Which?, 2 Marylebone Road, London, NW1 4DF
Date: June 2018

Which? response to HM Treasury "Cash and digital payments in the new economy" call for evidence

Summary

- Which? is concerned that industry forecasts of the growth of electronic payments – and associated decline in use of cash – do not reflect the interests of consumers and merchants, as a result of underlying market failures in payment systems, and ineffective regulation. Such market failures are leading to over-promotion of electronic payments, in particular, card payments, at the expense of alternative payment methods, especially cash.

- Which? is also greatly concerned that industry forecasts represent an ever-increasing consolidation of the UK payments market in the hands of two firms, Mastercard and Visa. Which? strongly questions this as leading to the best outcome for consumers and other payment users.

- The Government, working closely with UK and EU regulators, should therefore prioritise reform and enforcement of existing regulation, in particular, the EU Interchange Fee Regulation (IFR). The Government should also urgently consider the growing consolidation of the payments market and take action to ensure that the UK does not end up with the scenarios implied by industry forecasts.

- The Government should particularly look at international experience of payment systems regulation, such as the US and Australia, especially recommendations by Australia's Productivity Commission to ban payment card interchange fees and to mandate greater competition between alternative payment systems.

- In addition, the Government should also address other problems in the payment systems market, of significant competition issues, consumer access, and financial inclusion, which are resulting in detriment to consumers and other payment systems' users.

Introduction

1. Which? welcomes the opportunity to respond to HM Treasury's call for evidence on cash and digital payments in the new economy[1]. We welcome the growing adoption of digital payments by consumers and businesses, and the benefits these bring, in particular, of greater convenience and security. However, it is vital that such growth reflects the interests of consumers and other payment users.

2. In particular, Which? is concerned that misaligned industry incentives are leading to over-promotion of certain electronic payment methods, namely, retail card payments, at the expense of traditional cash or more innovative new payment methods, such as prospective Open Banking-enabled payment services.

[1] Cash and digital payments in the new economy: call for evidence, HM Treasury, March 2018.

3. Evidence for this problem is the continuing high costs for retailers of accepting card and electronic payments relative to cash payments, along with reduced access to cash resulting from ATM and bank branch closures.

4. Moreover, it is essential that consumers and small businesses have reasonable access to cash, especially those millions of consumers who continue to rely heavily on cash in their daily lives. Cash continues to be valued intrinsically by many, as 2.7 million people in the UK relying almost entirely on cash[2]. Hence, services such as free-to-use ATMs and access to bank branches serve a critical purpose in enabling many people to use cash, particularly those on low incomes, older people and those in rural areas, and the small businesses that serve those communities and consumers.

5. 2018 research by Which? found that many consumers depend heavily on ATM usage, with just under half (44%) using a cashpoint at least once a week. Meanwhile, four in five (80%) said that access to the free-to-use ATM network was important to their daily lives and paying for goods and services.[3]

6. In February 2018, Which? and the Federation of Small Businesses (FSB) launched the *"Save our cashpoints"* campaign in response to changes to the funding of the UK free-to-use ATM network. The campaign is calling on the Payment Systems Regulator (PSR) to intervene urgently and to conduct thorough analysis of the underlying competition issues driving the changes in the sector, as part of a wider review of consumer and business access to cash.

7. The effect of the proposed changes to the funding of free-to-use ATMs is that consumers are likely to suffer greater costs and inconvenience of accessing cash, so may have no choice but to use card payment methods, likely to result in higher retail costs of goods and services, along with loss of a preferred consumer payment method.

8. Further disincentives to use alternative (non-cash, non-card) payments includes the problem of authorised push payment (APP) scams[4]. Such scams – and associated lack of consumer protection – discourage use of inter-bank push payments, chiefly Faster Payments, and potential innovative new payment services that will depend on push payments (namely, prospective Open Banking-enabled payment services).

9. Government and regulators should therefore take action to reform (and fully enforce) existing payments regulation, especially the IFR, whose specific objective was to reduce the cost of accepting card payments. Government should also address related competition and financial inclusion issues related to access to cash, as well as supporting measures to prevent APP scams. Government should in particular learn from other countries, especially the US and Australia.

---

[2] Source: UK Cash & Cash Machines 2017, UK Finance.

[3] 'Cash machines: Which? warns on communities hit with lack of ATMs', Which?, January 2018

[4] Scams in which people are tricked into sending money to a fraudster by making a payment from their bank account to another bank account. See Authorised push payment scams: Report and Consultation, Payment Systems Regulator, November 2017.

10. Below are our responses to specific questions in the consultation.

Chapter 2: Supporting digital payments

Q1. How do you expect digital payment methods, and the adoption of these by merchants and consumers, to change over the next 10 years? What are the drivers of this?

11. Research from across industry is showing rapid growth in digital payments over the next few years. UK Finance, for example, forecasts that digital payment volumes will grow from 60% in 2016 to 79% of all UK payment volumes by 2026, with cash payments falling from 40% to 21%, as shown in the table below.

Table 1: Total UK annual payment transaction volumes by payment service

Payment type	*2016*	*2026 (forecast)*
Cash	15.4bn (40%)	8.7bn (21%)
Debit card	11.6bn (30%)	18.2bn (44%)
Direct debit	4.1bn (11%)	4.4bn (11%)
Credit card	2.8bn (7%)	3.7bn (9%)
Direct credit	2.1bn (6%)	2.2bn (5%)
Faster Payments	1.3bn (3%)	2.3bn (6%)
Standing orders	0.5bn (1%)	0.6bn (1%)
Other	0.5bn (1%)	0.8bn (2%)
Cheques	0.5bn (1%)	0.2bn (0%)
Total	38.7bn (100%)	41.1bn (100%)

Source: UK Finance[5].

12. As the table shows, almost all of the forecast increase in electronic payments is in debit cards (of which is chiefly contactless cards), with small increases in credit cards and Faster Payments transactions. In contrast, direct debits, direct credits, and standing orders remain static as a share of total payment volumes, and fall as a share of electronic payments.

13. Overall, the forecast indicates strong growth in consumer and merchant demand for electronic payments over the next 10 years, suggesting underlying benefits to consumers and merchants, for example, of greater convenience and security, or lower costs.

[5] UK Payments Market Summary 2017, UK Finance/Payments UK (total UK payments volume, excluding CHAPs, in 2016 and 2016).

14. Which? is concerned however that such forecasts do not reflect the interests of consumers and merchants, but instead result from underlying market failures (namely, competition issues) and misaligned incentives. Failure to address these competition issues will lead to merchants, and ultimately consumers, incurring greater costs, through higher prices of goods and services.

15. Furthermore, the UK Finance forecast also highlights the high and rapidly growing concentration of the UK payments industry, as illustrated in the table below. In particular, the table shows that Visa's share of the total UK payments market (including cash) is forecast to grow from 31% to 46% over the next 10 years, from 2016 to 2026, and Mastercard's share is expected to grow from 5% to 42%.

16. This forecast growth of the two leading payments providers reflects that Visa has almost 100% share of UK debit cards and large share of credit cards, and that Mastercard has recently acquired VocaLink, which now processes Bacs (direct credit, debit debit, standing orders), cheques, Faster Payments payments, plus LINK ATM transactions.

Table 2: Share of UK payments transaction volumes by payment provider

Payment system provider	*2016*	*2026 (forecast)*
Visa (credit and debit cards)	31%	46%
Mastercard (credit and debit cards)	5%	-
Bacs	17%	-
Faster Payments	3%	-
Cheque & Credit Clearing Co (C&CCC)	1%	-
NPSO (Bacs, C&CCC, Faster Payments)	-	-
LINK (ATMs)[6]	21%	-
Mastercard (also including NPSO and LINK)	-	42%
Other cash access[7]	18%	10%
Other	1%	2%
Total	100%	100%

Source: UK Finance[8].

[6] Equal to LINK's share total UK cash payments (namely £130bn of LINK cash withdrawals out of £240bn total UK consumer payments in 2016). Source: LINK (website), UK Finance (UK Cash & Cash Machines 2017).

[7] Equal to share of cash access by non-LINK means, e.g. "on us" ATM transactions (consumers withdrawing cash at own bank's ATMs) and cash withdrawals at bank branches.

[8] Which? analysis of: UK Payments Market Summary 2017, UK Finance/Payments UK (total UK payments volume, excluding CHAPs, in 2016 and 2016).

17. Overall, the table shows that, by 2026, Visa and Mastercard are forecast to represent around 90% of the UK payments market, from around 35% now. "Other" new payment methods are forecast to grow from just 1% to 2% during the same period.

18. This represents an extreme level and growth in market concentration. Which? strongly questions whether this will lead to the best outcome for competition or consumers, or other end-users of payments, such as merchants.

19. It is also greatly concerning that regulators have warned of the problem of such market consolidation for a long period, for example, the European Commission in 2012:

> "Moreover, more competition could mitigate the current domination of the payment cards market by the two existing international card schemes [Mastercard and Visa]."[9]

20. A report for the UK Government highlighted the same problem as far back as 2000:

> "The Visa, Mastercard and Switch schemes account for over 60 per cent of non cash spontaneous payments in the UK. This proportion has been growing throughout the 1990s. […] Visa, Mastercard and Switch all have significant market power […] over both customers and retailers."[10]

21. Mastercard subsequently acquired Switch. Which? also notes that frequently cited examples of payments innovation, such as contactless, mobile payments (e.g. Apple Pay), or mobile wallets (e.g. PayPal), are themselves largely a subset of Mastercard and Visa card payments, as these are another way to pay by a Mastercard or Visa card, rather than a competing payment provider or choice.

22. Regulation has sought to address the competition problem of the market power of the card payment schemes. However, there is strong evidence that this regulation is not working, and that growth in electronic payments is imposing much greater costs on merchants and consumers, not lower costs.

23. For example, the Bank of England, as well as the HMT Call for Evidence itself, highlights evidence that cards and online payments can cost retailers over 5-10 times more to accept than cash[11]. Accordingly, UK Finance's forecast of an increase in the share of payments of credit and debit cards from 37% to 53% over the next 10 years would itself represent a substantial cost increase to merchants and consumers over this time

---

[9] GREEN PAPER: Towards an integrated European market for card, internet and mobile payments (Text with EEA relevance), COM(2011) 941 final, European Commission, 2012.

[10] The Cruickshank Review of Competition in Banking, 2000.

[11] The Future of Money: Speech given by Mark Carney, Governor of the Bank of England, March 2018.

period. Such an increase would translate into an increase in UK consumer prices by around £0.5bn a year by 2026[12].

24. The disruption to consumers and merchants of Visa's major service outage across Europe this month further illustrates the harm to consumers and merchants, and potentially to UK financial stability, that concentration of the payments market can already cause[13].

25. Together, such an increase in concentration of the payments market is likely to reflect a combination of market failures, including that:
    - the EU Interchange Fee Regulation has not been effective;
    - competition issues in ATM networks are artificially raising the cost of accessing cash;
    - other obstacles are slowing take-up of alternative payment services; and
    - Mastercard's acquisition of VocaLink represents a loss of competition.

26. We comment on each of these further in response to Q2.

Q2. What further action could the government take to support greater adoption of digital payments by merchants and consumers (including civil society groups)?

27. Government's primary objective should be to promote a competitive payments market, whereby consumers and merchants have the right incentives to adopt the most efficient payments choices, rather than specific Government intervention to adopt digital payments by merchants and consumers, especially if such adoption results in greater costs to consumers.

28. Effective regulation must include effective competition regulation of payment systems, especially a reformed Interchange Fee Regulation, plus the removal of other barriers to competition, such as effective implementation of Open Banking and regulatory measures to reduce payments fraud.

29. Moreover, there have been numerous regulatory interventions in the payments market in recent years. However, as indicated in response to Q1, we do not believe that these have led to the intended outcome for consumers. The Government's priority should be on addressing these issues, as we set out below.

The EU Interchange Fee Regulation has not been effective

---

[12] Calculated based on the reported costs underlying the Bank of England's evidence (from the British Retail Consortium(BRC)), namely, UK Finance's 2016 actual and 2026 forecast transaction volumes, by payment type, multiplied by the BRC's reported costs per transaction by payment type (Which? calculation). See BRC data also further below.

[13] Visa payment systems in Europe suffer major outage, Financial Times, 1 June 2018. Visa also suffered a three-day outage in Ireland last year.

30. The EU Interchange Fee Regulation (IFR)[14] was introduced in 2015, with the promised benefits that:
    - lower interchange fees will benefit merchants and consumers;
    - retailers will pay less and so will be encouraged to accept card payments; and
    - consumers using low cost means of payment such as cash or debit cards will no longer "subsidise" the use of high fee cards[15].

31. The IFR originated in the EU's 2012 Green Paper on the market for card, internet, and mobile payments[16], which highlighted the problems of high costs and competition failures in card payments, including that:
    - "Payment cards are the most common and frequently used electronic payment instrument for retail payments";
    - "A steep increase of the volume of card payments over the past decade and the resulting large scale effects have not led to any significant fall in consumer costs and inter-bank or merchant fees";
    - "The real cost of [card] payment services is often opaque, both for consumers and for merchants, which leads to higher payment costs";
    - "Consumers are seldom aware of the full cost of using specific payment instruments, i.e. the costs that are not only imposed on them directly, but also on the payees (merchants). If the cost of using different payment instruments (e.g. different card brands, cash, cheques) is the same for consumers, they tend to believe that their choice of payment method is irrelevant to the merchant. Consequently, consumers base their selection of a payment instrument either on convenience or on potential benefits they could otherwise obtain by using a specific method of payment. […] The end result is that all consumers pay more for their purchases in order to cover the real cost of more expensive payment methods used by some."
    - "Competition authorities and regulators have been looking at [card payment] interchange fees for some time. In the EU, the European Commission and national competition authorities have adopted several decisions prohibiting specific [multi-lateral interchange fee] arrangements under EU competition rules."
    - "More competition could mitigate the current domination of the payment cards market by the two existing international card schemes."

32. In response to the Green Paper, the European Parliament noted how "the dominant position of two non-European card payment service providers can lead to excessive and unjustified fees for both consumers and merchants, in which their respective banks (the

[14] REGULATION (EU) 2015/751 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 29 April 2015 on interchange fees for card-based payment transactions (Text with EEA relevance).

[15] Competition Policy Brief: The Interchange Fee Regulation, European Commission, June 2015.

[16] GREEN PAPER: Towards an integrated European market for card, internet and mobile payments, COM(2011) 941 final, European Commission, 2012.

so called issuing and acquiring banks) take advantage of this situation" and called for card payment interchange fees to be regulated at a European level[17].

33. The EU subsequently proposed the IFR, highlighting that:
    - "Competition between card schemes appears in practice to be largely aimed at convincing as many issuing payment service providers as possible to issue their cards, which usually leads to *higher* rather than *lower* fees, in contrast with the usual price disciplining effect of competition in a market economy."
    - "The price increases caused by interchange fees are harmful to consumers, who tend to be unaware of the fees paid by merchants for the payment instrument they use. At the same time a series of incentivising practices applied by issuing payment service providers […] steers consumers towards the use of payment instruments generating high fees for issuing payment service providers."
    - "The result of the collectively agreed fees and transparency reducing measures is that banks are not made to compete on this element of their fees, which leads to higher retail prices to consumers, including those who do not pay with a card or who pay with low fee cards. In fact, the latter consumers are subsidising the use by other often wealthier consumers of more expensive means of payment through higher retail prices."
    - "In addition to limited choice as regards payment service providers, reduced innovation and higher prices for payment services, the interchange fees also call into question the [EU's] policy to promote and facilitate the use of electronic payments for the benefit of consumers."
    - "Over the last 20 years, the European Commission and national competition authorities have conducted a number of antitrust proceedings addressing anti-competitive practices in the card payment market […finding] that multi-lateral interchange fees restrict competition as they inflate the cost of card acceptance by merchants without leading to benefits for consumers."

34. The EU IFR was agreed and implemented in 2015, capping credit card and debit card interchange fees at 0.3% and 0.2% respectively, among other requirements, with the specific stated benefits that:
    - lower interchange fees will benefit merchants and consumers;
    - retailers will pay less and so will be encouraged to accept card payments; and
    - consumers using low cost means of payment such as cash or debit cards will no longer 'subsidise' the use of high fee cards[18].

35. However, industry evidence indicates that the IFR has not delivered these outcomes[19]. In particular, the Bank of England evidence cited above, originating from the British Retail Consortium (BRC), also referred to in the HMT Call for Evidence, shows that the costs for merchants of accepting card payments continues to be several times greater

---

[17] European Parliament resolution of 20 November 2012 on 'Towards an integrated European market for card, internet and mobile payments' (2012/2040(INI)).

[18] Competition Policy Brief: The Interchange Fee Regulation, European Commission, June 2015.

[19] Evidence from other countries, e.g. Australia and US, also shows how interchange regulation has only been partly effective. See response to Q3 further below.

than the costs of accepting cash, as highlighted by the Governor of the Bank of England. See table below showing the most recent reported costs for UK retailers of accepting alternative payment methods, after the introduction of the IFR.

Table 3: Costs for retailers of accepting alternative payment types (2016)

Payment method	*Cost per transaction (p)*	*Cost per transaction (%)*
Cash	1.5	0.15%
Debit cards	5.6	0.24%
Credit and charge cards	16.0	0.49%
Non-card payments	18.9	1.70%
Average	5.8	0.31%

Source: BRC[20].

36. The problem of the high costs of accepting cards is also not helped by the recent ban on card surcharges, from January 2018, imposed by the EU revised Payment Services Directive (PSD2), which had specifically relied on the IFR to reduce the costs of accepting cards:

    "The [EU's] proposed prohibition of [payment card] surcharging is directly linked to the capping of interchange fees […] for card-based transactions. Given the significant reduction of the fees that the merchant will have to pay to his bank, surcharging is no longer justified for the MIF-regulated cards which will represent more than 95% of the consumer card market. The proposed rules will thus contribute to a better consumer experience when paying with a card throughout the Union and to a greater usage of payment cards instead of use of cash."[21]

37. However, as the BRC evidence shows, the IFR has not sufficiently reduced the fees that merchants have to pay, with the costs of card payments remaining many times greater than the corresponding cost of accepting cash. This therefore leads to an additional detriment to merchants and consumers, namely, that merchants are unable now to pass on the additional costs of accepting cards – if they chose to – so must now either absorb these costs, pass on these costs to all consumers (including consumers that do not use cards), or stop accepting cards at all, as some merchants have done[22].

38. There are a combination of potential reasons for why the IFR has not evidently delivered its stated objectives, including that:
    - the regulated interchange fee caps are too high;

[20] Payments Survey 2016, BRC (published July 2017, showing retailers' costs in 2016).

[21] Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on payment services in the internal market, COM(2013) 547 final, European Commission.

[22] For example, as HM Revenue & Customs (HMRC), which decided to withdraw personal credit card payments to pay HMRC, in response to the PSD2 card surcharge ban. See HMRC Guidance CIP29.

- the IFR interchange fee caps include a significant number of exemptions – such as for commercial cards, foreign-issued cards, and three-party card schemes – and such exemptions are difficult to justify; and
- the IFR does not regulate card scheme fees charged to merchant acquirers, which have reportedly increased rapidly following the introduction of the regulation[23].

39. Potential circumvention of the IFR is a related concern. In particular, IFR Article 5 ("Prohibition of circumvention") prohibits "any agreed remuneration, including net compensation, with an equivalent object or effect of the interchange fee, received by an issuer from the payment card scheme, acquirer or any other intermediary in relation to payment transactions or related activities shall be treated as part of the interchange fee" and IFR Recital 31 specifically states that "it is important to ensure that the provisions concerning the interchange fees to be paid or received by payment service providers are not circumvented by alternative flows of fees to issuers".

40. National competent authorities with responsibility for implementing and enforcing the IFR, such as the UK Payment Systems Regulator (PSR), therefore have an important role in monitoring and investigating such potential circumvention. Lack of effective enforcement would itself further undermine the regulation.

41. The IFR is also subject to forthcoming review, as set out in IFR Article 17 ("Review clause"), which requires that, "by June 2019, the Commission shall submit a report on the application of the Regulation to the European Parliament and to the Council […looking] in particular at the appropriateness of the levels of interchange fees and at steering mechanisms such as charges, taking into account the use and cost of the various means of payments and the level of entry of new players, new technology and innovative business models on the market […and] shall, if appropriate, be accompanied by a legislative proposal that may include a proposed amendment of the maximum cap for interchange fees."

42. It follows from the BRC evidence that, in order to bring the cost of card acceptance into line with the cost of cash, the interchange fee caps would need to be much lower, at 0.11% for debit cards and -0.04% for credit cards (i.e. a negative credit card cap)[24]. Nevertheless, such reductions would be insufficient alone to remedy the current high cost of card payments, given the prospect of offsetting increases in scheme fees and other IFR exemptions. Accordingly, it would also be necessary to include scheme fees charged to merchant acquirers within a future cap, as the Commission's original impact

[23] For example, the BRC Payments Survey 2016 refers to "the recent surge in scheme fees and other charges for processing credit and debit cards". Visa has also repeatedly stated its intention to raise scheme fees in Europe, following the restructuring of Visa Europe in 2016, especially in presentations and communications to Visa investors.

[24] Everything else equal, these proposed interchange fee rates would equalise the costs of credit cards, debit cards, and cash, on the basis of the BRC payments survey evidence, i.e. a reduction of the debit card cap from by 0.09%, from 0.20% to 0.11%, to equalise the cost difference between debit cards and cash of 0.09%, and reduction in the credit card by 0.34%, from 0.30% to minus 0.04%, to equalise the cost difference between credit cards and cash of 0.34%.

assessment of the IFR itself envisaged[25], as well as including the other interchange fee exemptions.

43. One potential approach to reforming the IFR would be to regulate the *sum* of the interchange fee plus acquirer scheme fee, i.e. the total amount payable by merchant acquirers for access to the card schemes, rather than just the interchange fee. The interchange fee could then potentially be left unregulated, to be set competitively. Another approach would be a requirement that the total amount that card schemes charge acquirers, per transaction value, (i.e. the acquirer scheme fee plus interchange fee) must be the same as the total that schemes charge card issuers (i.e. the issuer scheme fees less interchange fee). This approach would also promote more effective competition between card schemes, i.e. competition for card issuers, while at the same time reducing the costs to merchants.

44. These are essentially the approaches now proposed in Australia, by the Australia Productivity Commission, which recommends to ban payment card interchange fees (i.e. set interchange fees to zero) and to regulate other card scheme fees at cost, among other measures[26]. See further comment in response to Q3 below.

45. The Government should consider all such approaches. The Commission must also consider such new approaches and relevant international experience in its forthcoming review and report on the IFR.

46. The Commission must also review all the current exemptions in the IFR, including commercial cards, foreign (non-EEA) issued cards, and three-party schemes.

47. For example, other countries, such as Australia, have already previously rejected interchange fee exemptions for commercial cards and foreign-issued cards. The Commission should also consider bringing three-party schemes within the IFR, for example, by requiring that three-party schemes over a certain size must provide access to third-party acquirers and issuers under the same regulated caps as for four-party schemes. This would create a proper level playing field between three-party and four-party payment schemes. This would also address the problem that the Commission recognised in its original Green Paper cited above that "Three-party schemes — under which there is only one payment service provider (PSP) servicing both payers and payees — apply an 'implicit' interchange fee that may raise similar issues of lack of competitive constraints."

Significant competition issues in ATM networks is artificially raising the cost of accessing cash

[25] The Commission's Impact Assessment (SWD(2013) 288 final) noted: "Finally, the possible circumvention of the Regulation, for example by raising non-MIF elements of fees, paid by merchants directly to the card schemes has to be considered." (Page 183)

[26] Competition in the Australian Financial System: Productivity Commission Draft Report, Australian Government Productivity Commission, January 2018.

48. Which? has expressed significant concerns that a recent decision by LINK – the UK's national ATM network – to reduce its ATM interchange fees[27], resulting in potential widespread ATM closures, has been allowed to proceed without sufficient regulatory scrutiny by the PSR[28], LINK's regulator.

49. In particular, Which? has highlighted[29] that:
    - LINK's consultation process lacked transparency and was narrow in scope and has raised serious concerns about underlying competition issues across the sector;
    - the PSR has a responsibility to protect consumers and promote competition in the market;
    - the real driver of LINK's approach is the threat of banks leaving LINK, itself caused by major underlying competition issues;
    - in the US, consumer groups and ATM operators are currently pursuing major competition lawsuits against the major banks, as well as Mastercard and Visa, alleging conspiracy to raise ATM access fees, which have risen rapidly, as a consequence of alleged anti-competitive payment scheme rules;
    - US regulators have intervened in strong support of the complainants about such anti-competitive practices;
    - the same Mastercard and Visa global ATM scheme rules challenged by US regulators also apply in the UK; and
    - the PSR has a duty to promote competition among payments networks, and as such it should investigate whether the rules that exist in the UK are having anti-competitive effects on the payments market, and if they were an underlying factor in LINK's interchange fee reductions.

50. Which? has therefore called on the PSR to investigate and analyse the underlying competition issues impacting the sector as well as assessing the implications of these on LINK's decision and consumers more widely, as a matter of urgency.

51. The Government (and PSR) should also review the wider market for access to cash for consumers and businesses, including specific regulatory measures to support continued access to withdrawal and depositing of cash, and other basic transaction services[30].

There are other significant obstacles to the take up of alternative payment services

52. The most significant obstacle to the take up of alternative (non-card) payment methods – such as inter-bank payments and new Payment Initiation Services (PISs), as

[27] THE LINK BOARD ANNOUNCES CHANGES TO OPERATION OF ITS ATM NETWORK, 31 January 2018.

[28] Which? letter to the PSR, 6 December 2017; Which? submission to the PSR: Why the Payment Systems Regulator should review the market for access to cash, March 2018; and Which? evidence to the House of Commons Scottish Affairs Committee on the ATM Network in Scotland, May 2018, among other things.

[29] See written and oral evidence by Which? to the House of Common Scottish Affairs Committee inquiry on the ATM network in Scotland, May 2018.

[30] For example, the Government could mandate that LINK enables a wide network of deposit-taking ATMs (through appropriate interchange fee incentives) and/or that the Government mandates a much wider extension of the Post Office branch banking arrangements, for example, to facilitate reciprocal/shared access to bank branches or to other third-party branch providers.

established by Open Banking and the EU revised Payment Services Directive (PSD2) – is the misalignment of incentives created by card interchange fees, as discussed above.

53. In particular, debit and credit card interchange fees currently represent £1.4bn of annual income to UK banks and other card issuers[31] – even after the IFR coming into force. This is a substantial proportion of banks' and card issuers' revenues and profits. Therefore there are strong disincentives on banks to support initiatives to promote alternative payment products, such as inter-bank push payments and/or new Open Banking-enabled payment services, that do not pay interchange fees.

54. Which? greatly welcomes that Open Banking will enable third party providers (TPPs), known as Payment Initiation Services Providers (PISPs), to instruct payments direct from a customer's bank account, subject to the customer's informed authorisation and consent.

55. However, such Open Banking-enabled services need to rely on the underlying bank account payment functionality, chiefly Faster Payments in the UK, which do not have interchange fees, and currently have limited consumer protections. These payment services have been subject to significant fraud. Such fraud, known as authorised push payment (APP) fraud, has caused considerable consumer harm, as highlighted by Which?'s 2016 super-complaint to the PSR[32]. These security risks contrast with the protections generally offered by card payments, such as under card scheme chargeback rules and/or the Consumer Credit Act section 75 protections for credit card payments.

56. A range of parties, including the Open Banking Consumer Representative[33], Open Banking Implementation Entity[34], and industry groups[35] have highlighted how security concerns and other usability issues are hindering the development of such new payment services. So far there have been very few PISPs authorised and no providers focused primarily on payments since the launch of Open Banking and PSD2 in January 2018[36].

57. In contrast, the chief growth in new payment services has been in products that are even more costly for merchants to accept than debit or credit cards, such as PayPal. According to the BRC[37], such "non card" retail payments are one of the fastest growing retail payment categories, growing by a third in 2016, but are also the most costly of all retail payment types for retailers to accept, at over 10 times the cost of accepting cash. The growth of such payments illustrates the wider problem of competition in payments, namely, that industry incentives tend to promote the highest cost rather than lowest cost payment methods.

[31] Namely, calculated assuming £487bn UK debit card value and £154bn UK credit and charge card value (source UK Finance, 2016), at the regulated interchange fee caps of 0.2% and 0.3% respectively, represents £1.4bn in annual interchange fees.
[32] Which? super-complaint: Consumer safeguards in the market for push payments, 2016.
[33] See the Open Banking Consumer Manifesto.
[34] Open Banking Implementation Trustee addressing the Westminster Business Forum, May 2018.
[35] See for example, the Emerging Payments Association open letter to the Open Banking Implementation Entity, May 2018.
[36] See Open Banking Implementation Entity and FCA register.
[37] BRC Payments Survey 2016.

58. An amended IFR, and/or corresponding new regulation, should accordingly apply to all payment products, among other things, because Mastercard and Visa are increasingly competing for non-retail payment types, such as recurring payments[38] and push payments[39], all of which apply interchange fees, and thereby are likely to contribute to new competition issues in relation to existing recurring and push payment methods, such as Bacs direct debits and Faster Payments, to which interchange fees do not apply.

The acquisition of VocaLink by Mastercard may further reduce competition in payments

59. In 2016, Mastercard announced the acquisition of VocaLink, the payments infrastructure provider to Bacs, Faster Payments, and LINK in the UK. Following Mastercard's acquisition, Bacs, Cheque & Credit Clearing Co (C&CCC), and Faster Payments have merged to become the New Payment System Operator (NPSO). VocaLink has also become infrastructure provider to C&CCC.

60. The CMA reviewed the Mastercard/VocaLink merger, finding that[40]:
    - Mastercard and VocaLink overlap in the supply of central infrastructure services to Bacs, Faster Payments, and LINK, and that this created a range of potential competition concerns;
    - the merger would result in a reduction from three (Mastercard, VocaLink, and Visa) to two of the number of credible bidders for supply of infrastructure services to LINK; and
    - there are a large number of credible alternative providers for supply of infrastructure services to Bacs and Faster Payments, other than Mastercard or VocaLink.

61. The CMA subsequently approved the merger, at Phase I, on the condition of undertakings that would make it easier for alternative bidders to compete against Mastercard or Visa for future supply of infrastructure services to LINK[41].

62. Bacs, Faster Payments, and LINK are currently in the process of tendering their infrastructure providers, following directions from the PSR[42].

63. Which? is concerned though at evidence submitted before the merger by some of the major banks, which call into question the CMA's assumptions about the viability of alternative providers to VocaLink or Mastercard. For example:

---

[38] Using Continuous Payment Authority (CPA).

[39] Such as *Visa Direct* and *Mastercard Send*.

[40] Anticipated acquisition by Mastercard UK Holdco Limited of VocaLink Holdings Limited: Decision on relevant merger situation and substantial lessening of competition, CMA, 2017.

[41] Anticipated acquisition by Mastercard UK Holdco Limited of VocaLink Holdings Limited: Decision on acceptance of undertakings in lieu of reference, CMA, 2017.

[42] Market review into the ownership and competitiveness of infrastructure provision: Remedies decision, PSR, 2017.

- "In our view, the costs of switching infrastructure provider are likely to be equivalent to the costs of maintaining the infrastructure for a period of two or three years. The risks inherent in switching are very difficult to quantify, but in a very worst case scenario they could be existential in nature (for example if payment systems cease to function for an extended period, and HSBC suffers a run on its deposits as a result)." (HSBC)
- "To a bank, the cost of core services is low relative to overall payment services costs, suggesting that any benefits are likely to be limited, while switching comes at a considerable cost to payment service providers. [...] Having examined potential competitors and barriers to switching and entry, evidence for effective competitors to VocaLink existing today or emerging in the future is not strong." (Lloyds Banking Group) [43]

64. Such statements however are inconsistent with the CMA's finding that there are a large number of credible alternative providers for supply of infrastructure services to Bacs and Faster Payments, other than Mastercard or VocaLink.

65. Furthermore, various recent major industry incidents also highlight the degree of risk and consumer harm associated with potential switching of payments and banking infrastructure platforms, including:
    - the major problems at TSB resulting from TSB's switch of banking infrastructure provider, of customers being unable to access their accounts for an extended period and widespread reports of fraud committed towards TSB customers[44];
    - the Europe-wide outage of Visa for several hours this month and similar previous outrages[45]; and
    - Tesco Bank online banking outage this month[46].

66. Which? is therefore concerned at the prospect of success of the current competitive tender processes of replacing VocaLink as the incumbent infrastructure provider for Bacs, Faster Payments, and LINK, without considerable risk and harm to customers – and therefore how Mastercard's acquisition of VocaLink is likely to entrench further Mastercard and Visa's position in the UK payments market.

Q3. Are there international examples of countries supporting the adoption of digital payments that the government should look to?

67. Yes, the Government should particularly look to the US and Australia.

---

[43] Market review into the ownership and competitiveness of infrastructure provision – Interim Report: Consultation Responses, PSR, 2016.

[44] For example, see House of Commons Treasury Committee letter to FCA re TSB IT migration, May 2018.

[45] For example, see House of Commons Treasury Committee letter to Visa Europe, June 2018. Visa also suffered a three-day outage in Ireland last year.

[46] TESCO BANK APOLOGISES AFTER ONLINE BANKING SERVICES UNAVAILABLE FOR FOUR HOURS, June 2018.

68. In 2010, the US legislated to regulate debit card interchange fees and prohibit payment card network exclusivity arrangements and routing restrictions[47]. Under the regulation, the maximum permissible interchange fee that an issuer may receive for an electronic debit transaction will be the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction, from 2011.

69. The regulation also prohibits all issuers and networks from restricting the number of networks over which electronic debit transactions may be processed, and prohibits issuers and networks from inhibiting a merchant's ability to direct the routing of the electronic debit transaction over any network that the issuer has enabled to process them.

70. The US therefore provides a longer period than the EU IFR to assess the effectiveness of the regulation of payment card interchange fees.

71. In Australia, payment card interchange fees have been regulated since 2003. Following this experience, the Australian Government Productivity Commission – which is focusing, among other things, on competition in Australia's financial system as a means to improve consumer outcomes – has recently recommended that[48]:
    - card payment interchange fees should be banned;
    - any remaining fees should be directly related to the costs of operating payments system and such fees should be made transparent and published; and
    - merchants should be given the ability to choose the payment network to route payment card transactions, including competition in payment cards.

72. The Productivity Commission's recommendations are based on its findings that:
    - "Australia's card payment systems are dominated by the major banks […] and the global card schemes, MasterCard and Visa";
    - "the dominance of the major credit card schemes has been reinforced by developments such as [contactless] facility at point of sale";
    - "In many overseas countries, either the merchant or the card holder is given the choice of payment pathway for dual network cards. In the United States, for example, merchants are given scope to select from at least two payment pathways"; and
    - "Regulation of bank interchange fees and surcharging has proved complex and there is little genuine commercial justification for interchange fees."

73. Which? therefore strongly urges the UK Government to consider the experience of the US and Australia, and in particular, Australia's current recommendation to ban card payment interchange fees, make all other fees cost related, and mandate that merchants should have choice of payment network, in order to promote effective competition and protect consumers.

[47] The Dodd-Frank Wall Street Reform and Consumer Protection Act and US Federal Reserve Regulation II (Debit Card Interchange Fees and Routing).

[48] Competition in the Australian Financial System: Productivity Commission Draft Report, Australian Government Productivity Commission, January 2018.

Q4. Why does the cost of processing payments differ between cash and digital payments? How is it changing? And do you expect the change to continue?

74. On the basis of the BRC evidence cited in response to Q2 above, the costs of processing payments differs between cash and digital payments, owing to the high costs of accepting card (and non-card) payments.

75. The primary cost of accepting card payments is "merchant service charges" (MSCs). This is the amount that a retailer has to pay its payment service provider (the merchant acquirer) for accepting card payments. The MSC for debit and credit card payments itself comprises three components:
    - the merchant acquirer's margins;
    - interchange fees; and
    - card scheme fees.

76. As highlighted in response to Q2, while the IFR has reduced regulated interchange fees, especially for credit cards, much of the reduction has been offset by increases in other components, in particular:
    - card scheme fees; and
    - unregulated interchange fee categories, such as commercial cards.

77. As noted in response to Q2, there are widespread concerns that such fees will continue to increase in future, absent regulatory intervention, thereby further undermining the effectiveness of the IFR.

78. As also highlighted in response to Q2, Which? is concerned that the cost of cash payments will also continue to rise in future, owing to the combination of prospective free-to-use ATM closures and ongoing closure of bank branches.

Chapter 3: The future role of cash

Q5. Who uses cash as their main form of payment and why?

79. Which? recently surveyed over 1,200 members to understand the impact that a potential reduction in free-to-use ATMs would have on the millions of consumers who use the network.[49] Overall, Which? found a heavy consumer dependency on ATM usage, with just under half (44%) using a cashpoint at least once a week. Meanwhile, four in five (80%) said that access to the free-to-use network was important to their daily lives and paying for goods and services.

80. Removing free-to-use access would leave one in 10 (9%) struggling to make payments, shutting many consumers out from local shops and services. A reduction would also lead

[49] 'Cash machines: Which? warns on communities hit with lack of ATMs', Which?, January 2018

to one in seven (16%) being deterred from using outlets that accept cash only, placing a strain on consumers and retailers alike.

Q6. How does cash usage and need vary by demographics, geography, and socio-economic status?

81. Positive Money reports that (based on a wide range of sources, including UK Finance and Toynbee Hall)[50]:

    - "Of the 2.7 million consumers who relied predominantly on cash during 2016, over half had household incomes of less than £15k per year. In 2015, 40% of consumers who rely on cash had a total household income of less than £10,000."
    - "Many of the people who rely on cash are 'unbanked', meaning that they have absolutely no access to a bank account. Toynbee Hall estimated that over one million of the people who use cash for their day to day payments are unbanked. And a 2015 survey of unbanked people carried out by Toynbee Hall found that 95 per cent earned £17,500 and below, with just three percent earning between £17,501 and £25,700, the UK's median household disposable income."
    - "For those not among the unbanked who still rely on cash for their day-to-day payments, it is often because they find cash to be a useful method of budgeting and managing low or irregular incomes. Using cash gives customers a greater sense of control over their money: it's obvious how much you have, and it's much more difficult to accidentally spend more than you intend to."

Chapter 4: Understanding the role of cash in facilitating tax evasion and money laundering

82. Which? is concerned that the role of cash in facilitating tax evasion and money laundering should not become a pretext for demoting access to cash for consumers and businesses, especially also considering the role of electronic payments in facilitating other types of economic crimes, such as APP scams, card payment fraud, online banking fraud, money laundering using cryptocurrencies or other electronic payment methods, and a wide range of other cyber crime.

83. Cash is a legitimate payment method for the large majority of citizens and businesses, and should not be automatically associated with tax evasion and money laundering. Accordingly, problems of tax evasion or money laundering should be addressed directly, not by regulatory measures to demote access to cash generally.

[50] THE FUTURE OF CASH: Protecting access to payments in the digital age, Positive Money, March 2018.

About Which?

Which? is the largest consumer organisation in the UK with more than 1.7 million members and supporters. We operate as an independent, a-political, social enterprise working for all consumers and funded solely by our commercial ventures. We receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.