Payment Systems Regulator

Market review of card scheme and processing fees

Stakeholder submissions to:

MR22/1.6: Recent changes to scheme and processing fees working paper

November 2024

Contents

Names of individuals and information that may indirectly identify individuals have been redacted. The places in this document where confidential material has been redacted are marked with a [✂].

Association of Convenience Stores

ACS Submission - Market review into card scheme and processing fees: Recent changes to scheme and processing fees

ACS (Association of Convenience Stores) welcomes the opportunity to respond to the Payment System's Regulator's market review of scheme and processing fees, looking at recent changes to these fees. ACS represents 48,590 local shops and petrol forecourt sites including Co-op, BP, Rontec and thousands of independent retailers, many of which trade under brands such as Spar, Budgens and Nisa. These retailers operate in all locations, such as neighbourhoods, villages, on petrol forecourts and in city centres, but our primary trading location in secondary shopping areas close to where people live and work.

Questions 1 and 2 for Mastercard and VISA to answer

3. Do the fee changes considered in our analysis include the most significant changes introduced in the period 2017 to 2021? Are there other fee changes introduced during the period that you think we should have considered? If so, please demonstrate how these changes impacted you.

Merchants, such as convenience retailers, are not typically aware of the detailed breakdown of fee changes as shown in Annex 1. The payment processing models used by merchants, whether they are based on a blended pricing model or an interchange++ model, do not provide any explicit details on mandatory, optional or behavioural fee changes.

For retailers operating under a blended pricing model, the fees they encounter come in a bundled format, without individual components, making it impossible for them to understand exactly what they are paying for. This lack of transparency poses a challenge when it comes to understanding and responding to specific fee changes, but the basic structure is often favoured by retailers as they know that their fees are charged at an equal and unchanged rate each month.

Similarly, for those retailers using the interchange++ model, the provided breakdown typically only covers the interchange fee, scheme fees, and acquirer fees. While card acquirers do usually offer a scheme fee breakdown for each card type (Mastercard Debit, Visa Debit, Mastercard Credit, Visa Credit, etc.), they typically segment these into categories such as international vs non-international and contactless payments vs non-contactless. Whilst it might be useful for merchants to see this, there is no detailed or specific information about individual changes in fees introduced by Mastercard or Visa.

It is therefore difficult for us to determine whether the fee changes detailed in the PSR's analysis are indeed the 'most significant'. These changes remain largely hidden from retailers/merchants, therefore making it hard to validate this assessment.

What is unequivocally evident to retailers, however, is the escalating trend in scheme and processing fees. This escalation runs parallel to a noticeable increase in interchange fees. This underscores the reality that the costs associated with card transactions have become increasingly burdensome for convenience retailers, impacting their operational costs and profit margins. Without a comprehensive breakdown of these fees, it is challenging to pinpoint any additional fee changes within the 2017 to 2021 period that might have had a substantial impact.

4. Do you have any views on our classification of fees as mandatory, optional or behavioural, as shown in Tables 1 and 4 in Annex 1? Are there fees indicated as optional in those tables that you consider cannot be avoided?

Given that the fees are hidden from retailers, it is difficult to offer specific views on the classification of fees as mandatory, optional or behavioural.

Retailers might not always be aware of the ability to 'opt-out' of certain fees, especially given the complexity and lack of transparency in fee structures. Furthermore, card acquirers are under no obligation to reveal their participation in optional fees. However, they might choose to opt-in to particular fees due to the types of transactions that retailers process, customer payment preferences, or the nature of their business operations. In that sense, these supposedly 'optional' fees might be more 'mandatory' in this context.

5. Do you consider that the fee levels are commensurate with the value provided by those services?

The increasing fee structures, coupled with the lack of transparent breakdown, make it difficult to justify these fees.

If you have any questions about this submission, please contact

[✂]@acs.org.uk

British Retail Consortium

BRC response to PSR working paper on fee changes

ABOUT THE BRC

The BRC's purpose is to make a positive difference to the retail industry and the customers it serves, today and in the future.

Retail is an exciting, dynamic and diverse industry which is going through a period of profound change. Technology is transforming how people shop; costs are increasing; and growth in consumer spending is slow.

The BRC is committed to ensuring the industry thrives through this period of transformation. We tell the story of retail, work with our members to drive positive change and use our expertise and influence to create an economic and policy environment that enables retail businesses to thrive and consumers to benefit. Our membership comprises over 5,000 businesses delivering £180bn of retail sales and employing over one and half million employees.

Background and importance of card fees

Scheme & Processing fees

Data from our most recent Payments Survey shows that cards account for almost 90% of retail sales, with the value of card payments in 2021 totalling £377.9bn (BRC Payments Survey). UK consumers rely heavily on card payments, resulting in merchants having no choice but to accept them. We are concerned that this must-take status of the card schemes is effectively being exploited, with fees being introduced without justification or valuation, and certainly without consultation.

The earlier Market Review by the Payment Systems Regulator (PSR) on the supply of card acquiring services involved a thorough study that confirmed the BRC's own findings that the benefits of legislation to reduce card fees have not been passed on to most retailers, and that the fees levied by the card schemes have been increasing aggressively for several years. As the PSR stated in 2020, card scheme fees have "more than doubled over the period from 2014 to 2018, with most of this increase occurring between 2016 and 2018, after the IFR caps came into force" (PSR, 2020).

Since Interchange Fee Regulation was implemented in 2015, it is estimated that subsequent changes to scheme fees have increased UK merchants' annual costs by £519 million (as of the start of 2021), acting to erode materially the benefits of interchange regulation for merchants. Of the total £519 million, £371 million is estimated to have been added since the European Commission's two-year review of the IFR. Further estimates suggest that the average Merchant Service Charge across IFR-regulated countries is now higher than it was prior to regulation (due to a combination of increases to both scheme fees and the acquirer margin component).[1]

Our 2022 Payments Survey shows that in 2021 scheme fees jumped substantially, averaging a 28% increase as a percentage of turnover. Credit cards saw the most significant impact, increasing by a very substantial 42%, whilst debit cards saw a 23% increase. In 2021, retailers spent £1.15 billion to process card transactions.

The card schemes are able to take advantage of a position of power, and we ask the PSR to seriously consider any long-term solutions to ensure that resulting measures cannot be undermined by the card schemes finding other methods to recoup costs.

[1] Estimates provided by CMSPI and Zephyre Scheme Fee Study (2020)

Response to the working paper

We strongly agree with the general overview of the paper; that fees are often set without any direct relation to service, and are often unquantified and unjustified. Most importantly, fee breakdowns are opaque and impossible to interpret, which makes any interpretation of value entirely impossible but the retailers have noted seeing little, if any, change to services, given the large changes to fees. We have gathered examples from our members below of the fees they see that are unavoidable and/or unjustified.

Key messages

- Retailers are never consulted before any fee-change rise decisions, there is no discussion as to the impact, amount, or justification for the fee rise with those that will be impacted.
- Acquirers create another layer of separation between merchants and the card schemes, which can result in delays, miscommunications, and reconciliation issues for merchants.
- Fee breakdowns are opaque and impossible to interpret. They differ entirely from the list provided in Annex 1 of the working paper. It is then impossible to determine if the fees they are being charged reflect any value, as merchants can't see what or why they are being charged.
- Our merchants' experience is that many optional fees can be, in-practise, mandatory. Optional fees may carry a penalty for not introducing or make business difficult to carry out if the retailer chooses to opt out.
- Most of the time when fee changes are introduced, retailers see no difference in the service they are receiving. This means that additional fees are added without justification or quantification of the value of said new fee, when the schemes are already gathering significant profit from retailers.

Consultation & decision-making of fee changes

The paper outlines that fees are often set without any consultation on the fee change. This is accurately reflects retailers' experience of engaging with the card schemes. Retailers are never consulted before any fee-change rise decisions, there is no discussion as to the impact, amount, or justification for the fee rise with those that will be impacted. This means that fees are set arbitrarily, or so it appears to those that have no choice but to pay them.

Acquirers create another layer of separation between merchants and the card schemes, with the acquirer communicating fee changes and answering any questions. This can mean that not only are merchants not consulted, but also sometimes find that information is communicated very late on. This makes forecasting very difficult. Further, fees are often communicated with a delay (ie. not in real time), making it nigh on impossible for merchants to reconcile accounts and ensure accuracy. Even where merchants use a payments consultant who has expertise in analysing costs, the consultants themselves can find they struggle with the complexity of some of the fee breakdowns.

For example, one of our retailers stated that they would usually get 2-3 months notice from the acquirer for any fee change. This is based on the date the fees are due to take effect. However, they often do not see these fees come through (ie. start being charged on the monthly statement) until a later date due to acquirer readiness (ie. to consume, report on and charge the new fees). The notice given is therefore only effective to a point as it doesn't advise when the merchant will actually start being charged.

One retailer highlighted that there have also been times where they have received inaccurate information from their acquirer on the estimated monetary impact to the business, in that it has under-estimated the commercial impact and cost, and the acquirer information on what the fee change relates to and the reason for the change is still not explained clearly (even with an estimated impact being shared).

New fees are often imposed before there is universal readiness across the ecosystem. An example is the Visa 'never approve' fee where there is evidence of a hard decline being authorised by the issuer on another attempt. Even though there isn't full support of a scheme's new fees, penalties are still imposed without oversight or a mechanism for dispute, and introduced even when issuers are not 100% ready for acceptance. The pattern between premature introduction of penalties, lack of visibility into the roadmap for readiness, and pre-emptive roll out of such fees without having a solid infrastructure, illustrates that the schemes make decisions based on commercial incentives rather than the core objective for the payment ecosystem that the networks uphold.

The card scheme fee structures are extremely complex, which in turn makes it hard for merchants to ascertain what they are paying for different transaction types or to avoid 'optional fees'. Some fees are so generically described in fee schedules that merchants cannot identify them and therefore merchants cannot even attempt to avoid or reject those fees (SCA fees, for example). Merchants can request fee schedules from acquirers, but this is difficult and still not fully transparent. For example, different acquirers pass the same fees with different names and sometimes even diverge from the network interpretation on optionality. Further, fees are often sent through quarterly and usually prone to manual adjustments between processor/networks and processor/merchants, so it is even harder to assess individual fees retrospectively. Given the apparently huge amount of effort by the schemes to standardise technical flows (EMV, tokenization, ISO 20222) it would be extremely positive to see the same effort to standardise fee reporting and transparency.

This highlights one of the key issues: transparency. It is completely impossible for merchants to map the fees listed in Annex 1 to their own accounts. One large retailer has attempted the mapping exercise and report that doing so has simply proved the opacity of fee breakdowns as they were two completely different lists. We have evidence of very large retailers that have entire payments divisions, or even payments consultancy firms, that are struggling to understand their fees or map them to those listed in Annex 1. It is then impossible to determine if the fees they are being charged reflect any value, as they can't see what or why they are being charged. If it would be of interest to the PSR team we would be happy to facilitate engagement with a retailer to show you a breakdown of what they see, compared with the list of fees you have seen as evidence from the card schemes.

We were also unsurprised to see the reflection that competition is rarely considered in fee-making decisions. When fee changes are introduced, they often appear to be independently decided and have no regard to other factors in the market, including competition. If anything, it seems that reverse competition is in effect as the card schemes often mirror the other scheme(s) when an opportunity is seen to add on new fees.

<u>Optionality of 'optional' fees</u>

The PSR paper discusses optional fees. Our merchants' experience is that many optional fees can be, in-practise, mandatory. Optional fees may carry a penalty for not introducing, or make business difficult to carry out if the retailer chooses to opt out. Further, not all merchants have the ability to consume decline codes directly from the networks, hence they have to rely on acquirers which bundle some of those decline codes, making it hard for merchants to create specific retry logics based on the network mandates which means there is no way to avoid being exposed to integrity fees.

We are very concerned at the evidence of the card schemes using their influence to circumvent regulatory interventions. For example, the card schemes are punishing merchants who make use of regulatory TRA exemptions under PSD2 for known/low risk transactions and create quicker checkout experiences for consumers. Both the Visa Secure Credential Framework update (where merchants will be charged a fee if they are not processing on Visa Secure or using network tokens, due October 2023) and the Mastercard SCA Exemption fee (which is 'optional' but unavoidable if a merchant chooses to submit an acquirer TRA exemption request in the authorisation request) are payable if a merchant opts out of 3DS by using TRA exemptions. This appears to be the card schemes using their influence to override regulatory interventions and guidelines to suit their own agenda and creates a scenario where merchants will pay a fee either way.

Another example of “optional fees” that aren’t truly optional, is “Mastercard Instalments” which is due to launch later this year; an offering which allows their customers to pay in instalments in a similar way to other buy-now pay-later providers. This carries scheme fees of [✂] per transaction, as well as a later settlement tenor than standard card payments. Additionally, the credit risk would still be carried by the retailer, so if a customer defaulted on paying later instalments it would be the retailer who carries the liability of the chargeback, and not the scheme. This additional fee therefore does not only not add any value, but actually adds liability. Whilst retailers can choose to opt out, consumers could still try to pay this way, which would cause an attempted pre-authorisation resulting in a charge to retailers. This would mean that even a retailer that has opted-out will still incur additional charges.

Another example to bring to your attention is the Mastercard Authorisation Optimiser Service (the “NSF .02 Fee” for non-sufficient funds). This comes into effect for the UK in Jan 2024 and is a mandatory fee for a service that should be optional. The service is aimed at recurring transactions and intends to increase successful authorisation approvals following a NSF (non-sufficient funds) decline by advising merchants of a date/ time to retry the transaction. There will be a fee for each transaction that returns a recommended date for retry. Additionally, if acquirers are able to process and pass this additional information onto the merchants, merchants will have to make fairly significant system changes (and therefore incur costs) to make use of this mandatory service. Furthermore, there is no data available to prove the value and effectiveness of this new service.

<u>Value and costs</u>

In regards to Question 5: that card schemes’ fee changes are indicative of the value they represent; the BRC would disagree with this statement. Card schemes have not ever been forthcoming to provide evidence of the quantification of any supposed value, which we would argue is because the fees do not represent equal value. Most of the time when fee changes are introduced, retailers see no difference in the service they are receiving. This is not to say that the card schemes have no value; cards are critical to the UK market at present, but that means that additional fees are added without justification or quantification of the value of said new fee, when the schemes are already gathering significant profit from retailers. It’s an abuse of the must-take status the card schemes currently hold.

An example of where this could be shown would be the 3DS Authentication Fee for Strong Customer Authentication (SCA) that were introduced to cover the cost of new requirements to counter fraud. It should be fairly straight forward to be able to quantify the level of fraud that has reduced and compare to the level of fees that were introduced. These kinds of valuations would also allow for post-implementation evaluations and adjustments if the fees are set too high.

In addition to the fraud aspect of this, historically merchants were charged lower fees for transactions processed via 3DS versus transactions which were sent directly to authorisation. However, there is now a Mastercard fee for both 3DS transactions and transactions sent direct to authorisation (such as transactions with an Acquirer TRA exemption request), and Visa has a similar fee update due to come to effect in October. So effectively UK merchants who are subject to SCA regulations and therefore need to process via 3DS or request an exemption, are now being charged in all scenarios. Plus, with an acquirer TRA exemption, merchants now have the liability for any fraud which logically should result in lower fees, not higher.

As all of the evidence has shown (see our background section above), fees have increased at a very high rate over recent years. The card schemes are justifying this by saying that this reflects improvements in services. Looking at recent years, it is hard for us to justify that services have changed significantly, and certainly not at the rate of increase of the fees charged.

Other comments and concerns raised by members

Commercial cards interchange fees

One of our members raised concerns as to the lack of review into the large interchange increases seen on commercial cards in 2022. Given these are out of scope of the interchange fee regulations, it appears that schemes are utilising this to gain additional profit and allows them to incentivise banks with rebates.

Fee structure

Something that is important to consider is the structure of the fees charged. At present, a percentage-based fee structure is still being used. The question arises as to why this should be the case, given the effort and associated cost to move £1 versus £1000 through the payments ecosystem is the same. With SCA applied, card-not-present transactions should carry the same level of risk as card-present transactions.

A more logical fee structure would be a ‘fee per transaction’ structure. In this instance, economies of scale can be utilised by merchants. Percentage-based fees preclude access to economies of scale by those merchants, meaning that all of the benefit remains with the PSPs and schemes.

We recognise that a ‘fee per transaction’ structure might overly burden low value payments, and would therefore see a proposition that would include a percentage based structure for payments below a certain amount, for example.

Concluding remarks

As the evidence has shown, there are lots of examples of fees that are extremely unfair to merchants when looked at in more depth, whether due to the mandatory adoption, regulatory work-arounds, or charging in circumstances where the risk has actually been transferred back to merchants.

However, the truth is that the lack of transparency in fee breakdowns and schedules makes it impossible for merchants to accurately analyse the card scheme fees they are being charged. Whilst some of our retail members have exceptional payments departments who have provided the evidence in this paper, expecting that of all sized retailers would simply be unfair and unrealistic. The huge hike in scheme and processing fees in recent years has been hidden under the complexity of the schedules; fee breakdowns should be accessible to all, which would then allow merchants, regulators, and the card schemes themselves to actually assess and quantify value, and to charge only what is necessary. The fact is that there could be many more examples, similar to those above, if we were able to truly understand what is being charged and why.

First Data

First Data email response

Good morning,

[✂] Please see below comments on the five questions within MK22/1.6 working paper.

If you have any questions on the below, we are more than happy to engage and discuss further.

		Answers
Question 1	Do you agree with the way we describe the different rationales for the fee changes in our selection?	Yes, we agree with this statement.
Question 2	Do you agree with our description of the degree to which competition influenced the decisions to introduce these fee changes?	We agree with point 1.5, page 3, scheme competition happens on the card issuing side not on the payment acceptance side hence competition cannot be an impediment on fees that you also have the power to make mandatory. It is a captive audience. If competition was a reason for fee changes they would not be getting more in size and in number also they would not be opaque to the merchant.
Question 3	Do the fee changes considered in our analysis include the most significant changes introduced in the period 2017 to 2021? Are there other fee changes introduced during the period that you think we should have considered? If so, please demonstrate how these changes impacted you.	Post an internal review we have no information that would suggest a significant miss.
Question 4	Do you have any views on our classification of fees as mandatory, optional or behavioural, as shown in Tables 1 and 4 in Annex 1? Are there fees indicated as optional in those tables that you consider cannot be avoided?	The behaviour of the card holder and/or the merchant oftentimes determines if behavioural fees will be incurred on a particular transaction - therefore, from our point of view, behavioural fees are still mandatory in their nature (i.e. if they are triggered, they are triggered, there is no optionality on a per-transaction-basis). If triggered they are being charged to the acquirer and passed on to the merchant through applicable pricing mechanisms.
Question 5	Do you consider that the fee levels are commensurate with the value provided by those services?	Looking at scheme fees holistically, we do not believe the fee levels are commensurate with the value provided by those services. However, upon detailed review of individual fees

		there may be benefits provided. The amassment and complexity of the fees cannot clearly show value though.

[✂]
[✂], Regulatory Compliance & MLRO.
CGL – Compliance, Government Relations & Legal
Office: [✂]

Fiserv
World's Most Innovative Companies 2022 | Fast Company
Fiserv | Join Our Team | Twitter | LinkedIn | Facebook

[✂]

HMRC

HMRC Email response

Good Afternoon

I have read the paper and offer the following responses:

Para 6.4 Q1&2 are directed at Mastercard/Visa and so no comment.

Question 3: Do the fee changes considered in our analysis include the most significant changes introduced in the period 2017 to 2021? Yes Are there other fee changes introduced during the period that you think we should have considered? No If so, please demonstrate how these changes impacted you.

Question 4: Do you have any views on our classification of fees as mandatory, optional, or behavioural, as shown in Tables 1 and 4 in Annex 1? No
Are there fees indicated as optional in those tables that you consider cannot be avoided? No

Question 5: Do you consider that the fee levels are commensurate with the value provided by those services? It is difficult to say if the fee levels are commensurate with the value provided by those services as the 2 schemes can charge different fees for what is, at face value, the same service. We do not readily understand what the added value is; nor the benefit to the merchant, when one scheme applies a higher fee than the other for those services.

Kind Regards

[✂]

[✂]
[✂]
HMRC Payments
Payment Strategy
7th Floor, 1 Atlantic Square
Glasgow
Email: [✂]@hmrc.gov.uk
Phone: [✂] Mobile [✂]

Please visit our Payment Strategy Team Pages

John Lewis Partnership

Questions

~~1. Do you agree with the way we describe the different rationales for the fee changes in our section?~~

~~2. Do you agree with our description of the degree to which competition influenced the decisions to introduce these fee changes?~~

~~3.~~ Do the fee changes considered in our analysis include the most significant changes introduced in the period 2017 to 2021? Are there other fee changes introduced during the period that you think we should have considered? If so, please demonstrate how these changes impacted you.

We believe that the fee changes considered in your analysis include all those which have significantly impacted us the most, particularly the revisions and increase in mandatory scheme and processing fees.

As stated previously in our responses to the PSR's Market Review papers, we follow an Interchange++ model with our acquirer, where the scheme fees are passed through to us. The monthly statement report we receive from our Acquirer, provides a breakdown by each fee type that is limited to how our acquirer has categorised the fees that they receive from Visa and Mastercard. Using this categorisation/ classification, we have listed below the 4 most significant fee changes introduced by Visa and Mastercard between 2019* and 2023 (as the fees considered in your analysis extend to 2023):

1. Mandatory Mastercard Domestic Scheme Fees
2. Mandatory Visa Domestic Scheme Fees
3. Mandatory Card Not Present Fees for 3DS authentication- categorised by our acquirer as ECom Authentication Fees
4. Mastercard Acquirer authentication exemption Fees

**As mentioned in our responses to previous papers, our data* is *from 2019*

We had listed these 4 fee changes in the spreadsheet as part of our response to the PSR's Scheme and Processing fees Merchants - Questionnaire in March this year, and have also attached it as part of our email for your reference.

[✂]

[✂]

[✂]

[✂]

[✂]

[✂]

~~4.~~ Do you have any views on our classification of fees as mandatory, optional or behavioural, as shown in Tables 1 and 4 in Annex 1? Are there fees indicated as optional in those tables that you consider cannot be avoided?

We believe that the fees listed as mandatory, optional and behavioural for acquirers in Tables 1 and 4 in Annex 1 have been correctly classified.

Given the data and information that we currently receive from our acquirer, it is difficult to definitively confirm if all the optional fees for acquirers listed in the tables are unavoidable for us. However, we believe that some optional fees are unavoidable in some circumstances. For example, Mastercard's Acquirer authentication exemption (direct to authorisation) fees are unavoidable when we request an Acquirer TRA exemption in the authorisation request for Mastercard transactions. While we are clear on the service which we are paying for and under what circumstances it is charged, the fact this fee exists when there is also a fee for submitting a transaction via 3D Secure means that we are being charged in both scenarios - i.e. for requesting an Acquirer TRA exemption in the authorisation request or submitting a transaction via 3D Secure making such fees unavoidable. As a UK Merchant, who is subject to the SCA requirements of PSD2, we have to either process a transaction via 3D Secure or request an exemption for transactions 'in scope' for SCA, thereby incurring a fee for every Mastercard transaction on EEA cards.

~~5.~~ Do you consider that the fee levels are commensurate with the value provided by those services?

As a UK merchant, while we acknowledge the value of being able to offer Visa and Mastercard branded cards as a trusted payment method with their ubiquitous acceptance and wide market reach, we do not believe charges are necessarily reflective of the value provided by the schemes, especially with the frequent increases in fees and introduction of new fees.

We are not consulted before any fee changes are introduced by the schemes and we primarily rely on our acquirer for communication of scheme and processing services and fees to us, and the explanation of these services and fees. Although we do get information from our Acquirer when fee changes are introduced - and we do ask for more details where required - the information initially provided is often not clear and detailed enough to give us a full understanding of the reason and context for the fee being applied, i.e. there is a description vs. a clear explanation of the fee and the description is often not self-explanatory. Thus, it is not always clear what services are being provided (if any), their value and their associated fees.

For example, while we pay some fees such as the 'optional' Mastercard Acquirer authentication exemption fee - in scenarios where we request an Acquirer TRA exemption in the authorisation request on a Mastercard transaction - given that no liability shift occurs for such transactions (i.e. we are liable for fraud on these transactions) and Merchants already incur additional fees for the Transaction Risk Analysis required to qualify a transaction for an Acquirer TRA exemption, it is difficult to fully understand the reason and therefore the direct value to Merchants for paying this fee. In summary, we cannot say that we believe that the fee levels are commensurate with the value provided by those services as otherwise their value and benefits would have been more clearly articulated and understood.

Mastercard

Mastercard response to PSR Working paper ‘*Market review of scheme and processing fees: Recent changes to scheme and processing fees MR22/1.6*’

11 AUGUST 2023

Contents

1. Executive summary

In the context of its market review into card scheme and processing fees, on 30 June 2023, the Payment Systems Regulator ('PSR') published its working paper on 'Recent Fee Changes' ('Working Paper'). This document sets out Mastercard's response to the Working Paper. <u>We find that the Working Paper omits relevant information, fails to reflect how Mastercard works, and employs methodologies that are neither robust nor appropriate to draw the generalised conclusions presented. As a result the conclusions drawn are unrepresentative and demonstrably inaccurate.</u>

This response is split into two sections. The first section provides an overview of Mastercard's pricing process, that has not been characterised correctly in the Working Paper. The second section assesses and comments on the analysis presented in the Working Paper.

The Working Paper relies on an incomplete view of Mastercard's pricing process

The PSR's Working Paper acknowledges that the analysis is based on incomplete information, stating that '*We focused on documents prepared for final decision makers. However, the process leading to the implementation of a fee change is typically more complex, involving several teams within Mastercard or Visa*'.[1] However, this significantly underemphasises the extensive, cross-departmental and cross-divisional internal deliberation that takes place within Mastercard prior to any formal proposal being presented to final decision makers.

These deliberations include internal discussions conducted by the [✂], an influential group that discusses and develops relevant price changes. Following discussions by [✂], a pricing proposal will be submitted to the [✂], which is the decision-making body referenced in the Working Paper.

The [✂] discussions involve a broad range of stakeholders from across the business including representatives from [✂] and [✂] teams from the European Mastercard [✂] (including the UK[✂]). [✂] representatives gather feedback from their teams, who have day-to-day interactions with customers, and therefore have a deep understanding of their needs and concerns. This is an important channel for customer views and market intelligence to be fed into the decision-making process.

These internal discussions regularly have tangible impacts on the pricing proposals, reflecting the competitive constraints faced by Mastercard. Section 3.3 presents several examples of changes to fee proposals that came about as a result of these discussions. There are clear cases where the constraints faced by Mastercard are reflected in its pricing decisions—even if they are not articulated in the final pricing proposal and assessment.

The analysis presented contains a number of significant shortcomings

The presented analysis of the fee changes and the conclusions drawn suffer from some significant issues and limitations. We have grouped these into the following four themes.

The sample selection means that conclusions cannot be generalised or extrapolated:

i. The analysis is conducted using a selection of Mastercard's fee changes that are not representative of the complete set of Mastercard's fee changes. In particular, the selection of fee changes accounts for less than

[1] PSR (2023), 'Recent changes to scheme and processing fees', p. 37, para 5.3.

1% of the pricing documents that have been submitted by Mastercard. Thus, conclusions from the Working Paper cannot be generalised as representative of Mastercard's pricing process.

ii. Some of the main conclusions from the analysis in the Working Paper rely on a very small number of fee changes. This means that the analysis may change, and significantly different conclusions may be drawn, should there be small changes to the sample. For example, if three of the 20 fee changes are excluded from the analysis in the Working Paper, it would instead show that: (i) expected revenue from non-mandatory fee changes (opt-in, opt-out and behavioural) is double the expected revenue from mandatory fee changes; and (ii) there is no difference between the expected revenue from mandatory fees charged to acquirers in respect to those charged to issuers. While analysing a small number of changes could be appropriate for considering fee evolution in a particular time period, it is not appropriate in order to extrapolate conclusions on any trends in fees.

The Working Paper's analysis misinterprets the available evidence

iii. [✂], the relative importance of mandatory fees in Mastercard's revenue is [✂]. The Working Paper does not correctly interpret the data, and the conclusions are not consistent with previous submissions by Mastercard, which the PSR appears to have not considered.[2]

iv. The Working Paper seems to be drawing a single conclusion about mandatory fee growth for both Mastercard and Visa, despite the data showing that they are, in fact, quite different.

v. The [✂] is incorrectly presented as an example of a UK-specific fee change. This change was in line with [✂] and [✂].[3] Further, [✂] currently has the [✂] in Europe. This example shows the importance of analysing a broader set of evidence and not relying only on a selection of final proposal documents. Nonetheless, this fee change is a key driver of the Working Paper's conclusions.

The analysis of the rationales for fee changes is not robust:

vi. The analysis of the rationales uses a methodology that is not clearly articulated and relies only on the final [✂] documents, which do not capture all significant parts of the discussions during the pricing process.

vii. The Working Paper suggests that 'reflection of value' is distinct from competition or addressing customer needs, which is incorrect. Rather, the underlying impetus of value creation is a response to competitive pressure and customer needs, with fee changes generally being considered after changes to scheme services have been embedded and demonstrated to the ecosystem.

The conclusions are not supported by the evidence available to the PSR:

viii. The Working Paper's main pieces of analysis rely only on pricing documents despite, for some topics, Mastercard providing the PSR with additional information that would have better informed its analysis[4].

ix. Whilst some of the various shortcomings in the analysis are acknowledged, including the fact that the PSR only considers the final stage of approval of the pricing proposals, they are not clearly reflected in the Working Paper's conclusions.

---

[2] 'The [✂] in total fees is mainly driven by the [✂]and [✂]by customers.' See Mastercard (2023), 'Mastercard response to [✂]

[3] [✂]are now implemented in [✂]. The rest will implement this change shortly.

[4] The analysis presented in the Working Paper would have been better informed by considering previous submissions, such as Mastercard's response to the [✂], the [✂] report submitted to the PSR in May 2022, [✂] report, the [✂] over time' report, Mastercard's response to the [✂].

Each of these points are discussed in further detail in this response.

2. Introduction

In the Working Paper, the PSR '*looks at documents produced by Mastercard and Visa to understand the factors that they consider when setting their fees*'.[5] The PSR explained that its purpose in publishing these working papers is 'to set out [its] methodology, analysis and emerging thinking',[6] and specifically addressed two questions to Mastercard.

- *'Do you agree with the way we describe the different rationales for the fee changes in our selection?'*[7]
- *'Do you agree with our description of the degree to which competition influenced the decisions to introduce these fee changes?'*[8]

The Working Paper follows the requests for information sent to Mastercard by the PSR dated 9 November 2022 ('RFI'), which contained specific questions about a selection of fee changes that the PSR had identified as relevant for its analysis. The PSR sets out the selection criteria in the Working Paper: '*Our aim was to cover the 20 fee changes implemented between 2017 and 2021 that were expected to have the largest revenue impact in the UK*'.[9]

The two questions set out for Mastercard in the Working Paper are related, and we therefore provide a consolidated response that addresses those two questions and other relevant topics covered in the Working Paper. As will be evidenced in this response, the PSR's methodology and analysis raises a number of significant concerns and shows that some of the emerging thinking is not supported by the evidence that Mastercard has submitted.

Section 3 of this response discusses Mastercard's pricing process, including: (i) the broader competitive dynamics that lead to fee changes; (ii) an explanation of what happens before pricing proposals reach the [✂]; and (iii) an explanation of how proposals evolve in their preliminary stages.

Section 4 reviews the PSR's 'Summary of Evidence' (section 4 of the Working Paper) and its 'Emerging thinking' (section 5 of the Working Paper). This response reviews each of the topics covered in section 4 of the Working Paper: (i) optionality; (ii) geographic scope; (iii) impact on acquirers and issuers; (iv) rationales for fee changes; (v) value; (vi) competition; (vii) costs; and (viii) customer engagement.

5 PSR (2023), 'Recent changes to scheme and processing fees', p. 3, para 1.1.
6 PSR (2023), 'Recent changes to scheme and processing fees', p. 3, para 1.1.
7 PSR (2023), 'Recent changes to scheme and processing fees', p. 41, para 6.4.
8 Ibid.
9 PSR (2023), 'Recent changes to scheme and processing fees', p. 5, para 2.2.

3. Mastercard pricing process

One of the main issues with the analysis set out in the Working Paper is the focus on a specific type of document, intended for a small group of Mastercard executives and their decision-making process.

The Working Paper acknowledges this weakness: '*There are, however, some limitations to our analysis. We focused on documents prepared for final decision-makers. However, the process leading to the implementation of a fee change is typically more complex, involving several teams within Mastercard*'. While the PSR had an objective to ensure the information-gathering process was proportionate, one of our main critiques is that the recognition of this weakness is not reflected in the findings and conclusions that are set out in the Working Paper.

To assist the PSR in closing this key gap, we start our response to the Working Paper by explaining the process that Mastercard follows before the implementation of a price change. This section references, where appropriate, the Mastercard pricing proposal documents that the PSR has reviewed[10] and that are related to the fee changes listed in Table 1 of Annex 1 to the Working Paper.

A more complete understanding of the broader pricing process followed by Mastercard (including from where proposals originate and the constraints that limit them) will help the PSR reassess the information considered for the Working Paper, as well as the substantial amount of evidence submitted by Mastercard during this market review.

3.1 Creating value in a competitive market

To understand fee changes and the process by which fee changes are considered, it is important to understand the broader environment in which fees are set. Mastercard seeks to deliver value to its customers and the wider economy by making its payments as easy, quick, and secure as possible.

Numerous changes in the payments landscape over the past decade, including technological developments, new entry, regulatory developments, and evolving risks, have implications for Mastercard directly and for the ecosystem more broadly. Mastercard confronts these risks by continually developing and enhancing its activities and services to meet the needs of issuers, cardholders, acquirers, and merchants, and to ensure the security and stability of payments made using its system. Many of the changes to Mastercard's activities are described in detail in the 'Mastercard's scheme activities – changes over time' report,[11] previously submitted by Mastercard to the PSR in April 2023.

Mastercard's innovations and the changes to its activities are a response to the dynamic competitive landscape for payment services. A detailed analysis of the competitive landscape can be found in the response to the '[✂]')[12] and in the '[✂]'[13] report ('[✂]'), both previously submitted by Mastercard to the PSR in April 2023.

The changes in Mastercard's activities and the value that it delivers are reflected in its fee schedule. This is what would be expected in a competitive market where businesses invest to improve their service offering to stay ahead of their competitors and to deliver a return to shareholders.

---

10 [✂].
11 Mastercard (2023), 'Mastercard's scheme activities – changes over time'.
12 Mastercard (2023), 'Mastercard response to the PSR Call for evidence "[✂]"
13 Oxera (2023), 'The competitive landscape in the UK'

As Mastercard explained in its 'Constraints on Mastercard's fees; supplemental submission' report submitted to the PSR in May 2022 ('Supplemental Submission on Constraints'),[14] the company has two overarching principles that guide its fee changes: (i) upfront notice, which states that its customers must be given enough time to implement any changes introduced by Mastercard,[15] and (ii) value-driven pricing, which means that each price is linked to the creation of value that system users receive from Mastercard products, either by an identified improvement in Mastercard's value proposition or some other change in circumstances.

Mastercard's sustained success in payment services depends on having an attractive value proposition for customers and system users more broadly; a clear, coherent and value-reflective fee structure is a central component of this strategic imperative. For this reason, as was set out in the response to the PSR's RFI on '[✂]',[16] in making changes to its fees Mastercard takes into account market conditions, changes in product characteristics, costs and underlying value, competition, and technology evolutions, all of which affect the payments ecosystem and Mastercard's position in it.[17] Changes to Mastercard's pricing are discussed and implemented through a combination of formal and informal processes. These consider a varied list of constraints imposed by external factors, such as competition, regulation and broader market conditions, among other things, as well as Mastercard's internal objectives and pricing principles.

In the next subsection, we explain in more detail the pricing process that operates within Mastercard's business, which will provide a better understanding of how the competitive constraints that Mastercard faces are considered in its pricing decisions.

3.2 Mastercard's pricing process

As Mastercard has previously explained in submissions to the PSR,[18] most decisions on changes to its scheme fees are made by Mastercard's [✂], while relevant switch fees are decided upon by the [✂].

[✂]. These [✂] oversee the pricing proposal review process, and typically [✂] for most of the relevant changes made [✂].

Importantly, as with any large corporation, there is a considerable amount of thought, analysis and discussion that takes place before a proposal reaches the formal decision-making bodies. In the introduction to its Working Paper, the PSR explains that its analysis focuses on documents prepared for senior decision makers, and that '*the process leading to the implementation of fee changes is more complex and may involve informal discussions between members of several teams within Mastercard*'.[19] The PSR thereby rightly acknowledges that its analysis is subject to some limitations. However, this limitation of its analysis does not seem to have been considered when drawing conclusions.

To ensure the PSR gives due weight to the wide range of factors that are part of the Mastercard pricing process, we provide an overview of the [✂] process, along with examples of how some of these discussions take place in practice and how the competitive constraints are factored into the pricing proposals that are presented to [✂].

---

[14] Mastercard (2022), Constraints on Mastercard's fees; supplemental submission

[15] Typically, at least [✂] before the implementation of the change.

[16] Mastercard (2023), 'Mastercard response to PSR Information Notice [✂].

[17] Pricing principles are further detailed in a guide included in many [✂] that have previously been submitted to the PSR (e.g., the [✂]submitted to the PSR, denominated [✂]). This includes: [✂]

[18] Including Mastercard's response to the [✂].

[19] PSR (2023), 'Recent changes to scheme and processing fees', p. 4, para 1.8.

Although there is [✂] for the internal discussions and considerations that precede the [✂] decisions, as well as [✂], the key features can be identified through the common practices of Mastercard management. Some examples are set out below.

The following description focuses on changes to scheme fees, rather than switch fees, as these are more common and make up most of the PSR's fee change selection considered in its Working Paper. However, Switch follows a similar process, with discussions among various teams shaping the proposals that are ultimately submitted for discussion and approval by the [✂]. Customer impact and reactions, value proposition and other commercial dynamics are taken into account as part of the [✂] discussions.

3.2.1 Initial stages of a fee change proposal

Fee change proposals may be initiated by [✂] Mastercard. Historically, the pricing process [✂], but as the value proposition to customers has been enhanced over time through, for example, the introduction of optional services, pricing initiatives [✂] have become more common.

If the proposed fee change is for a mandatory core fee (which is a relatively small proportion of fee changes) the discussion will generally be managed by the [✂]. Conversely, if the fee is mandatory non-core, opt-in or opt-out, the [✂] will tend to drive the discussion, with the support of [✂]. In either case, changes in Mastercard's activities and service proposition, in response to the competitive environment, evolving risks and technological developments are the main reasons for considering changes to its fee schedule.

Once a fee is being reviewed or a new fee is being proposed, the [✂] will [✂]. This will consider Mastercard's pricing principles and other specific objectives,[20] as well as competitive constraints. These initial ideas are [✂]. For example, if a pricing proposal is [✂].[21] These initial conversations will frequently involve feedback, and sometimes robust challenges from internal stakeholders, which will impact early versions of the price proposal. If a [✂], the [✂] will generally have early access to the proposals and deliver feedback as well as providing input.

If a relevant pricing proposal progresses through the early discussions and takes an initial shape, it must then be [✂]. This is done through the [✂]. This is an [✂] before they are submitted and discussed by the [✂].[22]

The [✂] is composed of members from [✂]: (i) [✂]; (ii) [✂]; (iii) [✂]; (iv) [✂]; (v) [✂]; and (vi) [✂]. [✂] include representatives of each of [✂] (including [✂] UK [✂]). Having a broad and diverse group enables the [✂] to function as a [✂] and [✂] within the business and to effectively reflect the competitive dynamics in each individual market and for each service.

[20] For example, [✂] (see footnote 11). Objectives can also be specific to a certain fee. For example, the dispute administration fee, [✂] (see box #3).

[21] Depending on the fee change, the [✂] team may be contacted also at an early stage, to confirm the initial idea is technically feasible.

[22] This follows the description of the process that Mastercard set out for scheme fees in its response to the [✂]: 'As highlighted above, scheme fees which apply to UK issuers and acquirers are set within Mastercard Europe. The setting of these fees will typically involve a [✂] and the [✂], but then be reviewed by [✂]: the [✂], p. 4.

Most of the interactions at this stage of the process are [✂] and the [✂] may be shared [✂], which have a [✂]. Thus, this section of the response captures the common practices of the discussions of the pricing process from people that participated in price discussions during the relevant period.

As the [✂], there are [✂]and there is [✂]. That said, it is a generally accepted expectation in the business that taking a pricing proposal through [✂] typically involves broad discussions including several internal stakeholders, as well as discussions among smaller groups.

[✂]. Also, the [✂] is more likely [✂]. Proposals that are not discussed within the [✂] are discussed between the [✂], the [✂] where the fee will be applied and the [✂]. The pricing proposal will be presented to the [✂] only after it is validated by [✂] or [✂] and the [✂].[23]

Through different channels, such as [✂], [✂] or [✂], [✂] scrutinise the initial proposal set out by [✂]. These discussions will consider all details of the pricing proposal and their implications for different customers and the competitive constraints in each market, among other topics. These discussions will directly impact —and in many cases completely reshape— the pricing proposal that will then be presented and discussed [✂].

The process of designing a [✂] will generally take at least [✂] before reaching the [✂] for [✂] or a significant expected [✂] on customers.[24] Many fee changes involve [✂], which means that the design of proposals can take [✂] and more than [✂] before reaching [✂]. In some limited cases, major comments may remain after [✂] discussions, and meetings of [✂] may take place before the pricing proposal is submitted to the [✂].

Additional details and examples about how the pricing proposals evolve during discussions at the [✂] are presented in section 3.3.

3.2.2 Submission and approval of finalised proposals

Following successful [✂] discussions, a formal pricing proposal will go through a formal discussion and approval process at the [✂].[25] The final [✂] proposals will have incorporated the outcomes of previous discussions, including amendments to take into consideration relevant constraints, even if these are not explicitly set out in the final proposal documents. Before a proposal is submitted to the [✂], it must receive [✂] and the [✂], which manages the [✂].[26] The [✂] members review the final [✂] and must approve the proposal before the fee change may be communicated to customers and implemented.

As further explained below, the [✂] on the fee change incorporate comments and constraints highlighted by different parts of the business. Informally, teams will be aware that [✂] approval will be materially more likely if the proposal

---

[23] In addition, before the submission to the EPC the pricing proposals must be validated by [✂] to check if the proposal is technically viable and the [✂] to check for [✂].

[24] [✂].

[25] In the case of Switch Fees, through [✂].

[26] See footnote 24.

has broad support across the business. However, the [✂] is still the final decision-maker, and proposals can and have been amended or rejected even at that stage.[27]

Figure 3.1 presents a summary of the process that has been described in this subsection.

Figure 3.1 ***Summary of the pre-[✂] pricing process***

[✂]

3.3 Initial proposals are challenged and alter during internal discussions

As explained in the previous subsection, there is a considerable amount of work and discussion that takes place before a pricing proposal reaches the [✂]. Within that informal process, the discussion within the [✂] is significant. The [✂] process is relevant for shaping the proposals that are finally submitted for formal discussion and approval. This subsection will further explain the process, along with examples that illustrate internal discussions and outcomes.

Among [✂] participants, [✂] from the [✂] and [✂] are particularly active in the discussions about proposed fee changes. This input is a key element of how competitive constraints faced by the company are identified and integrated into the pricing process. These teams' knowledge of Mastercard's customers' views and the wider competitive context enable them to assess whether price changes are consistent with customers' views and the competitive environment in which they operate. This allows the teams to raise concerns if price changes are not aligned with the value that their customers perceive or are not consistent with the market constraints and conditions that are faced by Mastercard.

The [✂] may have comments relating to the general approach of the proposed fee change, as well as views that are particular to the [✂]. As was described to the PSR in a previous submission, [✂].[28]

An example of the latter is the discussion in [✂] about [✂]. Although the [✂] agreed with the general approach being proposed,[29] they highlighted that [✂] After internal discussions, the proposal finally submitted to the [✂][30] excluded [✂], where the service [✂]. The [✂] document sets out that [✂],[31] but [✂]. The following box further describes the [✂] example.

[27] For example, as explained in previous submissions to the PSR, the proposal to introduce [✂] pricing [✂] was rejected by the [✂]. See: 'Constraints on Mastercard's fees; supplemental submission' report.

[28] Mastercard response to the [✂].

[29] The rationale to mandate the participation to the program is motivated by [✂].

[30] This is explained in slide 8 of the [✂] submitted to the PSR, denominated '[✂].

[31] Ibid.

[✂]

As explained in section 3.1, fee changes will be preceded by continuous enhancements in Mastercard's activities, which are necessary to maintain its competitive position in the market and are based on a deep understanding of the value it delivers to customers and users. Mastercard's [✂] interact with their customers very regularly and through those interactions build an understanding of issuers' and acquirers' needs and requirements, as well as their businesses and 'pain points', which allows customer views to be fed into discussions within the [✂]. [✂] seek feedback on proposed changes from [✂] and other internal stakeholders who have a direct view on the local market conditions that Mastercard faces and can anticipate how customers would react to changes in their fees and services.

The feedback that [✂] gather among the local [✂] teams can be of a different nature. Most commonly it will be about how a certain fee change would affect the competitiveness of Mastercard in the market, about the current state of relationships with their customers or about the capacity of certain customers to implement system changes within their organisations.

Feedback from [✂] can also be about the commercial strategy and ongoing plans from the [✂] teams. For example, when the [✂] decision to [✂]. As explained in Box #2, during the discussions that preceded [✂], the [✂] explained this to the [✂], and it was finally agreed to [✂] from the proposal.

[✂]

The examples above show how the discussions within [✂] (which can occur [✂] or in [✂]) consider [✂] competitive conditions. Product owners carefully consider the views from this [✂], as formal approval at [✂] is very unlikely to be successful if any major comments remain after the discussion among the [✂].

The [✂] documents that Mastercard has submitted to the PSR also show that these discussions may have diverse outcomes. Generally speaking, Mastercard aims to [✂]. However, for certain changes [✂]. This was also explained in a previous Mastercard submission to the PSR: '[✂]'.[32]

The previous point is consistent with one of the findings the PSR sets out in the Working Paper (although it fails to underline the reasons for that finding), about changes to mandatory fees [✂]. As these fees cannot be avoided, [✂]. This is not a feature specific to the [✂], as is set out in the Working Paper, but to all [✂].

However, the discussions at [✂] are not only about [✂]. While there was agreement on the general principles, there were concerns about how [✂]. After different alternatives were discussed between [✂] members, a final proposal was submitted to the [✂]. This is set out in more detail in Box #3.

[32] Mastercard response to the [✂].

[✂]

There are many other cases where different competitive constraints are considered early on in the pricing discussions. For example, the [✂] illustrates how competitive constraints are considered internally for the proposals that are finally approved.[33] Equally, for [✂], the [✂] was eager to [✂], and managed to introduce the change [✂].[34]

In the previous subsection we have explained how the Mastercard pricing process works internally. As in most large organisations, there are a series of informal interactions that precede the more structured and formal discussions among senior decision makers. In this subsection we have explained and provided examples of how the informal stages of the pricing discussions consider the views of various parts of the company, incorporate the various competitive constraints that Mastercard faces and shape the final proposals that are finally discussed at the more formal [✂] stage.

We have centred this detailed description of the pricing process on the impact it has on the proposals that reach the [✂]. However, it is also important to note that the [✂] discussions sometimes conclude with the proposal being aborted and never reaching [✂]. This may occur because of negative opinions from the corresponding [✂] or after extended pushback from [✂]. For example, there was a recent discussion about [✂]. [✂] challenged the introduction of this proposal on the basis that, while this change would be supported by the delivered value, at this time the market conditions were not suitable for it. The reasons for this will generally be similar to those explained in

[33] A fee was introduced for [✂], which was a valuable service for customers. During the internal discussions of the fee, the [✂] explained that it was a [✂] service in the [✂] and that it would have [✂]. The fee was introduced at [✂] and at [✂].

[34] As is recognised in the [✂] document, when the CNP fee was introduced one of the objectives was to [✂]. For this, the fees should not greatly differ between [✂] transactions. This alternative was proposed by the [✂] and, although the rest of [✂] opted to keep a difference between [✂] types, the [✂] was convinced of their borderless goal and chose to eliminate the cross-border fee for interregional transactions.

the examples above: various internal stakeholders opposing certain fee changes because of the different competitive constraints they face in the daily operation of the business.

4. Response to the main points raised in the PSR's Working Paper

This section reviews the PSR's 'Summary of Evidence' (section 4 in the Working Paper) and its 'Emerging thinking' (section 5).

The analysis in the Working Paper is stated to be to inform the PSR's interim findings and it is therefore important that it is robust, balanced and methodologically sound, and that it uses all the relevant evidence available. If there are important gaps in the evidence base, then this should not only be acknowledged, but also taken into account when drawing conclusions. As we explain below, our review raises significant concerns about the robustness of the methodology and the reliability of the analysis.

This section is structured as follows.

- Subsection 4.1 reviews the PSR's conclusion that 'the majority of fee changes in our selection relate to mandatory fees'[35] and explains that the [✂] with Mastercard's latest fee changes.
- Subsection 4.2 explains the geographic scope of fee changes and why mandatory [✂] than optional fees.
- Subsection 4.3 reviews the Working Paper's analysis of the distribution of fee changes among issuers and acquirers.
- Subsection 4.4 reviews the PSR's methodology for analysing the rationales for Mastercard's fee changes.
- Subsection 4.5 discusses the importance of value as a driver for Mastercard's fee changes and highlights that the PSR's Working Paper has not captured the underlying factors that lead to value creation.
- Subsection 4.6 addresses the PSR's second question about the competitive constraints faced by Mastercard when deciding on a fee change—we show that the analysis by the PSR does not adequately reflect the impact of internal discussions over fee changes, where constraints are actively considered before they even go to the decision-making bodies.
- Section 4.7 discusses the PSR's comments on costs.
- Subsection 4.8 addresses customer engagement and highlights how the Working Paper understates the importance of customers during the consideration of fee changes.

4.1 Optionality

The PSR's Working Paper concludes that '*Changes to mandatory fees account for the majority of expected revenue impact from the changes in our selection*'.[36] This conclusion is only valid in relation to *the selection* of fee changes considered in the Working Paper. The PSR fails to mention that the finding is not representative [✂][37] In order to correctly interpret the data, the PSR should have considered other factors, including the following.

- As is recognised in the Working Paper, the analysis covers only a *selection* of fee changes. The selection has been made by the PSR and prioritises fee changes with the highest expected revenue impact.
- Such an approach is not useful for drawing conclusions about the mandatory/optional distribution of fee changes. [✂] and will therefore likely be [✂] in a selection that uses expected revenue impact as its main criterion. Hence, there is a selection bias and the data presented in Figure 2 of the Working Paper cannot be

[35] PSR (2023), 'Recent changes to scheme and processing fees', p. 14 para 4.6.
[36] PSR (2023), 'Recent changes to scheme and processing fees', p. 12.
[37] Mastercard (2023), 'Mastercard response to PSR Information Notice [✂].

used for drawing conclusions about the general mandatory/optional revenue distribution of Mastercard's fee changes.

- Even if this selection bias is ignored, the PSR seems to have incorrectly interpreted the data. The PSR analysis focuses on the total expected revenue impact, with the PSR suggesting that around [✂] revenue would correspond to mandatory services and [✂] to optional services. However, the PSR does not account for the fact that in [✂] from mandatory fees is [✂] than revenue from optional services. Once that is taken into account, the [✂] for optional services is [✂] than that of mandatory services.
- That is to say, the [✂] of mandatory fees is [✂].
- The [✂] importance of mandatory services can also be illustrated using analyses that Mastercard submitted in its response to the PSR's RFI on '[✂]'.[38]
- This analysis shows that the gross revenue for mandatory services has exhibited [✂] than the gross revenue for optional services for both issuers and acquirers. The following table was included in Mastercard's submission.

		2017	**2021**	**Change**	**Change (%)**
Mandatory fees (ct/€ transacted)	Issuer	[✂]	[✂]	[✂]	[✂]
	Acquirer	[✂]	[✂]	[✂]	[✂]
Optional fees (ct/€ transacted)	Issuer	[✂]	[✂]	[✂]	[✂]
	Acquirer	[✂]	[✂]	[✂]	[✂]

- The data in the table above shows that in 2017 mandatory fees accounted for c. [✂] of Mastercard's gross revenue (across both issuers and acquirers), while optional services were [✂]. By 2021, mandatory services share in revenue [✂] while optional services [✂]
- The data shows that Mastercard's gross mandatory fees as a percentage of transaction value [✂] between 2017 and 2021. As the response noted, '[✂]'.[39] Again, this is not consistent with the conclusion set out by the PSR regarding the importance of mandatory fees in Mastercard's recent fee changes.

In summary, the analysis presented in the Working Paper cannot be used to draw general conclusions, is not correctly interpreted and is inconsistent with the data and analysis previously submitted to the PSR.

[38] Mastercard (2023), 'Mastercard response to PSR Information Notice [✂].

[39] Mastercard (2023), 'Mastercard response to PSR Information Notice [✂].

4.2 Geographic scope

The Working Paper concludes that among mandatory fee changes '*those with* [✂] *impact typically do not apply uniformly across the whole of Europe*'.[40] However, the PSR does not explore [✂].

As explained in section 3, mandatory fees are generally discussed within the [✂], where [✂], particularly from the [✂], will present their views about fee changes including potential negative impacts on the business. This representation of [✂] means it is natural to find more geographic [✂] among [✂].

Section 3.3 presents specific examples of how the internal discussions shape the [✂] pricing proposals and [✂] in market conditions and competitive constraints [✂], before the proposals are submitted to the [✂].

The PSR uses the '*revision of the acquiring volume fee, specific to* [✂] as an example of market-specific mandatory fees. The PSR's assessment should be mindful of the below.

- The [✂] was the first to introduce flat acquiring volume fees, and since then the [✂] in [✂] has been to move towards a flat fee. This is where the same rate is charged independent of the total transaction volume of each acquirer. As of 2022, [✂] countries had a flat acquiring volume fee and only [✂] have a tiered fee. It is expected that [✂] will have flat fees by [✂].
- The main rationale for the 'de-tiering' of this fee was [✂]. Hence, this fee change [✂]. This rationale is clearly set out in the [✂] document,[41] and was explained in the response to the PSR's RFI on '[✂].[42] The projection when introduced was that the fee change would [✂] of acquirers, creating a [✂] in the card-acquiring market.
- Mastercard's customers in the [✂] pay the [✂] acquiring volume fee among all their customers in [✂]. In fact, the [✂] has the [✂] among countries with [✂], and has a [✂] average fee than the remaining countries with tiered fees.[43]

The acquiring volume fee also illustrates another issue with the PSR's analysis; that some of the Working Paper's conclusions are sensitive to specific data points. If the acquiring volume fee were excluded from the analysis, Figure 2 from the Working Paper would actually show that [✂], while the difference between mandatory fees for issuers and acquirers in Figure 3 would be reduced by almost [✂].

[✂]

---

[40] PSR (2023), 'Recent changes to scheme and processing fees', p. 16, para 4.15.

[41] [✂] document previously submitted as [✂], p. 2, [✂].

[42] Mastercard (2023), 'Mastercard response to PSR Information Notice [✂].

[43] This considers the [✂] acquiring volume fee that was set after the introduction of the [✂] and the fees from other [✂] countries, from [✂] in most cases. If the same analysis would be undertaken using the [✂] that was in place for [✂], the [✂] would have the lowest of all flat fees. If compared with [✂], its flat fee would be lower than the lowest fee of [✂] countries. The other [✂], have a lower fee in their higher-volume tier, but have [✂] fees.

Source: Mastercard analysis of PSR data.

4.3 Impact on issuers and acquirers

In relation to the impact of fee changes on issuers and acquirers, the Working Paper concludes that '*the increase in revenue expected from fee changes comes mainly from acquirers rather than from issuers*'.[44] As noted above, the analysis is undertaken using a small selection of fees that are not necessarily representative of Mastercard's fee changes since 2017.

Aside from this general point, the conclusion depends heavily on three fee changes. In particular:

[✂]
[✂]
[✂]

For example, if the previous fee changes would be removed from the PSR's calculations, the analysis in the Working Paper would instead show that:

- expected revenue from non-mandatory fees (opt-in, opt-out and behavioural) [✂] the expected revenue from mandatory fees;
- [✂] the expected revenue from mandatory fees charged to acquirers in respect to those charged to issuers.

This shows how some of the emerging thinking set out by the PSR depends heavily on only a few fee changes. Therefore, conclusions on any trends in fees cannot be easily extrapolated from this sample. The specific rationale and details for each of these changes were included in the response to the PSR's RFI on '[✂]'.[45] This topic was also part of the PSR's 'Competitive constraints in card payment systems call for evidence'.[46] This submission provides a more detailed explanation of how and why Mastercard competes to attract issuers and acquirers.

4.4 Rationale for fee changes

The rationale for fee changes is one of the main themes in the Working Paper and the topic of the first question set out by the PSR in section 4 of the Working Paper. Mastercard considers that the PSR's analysis does not justify the conclusions that it draws. In particular, the PSR's assessment is based on an incomplete understanding of Mastercard's rationale for fee changes. Moreover, while the PSR has not provided full details of its methodology, it appears on its face to be overly simplistic.

PSR's understanding of rationale for Mastercard fee changes is incomplete

The Working Paper distinguishes between 'revision of fees for existing services' and the 'introduction of new fees'. The PSR finds that '*mandatory fees in our selection were not associated with any specific service, but rather with participation in the scheme*'.[47] Although the Working Paper includes a brief summary of Mastercard's view

[44] PSR (2023), 'Recent changes to scheme and processing fees', p. 37.

[45] Mastercard (2023), 'Mastercard response to PSR Information Notice [✂].

[46] PSR (2023), 'Competitive constraints in card payment systems call for evidence', p.17.

[47] As it is central to inform the PSR's thinking, we focus on the general approach to the assessment of the rationale of fee changes. However, the previous statement included in the working paper is not factually correct, as the 'Safetynet enhancement' and 'Mastercard CyberSecure' are mandatory services that are associated with specific services to Mastercard customers.

('*Mastercard told us that the underlying services have undergone continued improvements'*) and a similar view from an acquirer, the PSR fails to acknowledge how Mastercard's various activities must constantly evolve for it to effectively compete in the payments industry. Some recent examples are the introduction of necessary AI security enhancements through various Mastercard services and acquisitions and adapting its services to offer seamless and secure card-not-present transactions, while at the same time reducing fraud rates.

As explained in section 3.1 of this response, Mastercard has faced considerable changes in the payments landscape over the past decade, including technological developments, new entry, regulatory developments, and evolving risks.[48] Mastercard responds to these challenges by continually developing and enhancing its activities and services to meet the needs of its various customers and users. This process leads to value creation for the whole ecosystem and therefore, at times, a reasonable recalibration of fees.

Related to the discussion around rationales in [✂] documents, Box 2 of the Working Paper lists the 'pros and cons' of different options considered for Mastercard's New Connectivity fee. However, the description omits the point set out in the [✂] that relates to fee simplicity, which is an objective commonly set out during pricing revisions. It is surprising and misleading for the Working Paper to omit mention of one of the main advantages referenced in the selected fee change, especially taking into account that fee complexity was one of the themes that was discussed in its 'Competitive constraints in card payment systems call for evidence'.[49]

The PSR's methodology appears overly simplistic

The PSR then undertakes an analysis of the contents of [✂] documents based on a subjective categorisation of fee changes according to the rationales that apply to them. This analysis concludes that '*The rationale most commonly mentioned in the documents is 'reflecting the value of the service'. In most cases, however, the documents do not include any quantitative estimate of this value. This lack of specificity is consistent with a lack of engagement with customers'*.[50]

The PSR does not describe its methodology with enough detail for it to be replicated or verified by Mastercard. We infer from the language used in the Working Paper that the frequency with which a particular rationale was mentioned among the documents submitted has been relied upon. It is not clear what framework for analysis the PSR is using in this exercise, and it also appears to be questionable that a qualitative assessment or search for key words in these kinds of documents can capture the 'rationales'. In practice, like any large organisation, Mastercard considers and weighs up many competing priorities in making commercial decisions.

The problems with this apparent approach can also be observed in the definition of the categories. For example, a fee change will generally 'reflect value' because the underlying service was enhanced to address a customer need and/or in response to competition, i.e. an attempt to ensure that the product proposition remains competitive.[51] 'Reflecting value' will therefore also capture elements of 'addressing a customer need', and 'competitive constraints'.

[48] Mastercard has also contributed with innovation that has driven the introduction and adoption of new technologies, in the payments services sector and beyond. Similarly, the Mastercard scheme has facilitated entry at different levels of the supply chain in a number of ways. For additional discussion of these topics, see Mastercard (2023), 'Mastercard's scheme activities – changes over time'.

[49] Mastercard (2023), 'Mastercard response to the PSR Call for evidence [✂].

[50] PSR (2023), 'Recent changes to scheme and processing fees', p. 37.

[51] The relation between competition and value creation is discussed in section 3.1. An example of how this misperception affects conclusions in the working paper is presented in the next subsection.

The scope of the PSR's analysis is overly narrow

In the introduction to the Working Paper, the PSR notes that its 'analysis focuses on a specific type of documents – those related to fee changes' and that it does not look at other documents in which Mastercard and Visa discuss their product offering and the wider competitive conditions in their industry. Mastercard's response to the PSR's RFI on '[✂]' describes the rationales for each of the selected fee changes—it is not clear why the PSR has decided to ignore this and decided to draw conclusions based solely on its qualitative assessment of [✂] documents.[52]

The analysis has the same shortcomings as discussed in other sections of this Working Paper, namely that it only considers the final stage of approval of the proposals. The PSR seems to acknowledge this issue at paragraph 1.8 of the Working Paper, but this is not taken into account in its preliminary conclusions or findings. Section 3 of this submission outlines the process that precedes the [✂], which should be considered in any further conclusions.

In addition to the deficiencies of the Working Paper's general approach, the exercise conducted by the PSR considers a small, non-random sample that was not designed for this purpose and is not statistically representative. Thus, the findings from this sample should not be used to draw general conclusions about the rationales underlying Mastercard's fee changes.

In summary, the PSR's approach to understanding Mastercard's fee change rationale as presented in the Working Paper seems to be unreliable, as it (i) is missing a large part of the fee change process; (ii) does not have a clear framework for analysis; (iii) is seemingly based on a keyword review of specific documents; (iv) uses a sample that does not allow any findings to be generalised.

4.5 Value

As explained in section 3.1 of this response, the creation of value for its customers through continuous innovation is how Mastercard is able to offer an attractive commercial proposition and compete in the dynamic payments landscape. The creation of value precedes fee changes and is what makes it possible to propose a fee change. It is therefore unsurprising that 'reflection of value' is commonly mentioned as a driver of fee changes during [✂] discussions. Importantly, the underlying factors that led to that increase in value were likely to be competition and addressing customer needs. Presenting these two rationales as alternatives to value creation or value reflection does not result in a meaningful analysis or robust findings.

The process described above is also reflected in the view from an acquirer presented in the Working Paper itself: '*An acquirer told us that the card schemes typically "offer services first free of charge to allow for the market to adapt. At a later point in time, the payment networks introduce pricing and require payment for those service. Therefore, the scheme-level innovations at the time of the fee introductions are less relevant as the services are already adapted, accepted, and needed in the market." The acquirer added that these innovative scheme-wide services often enhance the quality and security of payments.*'[53]

[52] Mastercard (2023), 'Mastercard response to PSR Information Notice [✂].

[53] PSR (2023), 'Recent Fee Changes', p. 39.

The above extract from the Working Paper correctly reflects a common timeline for fee changes and shows why the PSR's approach to capturing the drivers of fee changes only through [✂] documents is not useful, [✂]. However, and even though the quote in the previous paragraph is included in its 'Emerging thinking' section, the PSR fails to incorporate it into the conclusions it draws in the Working Paper about the pricing process, the rationale of fee changes and the understanding of 'value' in this context.

Aside from the general approach and its limitations for this specific purpose, the PSR points out that value is rarely estimated quantitatively in Mastercard's pricing documents.[54] As noted by the PSR, Mastercard sometimes attempts to quantify the value of its services, but estimations are not included in all fee change discussions.[55]

Precisely quantifying the value derived from improved or new services can be a complex and time-consuming task and in practice, much of the time this will not be necessary, since the qualitative assessment made through its ongoing and regular engagement with customers will provide the insight and information needed for internal discussions, effective decision-making and communication of the rationale for the change to customers and market participants.[56] The Working Paper's assertion that the 'lack of specificity on the value of services is consistent with a lack of engagement with customers'[57] is unjustified and unsupported by evidence.

In summary, the PSR correctly identifies the reflection of value as being one of the central drivers in Mastercard's pricing. However, the Working Paper does not recognise that the underlying impetus of value creation is often a response to competitive pressure; with fee changes to capture a part of that value generally being considered after changes to scheme services have been embedded and demonstrated to the ecosystem.

4.6 Competition

Mastercard has submitted substantial evidence during the current market review. For example, the Supplemental Submission on Constraints explains that constraints can only be fully grasped if evaluated as regards the system as a whole, potentially including both sides of the market and the different users through the value chain. The Competitive Landscape Report sets out how competition works in the payments industry, the different types of competitive constraints that Mastercard faces in its business and why the outcomes that we observe are consistent with competition in a two-sided market with strong network effects. Moreover, the Call for Evidence Response presents further evidence around the various topics presented by the PSR.[58]

Despite these submissions, the Working Paper assesses competitive constraints in a superficial manner, by simply reviewing the pricing documentation searching for references to competition.

As explained in sections 3.2 and 3.3, during the fee change discussions within Mastercard, competitive constraints are generally [✂], where a [✂] is involved, including [✂] that are closer to the commercial operation of the business.

As shown by the various examples referenced in section 3.3, discussions among the [✂] members consider the various competitive constraints identified by internal stakeholders, which continuously impact the pricing proposal

[54] PSR (2023), 'Recent Fee Changes', p. 22, para 4.28.
[55] PSR (2023), 'Recent Fee Changes', p. 22, para 4.31.
[56] See sections3.2, 3.3 and 4.3.
[57] PSR (2023), 'Recent changes to scheme and processing fees', p. 39, para. 5.11.
[58] Mastercard (2023), 'Response to the [✂].

that will then be [✂] for its discussion and approval. The Working Paper overlooks this and only takes into account a small part of the internal discussion: that expressed in the [✂]. Although important, these [✂] are submitted only after most of the competitive constraints have already been taken into account by those who are closest to Mastercard's customers and competitors.

Moreover, the approach from the PSR disregards the competitive process that leads to changes in Mastercard's activities, which enhance existing services or are used for the introduction of new Mastercard offerings.

Not only is the Working Paper's approach to assessing competition incomplete, it is also erroneous. For example, paragraph 4.34 states that there was only one case where documents relating to a fee change contained a reference to competition with other card schemes. This statement is incorrect, as at least three other [✂] documents have direct references to competition with other schemes ('[✂],[59] [✂][60] [✂]'[61]).

Finally, it is unclear what framework or methodology the PSR has used to conclude that '*Competition does not appear to have been an impediment to implementing material increases in mandatory fees*'.[62] This statement overlooks the fact that Mastercard enhances its service offering in response to competition (and the changing needs of customers and evolving risks), and that fees are changed to reflect the changes in activities and the value delivered.

The previous responses and reports submitted by Mastercard provide a clearer picture of the competitive process that Mastercard faces in the operation of its business. Although not the main topic discussed in this response, sections 3.1, 4.4 and 4.5 of this response set out the relationship between competition, innovation and the creation of value in the payments landscape.

4.7 Costs

The PSR addresses costs in a qualitative way in the Working Paper. Mastercard considers that the following comments can assist with the interpretation of the available information.

- The Working Paper mentions [✂] documents which include data on margins. The PSR refers to '*The targeted level of gross margin*', although the documents cited present margins as a result of [✂] and not as a [✂] while deciding the level of fees.[63]
- Other evidence that could be misleading is found in paragraph 4.42, which contrasts the additional costs and revenues associated with the 'Revised Authentication Pricing' fee change. Notwithstanding the fact that we have explained before that [✂] at Mastercard, the comparison contained in the Working Paper overlooks relevant information. For instance, the [✂] document cited by the PSR refers to [✂], whereas [✂] is mentioned.[64]

---

[59] [✂] document previously submitted as [✂].

[60] [✂] document previously submitted as [✂]'.

[61] [✂] document [✂].

[62] PSR (2023), 'Recent changes to scheme and processing fees', p. 37.

[63] Perhaps the only exception is the [✂] is used as part of the pricing decision. However, this should be interpreted as a simple way of presenting the information in the document, especially considering that different options were included, which is not consistent with a 'target'.

[64] Mastercard (2017), [✂] p.1, [✂].

- Finally, the section concludes that 'Cost considerations formed the basis for the price rebalancing for processing services in 2017'.[65] [✂].

4.8 Customer engagement

The Working Paper overlooks the constant and regular engagement between Mastercard and its customers. Although our understanding is that this will be the topic of a separate working paper, there are a number of points that are particularly relevant in the context of this response.

- Before a fee change, customer views are considered through the [✂] representatives that participate directly in the pricing discussions such as [✂] (see section 3). Although [✂], their understanding of their customers business and demand for Mastercard services allows them to feed their views into the extensive internal discussions, through the divisional representative at the [✂].
- After a fee change is published, Mastercard ensures that clear and timely information is available for its customers, who must [✂] to be able to respond to the fee change. There is a [✂] for announcements and further engagement and support through [✂].
- While the PSR does acknowledge that '*the introduction of new optional services must be based on Mastercard's understanding of customers' demand for the service and on their willingness to pay*',[66] this greatly understates the importance of Mastercard's understanding of its customers. [✂] with issuers and acquirers; [✂].[67] Even if there is no formal consultation over specific fee changes, [✂] assess the perceived value from their customers, anticipate their potential reactions and ensure these views form an important part of internal discussions.
- The understanding of customer's demand and value is not only important for [✂]. Mastercard must offer a valuable proposition to be competitive in the payments industry[68] and for this it must price all of its services accordingly.
- Finally, the Working Paper sets out that '*The lack of specificity on the value of services is consistent with a lack of engagement with customers*'.[69] However, as mentioned above, the Working Paper does not present any supporting evidence for the relationship between these two topics. In any case, both topics (value and customer engagement) are covered in this response.

In summary, the Working Paper fails to identify the importance of customers and their views in the discussion of fee changes. Further detail and examples have been provided in section 3 3 of this response.

[65] PSR (2023), 'Recent changes to scheme and processing fees', p. 28, para. 4.43.
[66] PSR (2023), 'Recent changes to scheme and processing fees', p. 28, footnote 75.
[67] The process explained in section 3.2 and examples set out in section 3.3.
[68] This is further set out in section 3.1.
[69] PSR (2023), 'Recent changes to scheme and processing fees', p. 39, para. 5.11.

All queries in relation to this response should be to [✂] – Regulatory Affairs, Mastercard, 1 Angel Lane, London EC4R 3AB – [✂]@mastercard.com – [✂]

Schwarz Group

Scheme Fees – Why there is a need for a policy intervention

Introduction

While the interchange fee regulation (IFR)[1] caps the interchange fee for consumer card payment transactions, other components of the merchant service charge such as scheme fees remain unregulated. The lack of a guiding regulatory framework give (international) card schemes a lot of power to determine the merchant service charge. Therefore, this paper aims to analyse the development of the scheme fee over the last five years while suggesting some policy options which could address the underlying problem.

Policy asks

We have compared scheme fees across different Member States over a period of five years in our analysis below. Based on our observations, we are recommending the following policy options to address the increasing arbitrariness and opacity of fees implied by any scheme and therefore not negotiable by the retailer and also not regulated by competition, including scheme fees and any other may not existing fees (followingly named as "fees by schemes"):

- Transparency requirements for card schemes towards the merchants regarding the fees by schemes to prevent an abuse of market power vis-à-vis others.
    - Through a regulatory framework which introduces a cap of scheme fees as well as other fees introduced by cards schemes. Or regulatory ground rules to level the playing field regarding negotiations between merchants and schemes.
    - Introducing an EU-wide standard for fees by schemes–across all Member States.
    - Issuers should be encouraged to follow a co-badged obligation in order to engage competition on the customer and retail side for card payment.
    - Customers should be paying the fee of card payment in order to help the market regulate itself.
- Transparency requirements for card schemes towards the merchants regarding the fees by schemes.

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0751&from=EN

Problem statement

As a merchant, we at Schwarz Group are observing the following challenges which lead to significantly higher prices for the merchants and ultimately for consumers:

- **Increase of card payments:** The advent of the corona pandemic and the suggested health measures such as choosing contactless payment increased the number of card payments drastically. In the past two years Schwarz Group observed a raise in card payments by up to [✂]. For the retail sector this results in a growing volume paid by card and therefore an increasing volume of scheme fees to be paid to card schemes.
- **Lack of transparency**: The fee, which is based on the gross transaction value of each purchase is imposed by the card schemes on the acquirer, which collects it from the merchants. As a merchant, we don't have the possibility negotiate the scheme fees. Moreover, the way scheme fees are calculated are extremely complex and are the result of more than 31 different mandatory or scenario-based fees combined which are incomprehensible for the merchants. Overall, this results into a very opaque environment (compare Figure 2). More concretely, to validate the charged fees, a TX check would be required. However, this is not only technically not possible. There is also no reporting on the part of the acquirer and no regular information about scheme fee components. Schemes do not disclose scheme fees to merchants and while at the same time there are opaque discounts on scheme fees between acquirers and schemes.
- **Lack of competition**: We observe that the scheme fee varies from Member State to Member State. Especially those Member States which have no domestic card scheme have comparatively higher scheme fees. This results from the lack of competition as well as the dependency of merchant on only a few players (compare figure 1)
- **End of Maestro**: Mastercard announced recently[2] to stop the usage Maestro in Europe. Instead, consumers will have to switch to a Debit Mastercard. This is one example which shows the dependency on Mastercard and their decisions as issuers and costumers have to adapt to their decisions.
- **Other fees**: In addition to the fees showed in Figure 2, card schemes are increasingly introducing other fees which must be taken into account when analyzing the overall costs for merchants. Therefore, any policy intervention should investigate the merchant service fee as a whole to have an accurate picture of all fees involved.
- **No negotiating powers**: The system in place doesn't allow the merchants to negotiate the fees imposed by the schemes. This results into an asymmetry of power which can be easily abused by schemes when introducing additional or increasing fees.

[2] https://www.mastercard.com/news/europe/de-de/blog/de-de/2021/warum-sich-dieser-maestro-nach-30-jahren-zur-ruhe-setzt/

Figure 1 – Dependence of Schwarz Group on Visa/Mastercard

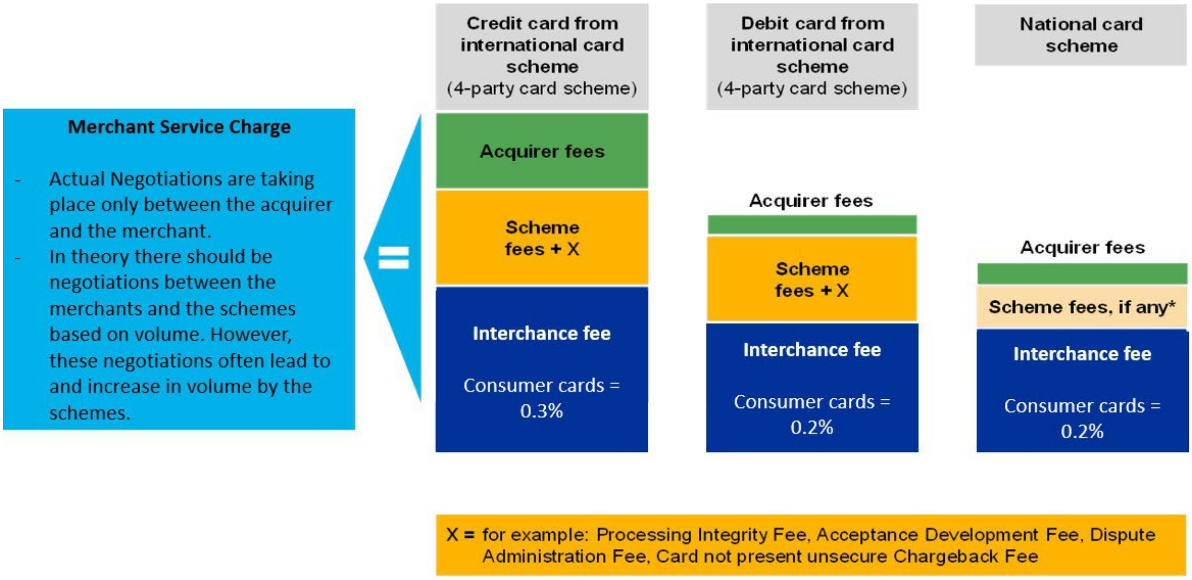
[✂]

Figure 2 – breakdown of scheme fees on the example of Mastercard Debit[3]

[✂]

[3] Compare Excel sheet 1

Figure 3 – card payments in Europe



Analysis of data

As Schwarz Group, we have analyzed the data of scheme fees in the years 2016-2021 (compare Excel file). We have compared the available data of scheme fees (in %) across all EU Member States, where we are operating our Lidl and/or Kaufland stores. We have left out those countries where data was missing. Furthermore, we have compared eleven countries (Germany, Italy, Belgium, Luxembourg, Netherlands, Ireland, Poland, Slovenia, Lithuania, Croatia, and Czech Republic). As an example of the data, we have complied Figure 4. However, our findings below relate to all card schemes and the data provided in Excel file 2.

Figure 4 - Comparison scheme fees for Mastercard

[✂]

The analysis of the data across countries over five years has underlined the following main worrying trends:

➔ **Scheme fees increase overtime**

- The comparison across countries over time has shown that that only in the case of [✂] and the [✂] the scheme fees slightly decreased in the past five years. Instead, we can observe that the trend in to increase the scheme fees. In some countries, for instance [✂], this meant that we lead to an increase of the scheme fees over time. In some countries, such as [✂], the fee almost [✂] from [✂] in 2019 to [✂] in 2020 and 2021.
- This corresponds as well to the findings of a study conducted by EY on the implementation of the interchange fee regulation, which analyses the developments of scheme fees over time. The study finds that the scheme fees increased in between 2015-2017 in a "statistically relevant manner".[4]

➔ **Scheme fees are significantly higher without national scheme**

- The average scheme fee for Mastercard ranges between [✂]-[✂]. However, in some Member States we can observe that the fees are significantly higher compared to the average. In [✂], the scheme fee is at [✂] in 2021. Even more striking in the example of [✂], where the scheme fee increased from [✂] in 2017 to [✂] in 2021. The absence of domestic schemes as we can see in [✂] leads to higher fees.
- Also, this also resembles the findings of the EY-Study stating that "*it is also important to notice that domestic schemes mostly continue to charge low and stable issuer scheme fees compared to international schemes*".

Example – ICF in the UK

With leaving the EU, the UK is no longer complying with the EU ICF. Our data collected in the UK market underlines the fact that an unregulated interchange fee leads to a massive increase of charges put on the merchants. This highlights that unregulated fees are often exploited by market participants were possible and leads to an increase in costs in comparison to other EU Member States.

[4] https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/7/527/1590485839/copenhagen-economics_march_ifr-report.pdf

About Schwarz Group

The Schwarz Group is a leading international retail group with 458,000 employees worldwide and over 12,500 stores in 33 countries. In the 2019 fiscal year, it generated 113.3 billion euros in revenues. At its core, the Schwarz Group, headquartered in Neckarsulm, Baden-Württemberg, is based on its two food retailers Lidl and Kaufland. In addition to retail business, the Schwarz Group is also engaged in business ranging from food production (Schwarz Produktion) to management of recyclables (PreZero) - and is thus able to close recycling cycles on its own.

Scottish Grocers' Federation

PSR - MR22/1.6: Recent changes to scheme and processing fees working paper – Call for views

Sent by E-mail to: cardfees@psr.org.uk
(Link to consultation page: https://www.psr.org.uk/publications/market-reviews/mr22-1-6-recent-changes-to-scheme-and-processing-fees-working- paper/)

25th July 2023

To whom it may concern,

PSR - MR22/1.6: Recent changes to scheme and processing fees working paper.
Call for views.

The Scottish Grocers' Federation (SGF) is a trade association for the Scottish Convenience store sector. There are 5,098 convenience stores in Scotland, which includes all the major symbol groups, co-ops and convenience multiples in Scotland. SGF promotes responsible community retailing and works with key stakeholders to encourage a greater understanding of the contribution convenience retailers make to Scotland's communities. In addition, Convenience stores are known to be economic multipliers and an important source of local employment, providing over 49,000 jobs in Scotland (Scottish Local Shop Report 2022 (SLSR22)).

Convenience stores trade across all locations in Scotland, providing a core grocery offer and expanding range of services in response to changing consumer demands close to where people live. According to our Local Shop Report 2022, the valued services provided by local shops include **free-to-use cash machines (49%), cashback (70%), and charged cash machines (23%).**

It is also the case that stores offer various payment methods, such as Debit Card (99%), Credit Card (98%), Contactless & Mobile payment (94%) and Card not present transactions

(48%). All stores also offer cash as a payment method, confirming that cash is still an essential aspect of trade for the convenience sector.

SGF welcomes the opportunity to respond to the review of MR22/1.6: Recent changes to scheme and processing fees working paper.

Consultation

- **Question 3: Do the fee changes considered in our analysis include the most significant changes introduced in the period 2017 to 2021? Are there other fee changes introduced during the period that you think we should have considered? If so, please demonstrate how these changes impacted you.**

While the breakdown of fee changes provided in Annex 1 is helpful to understand the process of fee changes over the period, the month-to-month fee change information available to convenience retailers is more limited. Therefore, it is not possible for SGF to assess whether the fee changes considered represent the 'most significant' changes over the period. Similarly, for the reasons above, it is difficult to assess if there have been other fee changes that ought to have been considered in the review.

SGF and many or our retailer members are concerned, however, by the apparent and significant increase in fees. Largely due to the rise in scheme and processing fees. Adding to the extremely challenging trading environment being experienced by many convenience retailers. Including issues such as the cost-of-living crisis, higher than usual energy prices, increased inflation & interest rates and an additional burden from recent government regulation.

Of the two payment processing models used by retailers, Interchange++ or Blended Pricing, SGF is not aware of either model providing the significant breakdown of information required to carry out this assessment and provide a detailed response to the question.

While the Interchange++ model provides a more detailed understanding of fee categories, including card types and categories such as international vs non-international and contactless payments vs non-contactless, the Blended Pricing Model provides consistency and regularity of fees and is often the preferred model. However, this lack of transparency can increase the

Scottish Grocers' Federation, Federation House,
222/224 Queensferry Road Edinburgh EH4 2BN
T 0131 343 3300 F 0131 343 6147 E enquiries@sgfscot.co.uk

difficulty of understanding and accounting for fee changes. In each case, the understanding of fee changes is limited.

- **Question 4: Do you have any views on our classification of fees as mandatory, optional or behavioural, as shown in Tables 1 and 4 in Annex 1? Are there fees indicated as optional in those tables that you consider cannot be avoided?**

As discussed above, the apparent lack of transparency of the impact and source of fee changes for retailers makes it difficult to assess the usefulness of classifications such as mandatory, optional, or behavioural.

SGF believes that many retailers may not be aware of their options, or the ability and value of being able to 'opt-out' of particular fees.

- **Question 5: Do you consider that the fee levels are commensurate with the value provided by those services?**

SGF does not have the information available to assess whether fee levels are commensurate with the value provided by those services. However, we note that the lack of clarity for retailers may result in excessive and unnecessary fees being applied.

SGF welcomes the opportunity to respond to this consultation and hopes the PSR will find the information provided in this response useful.

Yours sincerely,

[✂]
[✂] (Scottish Grocers Federation) [✂]
[✂]@sgfscot.co.uk
222 Queensferry Road, Edinburgh, EH4 2BN

- SGF gives permission to PSR to publish its consultation response in full (name and organisation included) and to share this response internally as required.

- SGF is also content to be contacted again in the future, in relation to this consultation exercise.

Startup Coalition

STARTUP
C*ALITION

www.startupcoalition.io

STARTUP COALITION RESPONSE

MR22/1.6 Market review into card scheme and processing fees

About the Startup Coalition:

The Startup Coalition (formerly Coadec) is the policy voice of tech startups and scaleups in the UK. Since 2010, Coadec has worked to engage on behalf of tech startups in public policy debates in the UK across a range of priority issues for startups including access to finance, immigration and skills, and technology regulation.

Coadec is part of the Axe the Card Tax campaign, a coalition of trade bodies representing 240,000 businesses across the UK campaigning for measures to support payments innovation.[1] The coalition is calling for actions to promote competition in the payments sector, to reduce the costs of accepting payments, and to ensure there is a level playing field that enables the UK's burgeoning Fintech sector to compete with incumbents.

Question 1: Do you agree with the way we describe the different rationales for the fee changes in our selection?

We mostly agree with the different rationales for the fee changes and the selection of fee changes chosen by the PSR. It is important to note that the fees selected by the PSR will not necessarily provide the full picture of scheme and processing fee rises we have seen, due to the fact that some fee increases have not been included in the selection for either Visa or Mastercard, and because we believe that fees had already begun to increase since 2014.

We broadly agree with the description of the different rationales for the fee changes for both Visa and Mastercard.

Question 2: Do you agree with our description of the degree to which competition influenced the decisions to introduce these fee changes?

It is difficult to know whether we agree with the PSR's view on how competition influenced the decisions to introduce fee changes because a significant amount of the analysis offered within the paper has been redacted.

Visa's narrative response to mandatory fees charged on acquirers is key in understanding the lack of impact of competition within the market. Whilst Visa claims that *"many merchants can and will opt for alternative payment methods if they prefer the alternatives compared with card transactions",* it is clear that in practice this has not had a significant impact on Visa's ability to make substantial increases to mandatory fees.

This is partially due to the lack of viable alternatives currently. Whilst Visa themselves have noted that the Visa 'Everyday Spend' program was intended to ensure that cards are priced competitively versus other forms of payment (e.g. Open Banking), this does not mean that competition is adequate to stop future fee rises.

It's vital that the role of Interchange fees is considered in how Scheme and Processing fees have increased significantly and the role it has played in reducing competition within the payments landscape. Interchange fees play a significant role in entrenching the status quo of Visa and Mastercard dominance and provide significant incentives for issuing banks to quash potential alternatives. We discuss this further in the report produced for the 'Axe the Card Tax' campaign, of which we are part.[1]

In fact, we believe that competitive pressure from Open Banking and other forms of account to account payments could lead Visa and Mastercard to increase scheme and processing fees to compensate the banks and incentivise the continued entrenchment of card payments. This would circumvent the IFR cap. The ACT campaign believes there could be evidence to suggest that scheme and processing fees may be being used in this way, and support the ongoing PSR investigation to examine if this is the case.

Given Visa and Mastercard want to win more business and have more transactions running through their networks, they can raise scheme and processing fees paid by acquirers and merchants, offsetting fees paid by issuers to the schemes. These incentives, which come in many forms, could be seen as an indirect form of interchange fees. They help explain the continuous increases we have seen in scheme and processing fees despite the IFR attempting to prevent this type of circumvention.

Companies demonstrating large network effects and global scale economies will almost certainly not operate in competitive markets. This itself is the prime reason for economic regulation of such industries, as well also new regulation of digital markets, including the UK Digital Markets Unit (DMU) and EU Digital Markets Act (DMA), Such regulation is in recognition of the substantial network effects, global scale economies, and associated absence of competitive constraints and high profitability in such sectors.

Importantly, there are no meaningful competitive alternatives to Mastercard and Visa for the very large majority of merchants. Even where other payment methods exist, such as Amex, buy-now-pay-later (BNPL), or Open Banking/account-to-account payment methods, such payments are additional to Mastercard and Visa, not alternative, or even intermediary, with the end payment still relying on Visa and Mastercard. Namely, it is never an option for merchants to offer such payment methods instead of Mastercard and Visa, and many of these alternative credit based payment methods (e.g. BNPL) require card payments to eventually settle.

Question 3: Do the fee changes considered in our analysis include the most significant changes introduced in the period 2017 to 2021? Are there other fee

[1] https://coadec.com/wp-content/uploads/2023/04/Axe-the-Card-Tax-Report-FOR-RELEASE.pdf

changes introduced during the period that you think we should have considered? If so, please demonstrate how these changes impacted you.

For the most part we agree that these fee changes are the most significant changes. As stated in the previous question we think it is important to at least consider some of the alternative fees that have increased, such as cross-border, since these fees are closely linked and both have had significant effects on merchants. While we understand the reason the PSR has separated these two into separate consultations it is important that we recognise the nature of the interconnected fees. Often rising scheme and processing fees are utilised to subsidise interchange fees and act as a circumvention of the IFR.

Question 4: Do you have any views on our classification of fees as mandatory, optional or behavioural, as shown in Tables 1 and 4 in Annex 1? Are there fees indicated as optional in those tables that you consider cannot be avoided?

For many merchants a significant number of the fees are considered mandatory. The Terms of Reference of the PSR's MR22/1.1 market review of card scheme and processing fees outlined that certain factors for fee increases; including "high barriers to entry and network effects" and "limited payment acceptance alternatives for merchants and the "must take" status of Mastercard and Visa" as prospective reasons behind the scheme and processing fee rises. The impact of the must-take status of Visa and Mastercard means that whilst some fees are largely 'optional' many businesses do not have the capacity to challenge non-mandatory fees.

This is further made prevalent by the obfuscated nature of the fees. In particular, the scheme and processing fee are not transparent, and such lack of price transparency is itself a clear symptom of competition not working. Merchants have poor visibility of the specificity of scheme and processing fees, itself causing a reduction in competitive pressure (i.e. by making it difficult for merchants to compare between acquirers); and the complexity of scheme and processing fee structures can similarly make it difficult for acquirers to anticipate their own costs and set their own margins.

Even within the fee change description, provided by the PSR in Table 3 and Table 6, many businesses will have a significantly difficult time mapping these fee changes to the changes in fees they have seen themselves. That is not to say that these fee increases are not the most significant, or that they aren't mappable to a businesses individual fee increases, but that the fees charged by Visa and Mastercard are purposefully built to lack transparency.

Both the must-take status of Visa and Mastercard and the lack of transparency around fees create an effectively 'mandatory' status for a significant number of fees. Many non-mandatory fees, especially those considered 'opt-out' require a disproportionate amount of work from merchants and retailers. For small and medium sized businesses the work required to understand the fees charged by Visa and Mastercard, to understand which fees are increasing, and to understand the fees that they are able to opt-out of requires an insurmountable amount of work and so these fees effectively act as mandatory.

We have heard colloquially through our ecosystem that some fees which have been classified as optional are in reality mandatory. Whilst PSD2 offered some exemptions to fees it has been suggested to us that some of the card schemes have effectively punished those who were exempted out of certain fees. Whilst we do not have the specific data to be able to prove these claims it highlights a worrying potential. The PSR should investigate the nature of claims such as this one, if the card schemes are able to effectively bully retailers and merchants with higher fees it suggests a significant market failure and lack of competition.

Question 5: Do you consider that the fee levels are commensurate with the value provided by those services?

We believe that the fee levels are in no way commensurate with an additional value provided by the services.

In a market that is functioning correctly then any price that a customer willingly pays can be said to be “reflective of the value” of the goods or services that the customer is paying for. However if prices are set in a market constrained by a lack of competition, especially in a market where that good or service has a ‘must-take’ status then the fee increases are irrelevant to the value of the service provided.

Until the payments market is sufficiently competitive the fee increases will never be commensurate with the value provided by Visa and Mastercard. From a competitive perspective, it is the job of regulators and the Government to monitor the payments market to ensure two conditions exist:

- It is critical that the payments market is structured in a way that promotes technological innovation and competition to drive value for both retailers and consumers
- Where one technology prevails, even temporarily, competition in the sector must be guaranteed to drive value.

Even if, in the best case scenario, the fee increases were directly mappable to a significant value increase, it is impossible in a non-competitive market for merchants and retailers to ever accrue the value provided since potential payment alternatives are currently only additional to Visa and Mastercard instead of being directly competitive.

Tesco

TESCO RESPONSE

Working paper Market review into card scheme and processing fees Recent changes to scheme and processing fees June 2023.

Questions

1.4 The analysis developed in this working paper is based on Mastercard and Visa's documents. Mastercard and Visa are therefore best placed to comment on our current interpretation of the documents and information they provided. We welcome any comments from both companies on the contents of this working paper, and in particular on the following questions:

Question 1: Do you agree with the way we describe the different rationales for the fee changes in our selection?

Yes.

Question 2: Do you agree with our description of the degree to which competition influenced the decisions to introduce these fee changes?

Yes, to the extent that the term 'competition' is used ambiguously with no quantifiable evidence to support it.

1.5 We also invite comments from other stakeholders. You are welcome to provide whatever comments you see fit, but it will be most helpful if you can focus in particular on the following questions:

Question 3: Do the fee changes considered in our analysis include the most significant changes introduced in the period 2017 to 2021? Are there other fee changes introduced during the period that you think we should have considered? If so, please demonstrate how these changes impacted you.

The requirements asked for in this question are the type of detail and information that is not transparent to Tesco as a merchant. To keep up with these changes and provide all the detail needed we would need a much bigger team assessing and tracking the information which in part is what we pay our acquirer to do for us.

Question 4: Do you have any views on our classification of fees as mandatory, optional or behavioural, as shown in Tables 1 and 4 in Annex 1? Are there fees indicated as optional in those tables that you consider cannot be avoided?

In practice, some fee changes presented as optional are not always avoidable. For example, the Mastercard '3DS1-only' 'opt in' fee, is mandatory for merchants which have not yet moved to 3DS2.

Optional fees are also set as opt out, as opposed to opt in. This can often be a contributing factor to increased bills, which are not provided with clear reasoning for additional charges.

Question 5: Do you consider that the fee levels are commensurate with the value provided by those services?

Accepting debit and credit cards issued using Visa and Mastercard is essential to UK retailers, they dominate the market as 2 parallel monopolies rarely competing against each other for end customers (who essentially choose an issuing bank rather than a card scheme) and are free to exploit this.

Neither scheme consult, which we feel would be beneficial as we deal with the end customers daily, or publish these fees or fee increases directly to the merchants. As a merchant we have never received quantifiable evidence to explain the value of any fee changes.

We understand that occasional changes to card scheme fees will be required to maintain security features and upgrade systems. However, currently fee increases are regular, not clearly communicated, and often do not appear to result in improved products or services.

Teya

PSR’s scheme and processing fees review

Response to MR22/1.6.: Recent changes to scheme and processing fees

11 August 2023

Table of Contents

About Teya

Teya is bringing a one-stop solution to European businesses. Formerly known as SaltPay, Teya combines payment acceptance and business management tools in one ecosystem - including electronic-point-of-sale, merchant account services, a digital loyalty platform, and other software-as-a-service solutions. Teya is headquartered in London, has offices in 15 countries across EMEA, and has 300,000 merchants using its products globally.

Teya exists to ensure that every small, medium, and growing business in Europe has the opportunity to thrive. Our payments and business management technology is designed to help the people running businesses to take hassle-free payments, manage their business, and find and reward their customers - all on fair terms. We want to free business owners from the everyday complexities and headaches that stop them from being successful. With our commitment to care and innovation, they can feel confident in making the most of every opportunity and experience the joy of running a business.

1. Introduction

Teya welcomes the opportunity to respond to the PSR's paper on the recent changes to scheme and processing fees. This latest paper [✂] depiction of the multiple new fees that the [✂] schemes have introduced. In particular, [✂] failure to provide an adequate rationale behind the changes and the insufficient engagement with customers [✂].

The multiplicity of papers and evidence submitted for this investigation, coupled with the previous analysis conducted by the PSR in its Card-Acquiring Market Review, have formed a [✂] diagnosis of [✂].

This response focuses on [✂]. Their overarching goal is to enable the PSR to fulfil its role as the economic regulator for payments by [✂]. As outlined throughout this response, [✂], and in fact they follow the original intention behind the creation of the PSR as well as the actions being taken by other Payment Systems regulators around the world.

Firstly, Teya believes [✂] are crucial to [✂], despite the economies of scale the mature UK card market ought to bring. [✂].

Secondly, the [✂]**.** Article 5 of the Interchange Fee Regulation was designed to prevent circumvention on the 0.2% and 0.3% caps on consumer debit and credit interchange respectively, [✂].The PSR, as the competent authority for the Interchange Fee Regulation, [✂].

Thirdly, Teya submits that [✂]. By doing so, the PSR will [✂].

Fourthly, a [✂].

2. [✂]

The PSR has noted in both of its working papers, on Competitive Constraints (MR22/1.4.) and on Recent Changes to Scheme and Processing Fees (MR22/1.6.), the lack of transparency of scheme and processing fees as an obstacle to competition among acquirers. [✂].

Teya believes that [✂]. This is due to [✂].

[✂].

[✂].

Possible [✂] are discussed below. [✂], this response also considers the objectives, functions, powers, and limitations placed on the PSR by the Financial Services (Banking Reform) Act 2013 (FSBRA 2013).

2.1. [✂]

The lack of transparency around scheme fees, [✂] obscuring the level of fees that they charge for their services. [✂], it reduces competition downstream in the acquiring market by making it difficult for acquirers to understand their true cost of card payments, thereby making it difficult for new entrants to challenge incumbents who often have large teams dedicated to deciphering scheme and processing costs.

[✂] Visa and Mastercard [✂] publish multilateral interchange fees on their websites for public access at present. [✂] both Visa and Mastercard publicly disclose the default or multilateral interchange fees (MIFs) that acquirers must pay issuers on every transaction. As such, it is worth comparing the rationales behind the publication of MIFs with the possible case for mandating schemes to [✂].

MIFs are set by the card schemes as a fallback fee that by default applies for all transactions routed through their network. In other words, it forms a part of the scheme rulebooks maintained by Visa and Mastercard, to which acquirers and issuers agree to in full when joining the schemes as members. Beyond this, acquirers and issuers are allowed to negotiate their own bilateral interchange fees. However, this is often not a realistic option, as noted by Phillips J in his Hight Court judgment of *Sainsbury's Supermarkets Ltd v Visa Europe Services LLC [2017]:*

> *""Although a MIF is, in theory, only a default provision applying in the absence of agreement, it was common ground that no bilateral agreements as to Interchange Fees are in fact made in the UK market…neither [the acquirer nor the issuer] has a reason to depart from that position and certainly no incentive to incur the significant costs of entering negotiations with multiple counterparties…"*

Accordingly, MIFs serve effectively as mandatory fees that the card schemes charge acquirers, which is then collected by issuers. While both Visa and Mastercard have been publishing this key component of the merchant service charge (MSC) publicly on their websites, this was not always the case. In fact, the European Commission, in its impact assessment study accompanying the 2015 Interchange Fee Regulation (IFR), considered that the lack of publication of the different interchange fees associated with different types of cards (e.g., debit/credit, consumer/commercial, standard/premium), served as an obstacle to competition.[1] This is because, as the Commission noted, merchants had to accept cards "*without information on the real cost of accepting a particular card category*".[2]

In fact, Visa and Mastercard did not publicly disclose the MIFs that they set for different types of transactions in the EEA until 2009, when Visa and Mastercard agreed to a series of commitments and undertakings to change their business practices in light of the European Commission's 2007 'Prohibition' decision.[3] As summarised by the Commission as part of its IFR Impact Assessment, this decision "*states that the [schemes'] MIF restricts price competition between acquiring banks by artificially inflating the basis on which these banks set their charges to merchants and effectively determining a floor under the merchant service charge below which merchants are unable to negotiate a price".*[4] Following unsuccessful appeals by the schemes to the General Court and the European Court of Justice, Mastercard provided a list of Undertakings to the Commission in 2009, and Visa a list of Commitments the following year. As part of the same, both international card schemes changed their business rules to ensure publication of all MIF rates on public forums (mostly their websites).

Therefore, the primary goal behind getting the schemes to publish their MIFs was to increase transparency for merchants (i.e., one set of end-users in the four-corner card model). [✂].

Firstly, similar to the issue cited by the Commission above, that led Visa and Mastercard to publish their MIFs publicly, [✂]. The level of scheme fees varies drastically based on the type of transaction (inter-regional, intra-regional, international, etc.). In addition, there are also instances where the schemes charge scheme and processing fee lines based on the type of card used in the transaction (e.g., Mastercard Netherlands Intracountry Debit E-Commerce Fee Acquiring fee). [✂].

Figure 1 - [✂]

[✂]

[✂]

[✂] following the rise of payment facilitators, has meant that small merchants often prefer blended pricing in order to forego the resource strain of having to deal with scheme and processing fees themselves. [✂].

[✂].

[1] https://eur-lex.europa.eu/resource.html?uri=cellar:906ed6d3-f509-11e2-a22e-01aa75ed71a1.0001.04/DOC_2&format=PDF, pgs 105-108.
[2] Ibid., pg 99.
[3] Case COMP/34.579, *MasterCard*, Commission Decision of 19 December 2007. <http://ec.europa.eu/competition/antitrust/cases/dec_docs/34579/34579_1889_2.pdf>.
[4] https://eur-lex.europa.eu/resource.html?uri=cellar:906ed6d3-f509-11e2-a22e-01aa75ed71a1.0001.04/DOC_2&format=PDF, page 105.

The European Commission discussed the topic of blending in its IFR Impact Assessment prior to the 2015 Regulation. It identified that blended pricing from acquirers, where merchants are charged a single per transaction fee irrespective of the situation, prevented merchants from optimising their costs as they could be over- or under-charged in different scenarios considering the divergences in the interchange fees charged by card networks based on transaction and card type: *"Many retailers are therefore not aware of the differences in the costs for the various payment instruments".*[5] However, in this argument, scheme and processing fees were not considered, which as highlighted above form a much larger proportion of the MSC than they did prior to the IFR in 2015. Furthermore, as noted in the PSR's card-acquiring market review, the rise of payment facilitators serving small businesses has been a key trend in the payments market in recent years, meaning that the Commission's assumption that blended pricing is inherently more harmful for merchants is no longer of much relevance.

Indeed, the Reserve Bank of Australia, in considering transparency around Visa and Mastercard scheme fees, considered that *"the lack of transparency of scheme fees [makes] it impossible for merchants to compare fees under different pricing plans."*[6] Rather, when armed with publicly available scheme fee information, merchants can decide whether to take on the complexity of scheme and processing fee arrangements under IC++ or prefer simplicity under a blended arrangement based on their card mix tending to generally be less expensive. [✂].

Hence, in terms of comparing the rationale behind public disclosure requirements for scheme fees ad interchange fees, [✂]. Nevertheless, there may be certain practical considerations that suggest that [✂].

[✂].

[✂]. As noted by Tirole et al in a 2003 report published for the European Commission (DG COMP): *"The harder it is to obtain data on prices and quantities, the harder it may be for the firms to work out…what would constitute a monopoly price."*[7]

[✂]. In line with this, Tirole et al note: *"if the technology in the industry is fairly standard and the goods produced fairly homogeneous, the monopoly price may be fairly easy to work out even if there is no transparency about individual production levels."*[8]

[✂]. As the PSR has determined [✂], billing lines received from schemes can include several hundred separate events, finding details on each of which can require several employee hours to sift through. For SMEs, who should be the primary beneficiaries of transparency remedies given that they suffer the largest degree of harm as a result of current practices around scheme and processing fees, in line with the PSR's service-user objective (section 52 FSBRA 2013 – see below for more details), [✂]. The Reserve Bank of

---

[5] https://eur-lex.europa.eu/resource.html?uri=cellar:906ed6d3-f509-11e2-a22e-01aa75ed71a1.0001.04/DOC_2&format=PDF, pg 242.
[6] https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/conclusions-paper-202110/scheme-fees.html.
[7] Jean Tirole et al, *The Economics of Tacit Collusion*, pp 26.
[8] Ibid.

Australia (RBA) considered a public disclosure remedy in its own investigation around scheme and processing fee investigations in 2021, and had a similar conclusion to Teya on this issue:

> *"Requiring card schemes to publish all of their multilateral scheme fees and fee-related rules would be a low-cost way of increasing the transparency of these fees. However, the usefulness to [merchants] of detailed scheme fee schedules is questionable, given their complexity. If schemes were to publish their entire fee schedules, it is likely that even payment specialists – let alone non-specialists such as smaller merchants – would find it difficult to understand and effectively make use of that information."* [9]

Though this conclusion is made in the context of the Australian payments market, the PSR noted evidence of similar opacity from Visa and Mastercard in the UK market in MR22/1.4.: "*stakeholders argued that the complexity of fees translates into higher operational costs, diverting issuers' and acquirers' resources from more productive uses and ultimately increasing the overall cost of doing business with card scheme operators."*[10]

Lastly, one of the most pertinent issues with regards to transparency that [✂]. The Reserve Bank of Australia noted a similar issue: *"If schemes were to publish their entire fee schedules…the schedules would not capture rebates, which are needed to fully quantify the net flows from issuers and acquirers to card schemes."*[11]

As the PSR's MR22/1.4. noted, certain stakeholders have argued that: *"the higher degree of competition on the issuing side (that is, for cardholders) creates powerful incentives for the card schemes to organise financial flows from the acquiring side to the issuing side."* [✂]:

i. [✂] Article 5 IFR [✂].

ii. [✂] the contractual chain of responsibility between issuers and acquirers in Visa and Mastercard's multilateral scheme arrangement is structured as followed: the schemes are owed a bulk settlement amount from issuers, which they then owe to acquirers.

    Yet, the structure of the four-corner card market (in particular the '*must-take'* nature of Visa and Mastercard in the UK),[12] as noted by the PSR extensively in MR22/1.4. and in the introduction to this response, [✂].

    In its 2007 decision against Mastercard, the European Commission noted the existence of such an asymmetry: *"MasterCard derives [the imbalance between the issuing and the acquiring business in*

[9] https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/conclusions-paper-202110/scheme-fees.html.
[10] PSR, *MR22/1.4.*, para 3.30.
[11] https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/conclusions-paper-202110/scheme-fees.html.
[12] *Sainsbury's Supermarkets Ltd v Visa and Mastercard* [2020] (UK Supreme Court), para 132.

> *the scheme] from the fact that the average issuer would "incur the vast majority of the Scheme costs" because in the United Kingdom market 95% of the costs are skewed towards the issuing side."*[13]

Therefore, Teya recommends [✂].

2.2 [✂]

[✂], there are four main obstacles that make mandating their public disclosure (parity with the schemes' practices around MIFs) undesirable:

- The risk that the potential commercial sensitivity for the dominant international schemes of disclosing individual fees distracts from the goal of transparency remedies.
- The increased risk of tacit collusion brought about by Visa and Mastercard's ability to view each other's individual fees in a market characterised by competitors (payment schemes) providing homogeneous services.
- The inability for SMEs, as the intended primary beneficiaries under the PSR's FSBRA 2013 objectives of transparency remedies, to benefit from publicly available individual scheme and processing fees due to the former's lack of resources and the latter's opacity.
- The unlikelihood that a public disclosure mandate will help identify a net financial flow of funds through scheme and processing fees from the acquiring to the issuing side (i.e., a circumvention of Article 5 IFR).

In this section, [✂]. The Reserve Bank of Australia, in its own investigations in 2021 into Visa and Mastercard scheme and processing fees, opted for the following approach:

> *"Schemes will be required to share all scheme fees and scheme rules with the [regulator], as well as quarterly aggregate data on the value of scheme fees charged and rebates provided to…scheme participants."*[14]

Under the RBA's remedy, the schemes would have to disclose the following data to the payments regulator:

a. All multilateral scheme and processing fees and rules relating to scheme and processing fees that apply to scheme participants. The schemes would also have to promptly notify the regulator of any changes made to these.

[13] Case COMP/34.579, *MasterCard*, Commission Decision of 19 December 2007. <http://ec.europa.eu/competition/antitrust/cases/dec_docs/34579/34579_1889_2.pdf>, para 684.
[14] https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/conclusions-paper-202110/scheme-fees.html.

b. Quarterly data on the aggregate value of the scheme fees charged and rebates provided to scheme participants, with the data split into categories based on various characteristics such as: issuing and acquiring fees, debit and credit transaction fees, and domestic and international transaction fees.

c. List of the top 20 fees by value and share of total scheme and processing fee revenue that each of these fees account for.

d. In addition, larger scheme participants will also be required to report annually to the regulator the total scheme and processing fees paid to, and rebates received from, each card scheme that they participate in.[15]

[✂], the RBA would have the schemes disclose raw data and business rules to the regulator, who would then be able to publish some of the aggregate data provided to the public. This would then help merchants, particularly SMEs, compare the average levels and growth rates of scheme and processing fees across card schemes, card types, and transaction types. [✂]. As an example of the usefulness of the regulator publishing such data, consider the RBA's recent aggregate publications, which highlight the stark different in the treatment by Visa and Mastercard of acquirers and issuers.

Figure 2 – Basis points of value of card transactions in Australia, 2021/22

[15] Teya would recommend here that only non-issuing acquirers are taken into account here, as traditional bank acquirers often leverage their large issuing portfolios to get better deals on acquiring fees from the schemes.

	Gross fees	Rebates	Net fees
Domestic card transactions			
Debit cards			
– Issuers	15	13	2
– Acquirers	10	1	9
Credit cards			
– Issuers	16	12	4
– Acquirers	13	2	11
International card transactions in Australia			
All cards	165	8	157

(a) Includes scheme fees paid to eftpos, Mastercard and Visa.

Source: Reserve Bank of Australia[16]

[✂] the RBA's 2021 scheme and processing fee investigation, [✂]. In that investigation, Visa and Mastercard argued that the publication of aggregate scheme and processing fee data would still be commercially sensitive, as other schemes could estimate the levels of individual prices and the schemes' pricing strategy, and scheme participants could estimate the level of rebates and incentive payments received by their competitors. [✂].

[✂]. The RBA found [✂] in its 2021 investigation: *"Given the complexity of scheme fee arrangements, users of the payment system would find it difficult – if not impossible – to pinpoint specific price points from the aggregate data that may be published…Overall, the [RBA] expects that the increase in competitive tension generated by publishing aggregate scheme fees would outweigh any adverse consequences".*[17]

Secondly, on the issue of a lack of transparency around acquirer margins, this is an increasingly improving situation in the UK card market, due to the remedies brought about as part of the PSR's card-acquiring market review. In particular, the mandate for the 14 largest UK acquirers to provide their merchants with summary boxes,[18] aims to provide merchants with added transparency on their merchant service charge, which comprises MIFs, scheme and processing fees, as well as the acquirer margin. As a welcomed market development, the rollout of summary boxes since 6 July 2023 has led to the emergence of direct comparison tools which use summary box information to shed further public light on the margins taken by different acquirers in the UK.[19] This, of course, is on top of existing transparency requirements on acquirers under the IFR Article 9 and 12.

[16] https://www.rba.gov.au/speeches/2023/sp-so-2023-03-28.html.
[17] https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/conclusions-paper-202110/scheme-fees.html.
[18] https://www.psr.org.uk/media/t1il1jh2/specific-direction-14-summary-boxes-online-calculators-oct-2022-final.pdf.
[19] See for instance Statement (now Tuza) and

Moreover, in its card-acquiring market review final report, the PSR noted that rises in scheme and processing fees could be a key issue that restrict competition in the card market, which led to the regulator rightly commencing a dedicated investigation into such fees.[20] [✂].

[✂], the PSR's Annual plan and budget 2023/24 states that one of the key changes made this year by the regulator is *"bringing our compliance monitoring and supervision functions together with our enforcement team…This will give us a robust and effective way of ensuring that the various rules we oversee are effective."*[21] [✂].

As will be elaborated further under [✂] critical in allowing for compliance monitoring, supervision, and enforcement of the PCIFRs. As such, any initial [✂]. This fits in well with the PSR's other main objective in the next five years and its JROC workstream to promote the uptake of account-to-account payments at retail as a competitor to cards.

Therefore, [✂].

2.3. [✂]

The analysis in part 2.1. above shows that the public disclosure of scheme and processing fee schedules, as well as the rulebooks around them, would have negative consequences. Accordingly, [✂].

[✂].

Hence, [✂]:

a. [✂].

b. [✂].

c. [✂].

d. [✂].[22]

e. [✂].

[✂].

[20] https://www.psr.org.uk/media/p1tlg0iw/psr-card-acquiring-market-review-final-report-november-2021.pdf.
[21] https://www.psr.org.uk/publications/annual-plans-and-reports/payment-systems-regulator-annual-plan-and-budget-2023-24/, pp 19.
[22] Presently, schemes sell services such as 'how to understand our billings', which ought to be included in participant manuals as basic information, for a large premium.

[✂].

2.4. Relevant FSBRA 2013 powers

Based on the discussion at the start of Part 2 of this response, [✂] PSR's investigations into the scheme and processing fees set by Visa and Mastercard as a means for the regulator to further its service-user and competition objectives. In light of the same, this section explores the PSR's objectives and powers to implement the transparency remedies proposed.

2.4.1 Objectives

As section 50(2) of the FSBRA 2013 clearly states, it is the explicit objective of the PSR to promote competition between payment system operators ('PSOs') and infrastructure providers, a mandate which includes scrutinising Visa and Mastercard's conduct both as scheme and processing entities in payment systems designated by the Bank of England under section 43 FSBRA 2013 (recognised payment system operators – 'RPSOs').

[✂], the PSR's competition include both:

(a) Intra-system competition: *"to promote effective competition in…the market for payment systems, and…the markets for services provided by payment systems, in the interests of those who use, or are likely to use, services provided by payment systems"* (section 50(1) FSBRA 2013).

The [✂]. As such they are clearly compatible with the PSR's objective to promote competition within card payment systems.

(b) Inter-system competition: *"to [promote] effective competition includes, in particular, promoting effective competition…between different operators of payment systems, between different payment service providers, and between different infrastructure providers."* (section 50(2) FSBRA 2013).

As both Visa and Mastercard are designated as payment systems in their own right, improving competition between them would be a legitimate objective for the PSR under section 50(2). By providing [✂], the PSR would improve competition between the schemes.

[✂].

Therefore, [✂] in line with the new rules in the Financial Services and Markets Act 2023 on the accountability of the PSR (Schedule 7, paragraph 102A), where HMT may *"make recommendations to the Regulator about aspects of economic policy…to which the Regulator should have regard when considering…how to advance one or more of its payment systems objectives".* HM Treasury has reaffirmed its commitment, via its work on JROC as well as with the launch of the Future of Payments Review 2023, to achieving a retail payments landscape where a wide array of payment options is available for consumers and SMEs, and that they are empowered with the knowledge required to decide which payment method works best for them in any given scenario. For the reasons listed above, Teya believes that the [✂] align with the HM Government's vision for retail payments.

2.4.2 FSBRA powers

Section 53 FSBRA 2013 explicitly acknowledges the power for the PSR to enforce transparency remedies:

> *The regulatory principles…are as follows…the desirability in appropriate cases of the Payment Systems Regulator publishing information relating to persons on whom requirements are imposed by or under [the PSR's FSBRA powers], or requiring such persons to publish information, as a means of contributing to the advancement by the Payment Systems Regulator of its payment system objectives".*

Further, section 54 FSBRA 2013 gives the PSR the power to issue specific directions to all participants of RPSOs, in particular Visa and Mastercard in their role as scheme operators and infrastructure providers within designated card payment systems.

Section 55 FSBRA 2013 provides the PSR with strong powers in relation to payment system rules imposed by scheme operators:

> *"(1) The Payment Systems Regulator may require the operator of a regulated payments system–*
>
> > *(a) to establish rules for the operation of the system;*
> >
> > *(b) to change the rules in a specified way or so as to achieve a specified purpose;*
> >
> > *(c) to notify the Payment Systems Regulator of any proposed change to the rules;*
> >
> > *(d) not to change the rules without the approval of the Payment Systems Regulator.*
>
> *(2) A requirement under subsection (1)(c) or (d) may be general or specific."*

[✂]:

- [✂].
- [✂]. Given the flexibility afforded to the PSR under section 55(2) FSBRA 2013, the PSR [✂].

The [✂] would be covered under section 81 FSBRA 2013:

> *"(1) The Payment Systems Regulator may by notice in writing require a person to provide information or documents…*
>
> > *(b) which the Payment Systems Regulator otherwise requires in connection with its functions under this Part.*

(2) In particular, a notice under subsection (1) may require a participant in a regulated payment system to notify the Payment Systems Regulator if events of a specified kind occur.

(3) A notice under subsection (1) may require information or documents to be provided—

(a) in a specified form or manner;

(b) at a specified time;

(c) in respect of a specified period."

[✂].

[✂] the PSR has powers to [✂], and the power to [✂].

2.4.3 Compatibility with confidentiality protections

[✂] the PSR's objectives, functions, and powers, as listed in Part 5 FSBRA 2013, the question remains around the PSR's ability to [✂]. This is in light of the confidentiality provisions contained in section 91 FSBRA 2013:

"(1) Confidential information must not be disclosed by [the PSR], or by any person obtaining the information directly or indirectly from a primary recipient, without the consent of—

(a) the person from whom [the PSR] obtained the information; and

(b) if different, the person to whom it relates.

(2) In this section "confidential information" means information which—

(a) relates to the business or other affairs of any person;

(b) was received by [the PSR] for the purposes of, or in the discharge of, any functions of the Payment Systems Regulator under [Part 5 FSBRA 2013]; and

(c) is not prevented from being confidential information by subsection (4)"

On the face of it, section 91 provides strong protections for the schemes and large scheme participants against the disclosure of even aggregate fee information. However, it is worth noting that section 91(4) provides certain exclusions for the publication by the PSR of potentially confidential information:

"(4) Information is not confidential information if—

(a) it has been made available to the public by virtue of being disclosed in any circumstances in which, or for any purposes for which, disclosure is not precluded by this section, or

(b) *it is in the form a summary or collection of information that is framed in such a way that it is not possible to ascertain from it information relating to any particular person."*

[✂] it was proportional, given the potential benefits to competition and service-user outcomes that [✂] would bring, for the PSR from time-to-time to [✂].

[✂], in line with section 91(4)(a), [✂].

[✂], it might be difficult for the PSR to highlight the differential fees charged by the schemes. However, the [✂]: transaction type; card type; optional, mandatory, or behavioural; etc.

2.5. [✂] Conclusion

In summary, [✂], as they would be compatible with its objectives, functions, powers, and limitations under the FSBRA 2013. This involves the implementation of both Option 2 (part 2.2.) and Option 3 (part 2.3.) above.

2.5.1 [✂]

[✂]:

a. [✂].

b. [✂].

c. [✂].

d. [✂].

[✂].

2.5.2 Improving [✂]

[✂]:

(a) [✂].

(b) [✂].

(c) [✂].

(d) [✂].

(e) [✂].

[✂] with the PSR's Supervision and Compliance Monitoring Division.

3. [✂]

[✂].

MIFs are regulated given the incentive schemes have to increase interchange fees in order to win issuing businesses and given the must-take nature of cards, which leads to the reverse competition effect of increase MIFs as schemes naturally compete. The same effect, known as the competitive bottleneck, applies to scheme fees as well. [✂]. This is explicitly recognised by the existence of Article 5 of the IFR which prohibits the circumvention of the caps via other forms of net compensation for card issuance. IFR Recital 31 makes this very clear:

> *"It is important to ensure that the provisions concerning the interchange fees to be paid or received by payment service providers are not circumvented by alternative flows of fees to issuers. To avoid this, the 'net compensation' of fees paid or received by the issuer, including possible authorisation charges, from or to a payment card scheme, an acquirer or any other intermediary should be considered as the interchange fee. When calculating the interchange fee, for the purpose of checking whether circumvention is taking place the total amount of payments or incentives received by an issuer from a payment card scheme with respect to the regulated transactions less the fees paid by the issuer to the payment card scheme should be taken into account. Payments, incentives and fees considered could be direct (i.e. volume-based or transaction-specific) or indirect (including marketing incentives, bonuses, rebates for meeting certain transaction volumes). In checking whether circumvention of the provisions of this Regulation is taking place, issuers' profits resulting from special programmes carried out jointly by issuers and payment card schemes and revenue from processing, licensing and other fees providing revenue to payment card schemes should, in particular, be taken into account. As appropriate, and if corroborated by further objective elements, the issuance of payment cards in third countries could also be taken into account when assessing potential circumvention of this Regulation."*

The PSR's analysis in MR/1.6. notes that "of the approximately 40 changes analysed in this working paper, the largest revenue impact resulted from mandatory fees. Almost all the fee changes in our selection imply revenue increases for Mastercard or Visa. The increased revenue comes mainly from acquirers rather than from issuers." Furthermore, for Mastercard, the PSR notes that "it is evident from the data that most of the revenue increase Mastercard obtained from the changes we have considered has come from acquirers."

[✂]. This places an obstacle to the enforcement of Article 5. Accordingly, [✂].

[✂].

[✂]. The IFR, [✂] is intended to remedy the market failure inherent in the incentive structure of card payment schemes (the competitive bottleneck where schemes compete solely for the business of issuers). It is designed to prevent this unfettered reverse competition, which is defined by the European Commission in its IFR Impact Assessment as:

> *"In the context of card payments, reverse competition means that card schemes compete with each other by offering higher MIF revenues to banks that issue their cards. This results in higher fees for card payments in general, which are passed on merchants and, ultimately, consumers (rather than lower fees which would be the case under normal competition). As a result there is a welfare loss for merchants and consumers and a restricted market entry for new players, as ever increasing levels of MIFs are considered as a minimum threshold by banks that issue cards. "*

Moreover, with the Financial Services and Markets Act 2023 receiving Royal Assent and enabling HM Treasury to ask the PSR to have regard to aspects of economic policy, the need for more effective enforcement of the IFR caps takes on added importance. After all, the success of more innovative payment methods such as account-to-account, which HM Government has championed, is contingent on issuing banks' support. [✂], their incentives to support the uptake of account-to-account payments via open banking in their capacity as ASPSPs will only decline.

[✂].

3.1. [✂]

As mentioned above, [✂].

[✂].

The Reserve Bank of India (RBI) opted for [✂] approach recently, when it proposed the following:

> *"a. Card issuers shall not enter into any arrangement or agreement with card networks that restrain them from availing the services of other card networks.*
>
> *b. Card issuers shall issue cards across more than one card network.*
>
> *c. Card issuers shall provide an option to their eligible customers to choose any one among the multiple card networks. This option may be exercised by customers either at the time of issue or at any subsequent time."*[23]

This remedy was released on July 5, 2023, and will apply to both existing and fresh agreements that the card schemes have with issuing banks.

[✂] section 57 FSBRA power [✂]:

[23] https://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=4280.

a. [✂].

[✂].

[✂].

b. [✂].

[✂].

[✂].

[✂] giving consumers the choice of network here differs from other policy proposals for addressing inter-scheme competition, such as the co-badging mandates under the USA's Durbin Amendment. These mandates oblige issuing banks to put two networks on a single card, thereby giving merchants the choice of network through which to route each transaction. This gives rise to the practice of least-cost routing, where acquirers automatically determine which scheme is cheaper and make sure that the merchant gets the best possible rate for that transaction. [✂].

[✂].

[✂].

[✂].

3.2 [✂]

In 2016, in order to address the issue of circumvention of its interchange fee caps by Visa and Mastercard through the use of rebates and incentive payments, the Reserve Bank of Australia adopted the following remedy:

> *"Interchange-like…issuer fees and interchange rates in four-party schemes would be subject to the same regulatory benchmarks. Other payments to issuers…would be subject to rules on 'other net payments'. This implication of the latter is that schemes would not be able to make non-interchange payments to issuers in excess of any payments that they may receive from issuers."*[24]

Interestingly, the RBA went on to further note, referring to the IFR which had been passed a year earlier with its anti-circumvention clause, aimed to prevent the use of scheme and processing fees as a means to create net compensation for issuers:

[24] Reserve Bank of Australia, *Review of Card Payments Regulation* (Conclusions Paper, May 2016), pp 25.

> *"[In its 2007-08 review of the Australian payments system] the [RBA] acknowledged that, to be effective, regulation would need to capture both interchange-like payments and other payments to issuers. The [RBA's] view was that regulating the latter payments would be a major step that it was not prepared to take at that time. However…the [RBA] Board has reconsidered that view, partly reflecting the implementation of similar restrictions in other jurisdiction.*
>
> *The inclusion of a broader range of flows between issuers and schemes is consistent with recent changes to the regulatory framework for credit and debit cards in the European Union".*[25]

Therefore, the RBA was inspired by Article 5 IFR to enforce more strictly against net compensation received by issuers from the schemes. [✂].[26] [✂].

[redacted]

[redacted]

[redacted]

Therefore, [✂].

[✂] what is included in the scope of the two sides of the equation: on the accounts payable side the types of fees that are in-scope (e.g., mandatory, optional, and behavioural fees), and on the accounts receivable side how rebates, incentive payments, and discounts are calculated across different segments of an issuers'

---

[25] Ibid., pp 26-30.
[26] The PSR's findings in MR22/1.6.
[27] https://www.rba.gov.au/speeches/2022/sp-gov-2022-12-14.html.

card portfolio. The RBA encountered similar obstacles three years following the implementation of the aforementioned rule in its 2019 review:

> *"Under the standards [established in 2016], schemes and issuers in designated schemes are required to certify to the Bank annually that they have complied with certain provisions, including the net compensation provision…This initial certification process indicated that the new standards were working as intended from a broad policy perspective. However, it also suggested that there were some issues with the interpretation of the net compensation provision that might benefit from some clarification, and areas where some potential minor variations to the standards might be beneficial."*[28]

The main issue that the RBA attempted to resolve was around the definition of what constitutes 'Issuer Payments' (accounts payable i.e., scheme and processing fee invoices) and what constitutes 'Issuer Receipts' (accounts receivable i.e., rebates, incentive payments, and discounts). On what constitutes Issuer Payments, the RBA stated that:

> *"The [RBA] considers that one way to improve the clarity of the definition in a manner that is consistent with the purpose and intent [of its interchange fee regulation, which also capped MIFs…] would be to explicitly define Issuer Payments as those payments made to schemes…for 'core services' provided by the scheme to the issuer – namely, those services that are the minimum necessary for the issuer to effectively participate in a scheme and which are provided to issuers in the scheme globally and in exchange for scheme and other processing fees."*[29]

The RBA's intent behind narrowing the scope of what constitutes' Issuer Payments to mandatory scheme and processing fees alone (as defined by the PSR in MR 22/1.6.), was to prevent further circumvention by Visa and Mastercard:

> *"This definition makes it clear that fees or payments for non-core services…are not captured in Issuer Payments. The [RBA] notes that an unduly wide definition could enable an extensive range of payments made for bundled and optional services to be included in Issuer Payments, <u>creating potential for substantial payment of incentives to particular issuers. The scope for this to occur could grow as schemes become involved in more parts of the payment value chain and provide a wider range of services to issuers</u>. In view of this, and the likelihood that an increase in incentives paid will lead to an increase in merchants' cost of accepting card payments (similar to an increase in interchange fees), an unduly wide definition of Issuer Payments is unlikely to be in the public interest."*[30]

Based on the above passage, Teya sees multiple parallels to the UK card payments market. [✂].

[28] [✂].
[29] [✂].
[30] [✂].

Hence, considering mandatory fees alone when it comes to Issuer Payments is appropriate. Regardless, [✂].

In terms of Issuer Receipts, the RBA noted that while *"the majority of incentives provided to issuers by schemes are in the nature of financial flows (payments, rebates, discounts and similar), there are some incentives provided that have more of a non-financial nature…[T]hese can take the form of goods or services provided by schemes to issuers or credits for services that can be accessed at some point in the future."*[31] An example of non-financial means through which the schemes could be [✂].[32] Considering the complexity of scheme and processing fees, such non-financial compensation could be the equivalent of considerable cost savings for issuers.

To resolve this potential use of non-financial compensation by the schemes to issuing banks to further circumvent the regulations around interchange fees, the RBA proposed the following solution:

> *"The [RBA's] preliminary expectation is that this means entities should use the fair (or market) value of the goods and services provided to determine the value of the incentive; fair value could be arrived at by following the principles of the 'fair value measurement' approach under relevant accounting standards…Schemes and issuers may need to independently estimate the fair value of a non-financial benefit provided. The [RBA] may require schemes and issuers to substantiate their estimates of fair value and the key assumptions underlying their estimates."*[33]

Therefore, the RBA required the use of a test to ensure that it captures any potential flows from the schemes to the issuers, whether financial or non-financial, to estimate whether they are in contravention with the anti-circumvention rule (Article 5 IFR equivalent).

[✂].

[✂].

To elaborate, [✂]. Rather, [✂]. In other words, [✂]. In turn, [✂].

Lastly, [✂]. From the PSR's perspective, this [✂] can be [✂], for which the PSR is the competent regulator. [✂]. This is because, as stated above, [✂].

It should be noted, however, that this [✂]. Rather, it is [✂].

However, this [✂]. In other words, [✂].[34] [✂].

---

[31] Ibid., pp 7.

[32] Teya, for instance, has been the subject of pitches of Mastercard's consultancy service.

[33] Reserve Bank of Australia, *The Operation of the Interchange Standards* (Consultation Paper, February 2019), pp 7.

[34] The payment guarantee rule refers to the contractual commitment for issuers to settle each transaction authorised through the Visa and Mastercard networks.

3.3 [✂]

[✂] 96 FSBRA 2013 power [✂] Article 5 IFR, [✂]:

a. [✂].

b. [✂].

c. [✂].

4. [✂]

4.1 [✂]

[✂].

The section above on the PSR's FSBRA 2013 powers outlines the PSR's formal duties to promote both intra-system and inter-system competition and innovation. The government repeatedly expressed at the time of the PSR's formation that these statutes would bring *"payment systems under economic regulation"* and that the *"new regulator [the PSR] will operate in accordance with the Government's Principles for Economic Regulation"*.[35] These state that:

> *"Competitive markets are the best way in the long run to deliver [high quality and efficient economic infrastructure] to consumers and provide incentives to invest and improve efficiency and service quality. [...]*
>
> *"In the UK, economic regulation has aimed to promote effective competition where this is possible, and to provide a proxy for competition, with protection of consumers' interests at its heart, where it is not meaningful to introduce competition. [...]"*
>
> *"The role of economic regulators should be concentrated on protecting the interests of end users of [the applicable] services by ensuring the operation of well-functioning and contestable markets where appropriate or by designing a system of incentives and penalties that replicate as far as possible the outcomes of competitive markets."*

This clearly elucidates that competition is the best way to drive innovation and promote the interest of end-users, unless such competition is not possible. Hence, the PSR's primary objective is to promote effective competition where this is possible. Where competition is not possible should the PSR then step in to act a

[35] HM Treasury, Opening up UK payments, March 2013.

"proxy" for competition, for example, in needing to regulate prices or define an industry standards-setting process.

It is well accepted that this rationale justifies the need for price regulation of Multilateral Interchange Fees (MIFs) which led to the introduction of the Interchange Fee Regulation. [✂].

Firstly, MIFs are insulated from competitive pressure by acquirers and merchants and therefore form a price-floor that restricts competition between acquirers. This point was established by the Supreme Court in the landmark case of *Sainsbury's v Visa and Mastercard* [2020] UKSC 24. At Paragraph 93 and 103 the apex UK court states:

> *"93. In our judgment, the essential factual basis upon which the Court of Justice held that there was a restriction on competition is mirrored in these appeals. Those facts include that: (i) the MIF is* ***determined by a collective agreement between undertakings****; (ii) it has the effect of* ***setting a minimum price floor for the MSC****; (iii) the non-negotiable* ***MIF element of the MSC is set by collective agreement rather than by competition****; (iv) the counterfactual is no default MIF with settlement at par (that is, a prohibition on ex post pricing); (v) in the counterfactual there would ultimately be no bilaterally agreed interchange fees; and (vi) in the counterfactual the whole of the MSC would be determined by competition and the MSC would be lower.*
>
> *"103. There is a clear contrast in terms of competition between the real world in which the MIF sets a minimum or reservation price for the MSC and the counterfactual world in which there is no MIF but settlement at par. In the former* ***a significant portion of the MSC is immunised from competitive bargaining between acquirers and merchants*** *owing to the collective agreement made. In the latter the whole of the MSC is open to competitive bargaining. In other words, instead of the MSC being to a large extent determined by a collective agreement it is fully determined by competition and is significantly lower."*

Furthermore, a similar analysis also formed part of the European Commission's decision to regulate MIFs via the Interchange Fee Regulation. In the IFR Impact Assessment, the Commission states at page 96 and 105:

> "[Page 96] *Interchange fees for such schemes are retained by the issuing PSP on transactions carried out with cards it has issued. The issuing PSP pays to the acquiring PSP the amount of the transaction after deduction of the MIF. The MIF along with other fees (a scheme fee and a fee for the acquiring PSP) is passed on by the acquiring PSP to the merchant through the Merchant Service Charge (MSC). Hence, when a customer uses a payment card to buy from a merchant, the acquiring PSP pays the merchant the sales price after deduction of the MSC. Merchants have difficulty negotiating MSCs below the level of the MIF. MIFs thus act as a collective 'floor' in MSCs. The interchange fee effectively determines to a large extent (in general 50 % or more) the price charged by PSPs to merchants for card acceptance.* ***It restricts price competition between acquiring PSPs at the expense of merchants and subsequent purchasers.***
>
> [Page 105] *The Commission's Decision of 19 December 200721 ('the Prohibition decision') is particularly important. This prohibits MasterCard's multilateral intra-EEA fall back interchange fee for cross-border payment card transactions made with MasterCard and Maestro branded debit and consumer credit cards. It states that the MasterCard's* ***MIF restricts price competition between***

> ***acquiring banks*** *by artificially inflating the basis on which these banks set their charges to merchants and effectively determining a floor under the merchant service charge below which merchants are unable to negotiate a price. In addition, MasterCard had not demonstrated that they were covered by the exception in Article 101(3). The Commission's view was that MIFs are a restriction of competition by effect. MIFs arguably also restrict competition by object as they reduce the level of uncertainty on the market for acquiring banks and they have an impact on MSCs, as the Commission argued in its subsequent case against Visa22. It was established in the MasterCard decision that they* ***anyway restricted competition by effect between acquiring banks*** *by artificially inflating the basis on which these banks set their charges to merchants and effectively determining a floor for the merchant service charge below which merchants are unable to negotiate a price."*

As discussed by multiple stakeholders in the Competitive Constraints consultation, the same applies to scheme and processing fees on acquirers. As reported by the PSR at paragraph 3.34.:

> *"3.34 Mastercard and Visa each effectively act as monopolists when setting the conditions to access their own networks, and the associated fees. They argued that, as UK merchants have little choice but to accept both Mastercard and Visa card brands, acquiring services for the different card brands are not substitutable. An acquirer wishing to offer acquiring services for Visa card payments would therefore have no alternative but to participate in the Visa scheme and pay the fees imposed by Visa, and similarly for Mastercard"*[36]

This means that *"Mastercard and Visa each leverage their 'must-take' status to charge high fees to acquirers and/or issuers, unless constrained by other factors"*[37]. In essence, any fee that is set by the schemes, whether a MIF or a scheme and processing fee, is not disputable by acquirers and thus also constitutes a price floor for merchant MSCs which restricts intra-system competition, i.e., between acquirers.

[✂].

This aspect was discussed by stakeholders as noted by the Competitive Constraints paper:

> *"3.25 In a context of near-universal acceptance by merchants and accelerated decline in cash use, supporters of this view argued that to further increase transaction volumes (and therefore revenues), established card payment schemes such as Mastercard and Visa mainly compete for the same pool of cardholders. That is, the focus of card schemes' competitive efforts is on attracting issuers, by granting issuers various incentives so they offer a specific brand of card to their own customers.*
>
> *3.28 [..]the higher degree of competition on the issuing side (that is, for cardholders) creates powerful incentives for the card schemes to organise financial flows from the acquiring side to the issuing side."*

[✂].

[36] https://www.psr.org.uk/media/z2knwetq/mr22-1-4-competitive-constraints-in-card-payment-systems-call-for-evidence-february-2023.pdf
[37] Ibid at para 3.35

Lastly, MIFs are regulated [✂]. This was also an explicit reason for their regulation within the Interchange Fee Regulation. As highlighted by the European Commission in the IFR Impact Assessment:

> *"On a more general level of analysis, the structure of the current payments market, most notably the two-sided nature of the payment cards market and the existence of the MIF-based pricing model, acts as a major factor against the introduction of new and alternative payment solutions. The incumbents – in particular banks issuing cards and card schemes - are vitally interested in protecting and, if possible, increasing the revenues from card payments, above all from MIFs. Card schemes competing with each other in order to get their cards issued lead to the paradoxical situation that competition gives rise to increasing MIFs (that encourage issuing banks to issue the cards concerned) instead of decreasing MIFs."*[38]
>
> *[…] Any payment solution offering lower profit opportunities will be seen by banks as less interesting to implement from the commercial perspective"*

[✂].

Ultimately, [✂].

PSR's clear mandate as an economic regulator – like Ofcom, Ofgem, and Ofwat – marks HM Government's recognition that payment systems have similar characteristics as other UK regulated utility companies, such as communications, energy, and water providers. Within utility companies, for-profit shareholder-owned companies can still act for the benefit of society and service users as a whole, subject to effective economic regulation, [✂]. Regulators like Ofcom, Ofgem, and Ofwat all regulate wholesale prices to ensure that the firms within their remit don't exploit their powerful positions, as providers of essential infrastructure, but rather promote the interests of end-users. [✂]. In this scenario, it is the duty of the economic regulator to act as a corrective body that ensures these for-profit firms sufficiently serve the interests of end-users rather than just their own shareholders.

4.2 [✂]

The Interchange Fee Regulation currently caps net compensation paid to issuers (i.e. interchange fees net of issuer scheme fees), which is hard to monitor and only account for one aspect of the problem. [✂] reflects the emerging thinking around compensation for premium Open Banking payments. [✂].

[✂]. The higher cost burden for schemes to serve issuers was, in fact, argued by Mastercard leading up to the European Commission's 2007 judgment against MIFs:

[38] Page 71

> *"MasterCard derives [the imbalance between the issuing and the acquiring business in the scheme] from the fact that the average issuer would "incur the vast majority of the Scheme costs" because in the United Kingdom market 95% of the costs are skewed towards the issuing side."*[39]

In this way, [✂].

4.3 [✂]

The PSR [✂]. As explained above, [✂].

[✂].

[✂].

Importantly, [✂]. Rather [✂] the PSR has a duty to introduce where competition is not delivering good outcomes for end-users.

[✂], the stable margins the schemes have enjoyed for the past five years couples with the continuous increase in acquiring scheme fees can indicate that [✂].

5. [✂]

[✂] i.e., inter-system competition.

Co-badging refers to inclusion of two or more payment brands or payment applications of the same brand on the same card-based payment instrument. Co-badging is essentially a way of multi-homing from issuing banks that, in some countries, provides a merchant with a routing choice. A combination of multi-homing on the issuing side and merchant routing can help mitigate the reverse competition effect in card payments by allowing the payee side of market to exert direct competitive pressure on the schemes. This is the reason why, to be advantageous for merchants, one cannot go have one without the other: issuing co-badging (multi-homing) and the sovereignty of the routing choice made given to merchant and not the cardholder, as currently prescribed by the Interchange Fee Regulation.

If these conditions are met, then the merchant can choose the least costly route of acceptance, with the help of the Payment Service Provider. Co-badging enables merchants to accept the cardholder's chosen payment method while still having a say on the routing choice.

[39] Case COMP/34.579, *MasterCard*, Commission Decision of 19 December 2007. <http://ec.europa.eu/competition/antitrust/cases/dec_docs/34579/34579_1889_2.pdf>, para 684.

The United States provides an interesting example of co-badging effectively reducing the cost of acceptance. The United States is to date one of the developed countries with the highest card acceptance costs. The only substantial form of card regulation, to address competitive bottleneck issues mentioned previously, came in 2011 with the Durbin Amendment (DA, also known as Regulation II). The DA capped the interchange fees in debit transactions at 0.05% plus twenty-one cents.

An additional requirement set by the Durbin Amendment was that issuers were prohibited of restricting the number of networks over which debit transactions could be processed to less than two unaffiliated networks. This essentially mandated co-badging for debit cards. An important note however is that only single message transactions (PIN transactions) fell under the scope of DA while dual message transactions (signature transactions) were exempted from the co-badging mandate. Additionally, the DA prohibited issuers and networks from inhibiting a merchant's ability to direct the routing.

Given that interchange fees were regulated at the same time as the co-badging and routing mandate, the most informative way to see if co-badging and routing exerted a competitive pressure on schemes is by analysing the evolution of scheme fees. The payments consultancy CMSPI compared the evolution of scheme fees in the U.S. of dual-message debit transactions (no mandate) with single-message debit transactions (mandate). They found that the average acquirer scheme fees increased from [✂] to [✂] from 2011 to 2019 while the same fees for single-message transactions remained stable at around [✂] (even briefly lowering to [✂]) over the same period (Figure 3). Whilst the co-badging policy is in no way perfect in the United States, this is indicative of a competitive pressure exerted thanks to the routing option between schemes given to the merchant.

Figure 4: CMSPI analysis of Average Acquirer Network Fees for co-badged versus non-co-badged cards

[✂]

Source: CMSPI

Moreover, the benefits of co-badging can only come to fruition through the practice of least-cost routing, in which the merchant can choose to route their transaction through the network most beneficial to them. This practice is strongly supported by the RBA in Australia which, through multiple combined efforts, incentives and places requirements on acquirers to provide it as a service to merchants:

> *If a merchant uses least-cost routing, it does not affect which deposit account the funds are paid from, and the three networks offer similar protections to the cardholder from fraud and disputed transactions. A customer can always select a particular debit network by inserting their card and selecting a network rather than tapping their card when making an in-person transaction. And least-*

> *cost routing only applies to dual-network debit card transactions; it does not affect customers using credit cards.*
>
> *Least-cost routing is expected to bring down payment costs by (1) giving merchants the ability to route dual-network debit card transactions to the lowest-cost network, and (2) increasing the competitive pressure between the debit card payment schemes such that there is greater incentive for all schemes to lower the fees – interchange fees and scheme fees – that they set on debit card transactions. These fees are a key component of the price that merchants pay to accept card payments.*[40]

The quote above begins to address one the arguments often levied against merchant routing, namely that it unfairly removes consumer choice over payment rails and would also disincentivise issuers from investing in improving the payments infrastructure they utilise. [✂].

Consumer Debit cards are by far the most utilised payment method at point of sale. They are also the card type with the lowest interchange fee and thus likely to attract the least rewards for cardholders. This indicates how digital payments for most consumers are a commodity, merely a basic tool which they expect to receive from whatever account they store their funds with and want to be as frictionless as possible. This is particularly true when considering that while the cost of acceptance is (at least in part) passed down to consumers, this is an invisible cost to them.

Therefore, any claim that further regulatory intervention into fees or over choice of payment rails could lead to a lower issuance of cards or lower service quality fails to recognise how ubiquitous and commoditised the payment instrument is. Providing a commonly accepted and well-functioning digital payment method is indispensable for any account provider to attract customers, and this would not change if there were further regulation. [✂]. In fact, it is very common for the payment rail to regularly change on these cards without consumers noticing or exerting any influence over the change. [✂].

Ultimately, a combination of mandatory co-badging and merchant least cost-routing drawing form the American and Australia models [✂].

5.1 [✂]

[✂].

5.2 [✂]

[✂].

[40] https://www.rba.gov.au/payments-and-infrastructure/debit-cards/least-cost-routing.html

[✂]. Several domestic schemes around Europe including MB in Portugal or Bancomat in Italy are based on solutions build on top of the National Central Bank infrastructure for clearing and pan-European infrastructure (TARGET2) for settlement.

Considering the public investment that went into the ongoing Bank of England RTGS renewal programme (and the recently concluded migration of the RTGS to ISO 20022), it would be prudent to use the recently upgraded clearing and settlement infrastructure for use-cases beyond wholesale payments. [✂].

[✂].

5.3 [✂]

[✂].

Given the decision over creating a digital pound has not yet been made and its potential release is still years away, [✂].

Visa

VISA Europe's Response to the PSR's Working Paper on Scheme and Processing Fees

11 August 2023

Introduction

Visa Europe (referred to as 'Visa' or 'we' in this document) is pleased to respond to the Payment Systems Regulator's ('PSR') Working Paper of 30 June 2023 on recent changes to scheme and processing fees ('Working Paper'). Visa welcomes the opportunity to continue to work constructively with the PSR as it proceeds with its market review into card scheme and processing fees (the 'Market Review').

As the PSR will appreciate, this response contains highly commercially sensitive information that should be considered 'confidential information' within the meaning of s91 of the Financial Services (Banking Reform) Act 2013 (FSBRA) and treated accordingly. Following from this, we expect the PSR will engage with Visa in advance of any elements of this response being published.

Structure of this response

This response is structured as follows:

- Section 1 sets out important context on the competitive landscape that we operate in and against which Visa's fees and recent fee changes should be understood.
- Section 2 contains our response to the PSR's Question 1 and Question 2.
- Annex 1 contains our further comments on the Working Paper.

1. Background on the competitive landscape in which Visa operates

The PSR's Working Paper is intended to set out some initial analysis and emerging thinking, based on a limited subset of internal governance documentation, which will ultimately inform the competitive analysis in the PSR's interim report.[1] Visa would like to take this opportunity to set out important considerations regarding how we operate our business, including how we set fees.

Competition is of one of several factors which influences all of our commercial decisions including on fee changes. The question of how competition influences our commercial decisions cannot be answered through a narrow exercise of reviewing Visa's internal documents specifically related to fee changes. As highlighted previously to the PSR, it is critical for the PSR to conduct a forward-looking assessment of competitive dynamics in UK payments.

In this light, given the very limited scope of the exercise set out in the Working Paper, the PSR's central observation that competition "*does not appear to have been an impediment to implementing material increases to mandatory fees….*" [2] is overly broad in nature and not an accurate description of the degree to which competition influenced Visa's decisions to introduce the fee changes considered by the PSR.

Visa's mission is to be the best way to pay and be paid, everywhere. We facilitate and protect millions of transactions so people and businesses can buy and sell with confidence. To best serve our customers, we are constantly innovating, driving competition, and promoting choice. Our global network, in which we have invested more than $10 billion over the past five years, allows us to play an important role in digital commerce at a global scale by giving consumers and merchants secure and convenient ways to pay and be paid in store, online, and across borders.

The competitive landscape within which we operate and aim to deliver on this mission is constantly evolving. The payments sector in the UK has changed significantly over the period the PSR is looking at and continues to show great dynamism and change. In recent years, the sector has experienced significant entry and expansion of new payment solutions and services, which are driving greater choice for issuers, acquirers, consumers, and merchants. These include:

- new entrants to the sector, as observed with buy now, pay later services such as Klarna and online banks such as Monzo;
- existing UK payments sector firms extending into other parts of the payments value chain;
- large firms, particularly from the technology, large retail and banking sectors, leveraging their direct consumer relationships to enter or expand into providing different types of payment services; and
- established payments sector firms from other jurisdictions entering the UK market, leveraging their established presence, scale and assets from those other jurisdictions.

In addition to these developments progressing, many players at all levels of the value chain are providing a wide range of payment services and functionalities in the UK. These include:

- a wide range of card payment schemes;
- open banking-enabled payments;
- real-time account-to-account ('A2A') payments;

1 Working Paper, paragraph 1.1.
2 Working Paper, paragraph 1.5.

- digital wallets, including PayPal, Revolut, Google Pay, Apple Pay and Samsung Pay;
- Buy Now Pay Later ('BNPL') services;
- payment facilitators; and
- payment orchestration platforms; and
- alternative payment service providers.

In the UK payments sector, there are also some policy initiatives aimed at fostering competition for payment-related services. These include:

- Initiatives relating to **Open Banking** which have directly boosted competition in the sector by facilitating the entry and expansion of a wide variety of operators in the UK payments sector.[3] Indeed, the Open Banking Implementation Entity reported that the number of open banking payments increased by over 100% during 2022.[4]
- Development of the **New Payments Architecture ('NPA')**, which is expected to facilitate the expansion and use of account-to-account retail payments. The PSR's ambition underpinning the development of this programme is in part to "*enable competition between existing and new payment services*" and "*facilitate innovation in the interests of users*".[5]

The ways in which consumers engage with payments is also evolving rapidly.[6] Alternatives to card-based payment options already play an important role in the context of retail transactions and there is emerging evidence of the role that merchants can play in influencing consumer behaviour.

It is within this wider competitive context that we make our commercial decisions, which reflect considerations not only around pricing but also around how we invest, innovate, and continue to build resilience into our network and the wider ecosystem, to better meet the growing needs and changing expectations of consumers and merchants.

In a competitive context, Visa invests in developing and providing high quality and innovative payment solutions for the benefit of end-users, contributing to positive outcomes for consumers and merchants

While the PSR is already working carefully to understand a range of features of the UK payments sector, we understand that the PSR will ultimately be thinking about how these features work to create good outcomes for service users.[7] At Visa, we understand the importance of good outcomes and we work to deliver outcomes that matter most to the consumers and merchants using our network. We are constantly innovating and enhancing our product offering in response to the evolving needs of consumers and merchants, and to reflect the wider competitive dynamics in the payments sector.

We are proud to offer a trusted and high-quality service focusing on outcomes that matter most to end users. These include:

- **A reliable and resilient payments infrastructure.** Visa's payment infrastructure is highly reliable, with 99.999% processing quality. We invest significantly to achieve and maintain this level/quality of service, which ensures that transactions between merchants and cardholders are processed

---

3 See, for example, CMA 'Corporate report: Update on open Banking', 5 November 2021.
4 Open Banking Impact Report (March 2023).
5 See paragraph 1.3 of the PSR Call for input: 'Competition and Innovation in the UK's New Payments Architecture' (January 2020).
6 See, for example, recent evidence published by UK Finance in its Payment Markets Summary 2022.
7 Paragraph 1.1 of the PSR's guidance on its objectives says that: "*Our primary focus is on making payment systems work well for service-users*." PSR Objectives Guidance, 2015.

seamlessly. We provide 27 different ways to route transactions across our network, which combines our triple redundant global data centres with our double-redundant data networks and access servers.

- Rapid and seamless transactions: Visa card payments offer consumers speed and convenience when making payments both in person and online, with near-instantaneous authorisation of transactions giving merchants the confidence that transactions will be successful. This speed and accuracy is supported by the significant investments we have made in advanced fraud-detection technology without which digital payments would be marred by repeat credential checking and false declines. Our Advanced Authorisation services use artificial intelligence to test the likely authenticity of transactions (500+ unique attributes are evaluated per transaction in about a millisecond). Globally, the Visa group has invested over $10 billion in technology over the last five years, including to reduce fraud and enhance network security. This has helped prevent an estimated $25 billion in global fraud each year and has meant that incidents of fraud occur in less than [✂] of Visa transactions for UK issuers.
- Robust payment protections and security: In addition to investments made to help prevent fraud, Visa offers robust protections for merchants and consumers against fraudulent transactions, including chargebacks, refunds, fraud prevention systems, and payment guarantees such as our Zero Liability Guarantee bringing peace of mind to consumers.
- Innovative and dynamic functionality: Visa is responsive to consumer and merchant demands for increasing flexibility and innovative service offerings, and the Visa group invests in market-leading innovation to enable new ways to pay and be paid and to improve the payment experience for end users. For instance, we partnered with Lloyds Bank to launch a subscription management service that allows consumers to manage and cancel regular payments in a few simple clicks. This tool facilitated over 1.2 million subscription payment cancellations between summer 2021 and April 2022, bringing significant financial benefit to consumers.[8]

Our business in Europe has evolved over time alongside the payments sector to enable greater investment and innovation

We continue to invest in and innovate our payment services and ecosystem, to better meet the growing needs and expectations of consumers and merchants including. This includes investing in the security and reliability of Visa's global network, developing new technologies that improve the consumer experience and enable clients to respond to new requirements and use cases, and driving behavioural change that protects system integrity and strengthens the Visa payments ecosystem. This reflects the ongoing evolution of the payment sector, which is dramatically different today compared to several years ago.

Recent changes to our fees also reflect our evolution as a business in Europe – we transitioned away from being a closed 'member association' owned by banks, into an open and independent commercial network. This transition has meant that we have been able to better adapt to, and invest in, the changing needs and expectations of merchants and consumers and the growing diversity of the payments value chain. As an example of this, integrating Visa Europe into Visa's global network infrastructure has helped deliver extremely high levels of resilience resulting the 99.999% processing quality mentioned above and ensuring that transactions between merchants and cardholders are processed seamlessly.

As explained above, we operate in a competitive, diverse, and dynamic payments sector. Ultimately, if the quality and pricing of Visa's products does not support downstream services that are competitive

[8] Lloyds Banking Group press release.

and compelling to merchants and consumers, this will lead to Visa's products and services not being adopted or utilised fully. This is the context to every decision Visa makes, including on the pricing of its services.

Visa's fees represent a small fraction of the overall costs for merchants to accept Visa card payments

While we have made adjustments to our fees over time, in the context of the dynamic competitive payments landscape in the UK and the significant benefits for both merchants and consumers from Visa's significant investments in security, reliability and innovative payment services, it is important to note that Visa's scheme and processing fees represent a small fraction of the overall cost for merchants to accept Visa card payments.[9] In particular, for an average purchase [✂] across all domestic transactions, a merchant pays only 2 pence in Visa fees compared with an overall estimated acceptance cost of [✂],[10] meaning that our fees make up the smallest component of the cost of acceptance for retailers on average. This is particularly important for small and medium sized merchants who deal predominantly with domestic transactions.

As we have changed our fees, we have been mindful of the importance of good outcomes for consumers and merchants alike and, in particular, the implications on some sectors of the UK retail economy. The UK is a key market for Visa, and we are fully committed to playing our part in ensuring the payments industry continues to deliver benefits to all consumers and merchants. The scheme fees we charge for domestic transactions in the UK are among the lowest in the world, and we have further introduced initiatives in the UK such as our Everyday Spend Programme, which applies a lower rate to Visa's fees on transactions with certain types of merchants associated with everyday spend (grocery stores/supermarkets, automatic fuel dispensers, service stations, utilities, charities, local transportation, and tax). As a result of this programme, for domestic consumer transactions with these merchants, Visa's core fee rates have not increased since 2017.

We look forward to continuing to engage with the PSR throughout the Market Review

The wider competitive dynamics discussed in this section shape our commercial decisions, which reflect considerations not only around pricing but also around how we invest, innovate, and continue to build resilience into our network and the wider ecosystem, to better meet the growing needs and changing expectations of consumers and merchants. We look forward to engaging with the PSR further on these wider competitive dynamics as the Market Review proceeds.

---

9 We note that Visa's fees are often wrongly conflated with the overall cost of card acceptance. Visa does not control how other participants in the value chain such as card acquirers price their services and charge them to merchants.

10 For an average UK domestic consumer card transaction (consumer debit & consumer credit, card present & card-not-present), 2022. For the acquirer margin, we have used 0.9%, which is the average net revenue identified by the PSR in Table 6 of *Annex 2 - Pass-through analysis of the Market review into the supply of card-acquiring services: Final report*.

2. Response to the PSR's Questions

Question 2: Do you agree with our description of the degree to which competition influenced the decisions to introduce these fee changes?[11]

Visa does not agree with the PSR's description of the degree to which competition influenced Visa's decisions to introduce the fee changes considered by the PSR.

Visa operates in a competitive market in which there is a wide range of payment solutions providers. The section above reiterates some of the key considerations in this area, but we also refer the PSR to the broader competitive context outlined in previous submissions, such as our submissions of:

- [✂], which provided an overview of the key market dynamics most relevant to Visa's commercial decisions and emphasised the optionality and choices of participants across the value chain.
- [✂], which provided details of how the broader commercial considerations and the evolution of the payments system factor into Visa's pricing decisions, along with a discussion on dynamics for five different categories of fees.
- [✂], which discussed Visa's approach to pricing in light of the competitive environment and focus on delivering value and positive outcomes for service users.
- [✂], which provided contextual information around Visa's approach to pricing and the key rationales behind the scheme fee changes selected by the PSR.
- [✂], which provided an overview of the dynamic and rapidly evolving competitive landscape within which Visa operates. This response included references to several examples of internal Visa documents that showed the changing landscape of payment acceptance solutions, including non-card payment options available in the UK.

The PSR's Working Paper is focused on internal governance documentation provided by Visa. [✂]

The above means that there are inherent limitations to the PSR's exercise. The PSR recognises this - e.g., by acknowledging that "*the absence of references to a particular issue in the documents does not necessarily imply that it was ignored in the decision to implement a fee change*".[12]

Given the very limited scope of the PSR's exercise, the central observation in the PSR's Working Paper that competition "*does not appear to have been an impediment to implementing material increases to mandatory fees….*" [13] is overly broad in nature and <u>not</u> an accurate description of the degree to which competition influenced Visa's decisions to introduce the fee changes considered by the PSR.

Competition is of one of several factors which influences <u>all</u> of our commercial decisions including on fee changes. The question of how competition influences our commercial decisions <u>cannot</u> be answered through a narrow exercise of reviewing Visa's internal documents specifically related to fee changes. As highlighted previously to the PSR, it is critical for the PSR to conduct a forward-looking assessment of competitive dynamics in UK payments - including, for example, all of the developments mentioned in Section 1 above.

It would not be appropriate for the PSR to assess competition in the UK payments sector with reference only to the fees charged by Visa (and Mastercard). As explained above and in previous submissions to

---

11 Our response to Question 1 includes a more detailed table of responses, so we answer Question 2 first.

12 Working Paper, paragraph 5.3.

13 Working Paper, paragraph 1.5.

the PSR, (i) the UK payments sector is competitive sector with many differentiated payment options, systems and products, with a wide range of players; and (ii) Visa invests significantly and continuously to develop and innovate its payment ecosystem to deliver value and ensure good outcomes for end-users in this context.

Question 1: Do you agree with the way we describe the different rationales for the fee changes in our selection?

Visa does not agree with the PSR's discussion and assessment of the rationale(s) for Visa's fee changes as set out in the Working Paper.[14]

In particular:

- We do not agree with the PSR's assessment regarding which fee changes respond to or account for competition. As we have explained in our response to Question 2 (and, indeed, in our previous submissions), Visa operates in a dynamic and competitive payments landscape.
- The PSR's analysis does not account for the important link between the 'other' rationales (i.e., rationales other than 'competition' per the PSR's categorisation) and the broader competitive environment and commercial realities within which we operate as a business. For example, behavioural fees are designed to encourage behaviours that improve the security, integrity, and efficiency of the overall ecosystem which ensures that payments are safe, reliable and seamless for consumers and merchants.
- We do not agree with the PSR's analysis in some instances in respect of these other rationales. We set out our comments in relation to these rationales in Table 1 below.

Ultimately, as we have explained above, we believe that the PSR should consider the rationales for individual pricing changes in the context of the competitive landscape within which Visa operates.

[14] Working paper, paragraph 4.65 onwards.

Table 1: Further comments in relation to the PSR's description of rationales and their relevance to individual fee changes

Rationale	Relevant fee change(s)	PSR assessment	Visa response
Reflecting value of the service	All	Figure 9 suggests that the PSR identified 'reflecting value of the services' as a rationale in relation to only four of Visa's fee changes (mainly fee changes involving the introduction of an optional service and changes to core processing fees).[15]	We do not agree with the PSR's characterisation of value as something that only relates to a relatively small subset of Visa's fee changes. This does not reflect how Visa operates. At Visa we deliver the outcomes that matter most to consumers and merchants, and our clients. We are constantly innovating and enhancing our product offering in response to the evolving competitive dynamics of the payments sector. Further, we do not agree with the PSR's assessment in Table 5. As explained in [✂], we consider Table 5 to be misrepresentative.
Reflecting value of the service	Visa Instalments	The PSR says that it identified 'reflecting value of the service' as a relevant rationale in relation to four optional fee changes.[16] However, the PSR did not include 'reflecting value of the service' as a relevant rationale for Visa Instalments (one of the four optional services) in Annex 1 (Table 5) or its spreadsheet analysis.	We note that there seems to be a discrepancy between the PSR's stated approach and its actual analysis in the Working Paper. We also do not agree with the PSR's position that 'reflecting value of the service' is not a relevant rationale for Visa Instalments. As we have explained to the PSR in our narrative submission,[17] [✂].

[15] Working Paper, paragraph 4.69 bullet (5).
[16] Working Paper, paragraph 4.69 bullet (5).
[17] VISA Europe's response to [✂].

Rationale	Relevant fee change(s)	PSR assessment	Visa response
Transition to commercial entity	Acquirer service fees	The PSR explains that it identified 'transition to a commercial entity' as a rationale "*in relation to mandatory scheme fees and core processing fees implemented in 2017 and 2018, which followed the acquisition of Visa Europe by Visa Inc.*"[18] The PSR notes that "*In its narrative response, Visa also mentions this as one of the rationales for a further change to mandatory acquirer fees in 2020*" but considers commercialisation to be "*less directly relevant*" for changes to acquirer service fees "*given the time passed since the acquisition of Visa Europe*".[19]	We do not agree with the PSR's assessment. As we explained to the PSR in our narrative submissions,[20] [✂].
Alignment with other regions	VbV / 3DS Fees	The PSR explains that it identified 'alignment with other global Visa Inc. regions' as a relevant rationale for the introduction of a fee on 3DS in 2019 based on a document submitted by Visa to the PSR.[21] This document (from 2017) states that [✂].	We do not agree with the PSR's assessment. [✂].[22]
Alignment with other regions	[✂]	Following a review of the PSR's spreadsheet analysis, we understand that the PSR does not consider 'alignment with other regions' as a relevant rationale for [✂] fee. The PSR does not explain its reasoning for this.	We do not agree with the PSR's assessment and findings. We explained to the PSR in our narrative submissions that [✂].[23] We previously explained that [✂].[24]

18 Working Paper, paragraph 4.69 bullet (3).
19 Working Paper, footnote 42.
20 See, for example, [✂].
21 Working Paper, paragraph 4.69 bullet (2) and footnote 41.
22 VISA Europe's response to [✂].
23 VISA Europe's response to [✂].
24 [✂].

3. Annex: Other comments on PSR's Working Paper

Comments on the PSR's analysis of the rationales for each fee change

We have reviewed the PSR's spreadsheet analysis of the rationales for each fee change and we find that, in some instances, the PSR's analytical findings do not seem to match its stated approach.

- As noted above, the PSR identified 'reflecting value of the service' as a relevant rationale in relation to four optional fee changes. However, the PSR did not include 'reflecting value of the service' as a relevant rationale for [✂] (one of the four optional services) in Annex 1 (Table 5) or its spreadsheet analysis.
- The PSR explains that it identified 'simplifying the fee structure' as a relevant rationale in relation to "*all changes to mandatory scheme fees and core processing fees*."[25] However, the PSR's analysis in Figure 9 (and associated spreadsheet analysis) suggests that the PSR has not included this rationale in its analysis for two mandatory fee changes (namely, [✂] and [✂]).
- Finally, the PSR explains that "*we have typically taken the revenue impact in the first full year of implementation of each fee change*." [26,27] However, the PSR's analysis in Figure 8 (and associated spreadsheet analysis) suggests that the PSR has used alternative revenue impacts for two fee changes (namely, [✂] and [✂]).

Other comments on the PSR's Working Paper

We have some further comments regarding the methodological approach adopted by the PSR and the accuracy of the PSR's Working Paper:

- The PSR states that [✂][28] The PSR's statement does not fully reflect Visa's descriptions of our internal governance. As we have explained previously to the PSR, [✂].
- The PSR states that "*The lack of specificity on the value of services is consistent with a lack of engagement with customers*."[29] The PSR's statement is not an accurate representation of how we engage with our customers. As we have explained to the PSR in our previous submissions,[30] [✂] However, we consider it important to understand client challenges and overall sentiment towards fee changes, particularly with regard to our clients' perception of our value proposition, or any risks that fee changes may pose to our clients. [✂].
- Finally, we note an instance of inaccurate wording in the PSR's Working Paper, which we assume is a drafting error. In paragraph 4.48, the PSR sets out a list of themes that are relevant to Visa's fee changes. However, the fourth, sixth and seventh sub-bullets refer to Mastercard rather than Visa. We assume that these were intended as references to Visa.

[25] Working Paper, paragraph 4.69 bullet (1).
[26] Working Paper, paragraph 4.46.
[27] The PSR explains that it has used a different revenue impact for one fee change [✂].
[28] Working Paper, paragraph 3.26.
[29] Working Paper, paragraph 5.11.
[30] VISA Europe's response to [✂].

PUB REF: MR22/1.6 submissions

12 Endeavour Square
London E20 1JN
Telephone: 0300 456 3677
Website: www.psr.org.uk