PSR Market Review into supply of card-acquiring services: pass-through methodology consultation

Date: 01 March 2019

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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.

General comments

UK Finance welcomes the opportunity to engage with this first stage of the PSR Market Review into the supply of card-acquiring services, and will continue to do so throughout the course of the Review process.

This first consultation paper concerns fees that retailers pay to acquirers for accepting card payments – known as the Merchant Service Charge (MSC). An element of the MSC is the interchange fee. Interchange fees are paid by acquirers to issuers, via the card scheme operators. Interchange fees are an important component of card payments, ensuring a funding balance in the card ecosystem between card companies and retailers, and playing an important role in assisting with the investment necessary to keep card payments secure, reliable and convenient.

A cap on interchange fees was introduced in the UK market in 2015 through the European Interchange Fee Regulation. The PSR's working paper proposes a methodology for measuring the 'pass-through' to retailers of this reduction in interchange fees, and of changes to other fees charged by card schemes to acquirers.

We have several comments on the general approach of this consultation paper:

- Although the paper seeks to measure both changes in interchange fees and other card scheme fees, there is an implied assumption that the reduction in interchange fees will see a corresponding reduction in MSCs[1]. This continues the position set out in the PSR's 2015 regulatory approach paper on interchange fees.[2] However, there is no legal requirement for acquirers to pass on a reduction and, as recognised by this consultation paper, there is are a multitude of factors that can impact MSCs.

- It is not clear how the results of the PSR's pass-through analysis will be interpreted and fed into the wider market review assessment. For example, in some markets pass-through analyses have been used as a measure of competitiveness; however, as noted in the RPB

[1] This was also an assumption in the Interchange Fee Regulation recitals https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2015_123_R_0001&rid=1.
[2] https://www.psr.org.uk/sites/default/files/media/PDF/psr-cp14-1-5-sp5-interchange-fees.pdf (5.12 and 5.13).

Economics paper cited in the consultation, '*the degree of pass-through depends on several demand and supply factors'*.[3]

- The paper states that '*as we develop our analysis, we will consider whether it is appropriate to provide further information on how our analysis has developed'*.[4] We believe it is critical that the PSR give stakeholders further opportunities to engage in both the quantitative analysis and the interpretation of this analysis before the interim findings stage. For example, this could be through provision of a data room; review of the mathematical code used to estimate the pass-through models, once the modelling is complete; and engagement on emerging findings[5].

- Coming to robust conclusions from this analysis will be challenging, due to likely data limitations, and econometric specification issues. Further, the complexity of the acquiring market, with its multiplicity of players and diverse pricing models, will make it difficult to isolate and estimate pass-through of changes in scheme fees and interchange fees.

- The PSR should consider whether to capture data from small acquirers as well as the largest five acquirers. Operational costs and scheme fees are likely to vary significantly between these two groups.

- We would also like the PSR to consider alternative approaches to understanding pass-through beyond econometrics; for example, changes in the quality of services provided by acquirers to retailers.

Responses to questions

Are there variables you think would have a material influence on the degree or speed of pass-through which are not covered in the chapter *Data we propose to use*?

The PSR's approach to estimating pass-through focusses only on whether changes in interchange and scheme fees have been passed-through to changes in merchant service charges (MSCs). However, pass-through may also manifest in ways in which the PSR's proposed analysis does not capture at all. For example, changes in fees may be passed through in changes in non-MSC payment acceptance charges, or in changes in non-price elements (such as improved quality, new product capabilities etc.).

Are there variables covered in the chapter *Data we propose to use* that you think would be irrelevant or immaterial to the degree or speed of pass-through?

It is difficult to comment on this question at this stage of the process and emphasises the need for the PSR to provide stakeholders with the opportunity to engage with the data and methodology during the actual application of the pass-through analysis.

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[3] 1.14, page 6
[4] 1.12, page 6.
[5] A similar approach was taken by the FCA on the Credit Card Market Study.

Do you have any views on the comparators we are proposing to use in the difference-in-difference approaches?

There are several issues that we believe may complicate and reduce the robustness of the proposed approaches:

IC++ as a comparator: It is important that the PSR analysis accounts for the fact that types of merchant on IC++ tariffs are not representative of the merchant population as a whole.

Commercial cards as a comparator: It is important that the PSR analysis accounts for the fact that the usage of Commercial cards is very small relative to that of non-Commercial cards. Commercial card usage is also typically focussed in certain merchant sectors (such as Travel).

Given the contracting arrangements, is three years sufficient for the MSC to reflect the effects of the IFR caps?

The PSR's staggered approach to merchant sampling means that only a fraction of the total sample will include a full three years' worth of data post the introduction of the IFR caps. This is likely to reduce the robustness of the proposed approach.

ENDS