PSR Acquiring Market Review Interim Report (AMR)

UK Finance Response to AMR Consultation

Date: 5th February, 2021

Sent to: cards@psr.org.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

Our response to the AMR is made following detailed engagement with UK Finance's Payment Acceptance Policy Group (**PAPG**), which includes major UK banks, long established international payment services providers and newer entrants to the market.

Introduction

In this response we set out key impact statements in Part 1 and more detailed commentary in Part 2.

UK Finance welcomes the Interim Report and the continued positive engagement of the PSR in the consultation process.

The Interim Report accurately describes elements of the *card-acquiring* market, its operation, charging structure and overall importance to UK business.

We are pleased that the PSR concluded that the market is working well for larger merchants, and in the case of smaller merchants "*Most merchants reported high levels of satisfaction with their current provider*"[1].

[1] Paragraph 6.94, ibid

The Interim Report concludes that the card acquiring market may not be "working well" for some merchant segments; however, as this response will detail, our members express some material reservations on (a) the robustness and appropriateness of the pass-through data methodology and (b) the insufficient evidence used to formulate the conclusions. The material concern is the risk that remedies might be implemented founded upon a misunderstood and narrow appreciation of how merchants value the services the payments industry provides and how they choose their payments provider. In turn, our members are concerned that remedies should not create unintended and harmful consequences for the merchants that the payments industry serves.

Part 1 - Overview and Impact Statements

Impact Statement 1: Data

Members report significant concerns that the econometric pass-through analysis performed by the PSR is materially flawed in a number of respects. Members also report concerns as regards the merchant survey exercise, which whilst appearing to demonstrate broad satisfaction and ability to switch and negotiate better prices is also the foundation for proposed remedies. Members question the robustness of those foundations.

Impact Statement 2: The PSRs Findings

Members are concerned that the shortcomings with the pass-through analysis and other evidence means that the PSR incorrectly concludes that the "market is not working well" for those merchants with under £50m turnover.

Impact Statement 3: The Evolving Payments Market

Our members believe that a broader understanding of the overall payments market is required to develop a more forward-looking payments policy, reflecting the dynamic nature of payments (and payments innovation) and its evolution, beyond core acquiring. Price is an important element of the market but more emphasis should be given to other elements such as:

- ***the quality characteristics of the products and services provided by acquirers (such as speed of settlement, value-add services provided etc.)***
- ***the maintenance of liquidity and consumer protection (risk)***
- ***evolving and alternative payment types (such as direct bank payments being enabled by Open Banking and "Buy Now Pay Later" payment checkout options)***
- ***the evolution in how merchants choose, interact and contract with payments providers (such as integrated hardware, software, and gateway channels)***
- ***the breadth and pricing of other payment and related services offered by participants***

Acquiring is not a product in isolation and the approach of treating acquiring as similar to a binary and homogenous utility (e.g. electricity) is flawed.

Impact Statement 4: Covid-19

The payments market (and acquiring in particular) has rapidly evolved over the last five years and Covid-19 has provided some useful live examples of the risks and opportunities that the payments market presents for all participants. Our members believe that the payments industry met the challenges of Covid-19, providing a reliable and resilient service to the UK

economy, supporting the acceleration of on-line spending and increasing contactless payment acceptance by volumes and transaction amounts. Our members carry billions of pounds of retail insolvency risk and voluntarily implemented support packages, discounts, waivers and deferrals. The market not only served its clients well but also served consumers well by underpinning consumer protection in unprecedented times.

Impact Statement 5: Remedies

We are open to working with the PSR on consideration of potential interventions that improve the functioning of the market, but believe that the proposed transparency remedies are too narrowly focussed on price at the expense of other important considerations, such as card and non-card payment options for consumers, resiliency of platforms, speed of settlement, fraud tools, currency options and authentication processes, account management and servicing, reporting, billing, data analytics and integrations with specialist platforms (such as found in the hotel, travel, restaurant or leisure sectors).

Impact Statement 5A: Transparency and Comparability

Our members consider that additional transparency will be helpful but have reservations on comparability – the remedies should balance transparency with a clear articulation of what is being priced for and what are the comparable elements from a risk, servicing, other products, and merchant segment perspective. Acquiring is not a binary utility and transparency and comparability must be based upon a range of factors relevant to each individual merchant – a "one size fits all" approach will not be in merchants' interests.

Our members believe that there needs to be a clear statement of what metrics merchants want to compare (and a standard basis for comparison). All of this should be within a framework that does not add further complexity or friction to the merchant on-boarding, renewal or switching journey.

Members have also noted the inherent tension between (a) simple pricing packages as an aim, making it easier for merchants to compare prices and (b) the transparency requirements of the Interchange Fee Regulation, which are very prescriptive and are solely founded on a transaction-based pricing model. Not all merchants want a traditional pricing package – many would prefer certainty-based models, such as a fixed subscription based model or all-in pricing models including value added services and terminals. Transparency and comparability objectives should not overlook what many merchants want: certainty.

Impact Statement 5B: Contracts

There are already several prompts for merchants to consider their existing acquiring relationship (including regular billing, approaches from rival acquirers etc). However, our members are not opposed to exploring some form of additional prompt for merchants to periodically consider their current arrangements and potential alternatives. But, our members do not agree that fixed term contracts or banning evergreen contracts will achieve this. There is a place in the market for flexible contracts on evergreen terms that can be exited quickly. Also, there is a difference between an indefinite contract with a long exit period and an indefinite period with a short exit period. Our members express the view that short exit periods promote switching.

Our members concur that contract lengths, termination fees and other exit hurdles should not be used to unfairly prevent merchants from switching and/or renegotiating. Our members note that there is a place in the market for fair longer contract terms and fair and transparent termination fees where capital and set up costs need to be recovered or where longer contract terms offer more competitive rates.

Impact Statement 5C: Terminal Hiring Regulation is Not Fit For Purpose

It is noted that the Interim Report references the existing regulation of terminal hire under the Consumer Credit Act. To the extent that the PSR is considering remedies dealing with terminal hiring and practices, the Consumer Credit Act is not suitable for the modern market, is unnecessarily unwieldy, the documentary requirements create friction (and thus delay on-boarding and switching) and is not the right starting point for addressing market conduct. The Consumer Credit Act also makes it unnecessarily difficult to promote innovative pricing models for the whole suite of services.

Any remedies relating to terminal hiring should consider contracting and pricing practices as a whole, replacing the application of the Consumer Credit Act with specific and targeted objectives that do not differentiate between business models (sole traders vs out of scope limited companies) or legal forms of the applicable contract. To that end, in the remedies consultation phase, we recommend that the industry and the PSR consult with the FCA and HM Treasury on the regulation of terminals (it being acknowledged that the Consumer Credit Act is not within the regulatory perimeter of the PSR).

Impact Statement 5D: £50m turnover band

Our members do not agree with the £50m turnover band breakpoint. Any potential remedies should only apply at a much lower threshold.

Impact Statement 6: Remedies Design

It is acknowledged that the Interim Report is a "work in progress" and that a remedies consultation is expected to be issued in 2021. Our members believe that remedies design should not exclusively rely on the analysis or the findings in the Interim Report (because members find them unreliable sources upon which to base remedies) and that market relevant and merchant relevant factors should be taken into account in the remedies' intent and purpose.

Impact Statement 7: Remedies: Formulation, Validation and Implementation

We think the PSR needs to outline in its final report its approach as to how the remedies will be formulated, validated and implemented. We think the remedies should be formulated on a level playing field. Participants involved in the activity of selling acquiring services should be subject to the same legislative rules or codes of conduct and the remedies should not be imposed solely upon regulated entities. Acquirers should not have the responsibility for quasi-regulating ISOs, for example.

Part 2 – Detailed Commentary

1. THE PSR's FINDINGS, THE DATA AND THE EVOLVING PAYMENTS MARKET

1.1 Market Scope

1.1.1 The report provides a reasonable summary of some elements of the "*Competition between providers of card-acquiring services*". It identifies a number of behaviours and approaches which enable and drive merchant choice in the identified segments.

1.1.2 "Simple standard pricing", "low cost hardware" and "quick and simple onboarding process" are identified as good behaviours that enable merchants to make informed choices; this clarity and simplicity has underpinned the success of the new payment facilitators and simplified acquirer service offerings. However, we think that these behaviours need to be put in the context of PF, ISO and "simple" acquirer models and that the basis on which more complex service and hardware models operate should also be outlined.

1.2 Pass –Through Analysis

Those members who had access to the pass-through analysis data room express serious concerns about the analysis used by the PSR to validate and underpin the pass-through conclusions. We understand that a number of acquirers will make direct representations to the PSR about the analysis and the conclusions that the PSR has drawn from the pass-through data.

1.3 Focus on price

Our members do not believe that remedies founded solely on price will have significant impact on the competitive functioning of the payments acceptance market. It is not sufficiently clear or sophisticated enough to create a level playing field. There are other outcomes for merchants and consumers that need to be taken into account and incentivised which are discussed below and should be considered further in the final report and remedies phase.

1.4 Global Pandemic

1.4.1 The industry was able to respond to COVID-19 swiftly. It increased the contactless limit to £45, effected the switch to on-line shopping and granted considerable postponements or waivers of fees and charges (without any directions from the PSR or the FCA) and supported credit and liquidity stressed merchants (without any direct public guarantees). These factors do not represent a "market not working well" and the positive efforts of the industry are under-represented in the Interim Report.

1.4.2 The payments industry has always - and demonstrably during COVID-19 - supported consumers by underwriting their redress (through the possibility of chargeback) even when retailers were unwilling or not capable of doing so; this was particularly the case in the travel sector when responding to the travel restrictions placed on consumers by COVID-19.

1.5 Card-Acquiring vs Payment Acceptance

1.5.1 Whilst payment providers “touch the money” on behalf of merchants and therefore must be appropriately regulated, capitalised and be required to keep merchants’ funds safe from payments provider insolvency, our members do not think that it is useful to base competition regulation in the payments market by reference to the "***card-acquiring***" market alone – traditional merchant acquiring no longer exists.

1.5.2 While the distinctions between cash, cheques, banking payments and cards are still generally relevant in the context of infrastructure, consumers now have an increasing number of "ways-to-pay". For example, if one looks at the modern checkout options available through a retailer’s ecommerce website, one will find that the on-line checkout payment page may display many payment options: traditional cards, Applepay/Googlepay/Samsung pay options, bank account to bank account payment, buy now pay later, traditional instalment credit and e-money. As technology and innovation drive new ways to pay, retailers are no longer solely concerned with "acquiring" or payment cards but with the ability to maximise sales by accepting the widest range of payment methods possible with minimal consumer friction throughout the checkout stage. Physical in store (or off-line) payment options are likely to follow on-line developments and the distinctions between the two are narrowing. Moreover, the proliferation of payment options is not limited to the large retailers – many SMEs now offer their customers many ways to pay, accelerated by the Covid-19 pandemic. Whilst traditional acquirers are constantly innovating, the availability of the payment options are not solely driven by the acquirers – it is often driven by the ecommerce platforms and payment gateways. It is often the case that the merchant’s primary choice is the functionality offered in the payments package as a whole, rather than the price of payment acceptance of one type of payment (cards).

1.5.4 Therefore, any competition policy focus should focus on **payment acceptance -** being on the one hand all the means by which a consumer transacts with a merchant at the point-of-sale as opposed by reference to one of the actual means that they use to "pay" the merchant, which seems an arbitrary distinction nowadays and on the other all the means by which a merchant transacts with its payment service providers.

1.6 Basis of Analysis

Too much reliance has been placed on theory, based upon an apparent assumption that the acquiring market can be compared to a consumer utility market such as gas or electricity where the unit of consumption and its delivery is homogenous. As this response explains, the market is complex (even in the SME segment), not homogenous and there are a multitude of offerings and channels, with providers competing on both price, functionality and quality.

1.7 Econometric Pass-Through Analysis

Whilst UK Finance has not had access to the data room, our members that have had access to the econometric pass-through data room (through their advisers) report material misgivings about the robustness of the methodology and analysis. A number of our members will provide their own commentary on the data exercise in their bilateral responses to the Interim Report.

1.8 “The Market Is Not Working Well”

1.8.1 Regardless of whether or not the analysis supports the finding of “*no evidence of pass-through”* (which many of our members dispute), the conclusion that the market is not working well is too binary. Our larger members point to a competitive environment witnessing a significant number of merchants

switching to providers on more favourable terms. The data that they have demonstrates a market that is functioning well in terms of prices and quality of service choices that merchants are making.

1.9 Price vs Value

1.9.1 Merchants do not switch purely because of core acquiring *price* – they decide to switch because they may obtain better *value* elsewhere. The Interim Report does not address what merchants value and what they are willing to pay for that value. In our view the value is derived by others factors in addition to price (but of course acquiring price is relevant). All merchants require increasingly sophisticated offerings and have a wide variety of needs, including choice of terminals and industry specific point of sale hardware, software and gateway integrations, payment methods accepted and settlement times (and a variety of value-added propositions around data analytics). The acquirers have recognised that ease of integration with the merchant's wider requirements is fundamental to any payment proposition. New entrants have offered faster onboarding and less fixed pricing structures as a means of attracting merchants who just need the ability to take card payments quickly. Merchants value risk appetite, fraud tools, connected services, high card authorisation rates, data analytics, merchant portals, servicing, reliability, innovation and so on.

1.9.2 If there is no understanding of value and what drives merchants to switch or not switch providers, then the risk is that remedies will not change merchant or acquirer behaviour and may lead to unintended consequences of marginal gains for merchants on MSC when they switch, but a reduction in the total value derived from their choice of payments provider.

1.9.3 It is suggested that more thought needs to be applied with respect to merchants' payment acceptance needs:

- how they value those needs relative to the cost of acceptance
- how relevant this is to merchants' choice of provider

2. PROPOSED REMEDIES

2.1 Overview

2.1.1 Whilst members express reservations on the analysis and the findings, they are willing to positively engage on how the market can be improved for smaller merchants. Members are open to working with the PSR on potential interventions that improve the functioning of the market.

2.1.2 It is important that the PSR considers carefully whether the adoption of a utility-type approach (electricity, water etc) may lead to unintended consequences, that could stifle innovation and reduce merchant choice.

2.2 Context and Approach

The remedies should reflect our "broader market" and "value" observations in this response, and not be designed to solve the wrong problem.

Turning to the specific high-level approaches:

2.3 POS Contract Length

Any potential remedies regarding POS contract lengths must be balanced against other benefits:

- some merchants prefer contracts with flexible short exit periods whilst others prefer longer contracts (as lower transaction fees can be negotiated);
- for terminals, appropriate and fair termination fees support investment costs for new point of sale equipment that the market may be otherwise unwilling to invest in; and
- termination fees support low monthly payments – banning termination fees may end up in higher monthly costs for merchants or discourage investment.

2.4 Prompts to Consider Switching

There are already several prompts for merchants to consider their existing acquiring relationship (including regular billing, approaches from rival acquirers etc). However, our members are not opposed to exploring some form of additional prompt for merchants to periodically consider their current arrangements and potential alternatives. We and our members look forward to discussing potential options during the remedies consultation phase.

2.5 Terminal Contract Barriers

As a general principle it is agreed that merchants should not be locked into contracts because of onerous ancillary obligations that are disproportionate to the upfront investment costs borne by the payments provider. Regulation should focus on transparency and fairness and not dictate what commercial models should or should not be available. Again, we and our members look forward to discussing possible options in the remedies consultation phase.

2.6 Terminals Regulation

Our members think that the regulatory oversight of terminals should not distinguish between different legal models. If there are to be “protections” over terminal arrangements they should apply equally to sole traders, partnerships and limited companies. The Consumer Credit Act is not the place to regulate terminals and some other form of regulation is required that focuses on payments services and not on credit. The Consumer Credit Act itself has onerous requirements that appear to give very little benefit in a payments context and are more likely to hamper efficient switching than promote it and more likely to inhibit pricing models that merchants want.

2.7 ISO and Acquirer Pricing Transparency and Comparability

2.7.1 **Transparency** is a worthwhile goal and would be better expressed through a principle led market requirement (such as clearer information on key commercial terms and what (permissible) termination fees could apply), rather than achieved through a prescribed binary price for a single element of a total pricing and product package that does not capture **value.** To the extent that **comparability** is a desirable outcome then there needs to be some benchmarking and templating for information so that the comparison is feasible and effective. Given the vast array of risk profiles and transaction type profiles, a one size fits all “comparison” site or published pricing is neither workable, nor appropriate. The cost of acquiring for a travel company against a cash-and-carry is very different. Any comparison exercise needs to clearly define what "basic acquiring" looks like and prompt merchants to assess **value**.

2.7.2 **Non-Transaction Based Pricing Models**: Regulation should not determine commercial models. **Transparency** principles could work for distinguishing more clearly between pricing models such as pure transactional based pricing or “all-in” pricing or subscription style pricing. **Transparency** requirements should focus on a clear explanation of what is and is not included in

non-transactional pricing models. Our members do think it is not necessary to break down all-in pricing models into a transaction-based pricing model – and their concern is that **comparability** will require this. The market should be free to offer different bases of pricing, as that is what merchants want.

2.7.3 **IFR/CCA**: We note that the Interchange Fee Regulation, alongside the Consumer Credit Act makes it very difficult to innovate on pricing models, such as offering a total fixed price package whilst complying with very technical requirements. Many merchants, especially those that are start-ups or new to accepting cards will wish for certainty and choice of pricing models over transaction based transparency as to how one element of the pricing package is calculated.

2.7.4 **Tariffs**: Consideration should be given as to how standard (usually non-negotiable) additional fees should be presented (such as requirements to publish standard tariffs for non-transactional items). Consideration should be given as to a requirement that the comparison methodology adopted (and any prompts) sets out the fees (and any termination fees) for additional services such as currency conversion, gateway, fraud tools etc.

2.8 Merchant Turnover "Breakpoint"

Our members express strong reservations that the remedies may apply up to turnover bands of £50m. This "breakpoint" is not supported by the evidence and is not recognised by the payments providers as the measure by which merchant sophistication or understanding is increased. Whilst it is accepted that there needs to be a level where the remedies do apply, the breakpoint should be at a much lower level. Further, the merchant survey did not consider merchants with a turnover over £10m. To the extent any remedies treat acquiring as a consumer-type utility, then it is submitted that the turnover level should be at the micro-merchant segment only.

3. REMEDIES DESIGN

Our members advocate that the PSR should take a fresh approach to the remedies design, that is not solely anchored on the analysis and the findings, nor takes a consumer utility approach, but instead focusses on what is required to promote a secure, open, transparent and competitive payments acceptance marketplace as a whole. UK Finance and its members would welcome a thorough remedies consultation process, in a collaborative effort with merchants, regulators and the payments industry to design workable and effective ways to ensure the payments acceptance market remains competitive and innovative.

4. REMEDIES IMPLEMENTATION

4.1 It is acknowledged that the "what" and the "how" of the implementation are dependent on the PSR's final findings, further consultation and merchant interaction. We would encourage the PSR to engage with our members and set out in the final report how the PSR foresees implementation.

4.2 UK Finance is particularly interested in how remedies will be imposed on non-regulated parties, such as ISOs or those that provide terminals or other payments services directly to merchants. What will be the legal basis for this?

4.3 UK Finance and its members think that assuming that the acquirers should "regulate" other industry players is not appropriate. Financial regulation policy at the *entity* level (capital, safeguarding,

solvency) of card acquirers is an important and necessary regulatory imperative and is less of an issue for those providers that use an acquirer to collect merchant funds and settle transactions. However, when it comes to market conduct and transparency we advocate regulation policy at the *activity* level: all parties in the payments system, regardless of their current regulatory status, that contract with merchants for payments services should be bound directly by the same rules and be subject to the same consequences and enforcement processes.

5. NEXT STEPS

We and our members look forward to further engagement with the PSR and other stakeholders and are pleased to submit this response to the Interim Report. We look forward to discussing this response with you and to receiving the final report. We hope that the final report not only takes into account the contextual comments we make in this report but also sets out the direction of travel for the design and implementation of the remedies.