



## PSR: Draft Terms of Reference for Market Review of card acquiring services

14 September 2018

### INTRODUCTION

UK Finance is the trade association which was formed on 1 July 2017 to represent the finance and banking industry operating in the UK. It represents around 250 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance has been created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

Our objective is to work with our members to build a more customer-focused and innovative finance and banking sector, cementing the UK's role as a global leader in financial services for the benefit of the wider economy. The interests of our members' customers are at the heart of this work.

UK Finance welcomes the opportunity to respond to the Payment Systems Regulator's (PSR) consultation on the draft Terms of Reference (ToRs) for its Market Review of Card Acquiring. Merchant card acquiring is an integral part of the UK economy enabling retailers to accept payment by card for the goods and services they provide. It is imperative that any market review of this sector is undertaken on the right basis and with access to all the necessary information.

### GENERAL COMMENTS

- *Growth of card payments*

The UK payments landscape has changed markedly over the past ten-years. The number of cash transactions has fallen with supporting evidence showing that transaction types are moving to other electronic payments: consumers and businesses alike are taking full advantage of differing payment methods that best suit their personal and commercial needs.

The flexibility and adaptability of the card payment proposition (as evidenced with its incorporation into other form factors (*fobs/tags, mobile phones, watches, clothes and other wearable technology*)) has seen the use of the debit card, as the most frequently used payment method, overtake cash for the first time in 2017. Over this period cards have played a habitual role in everyday life, with debit cards in particular, regarded as an important and trusted payment instrument offered as a standard component to a person's current account.

As the concept of 'digitalisation' becomes engrained at a wider societal level, it is likely that this will act as a natural catalyst for the development of further payment products and services, offering alternative and convenient ways for *customer-to-merchant* and *peer-to-peer* payments.

All this provides insights as to how merchant acquiring will play a fundamental role in helping to support this transition, and acts as a vital component in defining the future role of the High Street as the notion and concept of '*destination commerce*' radically changes - and as retailers offer their products utilising the full-range of digital channels.

- *The changing role of acquiring*

In recent years, the acquiring industry has become a far more complex industry, with a wide range of acquiring 'entities' now fulfilling the traditional activities that were once the preserve of a traditional bankcard acquirer, and to which a range of differing classifications could apply.

It can be argued that this new eco-system is not adequately represented by the tripartite demarcation put forward in the draft ToRs i.e. which seems to be predicated around the concept of an acquirer, payment facilitator and Independent Sales Organisation (ISO).

There exist a host of newer players now operating in the UK market (Payment Platform Providers, Payment Gateways, mPoS Solution Providers, ePoS System Providers and Specialist Service Providers). This can be attributed in part to the growth and popularity of online shopping, as well as an ever-growing reliance on electronic payments by customers, which has accelerated the demand for low-cost and 'friction-free' payment acceptance. It is also likely to result from a number of other contributing factors including the increasing use of contactless payments, shifting generational preferences and greater card acceptance.

These changes are being compounded by the commercial opportunities emanating from the implementation of pan-European initiatives such as PSD2, and the burgeoning growth of 3<sup>rd</sup> party payment initiators, as well as domestic initiatives (e.g. *Open Banking*) that are encouraging greater payment diversification. Payment service providers (PSPs) are exploring the use of alternative payment types, and newer processing arrangements, in terms of the services that are offered so as to enable merchants to accept payments.

Service providers operating in the digital content space (i.e. *PSPs, app-stores, multi-channel networks (MCNs)*) and online merchants, will inevitably drive this demand meaning incumbent players will compete with a host of newer cross-border acquiring entities, who are offering a potentially broader range of business models, hosted app-stores, and value-added services (e.g. business loans/ accounting & inventory support etc) into the UK market.

These developments and trends are likely to manifest themselves in a number of important ways:

- Newer entrants, particularly those entities described as Payment Platform Providers, will look to recalibrate their services to become fully licensed acquirers, so as to 'own' the merchant/retailer relationship.
- Established players will have to better promote their services as both standalone and recognisable 'brands' to begin offering a much wider and more holistic proposition.
- There is likely to be an inevitable increase in the number of strategic partnerships, coupled to a consolidation of 'niche' processing products.

These developments are demonstrative of how 'acquiring' will evolve in the coming years, not least in how these newer propositions fit into the traditional payment processing chain. As an example, we have seen that Payment Platform Providers and Payment Gateway services have increased in popularity, and demand, by helping design and develop software solutions as well as managing the integrations of proprietary wallet applications. This has been a catalyst in the wider FinTech movement, and the general phenomenon of the sharing economy.

Some of these developments do pose a much greater challenge as to how the industry best ensures the integrity and continuing security of the card payments system, as the distinction between face-to-face transactions and remote payments becomes increasingly blurred.

The PSR's Market Review needs to take account of this complex landscape and ensure that any eventual recommendations for action/change neither stifles innovation, nor make inaccurate conclusions about the market based on out-of-date data/assumptions; or, mistaken comparisons to developments taking place in other jurisdictions.

In short, we believe that more analysis needs to be done to both properly define what is meant by 'acquiring', which is a fluid and loaded term, and a much closer examination of those attributes that are unique to the UK market, which arguably are having a greater impact in helping shape the future direction of the acquiring industry.

## COMMENTS ON THE TERMS OF REFERENCE

- Several members noted that the scope of the Review as defined in the ToRs is not clear and could usefully be clarified in some places to ensure that the outputs are valuable. For example:
  - **The definition of 'acquiring'** could be clearer by differentiating between the regulatory payment service of acquiring as defined in PSD 2 (e.g. core acquiring) in contrast with the constituent elements and ancillary services that can be performed by third parties (e.g. acquirer processing).  
  
Similarly, the definition of 'payment facilitation' could be better clarified to draw out some of the nuances between this activity and the regulated payment service of acquiring as cross-referenced above.
  - **Geographic scope** – what are merchants and end-users outcomes that the PSR is wanting to focus on? UK merchants and UK consumers only?
  - The **card payment schemes** do play an important role in this environment and their place in this Market Review should be made more explicit.
- Members commented on the broad timing of the Review: as noted in our general comments, in the short-term, Brexit is likely to impact the economics of card acceptance. Over the longer term PSD2 will also begin to have an impact (i.e. increasing volumes of account-to-account based payments). These are significant change drivers for the market and while members can appreciate the PSR's desire to explore the acquiring market, there needs to be an appreciation of the risk in creating a 'moment-in-time' analysis that will become quickly outdated.
- It is not clear to what extent the Market Review will appropriately consider merchant segmentation, diversity of needs, and what potential issues apply to different segments.
- The ToRs suggest that interchange fees will form a part of the Review. There is no doubt that the issue of interchange is material to the acquiring market, and the cards payment industry more generally. However, members expressed some reservations about the PSR undertaking work on the issue of interchange just prior to the start of work due to be undertaken by the European Commission on the same issue. However, members also commented that if interchange is to be included, then it is important to understand the degree to which reductions in interchange fees are being passed on by (i) acquirers-to-merchants (excluding ISO accounts); (ii) Accounts operated under an ISO model to merchant; and (iii) by merchants-to-consumers.
- UK Finance, as a result of its historical place with the industry, undertakes some roles linked with the acquiring market by presenting common industry positions on card processes at the point of sale/ interaction (i.e. where cards are presented and accepted for payment). This includes managing the Standard 70 (and Standard 60) documentation set on behalf of the industry. These standards act as the main merchant-to-acquirer interface protocol and describe the business rules and specific message interchanges for authorisation and settlement transactions. They still remain the primary messaging standards used by retailers and device vendors to build their point of purchase solutions.
- In addition, UK Finance operates the Common Security Evaluation and Certification Consortium (C.SECC) (see appendix for more detail). This is currently under governance review internally, but we would be pleased to speak to the PSR in more detail about the role it plays in the market and its future.
- As per its mission, UK Finance also acts as a convenor, bringing together the acquiring industry on matters of collaborative interest. Earlier this year we put together a Payment Acceptance Policy Group (PAPG) to represent the views of acquirers and the wider payment acceptance community. This group draws together many of the key players in the industry - we would be very happy for the PSR to engage with this group on the Market Review as it progresses.

- In section 1.13 you note that some stakeholders have raised concerns about the cost of card payments for merchants. Some members have noted that it would be useful to understand what these concerns are.
- In section 1.18 you state that card-related issues were discussed with the PSR Panel. Some members have noted that it would be useful to understand what issues were discussed.

## RESPONSES TO THE CONSULTATION QUESTIONS

**Q1: Do you agree with our description of card-acquiring services? If not, please explain how our description should be altered and why you think the description should be altered in this way:**

- As noted in our general comments, we believe that the definition of card acquiring could be clearer.
- The description of card acquiring services focuses on card acquirers, and whilst it reflects other elements of the value chain, the description needs to define how the costs or services offered by other parties will be removed from the consultation, in particular where the Acquirer is not able to influence whether interchange savings are passed on to the end merchant. Services can be bundled up to a single amount, and further thought is needed on how this can be decoupled to fully understand the card acquirer's element defined in the description.
- A definition of gateway versus a merchant account could usefully be provided, along with the services which are excluded from the consultation.

**Q2: Do you agree with the proposed scope of the market review? If not, please explain how the proposed scope should be altered and why you think the proposed scope should be altered in this way:**

- As per our general comments, we think that the scope of the Market Review as defined by the ToRs is currently quite unclear and could usefully be clarified in places.
- Paragraph 1.7 provides an unclear definition of card acquiring services, restricting the participants to acquirers and marketplaces. Some members believe that the parameters should include any party in the chain that charges for their services in relation to the provision of card acquiring. The scope makes assumptions that prices are controlled by the acquirers, when, in reality merchants can buy a number of services from a number of suppliers, and this may inflate the actual fees.
- These providers may only have limited connectivity or partnership, which could limit the options.
- One of the concerns this Review looks to investigate is the cost of card acceptance, and the compliance with the Interchange Fee Regulation (IFR) on unblended pricing, reseller & ISO's activity. These providers tend to sit outside of the IFR regulation, and outside of the FCA governance, so their adoption would be on a voluntary basis.
- Merchants, particularly in ecommerce, need a number of services – acquirer, gateway (PSP), web developers, shopping carts, card storage - and these services are sometimes bundled into a single fee, either monthly or per transactions. The scope should consider the component parts being utilised by the merchant to understand the cost of processing versus the cost of support services/value added services.

**Q3: Do you agree with our proposal to focus on card-acquiring services for Mastercard and Visa? If not, please explain how the focus should be altered why you think the focus should be altered in this way:**

As regards, the scope of the ToRs being limited to Visa and MasterCard, UK Finance has a diverse membership and there were mixed views on this point. Some members were supportive and other members wanted to see the scope broadened.

**Q4: Do you agree with our proposed approach? If not, please explain how our proposed approach should be altered and why you think the proposed approach should be altered in this way:**

- It is difficult to provide a considered response based on the short description set out at paragraph(s) 2.14 - 2.19, all of which seems derivative on how the term 'card acquiring' is likely to be defined.

**Q5: Do you have any comments on the specific issues of interest, including whether there are additional issues we should consider and whether the issues identified have the potential to be relevant to the market review? If not, please explain what, if any, additional issues should be included (i.e. factors that affect how the supply of card-acquiring services functions):**

- Part of the consultation should be the impact that un-blending has had on the market. The IFR required all PSP's to provide granular pricing and reporting, whilst the unregulated element was not required to do so. It is unclear if the requirement to unbundle has had a negative impact on the regulated PSP's, or whether merchant appetite remains.
- The consultation should look to determine if the market is comfortable with the number of parties in the value chain that do not fall directly under FCA regulation, and if this provides any negative aspects to the market.
- The consultation should consider the buying patterns of merchants post the introduction of IFR and look to determine if there is a general preference as regards the choice of pricing available.
- It is critical that non-regulated elements are considered to some degree, as devices or services providers may be linked to a specific provider, potentially creating an obstacle to switching. It should also take into account the frequent scenario where there is leasing of a device from a 3rd party where the Acquirer has no part to play in this component of the transaction and no ability to influence it.

## APPENDIX

### Standard 70 and Standard 60 Rulebooks

- Includes:
  - The cards domestic protocol (Standard 70) - Card Acceptor to Acquirer interface standard, Books 1 to 7.
  - ISO8583 Financial Transaction Card Originated Messages (Standard 60).
  - Interchange Message Specification standard for systems that exchange electronic transactions made by cardholders using payment cards. Published in three parts:
    - Part 1: Messages, data elements and code values
    - Part 2: Application and registration procedures for Institution Identification Codes (IIC)
    - Part 3: Maintenance procedures for messages, data elements and code values
- Upkeep of the Standards is managed by the UK Finance cards unit Business Standards Group.
- Services of the financial industry include the exchange of electronic messages relating to financial transactions. Agreements on application specifications are generally at a private level. The Standards are designed as an interface specification enabling messages to be exchanged between systems adopting a variety of application specifications. The application specification may remain at the private level. Designers of such applications have complete design freedom within the overall constraint that messages shall be convertible to this interface format in order that interchange may take place.

### Common Security Evaluation and Certification Consortium (C.SECC)

- Common Criteria (UK ONLY) was established in 2003 aligned to the introduction of Chip and PIN. The Consortium was created in 2015.
  - The necessity to protect the PIN entry at the POS to prevent exposure of PINs entered into POS devices (which can only be implemented by acquirers):
    - Security requirements for PIN entry devices.
    - Independent security evaluation of PIN entry devices.
    - Assessment of security evaluation reports and certification of PIN entry devices by representatives of the UK banking industry (UK Finance and its predecessors).
- Cooperation of bank-owned certification entities with full governance by the issuing banks.
- The underlying ISO 15408 (Common Criteria) methodology allows for a self-governed approval scheme for the UK market with global interoperability.
- ISO 15408 methodology requires vendors to improve their design and production processes (which is not necessarily covered by PCI), thus delivering better products globally.
- Recognition by the ECB and ECSG.