The Money Charity Response – PSR Interim Report on the Supply of Card-Acquiring Services (December 2020)

The Money Charity is a financial capability charity whose vision is to empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.[1]

We welcome the opportunity to respond to the Payment Systems Regulator's Interim Report on the market review into the supply of card-acquiring services (MR18/1.7).

In this response, we set out our Key Points, make some overall comments on the issue then answer the questions posed in the Interim Report.

[1] See box on back page.

Key Points

1. We support the switching remedies proposed by the PSR as far as they go, but we doubt that these remedies alone will be sufficient due to the widely observed inertia among small economic units when it comes to switching service providers.

2. We would like the PSR to bottom out the apparently regressive charging structure that leads to a £5 minimum card payment rule being applied by many small merchants. We would like to see consumers able to make card payments with small merchants as easily as they do with large ones.

3. We would like to see the PSR directly regulate scheme fees, as these are the most monopolised part of the card payments system at the moment, with only two providers (Visa and Mastercard) controlling virtually the whole market.

Overall Comments

As a financial capability charity, we approach this review with the following concerns in mind:

1. For consumers, payments should be as easy, cheap and quick as possible with a minimum of overheads in the payments system. This means, for example, no artificial barriers such as the £5 minimum card payment rule applied by many small merchants.

2. The payments system should be as transparent as possible so it is clear what we are paying for the payments system, the various fees in the payments chain, how these fees change, whether there are cross-subsidies, whether there is monopoly or other forms of non-competitive pricing etc.

3. Appropriate consumer protections should apply, especially where people switch from established card systems to new forms of payment.

4. A multi-channel approach to payments should be maintained, for example ensuring that cash continues to be available alongside the expanding digital payments networks.

The issue of the £5 minimum card payment is one that we would particularly like the PSR to bottom out. A significant number of small merchants apply a £5 minimum payment rule (or ask for a payment surcharge, even though it is illegal) and have continued to apply such a rule, even during Covid-19, when generally there has been a large shift toward card payments. When we have asked merchants about this, we have been told that they face high per transaction charges (e.g. 30p to 50p) and that this makes small card payments uneconomic for them. High per transaction charges for small payments suggest that a regressive pricing system is in play. Whether this comes from card acquirers, card schemes or other sources, we are not clear, but we think it needs to be urgently investigated by the PSR and the appropriate regulatory response put in place.

Minimum payment rules do not apply at large merchants, e.g. supermarkets, so a different fee structure appears to apply in their cases. In our view, the policy objective should be that a small fee applies to small transactions at small merchants, so that no minimum payment rule need be applied and consumers can use cards as easily with small merchants as they can with large ones.

Answers to consultation questions

1. Do you have views on the provisional findings set out in this report?

We congratulate the PSR for producing a clear and insightful report into card-acquiring services. As we say above in our Opening Remarks, for most consumers – including charities such as ourselves – the payments system is non-transparent, and it is very helpful to see the system and its fee structure described clearly.

In our 2015 response to HMT's consultation on the Interchange Fee Regulation we suggested that regulating the interchange fee without regulating other aspects of the fee structure was unlikely to have the desired effect. We said:

> "Evidence from Spain and Australia suggests that consumers will not see the benefits of the fee capping passed on to them. Instead consumers may see increased costs resulting from card providers raising charges to cover the costs of interchange."[2]

Confirming this, the 2020 PSR Interim Report finds that:

> "Fees paid by acquirers to Mastercard and Visa for scheme services rose significantly from 2014 to 2018 and even after adjusting for changes in the volume, value and mix of card transactions, they approximately doubled over this period. For merchants in all turnover groups, the evidence available to us and our current analysis indicates that scheme fees were passed through by acquirers in full."[3]

This is an example of non-competitive (monopoly) pricing in which two dominant providers have been able to take a view of the demand curve as a whole and price

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[2] The Money Charity 2015, *Response to HMT Consultation – Interchange Fee Regulation*. Available at: https://themoneycharity.org.uk/work/policy/consultation-responses/

[3] PSR 2020, *MR18/1.7*, *Interim report on the market review into the supply of card-acquiring services*, page 10.

along that demand curve to maximise profit. The capping of interchange fees released some economic rent which the card schemes were able to absorb.

The Interim Report finds that this effect was unequally distributed, with large merchants (turnover £50 million plus) receiving the benefit of the fee cap, while small and medium-sized merchants did not.

There are two remedies for monopoly. Either (a) introduce sufficient competition to break the monopoly, or (b) regulate the prices charged by the monopolists. The PSR's Interim Report relies on the potential of competition, but in our view, it is also necessary to consider direct regulation. It is too early to say that increased competition, including from new payments providers, will undermine the card schemes' market power to the extent that competitive pricing will be achieved.

2. Do you have views on the potential remedies set out in this report? What are the potential benefits, challenges and unintended consequences that may arise from these, both individually and as a package?

The potential remedies set out in the report focus on increasing competition among card-acquirers by reducing the barriers to merchants switching providers. The remedies do not directly address card scheme charges, only card-acquirer charges. While we support the remedies proposed, we think there are two problems which still need to be addressed:

> 1) The market power of the card schemes, which set a fee baseline above which card-acquirers compete.
>
> 2) The difficulty of encouraging switching by small economic units (consumers and small merchants). There is strong evidence from other markets (e.g. insurance, bank accounts, energy etc) that consumers have high inertia. Their search costs are large in relation to potential savings and the opportunity cost of their time. The proportion of any consumer group that switches never seems to rise above a minority, often a small minority. Indeed, an entire pricing strategy (price discrimination or price "optimisation") has been developed on the basis that most consumers seldom switch suppliers. The banking industry, for example, is fond of saying that "people are more likely to divorce their partner than change their bank."

The PSR's findings are consistent with this, showing a low switching rate among small and medium sized merchants and new customers paying less than existing customers.[4]

We do see potential for new payment providers using Open Banking to provide competition to the card schemes,[5] but we doubt that card-acquirer competition alone will have much impact on scheme fees and the overall cost of card payments.

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[4] PSR, *Interim Report*, page 9.

3. Do you think there are other remedies that we should be considering? If so, what remedies and how do you think they would address the concerns we have identified?

There are two additional remedies we would like the PSR to consider:

1) Directly regulating the prices charged by the card schemes, to reduce or eliminate the monopoly rent secured by the schemes.

2) Addressing the structure of charges for small and medium merchants, to remove the apparent regressivity in charging that leads to a substantial number of merchants insisting on a £5 minimum card payment. The goal should be to have a pricing structure that makes it as easy for consumers to use cards with small merchants as they do with large merchants.

4. How does COVID-19 impact on our review?

We agree with the Interim Report that Covid-19 has accelerated established trends (page 6). LINK data show that in September 2020, ATM withdrawals were down by a third compared with the same month the previous year and the value of withdrawals was down by a quarter.[6] This must be putting great financial pressure on the cash distribution network, which was already under pressure before Covid-19. We support the Ceeney review and subsequent Government statements to the effect that a way must be found to sustain the cash network, while making it more efficient.

Two key reasons for maintaining the cash infrastructure are: (1) a substantial number of people still operate wholly or mainly in cash, even budgeting in cash, and many of these people are those in more vulnerable circumstances, and (2) switching to a system of electronic payments alone requires universal and reliable connectivity, which the UK does not yet have. Even with a complete electronic payments network, cash would have a back-up role, both for individuals and for the country (for example, in case of natural disaster). Currently most people are dual users of cards and cash.

Reduced use of cash increases the market power of card payment service providers, particularly the card schemes, so makes appropriate regulatory remedies for card-acquiring services and card scheme charges even more important.

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[5] See HMT July 2020, *Payments Landscape Review*.
[6] The Money Charity, *The Money Statistics October 2020*, page 14.

The Money Charity is the UK's financial capability charity providing education, information, advice and guidance to all.

We believe that everyone achieves financial wellbeing by managing money well. We empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.

We do this by developing and delivering products and services which provide education, information and advice on money matters for those in the workplace, in our communities, and in education, as well as through influencing and supporting others to promote financial capability and financial wellbeing through consultancy, policy, research and media work.

We have a 'can-do' attitude, finding solutions to meet the needs of our clients, partners, funders and stakeholders.

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