost of acceptance to the merchant. An example may be a 'headline rate' of 1.2% for acceptance but an annual marketing rebate or achieved sales target may bring the total cost of acceptance down to 0.8% - for all card types, be it consumer, corporate, inter and intra-regional transactions.

2.30 Negotiations with other 4 party schemes, such as JCB or Union Pay, typically take place between merchant and their card acquirer, though other 'contributions', such as marketing or promotional incentives, could be made with the scheme directly. Merchants who have a high tourist footprint (and therefore more likely to be accepting JCB and Union Pay) may have the opportunity to interact with the scheme directly to agree promotions and/or receive marketing support which could help them realise a lower overall cost of acceptance.

Card issuers

2.31 Card issuers have played, and continue to play, a decisive role in generating the present-day situation cited in Chapter 2, paragraph 2.12 whereby "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."

2.32 Consumers have arguably played little or no active role in creating this duopoly, and consumers arguably have little or no interest in the card scheme that they use to pay for goods and services. Rather card issuers and card acquirers have generated this duopoly respectively by the cards they issue to their account-holders and the cards they accept on behalf of the merchant customers.

2.33 Insofar as this duopoly in card schemes today creates the conditions for harm and abuse of dominant market positions, then the market review should consider the role of card issuers in contributing to and sustaining the situation, as well as the role card issuers could take in redressing the situation.

2.34 The PSR might look to Interac in Canada, which serves as the national debit card system. A similar national debit card scheme in the UK could potentially deliver better outcomes for end-users of the payments system. There are over 59,000 automated teller machines that can be accessed through the Interac network in Canada, and over 450,000 merchant locations accepting Interac debit payments.

Visual and electronic identification

2.35 The right of merchants to refuse different card categories is enshrined in the PSR. Some retailers may decide not to accept commercial cards which are not regulated by the IFR, not subject to the interchange fee caps and so continue to be relatively expensive for merchants to process.

2.36 The IFR obliges card issuers to make their cards visually and electronically recognisable across each of the four card categories: credit, debit, prepaid and commercial. Electronic identification is key here as merchants rarely come into contact with the card. Card issuers appear to have failed in this obligation, meaning that merchants are unable to identify and refuse certain card categories.

2.37 In 2017, the BRC proposed that the PSR make a recommendation to HM Treasury for the immediate, emergency designation of commercial cards under IFR rules. This would be a temporary relief measure for merchants in light of the card issuers' failure to meet their obligations under the IFR, mitigating against the adverse impacts to merchants that wish to refuse relatively expensive, unregulated commercial cards.

The impact of the card industry and its relationship with alternative payment methods on competitiveness of the payments industry as a whole

New payment methods

2.38 Recent political and regulatory measures designed to facilitate competition in digital payments have some way to go, and their likely impact is unclear. The movement to a New Payments Architecture (NPA) in the UK under the New Payment Systems Operator (NPSO) will take time to deliver and it is not immediately obvious if and how these developments will drive competition in retail payments. Payment Initiation Services (PIS), boosted by the revised Payment Services Directive (PSD2), appear to be more promising and generating interest from a range of stakeholders that wish to see enhanced competition in payments.

2.39 Much more remains to be done before PIS can compete with card payments on an equal footing, especially in the face-to-face environment whereby PIS is unable to operate with the advantages of card payments for low-value contactless transactions in which card transactions below £30 require no authentication, benefitting from an unlevel regulatory playing field.

2.40 Giropay in Germany and iDEAL in the Netherlands operate in a similar way to how PIS could operate in the UK and give a useful barometer of the popularity of these payment methods in markets where the political and regulatory framework supports their development. iDEAL is the most popular method for online payments in the Netherlands, well beyond credit card use, and was used for 54% of all Dutch online payments in 2014.

Relationship with cash

2.41 The primary driver for the decline in cash is consumer preference, however the decline is exacerbated by perverse incentives related to the card schemes' "war on cash" and factors such as the closure of bank branches and ATMs, where retailers and their customers both withdraw and deposit cash.

Question 3: Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

3.1 Yes.

Our proposed approach

Question 4: Do you agree with our proposed approach? If not, please explain: a. how proposed approach should be altered; b. why you think the proposed approach should be altered in this way. Please include any evidence you think is relevant to your response.

4.1 No, for reasons of scope and the ability of this market review to adequately address the harms of the card payments industry in a timely manner (as set out in our response to consultation question 2 above). However, insofar as the market review relates to card-acquiring services – yes, the BRC agree with the PSR's approach.

Question 5: Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? If not, please explain: a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions); b. why you think these additional issues have the potential to be relevant to the market review; c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review; d. why you think those issues do not have the potential to be relevant to the market review. Please include any evidence you think is relevant to your response.

5.1 The BRC support the inclusion within the market review of each of the issues listed under "Specific issues of interest." There are many additional issues that the BRC believe should be considered that are relevant to the market review. These are set out in our response to consultation question 2 above.

[redacted]

[redacted]

Cardswitcher

From: [redacted]
To: cards@psr.org.uk
Subject: Market review into the supply of card-acquiring services - Draft Terms of Reference

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Dear Sir/Madam
I refer to your consultation of the aforementioned review and note below response to the questions. We have only commented on 3 of the 5 questions posed.

[redacted] Cardswitcher.co.uk, the UK's first (and possibly only) price comparison website for merchant acquiring. We founded the business in 2013 in response to what I saw as a market gap for merchants to obtain transparent, comparable pricing for merchant services. The business has had moderate success over the last 5 years, with our website receiving around 10,000 visitors per month.

We partner with largely ISO's who are prepared to publicly disclose detailed pricing that they are prepared to offer to merchants. We have historically had discussion with many of the main acquirers as to their involvement with our website however these discussions have fizzled out due to the acquirers reluctance to publish detailed pricing terms (due to the point noted in our response to Question 5).

[redacted]

One of the reasons noted for your review is the belief that acquirers have failed to pass on the benefits of the IFR caps. We have commented on this on multiple occasions in our website blogs as the evidence is very clear that these benefits were not passed on in full. We have studied price change letters issued by various acquirers during 2015/2016 and the picture that clearly emerged was whilst the increases in the cost of debit processing were passed on in full (plus additional margin in some cases), the reduction in credit card processing (upwards of 0.5%) were largely retained by the acquirers, with only c.1/3 of the benefit being passed to merchants in the instances we reviewed.

Furthermore, the accounts of WorldPay plc clearly demonstrate the additional profit that was generated by these interchange movements. It may be unfair to single out Worldpay in this respect however they were the only "pure play standalone" acquirer in the UK who's financial filings give sufficient disclosure for such analysis. I am sure that if such financial data were made available for other acquirers then a similar picture would emerge. Again this is something we previously analysed on our blog.

The final point I would make is that whilst we can point to an abundance of service providers in the acquiring market (acquirers, payment facilitators, ISO's, etc), pricing is largely set by 2 acquirers. It is difficult to accept the argument that this abundance represents efficient competition when 2 acquirers alone (WorldPay and Barclaycard) dominate the market by virtue of their legacy market share. These 2 acquirers are typically price setters for the entire market.

I welcome your review and look forward to hearing your findings.

Regards

[redacted]

[redacted]

Response to Questions

Question 2
Do you agree with the proposed scope of the market review?

Response :
Provision of terminals is noted as in scope only if it affects the supply of card-acquiring services. We believe terminal provision should be fully in scope and should be a core to the review.

The reason for this is that, for SME's who rent terminals, the terms of the terminal rental contract (specifically termination fees and the duration of a minimum contract term and its rollover) can be sufficiently onerous to dis-incentivise switching of their acquirer. Consequently, whilst the merchants' acquiring contract may permit the merchant to break that contract (if for example the acquirer increases fees), the terminal contract does not permit such a break. So, an acquirer can hike a merchant's card processing fees by say 20% and grant the merchant a break right by virtue of a material contract change, but if the terminal contract termination costs are so high then the merchant can never realistically exercise that break and is therefore stuck with whatever processing terms the acquirer decrees.

The scope of the review should consider whether there needs to be linkage between the terminal rental contract and the merchant acquiring contract where the provider is the same party, or where the terminal contract is an effective barrier to switching. In doing so there also needs to be recognition that many ISO's (who bring necessary competition to the market) survive by virtue of the commercial benefits of a 3-4 year terminal contracts. One needs to bear in mind the benefits of the competition these ISO's bring to the market.

Question 3
Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

Response :
The logic for focussing on MasterCard and Visa is sound however to the extent the outcome of this review were in some way to cap or limit the charges that could be applied in acquiring those cards, one must also be sure to create a level playing field for other card types. Currently the cost of accepting an AMEX card is upwards of 1.8%, significantly higher than costs of acceptance for Visa/MasterCard. Further moves to widen that gap would be unfair. Many merchants feel the need to offer a wide range of payment methods as they believe it is detrimental to their business not to do so. As such they feel compelled to accept American Express and other non-Visa/Mastercard payment types.

Question 5
Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

Response :
The commercial pricing model for acquiring services is well established in that merchants

are offered low rates to switch providers then those rates are increased gradually year on year. Switching activity is relatively low as merchants have proven relatively price inelastic when presented with sub 10% price increases year on year. Consequently the average pricing for existing clients (the backbook) can be 30%-40% higher the pricing offered to new clients (the frontbook). The review should perhaps try to gather evidence of such divergence in pricing approaches for new and existing customers as this is really the hard evidence that supports the premise that there are barriers to switching.

Ciceroni

From: [redacted]
To: cards@psr.org.uk
Subject: Draft TORs

Dear Sirs,

One issue I believe need to be studied is that as someone who uses cards services as a Tour operator - we have no way of knowing what we are going to be charged by the merchant provider for the processing the card in advance. Yes we know what the fees will be - but some cards can be personal and some can be corporate with now ay of knowing. I know this is a business to business cost - but if I was a consumer I would be entitled to know the cost of the transaction BEFORE I process the card/use the service.

As we can not pass on fees for using Credit Cards anymore we now do not accept Credit Cards for balance payments (yes for deposits) as a tour operator and are now encouraging our overseas clients to use services such as TransferWise. For our UK clients we are encouraging cheques and bank transfers. [redacted]

Thank you.

[redacted]

[redacted]
www.ciceroni.co.uk

CMSPI

Payment Systems Regulator Card Acquiring Consultation Response

September 2018

About CMSPI

CMSPI is an international, independent payments consultancy that has worked with hundreds of leading international merchants to develop optimal payments strategies.

As an independent consultancy, we have no affiliation with any supplier globally. We work with some of the largest merchants in the world and are proud to be considered merchant champions and trusted impartial advisors to our clients.

Consulting with merchants across the globe, we have offices in Europe (UK), Singapore and the U.S., and work across all areas of global consumer payments. We are experienced internationally, and work with many multinational merchants with complex cross-border arrangements.

Our team of analysts and consultants has over 25 years' experience of supply chain market intelligence and an ongoing visibility of true supplier costs. Our knowledge, in-depth market insights, and benchmarking data, enables us to give our clients significant competitive advantage in complex and highly concentrated supplier industries. We use that knowledge to calculate the complex, underlying charging structures behind the fees merchants pay and to help them reduce those costs and optimise arrangements.

We have a unique visibility into the fees merchants pay globally to accept card payments and process cash transactions.

Executive Summary

There are a number of fundamental issues with the UK card industry that we would like the PSR's review to address.

We think the most important of these is in relation to the scheme fee increases we are currently seeing for our clients, and we believe the review should directly include a review of scheme fees. CMSPI estimates that UK merchants have paid an addition £1 billion in scheme fee in less than two years. This is proving a particularly large burden on smaller merchants, as the British Independent Retailers Association (bira) will atest.

Indeed, Visa and Mastercard have both told investors that they do not see the PSR's review as a threat to their business, and their share prices appeared to be unaffected by the news.

The bottom line is that the card schemes have always, and continue to, dominate the Merchant Service Charge (MSC), be it through interchange or scheme fees.

There are other issues for the PSR to consider. We would also like to have seen a review of interchange fee caps included within the PSR's review. The UK is by far Europe's largest card market with significant economies of scale, but has not followed many of its peer group in exercising its right to impose interchange caps below those imposed by the Interchange Fee Regulation (IFR). Additional interchange savings would benefit merchants and consumers.

In terms of the acquiring market, we are pleased that the PSR is directly looking at unbundling and switching, as we have identified issues here that are affecting the entire merchant community. In this document, we provide evidence that we hope will support the PSR's review.

Finally, we would have liked the PSR's review to encompass the LINK and American Express networks, as we maintain that there are competition issues that need addressing.

Introduction

CMSPI welcomes the opportunity to respond to the PSR's consultation on merchant acquiring services.

In June 2018, CMSPI responded to HMT's consultation on "Cash and Digital Payments in the New Economy"[1]. In this document, we explained that we support a pluralistic payments environment because we see competition between payment methods as key to driving down costs for merchants, and therefore, that we don't support the movement towards a cashless society.

In our response, we noted that the UK sees a higher rate of Visa and Mastercard penetration than any other major economy. This deeply entrenched position has led to increases in two of the three components of the card merchant service charge (MSC). First, interchange fees became a multi-billion-pound burden for UK merchants and, now that credit card interchange fees[2] have been lowered by the European Commission's interchange fee regulation (IFR), we are seeing substantial increases in scheme fees.

Indeed, these fees have been the source of litigation. In July 2018, the UK Court of Appeal ruled that multilateral interchange fees (MIFs) create a restriction of competition in the acquiring market, supporting an earlier decision by the European Court of Justice (ECJ): "*Under EU law, article 101(1) is infringed in circumstances where the MIF gives rise to a price floor in the acquiring market below which the fees charged to merchants cannot be driven*".[3] Scheme fee increases exacerbate this problem.

The third core component of the MSC is the acquirer margin. Over the course of several years we have noticed issues with the cost of switching, while the introduction of the IFR has created issues for merchants charged using bundled structures.

In this document, we will outline the issues with all three components of the MSC – interchange, scheme fees and the acquirer margin – and suggest how the PSR could use this review as an opportunity to address these issues.

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[1] https://cmspi.com/eur/resources/cash-and-digital-payments-in-the-new-economy-cmspi-consultation-response/

[2] Average debit card interchange fees have actually increased in many countries due to the conversion from a per item to an ad-valorem fee structure, including in the UK

[3] https://www.judiciary.uk/wp-content/uploads/2018/07/mastercard-appeals-judgment.pdf

Question 1

Do you agree with our description of card-acquiring services? If not, please explain: a. how our description should be altered b. why you think the description should be altered in this way Please include any evidence you think is relevant to your response.

As we note in our response to question 4, we think it is positive that the PSR has identified unbundling and switching as issues merchants face in the card acquiring market. In questions 2-5 we will discuss additional areas that we feel the PSR's review should include.

Question 2

Do you agree with the proposed scope of the market review? If not, please explain: a. how the proposed scope should be altered b. why you think the proposed scope should be altered in this way Please include any evidence you think is relevant to your response

CMSPI believes there should have been a wider review of the four-party card system. There are two major areas we think should be directly included within the scope of this review – scheme fees and interchange caps.

Scheme Fees

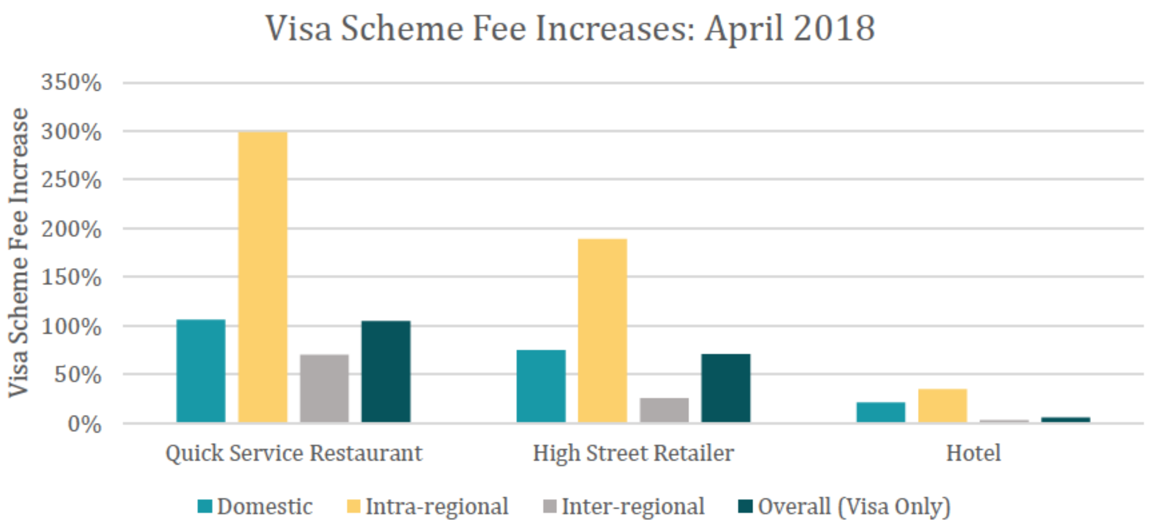
We have seen a circa 30% increase in Visa scheme fees from January 2017 followed by a circa 60% increase in April 2018. This is supported by evidence from the British Retail Consortium (BRC)'s annual payment survey published last year, which suggested annual scheme fee increases of 31.5%[4]. This means that average Visa scheme fees in the UK have more than doubled since 2016.

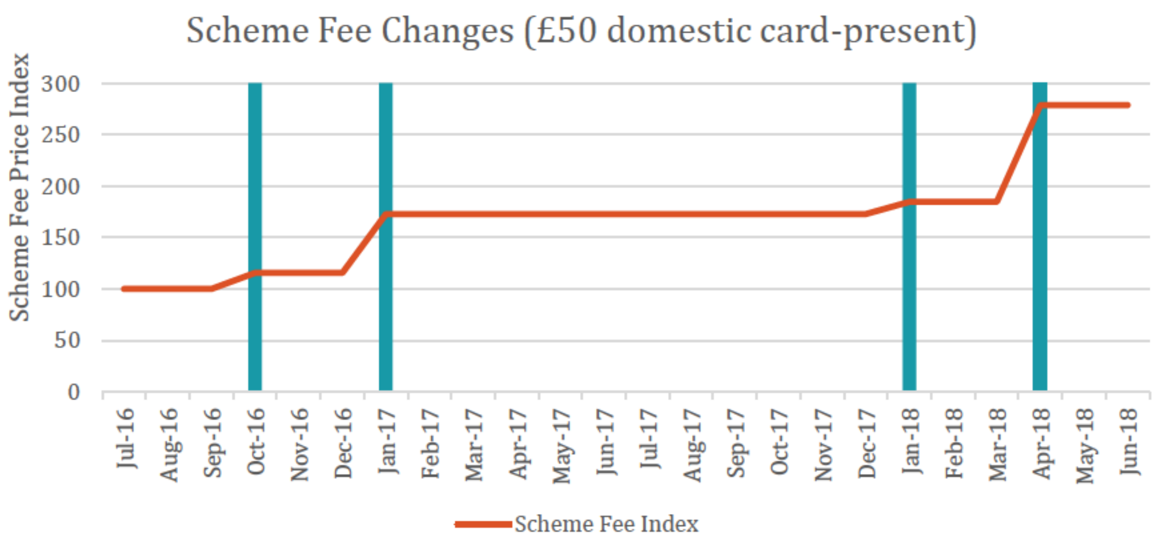
The January 2017 increases affected the ad-valorem (or percentage) element of scheme fees[5] and was particularly damaging for merchants with high average transaction values. Meanwhile, the April 2018 increases increased the per item component of the scheme fee and has been particularly harmful for merchants with low average transaction values (see *Visa Scheme Fee Increases – April 2018* below).

> *"Visa increased scheme fees April 2016, January 2017, April 2018. Total impact £840k. Mastercard increased scheme fees in April 2016, January 2018. Total impact £280k. Further increases due in July 2018 yet to be fully communicated but estimated impact of £80k. Mastercard cap on refund interchange at 3.5p. £100k impact. Mandated authorisation of refunds. Impact £50k. Higher chargeback fees."*
> EuroCommerce Survey Respondent - Large Retailer (UK)

> *"Visa increased scheme fees in October 2017 and April 2018 which impact our business by increasing costs annually by €307k and €305k respectively. Mastercard will increase their scheme fees in July 2018 by €3k. There has been an increase in costs of €580k per annum for no additional benefit and this is a cost that is borne by the business."*
> EuroCommerce Survey Respondent - Retailer (UK)

[4] https://brc.org.uk/media/179489/payment-survey-2016_final.pdf
[5] There were also increases in inter-regional (i.e. non-EU cardholder) scheme fees





Substantial fee increases were seen as inevitable following Visa Inc's purchase of Visa Europe for €16.5 billion (potentially rising to €21.2 billion) in 2016[6]. Visa Europe was owned by the banks and acquirers that used the network[7] while Visa Inc is a NYSE-listed entity with operating margins in excess of 50%[8]. Indeed, soon after the deal was announced, then Visa Inc CEO Charles Scharf told investors that there was '...an opportunity to expand yields in Europe as we align the economic model with the value we bring and genuinely evaluate pricing from the perspective of a commercial enterprise rather than a member-owned association.'

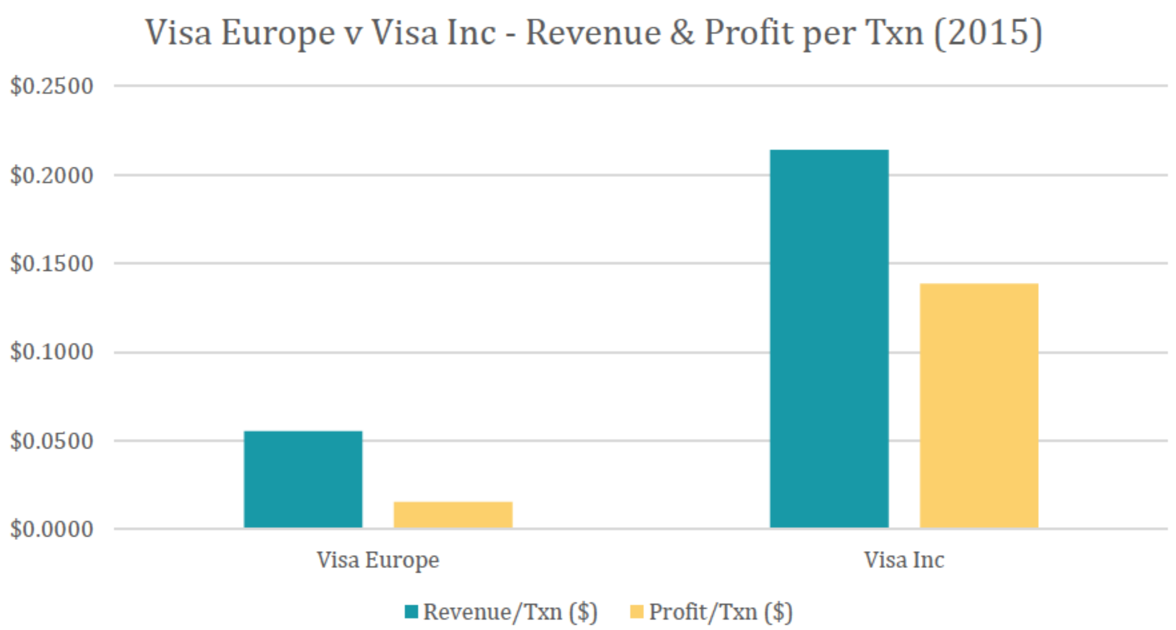
[6] https://www.telegraph.co.uk/business/2016/06/03/visas-165bn-merger-with-visa-europe-gets-the-green-light/
[7] https://www.visaeurope.com/newsroom/news/vi-to-acquire-ve
[8] https://investor.visa.com/SEC-Filings/

Visa Inc paid a premium of 70x earnings to acquire Visa Europe, and perhaps saw the post interchange-regulation period as the perfect time to recoup this income, as they did in the United States and Australia. Visa Inc had a revenue per transaction of around four times Visa Europe's in 2015, and the majority of this revenue differential was profit (see *Visa Europe vs Visa Inc. – Revenue and Profit per Txn* graph below).

We understand that more scheme fee increases are forthcoming. As recently as July 2018, current Visa Inc CEO Alfred Kelly told investors: "We have said before that we think that there is real pricing opportunity as we look at Europe over the next number of years. And we've started to take some of that pricing and we'll continue to over time". We have been informed that Visa will increase fees from October 2018, with further eCommerce increases next year.

Scheme fee increases are not confined to Visa - Mastercard increased its eCommerce fees in July 2018.

Scheme fee increases are also being keenly felt by smaller merchants. The British Independent Retailers Association (bira) are currently seeing dozens of their members write to them every week to complain about fee increases, out of a total membership of 6,000.



CMSPI has observed that UK scheme fees typically constituted only 10% of the merchant service charge (MSC) for large merchants before the interchange fee regulation (IFR) caps entered into force but is now 30% and would be more than half (51%) of total card fees if US level scheme fees were introduced in the UK.

We understand that scheme fees are being looked at by the European Commission as part of its wider review into the IFR. There is an anti-circumvention clause within the IFR[9] and this, combined

[9] Article 5 - http://data.consilium.europa.eu/doc/document/ST-5119-2015-INIT/en/pdf

with the IFR's impact assessment[10], could lead to regulation but it will be challenging and time consuming Therefore, the PSR should not see this review as a remedy and should address UK scheme fee increases. Scheme fees have been indirectly included within the scope of the PSR's review, but this means that addressing the issue could take a long period of time and we feel this is unnecessary.

Indeed, Visa and Mastercard do not seem to be viewing the PSR's review as a threat to their business. Upon news of the Consultation, Visa Inc CEO Alfred Kelly told investors[11]:

"This is very early. It's not unusual at all for the regulators in the UK to be looking at any and all aspects of payments. This particular piece is focused on acquirers; it's not focused on Visa. And I think it's safe to say that we will be watching it closely, certainly providing whatever support we need to provide to acquirers as they address any queries from the PSR in the UK.

But at the moment, again, this is just very early days and there's really nothing to report. There's no real clarity about what, if anything, they're specifically looking at. Sometimes these things open as just simple queries as to wanting to get information. And other times they result in action and sometimes they result in inaction, and we'll just got to watch this and see how it plays out".

Additionally, Mastercard CEO Ajay Bangar said[12]:

> *"…the UK PSR's report, by the time they actually get together, analyze all the aspects of the UK card acquiring services and their practices, that's going to take a fair amount of time to work our way through it.*
>
> *Look, what typically the PSR does is they will do a broad assessment of the market, and they'll figure out is it working properly? Is it delivering the outcomes they want? And they're going to look at all the range of factors related to the services which acquirers provide to merchants. And I think this whole thing is a year to two years in the making.*
>
> *So then to get to that, I'm sure they'll also want to talk to us about – even though we're not an acquirer, they'll want to talk to us about the role we play in that whole ecosystem, and that's a good thing. I actually believe that transparency and a dialogue around the role we play, the role acquirers play in the ecosystem is great in a market like the UK."*

In lieu of the evidence presented above we believe that, at the very least, this issue requires a thorough review by the PSR. There are a number of possible solutions that the PSR may wish to consider:

1) Introduce a cap on scheme fees in much the same way that interchange fees are capped

2) Regulate the total fees paid by the acquirers - i.e. the sum of scheme fees and interchange fees.

3) Mandate that scheme fees charged to issuers are identical to scheme fees charged to acquirers. Our understanding is that historically, acquirer and issuer scheme fees in Europe have been similar. However, under a profit-driven model like we now see at Visa, there will always be an incentive for

[10] http://ec.europa.eu/internal_market/payments/docs/framework/130724_impact-assessment-full-text_en.pdf
[11] https://seekingalpha.com/article/4190232-visa-v-q3-2018-results-earnings-call-transcript?part=single
[12] https://seekingalpha.com/article/4190644-mastercard-ma-q2-2018-results-earnings-call-transcript?part=single

card schemes to keep issuer scheme fees low as they want their badge on the card, while there is less of an incentive for schemes to incentivise merchant acceptance.

Interchange Fee Regulation (IFR) Caps

IFR caps entered into force from 9th December 2015 and applied limits of 0.2% of the transaction value for debit cards and 0.3% for credit cards. However, these caps are a ceiling but not a floor, and individual Member States have the right to apply lower fees. There are three areas where we particularly feel that the PSR has reason to consider exercising this right:

A. Debit Cards

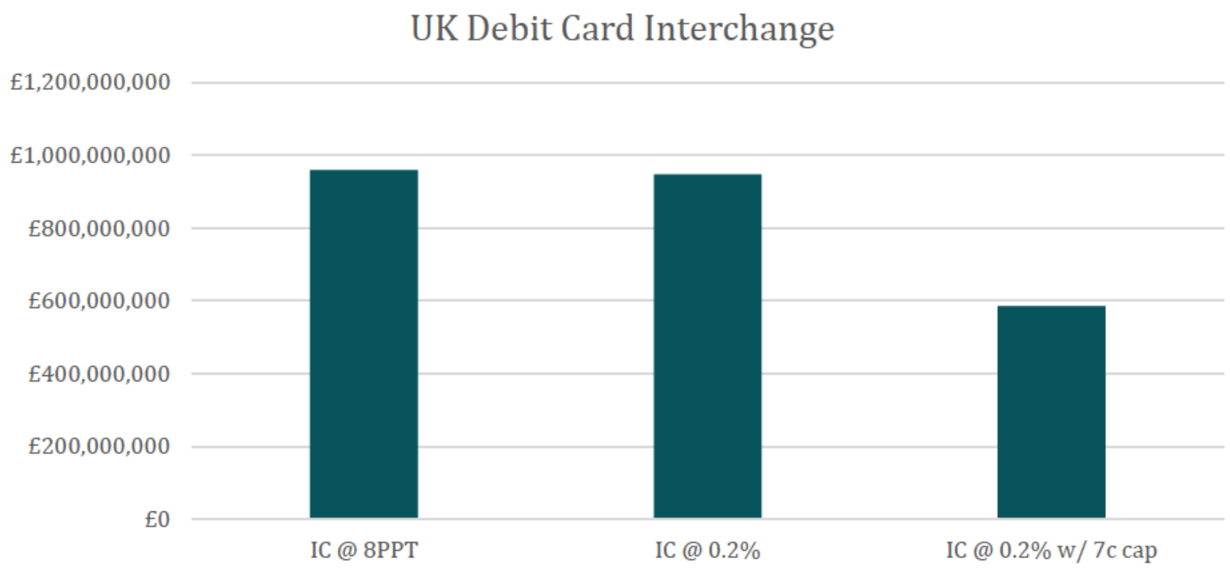
For debit card transactions, many other European countries have decided to exercise their right to impose lower (and quicker) caps than the IFR mandates (see table below), but the UK remains one of the only major EU economies to not do so.

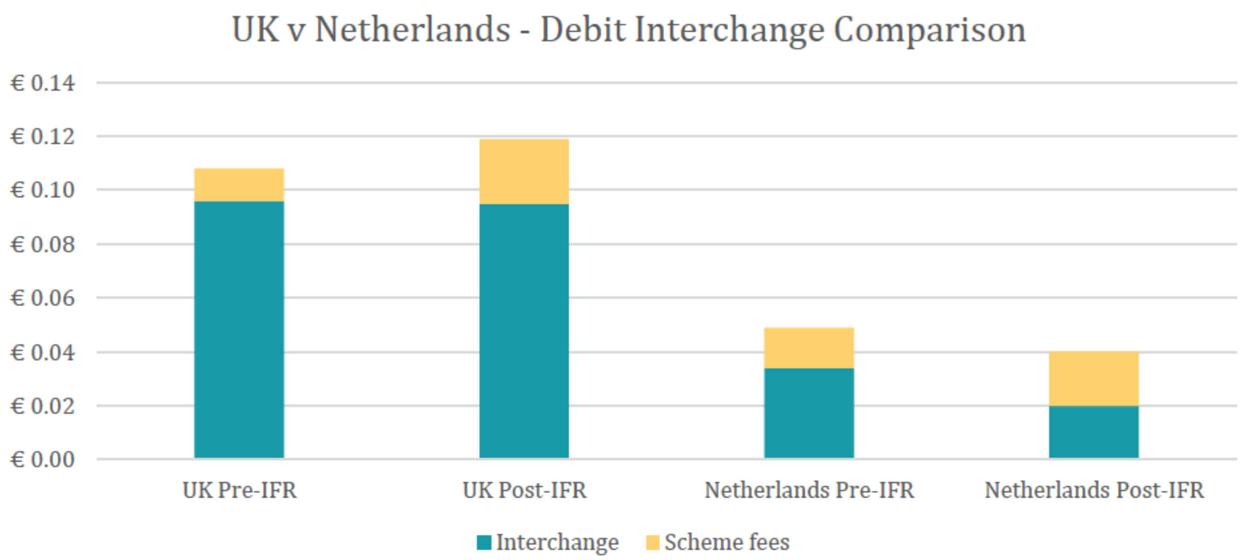
Country	Debit Card Interchange
Ireland	0.105% capped at €0.50
Spain	0.20% capped at €0.07
Denmark	Zero interchange debit scheme
Norway	Zero interchange debit scheme
Netherlands	Flat €0.02
Belgium	0.20% capped at €0.056
Malta	0.15%
Germany	Bilateral Girocard fees
Italy	0.18% < €5 (and €0.07 cap for Bollettini)
Poland	IFR Interchange caps from 2014
France	IFR Interchange caps from 2013
Hungary	IFR Interchange caps from 2014

In the UK, domestic face-to-face Chip & PIN Visa debit transactions (which constituted the majority of UK debit card transactions) had an interchange fee of 8 pence per transaction (PPT) prior to March 2015. The UK debit card average transaction value (ATV) is around £40[13] so the conversion of Visa debit interchange fees from 8PPT to 0.2% under the IFR has provided virtually no net debit card interchange benefits for UK merchants[14]. All there has been is a transfer of costs away from low ATV merchants towards high ATV merchants.

[13] https://www.ukfinance.org.uk/statistics/cards/

[14] 0.2% of £40 is 8p, so on average debit card interchange fees in the UK are virtually unaffected by interchange regulation





Other jurisdictions have introduced low debit card interchange fees. In August 2018, the Australian Productivity Commission submitted a proposal to the Australian government to abolish interchange fees altogether[15], while Canada[16] and Norway[17] both have local debit schemes with zero interchange fees. Furthermore, debit card interchange caps are high in the United States but a "no network exclusivity" routing provision means at least two unaffiliated networks need to be included on every debit card, giving merchants the opportunity to negotiate lower fees than this cap[18]. Finally, China

[15] https://www.pc.gov.au/inquiries/completed/financial-system#report
[16] http://interac.ca/en/current-fees.html
[17] https://www.finansnorge.no/contentassets/bd8444ec76ed4d688353e43d5f5e18c3/questions-and-answers1.doc
[18] Page 698 - https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf

has regulated card fees[19] and Japan still has very low debit volumes[20]. This suggests that the UK is lagging behind on debit card fees not just in Europe, but globally.

In an earlier iteration of the IFR, 7 eurocents per transaction (circa 6PPT) cap was included in addition to the 0.2% interchange fee[21]. This was removed before the final compromise text was published but is being looked at as part of the European Commission's ongoing four-year review into the effectiveness of the IFR[22].

We would like the PSR to consider introducing a per transaction cap on debit card interchange fees to prevent merchants with high average transaction values (ATVs) paying higher interchange fees than they did pre-IFR, and the PSR may wish to apply the 7 eurocents cap in the UK, as it has been in Spain (see *UK Debit Card Interchange* graph above). We can see from this graph that this would generate nearly £400 million of annual interchange savings for UK merchants.

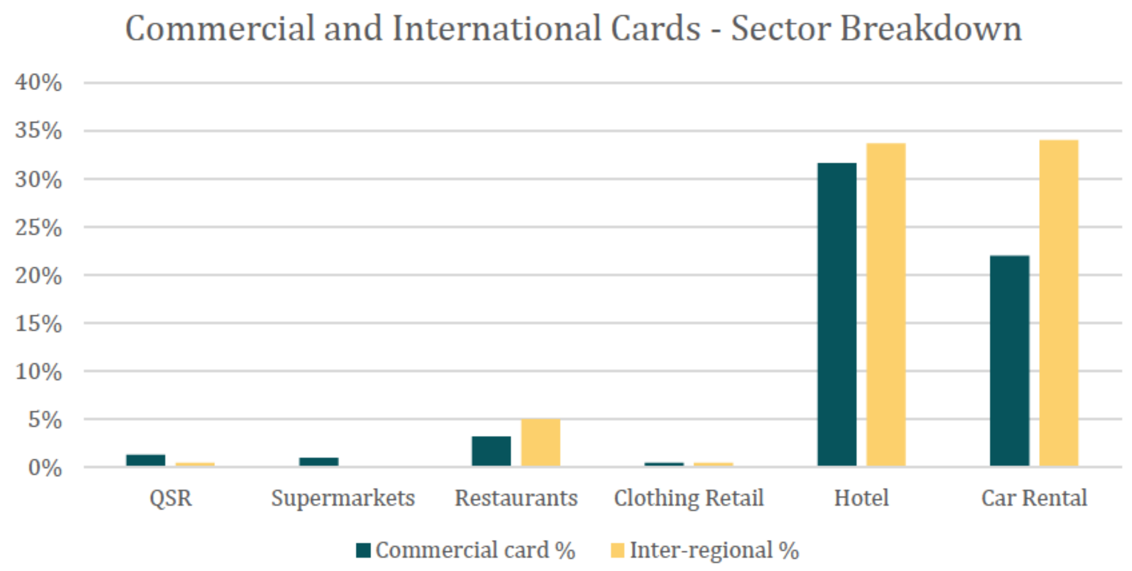
B. Commercial Cards

Commercial cards were excluded from the IFR. Current commercial card interchange fees average around 1.5% and place a particularly significant burden on merchants in the hotel, airline, car rental and wholesale sectors, where commercial cards typically constitute upwards of 30% of total card spending (see *Commercial and International Cards - Sector Breakdown* below).

It could be argued that the relaxation of the "honour all cards" rule included in Article 10 of the IFR allows merchants to avoid these interchange fees by refusing to accept commercial cards. However, commercial card transactions have a high elasticity of demand (see Amex section) so this is difficult in practice. Indeed, EuroCommerce's 2018 survey suggests that 84% of EU merchants would not surcharge due to customer service or competition reasons, while only 6% are surcharging commercial cards due to cost.

Commercial card interchange is another area being reviewed by the European Commission. We do not see a reasonable justification for excluding commercial cards from the regulation, and the relaxation of the honour all cards rule has not provided sufficient respite for merchants, so we would like the PSR to consider extending the current consumer card interchange fees to commercial cards.

[19] https://www.reuters.com/article/china-cenbank-idUSL3N16Q2TM
[20] https://asia.nikkei.com/Business/Banking-Finance/Debit-card-use-in-Japan-nearly-doubles-in-2-years
[21] Meaning that the applicable interchange fee would have been the lower of 0.2% and 7 eurocents for any given transaction
[22] http://data.consilium.europa.eu/doc/document/ST-5119-2015-INIT/en/pdf



C. Interchange Litigation

On 4th July 2018, the Court of Appeal ruled in favour of the merchant claimants in their litigation against Visa and Mastercard for levying illegal MIFs in violation of Article 101 of the Treaty of the Functioning of the European Union, bringing together three contrasting judgments to date[23]. There are elements of the case still to be resolved - Visa and Mastercard have sought permission challenge this judgment in the Supreme Court[24] and aspects of the case relating to exemptions have been referred to the Competition Appeal Tribunal for reconsideration.

We believe that the PSR should be closely monitoring the outcome of these cases and should the Supreme Court and the Competition Appeal Tribunal rule in the merchants' favour and determine that interchange fees are wholly or partially illegal, then we would expect them to be amended accordingly in the UK.

Impact on High ATV Merchants

The combined impact has been particularly strong on UK merchants with high ATVs (see *Average Visa/Mastercard Fees – 2018* below). We have identified six main factors causing this:

High ATV merchants tend to see…

1. High commercial card usage
2. High international card usage[25]
3. A large impact from the absence of a per transaction debit card interchange cap
4. High Amex usage – Amex MSCs are high and unregulated (see our response to Question 3)
5. Heavy scheme fee increases – high ATV merchants experienced a large hit in January 2017
6. The effects of a volume migration from debit cards to credit cards with the surcharging ban under Payment Services Directive II (PSD2) across Europe from January 2018. This removed

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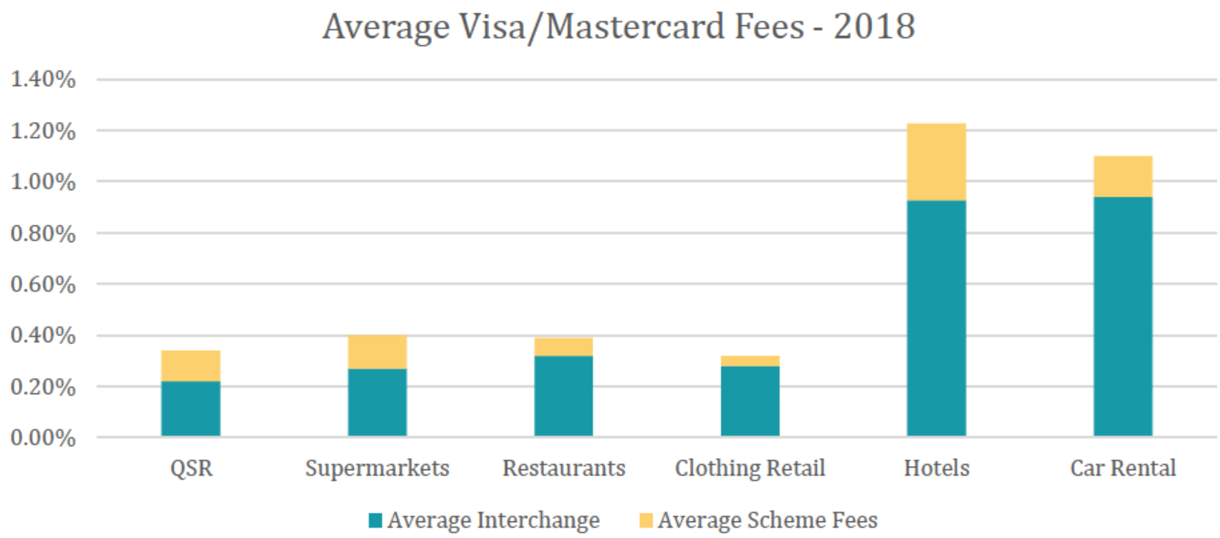
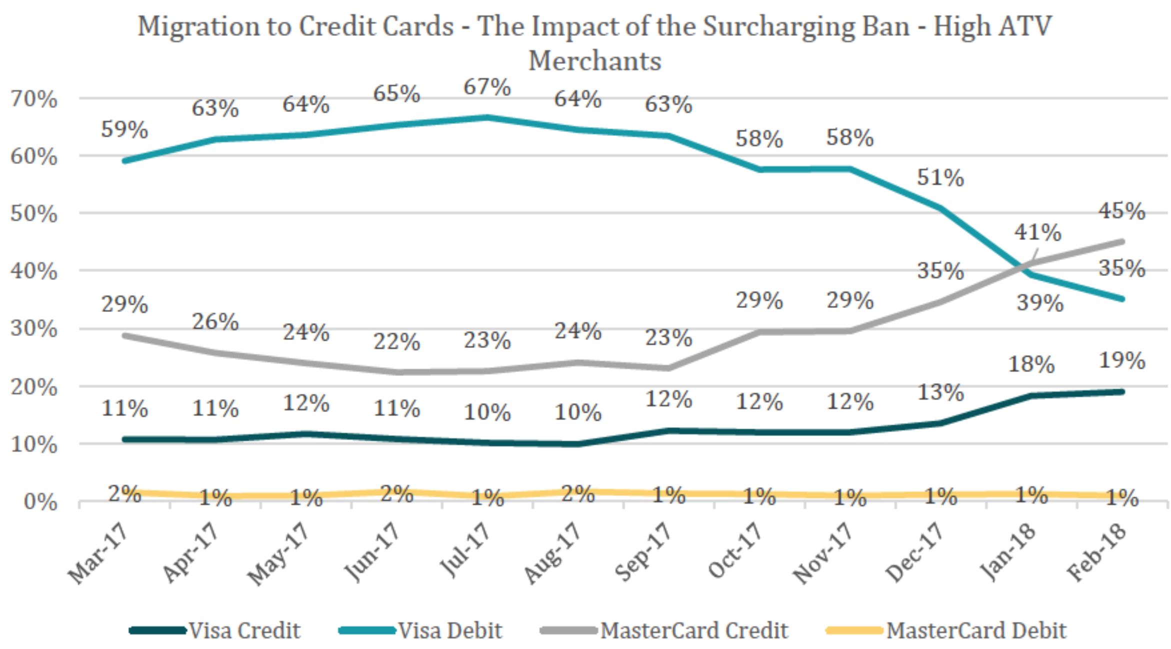
[23] http://1exagu1grkmq3k572418odoooym-wpengine.netdna-ssl.com/wp-content/uploads/2018/07/MasterCard-Appeals-Final-Hand-Down-Judgment.pdf
[24] https://www.law360.com/articles/1072103/visa-mastercard-take-swipe-fees-battle-to-uk-s-top-court
[25] Note that inter-regional interchange fees are also being addressed by the European Commission - https://uk.reuters.com/article/uk-eu-visa-antitrust/visa-to-defend-tourists-card-fees-at-eu-antitrust-hearing-idUKKCN1GA2FU

merchants' primary steering mechanism. Please see *GBP Card Split by Month* graph below, an example taken from CMSPI's client base.

7. The migration of large issuing banks such as TSB and Santander from Visa debit to Mastercard debit cards[26] should lead to scheme fee increases for high average transaction value merchants. This is because Mastercard's debit card scheme fee structure appears to have a larger ad-valorem element.





Many of the issues identified above have been cited by Which?, the UK's largest consumer group, in its consultation response to HMT[27].

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[26] https://www.ft.com/content/7d6f5e48-4d53-11e8-8a8e-22951a2d8493

[27] https://www.which.co.uk/policy/money/2813/which-responds-to-the-governments-review-of-cash-and-digital-payments

Question 3

Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa? If not, please explain: a. how the focus should be altered b. why you think the focus should be altered in this way Please include any evidence you think is relevant to your response.

We believe the review should have included American Express (Amex) and LINK because we have identified issues with these networks.

LINK

ATM interchange fees are reversed from point of sale (POS) card transactions – meaning that the issuer pays the acquirer. For LINK – the UK's domestic ATM network - these fees have historically been set on a transactional basis based on the results of an independent cost study conducted by KPMG.

LINK is owned by the acquirers that use it. These are a mixture of banks and independent ATM deployers (IADs) such as Cardtronics and PayPoint[28]. The banks are net payers of ATM interchange while the IADs are (of course) net receivers. Competitive pressure from Visa and Mastercard put pressure on LINK to lower its ATM interchange fees to prevent an issuer member exodus, which began when Virgin Money left LINK[29]. Indeed, LINK announced in January 2018 that ATM interchange was being reduced from 25 pence per transaction (PPT) down to 20PPT over a four-year period[30]. This has led to public outcry because of the obvious implication that there will be ATM closures, resulting in access to cash issues for (vulnerable) consumers[31]. In lieu of this pressure, two of the four phases of the ATM reductions have been cancelled[32] but it is unlikely this will prove to be a permanent solution.

This market dynamic also affects merchants, as many have on-site ATMs and will be directly impacted by a loss of ATM interchange income. These machines will be less commercially viable, leading to lower customer access to cash and lower cash spending in-store. This is likely to migrate to card spending, where fees are increasing. The end result is an increase in merchant costs as data from the BRC[33], CMSPI[34] and The Governor of the Bank of England[35] suggests that the cost of cash is lower than the cost of cards for merchants.

We believe that the PSR should intervene to regulate the ATM interchange level at a minimum level. This will protect merchants and, particularly, consumers. A wider solution would be to separate ownership of the LINK ATM network from banks, as there is a clear conflict of interest within the scheme. In other countries such as the US, independent ATM networks operate at the point of sale

[28] https://www.link.co.uk/about/statistics-and-trends/
[29] https://www.telegraph.co.uk/personal-banking/current-accounts/banks-crisis-talks-half-free-atms-threat/
[30] https://www.ft.com/content/bae5786e-06a6-11e8-9650-9c0ad2d7c5b5
[31] https://www.telegraph.co.uk/money/consumer-affairs/three-hundred-cash-machines-disappearing-month-leaving-villages/
[32] https://www.ft.com/content/d291580c-88f6-11e8-bf9e-8771d5404543
[33] https://brc.org.uk/media/179489/payment-survey-2016_final.pdf
[34] https://cmspi.com/eur/content/uploads/2018/06/Cash-and-Digital-Payments-in-the-New-Economy-CMSPI-Consultation-Response-1.pdf
[35] https://www.bankofengland.co.uk/-/media/boe/files/speech/2018/the-future-of-money-speech-by-mark-carney.pdf?la=en&hash=A51E1C8E90BDD3D071A8D6B4F8C1566E7AC91418

and compete with Visa and Mastercard for debit card transactions, while in Denmark[36] and Canada[37] the governments have protected the local schemes.

American Express

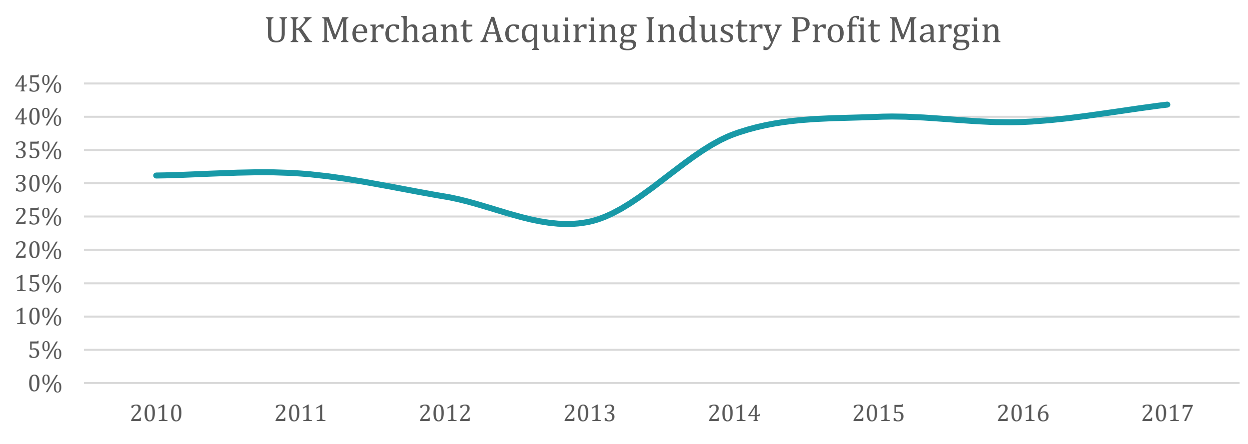
As a three-party card scheme, Amex operates as an acquirer, a scheme and an issuer. Amex fees tend to be higher than virtually all other payment methods and were 2.46% on average globally in 2017[38]. CMSPI has observed that for individual merchants Amex fees are positively correlated with Amex volumes. This is because many merchants feel forced to accept Amex cards as they tend to have a high price elasticity of demand.

We believe that competition on the merchant acquiring side of the market for Amex transactions would result in downwards pressure on end user pricing. This would mean that the interchange element received by Amex (or a third-party issuer of Amex) would be capped at the EU levels of 0.3% of the transaction value, and having a third party acquirer would also put downwards pressure on the other transaction fee elements.

Question 4

Do you agree with our proposed approach? If not, please explain: a. how proposed approach should be altered b. why you think the proposed approach should be altered in this way Please include any evidence you think is relevant to your response.

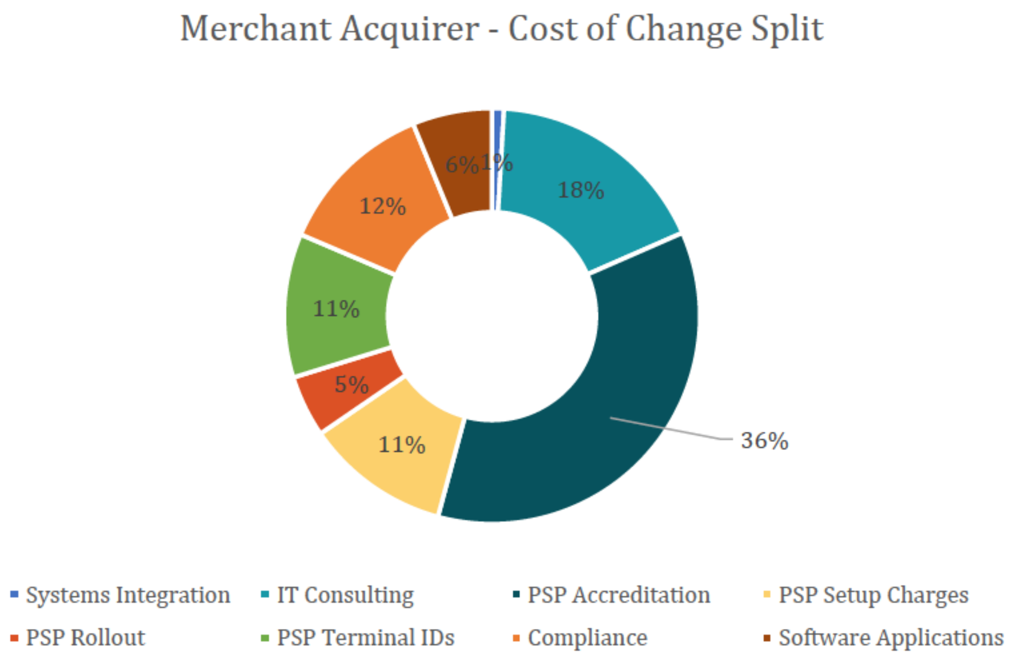
We think it is positive that the PSR is looking at unbundling and switching – two issues that have concerned us for a long time. The UK merchant acquiring industry reports 30-40% profit margins on average (see graph below[39] and Appendix 1), compared with increasingly small margins in the retail industry. This suggests that there are issues in the card industry greater than just with interchange and scheme fees.



[36] https://www.nationalbanken.dk/en/publications/Documents/2017/05/Dankort%20Assessment.pdf
[37] https://interac.ca/en/co-badged-cards.html
[38] http://ir.americanexpress.com/Cache/1001233963.PDF?O=PDF&T=&Y=&D=&FID=1001233963&iid=102700
[39] Source – Companies House filings

Switching

CMSPI believes a large reason why margins are so high is that there are very high costs associated with switching acquirers. For large merchants, CMSPI regularly observes six-figure switching costs, primarily to the payment systems provider (PSP) (see *Merchant Acquirer – Cost of Change Split* below). CMSPI believes that this cost affects the way acquirers price in tender processes, as we have observed that incumbent acquirers tend to price less competitively than challenger acquirers. Indeed, in a recent tender process we saw an incumbent acquirer bid more than 3.1 times more expensively than the most competitive bid.



These costs could potentially be addressed if universal industry standards are introduced, such as the ISO 2022[40]. There have been attempts to do this – for example, Nexo standards have signed up many top merchants and acquirers[41] – and the support of a powerful regulator such as the PSR could be a key difference maker in achieving one universal industry standard.

Unbundling

The IFR did contain a clause - Article 9 - covering unbundling[42]:

> *"Acquirers shall offer and charge payees merchant service charges individually specified for different categories and different brands of payment cards with different interchange fee levels unless merchants request in writing acquiring payment services providers to charge blended merchant services charges"*

This text appears to treat unbundled pricing as an "opt out" for merchants. However, evidence suggests that the acquiring industry is treating the clause as an "opt in" whereby merchants have to request unbundled pricing from acquirers. This is particularly an issue for smaller merchants, who are more likely to be charged on bundled structures and typically pay far higher acquiring margins.

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[40] https://www.iso20022.org/
[41] http://www.nexo-standards.org/about-us#members
[42] http://data.consilium.europa.eu/doc/document/ST-5119-2015-INIT/en/pdf

US data from 2004 suggests that small merchants constituted 42.4% of acquirers' net revenue but only 8.7% of sales volume[43].

The PSR has issued Guidance on Article 9, stating that the requirements apply " whenever a new contract is negotiated or agreed, whether for a new customer or an existing customer, even if the price for existing customers does not change. The requirements also apply whenever an acquirer proposes new pricing to an existing customer, including within a rolling contract."[44]. This interpretation of Article 9 means that, in many cases, acquirers are able to wait a number of years before providing unbundled pricing to merchants. EuroCommerce's 2018 merchant survey - whose respondents were primarily larger merchants - suggests that, more than two years after the regulation, 21% of merchants have either not received the full IFR savings, had received no savings at all, or were unaware.

The end result of this is that acquirers have benefitted from the IFR, with the UK's largest acquirer WorldPay informing investors of significant gains, which we believe is likely to be primarily at the expense of smaller merchants (see Appendix 2).

Despite this clause, a large portion of UK merchants are still charged using blended pricing. WorldPay – the UK's largest acquirer with a 40% market share – told investors in early 2016 that as many as half its clients were still charged on blended pricing (see Appendix 2).

Question 5

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? If not, please explain: a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions) b. why you think these additional issues have the potential to be relevant to the market review c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review d. why you think those issues do not have the potential to be relevant to the market review Please include any evidence you think is relevant to your response.

We do not believe the PSR has prioritised the right areas. In lieu of the evidence provided in Question 2, it seems the review should have focused around an immediate review of scheme fees, with commitments to a later review of the IFR caps in lieu of legal rulings.

Many of the issues discussed in this paper have been prevalent for more than two years, and parties such as the BRC, EuroCommerce and CMSPI have been providing the PSR with information during that time. Although this review is welcome, it should have been looked at long ago.

Our final concern relates to what we refer to as the "whack-a-mole" principal, whereby regulations can be easily circumvented via loopholes. To address this, the PSR should put procedures in place to identify and address circumvention issues when they arise.

---

[43] Small merchants defined as less than $100,000 of sales volume. Page 23. https://philadelphiafed.org/-/media/consumer-finance-institute/payment-cards-center/publications/discussion-papers/2007/D2007OctoberMerchantAcquiring.pdf

[44] https://www.psr.org.uk/sites/default/files/media/PDF/PSR-IFR-Phase-2-Policy-Statement.pdf

Conclusion

This consultation provides an excellent opportunity to address issues that have been present in the UK payments industry for many years.

We are pleased that the PSR has decided to directly address issues within the merchant acquiring market. Unbundling is proving a major issue for small merchants following the introduction of the IFR in 2015, while the cost of switching acquirers has long been a problem for medium and larger merchants.

However, we think that the scope of this review is too narrow. We firmly believe the review should have directly incorporated scheme fees, which have more than doubled for UK merchants over a period of less than two years and are set to increase further. Although it is positive that these problems may eventually be resolved starting with this review, it is likely to take a long time with the current approach.

We are concerned that the review does not include a review of the interchange caps. The PSR has not taken an active approach to interchange fee caps and, as a result, UK merchants are paying higher debit card interchange fees than most other major European economies. There is hope for merchants – interchange litigation may determine that interchange fees violate competition law, while the IFR is currently being reviewed by the European Commission. However, we do not see this as an excuse for the PSR to maintain its passive approach.

Although perhaps only indirectly affecting the merchant acquiring market, merchants are being negatively affected by issues within the LINK and Amex networks, and we would like these to be looked at by the PSR.

We have gained support from a number of merchant and consumer advocates – we will follow up with more details shortly.

Appendix 1

Revenues

£m	2010	2011	2012	2013	2014	2015	2016	2017
Worldpay	£260.5	£260.5	£313.0	£380.0	£341.0	£420.0	£566.0	£622.8
Global Payments	£143.8	£172.1	£188.1	£205.0	£227.1	£257.0	£306.9	
Cardnet	£56.0	£60.6	£62.5	£59.2	£54.0	£67.0	£75.0	£71.0
Elavon (GBP)	£44.9	£65.9	£69.7	£90.5	£109.6	£113.4	£123.3	
First Data	£86.4	£86.4	£64.5	£88.3	£93.7	£106.9	£119.5	
Total	£591.7	£645.5	£697.9	£823.1	£825.4	£964.3	£1,190.7	£693.8

Operating Profit

£m	2010	2011	2012	2013	2014	2015	2016	2017
Worldpay	£84.7	£84.7	£58.0	£32.0	£108.0	£135.0	£198.0	£233.2
Global Payments	£45.2	£58.7	£70.0	£80.4	£93.1	£118.4	£129.5	
Cardnet	£41.8	£45.1	£55.0	£49.3	£43.0	£52.0	£62.0	£57.0
Elavon (GBP)	£0.2	£2.1	£10.3	£19.7	£36.2	£41.5	£39.3	
First Data	£12.5	£12.5	£2.3	£18.2	£28.5	£38.7	£38.2	
Total	£184.5	£203.1	£195.5	£199.5	£308.7	£385.6	£467.0	£290.2

Operating Margin

Supplier	2010	2011	2012	2013	2014	2015	2016	2017
Worldpay	32.52%	32.52%	18.53%	8.42%	31.67%	32.14%	34.98%	37.44%
Global Payments	31.41%	34.10%	37.20%	39.21%	40.97%	46.07%	42.20%	
Cardnet	74.61%	74.42%	87.94%	83.21%	79.63%	77.61%	82.67%	80.28%
Elavon (GBP)	0.47%	3.18%	14.73%	21.74%	33.00%	36.60%	31.83%	
First Data	14.52%	14.52%	3.50%	20.60%	30.39%	36.26%	31.97%	
Total	31.17%	31.47%	28.01%	24.24%	37.40%	39.99%	39.22%	41.83%

Notes:

- Barclaycard data is not publicly available.
- WorldPay's 2011 UK annual report covered a 17 month period from 15th July 2010 to 31st December 2011

Appendix 2

Worldpay 2015 10k call transcript quotes – March 2016[45]:

- The UK's performance in 2015 was extremely pleasing, with revenue up 11% and profit up 15%, although of course within that there was some benefit from the new interchange fee regulations

- in the UK where we have improved our spread from 19 to 20 bps, both improving the proposition, selling more into the SME space where margins are higher as well as benefiting from lower interchange costs

- Card related income grew in all divisions but particularly in Global eCom and the UK which both benefitted from growth of existing customers and new customer wins. And in the UK as well, the interchange benefit helped.

- UK spread has shown the best improvement of all our divisions, reflecting the improved customer proposition focusing on SMEs where spreads are higher there typically, and we have also benefitted from lower interchange costs. Although I want to stress that we have passed on the vast majority of these interchange reductions to our merchant customers. And remember that 50% of our revenues in the UK are from customers who are on a cost plus basis. So they get it automatically.

- First of all, as I have said, half our customers in the UK are on a cost plus, interchange plus, plus basis. So as a result, they get that as immediately as a pass through. So on the remaining part, it has been phased in various different times through the year. Changes happen in April, changes happened in July, changes happened in September and finally in December, and it is still going on. We estimate and as I say, this is not an exact science. We estimate the benefit is around £10-12 million in 2015 and a similar benefit in 2016. I think when you look at that, that is probably in terms of the spread improvement in the UK, about half of the spread comes from the interchange benefits. The other half of the spread improvement is really down to the penetration of SMEs and I want to make that point clear. SMEs clearly are much more profitable as a percentage net spread, compared to the big corporate customers. So that is the sort of number that we have seen. And when you take 2015 Full Year Results – 08 March 2016 15 that away, it is clearly a benefit in 2015 and 2016. We have seen something like 7.5% underlying growth in the UK. And I think that is a really strong underlying proposition place. And remember that is in line with the guidance that we gave you of mid to high single digits, medium term growth in the UK. So I think the underlying business is being sustained.

- But again, just reminding you that on the Worldpay UK it was 11% growth in the second half year over year. And if you take off the interchange benefit it was still about a 7.5% growth.

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[45] http://investor.worldpay.com/phoenix.zhtml?c=250843&p=results_archive-wp

Ecommpay

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London, England, W1J8LQ

Payment Systems Regulator Limited
12 Endeavour Square, Stratford, London,
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7th September 2018

No. 01-3-2/322

TO WHOM IT MAY CONCERN

ECOMMPAY LIMITED has received the email about plans of Payment Systems Regulator to carry out a market review into the supply of card-acquiring services in the UK. After studying the document "Market review into the supply of card-acquiring services", I would like to provide the following answers to the consultation questions.

As regards questions 1 to 4, I fully agree with the Payment Systems Regulator and there is nothing to be added. However, as regards question 5, I would like to draw your attention to the following comments, which ECOMMPAY considers have the potential to be relevant to the market review:

1. The restrictions for acquirers applied by the card schemes operators Mastercard and Visa (hereinafter – 'Mastercard/Visa"), which concern settlement possibilities, namely:

a) settlement from Mastercard/Visa in one currency may be received by the acquirer only to one designated bank (these banks may vary for Visa and Mastercard). I.e., an acquirer does not have the possibility to arrange with Mastercard/Visa that part of the settlement in EUR, for example, would be received to one bank and the other part – to another bank. Therefore, if the acquirer wishes to diversify risks by receiving the settlement from Mastercard/Visa to different banks, the acquirer may solely arrange that, for example, EUR would be settled to one bank and GPB – to another. I consider that it would be beneficial if acquirers could diversify risks by being able to receive settlement of one currency to different banks, not only different currencies to different banks.

b) The process of changing the settlement bank of the acquirer designated to Mastercard/Visa for settlement may take up to two months. This means that if, for instance, the settlement bank of the acquirer or the correspondent bank has any difficulties which could delay or disable settlement to the acquirers bank, the acquirer will not have the opportunity to timely perform its obligations towards a merchant or may incur losses due to currency conversion, because the acquirer may be forced to convert settlement amounts received in another currency to the currency which was not received to ensure further settlement to the merchant.

2. Understanding of the manner and the length of time required to activate a particular service with Mastercard/Visa, without which it is often not possible for acquirers to timely provide services to merchants. Even if the procedure of a service activation is clear, it may take several months to activate a service causing

delays in the delivery of services to the merchants and the consumers, ultimately. This has an impact on responsiveness and quality of provided services. Additionally, in the process of the service activation new requirements are being imposed on acquirers, causing further delays in service activation.

I believe my comments will help you to review the market not just in terms of that the market may not be working well for merchants, and ultimately consumers, but also in terms of acquirers who should be regarded not as an independent unit, but as the unit which assumes all the risks related to servicing merchants and ultimately consumers.

If you have any questions, do not hesitate to contact me!

Sincerely,

[redacted]

[redacted]

Edgar, Dunn & Company

PSR's market review into the supply of card-acquiring services

Edgar, Dunn & Company's response to the draft terms of reference

September 2018

Edgar, Dunn & Company
Strategic Payments Consulting
40 Years Since 1978

Contents

Table of Figures

1 Introduction

Edgar, Dunn & Company (EDC) is a management-consulting firm established in 1978 that assists organizations in developing and implementing strategies and capitalizing on the opportunities that change provides in the payments industry. 40 years' experience and with offices in the San Francisco, London, Frankfurt, Paris, Istanbul and Sydney, we are international business experts in the payments industry.

We have conducted payment projects in 35 countries worldwide. Within card payments, our extensive experience spans all card types –credit, debit, prepaid, gift, loyalty, stored value and commercial. EDC has built up a holistic view of payment issuing and payment acceptance as a result of working across the payment processing value chain.

EDC has developed and run an acquiring forum with 13 members for the past 8 years covering many European markets. EDC has deep expertise and knowledge in the acquiring space. EDC knows and understands the acquiring market in terms of the UK market landscape, the acquiring value chain, the various players within the acquiring ecosystem and the fees and costs associated with it.

Below is EDC's response to the questions posed by the PSR on their draft Terms of Reference (ToR). In addition to the input provided below, EDC would like to make the PSR aware of the fact that there are other market issues that may impact the market review and acquiring landscape in the coming months.

The ongoing implementation and adoption of the Regulatory Technical Standards (RTS) under the PSD2 and the advent of Brexit is likely to put considerable pressure on all players within the payments ecosystem as they try and adapt to the regulatory and political changes within the market. The PSR may want to consider these topical issues when defining its timelines for the market review.

2 PSR Question 1

Do you agree with our description of card-acquiring service? If not, please explain:
a. how our description should be altered
b. why you think the description should be altered in this way
Please include any evidence you think is relevant to your response.

EDC does not disagree with the PSR's description of card-acquiring services; however, EDC believe that it is not an entirely complete description of card acquiring services. The description should be altered to distinguish and acknowledge the various parties involved in the card acquiring value chain. Card acquiring involves more than just acquirers and payment facilitators. Suppliers of card acquiring services such as payment services providers, gateways, independent sales organisations, etc. covering both the physical and online card acquiring need to be fully included in your description of card acquiring services. Online merchants and acquiring services for ecommerce have grown over the past 5-10 years and have reshaped the acquiring market – without explicitly distinguishing and including both physical and online acquiring services, the PSR risks conducting a review that doesn't fully reflect the market landscape. The diagram below is a recognised acquiring value chain depicting the breadth of services offered by various players.

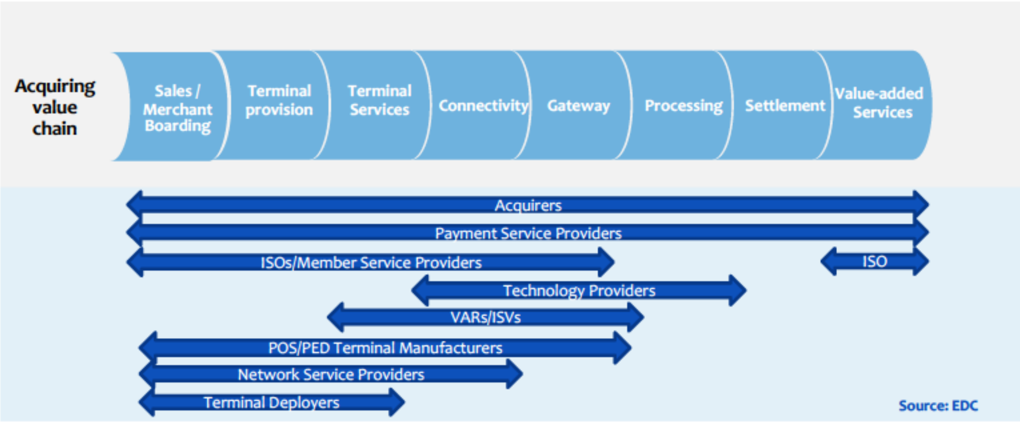

Figure 1: Merchant Acquiring Value Chain

In an increasingly competitive market acquirers compete with each other for each of the functions listed in the above value chain. As can be seen from Figure 1: Merchant Acquiring Value Chain above, acquirers provide a wide range of services, not just a connection to the schemes etc. What also needs to be noted is the number of other providers that compete with acquirers for these services.

Therefore, it is important for the PSR to expand its description to either consider including the above-mentioned players in order to ensure a comprehensive review of the card-acquiring or be very specific as to which services / functions the review will focus on. All these providers play an integral role to service merchants in the card acquiring market, particularly in the ever-growing ecommerce environment and where online card acquiring service providers are increasingly supplying services to physical merchants.

Without the inclusion of such players, the PSR will be excluding a large proportion of the card acquiring suppliers and service providers. Merchants are often approached by different types of providers, all offering different propositions, for example, acquiring services with POS equipment, acquiring services with gateway services, acquiring services with POS equipment and gateway services, etc. The different combination of providers will impact competition in the card acquiring market differently.

3 PSR Question 2

Do you agree with the proposed scope of the market review? If not, please explain:
a. how the proposed scope should be altered
b. why you think the proposed scope should be altered in this way
Please include any evidence you think is relevant to your response

EDC believes that the proposed scope of the market review should be amended. As per Question 1 above, it is vital that the PSR widen the remit of the study to include other players (apart from acquirers and payment facilitators) within the acquiring value chain (see Figure 1: Merchant Acquiring Value Chain). The "other services" cited by the PSR to be in scope only if they affect the supply of card acquiring services should be, in EDC's opinion, considered part of the core scope of the study. Not including 'other services' will make it difficult for the PSR to understand and review the acquiring market in its entirety as they would not have the full view of the market in terms of players, the value the take from the supply chain and the subsequent pass through to the merchants. As stated earlier, merchant acquirers provide a breadth of different services beyond terminal provision and connection to schemes. Some acquirers have developed niche propositions for certain merchant segments that could not easily be replicated by others. In EDC's view, it would be entirely misleading to undertake such study by focussing on pricing arrangements between acquirers and merchants alone.

Considering ISOs as merely a sales channel can distort the market review – whilst ISOs do provide a sales channels for acquirers for merchant accounts, they also provide other services, such as terminal provision, gateway services, short term lending, Dynamic Currency Conversion (DCC) etc. which may be offered at a bundled or additional cost to the merchant. These additional services form part of the overall acquiring contract that a merchant may undertake and creates competition amongst merchant service providers for acquiring services.

Similarly, EDC believe that non-card-based products within merchant acquiring (e.g. alternative forms of payments) should be included within the scope of the study. Suppliers of merchant services (especially those that target small and medium merchants) offer a monthly subscription-based price plan (e.g. SagePay), whereby a package that includes card-based acquiring (of X number of transactions), select alternative forms or payments, fraud screening tools, etc. are provided for a fixed monthly fee.

For the PSR to understand how costs are passed through to the merchants, the competitive nature of the acquiring industry, transparency of fees, etc. the PSR will need to consider ISOs (and others such as payment service providers, gateways, etc.) as a supplier of acquiring services and include them within the scope of study. Similarly, the PSR needs to include other forms of payment within the scope of its study. Isolating merchant accounts as acquiring services will provide a very narrow and inaccurate view – and will not be reflective of the complex acquiring market in the UK.

4 PSR Question 3

Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa? If not, please explain:
a. how the focus should be altered
b. why you think the focus should be altered in this way
Please include any evidence you think is relevant to your response.

It is entirely true that the card payments market in the UK is dominated by Mastercard and Visa. There are many historic reasons for this, but it is also a reflection of the strong usage of debit cards in the UK. These debit cards run entirely through Mastercard and Visa (until recently Mastercard had close to 100% of the debit card market, debit cards are now predominantly Visa).

Given this market dominance, it is only natural that merchant complaints are related more to Mastercard and Visa transactions.

However, it is, in our view, important to consider other payment schemes as well. These would include American Express, JCB, Diners Club and Unionpay. Whilst the overall volume of transactions based on these schemes might be low, they are a relevant element in an acquirer's product offering. For example, some of these schemes provide a license to an acquirer in a given market (sometimes on an exclusive basis) who then have the ability to offer acceptance of that particular brand to a merchant. Many merchants, especially in travel and entertainment related segments, have a strong need to offer acceptance of those schemes to their customers. Consequently, for an acquirer to be able to offer such product could be a unique selling point and might prevent the merchant from 'buying' acquiring services from someone else.

Although not specifically applicable to the UK, many European markets have seen acquirers forming partnerships with Chinese payment schemes / providers to be able to offer a 'domestic-feel' product to the growing number of Chinese visitors in Europe.

Also, in the overall context of the study it might be important to determine the value that merchants attach to these payment schemes considering that the pricing tends to be higher than for Mastercard and Visa transactions.

Furthermore, and as stated before, there are also alternative forms of payments that play a crucial part in the e-commerce space and being able to offer acceptance of such products can be a differentiating factor in the product offering of acquirers / payment gateways that cannot be neglected.

5 PSR Question 4

Do you agree with our proposed approach? If not, please explain:
a. how proposed approach should be altered
b. why you think the proposed approach should be altered in this way
Please include any evidence you think is relevant to your response.

Whilst EDC does agree with the PSR's proposed approach as a whole, EDC does not believe that the PSR will be able to achieve its market review objectives within the current limitations of the proposed scope.

It is critical that the scope of the study is clearly defined and amended as per our responses to Q1-Q3, taking into consideration the full value chain of acquiring services and providers as depicted in Figure 1: Merchant Acquiring Value Chain above, the inclusion of e-commerce and all payment schemes.

6 PSR Question 5

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? If not, please explain:
a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions)
b. why you think these additional issues have the potential to be relevant to the market review
c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review
d. why you think those issues do not have the potential to be relevant to the market review
Please include any evidence you think is relevant to your response.

EDC are in broad agreement with the specific issues of interest that the PSR will consider. However, EDC believe that the PSR should consider the impact of the PSD2 as an additional specific issue of interest. In particular, the PSR should consider Payment Initiation Services Providers (PISPs) and how they are or can play a role (now or in the future) in the acquiring market. PISPs would have the ability to provide merchants with an alternative payment option to cards – how is this likely to impact competition in the card acquiring market? How are acquirers and other card acquiring service providers reacting to the advent of PISPs and access to accounts.

Another requirement from the PSD2 and specifically the Regulatory Technical Standards (RTS) on Strong Customer Authentication is also creating a significant burden on merchants who need to work with their acquiring partners to make necessary implementations.

These questions and this specific issue of interest has the ability and potential to change the acquiring market; for example, it may force acquirers to find innovative ways to retain merchants (e.g. by providing value added services) or become PISPs in their own right so as not to lose their merchants, thus impacting the competitiveness of the card acquiring market.

Elavon

Elavon
Financial Services DAC

Card-Acquiring Market Review Team
Payment Systems Regulator
12 Endeavour Square
London E20 1JN
UNITED KINGDOM

By Email: cards@psr.org.uk

14 September 2018

Dear Sir/Madam,

Re: Market review into the supply of card-acquiring services
Draft terms of reference- July 2018

We are very pleased to make this submission on behalf of Elavon Financial Services DAC United Kingdom Branch (**Elavon**), to the Payment Systems Regulator's (**PSR**) consultation on the draft Terms of Reference (**Draft Terms**) for its proposed Market Review into the supply of Card Acquiring Services (**Review**).

Elavon is a wholly owned subsidiary of U.S. Bank National Association (**U.S. Bank**), which has developed relevant business models and invested in both technology and people to deliver growth, improve customer experience, drive efficiencies, maintain appropriate controls and develop sustainable and compliant products and services in the European merchant acquiring sector, among others.

Elavon is comprised of three primary business lines; Elavon Merchant Services (**EMS**), Corporate Payments Systems (**CPS**) and Global Corporate Trust (**GCT**). As a credit institution authorised and regulated by the Central Bank of Ireland, Elavon has a strong compliance and conduct risk management culture.

EMS is part of U.S. Bank's global merchant acquiring business. 'Elavon' is one of the leading acquirers in North America and Europe. With this strategic focus on the payments sector, Elavon is committed to a strong relationship with the PSR, and welcomes the exercise by the PSR of its powers under the Financial Services (Banking Reform) Act 2013 to consider concerns raised by stakeholders about card payments, and address any possible significant harm arising from a lack of effective competition, the interests of the service-user focus or innovation in the supply of card-acquiring services.

Elavon Financial Services DAC
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Registered Office: Building 8, 1st Floor, Cherrywood Business Park, Loughlinstown, D18 W319, Ireland. **Telephone** +353 (0)1 272 5000 **Facsimile** +353 (0)1 272 5001 Directors: John Dunning (USA), Craig Gifford (USA), Andrew Hastings (UK), Christopher Higgins (USA), Jeffrey W Jones (USA) Shailesh Kotwal (USA), Declan Lynch, Troy Remington (USA), James Walker (USA), Adrian Wrafter.
Elavon Financial Services DAC is regulated by the Central Bank of Ireland

Elavon
Financial Services DAC

Elavon would be very happy to have a meeting with the PSR to further address the content of this response.

1. SUMMARY OF ELAVON'S VIEWS

We support the overarching objectives that the PSR has set out in its Draft Terms, namely to ensure that: (i) there is a competitive card-acquiring service provider market with minimal barriers to entry; (ii) merchants have sufficient transparency in respect of card-acquiring service provider fees and information; (iii) there are minimal barriers in place that prevent merchants from being able to change card-acquiring service providers.

We have some comments in respect of the Draft Terms.

1.1 Regulatory context of the Review

*Interchange Fee Regulation (**IFR**)*

We think that many of the objectives and issues that the PSR has raised concerns about in the Draft Terms should be addressed by the requirements of the IFR. The PSR has a concern that they are not and we wish to assist the PSR in understanding why this is the case.

In our view, the card-acquirer service provider market is already highly competitive and transparent. We want to continue to work with merchants to ensure they are reviewing and comparing the information that is available and to exercise the rights that they are given under the IFR.

In particular merchants as a matter of default should be provided by acquirers with granular information regarding fees both at the start of a relationship and on an on-going basis. This high level of transparency should in theory enable merchants to easily compare fees at least on a per brand category basis.

Specifically:

- under Article 9 of the IFR, acquirers are required to offer and charge merchants unblended fees for different categories and different brands of payment cards with different interchange fee levels.
- under Article 12, acquirers are also required to disclose detailed fee information to merchants on an on-going basis and after the execution of an individual card-based transaction, acquirers are required to disclose the amount of any charges for the transaction, separately indicating the merchant service charge and the amount of interchange fee;
- Article 10 prohibits "honor all cards" requirements such that merchants can effectively decline to accept more than one brand or category of card; and

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- under Article 11, acquirers and payment card schemes are prohibited from preventing merchants from steering consumers to use their preferred cards or from informing consumers about interchange fees and merchant service charges. .

The above provisions were only required to be implemented in December 2015 and June 2016.

Given that this is all relatively new, some merchants may not yet as a matter of practice be taking full advantage of the information and rights above.

Pro-competitive impact of PSD2

In the medium to long-term, we expect also that PSD2 is likely to have a pro-competitive impact on the number of market participants engaged in merchant acquiring activities and the volume of direct account-to-account payments. There are a number of commercial opportunities emanating from the implementation of PSD2, for example, of becoming a third party payment initiation service provider as well as domestic initiatives (e.g. open banking) are in sum certain to result in greater payment diversification.

The market is also shifting from card present to card not present transactions as a result of consumer demand due to expanding growth in online shopping and electronic payments. New market entrants are also continuing to enter the UK market (e.g. payment platform providers, gateways, mPoS solution providers, ePoS system providers and specialist providers).

Service providers and online merchants will inevitably drive this demand, meaning incumbent players will compete with a host of newer cross-border acquiring entities, who are offering a potentially broader range of business models, hosted app-stores, and value-added services (e.g. business loans/ accounting & inventory support etc.) into the UK market.

With those two considerations in mind, Elavon is very supportive of the Review at this time.

1.2 General comments

Our general comments that did not fall strictly within any one of the questions were as follows:

- Geographic scope – the PSR might clarify whether "acquirers and payment facilitators" are limited to domestic players or any firm which provides services to UK merchants internationally or via a branch or on a cross border basis.
- The card payment schemes play an important role in the market and the Draft Terms might more clearly define their status within the scope of the Review. There is no doubt that the issue of interchange and scheme fees is material in the acquiring market, and the card market more generally.

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Financial Services DAC

1.3 Initiatives to meet the PSR's objectives

As we have expressed above, we fully support a competitive and transparent market that results in merchants receiving fair pricing. We think, however, that the main barrier to achieving this goal might be that merchants lack awareness and understanding of the rights or information available to them under the IFR.

Therefore, we think that an initiative by the PSR to produce and provide merchants with educational or explanatory materials, which explain their rights and the information available to them, would be a simple and effective means of achieving many if not all of the objectives set out the Draft Terms.

2. RESPONSES

Q1: Do you agree with our description of card-acquiring services? If not, please explain how our description should be altered and why you think the description should be altered in this way

A1:

- Elavon agrees with the PSR's definition of 'merchant acquiring' for the purpose of the Review. There are three other types of entity in the value chain that would not be covered by the review and these are 'payment facilitators', 'gateways', and 'ISOs' who provide ancillary or distribution services.

Q2: Do you agree with the proposed scope of the market review? If not, please explain how the proposed scope should be altered and why you think the proposed scope should be altered in this way:

A2:

- We agree that the Review scope is appropriate, and could also usefully examine whether barriers to switching may arise as a result of devices or services that may be linked to a specific provider.

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Q3: Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa? If not, please explain how the focus should be altered why you think the focus should be altered in this way:

A3:

- While we do agree that Visa and Mastercard represent the preponderance of the market, we think that other card schemes (Amex, Diners etc.) and new payment types under PSD2 do need to be reflected in the Review to give a whole of industry view.

Q4: Do you agree with our proposed approach? If not, please explain how our proposed approach should be altered and why you think the proposed approach should be altered in this way:

A4:

- Elavon would hope that the Review would take into account the changes and implementation dates as a result of the IFR and PSD2, all within the context of the U.K.'s exit of the European Union.

Q5: Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? If not, please explain what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions):

A5:

- Elavon supports the PSR in obtaining the most competitive and transparent market possible for merchants in the UK.
- As indicated above, we think, that the main barrier to achieving the objectives set out in the Draft Terms might be that merchants lack awareness and understanding of the rights or information available to them under the IFR.
- Therefore, we think that an initiative by the PSR to produce and provide merchants with educational or explanatory materials, which explain their rights and the information available to them, would be a simple and effective means of achieving many if not all of the objectives.

Should you require additional information or wish to schedule further discussion regarding this letter please feel free to contact me at Hannah.Fitzsimons@elavon.com.

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Yours sincerely,

[redacted]

Electronic Money Association

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By email: cards@psr.org.uk

14 September 2018

Dear Sirs

Re: Draft Terms of Reference: Market review into the supply of card acquiring services MR18_1.1

The Electronic Money Association ("**EMA**") welcomes the opportunity to respond to the consultation on the Draft Terms of Reference for your proposed review of the card acquiring market.

The EMA is a trade body representing some 60 electronic money ("**e-money**") issuers and innovative payment service providers operating within the EEA, including the UK. Our members are leading payments and e-commerce businesses worldwide, representing online payments, card-based products, vouchers and those employing mobile channels of payment. A list of EMA members is provided at the end of this letter.

We would be grateful if you would consider our comments.

Yours faithfully

[redacted]

The EMA's Response

Question 2: Do you agree with the proposed scope of the market review?

Ancillary services

Paragraph 2.10 proposes that ancillary services provided with acquiring services remain outside the scope of the review, except in cases where ancillary services affect the supply of acquiring services. Ancillary services are arguably equally as important as core acquiring services as they are often the means through which the core acquiring services can be provided. Furthermore, ancillary services can include assisting merchants with fraud detection and helping manage customer disputes. Hence, the review should not consider the acquiring part of services offered in isolation.

As the PSR has stated that fees charged to merchants are a key issue of interest in this review, the terms of reference should be tailored to include ancillary services within scope so that the structure of merchant fees are understood in the full context of all the services that acquirers offer. Otherwise the outcome of the review may give an incomplete picture of fees charged to merchants.

Question 4: Do you agree with our proposed approach?

Representation from all stakeholders

Paragraph 2.14 indicates the PSR's approach to understand whether the supply of card acquiring service is 'working well for UK merchants and ultimately consumers'. This approach suggests that issues affecting merchants may be prioritised over those providing acquiring services.

Acquirers and payment facilitators take on significant risks as a result of providing acquiring services; understanding these risks and the subtleties of the acquirers' operational environment should be given an equal weight in the review and the terms of reference should be amended to reflect this.

Methods and Techniques

Paragraph 2.15 omits the methods and techniques the PSR will employ to carry out the review. In light of our response above, regarding equal representation of all views on both the supply and demand side of the sector, we recommend the PSR include in the terms of reference the methods and techniques the PSR intends to use. An examination of the items listed in paragraph 2.15 would not be complete without information provided by all stakeholders comprising the card acquiring service chain, including merchants, payment facilitators, ISOs and acquirers in a balanced manner.

Objective criteria to benchmark pricing and service quality

In Paragraph 2.16 the PSR proposes to examine the outcomes of the competitive process by 'looking at the fees merchants pay and the quality of service they receive'. The manner in which the PSR will carry out this benchmarking exercise and obtain such information is not specified. Paragraph 2.16 should include how this information shall be obtained to ensure that data is obtained from both service providers and merchants on a confidential basis.

Further, the terms of reference should include objective criteria comprised of independent metrics that services will be measured against. Without independent criteria, data derived from merchants informing their views of pricing and service quality may not provide a balanced view of the acquiring market.

Additional issues

Timing of Review

The PSR website indicates the terms of reference will be finalised 'by the end of 2018' and that a timetable for the review will be communicated in the final version. We urge the PSR to consider the timing of the review in light of the current environment faced by the acquiring and payments industry as a whole. The implementation of PSD2 requirements in 2019, the review of the Interchange Fee Regulations, alongside the uncertainty and impact on the competitive landscape for UK acquirers caused by Brexit should all be considered when determining when to conduct this review.

In addition, we would hope that the outcomes of the review will take a forward looking view, with recommendations recognising the competitive pressures that card payments will face as new and innovative types of payment may become more prevalent in the UK market.

List of EMA members as of September 2018:

- Airbnb Inc
- Allegro Group
- American Express
- Azimo Limited
- Bitstamp
- BlaBla Connect UK Ltd
- Blackhawk Network Ltd
- Boku Inc
- CashFlows
- Circle
- Citadel Commerce UK Ltd
- Coinbase
- Corner Banca SA
- Curve
- Ebanx
- eBay Sarl
- Euronet Worldwide Inc
- Facebook Payments International Ltd
- First Rate Exchange Services
- Flex-e-card
- Flywire
- GoCardless Ltd
- Google Payment Ltd
- IDT Financial Services Limited
- Imagor SA
- Intuit Inc.
- Ixaris Systems Ltd
- Merpay Ltd.
- MuchBetter
- Nvayo Limited
- One Money Mail Ltd
- Optal
- Ozan
- Park Card Services Limited
- Paybase Limited
- Payoneer
- PayPal Europe Ltd
- PayPoint Plc
- Paysafe Group
- PPRO Financial Ltd
- PrePay Solutions
- R. Raphael & Sons plc
- Remitly
- SafeCharge UK Limited
- Securiclick Limited
- Skrill Limited
- Starpay Global Ltd.
- Stripe
- Syspay Ltd
- Transact Payments Limited
- Transact24 (UK) Ltd
- TransferWise Ltd
- TrueLayer Limited
- Trustly Group AB
- Uber BV
- Valitor
- Vitesse PSP Ltd
- Viva Payments SA
- Wave Crest Holdings Ltd
- Wirecard AG
- Wirex Limited
- Worldpay UK Limited

Emerging Payments Association

Response for PSR – Pre-consultation on Card Acquiring

From the Emerging Payments Association

About the Emerging Payments Association

The Emerging Payments Association (EPA) is a thriving community of payments professionals to strengthen and expand the payments industry to the benefit of all stakeholders.

Since 2004 the EPA has been instrumental in helping to connect the ecosystem, encourage innovation and promote competition in this market.

We achieve this by delivering a comprehensive programme of activities for over 130-member companies, with the help of our independent Advisory Board, which address issues affecting the payments industry and its users.

This include events, conferences, award ceremonies, research, projects and lobbying activities.

The Emerging Payment Association's response

Question 1:

Do you agree with our description of card-acquiring services?

The definition of card acquiring services in the terms of references should be replaced with the definition specified in article 4, clause 44 of Directive 2015/2366 ('PSD2');

'Acquiring of payment transactions' means a payment service provided by a payment service provider contracting with a payee to accept and process payment transactions, which results in a transfer of funds to the payee.

In addition, there should be an understanding of Payment Facilitators and ISOs and PSPs who provide payment services to the SME sectors:

Payment Facilitator - An agent of the card-acquirer that works directly with merchants to simplify the merchant enrolment, manages their transaction data and settle the merchant's funds on behalf of the card acquirer. These entities are usually also regulated as they are in the flow of merchant funds

ISO (Independent Sales Organisation) - A third party sales company contracted by a card-acquirer to re-sell that card-acquirer's services.

MSP (Member Service provider) – Usually a gateway connected to an acquirer that works directly with merchants, will have a buy rate with an acquirer but generally sets pricing to the merchant (with Acquirer ability to override), they may also take full or partial liability for risk. Usually the merchants are paid direct by the acquirer.

Wallets/aggregators – Whilst technically a Merchant for the purposes of the contract between them and the acquirer these businesses essentially operate as "mini-Acquirers" in their own right. The Card Scheme Rules apply to them equally and their voice should therefore also be heard. These entities are usually also regulated as an acquirer because they are in the flow of merchant funds.

Question 2:

Do you agree with the proposed scope of the market review?

The consultation should include ISOs, Payment Facilitator models, MSPs and wallets/aggregators since they influence what merchants are charged and the level of service they receive.

To conduct a full review of card acquiring services then the service, regulation and sales distribution should be considered. Within the ISO channel, and for some acquirers, the provision of POS terminals should also be included in this review. From the card scheme perspective review of the scheme fees along with collateral costs across the industry should also be examined much more comprehensively to understand the true cost of acquiring services.

It should also be noted that the setting of fees from acquirers will be based on the Merchant Category Code (MCC). A MCC classifies each merchant by the type of goods or services they supply. Understanding how findings differ between each MCC is important because the MCC dictates several aspects of pricing. For instance, the amount of interchange payable by the merchant. Second, certain MCCs impose more risk on acquirers than others. For example, there is a higher risk of chargebacks incurred when providing acquiring services to a merchant classified under 'gambling'. The PSR has indicated they seek to examine the fees that are charged to merchants. The setting of fees by an acquirer is greatly influenced by the amount of interchange charged for a transaction as well as the risk profile of the merchant, both of which are indicated by the MCC.

In addition, there are additional fees levied by the card schemes for certain MCCs that are considered high risk that require additional registration with a card scheme which attracts additional costs. These differences will occur along with higher collateral requirements from the card schemes. This has an impact on smaller acquirers and new entrant acquirers who are required to pay and fund collateral versus the larger acquirers who fall outside of collateral requirements, due to their better risk rating by the card schemes.

Question 3:

Do you agree with our proposal to focus on card-acquiring services for MasterCard and Visa?

Yes.

Question 4:

Do you agree with our proposed approach?

This approach suggests that issues affecting merchants will be prioritised over those issues affecting acquirers. Acquirers take on significant risks because of providing acquiring services and these risks and justifications for certain costs imposed on merchants will be overlooked if acquirers are not given an equal involvement in the review.

Paragraph 2.15 omits the methods and techniques the PSR will employ to carry out the examination of those six listed items. Considering our response to paragraph 2.14, we recommend the PSR include in the terms the methods and techniques the PSR intends to use. An examination of those items listed in paragraph 2.15 would not be complete without information provided by all stakeholders comprising the card acquiring service chain, including merchants, payment facilitators, ISOs and acquirers and MSPs in a balanced manner.

Merchants may not be able to sufficiently inform the PSR on the proposed items to be examined. A merchant's use of the acquiring services is limited to that of an end user whereby the merchant performs a transaction through use of a terminal and are the final beneficiary of the settled funds. The merchant does not have insight into the entire acquiring process or value chain as they may have limited visibility of the end to end authorisation, clearing, and settlement of transactions via card networks as it does not form part of their 'end user' experience.

Question 5:

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

Collateral requirements required by the card schemes impacts the smaller acquirers significantly. The main concern for acquirers is the lack of transparency around this process with both schemes setting different and varied amounts companies must pay, with some companies given alternative options that are not open to all. The larger acquirers are exempt these fees. There is no transparency on how this is calculated, and smaller acquirers are penalised financially.

Acquirers operating PF models are also required to provide even more additional collateral which makes it hard for smaller acquirers to afford to support these models. There may also be larger acquirers who have been exempt these fees.

There should be an examination of the collateral processes across the industry and how this impacts all players.

Card scheme billing is complex, recovery of card scheme fees is the most challenging issue faced by all acquirers trying to recover the true cost.

For example: brand fees are charged in arrears rather than when the transactions are processed. Acquirers struggle to understand the different fees being charged by the card schemes, their frequency and how each is calculated. It is also common for acquirers to only recover the transaction driven fees and no other types of fees. Large acquirers still benefit from tiered pricing which makes it harder for smaller acquirers to compete.

There are also examples of mandated fees that are not relevant to all types of acquirers. An example would be the Visa ATM locator fee per month which is charged to ecommerce acquirers even though they may have no ATMs.

There should be a review of the scheme fees and if these have increased disproportionally currently the fees are broken down into categories, but all need to be analysed.

- Membership fees
- Brand fees
- Processing fees
- Other fees (other fees should be examined closely)

Scheme fees all-round need to be simplified such that acquirers (and PFs, ISOs, PSPs) can much more easily calculate the necessary scheme fee for a specific single transaction and pass it on to the merchant as part of the interchange plus plus pricing.

Extensive set-up costs are initially covered by acquirers to facilitate service provision to merchants, such as:

1. Carry out pre-contractual checks on the merchant as they are required to by law
2. Integrate the software
3. Provide new hardware such as terminals

4. Provide training
5. Provide customer support over the term of the contract and so on including any registration fees with the card schemes

The acquirer's set up costs as well as ongoing costs are built into the price of the acquiring services and apportioned over the term of the contract. Accordingly, if a merchant was afforded a termination right after, say, one month of paying for the services, the cost of the set up would have to be covered by the merchant upon execution of the contract and ultimately cool the market for acquiring. Expensive initial set up costs for merchants would have the effect of merchants remaining in their current contracts for longer as switching providers would involve significantly more expense.

Timing

We would like to call the timing of the PSR's review into question. The Interchange Fee Regulation (IFR) is still a reasonably new legislation and is due to be reviewed in 2019. Article 17 of the IFR calls on the European Commission to submit a report on the application of the IFR by no later than June 2019, taking into account similar assessment criteria as the current PSR market review.

Given that the Second Payment Services Directive (PSD2) only entered into force nine months ago, it is important to understand that the current review comes at a time of significant change in the payments sector. PSD2 has already and will continue to further increase competition in the payments sector which will also drive costs down, with new market entrants and new business models changing customer behaviour and needs, alongside the uncertainty and impact on the competitive landscape for UK acquirers caused by Brexit should all be considered when determining when to conduct this review.

EuroCommerce

EuroCommerce
THE RETAIL, WHOLESALE AND INTERNATIONAL TRADE REPRESENTATION TO THE EU

EuroCommerce response to UK Payment Systems Regulator Market Review into the supply of card acquiring services - Draft Terms of Reference

EuroCommerce is the principal European organisation representing the retail and wholesale sector. It embraces national associations in 31 countries and 5.4 million companies, both leading multinational retailers such as Carrefour, Walgreens Boots Alliance, Metro and Tesco, and many small family operations. Retail and wholesale provide a link between producers and 500 million European consumers over a billion times a day. It generates 1 in 7 jobs, providing a varied career for 29 million Europeans, many of them young people. It also supports millions of further jobs throughout the supply chain, from small local suppliers to international businesses. EuroCommerce is the recognised European social partner for the retail and wholesale sector.

Summary
EuroCommerce welcomes the PSR's proposed draft Terms of Reference relating to the Market review into the supply of card acquiring services but is concerned that the scope, as proposed, is too restrictive and needs to be expanded for the following reasons:

Card-acquiring services

3.6 Question 1
Chapter 1, para 1.7

Do you agree with our description of card-acquiring services?
No.

If not, please explain:

a. how our explanation should be altered
   - *para 1.6 should be amended to read "Card payment systems enable people to make payments using debit, credit, charge and pre-pay cards. The systems are administered by the card scheme operators. To accept card payments, merchants need to buy card-acquiring services."*
   - *Para 1.7 should be amended to read "Card-acquiring services are services that accept and process card payments on behalf of a merchant to enact a transfer of funds to the merchant less associated fees."*

b. why you think the description should be altered in this way
   - *Card payments are not limited to just debit and credit cards, but also include charge cards and pre-paid cards*
   - *Para 1.7 doesn't adequately reflect the movement of funds or a fee being incurred for the provision of the service.*

EuroCommerce
THE RETAIL, WHOLESALE AND INTERNATIONAL TRADE REPRESENTATION TO THE EU

Why we are carrying out this market review

The statement at para 1.15 which states that "Interchange fees typically make up the largest portion of the fees that merchants pay to acquirers" may be true for the larger merchants who have been able to secure competitive card-acquiry pricing, however we suspect that this would not apply to smaller merchants where the card-acquiry fee can be significantly higher than the interchange fee as it seems the card acquirers may be using the additional profit from smaller merchants and SME's to subsidise in part the card-acquiry pricing quoted to the larger merchants.

Furthermore, following the introduction of the IFR and the corresponding reduction in interchange fees for consumer cards, new fees have been introduced or significantly increased others, which has resulted in interchange fees no longer being the largest portion of fees that some merchants pay to their card acquirer.

Scope

3.7 Question 2
Chapter 2, para's 2.7 to 2.13

Do you agree with the proposed scope of the market review?
No.

If not, please explain:

a. how the proposed scope should be altered
   - *Given that the fees levied by the card-acquirers and agreed with merchants include charges levied on them by the Card Scheme operator (for example card scheme fees, authorisation fees, network processing fees, chargeback fees etc.), the scope needs to be expanded to take into account all the other (non-negotiable) fees that contribute to the 'merchant service charge' (MSC) and not just the card-acquiry fee.*
   - *The scope should also take into account how card acquirers undertake their 'risk analysis' and the degree of appetite that card-acquirers have for risk. Quite often risk can be a reason why card acquirers decline to tender or levy significantly higher charges (see b. below).*

b. why you think the proposed scope should be altered in this way
   - *Since the introduction of the IFR, the card schemes have adapted their fee structure. Fees tend to act as a revenue generator and aren't commensurate to risk to the network or value to the merchant, particularly with regard to intra-regional costs, the card scheme fees of which have increased disproportionately over the last two years. The current scope is too narrow and focuses on only one portion of the cost that merchants pay as part of their overall MSC and fails to address the wider and growing problem of new or increasing other (non acquirer-related) charges levied by the card schemes.*
   - *Risk factors also need to be taken into account, since, as mentioned above, some card-acquirers decline to tender for a merchants business if they consider the risk of acceptance to be too high. As an example, we are aware of a tender by a merchant in the furniture sector that was circulated to five card acquirers for review. Three acquirers declined to tender, claiming the risk*

to them was too high and/or exceeded their risk 'threshold'. One acquirer submitted a response to the tender but their bank guarantee requirements were so high and onerous that acceptance would have had a material impact on the merchants' line of available credit from their bank. This resulted in them having to remain with their current acquirer.

- *Para 2.13 which makes reference to "Testing whether merchants have credible alternatives to card-acquiring services…" is therefore an extremely important requirement.*

3.8 Question 3
Chapter 2, para's 2.11 & 2.12

Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?
No.

If not, please explain:

a. how the focus should be altered
   - *It should also take into account fees levied by the card schemes which are ultimately passed through (in varying degrees) to the merchants.*
   - *Card acquiry arrangements for other card schemes should also be taken into account, such as China Union, American Express and JCB (in particular for SME's).*

b. why you think the focus should be altered in this way
   - *Card scheme and other fees are rising significantly and ultimately form part of the overall MSC*
   - *Given the dramatic rise in Asian tourists using other card schemes such as China Union and JCB cards should be taken into account in order to ensure that there is adequate competition in these areas. In doing so, the following comparisons should be drawn: How is pricing set for these type of cards? How much 'negotiating' power do merchants have? What are the margins being made by acquirers for these cards?*

Our proposed approach

3.9 Question 4
Chapter 2, para's 2.14 to 2.27

Do you agree with our proposed approach to understand whether the supply of card-acquiring services is working well for UK merchants and ultimately consumers?
No

If not, please explain:

a. how the focus should be altered
   - *See below*

b. why you think the focus should be altered in this way
   - *See below*

EuroCommerce
THE RETAIL, WHOLESALE AND INTERNATIONAL TRADE REPRESENTATION TO THE EU

3.10 Question 5
Chapter 2, para's 2.20 to 2.27

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

If not, please explain:

a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card acquiring services functions)
   - *The approach should also examine the level of differentiation applied by acquiring services between the large merchants and the SME's. Are differences restricted to price only or are other more onerous requirements imposed on SME's?. How transparent are the fees? Is the same level of reporting and transparency available to both?*
   - *Consideration should also be given to how card acquiry fees are calculated. What are the individual compenents that are used to calculate the fee? Are they fair & reasonable?*
   - *Given the huge range of card scheme fees that exist, how are card scheme fees calculated and how are they applied to individual merchants?*
   - *How can merchants verify they're being charged the correct fee when there is no transparency, particularly of card scheme fees?*
   - *Other new ancillary fees are being charged to merchants, such as authorisation fees, PCI non-compliance fees. Are they levied by the card schemes or by the acquirer or both? Are they consistently applied across all merchants or just SME's?*
   - *Is there any evidence that might indicate that card acquirers have exploited smaller merchants, particularly around fees and fines of non-compliance to PCI-DSS requirements.*
   - *Following the implementation of the IFR, what action (if any) were taken by card acquirers to engage with their merchants and make them aware of the Regulation and the impact it would have on their pricing? At what point were the reduction in fees passed through to merchants?*
   - *In January EuroCommerce undertook its own IFR survey[(1)], the responses to that survey suggested that a significant number of merchants (c.8%) had either not received the full reductions afforded to them by the Regulation or not seen any reduction at all, and a further 13% stating that they did not know. This suggests that the full benefits had not been passed through or merchants were unable to identify any benefit (perhaps because they hadn't been informed by their acquirer, or were on a blended rate and lacked visibility).*
   - *The scope should include a check to ensure that Article 9 (2) of the IFR has been correctly adopted by all acquirers and there is written evidence on file from all of their merchants on a 'blended' rate confirming that they did not want to accept transparent pricing i.e. an 'opt out' rather than their having to request transparent pricing or 'opt in'.*

b. why you think these additional issues have the potential to be relevant to the market review
   - *Because there is a suspicion that some acquirers and card schemes have used the IFR as reason to review their fees in other areas to either compensate for the reduction in interchange fees or as an opportunity to increase their prices (and margins).*

c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review
   - None

d. why you think those issues do not have the potential to be relevant to the market review
   - N/A

(1) The survey was undertaken in April, 2019, the purpose of which was to collect our own independent data on how effective the IFR has been perceived by retailers across the EU. There were 104 responses received from 54 legal entities (16% from the UK). The results of which were shared with the European Commission on 06 June, 2019.

[redacted]

[redacted]

Federation of Small Businesses

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

14th September 2018

Dear Sir/Madame

RE: FSB response to draft terms of reference for the market review into the supply of card-acquiring services

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to the draft terms of reference for the market review into the supply of card-acquiring services.

FSB is one of the UK's leading business organisations. It exists to protect and promote the interests of smaller businesses and the self-employed. FSB is non-party political, and with 165,000 members, it is the largest organisation representing small and medium sized businesses in the UK.

Small businesses – those with less than 50 employees – make up 99.3 per cent of all businesses in the UK. Medium sized businesses are another 0.6 per cent of the businesses in the economy. SMEs therefore are 99.9% of all businesses in the UK, and make a huge contribution to the economy. They contribute 51 per cent of the private sector output, amounting to £1.9 trillion and employ 60 per cent of the private sector workforce.

Thank you for considering our response to the consultation. We hope they are found to be useful. If you would like to discuss any of the points further please contact me via my colleague Lorence Nye, Policy Advisor, on 020 7592 8126 or lorencenye@fsb.org.uk.

Yours sincerely,

[redacted]

Federation of Small Businesses

Changing payment methods

It is impossible to ignore the changes in how consumers are choosing to make their payments. Digital payments recently took over cash payments in terms of volume after having a higher value than cash for a number of years.

The recent surge in low value transactions has been driven by the increase in prevalence of contactless payments. The UK currently leads the world in the proportion of cards that are contactless and this form of payment is clearly the easiest way to make low value payments.

The contactless system on the TFL has contributed to customer's changing behaviour. By making contactless payment an easy option to a vital part of people's daily lives, contactless has become very familiar to customers.

Small businesses who have high volumes of transactions suffer. The cost of processing card payments is greater than cash, the card payment processing cost appear to be ever increasing despite government action to reduce it and the fact that businesses have been banned from passing the cost on to consumers.

FSB is concerned that the costs of move toward digital payments is being is being shouldered by small businesses. Government legislation has protected consumers. Card issuers and service providers are able to shield their profit margins because of their market share. This has left small businesses caught in the middle. More must be done in order to spread the cost of these advancements across the economy.

Consultation questions

Question 1: Do you agree with our description of card-acquiring services?

Yes. It is correct that traditional card acquirers and payments facilitators are both being assessed as they appear to most merchants using them to be direct competitors. FSB hopes that through gathering evidence for this review more can understood about the differences between each model. If they are found to be significant understanding which model works better for different types of businesses should also be gained.

Question 2: Do you agree with the proposed scope of the market review?

Yes but PSR needs to be aware that there might also be need for a review that focuses on schemes. Visa have increased their scheme fees twice in two years. The first of these increases came in January 2017. The next April 2018 just three months after merchants were banned from passing on the cost of card payments to customers[1].

The potential that these increases prevent healthy price competition among acquirers is covered by the terms of reference. But if these fees are indeed a excessive or unfair in and of themselves may need to be looked at as a result of the current reviews findings.

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[1] Callum Godwin, Payments Intelligence extract: scheme fee increases, another uphill battle for merchants, 23rd January 2018, https://cmspi.com/eur/blogs/payments-intelligence-extract-scheme-fee-increases-another-uphill-battle-for-merchants/

Question 3: Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

Yes. As highlighted by the draft terms of reference the market share of Mastercard and Visa means that they are often the only cares small merchants are likely to come across with any regularity. There would be minimal benefit from assessing the other 2% of the market in any detail and getting this detail from merchants would prove difficult.

Question 4: Do you agree with our proposed approach?

Yes. FSB believes all of the key issues are being covered by the terms of reference as they stand.

Lack of clear competition and a seemingly captive group of merchants mean that looking at transparency and barriers to entry and switching are essential parts of this review.

The stipulation that scheme fees will be assessed if it is found that they have a negative impact on the rest of the market is an important one, however. The PSR must be acutely aware of the potential that schemes are functioning in a way that harms the wider market.

Question 5: Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

The efficiency, proportionality, transparency principles are all areas where the market is currently failing to deliver to small merchants. The fact that the PSR has made this central to the review is very important. FSB has heard from members that they do not feel that their card acquiring services deliver value for money.

A lack of transparency also plays a major part in this belief. As most small businesses are unable to understand the fees that they are required to pay by their acquirer, due to the unnecessarily complicated payment structure and bills. Because they do not see the link between cost and service it is difficult for merchants to see the value of the service and are instead using it because it is a necessity.

A lack of transparency hampers the ability for rich competition in the market because firms are unable to discern if they are able to get better value elsewhere.

Proportionality is also a concern as it is clear, particularly with the ban on card charges that small business owners are shouldering the bulk of the cost of moving toward digital payments.

First Data

PAYMENT SYSTEM REGULATOR'S MARKET REVIEW INTO THE SUPPLY OF CARD ACQUIRING SERVICES

FIRST DATA'S RESPONSE TO THE MARKET REVIEW'S DRAFT TERMS OF REFERENCE – 14 SEPTEMBER 2018

Introduction to First Data

First Data is a leading global payments processor and merchant acquirer, with 23,000 employees in 35 countries, serving customers in 118 countries on five continents. We have over 40 years of experience in payment processing and merchant acquiring.

We provide payment processing services to financial services customers including large, mid-tier and small card issuers in the United Kingdom. We also have fully-owned merchant acquiring businesses in the UK, Germany and Poland and merchant acquiring joint ventures with bank partners in the UK, Ireland and the Netherlands.

As a company with a long history of providing innovative solutions in the payments space, we support thousands of financial institutions and millions of merchants, large and small, in their management of domestic and cross-border electronic retail payments, whether these are by card, e-commerce or mobile payments.

First Data provides a comprehensive array of solutions, including debit, credit and prepaid card processing, card production, print and correspondence, customer contact, internet banking and bill payment, loyalty and marketing, risk and fraud management, data analytics and mobile commerce.

We also facilitate merchants to accept consumer payment transactions (e.g. credit, debit, stored value, contactless and loyalty cards) at the point of sale, whether those transactions occur at a physical location, over the phone or by internet. First Data Europe Limited holds a payment institution licence under the Payment Services Directive and is a principal acquiring member of both Visa and MasterCard.

First Data responses to specific questions in the consultation

Question 1

Do you agree with our description of card-acquiring services?

If not, please explain:

a. how our description should be altered

b. why you think the description should be altered in this way

Please include any evidence you think is relevant to your response.

First Data response:

The PSR's description of card acquiring services as being "services to accept and process card payments on behalf of a merchant resulting in a transfer of funds to the merchant" is strictly accurate. However, any analysis of UK card acquiring should not only include acquiring services provided by acquirers and payment facilitators, but should also look at card acquiring services in the context of the whole market, which includes multiple participants, not only traditional card acquirers.

Card acquiring services represent much more than payments to merchants, but can also include transfer of funds from the merchant, such as cardholder credits and refunds. There is also an important and robust consumer protection element within merchant acquiring. This is delivered in the form of fraud monitoring and risk underwriting, which mean acquiring services include a significant element of risk management and underwriting to underpin confidence in the payment system.

The Terms of Reference could therefore i) start with the EU legal definition of acquirer under the Interchange Fee Regulation (IFR), ii) clarify that this includes all entities providing relevant services, i.e. acquirers and payment facilitators, iii) clarify that this should include transfer of funds, and iv) clarify that the services provided by acquirers should include both a) risk management and b) underwriting.

We would also note that licensed acquirers protect cardholders against the consequences of a spectrum of merchant defaults and failures, and effectively underwrite a large part of UK payment activity in the process.

Question 2

Do you agree with the proposed scope of the market review?

If not, please explain:

a. how the proposed scope should be altered

b. why you think the proposed scope should be altered in this way

Please include any evidence you think is relevant to your response.

First Data response:

We agree with the proposed scope of the market review as covering acquirers and payment facilitators. We also agree that card scheme operators and other services that are related to card acquiring services, e.g. the provision of POS terminals, should be in scope if they affect the supply of card acquiring services.

We note that there is no clear definition or illustration of what may constitute "ancillary services" c.f. Point 2.10 of the draft Terms of Reference. It is therefore not clear whether the PSR intends to analyse <u>all</u> services provided by acquirers. In addition, does Point 2.10 target only services provided by non-acquirers?

We would also note that Point 1.15 of the Terms of Reference states that the IFR "relied on effective competition between acquirers to ensure benefits of the interchange fee caps flowed through to merchants and ultimately consumers". However, this statement does not reflect the fact that the EU legal framework aims at not only a competitive payments market, but also one that ensures secure, efficient, and innovative electronic payments. In other words, innovation is a key factor in the evolution of payments markets. We would therefore recommend that the PSR takes these issues into account as it reviews the UK acquiring market.

Question 3

Do you agree with our proposal to focus on card-acquiring services for MasterCard and Visa?

If not, please explain:

a. how the focus should be altered

b. why you think the focus should be altered in this way.

Please include any evidence you think is relevant to your response.

First Data response:

We agree with the PSR's plans to focus the consultation on Visa and MasterCard, as they are the two dominant payment schemes.

However, irrespective of whether the PSR's Market Review is to focus on MasterCard and Visa alone, there should in any case be a better recognition of the role that scheme fees play in the payments market, as well as the schemes' ability to dictate terms of business that drive mandatory technical and operational, cost and investment as well as the role that card acquiring has in facilitating and delivering benefit to players in the wider payments ecosystem.

We are also concerned that the proposed Terms of Reference may not allow the PSR to pick up in its findings the other entities playing in the card payments space and adding cost and complexity that might be broadly but wrongly attributed to the pure ' card acquiring' market.

We would also highlight that under the European Union's revised Payment Services Directive (PSD2), the UK acquiring market has been opened to increased competition in the e-commerce and mobile payment space, especially from new fintech market entrants. While these entities do not yet enjoy significant market share, it is possible that some of them could become major players in the future. As such, it may be worthwhile to examine this issue also.

Question 4

Do you agree with our proposed approach?

If not, please explain:

a. how proposed approach should be altered

b. why you think the proposed approach should be altered in this way

Please include any evidence you think is relevant to your response.

First Data response:

We support the PSR's approach in examining whether the supply of card acquiring services is working well for UK merchants and consumers.

We would ask the PSR to consider using the format of analysis foreseen under the IFR for the review of the Regulation, i.e. "*taking into account the use and cost of the various means of payments and the level of entry of new players, new technology and innovative business models on the market*".

For example, Article 17 of the IFR provides a list of specific factors to be assessed for the review of the Regulation. These include:

- **the development of fees for consumers**
- **the level of competition among payment card providers and payment card schemes**
- **the effects on costs for the payer and the payee**
- **the level of merchant pass-through of the reduction in interchange fee levels**
- **the technical requirements and their implications for all the parties involved.**

The PSR highlighted several issues in its consultation document, including whether there are credible alternatives to card acquiring services for merchants, how acquirers compete for merchants' business, and how merchants buy acquiring services. These are

all relevant issues, as are the examination of barriers to new market entrants, and any difficulty for merchants in switching acquirer or searching for alternative service providers.

Our experience is that the UK card acquiring market is very competitive (please see also our answer to Question 5 below), with few restrictions on new market entrants. However, notwithstanding the caps introduced on interchange, we have noticed a steady increase in fees being charged to acquirers by payment schemes since the Interchange Fee Regulation came into force in January 2015.

First Data supports therefore the PSR's envisaged approach to collect detailed data on scheme fees and interchange fees – including on how they have changed over time. The PSR should notably analyse the possible knock-on effects whereby the cost of certain card acquiring services to merchants may have been impacted by payment schemes' fees. This has in many instances offset any cost reduction the IFR introduced.

Question 5:

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

If not, please explain:

a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card
acquiring services functions)

b. why you think these additional issues have the potential to be relevant to the market review

c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review

d. why you think those issues do not have the potential to be relevant to the market review

Please include any evidence you think is relevant to your response.

First Data response:

Focusing on price controls through interchange fee caps would seem to have limited effect and only impacts an element of the fixed costs of accepting international payment cards. Generally, the UK payments market is highly competitive, which seeks through innovation and increased competition to provide the best possible value to merchants and consumers. The future regulatory focus should be on enhancing competition and removing restrictions on market entry and access, and focusing on the payment acceptance market as a whole. As an example, the introduction of PSD2 is helping to open up the market for payments in the UK.

The issues under review in this consultation are highly relevant for the UK acquiring market. As the market develops, the next generation of POS devices needs to be future-proofed as far as possible for new payment types. At the same time, these devices also need to provide security of both transactional and personal data. Industry standards to support these developments are rapidly emerging and, consequently, the investment in new POS acceptance devices and platforms is significant.

In that context, First Data believes that its next generation card acceptance solutions provide merchants with a future-proofed, best-in-class solution, enabling rapid deployment of value-added services tailored to specific merchant sectors in a clearly differentiated product offering.

First Data is one of the few acquirers in the UK market to invest in developing its own differentiated, highly-functional next-generation POS terminals. Our experience is that the development of these solutions is extremely costly. Additionally, certification of these solutions is fragmented internationally, which leads to increased compliance and deployment costs.

More generally, we would like to note that the UK card acquiring market is extremely competitive. In our estimate, there are approximately 35 merchant acquirers and Independent Sales Organisations (ISOs) vying for market share, with new ISOs entering the market all the time.

We estimate that the typical small merchant is approached by a competing card acquirer at least every month with the aim of winning their business. In that competitive environment, where many merchants are presented with new offers on a monthly basis, there would seem to already be a very wide choice for merchants. This competitive environment also ensures that attractive pricing to merchants for acquiring services are maintained.

Global Payments

Global Payments
51 DeMontfort Street
Leicester
LE1 7BB

www.globalpay.com

September 2018

Payment System Regulator - Market review into the supply of card-acquiring services.

Global Payments comments on the draft Terms of Reference.

Introduction

GPUK operate as a Merchant Acquirer within the UK and across some European jurisdictions. We currently serve around 70,000 merchants offering a range of card processing products that allow a variety of payments methods to consumers within the UK, EU and Worldwide.

GPUK would like to thank the Payment System Regulator for the opportunity to consider the draft Terms of Service proposed for their market review into the supply of card-acquiring services, and welcomes the chance to provide feedback to the questions posed within the consultation.

GPUK would also be happy to meet with Payment System Regulator directly to discuss our responses further should this be beneficial.

Question 1 - Do you agree with our description of card-acquiring services? If not, please explain a) how our description should be altered, and b) why you think the description should be altered in this way. Please include any evidence you think is relevant to your response.

Global Payments would like the Payment System Regulator to consider an alteration of the description of card-acquiring services. The description used focuses on Card Acquirers, and whilst it reflects other elements in the value chain, the description needs to define how costs or services offered by other parties within this chain will be removed from the review.

Services are often bundled together by non-acquirer suppliers within the chain, which can lead to a single bundled cost to the merchant. An example would be the various ISO's operating within the market, providing terminals, services and memberships that are often included in the overall acquiring costs seen by the merchant. There are also many eCommerce gateway providers operating within the market that also include their costs within a bundled overall acquiring price.

Global Payments urges the Payment System Regulator to consider these comments, and make the definition clearer to include these non-regulated entities within the review. It would also be useful if exclusions of the review are defined.

Question 2 - Do you agree with the proposed scope of the market review? If not, please explain a) how the proposed scope should be altered, and b) why you think the proposed scope should be altered in this way. Please include any evidence you think is relevant to your response.

Global Payments is of the view that whilst the Payment System Regulator has achieved a good definition of card acquirers, this is limiting, and does not accurately reflect all the current participants within the industry.

Paragraph 1.7 provides a wide definition of card acquiring services, but restricts the participants to a traditional acquiring model, and marketplace. Global Payments view is that the parameters should include any party within the value chain that applies a charge directly to merchants for the provision of card acquiring, especially where this is bundled with other service/supplier charges. The scope appears to reference that prices are controlled purely by the card acquirers, when in reality, merchants can chose to buy a number of services from a number of suppliers, or a number of services from a single provider and this can lead to an inflation of the actual fees.

The scope should also consider rental costs, and if these rental agreements or memberships create any form of obstacle, either through the duration of the agreement, or penalty fees for early exits. However it is worth noting that a majority of the suppliers currently sit outside the regulations, so are able to circumnavigate the requirements to be registered with the FCA, thus removing some protections for merchants such as FOS rights.

Following on from the above point, the consultation paper references a review of the cost of card acceptance, and compliance with the IFR on unblended pricing within reseller and ISO activity. However as stated, these providers usually sit outside the regulations and FCA scope, so currently any adoption of the requirements is on a voluntary basis.

Another example of this is where an eCommerce merchant usually requires a number of services such as a card acquirer, gateway (PSP) provider, web development provider, shopping cart provider, card storage providers etc.. and these services are sometimes bundled into a single fee, either monthly or per transaction. Therefore the scope of the review should consider the component parts being utilized by merchants to understand the cost of processing a transaction versus the cost of support and add on services.

Global Payments would welcome the scope of the review to include these ancillary services/providers.

Global Payments would also like the Payment System Regulator to consider the non UK card acquirers and their impact on the industry.

Question 3 - Do you agree with our proposal to focus on card-acquiring services for MasterCard and Visa? If not please explain a) how the focus should be altered, and b) why you think the focus should be altered in this way. Please include any evidence you think is relevant to your response.

Whilst MasterCard and Visa do represent a majority share of the UK Market at present, other card schemes could be considered as they are starting to represent a growing percentage.

Global Payments would welcome the Payment System Regulator to consider extending the scope of the review to other card schemes operating within the UK, and include both 3 party and 4 party schemes. The IFR is inclusive of other card schemes within the industry, so it would appear unfair to exclude these schemes from the review in particular when exploring the implementation of the IFR.

Question 4 - Do you agree with our proposed approach? If not, please explain a) how proposed approach should be altered, and b) why you think the proposed approach

should be altered in this way. Please include any evidence you think is relevant to your response.

Global Payments would welcome a revised approach to the review based on the feedback provided within the other sections of the consultation.

In principle, Global Payments is supportive of the review the Payment System Regulator outlines within the draft Terms of Reference.

Question 5 - Do you have any comments on specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? If not, please explain a) what, if any, additional issues should be included (ie factors that affect how the supply of card-acquiring services functions), or b) why you think these additional issues have the potential to be relevant to the market review, or c) which, if any, of the issues in Chapter 2 do not have the potential to be relevant to our market review, or d) why you think those issues do not have the potential to be relevant to the market review. Please include any evidence you think is relevant to your response.

Global Payments would welcome the review to consider the impact the IFR has had on the market, in particular any unintended consequences that may have arisen.

An example is the impact unblending has had on merchant's ability to understand their pricing and statements. Whilst Global Payments is fully supportive of transparency in this area, feedback from merchants suggests this can sometime be confusing, especially where other suppliers such as ISO's include their pricing within the structure. Global Payments is constantly looking at ways to compliantly make merchant statements easier to understand, however there appears to be some inconsistency within the industry within this area.

The Payment System Regulator may also want to consider the number of participants within the industry that fall outside of any direct regulation, in particular by the FCA, and the impacts this is having on the market within the UK.

The review could also include an activity to validate contractual terms for all elements within the value chain. The ability to purchase add on services from multiple suppliers could create barriers to switching. It is critical that non regulated elements are considered within the scope, as device or service providers may be tied into a specific provider, but not a card-acquirer.

Lastly consideration of eCommerce gateway providers and similar participants could add value to the review to understanding what barriers there are to switching.

Gradeon

From: [redacted]
To: cards@psr.org.uk
Subject: Payment review

Hi. I read through the objectives of the review and note that this seems to be a financial review to establish if merchants are being treated fairly.

I would like to see some qualification of the responsibilities of merchants to secure card holder data. In our experience after nearly 9 years most merchants have no understanding of PCI-DSS regulations or their responsibilities. Most acquirers and payment service providers see non compliance fees as a cash cow so the industry will never evolve and change unless something changes or the pressures increase to force fines and effect change.

It would be nice to at least highlight the issue.

Thank you,

[redacted]

HSBC

HSBC BANK PLC and HSBC UK BANK PLC

MARKET REVIEW INTO THE SUPPLY OF CARD-ACQUIRING SERVICES:

DRAFT TERMS OF REFERENCE

RESPONSE TO PSR CONSULTATION DATED JULY 2018

14 SEPTEMBER 2018

COVER SUBMISSION

Both HSBC Bank plc and HSBC UK Bank plc welcome the opportunity to respond to the Payment Systems Regulator's consultation on the draft Terms of Reference for the card-acquiring Market Review.

As highlighted in the draft Terms of Reference Introduction, both Debit and Credit Card payments are of critical importance to the UK economy. The merchant and card-acquiring ecosystem has evolved significantly over the last decade and will continue to develop in light of PSD2 and the introduction of alternative payment methods. At its very heart, card-acquiring continues to fulfil a critical function, providing merchants of goods and services with guaranteed funds for card payments, provided of course the appropriate Card Scheme rules have been followed.

Background

In August 2008 HSBC Bank plc (HSBC) entered into a joint venture with Global Payments Inc. in respect of HSBC's UK Visa and MasterCard acquiring business, HSBC Merchant Services LLP (HMS). HMS was 51% owned by Global Payments, with the remaining 49% of shares continuing to be held by HSBC

In July 2009, HSBC sold its remaining shareholding in HMS to Global Payments, with the result that HMS became wholly owned by Global Payments.

On the basis that neither HSBC Bank plc nor HSBC UK Bank plc have been directly involved in card-acquiring in the UK for the last decade, we are unable to comment on a number of aspects of the Terms of reference, but we do have some general comments to offer for the Payment Systems Regulator's (PSR) consideration

1. **Question 1: Do you agree with our description of card-acquiring services? If not please explain:**

a) How our description should be altered;

b) Why you think this description should be altered in this way;

Please include any evidence you think is relevant to the response.

1.1 The description of card-acquiring services appears to be very broad and in order to ensure an effective Market Review, we recommend that the description should be refined.

1.2 Card-acquiring today is a multi-faceted set of propositions and it is important to distinguish between the core card-acquiring transaction service and ancillary or complimentary services that may be offered to merchants. Today a range of third parties can be involved in a single transaction (e.g. gateways and terminal provision) and it is therefore important to define clearly what components of the card-acquiring services are and are not included within the scope of the Market Review.

1.3 It is also important to be specific on the geographic scope of the Market Review. Given the PSR's remit, we are assuming that the scope is limited to UK cardholders and UK merchants, undertaking domestic sterling transactions. It would be helpful if clarification is provided as to whether intra-regional (within Europe) or international (rest of the world) card transactions are included and if so, is that from the cardholder's, merchant's or both perspectives.

2. **Question 2: Do you agree with the proposed scope of the market review? If not please explain:**

a) How the proposed scope should be altered;

b) Why you think the proposed scope should be altered in this way;

Please include any evidence you think is relevant to the response.

2.1 We recommend that the role of the Card Schemes be more precisely defined within the Market Review, given the influence that the Card Schemes have in the card-acquiring market place. Two examples for consideration are the impacts of the Card Schemes rules and regulations and the Card Schemes' card-acquiring core and non-core processing fees.

2.2 Given the divestment of HSBC's UK Visa and MasterCard acquiring business, we do not have any further comments or issues to raise for the PSR's consideration.

3. **Question 3: Do you agree with our focus on card-acquiring services for MasterCard and Visa? If not please explain:**

a) How the focus should be altered;

b) Why you think the focus should be altered this way;

Please include any evidence you think is relevant to the response.

3.1 Today MasterCard and Visa transactions account for the majority of UK card traffic. However other card schemes are continuing to grow and it is worth considering when is the right time to bring other card schemes within the scope of the market review. In any event, we suggest the PSR should consider whether any of the matters it considers as part of the review could have an impact on future development of the relevant markets, including on acquiring services for other schemes.

3.2 Given that the Interchange Fee Regulation includes provisions for the other Card Schemes within the regulation, it would seem prudent to consider their inclusion within the market review.

4. **Question 4: Do you agree with our proposed approach? If not, please explain:**

a) How the proposed approach should be altered;

b) Why you think the proposed approach should be altered this way;

Please include any evidence you think is relevant to the response.

4.1 Given the divestment of HSBC's UK Visa and MasterCard acquiring business, we do not have any further comments or issues to raise for the PSR's consideration.

5. **Question 5: Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review:**

a) What, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions);

b) Why you think these additional issues have the potential to be relevant to our market review;

c) Which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review;

d) Why do you think those issues do not have the potential to be relevant in the market review;

Please include any evidence you think is relevant to the response.

5.1 Given the divestment of HSBC's UK Visa and MasterCard acquiring business, we do not have any further comments or issues to raise for the PSR's consideration.

iZettle

From: [redacted]

To: cards@psr.org.uk
Cc: Subject: [redacted]
Re: Non-confidential version of your response to PSR MR18/1.1 - Deadline 24 October

"Question 1
Do you agree with our description of card-acquiring services?
If not, please explain:
a. how our description should be altered
b. why you think the description should be altered in this way

iZettle's feedback: We agree with your description.

Question 2
Do you agree with the proposed scope of the market review?
If not, please explain:
a. how the proposed scope should be altered
b. why you think the proposed scope should be altered in this way

iZettle's feedback: We agree with your proposed scope. Especially we support that Point-of-Sale terminals should be in scope as we believe they do affect the market conditions. See further comments on this topic under Question 5.

Question 3
Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?
If not, please explain:
a. how the focus should be altered
b. why you think the focus should be altered in this way

iZettle's feedback: We agree with your proposed focus.

Question 4
Do you agree with our proposed approach?
If not, please explain:
a. how proposed approach should be altered
b. why you think the proposed approach should be altered in this way

iZettle's feedback: We agree with your proposed approach.

Additional feedback: We do look forward to the market review and its outcome. Regarding sections 2.25-2.27 we agree with the PSR that it can be difficult for merchants to find comparative services that facilitate their decision making. Just like the PSR, we hope that one outcome of the review will be that it becomes easier for the merchants to inform themselves, make informed decisions and get a better understanding of the card-acquiring market.

Question 5
Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be

relevant to the market review? If not, please explain:
a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions)
b. why you think these additional issues have the potential to be relevant to the market review
c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review
d. why you think those issues do not have the potential to be relevant to the market review

iZettle's feedback: We believe all the issues of interest have potential to be relevant to the market review.
In addition, we propose that you include as a specific issue of interest, the different certifications that payment facilitators and acquirers need to go through when launching new or making changes to the POS terminals. For each new or changed kernel update or configuration setting of a POS terminal, the firm needs to obtain the appropriate certifications with EMVco, card schemes and acquirers (in the case of payment facilitators).

In our view, the certifications serve as a barrier of entry which slows down the time-to-market for both innovative solutions and general product updates. "

Best regards

[redacted]

[redacted]

iZettle – Tools to run your business

izettle.com

Lloyds Banking Group

LLOYDS BANKING GROUP PLC

PSR market review into the supply of card-acquiring services

Response to the draft terms of reference

11 October 2018

The information contained in this response is provided to the Payments Systems Regulator (PSR) in relation to the PSR's market review into the supply of card-acquiring services. This response has redactions from the original sent to the PSR on 14th September, to remove confidential information that should not be shared with third parties or be made publicly available.

LLOYDS BANKING GROUP PLC

Response to draft terms of reference

Lloyds Banking Group is a provider of card acquiring services through Cardnet. Cardnet is a joint venture with First Data, one of the world's largest card processors.[1] We are also a provider of business banking services to merchants, and a card issuer to consumers in the UK. We therefore serve all of the customer groups that will be affected by this market review, and so are well placed to help the PSR understand the relevant markets. We would welcome an open engagement and discussion with the PSR on the issues and evidence throughout its review.

In relation to the interchange fee cap, we passed on the reduction in interchange fees in full to our customers at around the time the cap was introduced. [redacted] Interchange fees per transaction have significantly reduced [redacted]. In the meantime, scheme fees per transaction have increased by 150% since 2012. We will be pleased to provide further data to support the PSR as its investigation progresses.

Figure 1. Index of Cardnet merchant acquiring fees per transaction over time

Table "Figure 1" redacted

Source: LBG analysis

We respond below to the PSR's consultation questions, but do not comment further on the specific issues raised at this time. We have three main comments on the PSR's draft terms of reference:

- One of the concerns given for why the PSR is carrying out this review is that "the scheme fee portion of the fees that merchants pay to acquirers is increasing significantly". [redacted]. However, the three specific issues that the PSR has identified as the focus of this Review do not address any potential concerns around scheme fees.

  The PSR does say it will collect data on how scheme fees have changed, but that further investigation of scheme fees is not part of this Review. We understand that the PSR may wish to keep an investigation into scheme fees separate. However, before it undertakes a full Review of card-acquiring services, it should first establish the extent to which any concerns are

[1] Customers contract with Lloyds Bank plc trading as Cardnet.

explained by rising scheme fees. Only then will it be able to identify what further concerns remain and what the specific issues of interest should be.

- The PSR identifies three specific issues for its review. These relate to the:

  1. supply side (barriers to entry or expansion in card-acquiring services);
  2. demand side (barriers to switching or searching that merchants face); and
  3. the availability of services that facilitate merchant decision-making.

  We acknowledge the PSR's concern that there might currently not be enough services in the market to help with merchant decision-making. However, when assessing issue 3 the PSR should avoid prejudging a finding within issue 2 that the availability of such facilitation services is a barrier to effective competition on the demand-side. It is too early to draw this conclusion without completing first an assessment of scheme fees and then of issues 1 and 2, particularly an assessment of barriers to searching that merchants face. The availability of services that facilitate merchant decision-making may not be a barrier, or maybe less important than other barriers that are identified.

  The PSR should conduct its work in phases and first reach its findings on scheme fees and issues 1 and 2. It can then identify whether issue 3, or some other more specific issues, require further review, and which of these should be prioritised. This will help to focus the PSR's work and ensure it gives the appropriate weight to each issue in its review.

  The PSR should avoid narrowing its scope and should consider all merchant acquiring services in the market, including those that compete with card-acquiring for Visa and Mastercard. This is important for understanding competition in the market today, particularly for online merchant acquiring where there are significant non-card acquiring services. We estimate that PayPal processes 23m payments a year with a total volume of £580m in the UK, and it offers both card-acquiring and online payment services.[2]

  The PSR's review should also be forward looking and its findings relevant to how competition will work in future with the emergence of new services, including PSD2-enabled merchant acquiring (i.e. Payment Initiation Service Providers or PISPs), not just at the acquiring models used in the recent past.

Finally, we would encourage the PSR to consider its approach to engaging with the parties during the review. In our experience, the robustness of findings is enhanced by working with providers and engaging in a two-way dialogue on the specific issues. This does not require additional formal publication, but should allow for an exchange of views on emerging thinking. We would be very happy to engage with the PSR in this way throughout the investigation.

We provide comments on the specific questions below.

[2] PayPal payment volume and value is estimated using LBG internal data on its customer base

Response to consultation questions

1. Do you agree with our description of card-acquiring services?

We broadly agree to the general description of card-acquiring services in Chapter 1, paragraph 1.7: "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". This description should cover several different models of acquiring services that exist or are currently emerging.

However, in paragraph 1.2 of Annex 1, the PSR describes a very specific model of card acquiring: "When a card is presented to pay for goods or services, the merchant sends an authorisation request to the acquirer who forwards this to the issuer via the card scheme operator. 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".

This is a narrower description of card acquiring services, which excludes other relevant services that can be provided today. For example, for the increasing volume of online transactions, merchants can choose to accept different models of card-acquiring, such as Paypal and Amazon Pay which do not follow this description. These other services are substitutes for both consumers and merchants and compete with the more traditional models.

The FCA acknowledge the range of models that may be possible in its Approach Document on Payment Services and Electronic Money: "While other models of acquiring may be possible, the PSRs 2017 define the 'acquiring of payment transactions' as a payment service "provided by a PSP contracting with a payee to accept and process payment transactions, which results in a transfer of funds to the payee," and this is in line with our view that the contract between the merchant and the merchant acquirer to which the definition refers involves the execution of payment transactions."

The PSR in its study should ensure that it maintains a generic definition of card-acquiring services (as set out in paragraph 1.7) and is agnostic to the particular model used.

2. Do you agree with the proposed scope of the market review?

The PSR proposes to narrow the scope of the review to exclude "the supply of products and services that are related to card-acquiring services", with the examples given of "services provided by card scheme operators…and the supply of point of sale terminals". The PSR does recognise that such related services should be in scope "insofar as they may affect the supply of card-acquiring services". Some of these related services may be relevant to the market investigation. The PSR will need to quickly identify which services should be in or out of scope based on how they affect the supply of card-acquiring services. We consider the provision of point-of-sale terminals to be within scope as it directly relates to the issues around supply of card-acquiring services.

3. Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

We agree that the PSR should focus on the supply of card-acquiring for Mastercard and Visa. However, this should not be to the exclusion of other acquiring services given the significant changes in merchant acquiring services expected over the next few years. The PSR proposes to exclude "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". For the PSR to give a complete and relevant assessment of competition in the market, it is critical that the market review is forward looking and considers in a robust way what competition for acquiring services is likely to be in the near future, not in the past.

4. Do you agree with our proposed approach?

We have no comments at this time on the PSR's proposed approach to the analysis. We would encourage the PSR to also consider its approach to engaging with the parties during the review. In our experience, the robustness of such reviews can be enhanced by working with providers and engaging in a two-way dialogue on the specific issues. This can be outside of the formal publications, and allow for an exchange of views on emerging thinking. We would be very happy to engage with the PSR throughout the investigation.

5. Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

The three specific issues that the PSR has identified as the focus of this Review do not address any potential concerns around scheme fees.

The PSR does say it will collect data on how scheme fees have changed, but that further investigation of scheme fees is not part of this Review. We understand that the PSR may wish to keep an investigation into scheme fees separate. However, the first specific area of interest should be the extent to which any concerns are explained by rising scheme fees. Only then will it be able to identify what further concerns remain and what other specific issues of interest should be.

In terms of card-acquiring, we agree that the specific issues relating to the supply-side (barriers to entry or expansion in card-acquiring services) and demand-side (barriers to switching or searching that merchants face) are a useful framework to approach the review. Focusing on these issues will allow the PSR to investigate the effectiveness of competition in the market.

The third specific issue is the 'availability of services that facilitate merchant decision-making'. This could be a useful issue for the PSR to investigate. However, it prejudges findings relating to the second issue (barriers to searching that merchants face). It may be that the availability of services to help merchant decision-making is a barrier, but it is too early to draw this conclusion.

The PSR should conduct its work in phases and first reach its findings on the other two issues. It can then undertake its work on the third issue if it finds this is required for effective competition in the market, or on any other issues it identifies through its review which become a higher priority. This will help the PSR to focus on the most important issues that emerge from its review.

Mastercard

CONSULTATION PAPER RESPONSE

Mastercard response to *PSR ‘Market review into the supply of card-acquiring services: Draft Terms of Reference‘*

14 SEPTEMBER 2018

mastercard

Introduction

In line with the scope of its regulatory remit, Mastercard recognises the importance of the PSR undertaking work within the cards sector. Whilst noting that the focus of the market review will be on the card-acquiring market, rather than on the card schemes, we look forward to engaging with the PSR wherever it may be helpful or relevant for us to do so.

However, we had understood from the PSR's previous statements on the cards market that its priority was to assess the impact of the Interchange Fee Regulation (IFR) before beginning any other form of review. The PSR has said repeatedly that it was too early to consider alternative types of intervention before understanding how the IFR has affected all of the various parties in a card payment transaction. That would have required an assessment of the impact on issuers and most particularly on cardholders, of the reduced levels of interchange. It would also have included a measurement of the extent to which consumers had benefitted (by way of lower prices) as a result of the reduced levels of interchange paid by merchants.

The proposed scope of the market review will not include any of these factors, which we regard as a significant omission, bearing in mind the priority to which the PSR itself has always attached to such an assessment. Indeed, the IFR is mentioned only very briefly in the draft Terms of Reference, which is noteworthy in view of its fundamental role in regulating card payments in general and card-acquiring services in particular.

The impact of the IFR on consumers is particularly relevant because they are mentioned several times in the draft Terms of Reference. The PSR makes various generic references to the importance of ensuring that the market is working "*in the interests of merchants and ultimately consumers*", on the assumption that their interests are always aligned and that consumers will automatically benefit as a consequence of the merchants doing so. As we outline later in this response, Mastercard fundamentally contests that assertion – the PSR cannot assume that consumers will benefit in any way from cost savings achieved by merchants.

The draft Terms of Reference makes no mention of the European Commission's review of the IFR which is expected to take place over a similar timeframe. Whilst the potential impact of Brexit on the application of the IFR in the UK is uncertain, there is clearly the potential that both the Commission and the PSR will be proposing remedies which will be designed to address the same issues and at least the possibility that those remedies may conflict. It is unclear how the PSR may be proposing to manage this situation, but it presents a significant regulatory risk to those who may eventually be subject to any remedies. The PSR should be explicit in the final Terms of Reference as to how it intends that its market review will run alongside the work of the Commission and how any remedies may co-exist.

Aside from these specific points, there are a number of areas in which we are seeking clarification of the PSR's intentions. In particular, we want to understand the extent to which the PSR is proposing to consider the competitive constraints on the card-acquiring market of alternative competitive forms of electronic payments, because we are concerned that the PSR may not be planning to do so in sufficient detail.

In addition, we are also somewhat concerned by the process which has led to the publication of the draft Terms of Reference. As we outline in the next section (and throughout the response) it appears that the PSR has made proposals as to the scope of the market review and its proposed approach, on the basis of a limited level of engagement with a small subset of self-selected stakeholders. This risks create bias in the market review from the outset, which the PSR will obviously want to avoid.

Existing Analysis

In its Annual Plan in March 2018, the PSR made a very brief reference to a proposed piece of work in the cards market. In the section entitled "*Our aims and activities for 2018/19*", the PSR outlined its proposals to continue to monitor compliance with the IFR, at the end of which it mentioned:-

> *"In the coming year, we also aim to explore wider issues relating to the way that the cards market works."*

Since that time, the PSR has made no further public statements about the nature or progress of this project. Mastercard has not been engaged in any form of evidence-gathering process nor had the opportunity to input or assist the PSR with developing its draft Terms of Reference.

Whilst we understand that the purpose of this current consultation is to allow for this input, we are nevertheless concerned that the PSR is already drawing conclusions on the basis of the limited engagement which has so far taken place. As we outline further in response to Questions 2 and 3, the PSR states that the proposed scope of the market review has been determined by those conversations, into which other interested parties have had neither input nor visibility.

Mastercard believes that the issues encompassed by the market review may be somewhat more complex and nuanced than the PSR has yet recognised. We are concerned that the PSR's limited engagement to date has given it narrow and binary view of the functioning of the cards market. It appears to be responding to specific complaints made by (unavoidably) self-interested parties, which may not providing a more holistic view as to the functioning, competitive nature and value of card payments.

The PSR has not identified the 'stakeholders' who have been raising concerns and so we cannot know how varied or representative they may be. We note the PSR's recognition that in the UK 1.38 million outlets accept card payments and so it is incumbent on the PSR to ensure that it engages a very wide range of opinion at every stage of the process and before any views are formed. Those outlets represent an incredibly diverse range of merchants, who are likely to have very different views on the importance and value of various forms of electronic payments. So we are concerned that attributing the views of a potentially very small sample, to "*most*" or "*many*" merchants might be inaccurate and risk distorting the market review from the outset.

The PSR must do everything possible to ensure that it reaches beyond the core group of merchants with which it usually engages and that it is more transparent about the engagement which does take place. The PSR's general practice is not to publish (non-confidential) responses to its consultations or even to list the respondees or attribute any views directly to them in its subsequent consultations or statements.

We would encourage the PSR to review this approach and consider being much more open about the views which it is hearing and from whom. The conduct and outcome of the market review will be determined largely by the representations made to the PSR. In the interests of ensuring that the market review is both fair and evidence-based, it would be helpful for all stakeholders to understand the views expressed by others.

Mastercard recognises that from time to time the PSR will want to have confidential conversations with certain interested parties, but it must adopt an inclusive approach which ensures that its views are not biased by the self-selecting nature of those who have chosen to make representations.

Response to Questions

Question 1

Do you agree with our description of card-acquiring services?

If not, please explain:

- ***a. how our description should be altered***
- ***b. why you think the description should be altered in this way***

Please include any evidence you think is relevant to your response.

Mastercard assumes that the first sentence of the description provided in para 1.7 is the formal definition of 'card acquiring services' which the PSR will adopt for the purposes of the market review, but we would welcome explicit confirmation.

The definition includes the core services provided by acquirers/payment facilitators, but it makes no reference to the role of payment gateways. Gateways perform a critical function in card payment transactions, although the services are often bundled with those provided by acquirers, so it is unclear whether the PSR has included them within its proposed definition. Either way, we assume that they will be within the scope of the review, but would welcome clarification as to how or where the PSR sees gateways being included.

It is important that the PSR recognises that there may be multiple participants in a payment transaction, depending on the complexity of the model adopted, which might depend on the size of the merchant in question. The merchants' acceptance costs may vary significantly as a consequence of which model is utilised. The PSR appears to recognise this at para 1.13, but has decided not to consider these factors, although they play a key role in the payment transaction. It would be helpful for the PSR to be explicit as to exactly which participants are included within its definition.

That aside, the PSR's definition appears to be self-explanatory and on which Mastercard has no comment. However, para 2.10 is less clear, where it states:-

> *"Supply of products and services that are related to card-acquiring services, including ancillary services, are not in scope except insofar as they may affect the supply of card acquiring services."*

We address the scope issues in response to Question 2, but Mastercard would welcome clarification from the PSR as to what exactly is meant by products/services "*related to card-acquiring*" and specifically "*ancillary services*", as well as those services which "*may affect*" card acquiring. Significantly (from Mastercard's perspective) para 2.10 also states.

> *"Services provided by card scheme operators would be an example of a service that could affect the supply of card-acquiring services."*

This raises two important questions upon which we would also welcome the PSR's further clarification.

- Firstly, which services provided by card scheme operators are being referred to? Card schemes provide a very wide variety of services ranging from rule-making and dispute resolution to fraud prevention and tokenisation. Arguably they might all in some way be viewed as indirectly affecting card-acquiring, but clearly the PSR is not intending to include the entirety of card schemes operations within this market review.

  So it is critical to understand which services provided by Mastercard are within the PSR's contemplation. It may be thought that the core service affecting card-acquiring is transaction authorisation, but that is actually a function of the Mastercard switch, rather than scheme (as separated by Article 7 of the IFR). Again, clarification is required.

- Secondly (and depending on the answer to the first point), the PSR should clarify its reasoning as to <u>why</u> it views certain card scheme services as affecting card-acquiring and therefore falling within the scope of the market review. Specifically, what is it about those services which "*affect*" the core card-acquiring service described in para 1.7, in a way which justifies their inclusion within the market review. Whilst there is clearly a close connection between the services provided by card schemes and acquirers, they perform distinct roles in card transactions and so there is a relatively high bar to overcome in order to conclude that one 'affects' the other.

  The inclusion of certain services may prove to be of some significance and so the PSR must explain at the outset the rationale for its decision. It is necessary because the reasoning will establish the parameters of what is included and allow all stakeholders a clear understanding of the basis upon which the PSR is conducting the market review.

Aside from card scheme services, the only other example given of 'other' or 'affecting' services is "*the supply of point of sale terminals*", which is a very specific case. It appears that the PSR has additional services in mind and so for all of the reasons outlined above, it would be helpful for the PSR to include more examples and possibly to expand its definition of card acquiring services, by reference to them.

Whilst we understand that at this stage the list of services to be included cannot be exhaustive, it is incumbent on the PSR to provide a more comprehensive view of what is included or (equally importantly) excluded, because of the impact which is has on the scope of the market review. Without certainty or clarity on this point, the final Terms of Reference will not provide interested parties with the essential information required to engage in the process.

Question 2

Do you agree with the proposed scope of the market review?

If not, please explain:

a. ***how the proposed scope should be altered***
b. ***why you think the proposed scope should be altered in this way***

Please include any evidence you think is relevant to your response.

The precise proposed scope of the market review is not clear to Mastercard, so it is difficult to provide a conclusive response on this point. In particular, it is not clear to what extent the PSR is intending to consider the competitive constraints on cards from other forms of electronic payments.

It appears from the extracts quoted below that the PSR may not be planning to do so in any detail. If so, Mastercard is concerned both by the reasoning which has led the PSR to adopt that approach, as well as effect it will have on the conduct and outcomes of the market review.

Will the PSR assess non-card forms of electronic payments?

In para 2.13, the PSR notes the existence of other (non-card) forms of electronic payments, but then states:-

> *"However, we propose to limit our scope of work to card-acquiring services."*

The reason for this decision would appear to be contained in the next sentence:-

> *"It appears likely that, for many merchants, accepting other types of digital payments is not currently a good alternative to accepting card payments."*

But in the following sentence, the PSR states:-

> *"Testing whether merchants have credible alternatives to card-acquiring services will be part of the market review."*

These statements appear to be potentially inconsistent. If testing whether merchants have alternatives to accepting card payments is an important part of the market review, the PSR should not be prejudicing that work by suggesting at this stage that such alternatives do not exist.

Mastercard believes strongly that there are indeed alternatives to accepting Mastercard cards and is most concerned that the PSR is suggesting otherwise. It is unclear on the basis of what evidence or analysis the PSR has made that statement. We noted at the start of this response the real risks of the PSR proposing positions on the basis of what appears to be a limited level of engagement with a very small number of stakeholders. It on this point at which those risks are most evident.

Whatever the basis of the PSR's decision to limit the scope of the review (or its assessment of alternative forms of payment), Mastercard believes that the PSR has provided wholly insufficient reasoning to justify its approach. These are critical questions which appear to have been based on a very limited view of the market. The PSR must consider the issues afresh, without any pre-existing bias which might have been inadvertently created as a result of limited engagement with a narrow group of stakeholders. It must then provide full reasoning for whatever decision it reaches.

For reasons which we address in further detail below, Mastercard strongly supports the PSR conducting a full analysis of the competitive ecosystem in which card payments operate. The PSR should refrain from drawing any conclusions about the effectiveness of competition in advance of having undertaken such an assessment.

Effect of not assessing non-card forms of electronic payments

Mastercard believes that it is critical for the PSR to include an assessment of non-card forms of electronic payments (most obviously various forms of interbank payments) within the scope of the market review.

The PSR's statement that "*many merchants*" do not have "*a good alternative to accepting card payments*" appears to be an unsubstantiated view which a certain category of merchants have expressed in the months leading up to the market review. But it cannot form the basis of the scope of the market review for two clear reasons.

- Firstly, the market review will begin in January 2019, which means that any remedies that the PSR might ultimately chose to adopt will not be in place before 2021, at the earliest. Any such remedies would presumably be designed to impact the market for a number of years beyond the date on which they are introduced. Therefore, views expressed on the payment methods available to merchants in 2017-2018 will have little, if any, relevance over the timeframe in which the outcomes of the market review are expected to have an effect.

  In any four to five year period, we might expect to see a significant level of evolution, but during this particular period the payments market will go through a revolutionary level of change, as open banking is implemented. The purpose of the reforms introduced by PSD2 was fundamentally to alter the competitive dynamics in the payments market and specifically to increase further the competition to card payments. The creation of Payment Initiation Service Providers will have a profound impact on how merchants accept payments and the sheer number of payment options available to them.

  The fact that open banking is not mentioned in the draft Terms of Reference appears to be a significant omission in the PSR's early analysis. Mastercard believes that it is impossible to understand the future of the card-acquiring market without analysing the competitive impact of open banking. It is vital that this is a core element of the market review, or else the outcomes will be based on an extremely limited and highly distorted view of the relevant market. It is essential that the PSR confirms in the final Terms of Reference that it will be undertaking this analysis.

- The second reason for questioning merchants' lack of alternatives to accepting card payments concerns the different payment options currently used by different types of merchant. As we outlined at the start of this response, the merchants which accept card (and other forms of electronic) payments are extremely diverse and cannot be treated as homogenous. But it appears as if the PSR might only have been engaging within a limited subset of high-street retailers for whom interbank payments are not yet a widely utilised payment method.

  The reality for other merchants is very different. Amongst larger merchants, we see that online card payments tend to be used more for occasional purchases with a variety of merchants, whereas interbank methods are favoured for regular or repeat payments. The latter category of merchants is incredibly diverse encompassing utility companies, financial services, childcare providers and government services, as well as those selling digital content, software, gambling services, website subscriptions.

  For many of these merchants (particularly utility or financial services providers) card payments may not even be accepted as direct debit is the only available option. For others, Faster Payments is the default or preferred option. In addition, there is a large number of (generally smaller) online merchants for whom digital wallets (funded by bank transfer) is an important and in some cases, the sole means of accepting payment. Alternative payment networks based on digital wallets are an increasingly significant factor in the payments market and therefore should be a core element of the PSR's analysis.

For all of these reasons, Mastercard believes that the PSR's view that merchants do not have alternatives to card payments is incorrect and not based on the available evidence. The introduction of open banking will further undermine this view. It is critical therefore that the PSR includes a consideration of all of these issues within the scope of its market review.

The PSR should also include within the proposed scope all forms of payment acceptance platforms, particularly some newer entrants to the market which are aimed at smaller merchants and those who may not previously have accepted card payments.

Question 3

Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

If not, please explain:

a. how the focus should be altered
b. why you think the focus should be altered in this way

Please include any evidence you think is relevant to your response.

We addressed in response to Question 2 the critical issue of whether the scope should be limited to card-acquiring services, so here we respond to the specific question of whether it should focus on the supply of those services in relation to Mastercard and Visa, as opposed to other card schemes.

We note from para 2.11 that although the PSR proposes to focus on Mastercard and Visa, this is a "*non-exclusive focus*" and that the PSR will also consider card-acquiring services in relation to other card schemes. It is not clear to Mastercard what the practical effect of a "non-exclusive focus" will be i.e. the extent to which other card schemes will or will not be within the remit of the majority of the PSR's activity. We would very much welcome further clarification on that point. However, for the purposes of this response, we assume that they will not be and that the market review will very largely focus on the supply of services in relation to Mastercard and Visa

The PSR's reasoning on this point is contained only within para 2.12 and appears to rely largely on a view of the combined market shares of Mastercard and Visa. But this analysis represents an overly simplistic view of the cards market by considering only the total number of cards operating under each scheme, which belies the considerable complexities and differences inherent in certain sub-sectors of the market.

In these sub-sectors, the 'smaller' card schemes may have a much stronger position than is apparent from the overall market shares. This is because the business models of the larger and smaller card schemes differ considerably, as the latter have a much more targeted focus on specific market sectors both in terms of the types of cardholders (generally more premium and international), but also the particular the merchant sectors in which they are seeking to achieve acceptance e.g. travel or high-end retail.

The importance of these sub-sectors should not be overlooked, simply because they may be smaller in absolute terms. For example, the co-brand market (most obviously where a card scheme partners with an airline or other large merchant) is significant in its own right and highly competitive between card schemes beyond Mastercard and Visa.

It is important for the PSR to develop an understanding of these wider issues. But as we outlined at the start of this response, Mastercard is most concerned that the PSR is drawing any conclusions, let alone making decisions on the scope of the market review, on the basis of limited stakeholder engagement and concerns raised to date.

It appears that the PSR has so far only heard the views of a particular category of merchants who might not perhaps be within the sub-sectors targeted by the smaller card schemes. Those merchants may not feel that acceptance of smaller schemes cards is important to their business. But Mastercard believes that other merchants operating in other sub-sectors will take a very different view. For them, the cardholders of the smaller schemes are very important customers and so the acceptance of those cards (and potential concerns related to that acceptance) is a much more relevant consideration.

However, even if the PSR does view considerations of market share as a relevant factor to consider (when deciding whether to include smaller card schemes within the scope) it is by no means the only one.

In para 1.11 the PSR outlines the factors (potentially adversely affecting merchants) which have led it to undertake this market review. Many of them are unrelated to the market positions of Mastercard and Visa. For example, concerns in relation to pricing transparency, scheme rules, acquirer switching and services to promote switching are no more or less relevant to card schemes with larger or smaller market shares. If those concerns exist, they will apply equally to all card schemes.

For that reason, Mastercard also does not agree with the logic of the third bullet of para 2.12, where the PSR states 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."*

As it is the customer who decides which payment instrument to use, the merchant may only complete the sale if it accepts that payment instrument. It is inconsequential to the merchant whether he chooses to use a card of a scheme with a larger or smaller market share, if that is the only payment instrument which the customer wishes to use.

On the question of the card acceptance fees paid by merchants, the PSR may find that those set by some smaller card schemes are above those set by the larger schemes, so it is not logical only to consider the impact of those lower fees. Once again, Mastercard believes that the PSR may have a distorted view of the issue due to the narrow set of merchants with which it has engaged so far.

For all of these reasons, Mastercard does not agree that the focus of the market review should be limited on to card-acquiring services for Mastercard and Visa. There does not appear to be any benefit in doing so, whilst the adverse consequences could be significant, if the PSR limits itself to considering an artificially determined subset of the cards market.

Question 4

Do you agree with our proposed approach?

If not, please explain:

a. ***how proposed approach should be altered***
b. ***why you think the proposed approach should be altered in this way***

Please include any evidence you think is relevant to your response.

The PSR has provided only limited details of its proposed approach, with which Mastercard is broadly content. We understand that the PSR's focus is on the market position of acquirers/payment facilitators (not card schemes) which reflects the concerns that have been raised with the PSR. But there are some points which we wish to highlight.

- Firstly, as we mentioned in the introduction, the PSR's proposed approach is apparently designed to determine "*whether the supply of card-acquiring services is working well for UK merchants and, therefore, ultimately consumers*", implying that their interests are always aligned and that consumers will automatically benefit as a consequence of any benefit accrued to merchants. Mastercard strongly disputes that assertion which we believe is entirely unsupported by any available evidence.

  Even if we set aside the fact that consumers (as cardholders) have suffered adverse consequences as a result of lower levels of interchange, there is no evidence that consumers (as purchasers) have benefitted from the reduction of interchange paid by merchants. It is a clear example of where the interests of merchants and consumers are not aligned because merchants have benefitted and they have not shared any of that benefit with their consumers.

  Mastercard therefore very strongly contests the generic assumption that '*what's good for merchants is good for consumers*' and testing this assumption should have been a core element of the market review. The evidence to date clearly demonstrates that at best, consumers will receive no benefit from increased profits/reduced costs to merchants and at worst they may well suffer, because ultimately they may be paying that price themselves. As a result, the PSR should not believe that the market review will in any way benefit consumers, unless it can demonstrate precisely how that benefit will accrue.

- Secondly, as mentioned in response to Question 3, Mastercard believes that it is vitally important that the PSR properly understands the alternatives to card-acquiring services, which must be a core element of the market review. Any eventual remedies which have not taken into account the competitive landscape risk causing significant unintended consequences in the market.

- Thirdly, we are unclear what is intended by the PSR's proposal to examine "*the regulatory and legal framework that applies to the supply of card-acquiring services*" and would welcome further clarification on this point. Is this simply a reference to acquirers' obligations under the IFR or PSD2, or an intention to conduct a broader analysis, with the potential to make recommendations for change?

  As the PSR highlights in para 1.19, its powers under FSBRA are limited to the payment systems which it regulates. Mastercard's understanding is that this would not include the activities of the acquirers, which are regulated by the FCA, including for example the quality of services which they provide (referenced in para 2.16). In that context, it is unclear on what basis the PSR is conducting this market review (of the services provided by acquirers) and whether it may therefore be relying on the FCA's powers, should it decide that any remedies are required. Again, we would very much welcome clarification, which could be extremely important, depending on how the market review progresses.

- Fourthly, we would welcome further clarification of the PSR's intentions regarding "*the outcomes of the competitive process*" including the fees merchants pay. Whilst Mastercard is happy to assist the PSR in any way possible, it's unclear how the fees which we charge to acquirers could have any impact on the outcome of the competitive process between them. This is because Mastercard fees are set at standard rates, equally applicable to all acquirers. Those fees are simply one element of cost incurred by the acquirers which (together with all of its other costs) may inform its pricing to its merchant customers. Mastercard has no visibility of (and certainly no means of influencing) the commercial agreement between acquirers and merchants, regarding the fees paid for card-acquiring services.

  The PSR's intention to collect "detailed data" regarding fees suggests a potentially significant administrative burden to provide large quantities of historical data. We would like to understand better from the PSR how these data are relevant to an assessment of the supply of card-acquiring services. When seeking this information, the PSR must be precise in relation to which services (affecting card-acquiring services) it requires fee information. A general request for data in relation to all Mastercard's fees would neither be proportionate, nor in line with the scope of the market review, bearing in mind that the majority of card schemes activities/services will be excluded.

  Likewise, it is unclear why the PSR is proposing to "*explore the factors that determine the level of scheme fees*". It is a complex and potentially time-consuming topic which does not appear to have any direct relevance to the substance of the market review and competition between acquirers. Again, we would welcome clarification and request that the PSR adopt a measured approach to the type and quantity of data which it may be requesting.

Question 5

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

If not, please explain:

a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions)
b. why you think these additional issues have the potential to be relevant to the market review
c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review
d. why you think those issues do not have the potential to be relevant to the market review

Please include any evidence you think is relevant to your response.

Mastercard notes that the three specific issues of interest are rightly focussed on understanding the level of nature of competition between acquirers. We have no substantive comments to make, but would question the PSR's view that "*scheme fees and the rules set by card scheme operators create or exacerbate barriers to entry or expansion*."

Card schemes are required by regulation 103 of the Payment Services Regulations to establish "*objective, proportionate and non-discriminatory*" rules on access to payment systems and generally not to "*prevent, restrict or inhibit access*". The PSR will be aware from its own monitoring work that no issues or concerns have been raised about gaining access to card systems and will also know that there are large number of acquirers active in the UK market. In addition, all of Mastercard's scheme fees and rules apply equally and without discrimination to all of our customers and we are not aware of any concerns have been raised in that regard.

It is unclear what may have prompted the PSR's concerns in this area and we would welcome further clarification on that point. However, we do not believe that this issue should form a significant part of the market review, unless the PSR has evidence to substantiate that there is a problem which requires further investigation.

Mastercard has no suggestions to make regarding additional issues to be included.

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14th September 2018

Payment Systems Regulator
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Dear Sir/Madam

Market review into card-acquiring services

We have seen a significant increase in our Merchant Service costs since the regulation were changed on the Interchange Fees, however, rather than reducing, as was the idea behind the change, our costs have rocketed.

Due to the nature of our business, we take a low volume of high value payments, with more debit cards than credit card payments.

Under the old regulations we were only charged about 25 pence to process a debit card payment, with a cost based on a percentage value of transaction for credit card sales, but we were able to pass that cost on to our customers and applied a small admin fee for any large credit card payments. Unfortunately, we can no longer pass on our credit card fees to customer so have to take the full hit for them.

After the cap on Interchange Fees was introduced our debit card merchant costs were changed to be charged as a percentage value of the transaction with no cap, so accepting debit card payment went from costing us a few pounds a month to hundreds of pounds.

We tried arguing with our merchant service provider at the time that the point of the changes to the Interchange Fee was to reduce cost to customers and Merchants to no avail, even pointing out if the fees they now paid for Interchange Fees were capped, why wasn't there any cap on how much we had to pay them, but they refused to apply a cap to our fees.

We had switched to them about a year before the Interchange Fee regulations were introduced, and they had got our business by promising us lower rates, just omitted to mention that after a year we would be paying a lot more. We shopped around a found there were quite a few providers offering capped rates for debit card transactions, showing there was no reason for our current provider not to be doing likewise. We switched to one of them who was charging between 66p and a pound for debit card fees, more than before the changes to the Interchange Fee Cap but a lot less than hundred of pounds we were paying after the changes.

Directors
Raymond Douglas, Maureen Douglas

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Our previous Merchant Service Provider did not charge us a fee for cancelling our merchant service agreement, but they did try to charge us a very large fee to end the lease on our card machine, so much so that it was cheaper for us to carry on paying the lease for the remaining two years rather than cancel it early.

Our new provider reviewed their fees after a year, as our sales were down due to the oil industry downturn affecting Aberdeen we had not reached the estimated card sales for our original pricing, and our debit cards were switched to a percentage rate rather than a capped rate per transaction, but still a lot less than our previous merchant service provider.

Then this year, using the excuse of changes being made by Visa and Mastercard, they sent us a note of new prices, which would more than treble our costs. We complained, and they came back with figures that were still over double what we were currently paying. We had no option but to shop around again, and virtually everybody we contacted said they had been inundated with enquiries from companies who were with our current merchant provider, so it wasn't just us who had received a massive rate increase.

We are currently in the process of switching to a new provider, who are considerably cheaper than our current provider were going to be. The only catch is we have to lease the card machine from the Merchant Service Provider who we were with before our current provider, as they hold a monopoly on the type of card machine, but we have been assure they will not be involved in setting our card fees.

There needs to be some form of regulation on Merchant Service Providers, because at the moment, they are free to increase our prices excessively mid contract, forcing us to accept them or go through the hassle of sourcing a new provider, who will probably put our prices up again in a few months. The introduction of caps upon Interchange Fees is not being passed on to Merchants, any savings are being retained by the Merchant Service Providers.

Yours sincerely

[redacted]

Onestopmoneymanager Ltd

Onestopmoneymanager Ltd

Response to the Payments System Regulator: PSR MR18/1.1

Market review into the supply of card-acquiring services: Draft Terms of Reference July 2018

Submission by:
Onestopmoneymanager Ltd
West Sussex

13th September 2018

Submission to:

Payment Systems Regulator
Card-acquiring market review team
12 Endeavour Square
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1.EXECUTIVE SUMMARY

1.1 Onestopmoneymanager Ltd has been a merchant acquirer since 2013 and is relatively small compared to the larger acquirers that dominate the market. We are essentially a family business. However, our seasoned executives have many years of experience in the e-commerce space of the card acquiring market.

1.2 Onestopmoneymanager Ltd ("OSMM") would like to raise a number of concerns regarding stringently regulated but non-discriminatory access to market and also very real competition issues.

As referenced by the PSR, card payments are indeed critical to the function of the UK economy – credit card payment volumes are forecasted to reach 3.9 billion GBP by 2027[1]. These numbers also suggest that there is dire need for a market review relative to the supply of card-acquiring services.

Accordingly, we welcome the opportunity to provide our response to the Payment Systems Regulator ("PSR") in regards to the supply of card-acquiring services, titled 'Market review into the supply of card-acquiring services: Draft Terms of Reference July 2018'.

Consultation questions

Question 1:

Do you agree with our description of card-acquiring services?

We generally agree with your description of card acquiring services. Card acquiring services involve a multitude of parties involved in the transaction cycle. These parties include, but are not limited to - the cardholder, merchant acquirer, card issuer and the card networks.

Card transactions facilitate a payment request, on the behalf of a merchant and the cardholder. A merchant may contract directly with a merchant acquirer, who is licensed by the card associations and is therefore permitted to acquire the card transactions as part of the transaction cycle.

As stated in your document, a merchant may very well choose to contract directly with a payment facilitator. The latter must in turn hold the required licence for this business model and is ultimately connected to a merchant acquirer or several merchant acquirers. It is the merchant acquirer who ultimately processes the transaction and presents it for authorisation to the card associations.

[1] UK Finance, "UK Payments Market Summary" (2018) UK Finance Organisation

A merchant acquirer may also be the same financial institution, either a bank or an electronic money institution[2], that issues a card to the consumer. A card acquiring service, where the card issuer and the merchant acquirer are the same institution is referred to as an onus transaction.

More recently, the card associations themselves are increasingly offering card acquiring services on behalf of merchants, through the offering of their own payment processing services in the form of electronic wallets, such as Visa Checkout.

It is unclear whether the card associations are presenting the transactions for authorisation directly to their clearing systems. Our in-house research shows that merchants are invited to 'Register as a Visa Checkout Merchant[3]' on the Visa website. If it transpires that this is indeed the case, we would have legitimate concerns that this is by and large anti-competitive behaviour that impacts smaller merchant acquirers.

We would therefore like to understand better how the PSR is regulating the private 'sub-regulator' in the wider context of the plethora of services that they offer. The private regulator in this context could be Visa or Mastercard as an example, as they are responsible for policing merchant acquirers and card issuers.

Question 2

Do you agree with the proposed scope of the market review?

a. How the proposed scope should be altered

The proposed scope of the market review in our opinion is missing out an in-depth consideration of the vital parties of the transaction cycle, namely the card associations. Certain card associations dominate and lead the supply of card-acquiring services. The card associations are responsible for reviewing and approving merchant acquirer applications, as well as ensuring that these entities are compliant with the operating regulations which they themselves set.

Factually without a Visa or Mastercard licence, the merchant acquirer is not licensed and therefore not able to process transactions and accordingly unable to supply services to UK merchants.

We would like to draw attention to item 2.11 of your market review proposal, which refers barriers to entry or specific areas of interest.

We have major concerns that since the implementation of the Interchange Fee Regulations[4], one of the largest card associations is essentially passing on the subsequent 'loss' of interchange fees, onto the merchant acquirer. Over the past twelve months, we have seen a significant increase in scheme fees levied to merchant acquirers. One card association in particular is adding on basis points for international transactions and additional multiple ancillary processing fees to the merchant acquirer. In turn, the merchant acquirer must pass these fees onto the merchant or face the prospect of revenue

[2] The Electronic Money Regulations 2011
[3] Visa, "Visa Developer Center" (2018) https://developer.visa.com/capabilities/visa_checkout accessed 13th September 2018
[4] Regulation (EU) 2015/751

loss; bar those instances where the sheer size of their operations enables them to absorb these charges.

We would like to understand the regulator's position on this matter and how, if at all, they monitor the final implications for the merchant acquirer. The aforementioned *modus operandi* means that the merchant acquirer is the one party in the transaction process, who is forced to pay the highest fees and charges. Certain merchant acquirers may be unable to pass any interchange reductions across to their merchants and ultimately, to the end consumers, as they must cover their risk.

In this context merchant acquiring is essentially issuing a line of credit and the merchant acquirer is fully liable financially for the merchant, for insolvency or other adverse circumstances, by virtue of its contract with the card associations. We strongly believe that smaller merchant acquirers are at a disadvantage here. We do urge the PSR to review competition obligations in relation to these fees.

Furthermore, we agree that conditions of supply do indeed differentiate between categories of merchants, particularly with merchants that are deemed to be 'high risk' industries by the card associations and settlement banks. These include sectors such as adult entertainment, financial transactions and licensed legal gambling. Many acquirers could be essentially discouraged from accepting such merchants, as the card associations categorise these merchants as high risk. Consequently, the acquiring of such merchants, if approved by the card associations, attract 'high risk grading programs', chargeback penalties and global brand protection programs which can attract significant fines if they are allegedly violated.

We would therefore like the PSR to consider whether legal and licensed merchants of these industries, and their consumers are at a disadvantage and are restricted access to the payment system by virtue of moral consideration.

b. Why should the scope be altered?

In proposing to examine the supply of card acquiring services by focusing on acquirers and payment facilitators, we would again urge the PSR to consider modifying their perception of card acquiring services, through a full recognition of the 'food chain' pertaining to the card payment transaction lifecycle.

Payment facilitators do not have direct principal memberships with the card associations and instead contract with merchant acquirers. Merchant acquirers are then obliged to register these entities as payment facilitators with the card associations and must apply for approval from the card associations before they can process the transactions on their behalf.

One card association has recently imposed a rule, whereby if new merchant acquirer members wish to accept transactions from industries they deem to be 'high brand risk', or process high-risk payment facilitators, said member must have a significant and prohibitive portion of collateral. This could be construed as restricting the member's access to the card acquiring market.

Accordingly, the supply of card acquiring services rests ultimately with the card associations. A merchant acquirer may not be 'approved' to acquire certain card transactions, and a merchant acquirer may not be permitted to board payment facilitators.

Indeed, small merchant acquirers are finding themselves competing with large merchant acquirers, who appear to be working with the card associations as exampled with the Visa Checkout wallet. This is potentially a competitive disadvantage, which we believe should be investigated by the PSR.

Question 3

Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

We agree with focusing on the supply of card services in relation to Mastercard and Visa by virtue of the market share they possess. The importance that Visa has in particular to the card payments market, was demonstrated with a significant recent outage and/or system problem, which affected significant numbers of consumers and merchants. There were multiple reports in the press outlining consumer issues of not being able to make payments with concerning allegations of Visa cardholders including young families being stranded abroad due to the intermittent failure of the processing of card transactions. This is concerning on a social and reputational level, given the importance of consumer confidence in the card payment system.

We would also like to query whether the PSR has considered a potential regulatory capture element here as we believe Visa has a unique position of controlling the payment system by the sheer virtue of its market share and global presence. It is essentially 'owned' by its principal issuing and acquiring members. We would like the PSR to investigate and ask for more transparency on how the governance board deliberates and determines whom is eligible to become a Principal Member during the application process.

Question 4

Do you agree with our proposed approach?

a. If not explain why

We absolutely agree with your statement in the market review paper, which validates that the acceptance of other types of digital payments are not a good alternative to accepting card payments. For this reason, we again would like to reiterate our concern of potential regulatory capture where the major card associations such as Visa, are the judge, jury and executioner - with full and unfettered control over the acceptance of new merchant acquirers, issuance, governance and setting of the card association rules.

Although it is acknowledged that the card associations are private businesses in their own right, we have concerns that there is a lack of oversight of how they operate and impose rules and whether the PSR has any say in scrutinizing new rules and regulations to ensure that they are competitive.

b. Why you think the proposed scope could be altered in this way

For the reasons mentioned above and throughout this response, we would urge that the PSR takes cognizance some of our concerns summarised here and includes them in the scope. Due to the importance of the card payments system and in view of financial stability being crucial to the economy, the scope must thoroughly consider the governance and acceptance process from the card associations themselves.

We do urge thorough consideration of the matters listed hereunder:

a) Although the Interchange Fee Regulations have had a positive effect for some, i.e. the large merchant acquirers who we are confident that they can afford to pass on the cost savings to their merchants and absorb any losses. Smaller acquirers have found themselves at a disadvantage. The reasons for this are, in our opinion, due to two main reasons:

1) Merchant acquiring is a risky business - it is an extension of a line of credit. Where a merchant becomes insolvent or receives hefty penalties from the card associations for the alleged violation of operating rules, the merchant acquirer assumes full liability and must settle any fines to the associations themselves.

2) Often, it is not financially viable for a smaller merchant acquirer to lower the merchant discount rate to be in line with the IFR, due to the risk factors it must take into consideration with the processing of the transactions. Also, it must be noted, a merchant acquirer is also a business, and therefore must also register a healthy profit in order to be able to hire staff, operate and ultimately contribute to the UK economy.

   We believe that the potential imposition of passing on IFR reductions, would significantly benefit large acquirers and drive smaller merchant acquirers out of business; and this in total disregard of competition laws.

3) Echoing the concerns of the PSR in this document, we agree the fees and the rules set by the card associations favour the large acquirers and we strongly believe this is a competition issue that needs to be addressed.

   Moreover, since the imposition of the IFR, as previously indicated, we have seen multiple increases, from one card association in particular, regarding ancillary fees and program fees. We have additionally seen significant interchange increases on international transactions (which are incidentally outside the scope of the IFRs) set by one of the card associations. Moreover we have experienced significant increases in financial penalties for alleged violations of scheme rules, levied to merchants and subsequently to the merchant acquirer, where the merchant is unable to meet the fine. These increases are prohibitive to small acquirers and it appears that they coincide with, and are a result of the IFRs. For the small merchant acquirers to remain solvent, they must pass on the cost to the merchant which then has a negative effect on the consumer.

b) Competition in the supply of card-acquiring services is not working well.

Please consider that competition flows when a market has structured characteristic and the dynamic forces that shape them have been examined and are accountable. If a larger acquirer receives more advantages than a smaller acquirer, by virtue of financial reasons as explained, the smaller acquirer is left unable to pass on the savings. In addition the smaller acquirer is experiencing increasing costs and charges from the card associations themselves.

In the extremely competitive market that card acquiring is, the smaller merchant acquirer is simply unable to compete. To prevent this from happening, the PSR should review the card associations themselves, thereby ensuring that the supply of card-acquiring services does not impose, without efficient market reviews and justifications, set financial impositions which distort competition. The fees and rules set by the schemes, flow down the transactional chain, from the card issuer to the merchant acquirer. The merchant acquirer sets the merchant discount rate to the merchant and the consumer is charged to use their card.

c) We believe there is currently a barrier to market entry for smaller merchant acquirers from one particular card association.

d) A final concern we would like to be taken into consideration is a recent initiative set by one of the card associations regarding the outlet of a merchant location. This card association is operating a compliance program, which financially penalises merchant acquirers if the card association determines the merchant acquirer has contracted with a merchant outside of its jurisdictional remit. The card association takes several factors into consideration in its determination of whether the merchant has been correctly 'jurisdictionally' contracted by the merchant acquirer. These factors include, but are not limited to, an assessment on the sales tax of that merchant and a requirement that the merchant must be located where the merchant conducts business activities[5]. We would like the PSR to consider whether this is reasonable, given the global and cross-border nature of financial services.

   In our experience we have found that merchants commonly outsource certain parts of their operation, such as distribution and call centre operations. Indeed, the management of a business may engage many different jurisdictions across Europe and beyond, due to pricing, manufacturing and logistical reasons. At the time of writing this response, the UK is still operating under European Union Law before the official triggering of Article 50 of the Lisbon Treaty[6] on the 29th March 2019. We believe such an approach contrasts with the freedom of establishment and services[7], two of the four fundamental freedoms of the internal market. Additionally, we believe it fails to take into consideration the increasingly inter-connected and global nature of financial services and the rise in financial technology "Fintech" ventures.

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[5] This information is accessible on the public domain

[6] Article 50, TEU

[7] Articles 26 and 28-37 of the Treaty on the Functioning of the European Union (TFEU).

Paysafe

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14 September 2018

Paysafe: Response to PSR MR18/1.1 - Draft Terms of Reference: Market review into the supply of card-acquiring services

Paysafe Group is a global provider of online payment solutions, trusted by businesses and consumers to facilitate online payments. Paysafe Group has over 20 years of experience in the field of online payments. Paysafe brings together payment methods customers want and the payment services businesses need into focused solutions built around customer problems. Consumers use the multilingual and multicurrency NETELLER, Net+ Card, Skrill and Skrill Card stored-value offerings and paysafecard prepaid solutions to make secure and convenient payments. Paysafe Group also supports a wide variety of prepaid programmes from white-label prepaid cards to bespoke solutions. Merchants plug into Paysafe and use the Group's acquiring services, gateway platforms and innovative prepaid solutions to simplify how they accept credit and debit card, direct-from bank, and alternative and local payments. Paysafe's NETELLER, Skrill and paysafecard services are also used by merchants to increase revenue and capture new customers.

Question 1: Do you agree with our description of card-acquiring services?

We generally agree with the PSR's description of card acquiring services, and acknowledge that it also seeks to reflect the neutral definition incorporated in EU law, namely in Article 4 (44) of PSD2, which defines acquiring of payment transactions as

'acquiring of payment transactions' means a payment service provided by a payment service provider contracting with a payee to accept and process payment transactions, which results in a transfer of funds to the payee

Question 2: Do you agree with the proposed scope of the market review?

We generally agree with the proposed scope of the review of card acquiring services. We would however like to highlight a few issues related to the proposed scope of the PSR's review:

1. It is important to understand the interrelations between merchant service charges, interchange fees and scheme fees. Fees imposed by the card schemes determine the fees charged by acquirers to a

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great extent. We welcome that the PSR will carry out further analysis if evidence of potential harm that does not relate to the supply of card-acquiring services themselves will be found. We however think an assessment of the level of fees imposed by the schemes could also be included in the current review. This should include membership fees, brand fees, processing fees and any other fees.

2. It is important to reflect the respective role of every participant in the supply chain of card acquiring services. The role that products and services that affect the supply of card acquiring services play, incl. ancillary services, should also be considered when looking into card acquiring services. Additionally, a potential lack of competition in the provision of such services, e.g. the hardware space, could also have adverse effects on the provision of acquiring services.

3. We encourage the PSR to introduce a categorisation of merchants. Depending on the merchant's business model, the risk category varies. If the risk imposed by the merchant's business model on the acquirer is high, which is reflected in the Merchant Category Code, costs for the merchant will be higher too. Furthermore, different transactions have different costs. Cross-border transactions or corporate payments are priced differently than e.g. domestic payments. This needs to be reflected in the PSR's review in order to produce reliable and comparable results.

Question 3: Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

Since Mastercard-branded and Visa-branded cards accounted for over 98% of all UK debit and credit card payments in 2017, it seems reasonable to focus the review on card-acquiring services for Mastercard and Visa.

Question 4: Do you agree with our proposed approach?

We would like to understand how exactly this review will be conducted, and if the PSR will continue to liaise with all stakeholders involved, i.e. if acquirers and facilitators will be given the opportunity to comment again at a later stage of the review. Given that the PSR states in paragraph 2.14 of the draft ToR that the PSR is determined to understand if the "supply of card-acquiring services is working well for UK merchants and, therefore, ultimately consumers", we are concerned that it may be overlooked whether it is working for acquirers as well. As stated before, card acquirers highly depend on scheme rules and fees, which they cannot influence.

We would also like to understand more about the methodology and the criteria of the benchmarking process set out in paragraph 2.16. We are particularly interested in understanding how objective criteria will be defined in order to assess e.g. the quality of support merchants receive. Defining objective criteria is of essential importance for such a review. Different merchants have different needs, different acquirers offer different services, e.g. a combination of acquiring and processing or gateways services, which may not be offered by other acquirers and could therefore distort the comparability of the respective acquiring services.

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Question 5: Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

We encourage the PSR to assess how collateral requirements set by the card schemes impact the supply of card acquiring in the UK. These requirements may vary, depending on the acquirer. Smaller acquirers are impacted significantly whereas larger acquirers may be exempted from certain fees. A main concern is the lack of transparency around this process. A transparent process of how these collateral requirements as well as scheme fees are set and calculated is needed and would be beneficial for acquirers, merchants and, therefore, ultimately consumers. Currently, companies often struggle to understand the complex billing process, when fees are charged and how they are calculated.

It is also important to understand that every set-up of acquiring services comprises related set-up costs (e.g. due diligence or software integration) that acquirers usually build into the price merchants pay over the course of the term of the agreement. This should facilitate merchants switching acquirers as it seems less likely that a merchant switches its acquirer if confronted with massive initial costs.

Timing of the Review

We would like to understand better the timing of the PSR's review. A review of the IFR is due to be carried out in 2019, while PSD2, which will further increase competition in the payments sector and therefore also drive costs down, only entered into force in January 2018. Additionally, all UK authorised PSPs have to deal with the uncertainty caused by Brexit, which needs to be taken into account when defining next steps.

PSI-Pay

From: [redacted]

Subject: RE: PSR's market review into card-acquiring services

Question 1 Do you agree with our description of card-acquiring services? If not, please explain: a. how our description should be altered b. why you think the description should be altered in this way Please include any evidence you think is relevant to your response I agree with the description and see no reason to alter it.

Question 2 Do you agree with the proposed scope of the market review? If not, please explain: a. how the proposed scope should be altered b. why you think the proposed scope should be altered in this way Please include any evidence you think is relevant to your response. In general I agree. However, I believe it would be beneficial to put more focus on Visa/Mastercard themselves since they are one of the dominant forces that shape how acquirers must operate and their fees are a major constituent of any pricing policy.

Question 3 Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa? If not, please explain: a. how the focus should be altered b. why you think the focus should be altered in this way Please include any evidence you think is relevant to your response. I completely agree. The other card schemes you mention in the report comprise, within the EU, an insignificant amount of acquiring business. They are also, by comparison, more transparent in their pricing and operational requirements towards the acquirers.

Question 4 Do you agree with our proposed approach? If not, please explain: a. how proposed approach should be altered b. why you think the proposed approach should be altered in this way Please include any evidence you think is relevant to your response. I agree with the proposed approach.

Question 5 Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? If not, please explain: a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions) b. why you think these additional issues have the potential to be relevant to the market review c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review d. why you think those issues do not have the potential to be relevant to the market review Please include any evidence you think is relevant to your response. I think it would be of particular interest, for the purposes of this report, to focus on the activities of Mastercard/Visa with particular regard to the governance that is imposed on acquirers which has a divisive effect skewed in favour of the larger acquiring entities. In addition it would be useful to explore how the card schemes pricing is structured and how its complexity and lack of transparency creates issues, in this case for the acquirers themselves, which has an inevitable knock on effect for the merchants and consumers.

[redacted]

PSI-Pay

Secure Trust Bank

From: [redacted]

To: cards@psr.org.uk
Subject: RE: Non-confidential version of your response to PSR MR18/1.1 - Deadline 24 October

Following internal discussion we are happy for you to publish the following

not, please explain:
a. how our description should be altered
b. why you think the description should be altered in this way
Please include any evidence you think is relevant to your response.

1. We agree with this definition

Question 2 Do you agree with the proposed scope of the market review?
If not, please explain:
a. how the proposed scope should be altered
b. why you think the proposed scope should be altered in this way
Please include any evidence you think is relevant to your response.

1. We would prefer the scope to be widened to include card scheme operators . A small number of card scheme operators have a significant impact on the market, including in respect of pricing.

Question 3 Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?
If not, please explain:
a. how the focus should be altered
b. why you think the focus should be altered in this way
Please include any evidence you think is relevant to your response.

1. We agree as these are the main players

Question 4 Do you agree with our proposed approach?
If not, please explain:
a. how proposed approach should be altered
b. why you think the proposed approach should be altered in this way
Please include any evidence you think is relevant to your response.

1. We agree with this approach

Question 5
Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?
If not, please explain:
a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions)
b. why you think these additional issues have the potential to be relevant to the market review
c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review
d. why you think those issues do not have the potential to be relevant to the market review

Please include any evidence you think is relevant to your response.

1. It would be useful to include the complexity of pricing as an issue to be included.

Regards

[redacted]

Stripe

stripe

Response from Stripe:

PSR Draft Terms of Reference for Market review into the supply of card-acquiring services

14 September 2018

stripe

1. Introduction to this response

Stripe is a global technology company that builds economic infrastructure for the Internet. Businesses of every size – from start-ups to public companies – use our software to accept payments and manage their businesses online. We are a participant in the broader technology ecosystem for payments and build tools for developers that enable entrepreneurship and stimulate innovation in the UK's Internet economy.

We welcome the thinking that the PSR is undertaking on card-acquiring services and in this response set out our thoughts on certain aspects of the draft Terms of Reference (ToR) and relevant themes from the industry more broadly. We first provide an overview of our business (see section 2). We then set out some observations on the payments industry in the UK, including card-acquiring services and the ToR (see section 3).

2. About Stripe

Stripe launched in 2011, and is headquartered in San Francisco. We employ more than 1,000 people globally, with more than 100 people based in Europe in our offices in London, Dublin, Paris and Berlin. Our mission is to increase the GDP of the internet. We believe that enabling more commerce online is a problem rooted mainly in code and design, not finance.

[redacted] had first-hand experience of the difficulty of accepting online payments in an earlier business they had launched: while most other aspects of building and launching an online business had become easier, online payment services remained dominated by clunky legacy providers. It seemed clear that there should be a developer-focused, instant-setup payment platform that was scalable to support a business of any size. Stripe was formed to solve this problem.

Our payments platform enables online businesses to accept payments from a range of methods including card schemes, digital payment methods and mobile wallets. It also allows our customers to make payments out to third parties. In addition to our payments platform, we also offer billing tools allowing online businesses to manage recurring payments. Other Stripe services include business analytics, internet business set-up tools, fraud protection, and a card issuing platform.

We process billions of pounds a year for hundreds of thousands of businesses, from newly launched FinTech start-ups like Monzo, LendInvest and Nutmeg, to established listed companies like Sage and Salesforce, and household names such as John Lewis and Tesco. Other UK customers include Missguided, ASOS, MADE, Deliveroo, Comic Relief, and British Heart Foundation. In the past year, more than 40% of UK internet users bought something from a Stripe-powered business.

3. Observations on the payments industry in the UK including card-acquiring services and the ToR

3.1 Technology

We believe technology is key to the success of the payments industry. Technology and software have already brought about massive positive changes to the payments market, both for merchants as well as for individual users, and we believe there are more to come.

The UK has been at the forefront of this movement, with venture capital investment into the UK's tech sector nearing £3 billion in 2017 alone. London continues to be the top EU hub for tech investment, with start-ups concentrated around Shoreditch and Old Street, i.e., the "Silicon Roundabout".

For payment technology providers, user preferences and new demands from merchants drive innovation. For example, our Connect product for platforms enables marketplaces and platforms to accept money and make payments to third parties. It provides a complete set of software building blocks to support virtually any business model, including on-demand businesses, e-commerce, crowdfunding, FinTech, travel, and events. The Connect platform has helped a number of online marketplaces grow their business, and allows platforms to manage millions of payment cash flows between customers and independent suppliers, without themselves becoming regulated payment service providers in Europe.

Consistent with the broader industry trends, card acquiring is also moving from being a banking service to becoming a technology service, with card acquisition supplemented by additional products and services, such as integrations to accounting software providers, tokenisation functionality, and fraud detection and management software. For example, Stripe, Adyen, and Square all provide technology layers and applications in addition to acquiring. Stripe has innovated with APIs to integrate with rather than gateways or integrations to a bank.

These new technologies are particularly useful for online merchants and new business models, and have facilitated a much more integrated payment experience that often combines the online and offline. For example, with Deliveroo, customers can order food from one place/mobile phone application, and seamlessly coordinate delivery and payment within the application; there is no need to call a restaurant to place an order, provide a credit card number over the phone, or collect the order from the restaurant and pay in cash. Equally as convenient are Uber and similar car services, especially in smaller urban areas that have fewer taxis or other transit options. A customer can order a ride, travel to their desired destination, get out of the vehicle, and payment is made instantly, with no need to present a card or cash to the driver, improving safety, speed and convenience.

3.2 Online vs offline

The ToR do not distinguish between online and offline merchants. However, there are differences in card acquisition between the online and offline worlds. In addition to the role of technology (see above), these include:

(i) **Migration and switching costs** – It is easier for online merchants to pick up and use various companies offering acquiring services, and providers are moving towards interoperability in both hardware and software. In the online world, merchants are presented with greater choice and more information about acquirers. In addition, online merchants aren't contracted into a terminal lease in relation to hardware.

(ii) **Pricing** – The cost of online payment acceptance has true costs; it is not just the pass through of interchange and scheme fees. The cost of acceptance needs to include a real cost of technology services that integrate a number of services over and above payment processing, such as business reporting, fraud, subscription management, bill payments, and the ability to manage funds quicker and more efficiently. Payment processing, as well as pure acquiring, is a technology that merchants pay for.

(iii) **Cash-Flow** – Merchants tend to receive payouts of funds from online transactions (including from providers such as Stripe) earlier than they would in the offline world.

3.3 APMs/Digital Wallets/Open Banking

The ToR note at paragraph 2.13 that “It appears likely that, for many merchants, accepting other types of digital payments is not currently a good alternative to accepting card payments. Testing whether merchants have credible alternatives to card-acquiring services will be part of the market review”.

In our experience, other forms of digital payments are increasingly becoming effective alternatives to card payments. For example, PayPal is a credible and measurable alternative for online transactions, as well as other EU payment methods like Klarna. Open banking APIs may also become an alternative payment method in the future, and ensuring the (acquiring side) payments industry continues to invest and innovate in solutions for merchants is important.

In this context, it is important to ensure that digital payment methods are interoperable with the payment platforms used by online merchants. Stripe is agnostic as to the payment method used to effect payments through its infrastructure; our payments platform enables online businesses to accept payments from traditional (card schemes) as well as non-traditional/alternative payment methods which, as noted above, are increasingly popular in online commerce. Our platform and those like it can therefore play an important role in ensuring choice and competition between different payment methods.

3.4 Payment facilitators

The ToR appear to treat payment facilitators as a type of acquirer (paragraph 1.7, Annex 1 paragraph 1.8). In our experience, payment facilitators offer more than card acquisition services. They are commonly technology companies that also allow, for example, other software functionality, reporting, reconciliation services, subscriptions and data management. For example, Stripe isn't just an acquirer. We also provide other software such as fraud prevention and subscription management tools. Similarly in the offline world Square isn't just an acquirer, they also provide hardware and that different hardware comes with different pricing. In this respect, payments is becoming increasingly about technology and software tools to help businesses, rather than a simple extension of bank services.

These innovations are revolutionizing payments. In this way, payment facilitators are replacing more traditional acquirers - they are supplementing the core payments process with technology layers that provide much better, more customizable solutions that bring great value to the customer experience and value for the merchant.

4. Conclusion

As outlined in this response, the global payments industry has undergone significant change in a relatively short period of time, primarily due to the disruptive effect of new technology which the UK's tech industry has been at the forefront of developing.

We believe it has the potential to continue to transform the landscape of payments acceptance. Provided they are given space to grow - including ensuring future-proof interoperability of payment mechanisms - disruptive technologies, ongoing innovation and new market entrants and business models that challenge the norm can all deliver benefits to merchants and consumers alike in the supply of card-acquiring services.

In this context there are also marked differences between the online and offline world, and a number of the potential issues identified by the PSR in its consultation appear to be targeted at and more relevant to offline transactions and acquiring. Hence, we believe that the scope outlined in the ToR and the Market Review itself should remain narrow and focused on the practices and market conditions of incumbent card-acquiring providers in an offline world. The choice and adoption of payment services by merchants - driven by consumer demand and technological advancement - is fundamentally different in an online environment and the UK is at the forefront of seeing the changes play out as a result of healthy competition in this area. As a result, we believe that including the fast-changing world of online commerce and technology-driven payment providers in this review (as put forward in section 3) is unnecessary.

Should the PSR be interested in further developing its understanding and knowledge about this online landscape, Stripe would be delighted to be part of these conversations and efforts. We very much welcome the opportunity to participate in the PSR's market review into the supply of card-acquiring services and would be very happy to discuss this response with the PSR if that would be useful.

Transport For London

Response to PSR consultation:

Market review into the supply of card-acquiring services – Draft ToR

Transport for London (TfL) is a public transport operator utilising the world's first ticketing system based on contactless payment cards. The convenient payment method, which launched on buses in London in December 2012 and across Tube and rail services in London in September 2014, is now being used to make around 17 million journeys a week across London. Since it launched, more than 2 billion journeys have been made across the capital; the number of journeys made in London using contactless has risen from around 25 per cent just two years ago. On buses and trams, the use of contactless is also increasing rapidly - with around 45 per cent of all pay as you go journeys now being made using contactless.

In addition, TfL operates ticket vending machines used for the purchase of Oyster cards, Oyster card pay as you go as well as magnetic tickets in over 270 stations and Visitor Centres and accepts payment cards online and on the TfL ticketing app.

The cost for accepting card payments constitutes a significant proportion of the overall cost for collecting revenue and, therefore TfL has an interest in PSR's proposed market review.

Question 1

Do you agree with our description of card-acquiring services?

Yes

If not, please explain:

a. how our description should be altered

b. why you think the description should be altered in this way

Please include any evidence you think is relevant to your response.

Question 2

Do you agree with the proposed scope of the market review?

No

If not, please explain:

a. how the proposed scope should be altered

The market review should include card scheme operators and card issuers.

b. why you think the proposed scope should be altered in this way

Please include any evidence you think is relevant to your response.

TfL's position is that the provision of card acquiring services involves direct and indirect costs for merchants in order to be allowed to accept card payments.
As stated by the PSR in the ToR para 2.3, acquirers are responsible for merchants' compliance to rules set by card scheme operators.
For example, a form of indirect but directly attributable cost to the acceptance of card payments is PCI DSS compliance cost. Analysis and investigation of such costs need to form part of PSR's market review of card payments industry practices.
Moreover, the provision of card acquiring services incorporates charging elements that are described to merchants as 'pass-through' costs from card schemes operators, in the form of interchange fees payable to card issuers and card scheme fees that are payable to card scheme operators. Therefore assessing the competitiveness of the card-acquiring services market without incorporating these charges as an integral part of the market review will be unsatisfactory.
TfL notes that PSR propose (para 2.17) to analyse how the level of fees merchants pay have responded to changes in the fees acquirers pay to card scheme operators and card issuers and this analysis will include collecting detailed data on interchange and scheme fees including how they changed and the factors that determine the level of scheme fees.
The number of increases to the level of scheme fees since the introduction of the IFR Regulation in December 2015 and the impact to the overall cost of accepting card payments is evidence of potential harm that is not linked to the provision of card-acquiring services as defined in the draft ToR but significant in the overall position of merchants and consumers as end users of such services.

Question 3

Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

Yes

If not, please explain:

a. how the focus should be altered

b. why you think the focus should be altered in this way

Please include any evidence you think is relevant to your response.

Question 4

Do you agree with our proposed approach?

For the scope as defined by PSR, yes. However, TfL's comments on the scope are provided in the response to Question 2.

If not, please explain:

a. how proposed approach should be altered

b. why you think the proposed approach should be altered in this way

Please include any evidence you think is relevant to your response.

Question 5

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

No further comments; response to Question 2 incorporates comments relevant to this question as well.

If not, please explain:

a. what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions)

b. why you think these additional issues have the potential to be relevant to the market review

c. which, if any, of the issues of interest in Chapter 2 do not have the potential to be relevant to our market review

d. why you think those issues do not have the potential to be relevant to the market review

Please include any evidence you think is relevant to your response

UK Finance

PSR: Draft Terms of Reference for Market Review of card acquiring services

14 September 2018

INTRODUCTION

UK Finance is the trade association which was formed on 1 July 2017 to represent the finance and banking industry operating in the UK. It represents around 250 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance has been created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

Our objective is to work with our members to build a more customer-focused and innovative finance and banking sector, cementing the UK's role as a global leader in financial services for the benefit of the wider economy. The interests of our members' customers are at the heart of this work.

UK Finance welcomes the opportunity to respond to the Payment Systems Regulator's (PSR) consultation on the draft Terms of Reference (ToRs) for its Market Review of Card Acquiring. Merchant card acquiring is an integral part of the UK economy enabling retailers to accept payment by card for the goods and services they provide. It is imperative that any market review of this sector is undertaken on the right basis and with access to all the necessary information.

GENERAL COMMENTS

- *Growth of card payments*

The UK payments landscape has changed markedly over the past ten-years. The number of cash transactions has fallen with supporting evidence showing that transaction types are moving to other electronic payments: consumers and businesses alike are taking full advantage of differing payment methods that best suit their personal and commercial needs.

The flexibility and adaptability of the card payment proposition (as evidenced with its incorporation into other form factors *(fobs/tags, mobile phones, watches, clothes and other wearable technology)*) has seen the use of the debit card, as the most frequently used payment method, overtake cash for the first time in 2017. Over this period cards have played a habitual role in everyday life, with debit cards in particular, regarded as an important and trusted payment instrument offered as a standard component to a person's current account.

As the concept of 'digitalisation' becomes engrained at a wider societal level, it is likely that this will act as a natural catalyst for the development of further payment products and services, offering alternative and convenient ways for *customer-to-merchant* and *peer-to-peer* payments.

All this provides insights as to how merchant acquiring will play a fundamental role in helping to support this transition, and acts as a vital component in defining the future role of the High Street as the notion and concept of *'destination commerce'* radically changes - and as retailers offer their products utilising the full-range of digital channels.

- *The changing role of acquiring*

In recent years, the acquiring industry has become a far more complex industry, with a wide range of acquiring 'entities' now fulfilling the traditional activities that were once the preserve of a traditional bankcard acquirer, and to which a range of differing classifications could apply.

It can be argued that this new eco-system is not adequately represented by the tripartite demarcation put forward in the draft ToRs i.e. which seems to be predicated around the concept of an acquirer, payment facilitator and Independent Sales Organisation (ISO).

There exist a host of newer players now operating in the UK market (Payment Platform Providers, Payment Gateways, mPoS Solution Providers, ePoS System Providers and Specialist Service Providers). This can be attributed in part to the growth and popularity of online shopping, as well as an ever-growing reliance on electronic payments by customers, which has accelerated the demand for low-cost and *'friction-free'* payment acceptance. It is also likely to result from a number of other contributing factors including the increasing use of contactless payments, shifting generational preferences and greater card acceptance.

These changes are being compounded by the commercial opportunities emanating from the implementation of pan-European initiatives such as PSD2, and the burgeoning growth of 3rd party payment initiators, as well as domestic initiatives (*e.g. Open Banking*) that are encouraging greater payment diversification. Payment service providers (PSPs) are exploring the use of alternative payment types, and newer processing arrangements, in terms of the services that are offered so as to enable merchants to accept payments.

Service providers operating in the digital content space (i.e. *PSPs, app-stores, multi-channel networks (MCNs)* and online merchants, will inevitably drive this demand meaning incumbent players will compete with a host of newer cross-border acquiring entities, who are offering a potentially broader range of business models, hosted app-stores, and value-added services (e.g. business loans/ accounting & inventory support etc) into the UK market.

These developments and trends are likely to manifest themselves in a number of important ways:

- Newer entrants, particularly those entities described as Payment Platform Providers, will look to recalibrate their services to become fully licensed acquirers, so as to 'own' the merchant/retailer relationship.
- Established players will have to better promote their services as both standalone and recognisable 'brands' to begin offering a much wider and more holistic proposition.
- There is likely to be an inevitable increase in the number of strategic partnerships, coupled to a consolidation of 'niche' processing products.

These developments are demonstrative of how 'acquiring' will evolve in the coming years, not least in how these newer propositions fit into the traditional payment processing chain. As an example, we have seen that Payment Platform Providers and Payment Gateway services have increased in popularity, and demand, by helping design and develop software solutions as well as managing the integrations of proprietary wallet applications. This has been a catalyst in the wider FinTech movement, and the general phenomenon of the sharing economy.

Some of these developments do pose a much greater challenge as to how the industry best ensures the integrity and continuing security of the card payments system, as the distinction between face-to-face transactions and remote payments becomes increasingly blurred.

The PSR's Market Review needs to take account of this complex landscape and ensure that any eventual recommendations for action/change neither stifles innovation, nor make inaccurate conclusions about the market based on out-of-date data/assumptions; or, mistaken comparisons to developments taking place in other jurisdictions.

In short, we believe that more analysis needs to be done to both properly define what is meant by 'acquiring', which is a fluid and loaded term, and a much closer examination of those attributes that are unique to the UK market, which arguably are having a greater impact in helping shape the future direction of the acquiring industry.

COMMENTS ON THE TERMS OF REFERENCE

- Several members noted that the scope of the Review as defined in the ToRs is not clear and could usefully be clarified in some places to ensure that the outputs are valuable. For example:
    - **The definition of 'acquiring'** could be clearer by differentiating between the regulatory payment service of acquiring as defined in PSD 2 (e.g. core acquiring) in contrast with the constituent elements and ancillary services that can be performed by third parties (e.g. acquirer processing).

      Similarly, the definition of 'payment facilitation' could be better clarified to draw out some of the nuances between this activity and the regulated payment service of acquiring as cross-referenced above.
    - **Geographic scope** – what are merchants and end-users outcomes that the PSR is wanting to focus on? UK merchants and UK consumers only?
    - The **card payment schemes** do play an important role in this environment and their place in this Market Review should be made more explicit.
- Members commented on the broad timing of the Review: as noted in our general comments, in the short-term, Brexit is likely to impact the economics of card acceptance. Over the longer term PSD2 will also begin to have an impact (i.e. increasing volumes of account-to-account based payments). These are significant change drivers for the market and while members can appreciate the PSR's desire to explore the acquiring market, there needs to be an appreciation of the risk in creating a 'moment-in-time' analysis that will become quickly outdated.
- It is not clear to what extent the Market Review will appropriately consider merchant segmentation, diversity of needs, and what potential issues apply to different segments.
- The ToRs suggest that interchange fees will form a part of the Review. There is no doubt that the issue of interchange is material to the acquiring market, and the cards payment industry more generally. However, members expressed some reservations about the PSR undertaking work on the issue of interchange just prior to the start of work due to be undertaken by the European Commission on the same issue. However, members also commented that if interchange is to be included, then it is important to understand the degree to which reductions in interchange fees are being passed on by (i) acquirers-to-merchants (excluding ISO accounts); (ii) Accounts operated under an ISO model to merchant; and (iii) by merchants-to-consumers.
- UK Finance, as a result of its historical place with the industry, undertakes some roles linked with the acquiring market by presenting common industry positions on card processes at the point of sale/ interaction (i.e. where cards are presented and accepted for payment). This includes managing the Standard 70 (and Standard 60) documentation set on behalf of the industry. These standards act as the main merchant-to-acquirer interface protocol and describe the business rules and specific message interchanges for authorisation and settlement transactions. They still remain the primary messaging standards used by retailers and device vendors to build their point of purchase solutions.
- In addition, UK Finance operates the Common Security Evaluation and Certification Consortium (C.SECC) (see appendix for more detail). This is currently under governance review internally, but we would be pleased to speak to the PSR in more detail about the role it plays in the market and its future.
- As per its mission, UK Finance also acts as a convenor, bringing together the acquiring industry on matters of collaborative interest. Earlier this year we put together a Payment Acceptance Policy Group (PAPG) to represent the views of acquirers and the wider payment acceptance community. This group draws together many of the key players in the industry - we would be very happy for the PSR to engage with this group on the Market Review as it progresses.

- In section 1.13 you note that some stakeholders have raised concerns about the cost of card payments for merchants. Some members have noted that it would be useful to understand what these concerns are.

- In section 1.18 you state that card-related issues were discussed with the PSR Panel. Some members have noted that it would be useful to understand what issues were discussed.

RESPONSES TO THE CONSULTATION QUESTIONS

Q1: Do you agree with our description of card-acquiring services? If not, please explain how our description should be altered and why you think the description should be altered in this way:

- As noted in our general comments, we believe that the definition of card acquiring could be clearer.

- The description of card acquiring services focuses on card acquirers, and whilst it reflects other elements of the value chain, the description needs to define how the costs or services offered by other parties will be removed from the consultation, in particular where the Acquirer is not able to influence whether interchange savings are passed on to the end merchant. Services can be bundled up to a single amount, and further thought is needed on how this can be decoupled to fully understand the card acquirer's element defined in the description.

- A definition of gateway versus a merchant account could usefully be provided, along with the services which are excluded from the consultation.

Q2: Do you agree with the proposed scope of the market review? If not, please explain how the proposed scope should be altered and why you think the proposed scope should be altered in this way:

- As per our general comments, we think that the scope of the Market Review as defined by the ToRs is currently quite unclear and could usefully be clarified in places.

- Paragraph 1.7 provides an unclear definition of card acquiring services, restricting the participants to acquirers and marketplaces. Some members believe that the parameters should include any party in the chain that charges for their services in relation to the provision of card acquiring. The scope makes assumptions that prices are controlled by the acquirers, when, in reality merchants can buy a number of services from a number of suppliers, and this may inflate the actual fees.

- These providers may only have limited connectivity or partnership, which could limit the options.

- One of the concerns this Review looks to investigate is the cost of card acceptance, and the compliance with the Interchange Fee Regulation (IFR) on unblended pricing, reseller & ISO's activity. These providers tend to sit outside of the IFR regulation, and outside of the FCA governance, so their adoption would be on a voluntary basis.

- Merchants, particularly in ecommerce, need a number of services – acquirer, gateway (PSP), web developers, shopping carts, card storage - and these services are sometimes bundled into a single fee, either monthly or per transactions. The scope should consider the component parts being utilised by the merchant to understand the cost of processing versus the cost of support services/value added services.

Q3: Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa? If not, please explain how the focus should be altered why you think the focus should be altered in this way:

As regards, the scope of the ToRs being limited to Visa and MasterCard, UK Finance has a diverse membership and there were mixed views on this point. Some members were supportive and other members wanted to see the scope broadened.

Q4: Do you agree with our proposed approach? If not, please explain how our proposed approach should be altered and why you think the proposed approach should be altered in this way:

- It is difficult to provide a considered response based on the short description set out at paragraph(s) 2.14 - 2.19, all of which seems derivative on how the term 'card acquiring' is likely to be defined.

Q5: Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? If not, please explain what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions):

- Part of the consultation should be the impact that un-blending has had on the market. The IFR required all PSP's to provide granular pricing and reporting, whilst the unregulated element was not required to do so. It is unclear if the requirement to unbundle has had a negative impact on the regulated PSP's, or whether merchant appetite remains.
- The consultation should look to determine if the market is comfortable with the number of parties in the value chain that do not fall directly under FCA regulation, and if this provides any negative aspects to the market.
- The consultation should consider the buying patterns of merchants post the introduction of IFR and look to determine if there is a general preference as regards the choice of pricing available.
- It is critical that non-regulated elements are considered to some degree, as devices or services providers may be linked to a specific provider, potentially creating an obstacle to switching. It should also take into account the frequent scenario where there is leasing of a device from a 3rd party where the Acquirer has no part to play in this component of the transaction and no ability to influence it.

APPENDIX

Standard 70 and Standard 60 Rulebooks

- Includes:
  - The cards domestic protocol (Standard 70) - Card Acceptor to Acquirer interface standard, Books 1 to 7.
  - ISO8583 Financial Transaction Card Originated Messages (Standard 60).
  - Interchange Message Specification standard for systems that exchange electronic transactions made by cardholders using payment cards. Published in three parts:
    - Part 1: Messages, data elements and code values
    - Part 2: Application and registration procedures for Institution Identification Codes (IIC)
    - Part 3: Maintenance procedures for messages, data elements and code values
- Upkeep of the Standards is managed by the UK Finance cards unit Business Standards Group.
- Services of the financial industry include the exchange of electronic messages relating to financial transactions. Agreements on application specifications are generally at a private level. The Standards are designed as an interface specification enabling messages to be exchanged between systems adopting a variety of application specifications. The application specification may remain at the private level. Designers of such applications have complete design freedom within the overall constraint that messages shall be convertible to this interface format in order that interchange may take place.

Common Security Evaluation and Certification Consortium (C.SECC)

- Common Criteria (UK ONLY) was established in 2003 aligned to the introduction of Chip and PIN. The Consortium was created in 2015.
  - The necessity to protect the PIN entry at the POS to prevent exposure of PINs entered into POS devices (which can only be implemented by acquirers):
    - Security requirements for PIN entry devices.
    - Independent security evaluation of PIN entry devices.
    - Assessment of security evaluation reports and certification of PIN entry devices by representatives of the UK banking industry (UK Finance and its predecessors).
- Cooperation of bank-owned certification entities with full governance by the issuing banks.
- The underlying ISO 15408 (Common Criteria) methodology allows for a self-governed approval scheme for the UK market with global interoperability.
- ISO 15408 methodology requires vendors to improve their design and production processes (which is not necessarily covered by PCI), thus delivering better products globally.
- Recognition by the ECB and ECSG.

Vanquis Bank

VANQUIS
BANK

Card-Acquiring Market Review Team
Payment Systems Regulator
12 Endeavour Square
London
E20 1JN

14 September 2018

Dear Sir

Market Review of Card-Acquiring Services

I am writing on behalf of Vanquis Bank in response to your consultation MR18/1.1 "*Market Review into the Supply of Card-Acquiring Services – Draft Terms of Reference*", dated July 2018.

Introduction to Vanquis Bank

Vanquis Bank, part of the Provident Financial Group, is primarily a credit card issuer issuing Visa credit cards in the UK to individuals who may find it difficult to obtain credit from more mainstream lenders because they do not have a credit record, have a thin credit record, or have an impaired credit record. At the time of writing we have around 1.7 million credit cards in issue. Vanquis is a member of UK Finance and fully supports the submission made by that organisation in response to this consultation on behalf of its members.

Whilst merchant acquirers and payment facilitators have an obvious interest in the market review we believe that card issuers are an equally important stakeholder given the four-party payment model and the symbiotic relationship that exists between issuers and acquirers.

General Comments on Scope

In paragraph 1.1 you state that the purpose of the review is to ensure that "*the market is competitive and works in the interests of merchants, and ultimately consumers*" because, as you acknowledge in paragraph 1.8, "*the costs merchants incur for such services may ultimately be reflected in the prices they charge or the services they provide to consumers.*"

In paragraph 1.11 you list a series of concerns including whether "*acquirers have not passed on to smaller merchants the savings they made from the interchange fee caps introduced by the Interchange Fee Regulation (IFR)*".

In light of paras 1.1, 1.8 and 1.11, we would add a concern as to whether merchants, large and/or small, have passed on the savings they have made from the IFR to consumers. Although there was no obligation on merchants to so, this was an assurance regularly given by merchants as part of their campaign justifying a reduction in interchange fees.

It was also a clear expectation made by the Treasury when implementing the IFR. In fact, on 8 October 2015, when the Treasury published its response to its consultation on rules to cap the fees charged by banks to their business customers for processing credit and debit card payments, the then Economic Secretary to the Treasury, Harriet Baldwin MP, said the following:

> *"I am delighted that we reached an agreement to reduce the fees that banks can charge businesses for processing card transactions. <u>I expect businesses to pass on these savings to consumers in the form of lower prices</u>"*[1].

In fact, paragraph 1.15 of MR18/1.1 further acknowledges this point when it talks about "*ensuring the benefits of the interchange fee caps flowed through to merchants and <u>ultimately consumers</u>*".

Whilst we acknowledge that this issue may be more relevant and pressing when the PSR undertakes a specific review of the interchange regulations it may be worth considering within the scope of this market review, or at least being cognisant that this important question exists (consistent with the comment in paragraph 2.1 about taking into "*account other issues that might be relevant to…promoting innovation and the interests of service users*").

When reviewing the impact and/or success of IFR and thinking about interchange fees into the future we need to be sure that the merchant community did not make promises or create expectations that have not been fulfilled. In our view the fundamental questions are, did merchants pass on these savings; if not, why not; and where have the savings ended up?

With regard to your specific questions:

Q1 Do you agree with our description of card-acquiring services?

We think the essence of card acquiring is captured in the description but question whether the scope of the review is sufficiently forward-thinking when thinking about card payments and card-like payments. In particular, we question whether the review will appropriately consider the (r)evolution in payment acceptance (i.e. new providers, products and services, and technologies) that has been a feature of payment acceptance in recent years and will remain so for the foreseeable future.

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[1] https://www.gov.uk/government/news/rules-to-cap-credit-and-debit-card-fees-set-out-by-government

VANQUIS
BANK

Q2 Do you agree with the proposed scope of the market review?

Yes, subject to our comments on scope made earlier in this response i.e. regarding the extent to which reductions in interchange fees are passed on both by (i) acquirers to merchants and (ii) by merchants to consumers.

Q3 Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

On the face of it this seems a sensible approach given the fact that the two schemes account for 98% of the UK market. However, we feel that other cards schemes could usefully be considered given that we are often talking about long-established brands and businesses that have strong growth potential within the card acceptance market.

Q4 Do you agree with our proposed approach?

Yes, subject to our comments on scope made earlier in this response i.e. regarding the extent to which reductions in interchange fees are passed on both by (i) acquirers to merchants and (ii) by merchants to consumers.

Q5 Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

No comments.

I trust that the above is helpful.

Yours sincerely

[redacted]

[redacted]

Visa Europe

Visa Europe submission to PSR Consultation on Draft ToR for Market Review on Card-Acquiring Services

September 2018

Visa Europe (referred to as 'Visa' in this document) welcomes the opportunity to respond to the PSR's consultation on the draft Terms of Reference (ToR) for the **Market Review into the Supply of Card-Acquiring Services** ("the market review"), and to work closely with the PSR during the market review.

Our mission is to connect the world through the most innovative, reliable and secure digital payment network that enables individuals, businesses and economies to thrive. Together with our clients, we provide a range of capabilities and services (e.g. fraud detection systems and liability management rules) which enable consumers and merchants to maintain confidence in the digital payments ecosystem, and benefit from a seamless transaction experience. We recognise that digital payments play a critical role in supporting economic growth and Visa continues investing in market-leading innovation and security solutions to enable new ways to pay and be paid.

The UK is a key market for Visa, and we are fully committed to playing our part in ensuring the payments industry continues to deliver benefits to all of its end-users including consumers and merchants. Our view is that the UK's dynamic, competitive payments market is broadly working well to meet the changing needs of end-users and that the competitive landscape will evolve significantly, given the arrival of PSD2. We welcome this market review as an opportunity to work closely with the PSR and help deliver further positive outcomes to the payment ecosystem and its constituent users.

Our vision as a business is to be the best way to pay and be paid for everyone, everywhere. Therefore, we are committed to ensuring no groups within the payments ecosystem, including small merchants and businesses, are left behind. Now more than ever, digital payments are vital for these groups to compete in an increasingly global and digital market and we recognise the importance of enabling them to thrive in this changing environment.

Some of our current initiatives with small merchants and businesses include:

- Working with the Government and a number of partners as lead sponsor of the Great British High Street Awards - a nationwide campaign to support and recognise the important role of high streets in driving local economies and bring together communities.
- Additionally, as part of our financial inclusion programme, we are working with a range of expert third sector and industry partners on analysing and responding to the challenges faced by underserved small and micro merchants.

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- We have made investments in fintechs and new players, some of which are specifically aimed at supporting businesses. For example, earlier this year we have acquired Fraedom, a technology company providing payments and transaction management solutions for financial institutions and their corporate customers. Also, in August we announced our investment and partnership with Behalf, an Israeli startup, with the aim to supporting small business growth via easy-to-access capital and financing.

Importantly, we welcome this market review as an opportunity to progress constructively the conversation with the PSR on small merchants.

Finally, we would be pleased to share our perspectives on global acquiring markets and to work with the PSR to understand which elements may apply in the context of the UK.

1 Overview

1.1 Introduction

Globally, the payments market is constantly evolving as it adapts to changing consumer needs. In the UK, the payments industry has benefitted from a combination of a strong digital infrastructure, a thriving technology sector and a well-constructed regulatory environment, which has resulted in continual investment and expansion of the market, as well as innovation from both new and existing payment service providers.

This has enabled the UK to develop one of the most digitally mature and competitive payment industries in the world, with all players in the ecosystem working to meet the changing needs of both consumers and merchants. The payments industry is also instrumental in delivering a broader set of economic benefits, for instance, through driving growth by enabling cross border transactions, which support export of goods and services.

As our lives become increasingly digital, the need for a well-functioning and competitive market for digital payments where all end-users can fully participate is important. Therefore, Visa appreciates why the PSR has chosen to undertake this market review at this time.

Our view is that, as part of this review, the PSR should carefully consider the need for intervention and apply principles of proportionate and targeted regulation. It should also take into account that the implementation of the Interchange Fee Regulation (IFR) is relatively recent and it has introduced significant changes to which industry stakeholders are still adapting.

At the same time, the UK and Europe are currently in the process of implementing PSD2, which will further impact the competitive landscape of the industry. Therefore, we would support monitoring the effective implementation of such a far-reaching change before introducing any additional regulatory interventions.

1.2 Visa's relationship with the acquiring services market

As a global payments company, Visa has been dedicated to transforming the payments experience for consumers and merchants around the world for 60 years. Acceptance of Visa cards in over 46 million merchant locations globally is one of our most significant value propositions for cardholders. We focus on driving innovation and expanding the number of merchants that accept Visa in all of our markets, including the UK. As acceptance of Visa payments increases, more merchants and their customers benefit from the convenience and protection offered by our card scheme.

On the acceptance side, our contractual relationships have traditionally been with acquiring financial institutions (acquirers), which are critical in allowing merchants to accept card payments, connecting them with consumers. Therefore, we have historically worked closely with our acquiring clients to meet the needs of end-users, including both consumers and merchants.

The PSR, through this market review, has recognised that a well-functioning and competitive market for acquiring services is important for merchants to be able to accept methods of digital and online payments such as cards. Visa is committed to ensuring that [redacted] are able to offer the benefits of Visa card acceptance to their merchants as smoothly as possible.

Some of the ways in which we do this:

- Our membership rules are transparent and apply uniformly to all clients. They are not discriminatory and therefore do not favour a particular type of client.[1]
- Our rules are updated regularly (usually every six months) to take account of changes in the market and evolving customer needs, informed by our customer research and the feedback we receive from consumers, merchants and clients.
- In recent years, we have created a dedicated Merchant and Acquiring function in Europe, including dedicated account managers that help to on-board new acquirers and support them to achieve their business development objectives and acceptance development opportunities in the UK, across Europe and globally. Similarly, members of this team have developed, and are continuing to develop, strong relationships with some of the key merchants operating in the UK.

We welcome acquiring businesses who wish to participate and become licensees in our network, subject to Visa's Scheme rules. These are a global set of rules designed to minimise risks and specify the minimum requirements to uphold the safety, security, soundness, integrity and interoperability of the Visa system. For instance, when a payment is backed by Visa, merchants and consumers can rely on the liability protections detailed in the Visa Scheme. These include:

- Payment guarantees for merchants, usually within 24 to 48 hours, as long as they adhere to simple acceptance and authorisation rules.
- Chargebacks for consumers, which allows them to recover funds from merchants in the event of fraud or errors.

Separately, our clients may also choose to buy Processing services from us or alternative providers. Our Processing network provides added benefits through the different stages of a transaction cycle. For instance, our Real Time Scoring system allows financial institutions to screen for high risk transactions while optimising approval rates at point of purchase, reducing risk exposure and giving cardholders the confidence to use their Visa cards in more places. More broadly, our fraud prevention systems have helped keep Visa's global fraud rates near historic lows, less than one tenth of one percent of volumes transacted on Visa cards are lost to fraud.

Building on our mission, we constantly invest in the innovation and security driving the future of commerce, for the benefit of clients, consumers and merchants. Some recent examples include:

- Increasing security through tokenisation, which replaces sensitive payment card account information, such as the 16-digit card number, expiration date and security code, with a unique digital identifier (a "token") to process payments without exposing actual Primary Account Number (PAN) details.

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1 However, waivers to rules are sometimes granted subject to agreed conditions based upon commercial, operational and risk considerations.

- Extending fraud prevention via the roll out of 3D-Secure 2.0 protocol for e-commerce, credit and debit card transactions, which enables a real-time, secure, information-sharing pipeline that merchants can use to send an unprecedented number of transaction attributes that the issuer can use to authenticate transactions and individuals more accurately without asking for a static password or slowing down commerce.
- Increasing convenience with contactless payments, first introduced in 2007, offer a quick and convenient alternative to cash for low-value transactions, while including all the security and consumer protections embedded in card payment methods.

1.3 Visa's commitment to merchants

Visa's business model rests on merchants being served effectively, and we are committed to ensuring that the payments market functions to deliver the capabilities and services they need. Fundamentally, expanding acceptance of digital payments for all merchants, big and small, is critical for delivering on our strategic vision and we are fully committed to ensuring that merchants can fairly reap the benefits which digital payments offer.

While Visa's contractual relationships are not usually directly with merchants, we have been increasingly working closely with them across various campaigns in the UK. For example:

- Visa is proud to be lead sponsor of the Great British High Street Awards, a nationwide competition led by the Ministry of Housing, Communities and Local Government. Through the campaign, Visa has partnered with a number of merchants and merchant trade bodies including the BRC (British Retail Consortium), the CBI (Confederation of British Industry), the British Beer and Pub Association, the Association of Convenience Stores and BIRA (the British Independent Retailers Association), all of whom have shared valuable insight into the challenges faced by merchants across the UK today. The competition recognises, celebrates and supports local high streets across the UK and the small merchants that make them a success. Entrants can win prize money to spend on their community, as well as on-the-ground support and events from our campaign street teams. They also have the opportunity to participate in a 'spend & win' competition, which is aimed at driving consumer footfall and spend into stores. 30 high streets have participated, and the overall the competition has allowed us to engage with over 900 merchants to date, sharing best practice and innovative ideas for the future of British high streets.
- We have also recently become the lead sponsors of the Financial Inclusion Commission, the UK's foremost policy and advocacy organisation in the space of financial inclusion, and we are embarking on a new programme of work with them to address the complex challenges facing the UK in this regard. As part of this work, we are focusing particularly on underserved small and micro merchants.

- Finally, we would highlight the work that Visa, and our partner Square, have done in the town of Holywell, North Wales. Square offers an affordable and easy-to-use card-reader for merchants. It does this with an app which allows merchants of all sizes to process and manage credit card transactions through a device plugged into a smartphone or a tablet. Square partnered with the town of Holywell last Christmas to enable Holywell's 'Digital Town' initiative, whereby 50 local businesses were equipped with Square Readers so that they could accept credit and debit cards — many for the first time. The campaign was a great success for both shoppers and businesses, with over 95% of the town's independent high street businesses now accepting card payments.

Our view is that digital payments can bring significant benefits to merchants (e.g. through potential for greater sales) and an increasing number of merchants are now seeking to accept digital payments from their customers. We recognise that more can always be done and we are always seeking new ways to work with merchants. In particular, we welcome that this market review aims to explore some concerns relating to smaller merchants.

In the draft ToR, the PSR has highlighted a number of concerns relating to card-acquiring services that it seeks to address, including a concern that acquirers may not have passed savings from interchange fee caps introduced by the IFR onto smaller merchants.

Visa acknowledges the importance of addressing these concerns and welcomes this market review as an opportunity for industry stakeholders to understand the underlying reasons for these concerns more deeply. For instance, we understand that there are significant economies of scale in an acquiring business model and that pricing will incorporate the merchant's risk profile. As a result, the cost of accepting cards or digital payments can often be higher for smaller merchants.

There may also be wider issues around implementation of the IFR which could contribute to reduced visibility around fees. For instance, smaller merchants may not currently appreciate their right to see the breakdown of the Merchant Service Charge (MSC) and prefer simplified pricing structures in their contracts with acquirers.

We would welcome further conversations on any specific aspects the PSR identifies during the review, given our experience in the market both before and after the IFR was introduced.

1.4 Competition and innovation in the acquiring market

Competition and innovation have served well both consumers and merchants in recent years and the UK payments industry is evolving quickly. Today, digital payments are giving way to frictionless, fully digital experiences across a host of new connected devices and customer journeys. An increasing number of merchants are also embracing multiple acceptance options at the physical point-of-sales (POS) as well as on a range of virtual platforms.

We have seen the emergence of a number of new players and evolved business models in the market for acquiring services, which are serving changing merchant needs and tapping into previously underserved merchant segments. For instance:

- We see acquirers offering multiple acceptance solutions, which support all physical ways to pay (e.g. mobile, wearables and cards), including tablet or mobile-based POS terminals with cloud integration offering value added services such as bespoke analytics.

- Online merchants have a wide choice of payment gateways from traditional acquiring businesses as well as newer players, who compete on multiple value propositions such as ease of integration, choice of currencies and choice of payment methods.
- Payment facilitators such as iZettle allow fast, simple and easy on-boarding for merchant segments which had previously been underserved by traditional acquiring businesses.
- Retailers offering customers greater convenience/choice of payment experiences e.g. pay-at-table apps and "invisible payments"[2], such as with Uber.

We provide further detail of our perspectives on the acquiring market later in section 2.1 and welcome further engagement on it with the PSR during the market review.

Visa is committed to working with the PSR to ensure that the outcome of the review is ultimately positive for all end-users, including both merchants and consumers, and that their ability to realise the benefits of digital payments is not adversely affected.

1.5 The broader market for digital payments

At present, cards are the most widely adopted method of digital payments in the UK with the number of payments made by debit card surpassing cash for the first time in the UK last year.[3] Nevertheless, card payments sit within a broad and competitive payments landscape in the UK representing 41% of total payment value and 45% of payment volume.[4]

Furthermore, alternative and innovative methods of interbank and digital payments are also emerging. These trends are being driven by technological advances, collaboration with other organisations (e.g. via 'open source' coding where companies share platforms with one another to enhance user experiences), as well as a regulatory environment which is designed to further support this type of innovation and collaboration i.e. through PSD2 and Open Banking.

Generally, customers can and do switch between different payment products with ease and they are not locked in to any particular payment product. The vast majority of payment methods in the UK are currently free at the point of use. This availability in customer choice means that merchants are likely to seek to adopt an even wider range of digital payment acceptance solutions, some of which may not even rely on acquiring services.

In its proposed scope and approach for the market review, the PSR has chosen to focus on card-acquiring services for this market review. However, given evolving nature of the payments industry, we consider that this market review should consider competitive constraints that card-acquiring services may face from alternative payment service providers.

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2 These are payments which are completed via third-party or branded mobile apps, which safely secure card details.

3 https://www.finextra.com/newsarticle/32263/debit-cards-overtake-cash-payments-in-the-uk

4 UK Finance, UK Payment Markets 2018

2 Visa's responses to specific consultation questions

2.1 Question 1: Description of card-acquiring services

We note the PSR's description of card-acquiring services, and have no particular comments on this. However, we would like to take the opportunity to share our perspectives on the acquiring market.

In our experience, traditional acquirers have primarily provided core payment services, which connect merchants to payment systems, while outsourcing non-core services to third parties. This business model is characterised by economies of scale due to significant people and technology costs for any given merchant, meaning that acquiring services can often be cheaper for merchants with larger transaction volumes. Acquirer fees also incorporate an element of risk-based pricing, since acquirers are liable if merchants are insolvent.

However, this business model has evolved over time. Today, consumers are shopping across multiple channels (e.g. mobile, desktop, in-store) and choosing to pay with a range of instruments (e.g. card, mobile, wearables). At the same time, merchants have recognised the value digital payments can bring to their business, and merchant acceptance has expanded. Furthermore, merchants are always seeking out more ways to enhance the shopping experience for their customers (e.g. digitally customisable orders) and to leverage the latest digital capabilities to inform their business decisions.

These shifts in merchant needs have also resulted in the providers of acquiring services changing their value proposition significantly. Traditional players are upgrading their legacy infrastructures and embracing newer technologies (e.g. cloud-based services) to enhance efficiencies and respond to changing market needs.

The market has also seen entry from a number of new, often independent, players who specialise in particular segments of the broader spectrum of ancillary services (e.g. payment gateways) or in providing value-added services such as inventory tracking or chargeback management, often providing white-label solutions or solutions targeted at specific merchant segments. These players often also partner with providers of core acquiring services. A number of payment facilitators have also entered the market to meet the needs of previously underserved merchant segments.

Therefore, more integrated and targeted payment solutions are available to merchants today. These solutions are designed to enable merchants to deliver a consistent customer experience across multiple channels and to future-proof the POS by supporting payment acceptance from multiple form factors.

Merchants are also increasingly using acquirer solutions to unlock and protect enterprise value from latest technologies such as cloud computing. Therefore, the acquiring market is no longer only characterised by a service connecting merchants to a payment system. The proposition for acquiring services is much broader than ever before, and may often include services around enhanced fraud and risk management, data analytics, treasury services and business management tools.

Ultimately, various factors drive the cost to merchants, including value-added services. For the most basic payment solution, the cost to the merchant is determined by the minimum required set of services, such as the provision of a POS terminal (which may come from a third party), acquirer processing and access to a card scheme. However, merchant costs vary depending on the nature of the product that the merchant chooses and the capabilities that it offers.

We suggest the PSR considers all these factors and the evolving nature of the market for acquiring services when making its assessment during the market review.

2.2 Question 2: Proposed scope of the market review

Competition in the market for acquiring services is important to ensure that merchant needs are met, so that they, in turn, can meet the evolving needs to their customers. Visa's view is that the market for payments is responsive to changing needs of both merchants and consumers. As we have noted in section 2.1, acquirers are responding as more merchants are seeking to accept digital payments and expect their acquirers to offer future proof payment solutions with additional value added services.

We support the PSR in its efforts to ensure the best possible outcomes for end-users of card payments. For the rest of this section, we will comment on two particular aspects of the proposed scope of the review:

- The role of card schemes in the supply of card-acquiring services
- The impact of the IFR on the MSC

2.2.1 The role of card schemes in the supply of card-acquiring services

In the draft ToR, we note that the PSR wishes to understand how card schemes may impact the supply of card-acquiring services.

In terms of Visa's role in the acquiring market, our Scheme business agrees Visa licenses with card issuers and payment acquirers. The Scheme business develops and ensures adherence to operating regulations that set the specifications and standards for card-based payment transactions which preserve the integrity of the Visa brand. This means that there is a set of membership rules that we expect our acquiring clients to meet, including regulatory requirements, technology specifications and security standards, which are critical to the delivery of a consistent user experience across the payments ecosystem. Subject to these, we welcome all acquiring businesses who wish to participate and become licensees in our network. Additionally:

- Our membership rules are transparent and apply uniformly to all clients. They are not discriminatory and therefore do not favour a particular type of client.[5]
- Our rules are updated regularly (usually every six months) to take account of changes in the market and evolving customer needs, informed by our customer research and the feedback we receive from customers, merchants and clients.

[5] However, waivers to rules are sometimes granted subject to agreed conditions based upon commercial, operational and risk considerations.

Separately, our acquiring clients may also choose to buy Processing services from us or alternative providers. Processing manages the switching of payments instructions between card issuers and payments acquirers with authorisations and payment clearing and settlement services across the Visa network.

Because our contractual relationships lie directly with our acquiring clients, we charge them for either or both of Scheme and Processing services. Acquirers have full visibility over the amounts that they pay for our services.

We would also note that in recent years Visa has created a dedicated Merchant and Acquiring function in Europe, including dedicated account managers that help to on-board new acquirers and support acquirers to achieve their business development objectives and acceptance development opportunities in the UK, across Europe and beyond. Similarly, members of this team have developed, and are continuing to develop, strong relationships with some of the key merchants operating in the UK.

We look forward to working with the PSR to help establish a greater understanding of how we work with our acquiring clients and inform the PSR's assessments for this market review.

2.2.2 Impact of IFR on the MSC

We understand that the PSR, through this review, is seeking to investigate how the MSC has evolved for different types of merchants since the introduction of the IFR. We welcome the PSR's decision on collecting data on fees to inform its assessment during this market review. We would welcome further discussions on how to achieve this, given data restrictions and the complexity of contracts. We discuss some practical considerations around this in section 2.4.

As part of its analysis, we would also urge the PSR to consider that the IFR is a relatively recent piece of legislation to which the industry is still adapting.[6] Any impact of the IFR could be linked to issues around interpretation and implementation of its different requirements which should be assessed as part of this review.

For instance, we note that IFR gives merchants the right to have visibility over the different components of the MSC i.e. interchange, scheme fees and acquirer fees. However, this may not always happen in practice as merchants, particular smaller ones, may prefer simplified pricing structures in their contracts and opt-in for blended rates. Furthermore, they may not fully appreciate these rights fully yet given that the implementation of the IFR is relatively recent.

We welcome opportunities to work closely with our acquiring clients and the PSR to understand what more can be done to increase merchant visibility and understanding.

[6] We also note that the European Commission (EC) is also currently conducting its own review of the IFR; the outcome of this market review is therefore likely to inform the EC's assessment.

2.3 Questions 3 and 5: Focus on card-acquiring services for MasterCard and Visa and specific issues of interest

The PSR has proposed to focus its analysis on card-acquiring services for Visa and MasterCard branded cards due the large market share of cards and stakeholder concerns associated with these schemes. The PSR also notes that merchants are unlikely to consider card-acquiring services for other payment card systems or other digital payment methods as suitable alternatives for Visa and MasterCard. Testing whether merchants have credible alternatives to card-acquiring services will be part of the market review.

Cards are the most widely used method of digital payments today. Therefore, merchants will need to rely on card-acquiring services to accept digital payments. However, alternative methods of interbank and digital payments are emerging, and are likely to be increasingly adopted.

Established payments companies (such as PayPal) are increasingly gaining popularity, particularly on the e-commerce front, while new players (such as Yoyo Wallet) are entering the market to provide bespoke merchant solutions, driven by user experience. A growing number of merchants are also offering their own branded mobile wallets and incentivizing the use of them through offers and loyalty. Consequently, consumers now have a choice of an increasing range of methods of payments, which can bypass the need for card-acquiring services altogether.

Furthermore, new regulation such as PSD2 is also making way for industry players such as non-banks, merchants or FinTech businesses to directly access consumer bank accounts and offer alternative payment options, which can directly meet changing consumer needs without relying on card-acquiring services. Under PSD2, merchants will also be able to take online or mobile payments directly from a consumer's bank account.

In the draft ToR, the PSR has chosen to focus on the following issues of interest to inform its assessment of the competition in the market for card-acquiring services: barriers to entry or expansion in card-acquiring services, barriers to switching or searching that merchants face, and availability of services that facilitate merchant decision-making. The PSR proposes that it will be *"(t)esting whether merchants have credible alternatives to card-acquiring services will be part of the market review"*.

In the context of card-acquiring services, competitive constraints acting on a supplier can indeed be linked to barriers to entry or expansion in card-acquiring services. Equally, competitive constraints may also arise from suppliers who offer merchants alternative methods of accepting digital payments. We would encourage the PSR to recognise the rapidly evolving nature of the market, in order to "future-proof" the assessments and findings of the market review. Visa therefore urges the PSR to consider **emerging alternatives for merchants** as an additional issue of interest.

2.4 Question 4: Proposed approach

In this section of our response, we would like to comment on some practical considerations around the RFI process for the market review.

In its proposed approach, the PSR indicated that it will collect data on scheme and interchange fees, and assess how these have changed since the IFR. We anticipate this would involve collecting data from all relevant stakeholders, including card schemes such as Visa. We welcome the opportunity to work closely with the PSR to develop any information requests. We consider that the RFI process should entail early engagement and allow for flexibility around data requests, in particular as this data gathering exercise is the first of its kind.

Given that the PSR will be collecting data from multiple stakeholders, any single format of data request may not be compatible with different data and billing systems. Companies' reporting systems may not always categorise data in the requested format. Billing and reporting systems will often include a combination of fees, and may not always capture the underlying calculations. Providing data in a different format may involve manual intervention and reverse engineering, which could result in significant delays.

Therefore, we consider that it is critical that the PSR engages early with us to ensure that any information request can be suitable to the PSR's needs but is not constrained by limitations in billing systems and fee structures. We also would welcome a flexible approach over RFIs, including the ability to provide the PSR with contextual information, in order to facilitate a smooth exchange of data and minimise risk of errors and misrepresentation.

Which?

Which?, 2 Marylebone Road, London, NW1 4DF
Date: 14 September 2018

Draft Response to: PSR Market review into the supply of card-acquiring services - Draft Terms of Reference

Summary

- Which? greatly welcomes the Payment Systems Regulator's (PSR) plan to carry out a market review into the supply of card-acquiring services in the UK and the opportunity to respond to the PSR's draft terms of reference for the review.

- Which? agrees that card payments are critical to the smooth running of the UK economy, as card use is high and has been growing strongly in recent years. Since card-acquiring services enable retailers to accept card payments, any issues with card-acquiring services could have a direct impact on consumers, such as higher consumer prices.

- Which? has concerns about the high cost of card payments and the impact of this on consumers. Which? is concerned that the draft terms of reference are too narrow, as they do not sufficiently address the issues raised by stakeholders, in particular the impact of card scheme fees and scheme rules on card-acquirers and the resulting costs of card acceptance.

- Which? is also concerned that the payments market is becoming increasingly dominated by card payments to the exclusion of alternative payment methods. Rather than reflecting the interests of consumers and merchants, we are concerned that this trend is being driven by underlying market failures in payment systems, and ineffective regulation. This is resulting in less choice and higher costs for consumers.

The PSR card-acquiring market review should address the underlying drivers of high costs

Consumers are increasingly dependent on card payments. Cards account for 42% of all UK payment volumes (including cash). This is forecast to rise to 58% by 2027.[1] In retail, cards currently represent more than three-quarters of payments.[2]

The draft terms of reference highlight that stakeholders have raised a range of concerns to the PSR about card payments, including that:

- acquirers have allegedly not passed on to smaller merchants the savings they made from the interchange fee caps introduced by the Interchange Fee Regulation (IFR);

[1] See UK Payment Markets Summary 2018, UK Finance.
[2] Payments Survey 2018, British Retail Consortium.

- there is a lack of transparency around the fees merchants pay to accept card payments;
- there are barriers making 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; and
- the scheme fee portion of the fees that merchants pay to acquirers is increasing significantly.

The PSR notes that many of these concerns point to problems that go beyond the supply of card-acquiring services. We strongly agree.

In particular, Which? has previously highlighted that:

- industry forecasts of the growth of electronic payments, and associated decline in use of cash, do not necessarily reflect the interests of consumers and merchants, but instead are likely to reflect underlying market failures in payment systems, and moreover, that such market failures are leading to over-promotion of fee-generating card payments, at the expense of alternative payment methods, such as cash; and
- industry forecasts represent an ever-increasing consolidation of the UK payments market in the hands of two large firms, Mastercard and Visa.[3]

In addition, according to the British Retail Consortium, the cost of accepting card payments is rising and continues to be much higher than the cost of accepting cash.[4]

Of the concerns highlighted in the PSR's draft terms of reference, the chief concern is that the cost of accepting card payments has not fallen significantly, despite the express purpose of the IFR to reduce the cost of card payments for the benefit of retailers and consumers.

This has a direct impact on consumers, as the cost of accepting card payments is a cost that is almost certainly passed on to all consumers. This is owing to the low margins and high degree of competitiveness of the UK retail sector, especially for groceries and consumer goods. The cost of accepting card payments is also borne by all consumers, even those that do not use cards, especially due to the recent ban on retailers surcharging customers for card payments. Any concerns with the convenience, reliability, and security of card payments – such as the recent service outages at Mastercard and Visa, payment errors by

[3] See Which? response to "Cash and digital payments in the new economy: call for evidence", HM Treasury, March 2018. Which? has also raised related concerns in response to the FCA's Strategic Review of Retail Banking Business Models Progress report (June 2018), Payments Strategy Forum final consultation (September 2017), and to the PSR in relation to competition concerns about the ATM market (June 2018).
[4] See Payments Survey 2018, British Retail Consortium.

Cardnet, and breach of card details from British Airways – also have a direct impact on consumers.

The draft terms of reference attributes stakeholders' concerns that the cost of accepting card payments has not fallen to a combination of card-acquirers not passing on the IFR interchange fee reductions to merchants, plus increasing card scheme fees.

There are also other reasons why the IFR may not have led to lower charges for merchants, including that:

- the IFR has led to interchange fee increases for certain types of transactions, especially debit cards; and
- the IFR contains wide-ranging exemptions, such as for commercial cards, non-EEA cards, and three-party card schemes, and acceptance fees on such cards have also been increasing.

The PSR market review should therefore establish what explains the continuing high costs of card payments, including issues that go beyond the supply of card-acquiring services, and if necessary investigate further. As the draft terms of reference notes, card interchange fees and card scheme fees are the two largest cost inputs facing card-acquirers, and therefore should both be within the scope of the review and should be thoroughly investigated by the PSR. Which? strongly welcomes that the review proposes to collect detailed data on scheme fees and interchange fees.

Which? does not have a specific view on the competitiveness of the card-acquiring market, except to note that there are a large number of card-acquirers in the UK, most of which are non-banks, including several major new entrants focused on smaller merchants (such as iZettle, Square, and Stripe). This contrasts to the card scheme market, which is dominated by Mastercard and Visa. Moreover, Mastercard and Visa do not appear to compete with each other for supply of services to card-acquirers and merchants, as all card-acquirers and almost all merchants in the UK accept both Mastercard and Visa.

The market review should also consider the reasons for the dominance of merchant payments by Mastercard and Visa

We agree with the draft terms of reference that "most merchants are unlikely to see acquiring services for other payment systems as alternatives to Mastercard and Visa", as "it is the customer who decides which payment instrument to use". As the PSR notes, 98% of cards in issue in the UK in 2017 were Mastercard-branded or Visa-branded cards. We therefore agree that the review should focus on the supply of card-acquiring in relation to Mastercard and Visa. However this should not be to the exclusion of other (actual or prospective) competing merchant payment methods.

First, the market review should consider why most merchants do not offer other payment systems as alternatives to Mastercard and Visa. This should include analysis of the extent to which merchants are in a captive position, where they have little option but to accept the customer's choice of payment method, and therefore have little choice but to accept whatever charges and fees are then levied on the merchant. The captive position of merchants has been a longstanding competition and regulatory problem, which resulted in successive UK, EU, and international competition law challenges against Mastercard and Visa,[5] as well as the introduction of the IFR.

The review therefore should look at the factors that determine the level of Mastercard and Visa scheme fees and whether such scheme fees are excessive.

Second, in addition to Mastercard and Visa, the market review should also consider the position of alternative card payment systems such as American Express, PayPal, or Allstar.[6] American Express and PayPal have both grown their share of consumer merchant payments despite being even more costly for merchants to accept than Mastercard and Visa.[7] Use of these payment types reflects the same underlying features of payment systems as Mastercard and Visa, where the payer (e.g. consumer or business) decides which payment instrument to use (e.g. American Express, PayPal, or Allstar), then the payee (i.e. merchant) is in a captive position and must accept whatever charges and fees are levied on the merchant, even by such smaller payment schemes.

Third, the market review should consider why alternative payments[8] are currently not a good substitute for card payments. The draft terms of reference notes that "for many merchants, accepting other types of digital payments [such as interbank payment systems] is not currently a good alternative to accepting card payments", and therefore proposes that such payment methods should not be part of the review. However it is important to understand why merchants do not yet consider such services as a viable alternative to cards, especially as recent regulations have attempted to establish and promote new non-card payment methods.

In particular, the EU revised Payment Services Directive (PSD2), and corresponding UK Open Banking Order, expressly establishes new Payment Initiation Services (PISs) as a way to provide consumers and merchants with an alternative to card payments. PSD2/Open Banking specifically enables new providers to make payments to merchants directly from consumers' bank accounts using interbank payment systems.

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[5] See for example, Court of Appeal (2018), Judgment [2018] EWCA 1536 (Civ) in Sainsbury's v MasterCard; AAM v MasterCard; Sainsbury's v Visa, and Court of Justice of the European Union (CJEU) (2014), Judgment in Mastercard v European Commission, Case C-382/12 P.
[6] Allstar is a specialist payment card used at fuel retailers.
[7] British Retail Consortium, Payments Survey 2017.
[8] An example of such a service is VocaLink's Pay by Bank App (previously known as Zapp), launched in 2016

In Which?'s view, the chief barrier to development and take up of such alternative payment services is the continuing existence of card interchange fees. This is because interchange fees provide an enduring incentive for banks to promote card payments over all other payment types, such as Open Banking-enabled PISs and other non-card payment methods (including cash). Indeed, the FCA Strategic Review of Retail Banking Business Models highlights that card interchange fees (and related card fees) represent almost one third of banks' income and profitability from personal current accounts. Furthermore, the FCA finds that such interchange fee income represents a large part of the competitive advantage that the large UK banks enjoy over smaller banks and new entrants.

Consultation questions

Question 1: Do you agree with our description of card-acquiring services?

Yes, Which? agrees with the PSR's description in the draft terms of reference. It would also be useful if the PSR gave examples of what it means by "independent sales organisations" (ISOs) used to sell card-acquirers services.

Question 2: Do you agree with the proposed scope of the market review?

Which? agrees that the scope of the market review should include all providers that affect the supply of card-acquiring services, as set out in Figure 1 of the draft terms of reference. For the avoidance of doubt, this should include the card scheme operators, given that card scheme interchange fees and card scheme fees are the two largest components of the supply of card-acquiring services, and for further reasons set out above.

Question 3: Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

Yes, Which? agrees that the market review should focus on card-acquiring services for Mastercard and Visa. However this should not be to the total exclusion of of other actual and prospective retail payment methods. The market review should also consider why Mastercard and Visa have such a dominant and growing position in retail payments, and how this can be addressed.

Question 4: Do you agree with our proposed approach?

Yes, we agree with the PSR's overall approach, subject to the wider comments in our response above.

Question 5: Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

Yes. We have set out specific and additional issues of interest in the comments to our response above.

About Which?

Which? is the largest consumer organisation in the UK with more than 1.3 million members and supporters. We operate as an independent, a-political, social enterprise working for all consumers. We are funded solely by our commercial ventures and receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.

September 2018

Worldpay

PSR market review into the supply of card-acquiring services

Worldpay response to the draft terms of reference

September 2018

Non-confidential version

Contents

1 Introductory remarks

1.1 Worldpay looks forward to engaging positively with the PSR as it progresses its market review into whether the supply of card-acquiring services is working well for UK merchants and consumers.

1.2 Before providing our response to the specific questions in the Draft Terms of Reference, we set out some introductory remarks in this section in respect of:

- the role played by card-acquiring services within the card payments value chain;
- the changing nature of the card payments market in light of rapid innovation; and
- the timing of the review, given recent and imminent changes to the regulatory, economic and political environment.

The card payments value chain

1.3 The card payments value chain involves the interaction between numerous interconnected stakeholders. The services merchants receive within that environment (including the level and structure of the fees they pay) are driven by a combination of the card scheme operators, the issuers, the merchants, and the acquirers, together with the ever-increasing role of alternative payment methods and other suppliers.

1.4 In this regard, card-acquiring services are but one part of the value chain of services that enable merchants to accept and manage card payments. It is not clear how a market review can meaningfully and correctly examine the terms of the provision of card-**acquiring** services without full account being taken of the wider and interdependent value chain applicable to the provision of card-**acceptance** services more generally. A greater focus on card acceptance, rather than acquiring specifically, would also be more closely aligned with ensuring good outcomes for merchants and ultimately consumers.

1.5 As such, any assessment of competitive conditions for card-acquiring services will also need to take into account competitive conditions pertaining to the supply of card-acceptance services more generally, including:

- [✂];
- [✂];
- the provision of a range of different card-acceptance and ancillary services by different acquirers and payment facilitators;
- the deployment of different forms of hardware (e.g. point-of-sale technology) and software (e.g. payment gateways) in order to accept card payments;
- the role of innovation and new technology in changing the payments systems landscape (e.g. with the emergence of alternative payment systems);
- the role of regulation in driving the cost of payment acceptance (for example, the costs of GDPR compliance); and
- the growing number of merchants and ultimately consumers that are international in the nature of their payment transactions.

1.6 The interconnectedness of the supply of services across the acceptance value chain also means that many of its players perform multiple roles and related activities. [✂].

1.7 The degree of interconnection in the system is also reflected from the demand side. Merchants are provided with a combination of processing, settlement, post-payment services (e.g. chargebacks), together with other services such as the provision of online gateways or terminals. From the merchant's perspective these are often seen as forming part of an over-arching system for payment acceptance.

1.8 The merchant's interaction with the payment acceptance value chain will vary. Merchants access the card payments system through a multiplicity of means, sometimes contracting directly with card acquirers and, other times, contracting with a variety of other intermediaries or third parties that facilitate different parts of the payment acceptance process. Importantly, many of these third parties will hold the primary relationship with the merchant, with acquiring services an often unseen element of the card-acceptance services the merchant requires.

1.9 By way of example, payment facilitators offer merchants the means to quickly set up card-acceptance services. This may include the provision of services such as mobile point-of-sale terminals that, from the merchant's perspective, is the 'entry-point' product. Some merchants will contract with payment facilitators that incorporate acquiring services within a broader suite of other business related services. [✂]. In all of these cases, it may be that the card-acquiring service itself is perceived to be the ancillary service, in contrast to the other payment, business or accounting services that have in practice been the entry point for the relationship.

1.10 As explained below in our response to Question 1, the wide choice of services and relationships presented to a merchant wishing to access card-acceptance services is supported by the variety of models through which suppliers provide such services. These models have developed to meet the diverse range of merchant payment acceptance needs. Merchants have a wide choice of different providers with which to contract, who each offer a combination of different services in the value chain. Among others, these providers include:

- integrated providers (such as Worldpay);
- independent sales organisations (ISOs), payment facilitators and other intermediaries, who will in turn sub-contract other elements of the value chain;
- retail banks who will offer card payment acceptance services as part of a wider commercial banking relationship, either providing acquiring as part of an integrated business model or sub-contracting the services; and
- hardware providers that will provide the point-of-sale terminals required to physically accept card payments.

1.11 Competitive choice available through this system is further increased by the fact that some merchants may choose to contract with multiple providers of the same elements of payment acceptance, [✂].

1.12 The characteristics described above create a system for card-acceptance services where the interdependency of many of its elements is well established. It follows that consideration of just one element of such a system, without full regard being paid to other elements which also impact upon competitive conditions within that system, will be partial in terms of its evidential basis, analysis and any conclusions that are drawn to inform the PSR on outcomes for UK merchants.

1.13 As set out further below, we have concerns that elements of this interconnected system will not be given due regard in the context of the market review. [✂].

1.14 The stated aim of the review is to examine whether card-acquiring services are, ultimately, working well for consumers (in terms of the quality of the payment experience provided by merchants to consumers, or the payment acceptance costs reflected in end prices charged to consumers). As such, PSR should also give consideration to the dynamics of the pass-through of payment acceptance costs and quality from merchants to consumers (i.e. not just from payment acceptance service providers to merchants).

1.15 In summary, at present, card-acquiring services have been isolated and identified as the starting point, when they are but one element of a wider system of services provided to UK merchants and, in particular, may not be the key driver of the relationship or competitive dynamic. The decision to focus upon just one element of this system risks – even if regard is had to other influencing factors – the production of a partial analysis and report that will not address the issues identified by the PSR in the Draft Terms of Reference at paragraph 1.11. This will be a particular cause for concern were such a report to reach conclusions that fails to have regard to the competitive dynamics of the card payment system as a whole or, ultimately, recommends changes that lead to unintended consequences for the services that merchants and consumers receive.

A changing payments market

1.16 The UK card payments market is undergoing rapid and unprecedented changes driven by the introduction of new technology that has increased the competitiveness, dynamism and innovation in the market. The significant increase in contactless payments, for instance, has unlocked new innovations across the value chain, the final impact of which remains to be seen.

1.17 The pace of innovation in the payments market has in recent years been transformative. In the world of eCommerce alone, there are currently more than 300 different types of payment methods available globally that are at the cusp of revolutionising how consumers pay. In addition, some of the world's largest corporate investors in technology are currently backing alternative payment methods, including eWallets, mobile payment methods and fast bank transfers (including account-to-account payments driven by PSD2).

1.18 The pace of innovation in payment acceptance is also likely to accelerate, driven by a number of technological breakthroughs such as distributed ledger technology and cheap, cloud-based computing. The growing importance of innovation in shaping payments and financial services is evident in the focus of regulators, including the Financial Conduct Authority (FCA), which are supporting innovation not just in their local markets, but internationally[1]. These changes will not only improve the services merchants and, ultimately, cardholders receive, but will also impact the underlying business models of firms and the economics of payment acceptance across the value chain.

[1] For example, see FCA (2018) *Global Financial Innovation Network: Consultation Document*, https://www.fca.org.uk/publication/consultation/gfin-consultation-document.pdf.

1.19 It is important that the PSR's market review engages with both the recent and future technological changes in the card-acquiring value chain – and the new payment technologies that serve to constrain it – if it is to fully understand the competitive dynamics and ensure that innovation is not chilled. We would therefore emphasise the need for the PSR to take a forward-looking assessment in order to fully understand the impact of innovation on this market.

A new regulatory environment

1.20 Notably, the work of the PSR over the last 4-5 years has created an environment that enables greater competition across the UK payments markets. By way of example, the work of the Payment Strategy Forum has resulted in the creation of a single interbank payment system operator; the New Payment System Operator (NPSO). We welcome this development, and agree with the PSR that the NPSO has the potential to deliver dynamic competition and innovation in payments[2] [✂]. This, together with the introduction of the second Payment Services Directive (PSD2) and the sale of Vocalink to Mastercard, means that account-to-account payments will play an increasing role in servicing the acceptance needs of merchants in the near future.

1.21 Further significant changes are anticipated due to the UK's withdrawal from the European Union (Brexit), and its future relationship with other international jurisdictions. Therefore, the immediate future and operating environment for firms based in the UK is uncertain. The next 6-12 months alone will not only see change in legal and regulatory frameworks in the light of Brexit generally, but change will also be driven by the implementation of PSD2 and the European Commission's imminent review of the Interchange Fee Regulation (IFR). [✂].

1.22 The changes noted above, which are either yet to occur or whose effects are yet to fully play out or be understood, bring into question the timing of the PSR's market review. In particular, careful thought needs to be given to both the timing for the review and the definitive nature of any conclusions that it may reach, given the significant changes that have been introduced in the recent past or other developments – known and unknown – that will take place imminently.

Next steps

1.23 With regard to the comments above and answers below, we look forward to engaging in a positive and constructive manner with the PSR as the market review progresses.

[2] PSR (2018) *Annual Report and Accounts 2017/2018 – Fact Sheet,* https://www.psr.org.uk/sites/default/files/media/PDF/PSR-annual-report-2017-18-factsheet.pdf.

2 Response to questions

Question 1

Do you agree with our description of card-acquiring services?

2.1 The proposed definition of card-acquiring services set out in paragraph 1.7 of the Draft Terms of Reference is somewhat at odds with the current industry views and definitions used by other regulators[3]. If the PSR is to review the supply of card-acquiring services to UK *merchants*, it will need to consider a number of interdependent parties and services, and not just the functions provided by acquirers. As noted above, it is not clear how a market review can meaningfully examine the terms of provision of acquiring services to merchants without full account being taken of the wider and interdependent value chain applicable to the provision of card payment acceptance services more generally.

2.2 The acquiring market grew from its initial beginnings in the 1970s/80s in accordance with a model devised, managed and controlled by the card scheme operators (Visa and Mastercard). Whilst the essentials of the four-party model remain, it is not truly reflective of the significant change in the provision of acceptance services that the market has experienced in recent years.

2.3 These changes have blurred the definitions, roles and responsibilities of different parties in the card payment value chain. In particular, needs and wants of merchants are now addressed by a range of suppliers that typically procure (under unique contracts) elements of the products and services to meet those demands. Increasingly this translates into an 'entry-point' product holding the primary relationship, with the merchant and other contracting parties in the value chain (including the card acquirer) taking a subordinated role.

2.4 As set out in Figure 1 below, the payment acceptance value chain includes a broad range of interconnected services including:

- card-acquiring, which includes:
  - obtaining and managing licenses to permit acquiring operations in respective markets;
  - ensuring compliance with scheme rule books (and related local laws and regulations);
  - underwriting merchants (which means taking the credit risk of merchant failure; ensuring consumers receive chargeback protection even in the event of merchant insolvency);
  - monitoring merchants, including compliance with payment brand and industry standards (such as PCI); and

[3] See e.g. Case COMP/M.8640, *CVC/Blackstone/Paysafe Decision*, 21 November 2017, paragraph 22, http://ec.europa.eu/competition/mergers/cases/decisions/m8640_106_3.pdf; Case No COMP/M.7241, *Advent International/ Bain Capital Investors/ Nets Holding decision*, 8 July 2018, paragraph 12, http://ec.europa.eu/competition/mergers/cases/decisions/m7241_20140708_20310_3869673_EN.pdf.

   – settling the transfer of funds to the merchant in respect of the transactions carried out (which is broader than merely the settlement of funds to the acquirer itself);

- merchant processing or technical services which generally include the authorisation, processing and routing of individual transactions towards the corresponding card issuing entity and obtaining authorisation from the issuer. The European Commission considers this to be distinct from card-acquiring services, which is at odds with the PSR's view (as set out in paragraphs 1.1 and 1.6 of Annex 1 to the Draft Terms of Reference);

- recruiting merchants and vetting their creditworthiness and suitability to participate in the payment card network. This does not only relate to the sale of acceptance services, but extends to legal requirements that include conducting customer due diligence and assessing the risks associated with providing acquiring services;

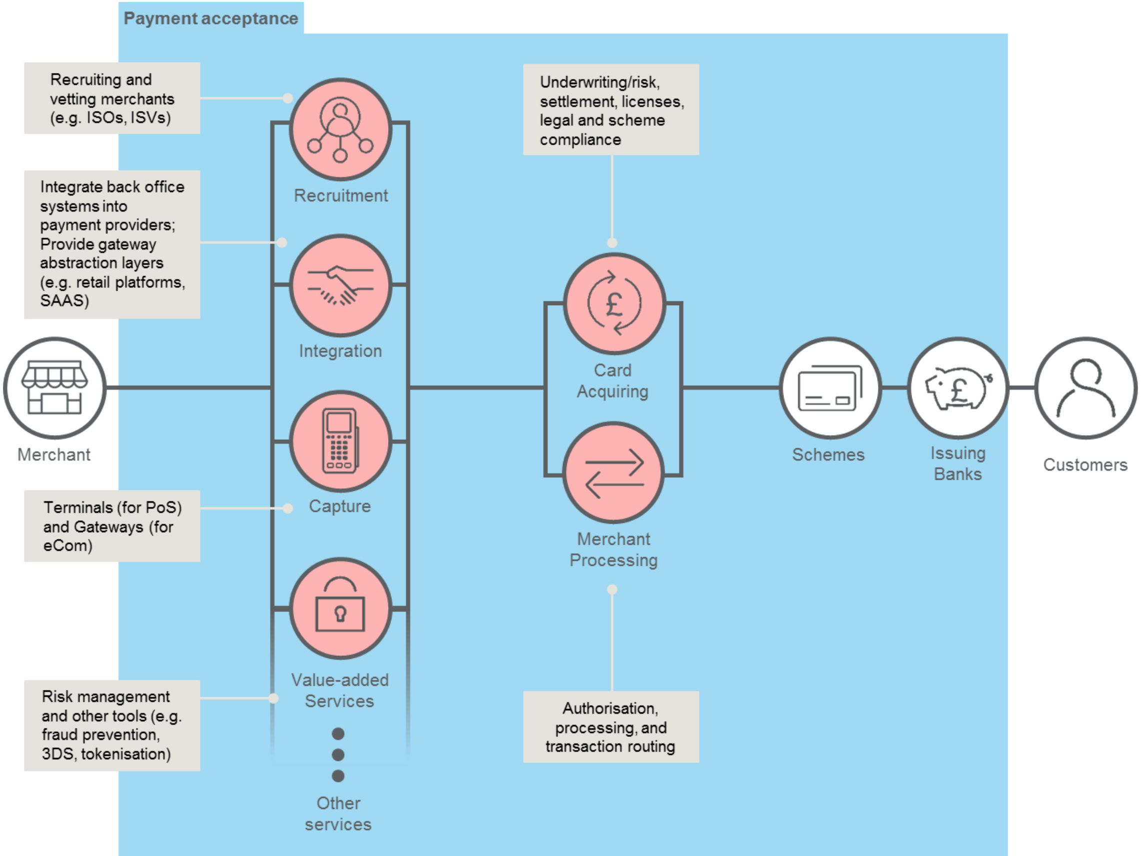
- the provision of the hardware (e.g. point-of-sale terminals) and/or software (e.g. gateway services) for retailers to accept payment and capture transaction data. From the merchant's perspective, particularly smaller merchants, this is the 'entry-point' product in many instances. Contrary to the PSR's view, the European Commission considers this to be core to card-acquiring services[4];

- the provision of other risk management and support services, such as transaction fraud monitoring; and

- the provision of a number of integrated services that are, for example, aimed at generating reports, statements and invoices for merchants; enabling them to analyse their transaction data and review their costs.

[4] See e.g. Case No COMP/M.7241, *Advent International/ Bain Capital Investors/ Nets Holding decision*, 8 July 2018, paragraph 12, http://ec.europa.eu/competition/mergers/cases/decisions/m7241_20140708_20310_3869673_EN.pdf.

Figure 1: An illustration of the payment acceptance value chain



2.5 [✂].

2.6 We question the logical basis for the PSR's distinction between card-acquiring services and so-called "ancillary services". For the reasons set out further below in response to Question 2, we consider all of the services identified within Figure 1 to be of primary importance in connection with the card acceptance value chain. However, the PSR does seem to recognise some services therefore are outside of, and ancillary to, the card acceptance value chain. [✂].

2.7 As noted above, competitive opportunities are increased by the fact that parties' business models may incorporate various combinations of the services described above, and can independently contract with merchants to do so. Many parties in the market choose to only provide a limited number of these services but remain essential in the provision of card payment acceptance services to merchants, for example:

- ISOs that also supply point-of-sale terminals for the capture of transaction data are often the entry-point for SME merchants when looking to accept card payments, [✂].
- Gateway services, similarly, may be offered separately from acquiring or processing services, but again provide the essential "capture" of the transaction.

2.8 Not only are the above examples essential elements of the payments acceptance value chain, but they also can have a direct influence on a merchant's ease of switching card-acquirer, and the perceived difficulty in comparing alternative end-to-end service offerings.

Questions 2 & 3

Do you agree with the proposed scope of the market review?

Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa?

2.9 The PSR has proposed to limit the scope of its market review to the supply of card-acquiring services provided by acquirers and payment facilitators. However, as noted above, individual elements of the card payment value chain should not be viewed in isolation. Although the Draft Terms of Reference allow for the PSR to consider "other services that are related to card-acquiring services", this creates uncertainty and potentially limits the opportunities brought about by the PSR's market review.

2.10 We set out our views on the different elements of the PSR's proposed scope below.

Card issuers

2.11 The Draft Terms of Reference do not include card issuers within the scope of the market review, even when they affect the supply of card-acquiring services.[5]

2.12 [✂].

2.13 [✂].

2.14 For these reasons, the PSR should consider the relevance of card issuers within the scope of its market review, at least to the extent that such services affect, directly or indirectly, the supply of card acquiring. [✂].

Scheme operators

2.15 The Draft Terms of Reference leave the scope of the market review in relation to scheme operators open to interpretation. Scheme operators are considered to be 'in-scope' to the extent that they "affect [the] supply of card-acquiring services" and, presumably, out-of-scope to the extent that they are not.

2.16 [✂].

2.17 [✂]:

- [✂]; and
- [✂].

2.18 Similarly, the setting of card scheme rules play an important role and involve all levels of the card acceptance value chain.

2.19 [✂]. In order for the PSR to review the terms on which scheme fees and scheme rules are set, it is important to remove any uncertainty as to the status of scheme operators within the market review. [✂].

[5] This is by virtue of the apparent exclusion of card issuers from "other services that are related to card-acquiring services" in the illustrative diagram provided at Figure 1 of the Draft Terms of Reference.

Ancillary services

2.20 As noted above, we do not consider that there is any logical basis for seeking to delineate between so-called "ancillary services" and the elements of the card acceptance value chain described in response to Question 1.

2.21 Firstly, it would not be appropriate to consider services such as those provided by card scheme operators or the supply of point-of-sale terminals as "ancillary" to card-acquiring. This is particularly the case where the services identified are critical to the card acceptance value chain and/or may account for a higher cost to the merchant than card-acquiring *per se*.

2.22 Secondly, from the perspective of many merchants, their 'entry point' into the card payment value chain is not the card-acquiring service but, rather, the provision of gateway services or physical devices such as a point-of-sale terminal. As set out above, we believe the provision of point-of-sale terminals are key to the acceptance value chain and, according to the view of other regulators, key to card acquiring services[6]. Furthermore, other merchants use card-acquiring services within a suite of payment and business accounting software,[7] within which card-acquiring services may itself be perceived as ancillary.

2.23 For these reasons and for the reasons set out in our response to Question 1 above, we propose that the PSR should reconsider the categorisation of card-acquiring as opposed to "ancillary" services, to better reflect the shared significance of the various products which, together, supply merchants with card acceptance services. [✂].

Alternative payments methods

2.24 The Draft Terms of Reference state that the scope of the PSR's market review will be limited to card-acquiring services. The PSR then asserts that other types of digital payments (such as interbank payment systems) are currently not a good alternative to card payments, but that it will test whether merchants have "credible alternatives" as part of the market review.

2.25 As noted above, the pace of innovation in the payments market has in recent years been transformative. This is implicit in the Draft Terms of Reference, which notes the strong growth in card payments attributable to higher online spending and a significant increase in contactless payments. In the world of eCommerce alone, there are currently more than 300 different types of payments available globally that are at the cusp of revolutionising how consumers pay.

2.26 The PSR should therefore consider both the actual and *potential* competitive constraints that affect card acquirers in terms of innovation. The PSR's work in this area alone, such as the establishment of the Payments Strategy Forum, has contributed to an environment where innovation in payment systems has the potential to thrive. [✂].

2.27 [✂]. Furthermore, some of the world's largest corporate investors in payment technology are currently backing alternative payment methods, including eWallets, mobile payment methods and fast bank transfers. For these reasons the Draft Terms of Reference should confirm that, in addition to merely testing whether credible alternatives to card payments

[6] See e.g. Case No COMP/M.7241, *Advent International/ Bain Capital Investors/Nets Holding decision*, 8 July 2018, http://ec.europa.eu/competition/mergers/cases/decisions/m7241_20140708_20310_3869673_EN.pdf.
[7] For example, Sage Pay.

exist today, the PSR's analysis will also consider the wider competitive environment and the potential for rival digital payment methods to rapidly emerge in the near future.

Geographic scope of the market review

2.28 The PSR states that it will examine "card-acquiring services in the UK" and whether the market is working well for "UK merchants and, therefore, ultimately consumers". The proposed geographic scope is then reinforced by a non-exclusive focus on Mastercard and Visa branded-cards (on the basis that they are predominant in the UK).

2.29 A growing number of merchants and ultimately consumers are international in the nature of their transactions. For example, multinational card-acquiring groups with a presence in the UK may provide card-acceptance services to both UK and non-UK merchants that, in turn, cater to both UK and non-UK consumers. This includes providing multi-jurisdictional services to international merchants that demand both domestic and cross-border card payment acceptance. Card acquirers operating in the UK must, accordingly, compete with other EU acquirers (subject to our comments at 2.31 below) for services to UK merchants and consumers, which may include card payment systems or payment methods, other than Mastercard and Visa.

2.30 These international modes of competition are particularly relevant in the eCommerce market for online payment acceptance (where, as noted above, alternative payment methods increasingly rival traditional card payments). Therefore, to understand whether card-acquiring services are working well for UK merchants and customers, the PSR must have regard to:

- the wider geographic scope of the market applicable to UK merchants using online eCommerce payment acceptance in general, where UK card acquirers compete with card acquirers outside of the UK; and
- merchants operating in multiple jurisdictions, including the UK, where card-acceptance is provided as part of a suite of payment services (that are not exclusive to the Visa and Mastercard schemes[8]) and may depend on consumer preferences for alternative payment systems across various global markets[9].

2.31 Furthermore, the PSR's analysis of how card acquirers compete internationally should have regard to Brexit and the UK's future relationship with other jurisdictions. [✂].

2.32 In summary, although the PSR's statutory powers and objectives are necessarily restricted to the UK, the PSR should consider the modes of competition that exist not only domestically, but internationally. The Draft Terms of Reference currently provide no indication of the extent to which these important competitive dynamics will be considered by the PSR as it relates to the definitions of "operating in the UK", "UK merchants" or “ultimate consumers”.

Larger acquirers and smaller merchants

2.33 There are further terms adopted in the Draft Terms of Reference that require definition. In particular, the PSR has raised as one of its potential concerns the terms on which card

[8] For example, in the Netherlands, the majority of online payment transactions operate on the iDEAL scheme.
[9] For example, the growing popularity of the Unified Payments Interface (UPI) in the Asia Pacific region.

scheme rules are set for "larger acquirers". It is not obvious, however, on what basis an acquirer is considered to be 'large'.

2.34 [✂].

2.35 Secondly, where the PSR has adopted the term "smaller merchant", it is unclear whether that is intended to capture the 99% of UK businesses that are small-and-medium enterprises, or a smaller subset of merchants, such as micro-businesses. It is important, particularly where these terms are adopted in relation to the potential concerns identified by the PSR, that clear definitions are used.

2.36 In summary, the Draft Terms of Reference should provide clearly defined terms for "larger acquirers" and "smaller merchants", particularly where these terms are used in relation to the concerns that the PSR has identified.

Question 4

Do you agree with our proposed approach?

2.37 We would welcome further detail in the final Terms of Reference on the practicalities of how the PSR will implement its proposed approach, including specific timings for the market review, and information on the groups of stakeholders the PSR will engage with (and the methods for doing so). For example, the types of merchants the PSR will seek input from and whether this will be done bilaterally, through focus groups, by commissioning independent consumer surveys or using representative trade associations.

2.38 In the remainder of this section, we present a number of specific points of feedback on the PSR's proposed approach. Note that these are in addition to the points raised at paragraphs 1.20 to 1.22 above regarding the context of regulatory change and timing of the market review.

The importance of taking a forward-looking approach

2.39 Consideration of the past and current state of the market for card-acquiring services will clearly form an important part of the PSR's market review. However, we would emphasise the particular need for the PSR to also take a forward-looking assessment throughout its work.

2.40 Merchant payment acceptance in the UK is rapidly changing and evolving, driven by new technology, regulation, and market players. Examples include the rapid growth in contactless payments and recent introduction of PSD2. We think this is likely to limit the usefulness of insights that may be drawn from past or even current experience, particularly when compared to market reviews undertaken in markets that are more stable and mature.

2.41 If and when the PSR begins to consider potential remedies to address any issues it identifies as part of this review, we would encourage consideration of the lessons learned from past interventions by other regulators. In addition, a recent review[10] of past regulatory interventions encourages the testing of remedies before their full implementation, to reduce

[10] Fletcher (2016) *The Role of Demand-Side Remedies in Driving Effective Competition*, https://www.regulation.org.uk/library/2016-CCP-Demand_Side_Remedies.pdf.

the risks of unintended consequences. We would support such an approach if the PSR concludes remedies are necessary.

[✂]

2.42 [✂]

- [✂];
- [✂]; and
- [✂].

Approach to assessing the quality of card-acquiring services

2.43 We note the PSR plans to consider the outcomes of the competitive process, in terms of both price and quality.

2.44 There are a number of different facets of quality across which providers of card-acquiring services compete, including:

- **Settlement timing**: How quickly merchants have access to the funds paid by customers that use their cards.
- **Risk management**: The assistance provided with managing the risk of accepting card payments e.g. fraud prevention and identification and managing chargebacks.
- **Resilience of service**: Maintaining a continuous, uninterrupted service to ensure merchants can accept payment whenever required.
- **Customer support**: The availability and responsiveness of support in instances where merchants have issues accepting card payments (e.g. terminal breakages).
- **Reporting and reconciliation services**: The accessibility, timeliness, granularity and level of insight provided to merchants regarding their card transaction activity.

2.45 To the extent that the PSR intends to undertake comparisons between card acquirers as part of its market review, it is important that differences in quality (as well as differences in the services provided and differences in fees) are taken into consideration for the comparisons to be meaningful.

Supply-side substitution

2.46 We are not clear as to the meaning of the question at the second bullet of paragraph 2.15 of the Draft Terms of Reference ("what are the merchants' demand side and supply side substitutes for these services?"). The consideration of supply-side substitution in the context of competition investigations is typically focussed on the **suppliers** of the products in question, rather than the **consumers** (i.e. card acquirers rather than merchants).

2.47 [✂]. More specifically, the PSR should not only consider the existence of alternative suppliers to merchants, but also the ability of potential entrants to rapidly expand or respond to changing market dynamics. [✂].

2.48 [✂].

Question 5

Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review?

2.49 Worldpay has set out above a number of points that it considers are relevant to the PSR's market review, and does not repeat them here.

2.50 In addition to the points set out above, the review also needs to consider the:

- impact of IFR Business Rules which introduced new and detailed disclosure requirements around merchant service charges (which promote transparency);
- impact and usefulness of services already available to merchants which enable them to compare their options for facilitating card payment acceptance, including a number of price comparison websites;
- [✂]:
  - [✂]; and
  - [✂];
- [✂]; and
- impact of other regulatory changes taking place. For example, PSD2 has introduced the requirement that many more transactions be subject to enhanced authentication (Strong Customer Authentication) than are at present, which is likely to result in higher scheme fees in the future.

worldpay

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