Market review into the supply of card-acquiring services

General submissions received in Q1 2020

June 2020

Contents

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

Cabinet Office

From: [redacted]
Sent: [redacted]
To: cards@psr.org.uk
Cc: [redacted]
Subject: Submission - Market review into the supply of card-acquiring services

GOV.UK Pay (operated by Government Digital Service, part of Cabinet Office) is a service which makes it easier for government services to take and manage payments. We've taken payments for over 300 government services and average about 10,000 payments per day, currently (>£500k in value, per day). https://www.payments.service.gov.uk/

We abstract the relationship between government services and Payment Service Providers (PSPs), which means that GOV.UK Pay can run frequent competitive tenders and change the PSP for all services without the services themselves incurring any switching/integration costs. GOV.UK Pay has not yet taken advantage of this due to the initial contract being quite long, and GOV.UK Pay has only been taking payments for just over 3 years (and our most rapid growth has been in the last year).

GOV.UK Pay has quite a lot of experience in this area, for example practical experience of the costs of integrating (and maintaining integrations with) Payment Service Providers. Our research suggests that an integration with GOV.UK Pay is simpler and cheaper than integrating directly with a PSP.

Kind regards

Mastercard

Mastercard submission to the PSR market review into the supply of card-acquiring services

24 JANUARY 2020

Contents

1 Summary

As part of its market review, the PSR is seeking to understand how well competition functions for the supply of card-acquiring services in the UK - this submission is intended to assist the PSR's understanding of the relevant issues. Although Mastercard's core business is not directly involved in card-acquiring, we have a broad perspective from which we can provide an unbiased view of how the market is operating, which may be of value to the PSR.

The acquiring sector is complex, consisting of an extensive ecosystem of providers offering a range of services across the value chain, some of which may be bundled by the larger players. As a result, assessing the effectiveness of competition is not straightforward and requires careful analysis of a considerable number of interwoven issues.

The UK acquiring market is generally functioning well, with a sizable number of participants and evidence of new entry by some well-established players, although new entrants' success in gaining significant market share is more limited. Merchants generally report high levels of satisfaction, although levels of switching are inconclusive in terms of the effectiveness of competition.

The acquiring sector has seen increased innovation in recent years, driven in part by a rapidly evolving and expanding ecommerce market, which is providing consumers with an increasingly wide array of products and services to purchase and new ways to pay for them. The sharing economy in particular has driven an upsurge in online and cross-border transactions, as consumers increasingly consume 'old services' in new ways, which in turn is changing the types of transactions for which card-acquiring services are provided.

Payment facilitators have often led the way in innovation, both in terms of the simplified approach 'why not' approach to card acceptance and their targeting of the previously underserved small merchant sector. The rise in contactless and the decline in cash usage has also created greater demands for all providers to address. The increase in competition has also led to greater consolidation and partnership amongst a variety of providers. All the time, schemes have facilitated new entry, competition and innovation both through evolution of Rules and licence requirements, as well as specific product solutions.

Competition in the card-acquiring industry is also affected by the broader competitive landscape for retail payments in the UK, which is in a period of transformation due to technological change and entry by new players, driven by regulatory changes. Card payments are facing increased competition from an increasingly wide range of non-card-based methods giving merchants greater freedom to decide whether they wish to purchase card-acquiring services, or whether they may wish to utilise (and steer towards) alternatives.

Both merchants and consumers choose the payment methods which best suit their needs and direct debit and credit transfers are popular alternatives to cards. They are witnessing significant increased volumes, particularly for subscriptions and repeat payments, where the benefits of card payments may be less relevant than they are for high street retailers.

There has been significant new entry in retail payments from a variety of providers and global brands ranging from online and high street retailers to device manufacturers and others. Open Banking and digital wallets have the greatest potential fundamentally to evolve the market, by offering merchants new forms of non-card-based payment methods, which offer consumers equivalent (or even greater) levels of convenience and security than they are used to from cards. At the same time, this will increase pressure on card payments and providers to innovate to avoid losing customer relationships, even before new providers actually gain market share. The ability of digital wallet providers effectively to steer consumers also provides a very effective competitive restraint. Merchants too, are developing increased steering tools, particularly online which will increase their ability to direct consumers to their preferred payment method, be it card-based or non-card-based.

The regulatory environment for account-based competition is developing a number of initiatives which are likely significantly to increase their attractiveness to consumers, by seeking to replicate or improve upon the features of cards which make them most attractive consumers, thereby strengthening the competition that they account-based payments provide to card-acquiring services.

The sector is also witnessing the start of some longer-term trends, which could have an increasingly significant impact on the provision of card-acquiring services. These include the increasing involvement of non-specialist payment providers, the use of online payments for instore transactions, as well as the creation of alternative forms of payment and infrastructure.

Card schemes play an important role in the ecosystem, most obviously through the extensive range of services which they provide to acquirers. As franchise businesses they develop and manage the scheme rules which are the fundamental core upon which the model depends, by creating the trust which is essential to both cardholder and merchant participants. The Rules serve to overcome coordination problems amongst issuers and acquirers and other network participants that would otherwise be reluctant (or practically unable) to cooperate.

It is in the interests of card schemes that the acquiring sector is well functioning, consistent with their commercial incentive to increase the volume and value of transactions using their brands. Therefore, they perform a variety of scheme activities designed to provide economic value to acquirers. These can be mapped against four drivers of economic growth.

Firstly, improved payment efficiency occurs through making transactions safe, simple and smart, accruing economic benefits to acquirers in various ways, including the efficient resolution of disputes.

Secondly, facilitating new entry and competition (whilst retaining resilience and integrity) through support to new entrants and a flexible approach to scheme rules, which allows new business models to develop.

Thirdly, driving innovation and the adoption of new technology across the sector, through a flexible approach to scheme rules which has led to the availability of innovative payments solutions to merchants.

Fourthly, ensuring security and stability in the payment network to the benefit of acquirers, through a range of activities designed to address four types of risk, namely: settlement; fraud; cyber attack and operational risk.

In conclusion, the card-acquiring sector is generally functioning well and merchants can expect to see a further increase in the choice and competitive offerings available to them. But the PSR's analysis may indicate that more needs to be done to ensure that all merchants fully benefit from these positive developments.

2 Introduction

As part of its market review, the PSR is seeking to understand how well competition functions for the supply of card-acquiring services in the UK - this submission is intended to assist the PSR's understanding of the relevant issues. In order to be as helpful as possible, the content is based on the matters which the PSR has previously raised with Mastercard (in information requests and more broadly) by providing more evidence and explanation of the issues in which we believe the PSR has a strong interest.

In so doing, we hope that this submission will usefully inform the PSR's analysis - it covers the following topics.

Card acquiring and the broader competitive landscape

Any assessment of competition in the UK card-acquiring sector needs to be understood in the context of the broader payments system, which is in a period of significant transformation due to technological change and entry by new players, supported by regulatory changes.

Section 3 of this report therefore provides a short overview of the current acquiring market, whilst section 4 addresses the broader payments landscape in the UK, outlining key market and regulatory driven trends that are relevant to the PSR's review.

The role and functioning of schemes in the card-acquiring sector

The card-acquiring industry forms an important component of four-party card schemes. These schemes bring together merchants and card-holders, making them two-sided markets with an objective of setting prices among their participants to maximise the usage of the platform. Mastercard plays an essential role in maximising the benefits to all participants within the card payment system by coordinating and facilitating the activities of issuers and acquirers.

Section 5 focuses specifically on the services that Mastercard provides to card acquirers, and the ways in which they benefit from the existence of the Mastercard scheme and its activities. It also explains how Mastercard promotes competition and a level playing field in the acquiring value chain.

Section 6 concludes and provides suggestions for further analysis and areas of focus for the PSR.

The appendix explains how two-sided platforms and wider market dynamics have implications for the fees charged in the card-acquiring sector.

3 Competitive landscape – acquiring

This section provides a short overview of the current acquiring market, outlining key market and regulatory-driven trends that are relevant to the PSR's review. It demonstrates the range of providers that play a role in the acquiring value chain, and the competition and innovation which that creates.

The role of card acquirers

Card acquirers provide services to merchants that enable them to accept and process card payments. The acquiring market sits within the broader card payment system and performs three core functions:

- recruit merchants to accept card payment and ensure that merchants comply with the scheme rules set by the card scheme operator, which govern how card payments are made;
- facilitate the authorisation, clearing and settlement of transactions through the card payment system, as well as dispute management between parties;
- assume responsibility for the risks associated with transaction processing.

Acquirers may outsource some activities to third parties. When this happens, the acquirer retains responsibility for allowing the merchant to access the card payment system and for making sure that third parties perform these functions in compliance with the scheme rules.

Acquirers may offer other services beyond the core functions, such as point-of-sale (POS) terminals and payment gateway services that support card payment processing. Third parties can also provide these services directly to merchants.

The card-acquiring value chain

Assessing the effectiveness of competition in card-acquiring is challenging due to the complexities in the value chain, which comprises a range of service providers. The definition and scope of 'card-acquiring' is not straightforward and elements of those services are provided by a number of different parties. In order to understand the various levels on which competition operates, it is useful briefly to list those service providers and describe their role.

- Rather than contract with an acquirer, some merchants purchase card-acquiring services from a payment facilitator (PayFac). These merchants do not have their own merchant identification number (MID), which is instead owned by the PayFac. In this way, PayFacs act on behalf of both acquirers and merchants and assume responsibility for conducting due diligence on each merchant, monitoring merchant activity and assuring compliance with the payment card industry.

  Payment facilitators include players such as iZettle, SumUp, Square, and PayPal Here. They have been successful in offering new services tailored to the needs of micro and small merchants. Existing acquirers have responded by setting up their own payment facilitators targeting smaller merchants e.g. Barclaycard Anywhere.

- Payment processors provide back-office processing systems and support services to connect acquirers to the card scheme networks and to process transactions for the acquirer. Most large acquirers connect directly to the card networks and process transactions in house. However, a small number connect via third-party processors. For example, Lloyds Bank Cardnet uses the processor First Data.

- Payment gateway providers connect merchants to the acquirer. While gateway providers may manage many of the same services as a payment facilitator, they do not assume primary responsibility for risk or settlement.

- Independent sales organisations (ISOs) are third parties that sell acquiring services to merchants and procure new merchant relationships on behalf of an acquirer. Examples include Handepay and Payficiency.

- Independent software vendors (ISVs) offer payment solutions to merchants that aim to manage different functions of a business operation. They do not control the underlying technology.

- Terminal providers supply POS hardware to merchants in order to accept card payment transactions. POSs are either sold directly to retailers or their service providers or are provided in partnership with an acquirer. Examples include Verifone and Ingenico.

Whilst all of these services can be provided by different service providers, several of them can be bundled, most obviously by larger acquirers. It will be for the merchant to decide whether and which services it wants to procure separately or jointly and the differences which exist in the market (particularly between large and small merchants) makes the assessment of competition for these services more challenging.

In assessing competition, it is obviously useful to consider the number of providers in the market, although due to the overlapping services provided across the value chain, understanding the effectiveness of competition requires a more detailed analysis. Approximately 100 licensed acquirers operate in the UK market[1], but the breadth of services which they provide varies significantly. Market shares also vary considerably, as 90% of transactions are processed by the five largest acquirers.[2] There are 64 payment facilitators in the UK and they account for a growing proportion of transactions, particularly among smaller merchants that accept card payments.[3]

There are also various gateway service providers, such as PayZone and Braintree, which are typically able to give access to a range of different acquirers. Most are independent providers, while some are owned by large acquirers (for example, Elavon is set to purchase payments gateway Sage Pay).[4]

Many merchants use independent gateway providers to connect to acquirers. Mastercard offers its own independent gateway services via Mastercard Payment Gateway Services (MPGS), which gives access to all acquirers active in the UK. Using a gateway provider that gives access to multiple acquirers is likely to make it easier to switch acquirer, since the switching process itself would be managed by the gateway service provider rather than the merchant. As such, independent gateways can

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[1] This number is likely to be affected by the final outcome of Brexit.
[2] RBR (2017), 'Payments cards Issuing and Acquiring Europe 2018', November.
[3] Mastercard (2019), 'Find a payment facilitator in your area'.
[4] Finextra (2019), 'Elavon to acquire Sage Pay for £232 million', November.

potentially play an important role in promoting competition in card-acquiring sector, but can struggle to gain market share from acquirers who bundle gateway services with their wider product offering.

Other ancillary players in the acquiring value chain include price comparison websites for merchant services, which allow merchants, particularly SMEs, to compare the cost of acceptance among a series of providers. An example is Cardswitcher, which merchants can use to obtain instant quotes from a range of acquirers.

Acquiring market functioning

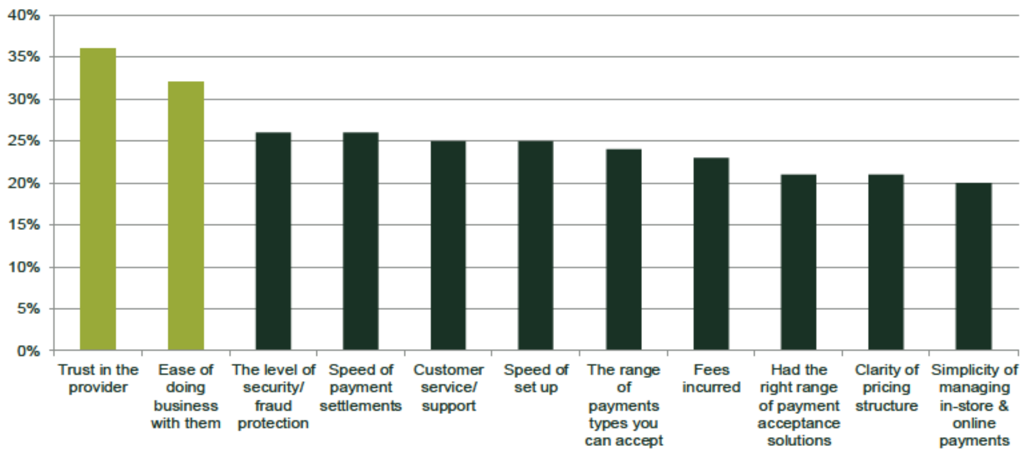
Effective competition in card-acquiring necessarily requires a well-functioning market, both to enable merchants to benefit from competition, as well as to encourage further market entry, with the improvements to innovation, service and value etc which that should bring.

[redacted]

Recent research carried out by RFI provides insight into the relationship between small merchants and their acquirers.[5] Merchants report high levels of satisfaction with their acquirer**,** where almost nine out of ten of merchants report being satisfied. This is supported by the 'good' net promotor scores (NPS) of 13 and 22 for online and offline merchants respectively.[6]

The research shows that trust in provider and ease of doing business are the key drivers of choice when selecting an acquirer, as illustrated in the figure below.

Figure 3.1 Drivers of acquirer selection



Note: Question asked: Why did the business initially choose the following provider as its merchant acquirer? Multiple responses allowed.

Source: RFI.

[5] Merchants with up to £20m in annual revenue were included in the survey. Source: RFI Research (2019), 'UK Merchant Acquiring Council 18H2'.

[6] Scores above 0 are considered good.

There is some variation depending on merchant size and acquirer. [redacted]

Switching is a useful indicator of market functioning and a potentially important consideration of the effectiveness of competition in the acquiring sector. It appears that a significant proportion of merchants switch provider. The survey indicates that 34% of merchants have switched in the past three years.

For those potentially looking to switch, the survey shows that merchants are likely to switch to new market entrants such as iZettle, indicating the potential for competitive constraints being exerted by these entrants.

While the results show that switching does take place, some merchants are less likely to switch. Disruption in transactions during the switching process, the length of time for account set-up and higher or unexpected fees, are the three key concerns. Only one in ten merchants state that they have no concerns about switching. However, for merchants who have switched, the vast majority (81%) report that they were satisfied with the process of switching, suggesting that concerns mainly arise out of perceptions of switching difficulty, rather than difficulty in the process itself. For those not fully satisfied, this is attributed to higher or unexpected fees, settlement times being interrupted or delayed and the switching process taking too long.

It would be useful to investigate further these potential barriers to switching and how these could be addressed.

The benefits of card-based innovation

Driven by competitive pressure, payment schemes such as Mastercard have played a key role in driving forward the adoption of innovative payment methods, thereby delivering efficiencies for users and merchants alike. Consumers in the UK have been very fast to adopt those new payment methods such as contactless, digital wallets and mobile payments, where they have identified a benefit in doing so.

The UK ecommerce market is one of the most developed in Europe, worth €178.5 billion and accounting for 35% of the European market,[7] and is projected to continue to grow rapidly in the near future. High rates of internet access and smartphone penetration, combined with a willingness to use new forms of payment, have contributed to the expansion of online spending (card-not-present, CNP). A significant proportion of online spending is with merchants located outside the UK, resulting in an increase in cross-border transactions.

<u>The role of the sharing economy</u>

The increase in CNP and cross-border transactions is not driven purely by the increasing purchase of goods online or from abroad (rather than from domestic high street retailers). While this is an important factor, so is the growth of the 'sharing economy' which has led to far more fundamental changes in the nature of services being consumed, which in turn has an impact on payment methods.

In particular, ride-hailing apps, accommodation-sharing services and music and television subscription and streaming services have changed the nature of how consumers receive (and therefore pay for)

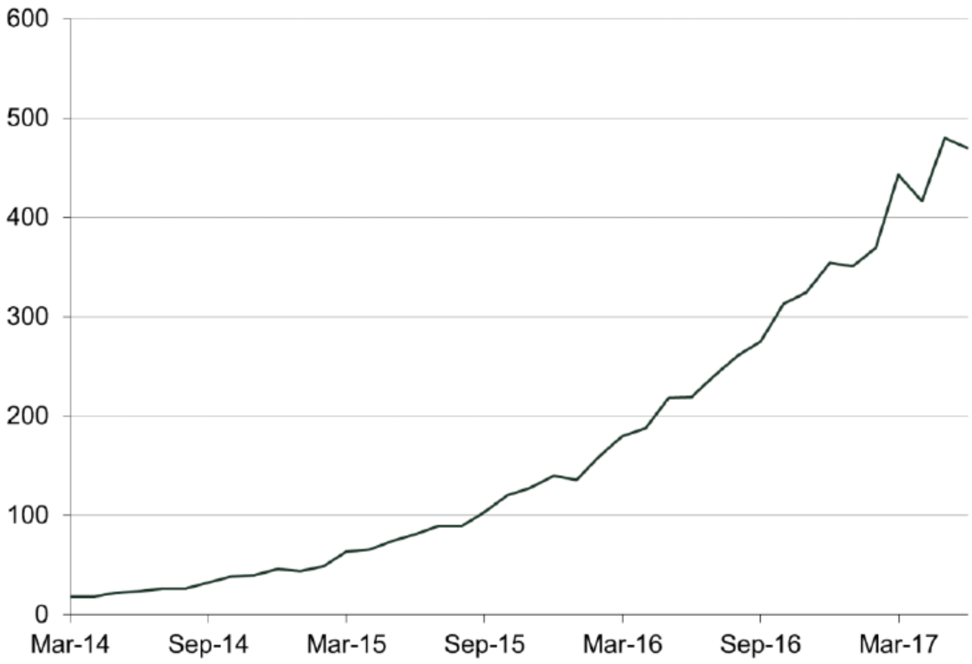
[7] J.P. Morgan (2019), '2019 Global Payments Trends Report – European Overview'.

some fairly basic services that have existed in various forms for many years. By their nature, these services are provided online and cross-border, which is why the volume of these payments has significantly increased.

The rise of contactless

The UK is one of the leaders in the uptake of contactless payments, with 59% of people making contactless payments in a given week.[8] Almost one in two in-store card transactions is now contactless.[9] 78% of people now have a contactless debit card, with 40% reporting that they prefer using this payment method to make purchases.[10] The benefit to consumers provided by contactless is set to increase in line with the commitment of card schemes to ensure that every payment terminal in the UK is capable of accepting contactless payments by January 2020.[11]

Figure 3.2 Number of monthly contactless transactions, m



Source: UK Finance.

Although cash is forecast to remain one of the major competitors to card-acquiring services for many years, its use has fallen significantly in recent years, with a 16% fall reported between 2017 and 2018 alone.[12] Consumers report a number of benefits associated with the use of card, compared to cash[13] and the large-scale shift from cash to contactless options for in-store payments has generated efficiencies for merchants. This is because there are a number of costs (direct and indirect) associated with cash that make it a less efficient means of payment, such as the risk of counterfeit coins and bank

[8] Based on survey results from Britain thinks (2019), 'Access to cash research with consumer and small businesses', commissioned by the Payment Systems Regulator, July, p20. See also: UK Finance (2017), 'Contactless 10 year report', September.
[9] Mastercard (2018), 'Almost 1 in 2 UK transactions are now contactless', press release.
[10] Britain thinks (2019), 'Access to cash research with consumer and small businesses', commissioned by the Payment Systems Regulator, July, p16.
[11] Payments UK (2017), 'UK Payment Markets: Summary', p. 4.
[12] UK Finance (2019), 'UK payment markets summary 2019', June.
[13] Britain thinks (2019), 'Access to cash research with consumer and small businesses', commissioned by the Payment Systems Regulator, July, p18.

notes, the lack of consumer protection, the risk of theft, its time-consuming nature, and the cost of storage, insurance, and collection.

New forms of acceptance

Along with the shift from cash to contactless, several other new technologies have further reduced costs to merchants for card-based payments. For example, mobile payment acceptance for physical transactions. These innovative approaches allow merchants (particularly SMEs) to take payments anywhere using a small card reader (as provided by iZettle, for example) and a smartphone.

Consumers and merchants have an increasing choice of card and non-card payment methods with differences in quality and consumer convenience such as consumer protection (against for example fraud or lack of delivery by the merchant) and functionality (such as providing credit access).

Trends in card-acquiring

The effectiveness of competition in card-acquiring has been influenced by a number of emerging trends, in response to developments within the acquiring sector itself, as well as changes in the wider payments landscape:

- entry by new players, from a variety of entry points;
- innovative solutions specifically targeting small and medium-sized merchants and expansion of service offering;
- increasing consolidation and partnership between acquirers and other players in the payment value chain.

These are explored in turn.

Trend 1 - new entry in card acquiring

The European payments market in general and the UK market in particular, have been notable for the level of new entry which they have experienced in recent years. Any assessment of competition in UK acquiring should analyse the scale of new market entry and how it compares with other global markets.

The first Payment Services Directive (PSD I) facilitated entry into the acquiring industry in Europe, by introducing a new licensing regime that enabled non-banks to become acquirers. As such, most acquirers in the UK are now non-bank organisations. Other regions, such as the USA and Asia, have more restrictive regimes and do not allow non-banks to become acquirers, which has a very significant impact on the relative level of competition and new entry in those markets.

As a result of regulatory changes, the role of the card schemes and the attractiveness of the UK market more generally, many new players have been successful in entering the card-acquiring industry in the past few years. There are a range of entry points, including players that are already active at other levels in the value chain, such as gateway providers, as well as from the emergence of new types of business model.

- Gateway providers such as Adyen have become acquirers, in part by leveraging their gateway customer base and developing innovative service offerings and a simple pricing model for both large and smaller merchants. Adyen's customer base includes various large global players such as Booking.com, Spotify, EasyJet and KLM.[14]

- Some providers have also successfully entered the acquiring space without having an existing customer base. Technology companies such as iZettle have entered as payment facilitators, offering a unique proposition relating to the development of innovative POS solutions for small merchants.

- Entry by existing banks has also been observed. RBS will launch NatWest Tyl, a new merchant-acquiring service for small and medium-sized businesses,[15] which will also provide customers with data analytics to help merchants measure and improve their performance.[16]

- Fintech company Revolut has announced that it will enter the acquiring industry.

- The sector has also seen entry by acquirers from outside the UK. Examples include Elavon, which partnered with Santander in 2009 to offer its UK business customers a card processing service, online account management and currency conversion services.[17]

Trend 2 - innovation in card acquiring and expansion of service offering

Innovation has become an increasingly important and marked feature of card-acquiring in recent years. It has often been led by new entrants, which in turn has both driven competition with existing players and been a consequence of those increasing levels of competition

In particular, PayFacs have had a significant impact by bringing an entirely new (non-bank) mentality to the sector, having originally emerged as a way for small merchants to benefit from, and gain access to, card payment services. This has been achieved by very deliberately designing services to make the process of starting to accept card payments as simple and straightforward as possible, particularly for merchants which might envisage a very low level of card acceptance at the start.

It is most evident from payment facilitators' simplified approach to pricing, which often charges on a per-transaction basis, with no sign-up or monthly fees. The terminals are inexpensive, attractive, easy to use and widely available, while the user interface for transaction monitoring is also designed to be clear and simple. This simple, risk free, pay-as-go service provides merchants with a 'why not' approach to card acceptance, for many who might previously have considered it only worthwhile for large merchants with guaranteed card volumes. The innovative 'democratisation' of card acceptance has been hugely to the benefit of both the small merchants and their card-paying customers.

This approach to providing card-acquiring services recognises that small merchants/sole traders have much more in common with consumers than they do with large merchants. It means that they will be most attracted by simplicity and ease of use, even if the per-transaction charges may be higher than those available elsewhere. It takes acquiring into an area that existing acquirers had not previously targeted, although they are now beginning to follow suit.

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[14] Adyen, 'Our customers'.
[15] Finextra (2019), 'NatWest launches merchant acquiring business', May.
[16] Pymnts (2019), 'RBS gets back into payments ten years after it unloaded Worldpay', May.
[17] Lafferty (2018), 'Merchant acquiring: Wester Europe', May.

Given the prominence of SMEs in the UK economy, with SMEs accounting for 99% of businesses and approximately 52% of business turnover,[18] acquiring services that can offer small and micro merchants low-cost terminals and value-added services are likely to capture significant growth and be an area of increasing focus for some acquirers.

Further, the development of new technology by payment facilitators (such as PIN on glass) and the introduction of appropriate algorithms and access to various databases to assist in carrying out anti-money laundering (AML) and Know Your Customer (KYC) checks, has significantly reduced the onboarding process. This has historically been a lengthy process.

In response to this competitive pressure, traditional acquirers have also developed their own digital onboarding and speeded up their own processes to compete with the service offered by payment facilitators, in some cases reducing onboarding to a matter of hours.[19] Technological changes will also serve to further this trend. Advancements in AI are expected to drive greater onboarding for both new and traditional players.[20] Innovative approaches to reducing customer onboarding hurdles are likely to continue in the years ahead.

Unlike the traditional merchant account model, where every merchant has their own account with an acquirer and corresponding Merchant Identification Number (MID), payment facilitators aggregate all of their merchants under one 'master MID'. The sign-up process is extremely quick and efficient and can easily be completed online in a few minutes.

The emergence of new models of acquiring marks a broader shift in the industry from a banking service towards a technology service, which is set to continue. As such, merchants increasingly have the option of purchasing acquiring services alongside complementary products and services, such as integration to accounting software providers, fraud detection and management software.

Some acquirers and PayFacs have developed new capabilities in house, whereas others partner with technology companies (see below). An example of the former is Square, which offers its customers access to a number of technology solutions, such as fraud management tools and payment management software, to cover broader business needs.[21]

Trend 3 - increasing consolidation and partnership

Over the last few years, the increasing intensity of competition in the acquiring sector and the influx of new entrants, has led to a wave of mergers and acquisitions. These have been driven in part by the increasing demand by merchants for integrated solutions and acquirers looking to benefit from economies of scale. This trend is set to continue, as indicated by the recent announcement of Elavon's intentions to purchase Sage Pay, the gateway provider.[22] Merchants, particularly SMEs, are opting for competitively priced integrated solutions that streamline the process while meeting customer expectations.

Examples of recent acquisitions include the following.

[18] House of Commons (2019), 'Business statistics', December.
[19] McKinsey (2018), 'The transformation of global acquiring', October.
[20] EY (2019), 'Fast forward to the future of payments'.
[21] Square, 'Software for small businesses'.
[22] Finextra (2019), 'Elavon to acquire Sage Pay for £232 million', November.

- PayPal, an online provider of merchant payment services, purchased iZettle, a payment facilitator, for $2.2bn as part of a strategy to obtain physical POS capabilities in competing geographies.
- Worldpay, an acquirer, completed a merger with US acquirer Vantiv in January 2018.[23] Further, FIS acquired Worldpay in 2019, with the aim of providing an end-to-end platform for payments and cross-border omnichannel commerce.[24]
- Worldline purchased Six Payments services as part of its strategy to realise scale in the merchant-acquiring sector.
- Global Payments acquired Realex Payments, a provider of ecommerce payment solutions, in 2015.[25] Global Payments also purchased TSYS, bringing together issuer and merchant acquiring, as well as the provision of SME solutions.

Further, players in the industry are increasingly partnering with one another, leveraging the competitive offering of others in the value chain to provide services to merchants. For example, SumUp has a referral agreement with First Data, a traditional POS company, such that merchants generating revenue below a set threshold will be referred to SumUp.[26] PayZone, the gateway provider, has preferential partnership with Barclaycard.[27] Further, Global Payments partnered with Intuit to provide the new service to its UK merchants.[28]

Pricing in the acquiring sector

The fees that acquirers charge to merchants (the merchant service charge, MSC) cover a number of different cost elements such as interchange fees, switch and scheme fees, and the acquirer's own margin.

Interchange fees, which are paid by acquirers to issuers, form the largest component of the MSC and are capped under the interchange fee regulation (IFR) at 0.3% and 0.2% for credit and debit cards transactions respectively. (For an explanation of the economics of interchange fees, see the Annex).

Acquirers (and issuers) pay scheme fees to Mastercard to participate in its card payment scheme. The amount of fees paid depends on the number and value of transactions conducted and on the characteristics of the transactions, as well as the usage of optional services. Depending on the arrangement, the acquiring contract may or may not include the provision of gateway services and/or the rental of POS terminals; these may be provided separately by other providers.

It is important to understand that since the value of scheme fees paid by acquirers depends on the characteristics of the transactions, increases in the sums paid need not have been driven by pricing changes, but will change over time, as a result of evolution in the mix of transactions (driven by underlying trends in the retail sector and consumer behaviour). For example, e-commerce in the UK has grown substantially in the past few years which has resulted in an increase in card-not-present (CNP) and cross-border transactions. Since scheme fees for these types of transactions are higher

[23] Finextra (2018), 'Vantiv closes Worldpay acquisition', January.
[24] Reuters (2019), 'U.S. firm FIS buys Worldpay for $35 billion in payments deal bonanza', March.
[25] *The Irish Times* (2015), 'Global payments buys Realex I deal worth €150m', March.
[26] CMA (2019), 'Completed acquisition by PayPal Holdings, Inc. of iZettle AB', June, para. 8.122
[27] PayZone
[28] Lafferty (2018), 'Merchant acquiring: Western Europe', May.

than for domestic and point of sale transactions, the rise in e-commerce has resulted in an increase in the amount of scheme fees (in total and per value of transactions) paid by acquirers over time.

These trends vary by acquirer and depend on the transaction profile of its merchants. Although e-commerce has grown in certain retail sectors, merchants with a traditional UK high-street business still drive a substantial proportion of retail spend. The value of scheme fees paid by acquirers in relation to merchants with mainly a high-street business have not changed significantly over time, allowing for the overall increase in the volume of such transactions.

The extent to which merchants can observe changes in the individual components of the MSC depends on the nature of the acquiring contracts which vary by merchant. Many merchants have blended rates, while others (in particular, larger ones) have moved to interchange + or interchange ++ contracts. Merchants with a blended rate pay one fixed fee for card transactions. Under the interchange + model, the fees to merchants are broken down into two components (an interchange fee and an acquirer fee), and under the interchange ++ model they are broken down into three components (an interchange fee, scheme fees, and an acquirer fee).

The increased competitive pressure has resulted in a trend towards more price transparency and a move away from blended rates. For example, new entrants such as Adyen typically offer interchange ++ contracts to all merchants irrespective of their size.[29] However, there may still be the potential for the overall effectiveness of competition between acquirers to be improved by changes to the ways in which fees are presented to merchants.

Implications for the PSR's market study

The evidence presented in this section demonstrates the following.

- The card-acquiring industry has evolved in recent years, with entry by new firms, increased competition from payment facilitators and gateway providers and technological innovations. Payment facilitators in particular have added a new competitive dynamic through their simplified approach to card acceptance and their targeting of the previously underserved small merchant sector.
- This new market entry has been facilitated by the first Payment Services Directive (PSD I), which enabled non-banks to become acquirers and changes in Mastercard scheme's rules. Entry and technological innovations have led to new services and have opened up card-acquiring services to a wider set of merchants.
- The UK ecommerce market is one of the most developed in Europe and is projected to continue to grow rapidly in the near future. High rates of internet access and smartphone penetration have contributed to the expansion of online spending and card-not-present transactions. The uptake of contactless and the declining use of cash has driven an increasing number and proportion of card-based transactions.
- A significant proportion of online spending is with merchants located outside the UK, resulting in an increase in cross-border transactions. The growth of the 'sharing economy' such as

[29] Adyen (2020), 'Pricing'.

accommodation-sharing services and music streaming services has further contributed to an increase in online and cross-border commerce.

These are important factors to consider as part of the PSR's market study.

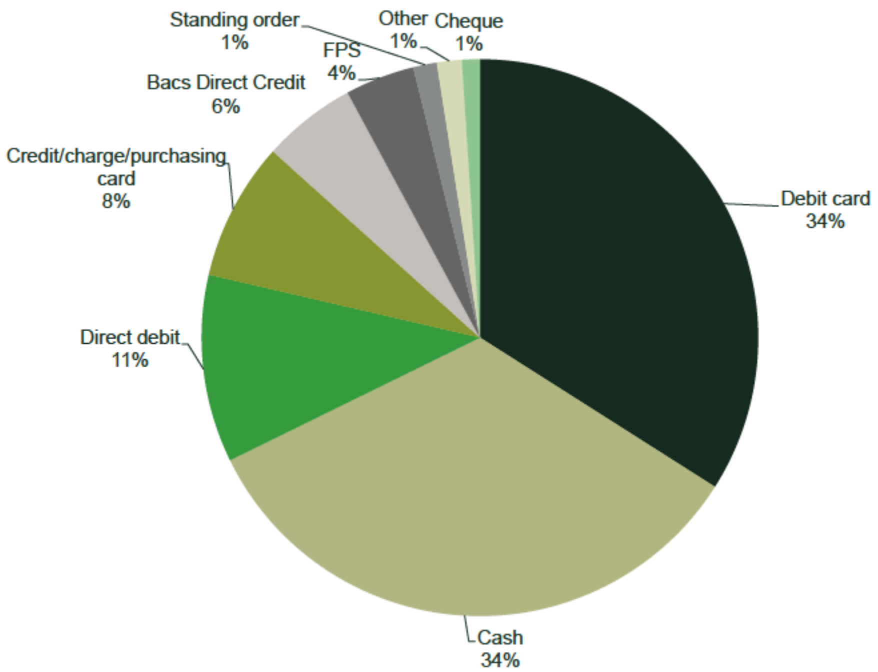
4 Competitive landscape – retail payments

Competition in the card-acquiring industry is affected by the broader competitive landscape for retail payments in the UK, which is in a period of transformation due to technological change and entry by new players, driven by regulatory changes.

Beyond the narrow sector of high street retailers, card-acquiring, supported by traditional card payment schemes faces increasing competition from non-card-based methods. These new payment methods give merchants greater freedom to decide whether they wish to purchase card-acquiring services or whether they may wish to utilise (and steer towards) alternatives.

As shown in Figure 2.2 below, customers in the UK use a variety of payment methods for online and in-store purchases. The majority of payments are made by cash (34%) or debit cards (34%), but a significant number of payments are made via credit transfers and direct debit (BACS) (17%), credit card (8%), or the faster payment service (FPS), which processes bank payments made online.

Figure 4.1 Share of payments volume, by payment method (in store and online)



Source: UK Finance (2018), 'UK Payments Market Summary 2018'.

Direct debit or credit transfers are popular payment methods, in particular in merchant segments where customers make repeat payments (e.g. utility companies, subscriptions, rent, charity payments). For instance, 63% of UK customers pay their electricity bill using direct debit, and the equivalent figure for gas is 66%.[30] More broadly, direct debits are used by nine in ten UK consumers to pay some or all of their regular bills, representing an established and widely trusted method for paying such bills.[31] Direct debit is also chosen by consumers as the mode of payment for fixed subscriptions

[30] Department for Business, Energy & Industrial Strategy (2018), 'Quarterly energy prices', June, Chart 2.4.
[31] UK Finance (2019), 'UK Payment markets summary 2019'.

and memberships. The use of direct debit is also growing significantly by 30.2% between 2015 and 2017, representing a total transaction value of €8.9 billion.

[redacted]

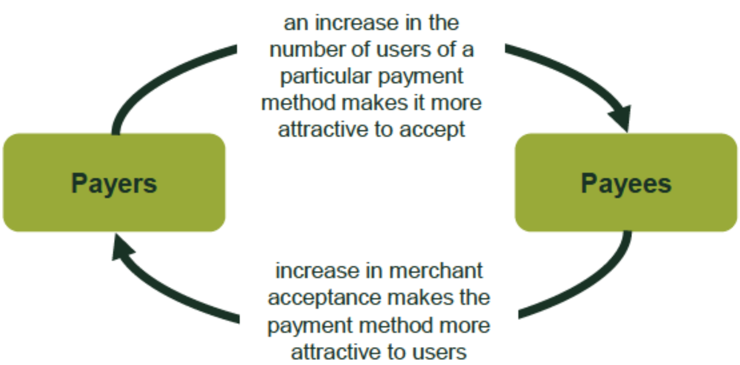
[redacted]

New entry

In assessing the extent and effectiveness of competition with card-acquiring that exists in the broader retail payment landscape, it is necessary to consider the degree and types of new market entry which exist in those markets.

Retail payment systems bring together merchants and consumers. Merchants want to accept a payment method that consumers like to use; and consumers want to be able to use a payment method that is accepted by merchants, creating a 'two-sided network externality'. This is illustrated in Figure below.

Figure 4.2 Network effects in payments



Source: Oxera.

The traditional view was that these network effects were so strong that it would be extremely difficult for new players to enter the retail payments space and be successful in creating a sufficient customer base on both the merchant and consumer sides. This would explain the small number of payment schemes that tend to operate in most European countries.

However, broader market trends (such as Open Banking, the rise in ecommerce and smartphone usage) have facilitated successful entry by various types of player. The network externalities still

[32] 2019 JPM Global Trends Report

matter, but technological, market and regulatory developments are resulting in a significant further reduction in barriers to entry and changing the way competition works in this sector.

One entry point has been through large customer bases established in other industries.

- Retailers (such as Amazon and Tesco) have leveraged their existing customer base to introduce new digital wallet services for online and point of sale payments (e.g. Amazon Pay and Tesco Pay+).
- Similarly, device manufacturers (such as Apple and Samsung) have leveraged their handset user bases and near-field communication (NFC) technology to enable in-store payments (e.g. through Apple Pay, Samsung Pay and Google Pay).
- More recently, the payments industry has seen new forms of competition that do not utilise card payments infrastructure. Banks have leveraged their current account customer base and existing interbank-processing infrastructure to enable retail payments—examples include Pay by Bank in the UK, iDEAL in the Netherlands, and Swish in Sweden.

Some providers have also successfully entered the payments industry without having an existing customer base by meeting a consumer or merchant need. PayPal is one example, and another is Klarna, which offers a convenience that appeals to consumers and therefore indirectly also appeals to merchants.

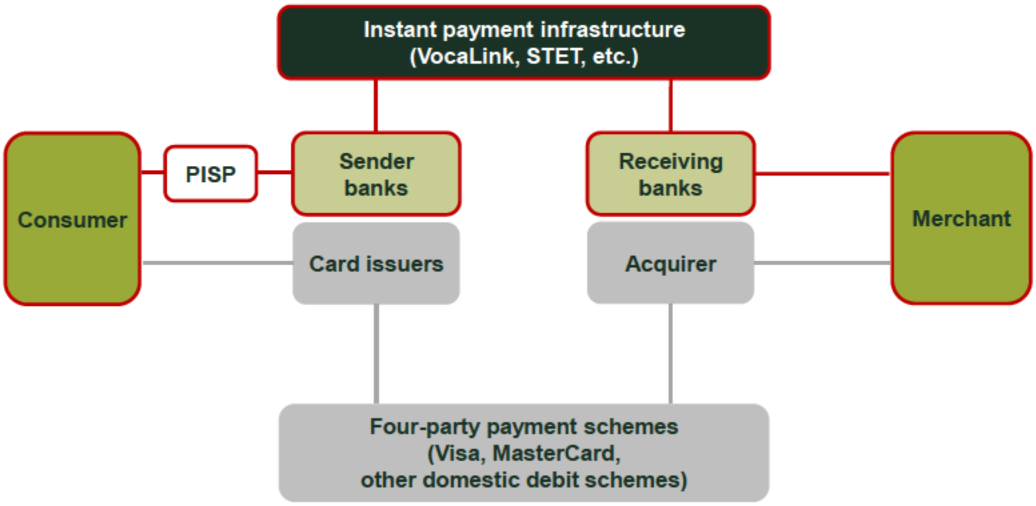
Innovation and competition from Open Banking

[redacted]

Figure 4.3 shows both the card and interbank infrastructure. Open Banking enables third-party payment initiation service providers (PISPs) to provide an alternative route to merchants, indicated by the red outline, whereby card infrastructure is bypassed entirely but can instead rely on the receiving/acquirer bank's infrastructure for settlement.[33]

[33] PISPs initiate a transaction on a customer's behalf, providing an alternative route to cards by making use of existing bank infrastructure (ACH). Services and tools associated with PISPs include apps that help customers manage money to ensure that a customer never goes over-drawn, avoiding the risk of overdraft fees.
Account Information Service Providers (AISPs) aggregate a customer's accounts in one place. AISP licence-holders are authorised to have 'read-only' access of bank account information. Services and tools that are associated with AISPs include price comparison and money management tools.

Figure 4.3 **Alternative routes of payment**



Note: PISP, payment initiation service provider.

Source: Oxera.

The existing new payment methods largely reflect entry into the payment market prior to the implementation of Open Banking. In this way, the full impact of Open Banking is yet to be seen.

One of the first players to take advantage of Open Banking is Adyen, which has already launched a new online payment service using the credit transfer infrastructure in the UK. This service is being rolled out in other European countries as well.

Open Banking will give existing digital wallet providers an additional and cost-efficient way of processing payments and will also facilitate the entry of new providers. Innovative propositions and business models from these providers will continue to exert competitive pressure on card acquirers and schemes.

These factors are expected to place increasing pressure on card payments and providers to innovate in order to avoid losing customer relationships. We would expect this to have two consequences.

- It will incentivise established payment and digital wallet providers to improve the quality and reduce the costs of their services in order to maintain their customer base. Such a development can be expected whether or not new entrants succeed in winning significant market share from established players (i.e. the threat of entry can generate incentives).
- The establishment of a large number of innovative payment providers with smaller customer bases can be expected to be followed by increased collaboration and consolidation of players. Larger institutions may leverage on smaller fintechs to improve internal processes and the customer experience.[34] In this way, innovations introduced by smaller players can be made accessible to consumers across the payments industry, and new entrants will have a route by which they can establish the scale needed to compete in the payment market in the long term.

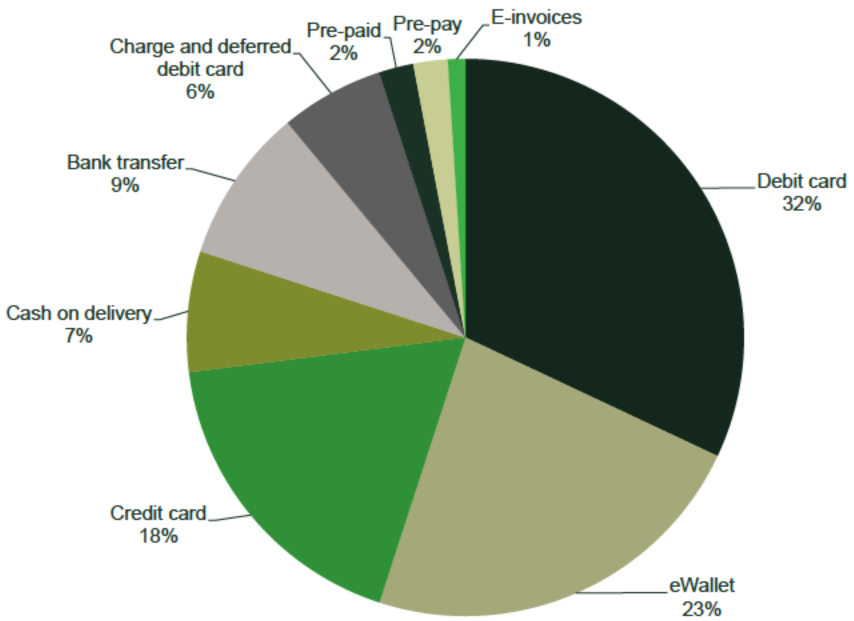
[34] EBA (2019), 'EAB report on the impact of Fintech on payment institutions' and e-money institutions' business models', July, p. 9.

The growth of digital wallets

When analysing how developments in retail payments are likely to impact on the competitiveness of card-acquiring services, digital wallets are a vital component to consider, due to their central role in the ecosystem and their attractiveness to consumers.

Payments via digital wallets account for more than 20% of ecommerce transactions in the UK (see Figure 2.2), and digital wallets are the preferred payment method for more than 45% for consumers.[35]

Figure 4.4 UK split of online retail payments



Source: Oxera analysis based on Worldpay (2018), 'Global Payments Report', November.

Digital wallets present specific economic features that set them apart from other payment methods. Digital wallets can combine the use of relatively basic payment methods, such as credit transfers and direct debits (which offer limited consumer protection), with consumer convenience and protection, thereby directly competing very effectively with card-acquiring for online transactions.

By storing consumers' details, providing a convenient app, and enabling customers to put various payment methods in one wallet, they tend to 'own' the customer relationship. This means that they can impose additional competitive pressure on the payment methods their customers can use to load the wallet or fund the transaction and specifically, card-acquiring services. In particular, digital wallets can steer consumer towards methods that are the most advantageous to the digital wallet providers, and the threat of using steering in itself puts pressure on the card schemes and acquirers.

Digital wallets are therefore not reliant on one payment method or infrastructure and consequently are an effective competitor to cards. For example, PayPal encourages its users to add their bank account details enabling transactions to be funded by direct debits. On its website and app, PayPal

[35] 23,849 consumers across 21 European countries, including Switzerland, were asked: 'Several payment methods exist when it's time to pay online. What is your preferred one?' Source: DPD European E-Shopper Barometer, September 2017.

highlights that once bank details have been added, there is no fee when users send money domestically to friends and family.

With Open Banking, digital wallets could also initiate credit transfers themselves by directly linking the wallet to the customer's bank account. While digital wallets can already take payment for balance from consumers via bank transfers and direct debits, Open Banking greatly facilitates their use on a regular, per-transaction basis without requiring the consumer to load any money into the wallet in advance. In the future, this will result in increased competitive pressure on card schemes from digital wallet providers having easier access to alternative underlying payment methods such as direct debits and credit transfers.

In some countries, we see digital wallets relying more on credit transfers and direct debit. For example, in Germany, an estimated 80–85% of PayPal and Amazon wallets transactions are funded using credit transfer and direct debit.[36]

Increased account-based competition

While the total volume of account-based payments exceeds that of card payments, many consumers often prefer to use cards where they have the ability to do so, particularly at merchants from whom they may be making one-off purchases. This is due primarily to the enhanced anti-fraud measures, combined with the protections that cards provide (through chargeback and s75 for credit cards), which have created a strong level of trust, as well as the greater flexibility and control that they have traditionally offered.

However, recent and planned changes to account-based payments are likely significantly to increase their attractiveness to consumers, by seeking to replicate or improve upon the features of cards which make them most attractive consumers, thereby strengthening the competition that account-based payments provide to card-acquiring services.

- *Confirmation of Payee (CoP)* — while push payments place a greater responsibility on the payer to ensure that the correct details of the payee are used, the introduction of CoP will give consumers greater confidence that their payment is being made to the intended recipient, and they are therefore much less likely to become the victim of fraud.

- *Contingent Reimbursement Model Code* — where fraud does occur, the Code will provide a guarantee that consumers will be compensated if they took reasonable care. This reassurance (which seeks to replicate the chargeback and s75 protections that exist for cards) is likely to have a significant positive impact on consumers' willingness to use Faster Payments for a much wide variety of payments.

- *Request to Pay (RTP)* — RTP has been designed to address the relative inflexibility of direct debit, in order to give consumers greater control over how and when they make regular payments, which again replicates (and potentially improves upon) some existing features of cards and will therefore become a very attractive option for those making recurring payments.

- *Strong Customer Authentication (SCA)* – SCA will require dual factor authentication for relevant account-based payments (as well as card payments) and will therefore give consumers greater confidence to use that payment method, because of the greater security

[36] See IT Finanzmagazin (2018), 'Die girocard ist vermutlich zu spät – Interview mit Hugo Godschalk, PaySys Consultancy', 19 September.

and anti-fraud tools which it implements. It may also drive merchants to incentivise consumers to make more recurring/merchant initiated transactions, for which SCA is only required once. As highlighted above, those types of payments are less likely to be card-based.

Initiatives to strengthen the attractiveness and promote the uptake of account-to-account payment methods will give rise to further competition between card and non-card-acquiring services.

Increased merchant payment steering

[redacted] Many merchants may not choose actually to employ steering if they are neutral as to the means of payment used, but their ability to steer indicates that competition to card payments can be effective, where they do have a preference.

[redacted] Steering can take place in a number of different ways, both online and offline. Some examples include:

- placing logos related to certain payment methods in specific locations on a webpage or instore — for example, some merchants make certain payment methods (such as PayPal) more visible on their website than other payment methods;
- the ordering of payment methods at online checkout — for example, some merchants list their preferred payment method first or display less preferred payment options less prominently;
- setting a minimum spend for certain payment methods, instore;
- surcharging, where allowed.

A consumer's strong loyalty to a particular retail brand or product can make them agnostic towards the payment option, which gives greater bargaining power to merchants that use external providers to process payments and can direct consumers to a default or preferred payment method. This, in turn, can be expected further to intensify competition.

[redacted] As explained above, PayPal encourages its users to add their bank account details enabling transactions to be funded by direct debits.

The roll-out of Internet of Things (IoT) technology is likely significantly to enhance a merchant's steering power. IoT refers to a concept of connecting all devices everywhere in real time. Many smart technologies also fall under the umbrella of IoT. Examples include Amazon buttons that allow customers to reorder washing powders by pressing a button, wearable devices that monitor health and automatically order medication, or smart fridges that monitor the contents of the fridge and automatically order milk when it is about to run out.

To the extent that IoT merchants are able to steer customers (through nudges, rewards, or setting defaults) away from card-acquiring services when making initial payment decisions, the IoT increases that steering power because the consumer does not make an active choice each time (i.e. it creates inertia). As a result, successful initial steering from the merchant would determine the subsequent transaction volumes through different providers and could place particular pressure on card payments.

Longer term trends

In addition to the points highlighted so far in this section, there are a number of trends in payments which we can expect to play an increasingly important role in the mid to longer term. [redacted]

- the increasing role for providers not specialising in payment
- more online payments providers expanding to physical transactions
- alternative forms of payment
- new infrastructures

These are explored in turn.

Trend 1 - the increasing role for providers not specialising in payment

Payment is an integral part of the experience offered to customers and an important cost item for some merchants. For some large technology firms, payment is a service that is complementary to the firm's offering. As a result, many companies are likely to seek to provide payment services as part of their offering and to become payment service providers themselves.

These globally recognised and trusted brands are able to leverage their considerable strengths in other markets to establish themselves in the payment market, which they have the potentially significantly to disrupt and fundamentally to restructure as they have already done in various other markets. Consumer electronics firms such as Apple and Samsung are examples of this, while Google, Facebook, and Amazon have also entered the payment market. Other large retailers and social media companies are also likely to enter the payment market in the future.

Further, the emergence of such players, facilitated by Open Banking, will give rise to the development of non-card forms of payment, bypassing card networks altogether.

The huge brand awareness and loyalty of these companies, combined with their non-payment service offerings, increases their ability to compete in the payment industry with card schemes and acquirers. This is because consumers may prefer a provider that has a strong retail brand and offers other services alongside its payment services (such as social media) over a provider that only offers payment services. The competitive advantage offered by non-payment services imply that large, non-payment-based companies will play an increasingly important role in the payments industry.

Trend 2 - more online payments providers expanding to physical transactions

The development of ecommerce has significantly blurred the boundaries between online and offline sales; for example, it is now possible to buy products online and pick them up in store. Meanwhile, online retailers such as Amazon and Alibaba are experimenting with brick-and-mortar stores. The boundary between online and offline retail market will continue to blur in the future.

As the boundaries between online and physical transactions become less distinct, it can be expected that it will be become less attractive for consumers to hold separate favoured payment methods for online and physical transactions. Instead, they will expect their favoured payment method to be available in both contexts, which will place significant competitive pressure on card-acquiring services.

Moreover, payment services will be able to improve their competitive position by being active in both online and offline markets in order to maximise their acceptance network and user base and thus the positive network externalities.

As a result, payment providers will try to offer both online and physical payments with equal convenience. This represents the continuation of a trend observed in its early phases: PayPal is expanding into the physical in-store purchases with the acquisition of iZettle; Visa and Mastercard are integrating their payment buttons to compete more effectively in the online market.[37] This trend will continue in the future through different channels, including the use of digital wallets based on a smartphone that can be used for both (e.g. Apple Pay) and the availability of online payment services at the POS (e.g. through QR-code readers)

Trend 3 - alternative forms of payment

Although face-to-face transactions are still overwhelmingly conducted using cash or debit or credit cards, technology is again making a difference as the broadening use of smartphones provide options at the point of sale.

For example, NFC and QR codes (which need not rely on card-acquiring) mean that various online payment methods and digital wallets have also become available for in-store purchases. In other words, the rise in mobile payments means that online payment methods and digital wallets are becoming available for purchases on the high street. This means that consumers can carry and easily switch between multiple payment methods not only online but also on the high street.

Trend 4 - new infrastructures

Technological advancement and regulatory developments may create alternative payment infrastructures such as blockchain, increasing the available choices of payment methods that do not rely on card-acquiring services.

Blockchain provides a peer-to-peer payment infrastructure, which is an alternative option to the existing infrastructures. Currently, many players (such as Mastercard, Visa, American Express and Bank of America) are already using blockchain technologies, primarily in cross-border transactions.[38] Wider applications of blockchain in payments in the future could constitute alternative payment infrastructure. Such technology has attracted considerable attention in the payments industry in recent years.

[37] Cards International (2018), 'Visa and Mastercard to integrate online payment buttons', 23 April.
[38] Forbes (2018), 'Blockchain continues to advance into the payment environment', 20 June.

To the extent that the new infrastructures are cheaper and better than the existing ones, they will also exert competitive pressure on the card schemes and ACH systems. The existing types of infrastructure that process electronic payments include various infrastructures for card processing, ACH, and infrastructures for on-us transactions.

Implications for the PSR's market study

The evidence presented in this section demonstrates the following.

- The UK retail payments sector as a whole is undergoing substantive change, with developing customer preferences and behaviours allied to an evolving supply-side picture. New technologies and lower entry barriers have altered the competitive landscape and enabled the introduction of digital wallets as well as new payment methods using interbank payments as an alternative to cards. This also changes the competitive dynamics in the card-acquiring sector.

- Many digital wallets and mobile payment methods already provide the customer with access to cards alongside credit transfer infrastructure and 'on us' transactions. As such, the next wave of competition in UK payments will not just be between international card providers and cash, but also with new payment methods and digital wallets, and competition with 'on-us' transactions and interbank infrastructure within the digital wallets.

- In particular, open banking will provide increased competition to card-acquiring services by offering merchants a further alternative payment method, which might better suit their needs. The existence preference of some merchant types for direct debit (combined with their increasing ability to steer consumers towards their preferred payment option) is evidence as to how payment methods might develop, for those merchants for whom open banking is most valued.

- Regulation is also driving significant developments in account-based payments, which will make them increasingly attractive to consumers, by replicating or attempting to improve upon, the features of card payments, which have traditionally made them popular.

- In the longer term, market developments might be even more dramatic, as non-specialist providers become more involved in payments, distinctions between online and offline blur and new payment forms and even infrastructure become commonplace.

These are important factors to consider as part of the PSR's market study.

5 The role of the Mastercard scheme in card acquiring

Mastercard plays an essential role in coordinating and facilitating the activities of issuers and acquirers within the card payment system. This section focuses specifically on the services that Mastercard provides to card acquirers and the ways in which they benefit from the existence of the Mastercard scheme and the activities it provides. It also explains how Mastercard promotes competition and a level playing field in the acquiring value chain.

Mastercard's role in payment systems

The Mastercard payment network involves a number of components: the scheme, the infrastructure for transaction processing (the switch), issuers and acquirers and the provision of ancillary services. Given the parts of a card transaction that are most visible to businesses and consumers, it would be easy to think that the core product is the transfer of money. This is not correct. There are many pre- and post-payment activities and rules carried out by Mastercard that are essential to delivering services to card acquirers and more generally, seamless transactions at the point of exchange. Evolving this framework is Mastercard's core product.

These activities have beneficial effects on acquirers and issuers, merchants and cardholders and ultimately the wider global economy. Payments are complementary services, as they generate value by enabling a transaction for another product or service to take place. As such, they are integrated into the functioning of all industries. Therefore, any incremental improvement in payments has the potential to make a significant contribution to the economy as a whole.

Mastercard scheme — services to acquirers

The Mastercard scheme is a franchise business and the scheme rules are the fundamental core upon which the model depends. In order to ensure that it operates effectively in the interests of scheme participants (franchisees), those participants must sign up to adhere to the same set of rules, practices and standards. Those rules must then be applied in a consistent, non-discriminatory and rigorous manner.

It is the existence and universal application of these rules that ultimately creates the trust in card payments, which is essential for both cardholders and merchants alike. In its simplest terms:

- cardholders need to be assured that wherever they see the Mastercard acceptance mark, they will be able to pay for goods/services in a simple and secure manner (with the additional protections which Mastercard provides);
- merchants need to be assured that if they accept a Mastercard card, they will receive payment in full, in all circumstances and without exception, regardless of whether the cardholder pays or if others in the value chain fail. It is known as the payment guarantee and is the underlying reason why merchants accept cards.

Without these assurances, neither cardholders nor merchants would have an incentive to participate in a card scheme. As a result, Mastercard's acquirers individually and collectively agree to abide by its rules, in return for the value which they (and their merchants) derive from card acceptance. It is the maintenance and enforcement of its rules, which is the core service which Mastercard provides to acquirers.

Through its rules, the scheme also overcomes coordination problems among issuers and acquirers and other network participants that would otherwise be reluctant to cooperate, driving forward innovation and promoting adoption of new technologies in the payment network and beyond.

The complexity of payment networks and evolving consumer demands require Mastercard regularly to update its rules in order to provide a seamless payment experience for its merchants and cardholders. For example, Mastercard updates its rules to ensure that issuers and acquirers invest and adopt measures that keep pace with the evolving fraud risks. In addition, the scheme rules are changed to promote the adoption of new technologies and product features (such as contactless) to meet changing consumer preferences.

Further, in order to remain competitive, Mastercard innovates to improve its payment services both through technological developments and innovations. Both with respect to its scheme rules and its technology, Mastercard will coordinate with external public and private stakeholders to ensure such innovations are effective.

Scheme activities

It is in Mastercard's best interest that the acquiring sector is well functioning, consistent with its commercial incentive to increase the volume and value of transactions using its brands. In order to build its success in a competitive market, Mastercard's activities are directed at ensuring that it delivers value to acquirers and the economy overall by making its payments as easy, quick and secure as possible. The economic value to acquirers generated by Mastercard's services are highlighted by mapping them against four drivers of economic growth.

1. ***Improving payment efficiency* -** by making payment transactions safe, simple and smart, Mastercard improves the payment efficiency in the transactions between consumers and merchants. The benefits of such activities extend to acquirers (and issuers) in a variety of ways e.g. through Mastercard ensuring fast and efficient resolutions in the event of payment difficulties. In particular, Mastercard's dispute resolution service, Mastercom, reduces the burden placed on acquirers (and issuers) as a result of a customer chargeback.

2. ***Facilitating new entry into the acquiring industry* -** Mastercard plays an important role in facilitating entry and competition in the card-acquiring sector, while retaining the resilience and integrity of the system. This includes providing advisory support to new and potential entrants looking to enter the market, as well as temporarily amending or flexing its scheme rules to enable payment facilitators to enter the market.

3. ***Driving forward innovation* -** there are two key characteristics of innovation in payment systems. First, innovations can be high-risk activities, often with benefits that are not realised until years later. Second, many of the benefits of the investments lead to innovation at the network level, rather than at the private level. Mastercard has flexed its scheme rules to promote innovation and the adoption of new technology in the acquiring sector, resulting in innovative payment solutions to merchants in the UK.

4. ***Ensuring security and stability in the payment network***, including activities aimed at ensuring the security of Mastercard's payment network, including acquirers. The Mastercard network faces four main types of risk, which the Mastercard scheme manages: settlement, fraud, cyber-attack, and operational risk. This is explored in more detail below, together with how these activities benefit acquirers and other scheme participants.

1. *Improving payment efficiency*

A key objective of the Mastercard scheme, reflected by its mission statement, is to use its technology and expertise to make payments safe, simple and smart. By doing so, it improves payment efficiency in the transactions between consumers and merchants. Importantly, improvements in payment efficiency also provide significant benefits to acquirers (as well as issuers and wider payment participants), through providing fast and efficient payment resolutions when issues arise.

In the event of a failure in the payment chain, the scheme rules on chargebacks and the provision of a dispute resolution platform (Mastercom) provide consumer confidence and a strong degree of consumer protection on the one hand, as well as a platform that streamlines the dispute process for issuers and acquirers on the other. This collectively services to reduce the transaction costs associated with such events.[39]

Without the coordination enabled by the platform provided by Mastercard, even if its acquirers agreed with its issuers to provide this type of consumer protection, there would be no realistic means of doing so. Under the Mastercard scheme rules, the customer can ask the issuer of the card to process a refund request if the goods or services that they bought with the card are damaged, never received or not as described. Mastercom defines a clear set of rules that smooth the process in the event that something goes wrong. This reduces the need for chargebacks and improves customer experiences, providing benefits to acquirers, as well as issuers. Benefits to acquirers include shorten resolution time, potentially solving disputes in hours or days, rather than weeks or months, as well as a reduction in costs associated with processing chargeback, arising from the increased automation and consolidation provided by the destitute process.

More broadly, reductions in frictions in card transactions themselves, arising from new technologies and innovations promoted by Mastercard, make the way for quicker, cheaper and more convenient payment methods. As payment methods become more efficient, this generates spill-over effects for those involved and the third parties indirectly affected by the transaction, resulting in cost savings for merchants and time saved for anyone involved in the transaction, including acquirers.

2. *Facilitating new entry into the acquiring industry*

Mastercard has played an important role in reducing entry barriers in order to enable payment facilitators to enter the market and thereby promote competition, while at the same time maintaining resilience in the system.

While the introduction of the first Payment Services Directive (PSD I) facilitated entry of non-banks into the acquiring sector, Mastercard also made efforts further to enable market entry for payment facilitators.

[39] Mastercard, 'Mastercom'.

- ***Providing support to new and potential entrants***. One way in which this has been done is through providing managed support to those looking to enter the market and become acquirers or payment facilitators. This was particularly the case following the introduction of PSD I, when a number of payment gateways and other financial institutions were interested in becoming acquirers. This involved Mastercard having conversations with prospective acquirers on how to meet the Mastercard scheme requirements. Mastercard's Franchise team exists to manage this critical responsibility on an ongoing basis, acting both as first point of any contact for any potential acquirer and managing them through the licensing and onboarding process.

- ***Increasing the volume threshold for payment facilitators to allow market expansion***. An acquirer is liable in the event that a merchant is unable to deliver the service and is unable to provide a refund due to, for example, bankruptcy. Mastercard does not monitor the transactions of payment facilitators, as these are monitored by acquirers. As such, Mastercard monitors the outstanding positions.

  Mastercard therefore mitigates risk by imposing a threshold on the size of merchants that payment facilitators can serve (measured by volume of transaction, per merchant). Mastercard has progressively increased this threshold from ~£100,000 to ~£1m per merchant to encourage the growth of payment facilitators as well as facilitate the acceptance of smaller merchants. There are a number of instances in which Mastercard has made exceptions to the threshold limit in order to expand acceptance to the types of merchant who would not otherwise use acquirers, such as hospitals and education providers. Further, Mastercard helps ensure a level playing field by providing payment facilitators with training, as well as partnering them with acquirers.

Mastercard also helps to reduce unnecessary card-acquiring costs. For example, it removed the requirements for magnetic stripe readers on mobile POS (MPOS) terminals in Europe in order to reduce the cost burden on both payment facilitators and merchants.[40] It is estimated that this has allowed MPOS companies to reduce the manufacturing cost of their device by approximately 18%.[41]

Magnetic stripe readers were used to verify magnetic stripe card payments whereby cardholders identify themselves with a signature on the receipt. The movement to EMV chip technology has seen a shift away from this payment method. Removing the magnetic stripe reader has allowed MPOS companies to reduce the manufacturing cost of their device, allowing the solution to be more accessible to small and micro merchants.

These measures have contributed to payment facilitators entering the card-acquiring industry and serving a previously underserved market of small merchants and reflects Mastercard's incentive to encourage a level playing field among scheme participants.

[redacted]

[40] As a result, Mastercard released a European Operations Bulletin in January 2018 that removed the requirement for magnetic stripe readers for MPOS terminals in Europe.
[41] Statistics received from Mastercard (5 July 2018).

3. ***Driving forward innovation***

Innovation plays a key role in card-acquiring and payment systems more generally. Mastercard has played a key role in delivering innovative solutions in the acquiring industry that have enhanced competition and promoted better system-wide outcomes.

One way in which this can be demonstrated in the card-acquiring industry is through Mastercard flexing its scheme rules (waiver) to enable the advancement of innovative technology.

Box 5.1 Mastercard rule waiver process explained

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]

[redacted]

[redacted]

- [redacted]
- [redacted]

[redacted]

- Mastercard played a critical role in the development of secure remote commerce (SRC). SRC offers an approach to promote security and interoperability within the card payment experience in a remote payment environment.[42] It seeks to address a number of vulnerabilities that can arise from making payments online, such as data breaches due to the harvesting of manually entered Primary Account Number (PAN) details into a website. Using SRC, Mastercard, in collaboration with American Express, Visa and Discover, is in the process of introducing a secure checkout button that aims to create a consistent, safe and simple user experience for all sites and cards. Users won't have to create or log in to an account to make a purchase, nor enter their card information into every new site.

4. ***Ensuring security and stability***

The effective functioning of the acquiring industry within the Mastercard payments network is highly dependent on the trust placed in the scheme rules and in particular the predictability and reliability of those rules in terms of facilitating stability, certainty and confidence in the network. To ensure the integrity of the system, Mastercard continually invests in the maintenance and monitoring of its network, providing benefits to acquirers both directly and indirectly. The Mastercard network faces four main types of risk, which the Mastercard scheme manages, and this is to the benefit of acquirers:

- settlement risk
- fraud
- cyber-attack
- operational risk

Settlement risk

Subject to certain limitations, Mastercard guarantees settlement of Mastercard transactions among principal issuers and acquirers. This helps to enable global acceptance by providing acquirers and (indirectly) their merchants with assurance that they would receive settlement in the event that a cardholder's issuing bank fails to settle. Mastercard therefore has a credit exposure to its principal issuers.

Mastercard has a dedicated underwriting team—the Customer Risk Management (CRM) team—to manage and mitigate its risk arising from its settlement guarantee. Mastercard chooses to bear this risk and commits to pay acquirers in the case of an issuer settlement failure. By acting as the payer of last resort, Mastercard provides confidence in the integrity of the system.

Fraud

The Mastercard network faces continuous and dynamically evolving threats. While issuers benefit from these activities most directly, acquirers and merchants benefit through the resilience that such measures introduce into the payments system and the trust thereby provided to cardholders to make payments. The scheme develops rules and standards to ensure confidence in the system

[42] EMVCo (2018), 'EMV Secure remote commerce – frequently asked questions (FAQ)'.

and invests in technologies that keep up with the pace of the evolving fraud activities. Key steps to the risk mitigation strategy are as follows:-

- *Strong customer authentication (SCA)* — new requirements for authenticating online payments were introduced in Europe as part of the revised Payment Services Directive (PSD2), aimed at reducing online fraud. Mastercard has been integral to leading and co-ordinating the industry's response to the SCA requirements, providing acquirers with a clear interpretation of the regulations and direction as to what they need to do to ensure compliance. It has also provided SCA-compliant product solutions, such as Mastercard Identity Check, which uses payment authentication protocols that will reduce fraud and basket abandonment, as well as provide a better customer experience.[43] As well as facilitating compliance, this solution also provides benefits to acquirers through reducing chargebacks and minimising the costs associated with fraudulent transactions.

- *Identification of fraud* — Mastercard can leverage its big datasets of the payment network to identify suspicious activity and accounts and shut them down where possible. The scheme works together with the issuers to identify suspicious activity (e.g. potential money-mule networks).

- *Due-diligence checks* — to protect against harmful merchant activity, Mastercard establishes rules which require acquirers to carry out due-diligence checks on merchants before entering into a relationship with them. The acquirer has an incentive to perform these checks as it may ultimately be liable for the merchant's actions under the scheme rules.

- *Developing technology* — the scheme needs to invest continually in best-in-class technology solutions to stay ahead of attackers that could destabilise the network. The next wave of scheme activities delivering on this requirement is perhaps best demonstrated by Mastercard's investments in tokenisation and biometrics.[44]

- *Ensuring adoption of the technology* — a critical part of the adoption of secure technology is ensuring that the secure customer authentication is quick and convenient, and therefore more likely to be used by cardholders. Figures released by the European Association for Secure Transactions (EAST) attribute the 13-year low in the level of card fraud in the EU to the effectiveness of EMV.[45] The Mastercard scheme rules are designed to put in place incentives to facilitate this adoption.

- *Monitoring the fraud risk of scheme participants* — Mastercard monitors the fraud events and quality of fraud defences of its scheme participants. As well as ensuring the central reporting of fraud events by its participants, Mastercard analyses the data to help scheme participants reduce potential security gaps.

- *Ensuring the integrity of the payment system* — Mastercard preserves the integrity of the payment system and provides significant benefits to acquirers by identifying merchants who introduce more than an acceptable level of risk into the system. For example, Mastercard's Business Risk Assessment and Mitigation (BRAM) programme restricts merchants' access

[43] Mastercard (2019), 'Online payments are changing – is your business future-proof'.
[44] Tokenisation is the process of replacing a card's primary account number—the 16-digit number on the plastic card—with a unique alternative card number, or 'token'.
[45] Finextra (2018), 'Card fraud at EU payment terminals hit lowest level for 13 years', https://www.finextra.com/newsarticle/32766/card-fraud-at-eu-payment-terminals-hits-lowest-level-for-13-years?utm_medium=newsflash&utm_source=2018-10-10&member=82091.

to the system, ensuring that Mastercard cards are not associated with transactions that may pose significant fraud, regulator and/or legal risks, or may cause reputational damage.

Cyber-attack

A related set of risks faced by the Mastercard scheme and acquirers and issuers are those stemming from cyber-attacks and data privacy. To protect the security and integrity of its payment scheme, Mastercard has to invest in the latest technology, monitor the network constantly and conduct regular tests to ensure that the system is resilient.[46]

Operational risk

Operational risks include the risk that the elements of the network might be unavailable for a brief or extended period of time or that it might not function at a sufficient speed. A large element of the trust of both cardholders and merchants is the expected reliability of the network.

Mastercard invests to ensure the resilience of its network against such failures, which can occur at the level of the acquirer (as well as issuers and Mastercard itself). In such cases, transactions may fail to be authorised, with obvious adverse consequences for acquirers and merchants' business. Further, errors can occur when transactions are cleared and settled, which Mastercard needs to mitigate against, in the interests of acquirers. This is a huge focus for Mastercard and the majority of its staff globally are employed in Operations & Technology roles to ensure the robust and resilient operation of its network.

Specific examples of Mastercard's risk mitigation measures include the following.

- *Investing in authorisation stand-in services* - Mastercard mitigates against operational risks through investing in back-up stand-in services. This sets minimum requirements for the availability of an authorisation system and its parameters for responding to authorisation requests.

- *Setting minimum availability requirements for clearing and settlement* - Mastercard sets minimum availability requirements for clearing and settlement. Mastercard also ensures that clearing and settlement systems provide currency conversion for transactions where the purchase currency does not match the card currency. Further, Mastercard ensures that clearing systems include a means of addressing transaction disputes, such as duplicate processing of transactions as well as an incorrect transaction amount.

Further, Mastercard maintains an Anti-Money Laundering (AML) compliance program that uses a risk-based approach to preventing its network from being used to facilitate money laundering, inter alia. To safeguard the Mastercard network and all of its participants, each entity seeking a Mastercard license must provide KYC information used to conduct due diligence on the entity and its beneficial owners. This enables Mastercard to assess the risk posed to the network, and what, if any, measures could be put in place to mitigate the risk.[47]

Mastercard also provides AI-based real-time tools, such as Brighterion, to help its customers with AML screening, furthering the resilience of the network.

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[46] The switch retains a limited set of transaction detail information (such as amount spent, merchant and primary account number, or PAN), and does not retain other personally identifiable information. This limits the value of the data that can be stolen.
[47] Mastercard, 'Overview: Mastercard anti-money laundering and sanctions'.

Implications for the PSR's market study

This section has set out the following.

- Mastercard undertakes a range of activities and services at scheme level which benefit acquirers and other network participants.
- Mastercard has a clear commercial incentive to encourage competition, service improvements, product innovation and growth in the card-acquiring industry, as this contributes to the volume of transactions for Mastercard.

Mastercard has actively promoted and supported competition in the card-acquiring industry by:

- optimising scheme rules to provide a seamless payment experience for merchants and cardholders;
- offering targeted and time-limited rule waivers where these will deliver benefits (balancing the resilience of the system with enabling new technologies);
- providing advisory support to new entrants on how to meet scheme requirements;
- taking steps to reduce unnecessary costs for acquirers (e.g. by removing the requirements for magnetic stripe readers on MPOS terminals in Europe).

Mastercard mitigates key risks and offers a resilient, stable and secure network for acquirers.

6 Conclusion

The card-acquiring sector has been subject to significant change in the past few years. We have seen new players entering, innovative solutions being developed and offered, and in particular micro and small merchants obtaining easier access to card payment services.

Broader market developments such as Open Banking, new forms of payment and digital wallets are likely to introduce significant further change in the medium term. We note that some of the new entrants have already taken advantage of Open Banking and have developed new payment methods that compete with payment cards.

The card-acquiring industry forms an important component of four-party card schemes which represents a delicate balance between the interests of all parties, from which they all benefit. It is in Mastercard's interest that the acquiring sector is well functioning, consistent with its commercial incentive to increase the volume and value of transactions using its brands. Mastercard has successfully facilitated the entry of new types of acquirer by adapting its Rules, enabled payment facilitators to enter and grow their customer base and enabled the development and adoption of innovative payment solutions.

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]

The PSR focus should be on allowing the market to develop freely, ensuring that there are no disincentives to the introduction of new card payment/acquiring features, and empowering merchants to take well-informed decisions about which service providers to use.

Annex

The card-acquiring industry forms an important component of four-party card schemes. These schemes bring together merchants and card-holders, creating two-sided markets with the objective of setting prices among participants to maximise the usage of the platform.

This annex explains how two-sided platforms and wider market dynamics have implications for the fees charged in the card-acquiring sector.

Commercial and economic implications of four-party card schemes

Payment card schemes bring together merchants and cardholders and are therefore two-sided platforms serving two distinct types of users. Two-sided markets can be distinguished in two ways.

- ***Participation on two sides*** — card schemes bring together cardholders and merchants who accept the card for payment. Merchants want to be able to accept a card that many cardholders carry; similarly, cardholders want to carry a card that many merchants accept. This means that the attractiveness of participating in the platform is a function of the level of participation on the other side of the market.
- ***Interaction between two sides*** — card schemes enable transactions between cardholders and merchants to take place. The decision to interact necessarily implies a joint decision of the two parties, although cardholders or merchants will not, in general, consider the costs and benefits of the interaction to the other side of the market. This means that cardholders will not generally consider the costs and benefits to merchants when deciding whether to use a card.

The two-sided nature of these platforms has several economic and commercial implications.

First, two-sided platforms face the commercial imperative to attract, and keep on board, both types of user. No merchant would accept a payment card which has only a few cardholders, and no consumer would carry a card that is not accepted by many merchants.

[redacted]

[redacted]

[redacted]

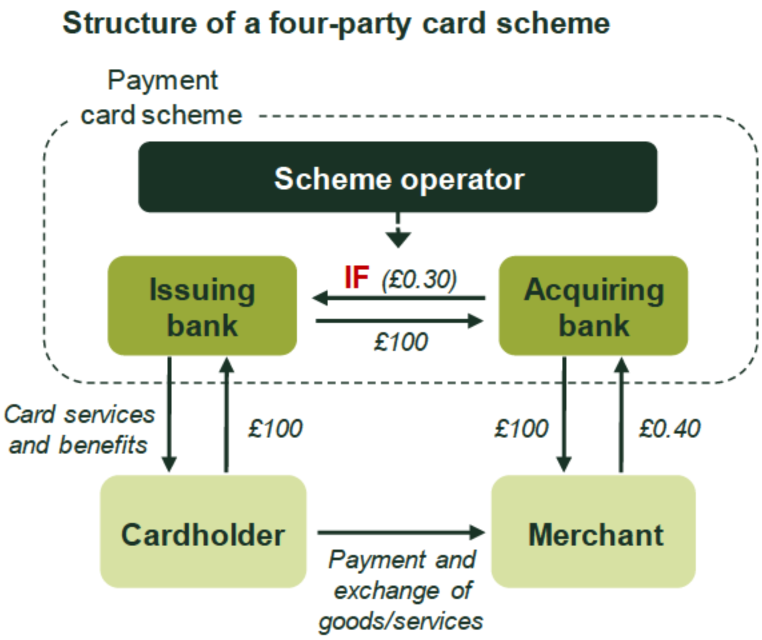
Interchange fees

Interchange fees are central to the functioning of many card payments and are a key mechanism through which card schemes attract and retain both merchants and cardholders, as well as encourage transactions between the two groups.

[redacted]

The figure below provides a stylised overview of the relationships in a four-party scheme between issuers and acquirers, and the two sides of the transaction (cardholders and merchants).[48]

Four-party card scheme



Note: IF: interchange fee. The payment from a merchant to an acquirer is called a 'merchant service charge' (MSC). The example abstracts from certain practical details.

Source: Oxera.

Assume a cardholder uses their card for a purchase of £100 at a particular large merchant. For illustration, assume that the interchange fee is 0.3%, and the acquirer 'margin'[49] is 0.1%.[50]

- After the card is verified with the issuer and the payment is authorised, the merchant's account at the acquirer is credited with £100, minus an agreed MSC.

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[48] In this example we assume that both the issuer and acquirer are banks, but nowadays there are also non-bank issuers (for credit cards) and acquirers.

[49] This is expressed as a percentage of the transaction value, and the term includes both the costs and the margin of the acquirer.

[50] In this example, we assume that the issuer and the acquirer are separate institutions. The European Commission estimated that the acquiring margin for large merchants is 0.06%, which is the basis for the illustrative 0.1% margin used in this example. European Commission (2015), 'Survey on merchants' cost of processing cash and card payments', Final results, March.

- The MSC will cover the acquirer's cost of providing transaction services to the merchant, plus some commercial margin. In the simplified case illustrated above, this is equal to the interchange fee plus the acquirer margin and costs (£0.40), so the merchant receives £99.60 from the acquirer.
- The acquirer receives £99.70 from the issuer (£100 minus the 0.3% interchange fee) and keeps revenue of £0.10.
- The issuer reduces the cardholder's balance by £100, pays £99.70 to the acquirer and so keeps revenues of £0.30, equal to the interchange fee. These revenues will contribute to the costs and margins of the issuer, who will in turn pass on the benefit to cardholders through lower fees or reward incentives, such as cashback or air miles.

[redacted]

As a result of the interchange fee regulation (IFR), domestic and cross-border intra-EEA[51] consumer debit and credit card transactions have a maximum interchange fee of 0.2% and 0.3% respectively.[52] Following commitments by Mastercard and Visa, inter-regional interchange fees were also capped at this level for in store transactions. These commitments introduced inter-regional interchange fee levels of 1.15% and 1.50% for online transactions, for debit and credit cards respectively. The higher interchange fee for CNP transactions reflect the difference in cost and value to the merchant attributed to the different transaction types.[53]

All queries in relation to this response should be to [redacted]

[51] Domestic transactions refer to transactions where the card issuer is located in the same country as the merchant. Cross-border intra-EEA transactions refer to transactions where the card is issued in one country within the EEA and the merchant is located in another country within the EEA.
[52] European Commission (2013), 'Proposal for a regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions', 2013/0265 (COD), 24 July.
[53] European Commission (2019), '[Antitrust: Commission accepts commitments by Mastercard and Visa to cut inter-regional interchange fees](#)', April.

Worldpay

worldpay from FIS

PSR MARKET REVIEW INTO THE SUPPLY OF CARD-ACQUIRING SERVICES

Worldpay supplementary submission

21 February 2020

Non-confidential version

1. The PSR announced that it was to conduct a market review into the supply of card-acquiring services, and published draft terms of reference for consultation, in July 2018. The PSR confirmed the final terms of reference in January 2019 (the "**Terms of Reference**").

2. We would like to thank the PSR for the opportunities it has provided to date for Worldpay to engage in the review process, including through the methodology consultations and information requests.

3. As the PSR now moves towards the publication of its interim report, this submission highlights some of the key themes that have emerged during the market review process to date, which Worldpay considers are relevant to the PSR in reaching its interim findings.

4. **First, the sector is undergoing rapid and unprecedented change and innovation**. The fast-moving technological, legal, and regulatory changes that are taking place are altering how the sector operates, resulting in new entrants to the payments sector and further enhancing the competitive process. The PSR will be aware of the significant changes to the existing legal and regulatory frameworks for payments that are being implemented (e.g. Open Banking and new PSD2 payment services, introduction of SCA under PSD2 and the European Commission's review of the IFR). The New Payments Architecture (the "**NPA**") has the potential to further disrupt the payments sector and increase innovation and competition. In such an environment, any assessment of competition must necessarily be forward-looking rather than being based purely on historical outcomes.

5. This was recognised by the CMA in *Paypal/iZettle*, which during the course of its investigation found that "*the payment services industry is a fast-moving and dynamic market. Such markets are distinguished by rapid growth in a relatively short period of time and notable technological and commercial developments that often result in disruption to the current state of competition and how consumers interact in the marketplace.*"[1]

6. The payments sector has also become more international in scope as a result of global expansion by payments firms and their customers. Worldpay itself was acquired by Vantiv, and then FIS, in a short period of time (with the latter taking place during the PSR's market review). The emergence of new technology, new regulation and new market entrants is likely to result in more internationalisation of the sector in the future.

7. It is difficult to predict market outcomes with any certainty in such a rapidly evolving market. This is further compounded by the uncertainty arising from the UK's withdrawal from the European Union. It is important, therefore, that the PSR takes a dynamic and forward-looking approach in reaching its conclusions as the sector continues to change.

8. **Second, the payments ecosystem involves many interconnected stakeholders**, of which card-acquiring services is only one part. Any assessment of competitive conditions for card-acquiring services will need to take into account the following factors, which all impact on the operation of card-acquiring services:

   (a) the role of the scheme operators, [✂];

   (b) the role of card issuers, [✂];

   (c) the provision of a range of different card-acceptance products and value-added services by different card acquirers and payment facilitators;

[1] Completed acquisition by PayPal Holding, Inc of iZettle AB (12 June 2019), paragraph 10.

(d) the deployment and integration of different forms of hardware (e.g. point-of-sale ("**POS**") technology) and software (e.g. payment gateways) in order to accept card payments; and

(e) the role of innovation, technology and regulation in the sector.

9. There are also many different providers active in facilitating card payments on behalf of merchants (ISOs, payment facilitators, technology providers, hardware providers, traditional acquirers, etc.). This results in customers having multiple business models and 'entry points' to choose from, through which they can receive card-acquiring services. Therefore, competition occurs not only among 'traditional' card acquirers, but also with banks, online marketplaces, social media platforms, large merchants and technology-led specialists.

10. **Third, there is a lot of evidence of competition being effective in this sector**. SME merchants in particular receive the widest range of choices, including technologists (PayPal, iZettle, Clover, Square, Stripe), high street banks (Barclaycard, Lloyds Bank), card acquirers (First Data, Global Payments, Worldpay), and ISOs (Paymentsense, Payzone, Handepay, RMS). RBS has also recently re-entered card acquiring, having been ordered to sell its former card-acquiring business (i.e. Worldpay) by the European Commission during the financial crisis.

11. The evidence indicates that quality and innovation are extremely important parameters of competition. [✂]. It is important that any comparison between card acquirers considers the overall service proposition including price, quality, and innovation metrics, which are all important to merchants.

12. There is a lot of churn in the sector as businesses come and go, and research conducted by RFi points to a high degree of switching. This creates opportunities for new entrants and smaller players to win new business, [✂].

13. The evidence also points to barriers to switching being low: [✂].

14. [✂].

15. Large merchants have [✂] and bespoke integration requirements. They run competitive tenders and have specialist procurement teams, and are aware of the offerings of different competitors. They often source terminals separately from third party suppliers, which highlights the ease of third party terminal integration.

16. The competition facing card acquirers is coming from various directions. [✂].

17. **Fourth, customers demand choice and different tariff options.** [✂]. Offering customers a choice between tariffs enables them to choose a plan according to their individual business needs, their risk appetite, and their preference in terms of simplicity versus transparency.

18. Worldpay has responded to customer demand for simpler tariffs, whilst offering more choice, with the launch of new tariffs including Simplicity, Pay As You Go and Fixed Monthly. [✂].

19. [✂].

20. **Fifth, the sector is coming up with new and innovative solutions.** As noted above, there are various industry-led and regulatory initiatives already taking place in the payments sector. The use of Open Banking, for example, is accelerating within the UK and internationally (and is a key component of delivering PSD2) and, over time, will foster the

emergence of account-to-account payments as an increasing rival to traditional card payments.

21. [✂].

22. [✂].

23. **Sixth, card-acceptance products are readily available from third parties.** Terminals, omni-channel services and other value-added card-acceptance products can all be purchased from third party providers, [✂].

24. However, card acquirers (and other parties in the card acceptance value chain) additionally compete for merchants that demand a more integrated service. Therefore, Worldpay offers a variety of innovative complementary card-acceptance products and services that have been developed to improve Worldpay's overall payment acceptance proposition, which provide significant benefits to customers in terms of service quality and cost savings.

Next steps in the market review process

25. We want this market review to produce robust outcomes, and recognise there are potential pitfalls that may face the analysis. We are aware that other regulators use working papers, indicate how methodologies have evolved post-consultation, and/or give advisors access to underlying data. Worldpay would therefore welcome the opportunity to engage further with the PSR either prior to, or shortly after, the interim report is published.

26. Worldpay would like to continue our constructive and open engagement with the PSR throughout the market review process, and welcomes the opportunity to continue to do so. Accordingly, Worldpay has voluntarily prepared this submission with a view to highlighting the key themes emerging from the evidence that has been submitted to the PSR.

27. We are happy to discuss any questions you may have regarding this submission. Should you wish to do so, please contact Jana Mackintosh, Director of Public Policy & Government Affairs ([✂]).

worldpay
from FIS