Market Review of card scheme and processing fees

PSR
June 2022

Response from The Payments Association

Introduction

The Payments Association welcomes the opportunity to contribute to the PSR "*Market Review of card scheme and processing fees*".

The community's response contained in this paper reflects views expressed by our members and industry experts recommended by them who have been interviewed and who are referenced below. As The Payment Association's membership includes a wide range of companies from across the payments value chain, and diverse viewpoints across all job roles, this response cannot and does not claim to fully represent the views of all members.

We are grateful to the contributors to this response, which has been drafted by Robert Courtneidge, The Payments Association's policy advisor. We would also like to express our thanks to the PSR for their continuing openness in these discussions. We hope it advances our collective efforts to ensure that the UK's payments industry continues to be progressive, world-leading and secure, and effective at serving the needs of everyone who pays and gets paid.

With special thanks to:

- Alex Mifsud, Co funder and CEO, Weavr
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<u>Please note that this response does not reflect the views of Mastercard or Visa.</u>

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Director General
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Contents

The section numbering below corresponds to the numbering of the 'questions for respondents' in this paper.

1. Do you agree with our description of scheme and processing fees?

Our members largely agree with the description of scheme and processing fees on the basis that a "Card Payment System Operator" refers to either Visa or Mastercard. However, some members have suggested including additional terminology used by the schemes such as service charges, assessment fees and billable indicators because it is important that all forms of scheme fees, however they are described, are included in the scope. Overall, we would like to see this resulting in greater consistency in terminology.

By way of simple explanation:

- **Scheme fees** (or assessment fees as they are also known) are the fees levied by the schemes on the acquirer. The acquirers pass those fees onto the merchant of course. Scheme fees comprise a combination of a fixed fee and a percentage cost. Therefore, we have two elements to factor in. *Note*: fees vary based on transaction amount and the size of the acquirer (the greater the volume the acquirer processes, the lower the overall scheme fees according to the tiers provided to the acquirer by the schemes).
- **Processing fees** are the fees levied by the acquirer to the merchant in addition to the base costs of Interchange, Assessment, refunds, chargebacks, foreign exchange or settlement costs. Where Interchange cannot be marked up, then the acquirer may apply additional fees on top of chargeback, refund, authorisation fees etc.

In terms of optional fees, these are minimal and include setup fees, monthly fees and annual fees. These are simply fees added by an acquirer who might wish to find additional lines of revenue. From a merchant's perspective, almost no fees are optional. The real challenge is that, whilst most fees are transparent (interchange fees are heavily documented online), and chargeback, refund, fx fees etc are all laid out in the scheme contract, some scheme fees can be opaque and tricky to calculate. Greater clarity on these would be appreciated by our members, where possible.

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

We largely agree with the proposed scope but would make the following comments:

- The term 'service users' should include both card issuers and acquirers? It was unclear whether it includes both.
- The scope should pay special attention to the variability of effective economics that apply to the large players towards the small players.
- If possible, the scope should be extended to cover how fees are allocated through the value chain.
- Within the scope, it is important to see the schemes as part of the wider retail payments market; to compete with the schemes you don't need to be a scheme, (e.g. PayPal) – competitive factors often come from non-card schemes.
- If within the scope you are including "processing fees", these should be clearly distinguished from "scheme fees" as they are charged by the processor not the scheme.

3. Do you agree with our proposed approach to the market review?

Once again, we and our members are generally in agreement with your approach but would make the following comments:

Whilst the initial objective enforced transparency, the growth of optional services has blurred this. In theory, merchants have choice but this is often not the case. Optional services are where our members believe the majority of scheme fee increases have happened in the last few years. Some of our members believe this approach does not encourage the roll out of 3DS – 3DS should offers consumers greater safety when they transact and reduces fraud.

There is a concern that the approach is very broad and hence challenging to deliver. There is a suggestion that to focus on specific transactions rather than all transactions would deliver a swifter and more defined result. One option would be to look at large domestic transactions where there appear to be a large number of complaints.

One member made specific reference to the second bullet of 2.7 related to payments acceptance alternatives. They believed that the growth of alternative payments methods (APMs) means that there are more competitors to the schemes.

4. Are there specific types of scheme and processing fees we should focus our work on? Perhaps because the scheme and processing fees represent a large percentage of total network fee revenues or because they have changed substantially?

By way of introduction, a common theme across all members is that scheme fees are generally extremely complex, and difficult to analyse and this often makes it difficult to properly review and manage. Allied to this, members would like to understand why the schemes have increased their fees and how this has affected the value chain. Specifically:

The concept of value added services or optional services remains a grey are; optional fees are often de facto mandatory and this has contributed to some of the fee increases since 2014.

3DS costs – not every participant in the market understands the cost of every transaction. The schemes have effectively doubled 3DS v1 authentication fees which has had a major impact on merchants. Some of our members believe that any future scheme fees price increase should be assessed and justified before being imposed.

CNP scheme fees are being applied when the customer is in fact present at the store. Specifically authentication fees and billable indicators which have added considerable costs to merchants and these are non-negotiable.

One member believe focus should be on domestic and face-to-face rather than every type of fee.

Other members have pointed out that fees do not always represent the entire cost, as penalties can represent a significant cost item – so should these be included in any review.

One member pointed out that, for pan-European fees, when transactions go up in value Visa fees reduce, whilst at MasterCard when transactions go up in value the fees remain almost the same (so proportionally their fees go up).

Are there specific types of scheme and processing fees we should not focus on? Perhaps because the fees represent a small percentage of total network fee revenues or because they have not changed substantially?

One member specifically noted that core scheme fees have not changed, hence there is no need to look at them (e.g. 2.5, 2.11, 2.12, 3.4.1, 3.4.2, 3.4.3, 5.2.1, 5.2.1, 5.2.3).

5. Do you have views on the potential factors that we propose to investigate (set out in paragraphs 2.7 and 2.8)?

A number of our members noted that they expect the PSR to be very robust with the schemes, show teeth and take strong action to ensure competition. One member noted that when schemes raise their fee “there isn’t much anyone can do except raise their own prices and hit the consumer”.

Specifically, some of our members have proposed the following:

2.7 should be expanded to consider the final destination of the money coming from increased fees and its impact on market competition.

The contribution of acquirers vs issuers is relevant to the study and the proportionality of the fees paid by the smallest entities vs the ones paid by the largest ones.

The key objective should be to reduce complexity and achieve transparency. Currently, acquirer and merchant statements and billing systems use different formats, terminology and at times fail to correctly separate scheme fees from interchange fees.

On 2.8, it is critical to establish the relationship that exists between the four moving parts here – namely the schemes, issuers, acquirers and merchants. In the simplest form, the issuers control the interchange, the schemes control the scheme/assessment fees, the acquirer controls the end processing costs and the merchant controls nothing. The three cost models put to the merchant are a blended rate, where all fees are rolled into an end rate to the merchant; the Interchange + model where the fees are broken out to cover Interchange + acquirer fees and the Interchange ++ model which also is + scheme fees. The last of these is the most opaque to the merchant as scheme fees can vary enormously. The other two can leave the merchant out of pocket if scheme or Interchange fees change.

Finally, one member has suggested that 2.7 should be rephrased to consider the barriers to “running a payments system” and not just a “card payments system”.

Are there other factors in relation to scheme and processing fees that we should be considering?

The only real comment here is to reiterate 2.7, in the need to consider barriers to entry and a continued call for greater simplicity and transparency in scheme fees.

About The Payments Association

The Payments Association (previously the Emerging Payments Association or EPA) is for payments institutions, big & small. We help our members navigate a complex regulatory environment and facilitate profitable business partnerships.

Our purpose is to empower the most influential community in payments, where the connections, collaboration and learning shape an industry that works for all.

We operate as an independent representative for the industry and its interests, and drive collaboration within the payments sector in order to bring about meaningful change and innovation. We work closely with industry stakeholders such as the Bank of England, the FCA, HM Treasury, the Payment Systems Regulator, Pay.UK, UK Finance and Innovate Finance.

Through our comprehensive programme of activities for members and with guidance from an independent Advisory Board of leading payments CEOs, we facilitate the connections and build the bridges that join the ecosystem together and make it stronger.

These activities include a programme of monthly digital and face-to-face events including our annual conference PAY360 and awards dinner, CEO round tables and training activities.

We run 6 stakeholder working Project groups: Inclusion, Regulator, Financial Crime, Crypto and Digital Currencies, Cross Border and Open Banking. The volunteers within these groups represent the collective view of The Payments Association members at industry-critical moments and work together to drive innovation in these areas.

We also conduct exclusive industry research which is made available to our members through our Insights knowledge base. These include monthly whitepapers, insightful interviews and tips from the industry’s most successful CEOs.

See www.thepaymentsassociation.org for more information. Contact malik.smith@thepaymentsassociation.org for assistance.