Payment Systems Regulator

Market review into the supply of card-acquiring services: Final report

Annex 5

Barriers to entry and expansion

November 2021

MR18/1.8 Annex 5

Contents

Note: The places in this document where confidential material has been redacted are marked with a [✂].

Introduction

1.1 This annex considers whether potential barriers to entry and expansion for providers of card-acquiring services might limit the ability and incentives of providers to enter or expand. We consider something to be a barrier to entry and expansion where an entrant or smaller provider incurs a cost that a larger provider would not have to, thereby putting it at a disadvantage relative to the larger provider in being able to grow its business.[1]

1.2 The prospect of entry and expansion by rivals is an important source of competitive constraint. Entry and expansion (or the threat of it within a short time period) can reduce the ability of incumbent firms to exercise market power and lead to more competitive outcomes such as lower prices, more innovation, better quality of services and greater choice for customers. This can sometimes offset the effect of features that might otherwise adversely affect competition. Conversely, a significant source of competitive constraint may be eliminated or reduced if there are barriers to entry and/or expansion.

1.3 In Chapter 4 of the final report, we observe that there has been entry and expansion in both the small and medium-sized merchant segment and large merchants segment since 2014. Particularly noticeable is the expansion of the largest payment facilitators and Stripe. The evidence indicates their expansion is predominantly driven by their success in onboarding merchants new to card payments, which suggests low barriers to entry and expansion for providers that target such merchants. Barclaycard and Worldpay serve approximately [40-50]% of small and medium-sized merchants only or mainly selling face-to-face with annual card turnover above £60,000 and around [40-50]% of merchants only or mainly selling online with annual card turnover above £380,000. Most other acquirers have gradually increased the number of merchants they serve but individually they have a small share of supply of small and medium-sized merchants.

1.4 The focus of this annex is on whether there are significant barriers to entry and expansion to serving small and medium-sized merchants. This is because issues identified in Chapter 6 of the final report primarily concerned this segment.[2]

1 Typically, this is where the five largest acquirers do not incur a cost that other rivals do, but in the case of scheme fees, larger and smaller acquirers are determined by the tiers or steps they sit in rather than whether they are one of the five largest acquirers or not.

2 We will only discuss barriers to serve large merchants where this affects barriers to serving small and medium-sized merchants.

1.5 In this annex, we first consider the inputs for providing card-acquiring services as this helps us understand potential barriers to entry and expansion. We then consider a number of potential barriers to entry and expansion including:

- scheme rules and scheme fees
- other barriers – in particular
  - economies of scale
  - regulation
  - referral relationships
  - restrictions on payment facilitators

1.6 We identified these issues based on provider concerns[3] and initial evidence gathering. Provider concerns form an important part of the assessment, particularly because a lack of concerns is highly indicative of a lack of harm. We have also considered features that restrict merchants' willingness or ability to searching and switching thereby making it harder for new entrants and smaller rivals to attract customers and expand, as this can also be a barrier to entry and expansion.[4] Concern that this is a barrier to entry and expansion were raised by some providers and are discussed in Chapter 6 (*Merchants' willingness and ability to search and switch*).

1.7 We have assessed the effect of potential barriers on the ability and incentive for new entrants or smaller providers to enter and expand, and in particular, whether potential barriers give an advantage to the five largest acquirers over new or smaller providers. Stakeholder responses to our interim report provisional findings on barriers to entry and expansion are discussed in the final report (in paragraphs 4.87 to 4.90).

3 Our work was mainly informed by concerns raised by stakeholders in responses to the final Terms of Reference, information requests and in bilateral meetings. There were some issues raised by stakeholders that may increase the costs to all providers but do not provide advantages to five largest acquirers over smaller providers. We have not considered these in detail.

4 See for example [CMA market assessment guidelines, paragraph 215]

Resources and inputs for providing card-acquiring services

Acquirers

1.8 To provide card-acquiring services, at a high level an acquirer will need the following inputs and resources:

- **Appropriate regulatory permissions:** We provide more detail on the regulatory framework that applies to acquirers in Annex 1.
- **Licences from the operators of the card payment systems:** In the UK, at a minimum an acquirer will need licences from Mastercard and Visa given the ubiquity of these cards.
- **Access to interbank payment systems:** Acquirers need access to these systems to be able to settle with merchants the money they are owed for card payments.
- **Financial capital:** To cover financial liabilities including from merchant default, fraud and breaches of scheme rules.
- **IT platform:** The systems that provide connectivity to the card payment system and enable the acquirer to support the authentication, authorisation, clearing and settlement of card transactions. See Annex 1 for more information on these processes.
- **Other technology:** Hardware and software that support activities such as billing, customer service and onboarding.
- **Staff:** This includes staff involved in sales, marketing and business support.

1.9 Where an acquirer operates in multiple jurisdictions, many of these resources and inputs will be used to provide card-acquiring services to both UK merchants and non-UK merchants. Similarly, the same resources and input may be used to provide both card-acquiring services and other products (if offered by the acquirer).

1.10 Acquirers may outsource some resources and inputs. For example, acquirer processors can provide an IT platform as well as other technology needed to provide card-acquiring services. Acquirers may also outsource sales to independent sales organisations (ISOs), which are third parties that sell card-acquiring services on behalf of one or more acquirers alongside card acceptance products and value-added services acquirer. We describe ISOs in Annex 1.

Payment facilitators

1.11 Payment facilitators need similar resources and inputs to acquirers to provide card-acquiring services. The main difference is that they need to partner with one or more acquirers to provide these services.

1.12 As described in Annex 1, under scheme rules acquirers can permit payment facilitators to recruit merchants on their behalf and contract with these merchants for card-acquiring services. The acquirer supports payment facilitators with the authentication, authorisation, clearing and settlement of card payments involving their merchants through the card payment system and transfers the money those merchants are owed to payment facilitators (for onward settlement to merchants).

1.13 As payment facilitators work with an acquirer, they do not need:

- licences from the operators of the card payment systems (though they still rely on the services the operators of the card payment systems provide to acquirers and must be registered with those operators by the acquirer(s) they work with)
- IT platforms that provide connectivity to card payment systems (though they will require technology that allows them to transmit payment messages to the acquirer and enables them to support the authentication, authorisation, clearing and settlement of card transactions)[5]

1.14 Like acquirers, payment facilitators need access to interbank payment systems, appropriate regulatory permissions, financial capital, and other technology and staff to support activities such as customer service and onboarding.

1.15 As with acquirers, payment facilitators may outsource some resources and inputs. Some resources and inputs may be used to provide card-acquiring services to UK and non-UK merchants (if the payment facilitator operates in more than one jurisdiction) and to provide goods and services that are not card-acquiring services.

5 See Annex 1 for a description of the role payment facilitators play in these processes.

Scheme rules and scheme fees

1.16 The operators of the card payment systems, such as Mastercard and Visa, set the rules and charge scheme fees[6] for the services they provide.[7] Some stakeholders raised concerns that collateral requirements and the structure of scheme fees act as barriers to entry and expansion. We outline the concerns and summarise our assessment below.

Scheme rules – collateral requirements

1.17 Under scheme rules, acquirers are liable for disputes between cardholders and merchants. Disputes are managed through the chargeback process as described in Chapter 3 of the final report. If an acquirer is unable to recover the amount from the merchant it must pay the issuer for chargebacks that are upheld (for example, because the merchant has become insolvent or was acting fraudulently), this may in turn lead the acquirer to default. This creates a credit risk for the operator of the card payment system, which is liable for money owed to issuers if an acquirer defaults. The risk of an acquirer defaulting is higher where it serves certain merchants, such as those who typically accept payment for goods and services some time before they are provided (referred to as 'deferred delivery merchants').

1.18 The operator of the card payment system can require acquirers to provide collateral to manage and mitigate the risk of an acquirer defaulting.[8] By requiring collateral, the operator of the card payment system reduces its exposure to the credit risk from an acquirer because it can use the collateral to cover some or all of the money owed to an issuer should the acquirer default. However, funds used by the acquirer for collateral, which are held by the operator of the card payment system, cannot be used to invest in acquirer systems or customer acquisition or other means to expand their business or improve their product offering, and therefore may make it harder for a new or smaller acquirers to expand and compete effectively.

1.19 A few acquirers raised concerns about collateral requirements. They told us that:

- the requirements are imposed unevenly, with the five largest acquirers exempt

6 We use the term 'scheme fees' to refer to all fees acquirers pay to operators of card payment systems including fees for scheme services and fees for processing services.

7 For further information about scheme rules see Annex 1. For further information about scheme fees, see Annex 4.

8 Operators of the card payment systems have no direct contractual relationship with payment facilitators and hence they do not require collateral from them. [✂]

- the requirements restrict the ability of some acquirers to provide card-acquiring services to some types of merchant because serving those merchants increases the amount of collateral required

- the processes for setting collateral requirements and the options for the form collateral can take are not transparent, potentially leading to unequal outcomes

1.20 To assess these concerns, we considered for the Mastercard and Visa card payment systems:

- how frequently collateral requirements are imposed

- the size of collateral requirements both in absolute value and in proportion to the value of card transactions the acquirer accepts

- on whom the collateral requirements are imposed

- how acquirers are made aware of the requirements

1.21 Mastercard imposes collateral requirements infrequently [✂]. Given the infrequent use of collateral requirements by Mastercard, there was no need to consider the other issues in paragraph 1.20 further.

1.22 Visa requires collateral from a number of acquirers as of February 2020, though these acquirers account for a small proportion of transactions at UK outlets. When it does require collateral, the amount of collateral Visa requires for nearly all UK-registered acquirers is small either in absolute terms [✂] or as a proportion of the value of card transactions [✂].[9] Collateral requirements are driven by Visa's assessment of acquirers' creditworthiness[10], which includes an assessment of the financial position of the acquirer, the risk management procedures the acquirer has in place and, in some cases, the acquirer's exposure to high-risk merchants.[11]

1.23 Where collateral is required, it is calculated based on:

- [✂]

- [✂][12]

- [✂]

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9 The calculation of collateral requirements as a proportion of the value of card transactions is based on (i) collateral requirements as of February 2020 as an acquirer; and (ii) the total value of all European transactions in 2019 for the acquirer. There are [✂] acquirers (out of [✂] who provide collateral) that are required to post more than [✂] collateral and [✂] acquirers (out of [✂]) whose collateral requirements are more than [✂] of the value of card transactions. For [✂] acquirers, collateral requirements are more significant under both measures.

10 Size is not explicitly part of the assessment (though it may be a factor in so far as it impacts the financial resilience of an acquirer).

11 Further information about the risks acquirers face is in Annex 1.

12 [✂]

1.24 Visa told us that the approach it uses to calculate the amount of collateral that must be provided also creates an incentive on acquirers to reduce the amount of collateral required through their own risk management procedures. While Visa's risk policy is not published, it told us that it informs acquirers how they can reduce collateral requirements and, if required, the options for the form of collateral.[13]

1.25 We consider it very unlikely that Mastercard's collateral requirements represent a significant barrier to entry and expansion, given they are used infrequently. Visa requires collateral from a number of acquirers as of February 2020, though these acquirers account for a small proportion of transactions at UK outlets. When it does require collateral, the amount of collateral Visa requires for nearly all UK-registered acquirers is small either in absolute terms or as a proportion of the value of card transactions acquired. In addition, collateral requirements are calculated based on Visa's risk assessment and this also incentivises acquirers to reduce the requirements by improving their management of risk. Overall, we consider that collateral requirements are not a significant barrier to entry and expansion.

Structure of scheme fees

1.26 Mastercard and Visa charge scheme fees to acquirers (and to issuers).[14] There are many different fees and the structure of these fees varies.[15]

1.27 Some acquirers expressed concerns that scheme fees favour larger acquirers and act as a barrier to entry and expansion. We examined the structure of scheme fees and found two types of fee structures that potentially favour larger acquirers:[16] fixed tiered fees and stepped per-transaction fees.

1.28 These fees consist of two or more fixed fees or rates[17], each of which corresponds to a tier or step defined with reference to a specified number or value of transactions.

1.29 For fixed tiered fees and stepped per-transaction fees, we considered:

- how it is calculated
- if the structure of the fee could provide advantages to larger acquirers
- the prevalence and significance of the fee type

13 Collateral can take the form of cash, letters of credit, fixed income securities or third-party guarantees.

14 In this section, we refer to both fees for scheme services and fees for processing services together as scheme fees.

15 See Annex 4 for further details about scheme fees.

16 This is compared to a flat fee structure where all acquirers pay the same fee or rate regardless of their size.

17 The rate for tiered and stepped fees may be expressed as a pence per-transaction charge or as an ad valorem charge.

Fixed tiered fees

1.30 The amount the acquirer pays to the operator of the card payment system for fixed tiered fees is calculated as follows. The total number or value of transactions acquired determines the applicable tier and the corresponding fee or rate is charged on all those transactions.[18] For example, in Table 1 we see a hypothetical fee structure where an acquirer with card transactions value of £5 million with the relevant card payment system in the relevant period would be charged the tier 1 rate of £40,000 but a larger acquirer with card transactions value of £5 billion would be charged the tier 4 rate of £160,000.

Table 1: Hypothetical example of fixed tiered fee

Illustrative fee structure			Example of fees for acquirers	
Tier	**Band (£m)**	**Fee (£)**	**Acquirer card transaction value (£m)**	**Average fee per transaction (%)**
1	0–10	40,000	5	0.008
2	10–100	80,000	50	0.0016
3	100–1,000	120,000	500	0.00024
4	1,000+	160,000	5,000	0.000032

1.31 Fixed tiered fees could provide some advantages for larger acquirers because although the amount the acquirer pays increases as the volume or value of transactions acquired for a card payment system increases, the average fee per transaction reduces. In effect, this represents a higher cost for smaller acquirers than larger acquirers. However, we find that the use of fixed tiered fees by Mastercard and Visa is limited:

- At the end of 2018, Mastercard had [✂] fixed tiered scheme fee(s) – that, on average, account for a very small proportion (less than [✂]) of all mandatory scheme fees paid by acquirers in 2018 to Mastercard. [✂].[19]
- By the end of December 2018, Visa had [✂] mandatory fixed tiered scheme fee(s)[20] – that, on average, made up a very small proportion of all mandatory scheme fees paid by acquirers in 2018.[21] [✂][22]

18 With a fixed tiered fee, an acquirer pays a set amount depending on the tier to which it belongs. The tier is determined by the number or value of transactions acquired for the card payment system.

19 [✂]

20 [✂]

21 [✂]

22 [✂]

1.32 Relative to no tiering of fixed fees, smaller acquirers also benefit from the presence of tiering as it reduces the absolute scheme fees paid by smaller acquirers relative to larger acquirers. The main reason that fixed tiered fees are a more significant proportion of total fees for smaller acquirers is because of the level of those fees, rather than the tiering structure. However, as the fees on average, made up a very small proportion of all mandatory scheme fees, we do not consider this to be a significant barrier to entry and expansion. We also recognise this charging model may reflect the nature of costs faced by operators of the card payment systems.[23] Fixed tiered fees are therefore unlikely to be a significant barrier to entry and expansion.

Stepped per-transaction fees and discounts

1.33 The amount the acquirer pays to the operator of the card payment system for stepped per-transaction fees is calculated as follows. The rate corresponding to the first step applies only to transactions that fall within that step; the rate corresponding to the second step is applied for transactions that fall within that step; and so on.

1.34 Table 2 sets out a hypothetical example of a stepped per transaction fee. In this example, an acquirer with £5 million of card transactions with the card payment system in the relevant period would pay £1,250 under a stepped fee structure, equivalent to 0.025% (see step 1 in Table 2). An acquirer with £500 million of card transactions would pay £80,500, equivalent to 0.016%[24], even though the rate applied to transactions above £100 million is 0.015%. This is because transactions between 0 and £10 million are charged the step 1 rate of 0.025% and transactions between £10 million and £100 million are charged the step 2 rate of 0.02%.

Table 2: Hypothetical example of stepped fees

Illustrative fee structure			Example of stepped fees for acquirers		
Step	Band (£m)	Rate (%)	Acquirer card transaction value (£m)	Total fee (£)	Average rate (%)
1	0–10	0.025	5	1,250	0.025
2	10–100	0.02	50	10,500	0.021
3	100–1,000	0.015	500	80,500	0.016
4	1,000+	0.01	5,000	555,500	0.011

23 We have not investigated the cost structure of operators of the card payment systems in this market review.

24 This is the sum of fees for Step 1 (£10 million x 0.025%) + Step 2 (£90 million x 0.02%) + Step 3 (£400 million x 0.015%).

1.35 The examples in Table 2 show that larger acquirers would pay less per transaction than smaller acquirers under a stepped fee structure. This could provide significant advantages to larger acquirers in two ways:

- Because larger acquirers face lower per-transaction costs if they are in a higher step, larger acquirers could offer the largest merchants with annual card turnover above £50 million a reduced merchant service charge (MSC) depending on certain volume/value thresholds being met. Stepped fees may then incentivise the largest merchants to use a single acquirer to process most of their card transactions, instead of using multiple acquirers, as they may be charged a lower MSC.
- If very few acquirers are in the highest step, stepped fees can also incentivise the largest merchants with annual card turnover above £50 million to use one of a limited number of acquirers because those acquirers could offer the lowest MSC as they pay less in scheme fees.[25]

1.36 By the end of December 2018, Visa had removed all stepped fees, moving to a flat fee structure.

1.37 This fee accounted for a very small proportion (less than [✂]%) of all mandatory scheme fees paid by acquirers to Mastercard in 2018.

Discounts

1.38 The move from stepped fees to flat rate fees [✂].[26]

1.39 Subsequent to this, Visa entered into commercial agreements with some acquirers (both larger and smaller acquirers) that resulted in discounts to those acquirers. [✂].[27]

1.40 We consider that discounts paid to acquirers, if recurring, are likely to have a similar impact to stepped fees, [✂]. As noted in paragraph 1.35, stepped fees are most likely to impact competition for the largest merchants. In addition, the details of these commercial relationships are not known to other acquirers unlike the structure of stepped fees. Discounts may, therefore, give some acquirers advantages when competing for the largest merchants.

25 This argument only applies where a merchant could not unilaterally move an acquirer into the top tier.
26 See Table 1, Chapter 4 (*Competition between providers of card-acquiring services*).
27 [✂]

Summary of stepped fees and discounts

1.41 Overall, we consider that stepped per-transaction scheme fees and associated discounts are unlikely to be a barrier to entry and expansion for acquirers seeking to compete for small and medium-sized merchants for the following reasons:

- Stepped fees are more likely to affect competition between acquirers for the largest merchants with an annual card turnover over £50 million. However, as noted in Chapter 5 (*Pricing and quality outcomes*), these merchants achieve good price outcomes and we did not find evidence that the supply of card-acquiring services does not work well for these merchants.

- This stepped fee accounted for a very small proportion of all mandatory scheme fees paid by acquirers to Mastercard in 2018.

- By the end of December 2018, Visa had removed all stepped fees. Discounts, introduced subsequently, while a more significant issue than stepped fees, are similarly more likely to affect competition between acquirers for the largest merchants with an annual card turnover over £50 million. As noted above, these merchants achieve good price outcomes and we did not find any evidence that the supply of these services does not work well for these merchants.

Other potential barriers

Economies of scale

1.42 A small number of acquirers highlighted the difficulties of competing on costs with the five largest acquirers, which indicates that economics of scale may be a potential barrier to entry and expansion. A main source of economies of scale is processing costs[28] associated with IT platforms (see paragraph 1.8) although other sources of scale advantages include scheme fees (discussed in paragraphs 1.26 to 1.41), compliance with regulatory requirements (see paragraphs 1.46 to 1.48) and compliance with scheme rules.

1.43 There are significant upfront costs to building an acquiring IT platform to process transactions as well as ongoing costs of maintaining the platform. Acquirers that process a greater volume of card transactions can spread the upfront and maintenance costs for the IT platform over a larger number of transactions, which reduces the cost per transaction.

1.44 Smaller acquirers can reduce the need to invest upfront in building an acquiring IT platform by outsourcing this to third parties, known as acquirer processors (see paragraph 1.10). Acquirer processors also enable new entrants and smaller acquirers to overcome other scale advantages as they can take responsibility for ensuring compliance with certain regulatory requirements and scheme rules relating to processing of transactions.

1.45 We consider that although there are some economies of scale, the ability to use acquirer processors is one important way in which new and smaller acquirers can also benefit from economies of scale so they do not act as a significant barrier.[29]

Regulation

1.46 The cost of complying with various regulatory requirements could act as a barrier to entry if these costs were proportionately more significant for new entrants. There are various regulatory requirements that providers of card-acquiring services must comply with, which are outlined in Annex 1. One of the five largest acquirers noted the cost and complexity of compliance with regulatory requirements.

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28 Processing involves (i) processing of authorisation requests from merchants including checking that they are compliant with scheme rules, forwarding them to the operators of the card payment systems and relaying responses back to the merchant; and (ii) Preparation and submission of clearing files including checking these are compliant with scheme rules and submitting them to the operators of the card payment systems.

29 This relies on competition working well between acquirer processors. Although we have not investigated how competition between acquirer processors operates as part of this review, we have not received complaints about this issue.

1.47 However, regulatory burdens were not raised as a barrier by smaller acquirers or new entrants. In addition, regulatory requirements apply to all providers of card-acquiring services and do not discriminate against new entrants or smaller acquirers.

1.48 Finally, where the costs of compliance with regulation decrease in proportion to the size of an acquirer, if an acquirer uses an acquirer processor, the processor can assist the acquirer in complying with some of the regulatory requirements as noted in paragraph 1.44. Our view, therefore, is that regulation is unlikely to be a significant barrier to entry and expansion.

Referral relationships

1.49 Referral relationships are common in the industry and represent an important source of customers for many acquirers (see Chapter 4 of the final report).[30] We recognise that referral relationships can act as a barrier to expansion if they are:

- a significant source of customers
- only available to a few providers
- difficult to replicate through other sources

1.50 We assess these factors below for the two most significant sources of referral: bank referrals and ISO referrals.

Bank referrals

1.51 Some acquirers told us that the absence of bank referral relationships was a challenge to their expansion. Two of the five largest acquirers are fully or partially owned by UK-headquartered banks while the other three have, or had in the past, referral relationships with major high-street banks.

1.52 [✂]. But our analysis of 2018 referrals data from acquirers shows that bank referrals accounted for less than 10% of all new customers of acquirers overall. Our view, therefore, is that while bank referrals historically may have been an important source of customers for acquirers, this is no longer the case.[31]

1.53 In addition, new entrants like Stripe and payment facilitators have expanded substantially without relying on these relationships. We therefore consider that bank referrals are not a significant barrier to entry and expansion.

30 Referral relationships are much less significant for payment facilitators.

31 See Figure 10, Chapter 4 (*Competition between providers of card-acquiring services*).

ISO referrals

1.54 ISOs are an important customer acquisition channel for acquirers seeking to attract small and medium-sized merchants. In 2018, ISOs accounted for over 50% of all new customer acquisitions for acquirers.[32] Around two-thirds of new ISO-referred customers came through five ISOs. We therefore considered whether relationships between ISOs and acquirers could act as a barrier to entry and expansion.

1.55 Some ISOs work with more than one acquirer [✂]. We found that an ISO's decision about how many acquirers to work with is driven primarily by commercial considerations rather than contractual restrictions:

- ISOs that choose to work with one acquirer told us that [✂].
- ISOs that work with more than one acquirer gave various reasons for doing so including to create some competitive tensions between acquirers and due to differences in acquirers' risk appetites ([✂]) and capabilities (some acquirers are better at serving certain sectors than others).

1.56 While we find that exclusivity clauses are not common, other contractual restrictions may have an effect similar to exclusivity. For example, one ISO (which works with more than one acquirer) told us that non-solicitation clauses in acquirer contracts[33] mean that in many cases ISOs do not want to contract with too many acquirers as this would limit the pool of merchants they could procure. We also find that acquirer contracts require or provide incentives for ISOs to generate a certain amount of revenue from referrals or refer a certain number of merchants, which may incentivise the ISO to focus on one acquirer.

1.57 While exclusivity could reduce opportunities for entry and expansion, we consider there are other possibilities for acquirers to expand, notably by hiring their own in-house sales force or entering into relationships with independent software vendors (ISVs). [✂] has focused on developing its own direct sales channel [✂].[34] While not all acquirers may develop a sales team on the same scale, it demonstrates the ability for an acquirer to develop their own in-house sales team and it is possible for an acquirer to scale up a sales team rather than needing a large sales team from the start.[35]

1.58 As a further mitigation, we also considered whether acquirers can easily win new ISO relationships, as acquirers could use these relationships to enter and expand without having to hire their own sales force. We therefore considered whether ISOs change the acquirer(s) they work with. We found limited evidence of ISOs changing the acquirer

32 See Figure 10, Chapter 4 (*Competition between providers of card-acquiring services*).

33 These clauses can prevent the ISOs from signing merchants already contracted to acquirers they work with. We also considered whether this was a potential barrier, but noted that it does not prevent other ISOs or acquirers competing for the acquirer's customers. We also recognise the need for some protections to the relationships between ISOs and acquirers, as long as these are not excessive.

34 [✂]

35 This contrasts with building an IT platform for payment processing, where a large outlay is required. In that case the ability to outsource the function reduces a potential barrier to entry and expansion. See paragraphs 1.8 to 1.10.

they primarily or (where they work with one acquirer) exclusively refer to, with only one instance of a new entrant acquirer setting up a significant relationship with an ISO. Some ISOs told us they run tenders to decide which acquirers they work with, or told us that they have started working with a new acquirer. However, these tenders are relatively infrequent and most relationships between the five ISOs referred to in paragraph 1.54 and the acquirers they exclusively or primarily refer to have been established for at least five years. In addition, some ISOs told us they look to work with acquirers with an established brand.

1.59 While ISOs are a significant sales channel for acquirers, given the absence of substantial concerns around the availability of ISO relationships, and the ability for acquirers to hire its own sales team and gradually scale up, we consider that ISO referral relationships with acquirers do not represent a significant barrier to entry and expansion for acquirers.

Restrictions on payments facilitators

1.60 Mastercard and Visa scheme rules both require that merchants who are customers of a payment facilitator and who have annual card turnover above US$1 million with that card payment system must also contract with an acquirer.[36] We have been told that the limits are imposed to mitigate the risk of merchant default when, for example, a merchant is unable to deliver the service purchased and is unable to provide a refund due to insolvency.

1.61 If these rules prevented payment facilitators from attracting sufficient custom (that is, numbers of customers or sufficient value of business), it could limit their incentives to enter and expand. However, the rule does not have a significant impact on payment facilitators because fewer than 5% of the small and medium-sized merchants they serve have an annual card turnover above £60,000, well below the threshold. We also note that some payment facilitators have customers that are larger than the $1 million threshold. In addition, payment facilitators themselves have not raised this restriction as a concern. This suggests that the limits are not affecting the commercial strategies of payment facilitators and their ability to grow.

1.62 Moreover, the limit on merchant annual card turnover has already been adjusted from US$100,000 to US$1 million by Mastercard in 2014 and Visa subsequently to allow for expansion of the payment facilitator business model.

1.63 Because the rules do not currently appear to affect payment facilitators' ability to recruit merchants, and payment facilitators have not expressed concerns, our view is that the rules considered here have not, to date, acted as a significant barrier to entry or expansion of payment facilitators.

36 The Mastercard scheme rules require that a merchant that accepts over $1 million of Mastercard card transactions must also contract with an acquirer, and the Visa scheme rules require that a merchant that accepts over $1 million of Visa card transactions must do the same. Other card payment systems also have similar restrictions but account for a much smaller proportion of transactions and are much less likely to have an impact on payment facilitators.

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