

Fingleton Insights

PSR market reviews into card scheme fees: a devilishly complicated end-game

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The UK's Payments Systems Regulator (PSR) has embarked on not one, but [two market reviews](#) into card schemes. Will the PSR shake up the UK payments market and, if so, is this likely to have repercussions internationally?

A UK market study enables the regulator to examine whether competition in one or more markets works effectively. It is not an investigation into whether existing laws are being broken, although if evidence of illegality is found, a separate investigation could follow along different rails. Instead it asks if there are "features" of the market that make it less competitive than it might be. If it finds there are, it has a very wide range of tools it can apply including price regulation and structural remedies.

This short piece describes the PSR's market studies, and outlines our view on the possible remedies that might result.

An inevitable reckoning: long, far reaching market reviews

As part of its Card Acquiring Market Review (CAMR) interim report, in September 2020 the PSR found evidence that card scheme fees had doubled in recent years. At that time, the PSR did not review whether these fees were excessive, but the seed of doubt around the extent of card schemes' market power had been sown (see [our December 2020](#) piece, where we speculated that the PSR would have to investigate further).

Since then, Mastercard and Visa came under the spotlight when they [announced a quintupling](#) of interchange fees on certain cross-border transactions no longer subject to EU IFR's cap in early 2021.

Against the background of a worsening cost of living crisis and [public scrutiny on the work of the PSR](#), on 21 June 2022, the regulator confirmed **two market reviews** into card scheme fees which will look in detail at:

- 1. Scheme and processing fees**, i.e. fees that issuers and acquirers pay to scheme operators for using the system, and processing entities charge them for each transaction; and
- 2. Cross-border interchange fees**, i.e. those fees paid on transactions using cards issued by EEA banks to buy from UK merchants, also referred to as 'outbound' interchange fees.

A market review is an in-depth investigation into how well markets are working for consumers and users. In the past they have taken around two years from consulting on the draft terms of references to issuing a final set of remedies.

The PSR will be looking for features that may lead to harm to competition and consumers. These may be structural features of the market and behavioural patterns on both the demand and supply side that may lead to market power and in turn consumer harm. For example, network effects and economies of scale can make entry more difficult and lead to persistent high concentration levels, effectively affording card schemes "must have" status with little threat of competition.

The reviews will involve extensive information and data requests for industry participants, detailed analysis of internal documents, set piece events with stakeholders (including potentially site visits or oral hearings) and formal consultation exercises. Stakeholders that engage strategically with this process stand to shape the evolution of the PSR's thinking on the extent of (and reasons for) any consumer harm and the

appropriate package of remedies to redress it.

Fast-forward: where could the reviews lead?

Under the Financial Services (Banking Reform) Act 2013, the PSR has sweeping powers to introduce a variety of remedies. We walk through some of the main options in turn:

- If the PSR finds that there is a lack of competition due to user engagement, one light touch remedy could be **informational remedies** that make cardholders more aware of the costs of different payment methods, or simplify fee-schedules so that merchants can better assess the cost of accepting different cards. However, regulators have experimented for a long time with informational remedies, and the current consensus is that in many situations they prove insufficient.
- Stepping up the scale, a more substantive intervention would be for the PSR to issue a **recommendation to the Government to amend** UK Payment System Regulations 2017 so as to allow surcharging. This would allow merchants to use financial steering towards lower cost payment methods.
- The PSR may also want to **intervene in card scheme rules**. For example, it may seek a relaxation of 'accept all colours' rules, although this may carry high risk of unintended consequences in weakening the appeal of card systems which relies on universal acceptance.
- Perhaps the most intrusive option for the PSR would be to **directly regulate the level of fees**, by introducing a cap.
 - A cap on outbound interchange fees, would be a sort of 'return' to pre-Brexit regulation under the Interchange Fees Regulation (IFR). While this makes it sound like an easy win, it still requires

a full-scale market investigation to be on solid legal ground and faces design difficulties related to cross-border payments.

- A **cap for scheme and processing fees** would be a world-first - so far only Interchange fees have been subject to a cap under the EU Interchange Fees Regulation (IFR). To do so, the PSR will likely have to establish that it is not possible to target the underlying causes of market power, and that regulating fees will both benefit consumers and not cause distortions in other segments of the market through a 'waterbed effect'.
- One option that might help the PSR achieve some early change would be the extraction of **voluntary commitments**. For example, it would be conceivable to see the regulator and industry work together to improve disclosure and transparency around interchange and scheme fees, possibly on the back of the remedies being implemented as a result of the CAMR.

It's worth also noting that the PSR is not the only interested governing stakeholder. The PSR may refer the market to the **Competition and Markets Authority (CMA)** for an in-depth investigation. Similarly to the PSR, the CMA has sweeping investigative and remedial powers and as an agency has developed extensive expertise in investigating markets. The **UK Government too could legislate** so as to accelerate the (re) introduction of a price cap, compared to the market review route available to the PSR. This is effectively what happened in the energy market, when the Government led by Theresa May urged Ofgem to design and implement a retail price cap in a matter of months.

Dancing with the devil in the detail

These recent announcements, hot on the heels of the CAMRs, indicate that the PSR is getting serious about regulatory intervention in card schemes.

What is certain is that effective and timely remedies will be far from straightforward to design. There will be winners and losers. Less certain at this stage is where the PSR will land, and what it will mean for the card scheme participants in the UK, and - as other regulators across the world look on - internationally too.

The PSR was set up almost a decade ago to inject greater competition into the payments market in the UK, following the failure of a series of long-running competition cases to achieve that. Thus far, the PSR has taken a very moderate approach, making modest tweaks here and there. It will be interesting to see if these studies mark a change in tack.

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