UK Finance

Response to PSR's Stage 1 Remedy Consultation CP24/14

Market review of UK-EEA consumer cross-border interchange fees

7 February 2025

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1. Executive Summary

Overview

UK Finance and its members do not agree with another description of the cards market as not working well. Both the Future of Payments Report by Joe Garner and HM Treasury's National Payments Vision (NPV) noted the benefits and positive attributes of the UK cards market. Garner noted that "cards work well".

Interim Cap

UK Finance and its members on both the acquiring side and the issuing side are not supportive of the imposition of an interim cap, and strongly against the introduction of a two stage approach which many view as being unnecessarily burdensome:

Disproportionate:	The market share of the relevant card traffic is less than 4%.
Prejudicial:	The regulator will be under pressure to not increase rates later on, even if fully justified by a study.
No data to support:	The proposed capped rates are not based on any econometric study.
NPV:	The Final Report and proposed remedies do not take into account the change in policy in the UK. The report and the remedies do not consider the important policy considerations, necessity of and benefits derived from commercial sustainability in payments.
Inefficient:	Requiring potentially a two-step remedy doubles the effort, cost and distraction for merchant acquirers, creating opportunity costs. Acquirers should be given sufficient time to implement in an orderly way, aligned with other mandatory changes.
Process:	Members would prefer to deal with the enduring remedy when it comes and not have an interim process delay uncertainty further, incur unnecessary costs, resources, time and potential risks to implement such changes.
Cross Border Fraud:	Cross border fraud, especially in the EEA-UK channel is significantly higher than UK domestic fraud. This justifies

	a differential in domestic rates of interchange to EEA-UK rates – even more reason why a 0.2% and 0.3% interim cap is not appropriate or warranted by the evidence.
EU Relations:	A UK-imposed cap on EEA issuers could provoke a retaliatory response from the European Commission, introducing further uncertainty.

Draft Directions : Monitoring

Acquirers do not support introducing any role for the schemes to either monitor or enforce acquirer pricing. The schemes are not equipped to perform this role and it could lead to unintended consequences.

Draft Directions: Information to Merchants

This is overly prescriptive and overreaching. Acquirers should be left to communicate to their merchants in the best way they see fit, and in a manner they think meets their Consumer Duty obligations.

Issuer Points

Issuers are interested in this consultation for a number of reasons, even though the EEA issuers are more immediately and directly impacted. The UK issuers expect some form of a response from the European Commission. The UK issuers also note that the Final Report and proposed remedies seem to not recognise the recent developments in broader government and payments policy priorities.

In addition to the above points:

- **SEPA**: Issuers are not convinced by the Final Report's claim that that the UK's access to SEPA marks out the EEA/UK corridor as somehow unique as compared to other corridors. Issuers do not think SEPA is at all relevant to the debate on card interchange and its inclusion as a compelling reason to go back to pre-Brexit rates is not grounded in any valid economic argument.
- **Economic Growth:** There is more than one way to align interchange policy with economic growth. The UK seems to be adopting an approach that reducing interchange will lead to economic growth. A deeper understanding of what interchange is for is required. It is not about issuer incentives but about covering the cost of the services that issuers deliver to their customers – including protecting them and merchants from fraud losses and wider consumer protection. Payments drive innovation, competition and facilitate growth. Payment services need to be investable.

- **Inward Investment**: The proposal will swiftly introduce caps without a full market study and the overly negative sentiment on the cards market from the PSR (seemingly in contrast to the National Payments Vision's commentary on cards) leads to investor concern, and contributes to significant uncertainty for scale up financial businesses. One challenger bank told us of multiple inquiries from investors regarding consultations, discussions and the direction of travel in the UK card market. Furthermore, in the challenger bank space, the funding benefit derived from consumer deposits is much lower than for the traditional banks. This creates a reliance on interchange as a sustainable route to market, as the payment account provider seeks to enter the UK market and capture a customer base, and an incentive to innovate and compete in retail customer space - leading to better outcomes for consumers.
- **Commercial and legal certainty:** The card market is important to the UK economy and is one of the most successful globally. It delivers significant contributions to consumers and businesses alike. The market needs to keep on innovating and investing in services, fraud, security and resilience. To achieve this it must have certainty of commercial outcomes. This means that issuers must be able to accurately predict their commercial income over the long term and that such income should be legally certain.

2. Basis of Response

In this response firstly we provide some overarching commentary on CP24/14. Secondly, we address our acquirer members' commentary and then thirdly we address our card issuer members' commentary.

References in this response to "issuers" or "acquirers" or "cards" is made in the context of the four party systems operated by Visa and Mastercard.

3. General Commentary

UK Finance and its members welcome the opportunity to comment upon the publication of the Final Report and the publication of the remedies consultation relating to the PSR's market review into cross border interchange.

The cards industry is very supportive of HM Treasury's National Payments Vision and in particular its emphasis on noting that the card industry delivers very good

solutions to its users. The National Payments Vision places commercial sustainability at the heart of developing a safe and trusted payments industry that is innovative and protects consumers appropriately.

Card issuers are the front-line in protecting consumers and serving their day-to-day needs. Card acquirers provide excellent services to merchants but also take the financial responsibility when things go wrong. These two sides of the card payment network have different roles and commercial models, but they are brought together via the card schemes. They have a common purpose of meeting all customers' needs, partnering with third parties, developing more tools to protect against fraud, keeping the system safe from external and cyber threats, and innovating in the way customers pay and get paid.

The consistent narrative of a market not working well has become exaggerated and it is time to recognise what the card industry delivers, in a fairer light. Moreover, we encourage regulators to consider the National Payments Vision as a re-set. That re-set places payments within a broader macro-economic context (payments facilitate and drive economic growth and deliver good outcomes) but also focusses on the micro economic factors within payments that explain why good outcomes come about. In the context of cards and CP24/14, interchange is the enabler that drives innovation, protects consumers and merchants from fraud and offers a remedy when a consumer did not receive what they should have received. Whilst figures of £150-200 million of fees paid over the old caps are badged as "unnecessary" and demand urgent remedy, these fees are a very small proportion of the total costs borne by retailers.

The need to address cross border interchange fees urgently is over-stated. It would be better to focus on the enduring remedy, by conducting the study sooner rather than later with the benefit of not risking, or not seen to be risking prejudicing the enduring cap exercise.

Regulators should be focussing on items that have a material impact to markets, merchants or consumers as a whole – this exercise is a disproportionate use of regulatory and industry resources that could be better deployed elsewhere.

Card market reviews have been ongoing for nearly a decade. This review was announced in November 2021 and is not likely to be completed until late 2027. The acquiring market review took over four years. The scheme and processing fees review is ongoing. Industry questions how efficient these reviews are. Whilst it is appropriate for regulators to consider whether markets are working well, industry would like the work to be completed much faster - to achieve certainty. Payments need to be investable for their providers (as per the National Payments Vision) and that means the commercial arrangements need to be predictable and legally certain. This is important for investors in consumer banking and the credit card market.

The market share of card payments covered by CP24/14 is according to the Final Report, 3.6% of volume. The outcome of this review will be to establish a pricing methodology to set caps for this “outbound” flow of interchange, but it is inevitable that it will set a precedent for any future discussions on the level of domestic interchange by ruling in or out what types of issuer costs or income are eligible costs for consideration and what a base pricing methodology will be. Industry does not desire another five to ten years of uncertainty as to what regulated price caps will be, let alone years of data requests and consultations. A bigger conversation is needed about the cards industry and what it delivers, and how commercial sustainability (as a current policy principle) relates to the ongoing work of the PSR. The cards industry is a critical component of the UK economy – hence it is right to have regulatory purview, but it is also right the industry should not have to be subject to over a decade of intervention and a consistent but unbalanced regulatory narrative that it is “not working well”. In his Future of Payments Report Joe Garner noted that “cards work well”. It does not foster a welcoming approach for investment into UK financial services – and that is not good for broader competition, nor economic growth.

We can continue to go down the path of intervening in the card market, but many of our members would prefer to encourage open competition from other payment types and point to the fact that there are other payments types available, typically more expensive to the merchant than four-party scheme issued cards.

4 Acquirer Response

4.1 Interim Cap

The Final Report provided a number of acquirer comments, supporting an interim cap of 0.2% and 0.3%. Having discussed and reviewed with our acquirer members, we report that they are in fact **not supportive** of an interim cap.

This is significant. If one takes the list of 15 acquirers subject to the Acquiring Market Review (95% of the market), UK Finance represents all but three of them. It is clear that the vast market share of acquirers do not support an interim cap and would strongly prefer the work on the enduring remedy to be prioritised. This would lead to a rate being set properly after the appropriate study and consultation and not being risked or delayed by the focus on the interim remedy.

Acquirers think it is appropriate that the enduring study work should be prioritised and commenced. They will support the smooth transition of any cap, when imposed. Acquirers would welcome reduced costs to merchants. Many of our members would

be able to complete the exercise within 6 months, but acknowledge it will be expensive and intensive. Some members will need longer to complete the exercise and would welcome sensible and measured regulatory accommodation. Whilst the majority of acquirers may be able to complete the technology change within 6 months, there remains a significant minority that may not be able to do so within 6 months. The timeline will unnecessarily force some acquirers to prioritise this activity over everything else – and in the context that the relevant flow is less than 4 % of all acquired card traffic, this seems disproportionate

Some members suggest that accommodation should be made to fit in with scheme mandate windows so that a complete “package” of change management can be executed on a more efficient basis. Interrupting execution of a planned “stack” of technology change, or blended portfolio re-pricing windows is very frustrating and highly inefficient. Not only does the change create one off costs, but it also causes delays and other planned changes, many of which are regarded as mandatory scheme rules compliance. These other changes can be related to innovation, improvements to customer servicing, wholesale platform renewal, fraud, resilience or security. The timing of the compliance date for any remedy should be further discussed with acquirers to avoid material opportunity costs or wasted costs.

4.2 Scheme and Acquirer Notification Requirements

This section of our response considers the draft directions. Section 3.4 of the draft directions states that:

> `”Each Directed Operator must notify their Acquirers of the Caps and request that their Acquirers, in turn, notify promptly their respective UK Based Merchant Customers and/or any intermediary acting on their behalf, stating that:
>
> a. this general direction has been adopted; and
>
> b. in respect of the Mastercard Payment System and/or Visa Europe Payment System as appropriate, UK-EEA Consumer CNP Outbound IFs will be capped for all future UK-EEA Consumer CNP Outbound Transactions using Credit Cards and Debit Cards from a specified date (which is within six Months from the Commencement Date) for the duration of this general direction or until this requirement is amended, replaced or revoked by the PSR”.

Our acquirer members question the need to introduce a new requirement mandating them to notify relevant UK based merchant customers, especially in the wider context of the transparency remedies introduced following the PSR's card acquiring market review enabling merchants to compare prices and other service features more efficiently. This suggestion is overreaching and overly prescriptive. It should be up to the merchant to use these tools to make an informed decision about which acquiring services they wish to use based on their specific needs and service features they require. The PSR should assess the impact the acquiring market remedies have had before introducing new related transparency requirements to assess the cost benefit analysis of doing so. The acquirers should be left to work with the principles based approach set out in the Consumer Duty

4.3 Scheme Monitoring

Remaining with the draft directions, we now refer to section 8.4. It states:

> "Without prejudice to the PSR's power to request such documents and information under section 81 FSBRA or under an alternative paragraph of this general direction, and to the extent not already provided to the PSR, each Directed Operator must provide promptly to the PSR such information (including clarification) as the PSR considers necessary and requests in writing of them in relation to or in connection with:
>
> a. the operation of this general direction or the implementation and/or enforcement of each of the Directed Operators' compliance with this general direction (or any provision of this general direction); and
>
> b. monitoring the effectiveness and appropriateness of this general direction (or any provision of this general direction), including for the purposes of any work carried out in connection with section 4" [*section 4 imposes the caps*].

Our acquirer members think section 8.4 b is not appropriate and should be deleted.

First, it is difficult to place in the hands of the schemes a requirement to monitor effectiveness and appropriateness when the schemes (amongst others) do not find the remedy as one that will be effective in its broadest sense or is at all appropriate.

Second, this section is far too vague. It seems to be implying, under the premise of an information response section, there is a requirement for the schemes to monitor that the acquirers actually do pass-through the lower rates on interchange. "Effectiveness" could be extended to schemes being required to monitor that the merchants pass through lower merchant service charges to consumers – such a

requirement would be impossible to manage. **"Monitoring" in this context seems to our members to mean "enforcing".**

Third, leaving aside the multitude of factors that an acquirer takes into account when setting its blended rates, acquirers are concerned that section 8.4 b of the direction has significant potential to confuse their commercial relationship as between them and the schemes. The schemes are not subject to the same regulatory standards, approach or governance as acquirers. Equally, acquirers are concerned that it could confuse the regulatory relationship between them and their regulators, or lead to risks where a scheme has one view that could later be challenged by a regulator, with consequences for the acquirer. Whilst the approach is novel, it is not supported by acquirers. The acquirers think that the schemes should not have any role in enforcing or monitoring acquirer pricing, and that is best left to the acquirers and their relationship with the requlators.

4.4 Acquirer pricing and costs

Schemes are set up to manage financial institutions as their members, not end users. They do not get involved with the end pricing that an acquirer charges its merchants. Moreover, that end pricing for customers on blended rates is fraught with a range of scenarios and it is too blunt an assumption that a reduction in cross border interchange will lead to an automatic reduction in the blended rate. This is because interchange is but one of the inputs. If an acquirer has invested in its platform and its costs have risen, it will seek, subject to market forces, to recoup those costs and increase its processing charges. In the context of a blended rate customer, there could be a reduction in interchange and an increase in other costs, leading to a limited or no reduction in the blended rate.

Merchants enjoy strong levels of competition from a broad range of acquirers, including many new entrants. In respect of small and medium-sized merchants, the experience of our members is that the market is competitive and merchants do shop around and switch, potentially due to ease of price discovery and clear information about available features.

In our members' experience, merchants do not switch solely due to acquiring price and instead merchants sign up for a broad range of factors, of which price is one. Other factors may include the ease and speed of merchant onboarding, fraud capabilities, range of payment methods, ease of integration, higher authorisation rates, API uptime, speed of settlement, core platform reliability, data insights, customer servicing portals, levels of personal relationship management, ability to offer working capital financing against card receivables etc.

The blended rate market responded differently to the increase in rates after Brexit. Some firms passed on the rate in its merchant service charge and some absorbed it in full or in part. A review of an acquirer's actions cannot be simply compared to another acquirer's action. An acquirer that does not pass through all of the cross border interchange reduction to its blended customers may have a range of perfectly legitimate reasons not to do so. It is important to understand that the cost of acceptance acquirers charge merchants includes a real cost of technology that integrates a number of services over and above payment processing, such as business reporting, fraud, subscription management, bill payments, and the ability to manage funds quicker and more efficiently. The cost of online payment acceptance today has true costs and in exchange, provides real value to merchants. It is not just the pass through of interchange and scheme fees. The only parties that should be responsible for setting acquirer pricing are acquirers and they should be judged directly by their customers and ultimately the PSR or the FCA (Consumer Duty). Placing that judgement in the hands of the schemes places it where it is not wanted and acquirers do not want the schemes interfering in areas that they do not have the competencies to deal with.

In conclusion, acquirers reject the notion that a scheme performing a monitoring role could make a reliable assessment of the effectiveness of the proposed remedies, without a more holistic understanding of why merchants choose the acquiring services they do. Simply seeking to monitor the effectiveness on price alone will miss the value of different service features and be a crude and ineffective metric. From the inception of the market review into acquiring, acquirers have repeatedly said that price is but one factor in merchants' choice of acquirer.

5. Issuer Response

5.1 Introduction

Card issuers welcome the opportunity to respond to the Payment Systems Regulator's (PSR) consultation on cross-border interchange fees in the cards market. Like the acquirers, the issuers are **not supportive** of an interim cap below current rates.

5.2 Why does this consultation matter to UK issuers?

Our UK issuer members acknowledge that in the main, they will not be directly or immediately impacted by any lower cap on the EEA/UK transactions.

Issuers are concerned that the interim remedy – and the longer-term remedy - place the UK in a position where EU member states will perceive these new caps as unilateral action taken against them. We think this raises broader risks for the UK's attempts to refresh relations with the EU and these risks go beyond the limitations of payments policy and this response.

UK issuers are concerned that a UK imposed unilateral cap impacting EEA issuers and not UK issuers is very likely to lead to a retaliatory response from the European Commission. A reciprocal rate could be imposed without any true study being undertaken – and it is far from clear that the UK consumer cards market and its costs are the same as the European consumer cards market. Regardless of what the true costs are in either direction, the setting of interchange across borders has a geo-political dimension.

The consultation is also highly relevant to UK issuers because it is the first consultation on interchange since the UK left the European Union. As such it may be indicative of the approach to future regulatory activity on other classes of interchange in the UK. In particular, how the study for the "enduring" rate will be established, its terms of reference, the basis on how an effective "true" rate should be calculated could all have a bearing on more important and significant reviews. However, the UK issuing market does not think that any further reviews are necessary and wishes to draw a line on further regulatory activity into interchange.

Issuers note that the Final Report is the first material publication from the PSR on the cards market post the change of government and the publication of The National Payments Vision. Issuers are somewhat concerned that the approach to the cards market as evidenced by the Final Report and the proposed interim cap are not at all reflective of broader policy developments in payments or commentary in the Future of Payments Report that cards work well. Payments need to serve their users at all times – but to do that they must also be commercially sustainable and represent investable opportunities.

UK issuers therefore have a very strong interest in this consultation, and like the acquirers, do not support the imposition of an interim cap at rates below current rates.

5.3 Summary of Key Points

Concerns About the Interim Cap:

- Like the acquirers, the UK issuing industry remains unconvinced that a two-stage remedy process is necessary or appropriate and that imposing an interim cap without sufficient evidence is premature.
- CNP cross-border transactions from EEA issuers to UK acquirers account for only 3.6% of all UK acquired card payments, highlighting that the issue is not urgent enough to warrant a temporary emergency solution.
- Issuers are particularly concerned about the prejudicial nature of the interim cap. While the PSR states that Stage 2 remedies will be conducted independently, the political reality and pervasive negative sentiment may make it unpalatable to later increase fees, even if justified. It runs the risk of setting up an expensive process where the outcome is pre-determined, or limiting the scope of eligible issuer costs to such an extent that no true or balanced conclusion could be made.

5.4 Points Issuers Welcome

Issuers welcome:

- the PSR's recognition that it did not make a finding that competition law was breached in the setting of cross border interchange rates;
- the decision not to impose a zero cap or exercise backward-looking remedies and instead focus on the future[1]; and
- maintaining the status quo ad valorem commercial structure of interchange fees – this is a prudent choice, as any fundamental change to this model would have introduced unnecessary complexity and risk and would have been very disruptive and without sufficient evidence to justify such a change.

[1] Remedies consultation, para 4.22:
"*While we note the views of merchants and acquirers that would like some redress in terms of the unduly high fees they have already paid, we do not view a stage 1 cap as a mechanism to 'compensate' merchants and their customers for the higher levels of IFs that they have paid since 2021. The conclusions in our Final Report do not include a finding that the schemes have breached competition law*,"

5.5 Cross-Border Costs and Interchange Fee Purpose

Issuers emphasise that cross-border transactions are inherently more expensive than domestic ones due to higher fraud risks, additional authentication requirements, and operational complexities.

5.5.1 Fraud and Financial Crime Costs: Cross-border CNP transactions involve higher fraud levels, requiring issuers to invest heavily in fraud prevention and detection measures. Comparing CNP fraud instances per regional channel (as a percentage of all CNP fraud) against the CNP transactions per region (as a percentage of all transactions) reveals that significantly more fraud instances per transaction occur in the EEA/UK CNP channel than in the UK/UK CNP channel.

Interestingly, the EEA/UK CNP channel generates more fraud instances per transaction than the RoW/UK CNP channel. The Appendix to this response sets out the data methodology and limitations (the main one being that we have had to estimate the regional share of transactions given that the Final Report does not spell out UK acquired CNP market share percentages per region on either a volume or value basis).

What data we used: We reviewed UK Finance card fraud data[2] for the whole of 2022 and 2023 and up until October 2024. Looking at UK acquiring CNP data only, we filtered the data into three issuer regions – UK issued, EEA issued and Rest of World issued. We made a reasonable estimate of the share of UK acquired CNP transactions from those issuer regions based on the representation in Figure 6 of the Final Report and compared those market shares with the share of card fraud coming from those issuer regions.

Data headlines:

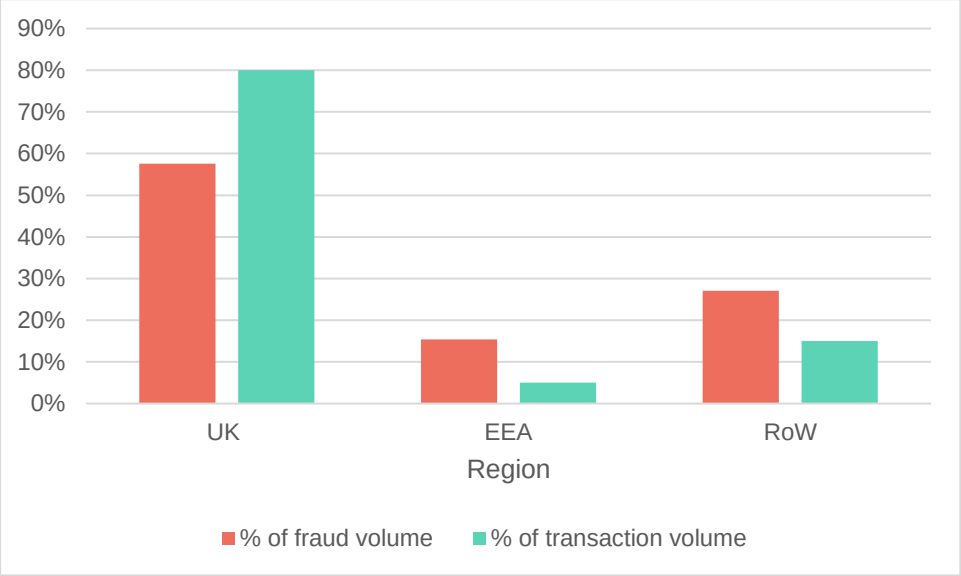
- Proportionately, compared to UK issued cards, international cards generate much higher volumes and values of CNP fraud
- Internationally issued cards generate 42% of all UK acquired CNP fraud even though the market share of transactions is much lower at c20%

[2] See the Appendix

- EEA issued cards, whilst representing around 4.5-5 % of UK acquired CNP transactions, represent over 15% of all UK acquired CNP frauds
- Rest of World (ex UK, ex EEA) issued cards, whilst representing 15% of UK acquired CNP transactions represent 27% of all UK acquired CNP frauds

What the data tells us: The EEA/UK CNP channel generates a much higher fraud volume rate than any other CNP region. On the basis that risk and cost of fraud, the cost of servicing customers, fraud recovery, preventing fraud and recovering fraud are relevant to interchange, **the fraud data presents evidence that cross border interchange should be higher than domestic interchange** but it also suggests that EEA cross border interchange should not be lower Rest of World interchange (i.e. the current rates in place for EEA/EEA CNP).

The table below shows UK acquired CNP transactions split into three regions, showing the fraud volume percentage and the transaction volume percentage (see Appendix for source data and methodology)



5.5.2 Consumer and Merchant Protections: Interchange fees fund critical services such as strong customer authentication, fraud tools, chargeback protections, and verification costs, which benefit both consumers and merchants. As a result of liability shift, merchants are protected when an authenticated transaction turns out to be executed on a fraudulent card.

5.5.3 Consumer Banking: Interchange fees provide significant value to consumers and foster competition and innovation.

The purpose of interchange fees is multifaceted and extends beyond mere incentives for issuers. These fees support market entrants and competition, operational sustainability, platform and operational costs, consumer protection, innovation and broader payment system benefits. This is part of a much broader discussion on the commercial sustainability of payments – and the value that they bring to merchants and consumers at the micro level and to the UK economy at the macro level.

HM Treasury's National Payments Vision recognises the importance of the cards market in the UK and the benefits it brings to merchants and consumers. It also sets out the principle that payments need to be commercially sustainable to the firms that offer the services. There has been a sea-change in payments policy over the last few months and issuers are disappointed that the proposed remedies reflect an overly negative approach to cards that is now out of date. The more progressive approach on commercial sustainability should apply to cards as well as to open banking or other payment systems. This is relevant to all card payments but particularly relevant to cross border interchange and transactions where issuers' costs, operational complexity and risks are far higher.

5.6 Rebates and Issuer Costs

The Final Report discusses issuer costs as relevant to interchange. The report is unclear as to whether incentives and rebates are treated together as "rebates". The report refers to data from only one EEA issuer as to "indirect" costs, but does not offer any detail of what "indirect" costs comprise – and of course a response from a single issuer only does not meet a statistically reliable data point. The report notes that : "So, even if we accepted that IFs should reflect some of the costs that issuers incur, we have seen that outbound IFs set by Mastercard and Visa significantly exceed such costs"[3].

In our issuer members' view it is very concerning that a significant and "urgent" intervention is based upon a very weak body of evidence and subjective policy positions that have been inadequately studied, debated and consulted upon:

- issuers believe payments should be commercially sustainable in their own right. Issuers' costs must be covered ("even if we accepted" wording is troubling as it indicates a view that they are not relevant to interchange);

[3] Final Report para 5.84

- commercial sustainability means that cost recovery and returns should be available;
- a full consultation is required to establish what direct costs and indirect costs are relevant to covering costs via interchange. It is absolutely necessary that the future study and consultation does just that; and
- there appears to be an automatic assumption at that all rebates should be netted off the scheme and processing fees by issuers[4]. This needs to studied and *objectively* assessed. Incentives and rebates in the card scheme / issuer context, often reflect strategic agreements, market positioning and incentives to roll out new products and services and market positioning, rather merely a means to lower the direct costs associated with processing cross-border transactions.

5.7 SEPA

The consultation paper includes commentary that the UK-EEA corridor is somehow special because the UK is a member of SEPA. We do not think the argument supports the narrative and is selected because it suits the narrative. There are many developments occurring in the EEA, such as the Digital Euro, which are not occurring here in the UK. There is no logical connection, or valid economic argument or relevance between SEPA and cross-border interchange fees for card payments. SEPA credit transfers are not a viable alternative for EEA consumers making consumer retail goods and services payments to UK merchants, whether in person/card present or card not present. Open banking layered on SEPA rails is nascent in a handful of EEA countries and does not yet have intra-EEA scale yet alone any UK-EEA practical acceptance or functionality. The SEPA justification for a unique one-way corridor for UK merchant and EEA consumer payments appears to many to be a somewhat selective argument.

5.8 Proposed Rates

Issuers would naturally prefer the mid-level proposal of 0.5% and 0.6% over the 0.2% and 0.3% proposal and the status quo proposal over the mid-level proposal. However, issuers do not think it is appropriate to engage in a “horse-trade” on such an important matter, based upon such a weak body of evidence and that any review should be conducted comprehensively and sooner rather than later. This means that

[4]Final Report, para 5.83

issuers do not support any cap at a rate lower than current rates, but will support an interim cap at the current 1.15% and 1.5% rates so as to give assurance that cross border interchange rates will not increase in the near future. This approach:

- better reflects genuine costs and acknowledges the higher risks and expenses associated with cross-border transactions (such as higher fraud rates as covered by section 5.5 above)
- avoids the risk that commentators will find any rise in capped rates unpalatable even when the Stage 2 study phase will show issuers' cross border costs, risks and models justify an interchange rate higher than the interim 0.2% and 0.3% rates
- provides a more sustainable framework for balancing costs and returns between merchants and issuers – see below.
- maintains the positive consumer banking competitive aspect that card interchange provides challengers – by making payments commercially sustainable.

5.9 Setting Rates Too Low

There are consequences for setting rates too low. Leaving aside issuer arguments already rejected in the Final Report and the other arguments in this response about what interchange pays for, setting interchange at too low a rate could harm the development of open banking or digital wallets as attractive alternatives to cards. Let open banking and other new entrants develop, on a commercial basis, and let the market "play it out" to determine prices.

5.10 Consultation on Stage 2 Methodology

The methodology for the Stage 2 study must be consulted upon as soon as possible. The industry has significant concerns about reliance on outdated studies, such as the EU's MIT study, which fails to account for:

- rising costs of authentication and digital wallet infrastructure;
- the fight against fraud and financial crime; and
- the irrelevance of cash comparisons for cross-border CNP transactions.

The study's approach must balance merchant costs with the needs of consumers and PSPs, ensuring the sustainability, investability and efficiency of the payment

system. Some common ground or logic with the FCA's approach on pricing for open banking payments should be explored so as to ensure a level playing field in the regulatory approach *between payment systems*. This is not to say that consumer banking overheads not related to payment activity should be considered in the pricing. It is to say, for example, that if open banking commercials are set on the basis that fraud and recourse claims losses and claims administration costs are "allowed", then the same principles should apply to card claims losses and claims administration costs.

As noted earlier, it needs to study (rather than prejudge as appears to be the case in the Final Report) scheme and processing fees and rebates and incentives and whether they can be fairly netted off in the cost analysis, or fairly attributed to other allocations (such as funding innovation and new features roll out). It needs to establish indirect costs. It needs to establish and recognise the policy principle that payments must be commercially sustainable for all participants and worth investing in.

The study needs to move away from an outdated and irrelevant comparison to cash and to have a broader recognition that risks and costs are higher in international transactions and that issuers need to be incentivised and rewarded/compensated for facilitating consumer driven international trade. Furthermore, it should take more account of alternatives and their relative costs (and not discount them as non-viable alternatives because they can be more expensive) – examples include Swish, Ideal (wero), Buzum, PayPal.

5.11 Conclusion (Issuers)

Issuers remain committed to working collaboratively with the PSR to develop evidence-based, proportionate remedies. The interim cap and two-stage process risk undermining the commercial sustainability of cross-border payments. We urge the PSR to prioritise a robust consultation on the Stage 2 methodology over the unnecessary diversion of an interim cap and ensure that the final remedies are informed by comprehensive, relevant and up-to-date evidence.

Appendix 1 : Fraud Data

Introduction

UK Finance receives card transaction data and fraud data from UK issuers and acquirers. We looked at our UK fraud acquirer data set for the period 1/1/22 to 30.10.24 (the latest available reporting data).

Our fraud data set includes identification of the issuer location, enabling a comparison of countries or regions.

We filtered the UK fraud acquirer data set to show only Card Not Present (CNP) fraud. We applied a second filter to that CNP data set to show the card issuer location by one of three regions: UK, EEA, and Rest of World (excluding UK and EEA).

Transaction Data

Whilst UK Finance receives comprehensive transaction volume and value data from UK issuers and acquirers, our transaction data set does not identify the issuer location – we have a “UK” or “international” flag only.

In order to identify the split between the three regions of transactions we referred to table 6.2 in the Final Report and as such can only infer in an approximate way the percentages of CNP transactions acquired in the UK by issuer regions.

Data Approach

It is noted that the periodicity of the two data sets do not match perfectly. It is also likely that the acquirer fraud data submitted to UK Finance and the scheme data submitted to the PSR will have differences (such as UK Finance data will not include data from non-members or those members who do not submit data).

It is acknowledged that a full data set of all UK acquired CNP fraud as compared to a full data set of all UK transactions, each broken down into issuer regions, reported for the same time periods, would be needed to calculate an accurate comparison of the value and volume of transactions per region to the value and volume of fraudulent transactions per region. A direct regional comparison of a fraud rate by volume and value could be calculated.

Given that the PSR data only shows volumes and not values we do not include a values comparison.

The remedies consultation called for data. Whilst we acknowledge that certain approximations have been made, we believe the data illustrates, with a satisfactory level of confidence, a general picture that EEA issued cards generate a much higher level of CNP fraud instances than do UK issued cards or cards issued in the rest of the world outside the UK and EEA. At the very least, the data shows that further data analysis into the higher propensity of EEA cards to generate CNP is necessary.

Issuers contend that fraud is a material cost and is directly related to the cost of card payments and should be included as one of the costs in calculating interchange. To the extent fraud is an eligible cost, it is clear that EEA issued cards used in cross border CNP in the UK, incur a higher cost than UK issued cards used for CNP in the UK. It therefore follows that EEA / UK CNP interchange rates should be higher than UK domestic rates. On a volume of fraud to transactions basis comparison, EEA issued CNP fraud acquired in the UK is higher than rest of world issued CNP fraud in the UK. On the assumption that the current RoW/UK CNP interchange rate is set at the "right" level, and to the extent that fraud is an important element of interchange, the analysis presented here suggests that EEA/UK cross border CNP interchange rate should be more closely aligned to the RoW/EEA cross border CNP interchange rate. It further calls into question how appropriate it is to place an interim cap at UK domestic rates.

Data

The table below identifies the percentages of CNP fraud transactions acquired in the UK (from actual UK Finance fraud data) and the percentage of CNP transactions acquired in the UK (inferred from the PSR data, Figure 6, Final Report).

UK acquired CNP fraud by issuer region

Region	% of fraud volume	% of transaction volume
UK	58%	80%
EEA	15%	5%
RoW	27%	15%

UK Finance Annual Fraud Report 2024 ("Fraud Report") – a note on methodology.

The Fraud Report can be found here :
https://www.ukfinance.org.uk/system/files/2024-06/UK%20Finance%20Annual%20Fraud%20report%202024.pdf

Page 66 of the Fraud Report includes a statement on methodology. The data sets on CNP fraud referred to in this response are from the same data sets used to generate the card data in the Fraud Report (and previous and ongoing fraud reports).

Highlights to note:

UK Finance publishes both the value of fraud losses and the number of cases. The data is reported to us by our members which include financial providers, credit, debit and charge card issuers, and card payment acquirers. Each incident of fraud does not equal one person being defrauded, but instead refers to the number of cards or accounts defrauded. For example, if a fraud was carried out on two cards, but they both belonged to the same person, this would represent two instances of fraud, not one.

All fraud loss figures, unless otherwise indicated, are reported as gross. This means the figures represent the total value of fraud including any money subsequently recovered by a bank. Some caveats are required for the tables in the document. The sum of components may not equal the total due to rounding. Data series are subject to restatement, based on corrections or the receipt of additional information.

Methodology for Data Collection. All of our data is collected directly from the firms we represent. We do not make any estimations (unless indicated) and have agreed definitions / reporting templates in use to ensure consistency across firms. All data submitted must pass clear plausibility phases.