IT'S TIME TO AXE THE CARD TAX

Delivering better value for UK businesses and unleashing payments innovation

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ABOUT THE ACT CAMPAIGN

The Axe the Card Tax campaign launched in October 2022: a coalition of six major trade bodies representing over 240,000 businesses across the economy. We are calling for actions that will create a payments sector where it costs businesses less to take payments and they have a competitive market of alternative providers to choose from.

ABOUT THE ACT COALITION

About Coadec

The Coalition for a Digital Economy (Coadec) is an independent advocacy group that serves as the policy voice for Britain's technology-led startups and scaleups, founded in 2010. Coadec works across a broad range of policy areas that matter the most to startups and scaleups: Access to Talent, Access to Finance & Technology Regulation.

We represent the startup community on the Government's Digital Economy Council, and the UK on the international organisation Allied for Startups Board. Coadec is at the forefront of the UK's Fintech policy conversations.

About the BRC

The British Retail Consortium's (BRC) purpose is to make a positive difference to the retail industry and the customers it serves, today and in the future.

Retail is an exciting, dynamic and diverse industry which is going through a period of profound change. Technology is transforming how people shop; costs are increasing; and growth in consumer spending is slow.

The BRC is committed to ensuring the industry thrives through this period of transformation. We tell the story of retail, work with our members to drive positive change and use our expertise and influence to create an economic and policy environment that enables retail businesses to thrive and consumers to benefit. Our membership comprises over 5,000 businesses delivering £180bn of retail sales and employing over one and half million employees.

About FSB

The Federation of Small Businesses (FSB) is a non-profit making, grassroots and non-party political business organisation that represents members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

Our lobbying arm starts with the work of our team in Westminster, which focuses on UK and England policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with Governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

About the ACS

The Association of Convenience Stores (ACS) is the voice of over 48,500 local shops, ranging from stand-alone family run independent stores, to symbol groups, to multiple convenience stores. These retailers operate in neighbourhoods, villages, on petrol forecourts and in city centres. ACS supports its members through effective lobbying, comprehensive advice and innovative networking opportunities.

About the CRA

The Charity Retail Association (CRA) is the primary membership association for charity shops in the UK. Charity shops generate more than £330m surplus funds per year from more than a billion pounds of turnover, and harness the skills of more than 186,800 volunteers nationwide. Charity retail promotes charitable causes and an environmentally sustainable retail experience. Its members run around 9000 shops between them.

About the FED

Founded in 1919, The Federation of Independent Retailers (The Fed) has consistently championed independent retailers by providing practical help and assistance, commercial support, and dedicated political representation. As one of Europe's largest employers' associations, The Fed supports more than 10,000 independent retailers and small businesses across the UK and Ireland who work primarily in the forecourt, news, and convenience sector.

LIST OF KEY ACRONYMS

A2A	Account-to-Account
ACT	Axe the Card Tax
ACS	Association of Convenience Stores
BRC	British Retail Consortium
CAMR	Card Acquiring Market Review
CMA	Competition and Markets Authority
EEA	European Economic Area
FCA	Financial Conduct Authority
FSB	Federation of Small Businesses
IFR	Interchange Fee Regulation
MIF	Multilateral Interchange Fee
MSC	Merchant Service Charge
PSR	Payment Systems Regulator
PSRs	Payment Services Regulations
ROW	Rest of the World

EXECUTIVE SUMMARY

Every business in the UK faces an unfair and unavoidable "tax" on accepting payments from their customers. This is called the "card tax": a "tax" levied by banks and global payment companies on every UK card payment. It imposes an unfair and unavoidable cost of doing business totalling £5 billion a year, putting the brakes on UK economic growth and investment. The Government and regulators can fix this.

Unfortunately, the current regulatory regime has not worked. Despite caps on some payments, costs have still risen by around 13% since 2014. Scheme and processing fees specifically have risen by up to 600% over the same period.

The total cost is now higher than the level they were when regulation was introduced in 2015, capping some specific fees. These fee rises have happened despite the Government having previously reassured UK businesses that "circumvention" of regulatory caps on fees would not happen.[1] Indeed, the UK regulator responsible for regulating payment systems, the Payment Systems Regulator (PSR), has admitted that "significant increases" in non-capped fees have now fully offset reductions in fees that are capped.[2] In addition to this, the UK's exit from the EU has led to a "fivefold" increase in UK/EU cross-border card fees.[3]

While regulation has failed to reduce costs, other technologies and firms have been unable to break through and meaningfully offer alternatives to retailers, partially driven by the current fee structure incentivising banks to maintain the status quo. This has long been recognised in the UK and the EU, but botched post-Brexit regulation now means the fees do not have a scheduled review under law.[4]

Businesses feel "bamboozled".

As part of this report, a focus group of small businesses was convened. The assembled firms described how they were facing a number of challenges today, from energy to industrial action, meaning the cost of accepting payments is often an overlooked issue. In spite of this, we heard from one participant that they felt card payments had "gone from being a lot more open to trying to squeeze out every penny from us." Complexity of fees featured heavily, with participating businesses reporting confusion and uncertainty: "I think they do it to bamboozle you a little bit. That just seems unfair, that they're taking money, you're taking their cards and you're getting charged".

Finally, when taken through the different fees involved in the process, including the fact that some fees are not regulated, many participants were concerned, with one business owner saying "I can't believe it's an unregulated service".

Meanwhile, consumers underestimate the cost of card payments to businesses, and are in favour of the card schemes lowering fees to support retailers through the cost of doing business crisis.

This report features the results of a survey of over 1,000 consumers which found a consistent underestimation of the cost of card payments on retailers. While 71% of the respondents were aware that card schemes charge a fee on every transaction paid for on cards, 81% of the respondents either underestimated or answered that they "don't know" the level of fees charged (on a £1,000 item). 90% of respondents also underestimated or answered "don't know" when asked about what this then equals in monetary cost to UK retailers each year.

When informed that the interchange fee increased fivefold post Brexit, 45% of respondents said that the fee should be reverted to the same as domestic transactions, while 20% said that they thought it should be higher than domestic, but lower than it is today.

Crucially, 80% of respondents said they would support card schemes, like Visa or Mastercard, committing to lowering the fees they charge retailers to help them deal with the economic pressures they are currently under.

These costs are not inevitable: Axing the Card Tax would put money back in businesses' pockets and open the door for a competitive payments sector.

In 2022 the PSR embarked on a landmark exercise to review why some of the fees have risen: this is a great first step, but so far it only scratches the surface. The Axe the Card Tax campaign is calling for politicians to match the ambition of the regulators by initiating their own review to work out what could be, saving businesses money and unlocking payments innovation.

In the short term, the ACT Campaign is calling for:

- No further fee rises of any kind whilst the Payment Services Regulator undertakes its investigations.
- The cross-border interchange fee hike to be reversed.
- His Majesty's Treasury to initiate a parallel review of the cost of accepting card payments.

In the mid to long term:

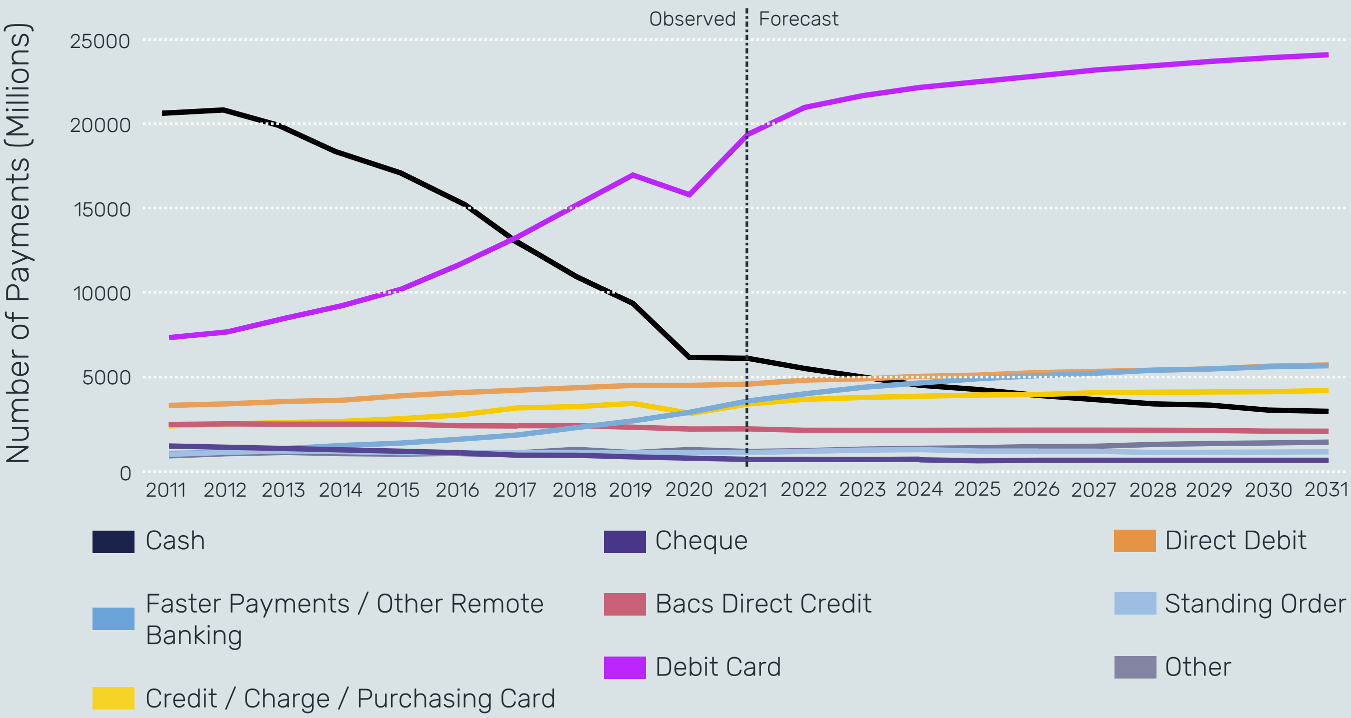
- Measures should be enacted to level the payments playing field. This involves expediting regulations to enable innovation, as well as safeguarding access to cash.
- Competition in the payments sector must be enforced where evidence of malfunctioning markets is found.

In short, it's time to Axe the Card Tax.

A BRIEF (RECENT) HISTORY OF PAYMENTS IN THE UK

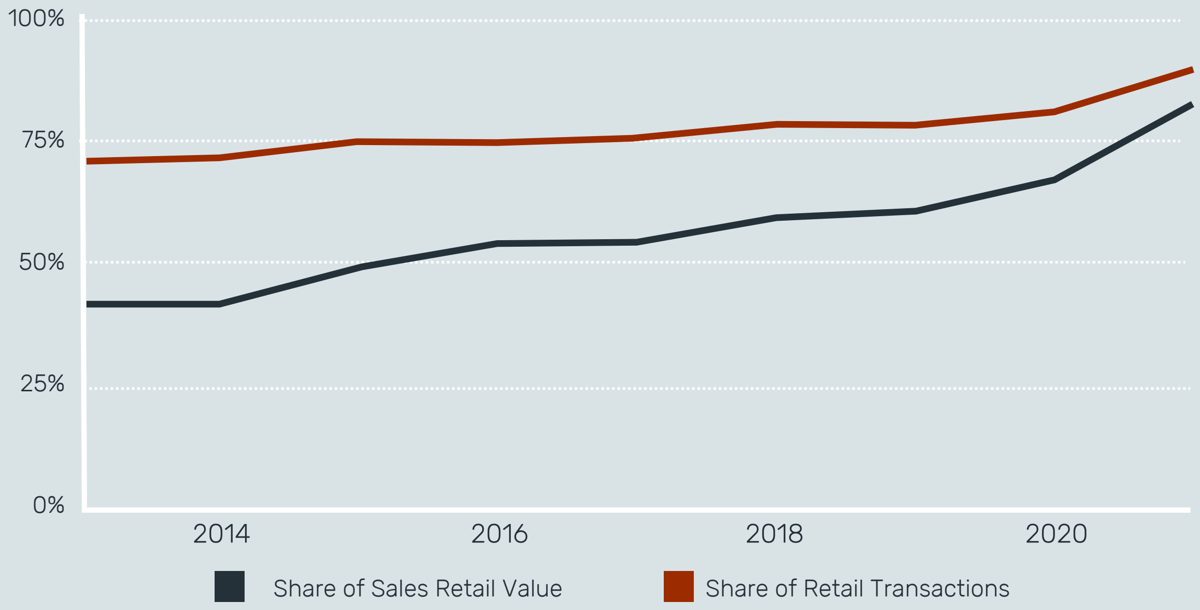
The rise of digitalisation across the UK economy has led to a drop in the use of cash. Instead of this leading to a groundswell of innovative technologies competing for retailers and driving forward innovation, however, only one technology has prevailed, with this trend set to continue.

Figure 1: Number of transaction by payment method (2011-2031)



Looking only at retail transactions, the share of cards is even higher. According to the BRC's 2022 Payments Survey, the latest in an annual series of reports it conducts with its members, combined, debit cards and credit cards constituted over 80% of retail transactions, and 90% of the value of retail sales.

Figure 2: Share of Retail Sales Value and Share of Retail Transactions[5]

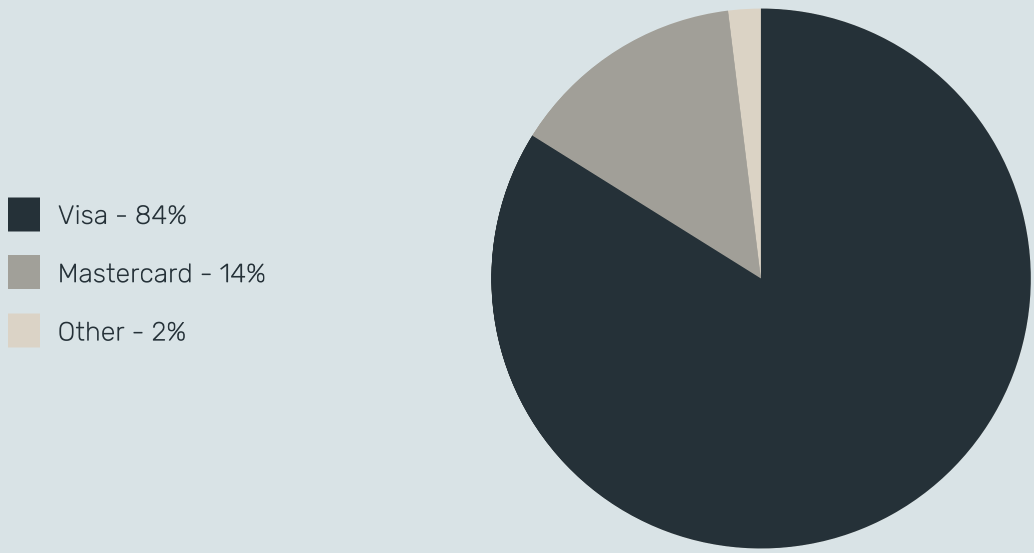


Does this look like a competitive market?

It could be: the dominance of card technology could be the result of the natural selection of the market. Cards are popular because they are secure, reliable, and convenient, which consumers in a poll for this report listed as their top three reasons for choosing a way to pay. Indeed, the rise of one technology isn't necessarily a bad thing, so long as the conditions are such that alternatives can compete.

To complete the picture, however, the graph below shows the market share within the card sector in the UK today. Visa and Mastercard own 99% of the UK card market, which in turn represents 80% of retail transactions.

Figure 3: Visa / Mastercard UK Market Share



Does *this* look like a competitive market?

From a competitive perspective, it is the job of regulators and the Government to monitor the payments market to ensure two conditions exist:

1. It is critical that the payments market is structured in a way that promotes technological innovation and competition to drive value for both retailers and consumers
2. Where one technology prevails, even temporarily, competition in the sector must be guaranteed to drive value.

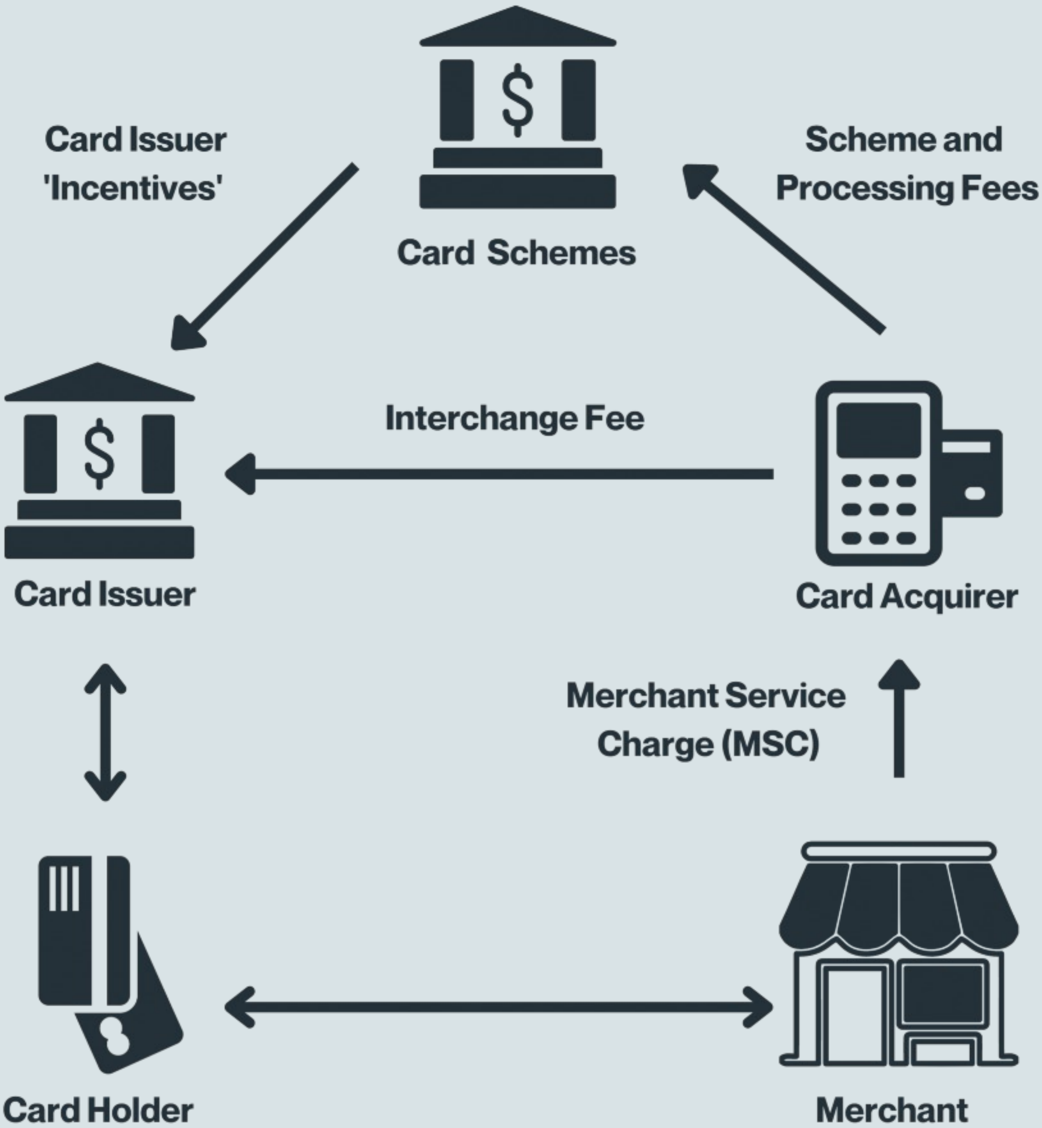
Figures 2 and 3 demonstrate the facts, indeed they are well known.

However, less well known are the consequences. The Axe the Card Tax Campaign is a unique coalition of trade bodies from across the UK economy that believes the payments market in the UK today is ripe for innovation, to improve levels of competition and transparency, cutting costs for retailers, and, ultimately, for consumers. This report sets out how the payments market currently operates, and how its problems can be remedied.

CHIP AND PAY

Every time you pay by card, it costs the business you're paying money. Behind every tap, swipe, and chip 'n' pin, there are a bunch of complex costs charged to the business.

Figure 4: The Card Four-party Model



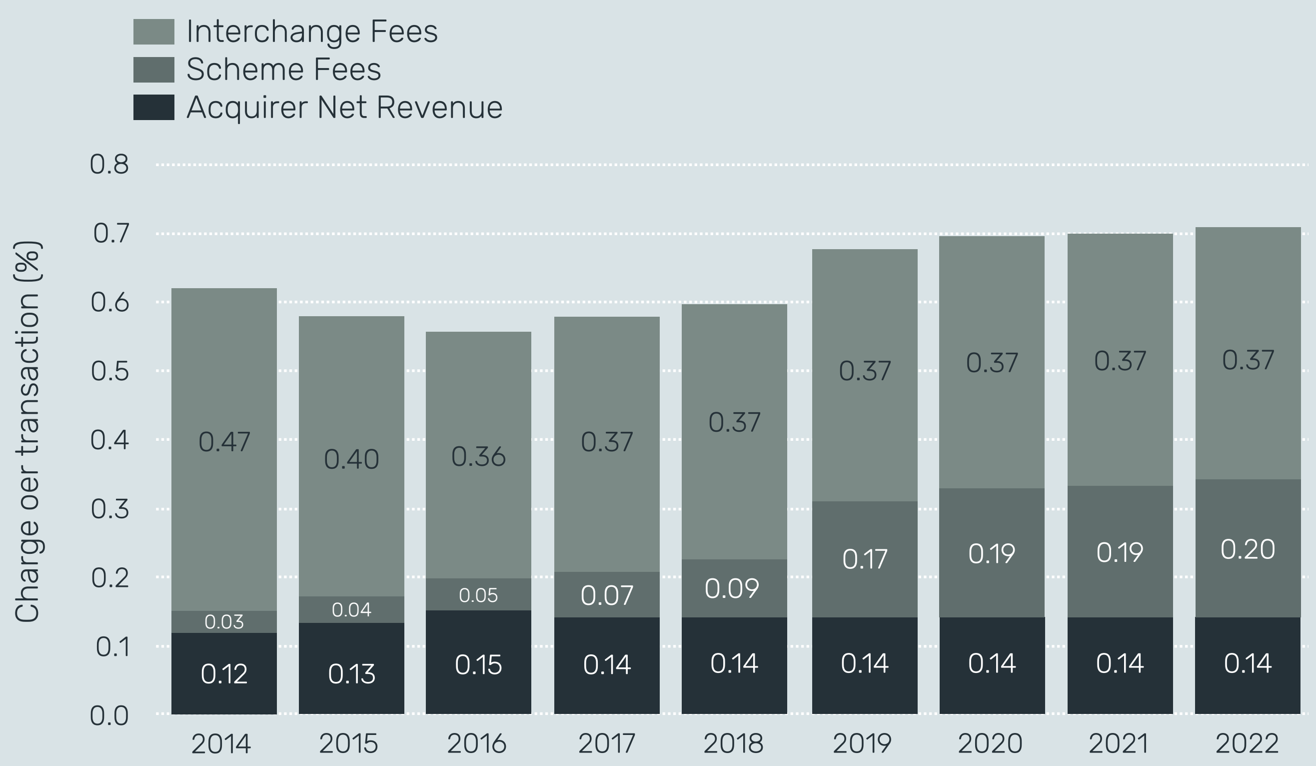
Businesses pay a Merchant Service Charge (MSC) on every card payment. This consists of three main types of fee: the acquirer fee, interchange fees, and scheme and processing fees. Distinguishing between the fees matters because each has fluctuated differently over the last eight years.

The Fees:

	Card Acquirer Fee	Interchange Fee	Scheme & Processing Fees
Description	Paid to the companies that manage and supply card machines and online payment portals (called card acquirers).	Paid to the payment service providers (such as banks) that have issued the credit or debit card.	Paid by payment service providers (such as card acquirers) and payment service users (such as retailers) to access the card schemes.
Who Sets the Fee?	The Card Acquirer	The Card Schemes	The Card Schemes
Regulated Status	Unregulated	Regulated: capped under the Interchange Fee Regulation (IFR).	Unregulated
Recent Trend	Remained nearly flat since 2017.	Remained flat since 2017, and is lower than it was when the IFR was introduced in 2015.	Increased since 2014 by up to 600%.

The graph below shows the trend in MSC between 2014 and 2022. Even though the IFR was introduced in 2015 to curb excessive card fees, the average cost for merchants is now larger than it was before the regulation.

Figure 5: Average UK MSC



Source: PSR Card-Acquiring Market Review and ACT Campaign Analysis Data

Note: The share of interchange fees exceeds the caps as it includes non-domestic transactions and non-regulated card types (e.g. commercial).

The reason for the failure of the IFR can be found in the evolution of the scheme and processing fees. Since 2015, the shares of each component of the MSC have changed dramatically, with a larger proportion of the fee today determined by scheme and processing fees, which are paid to the card schemes.

Figure 6: Constitution of fees within the MSC (pre-IFR)

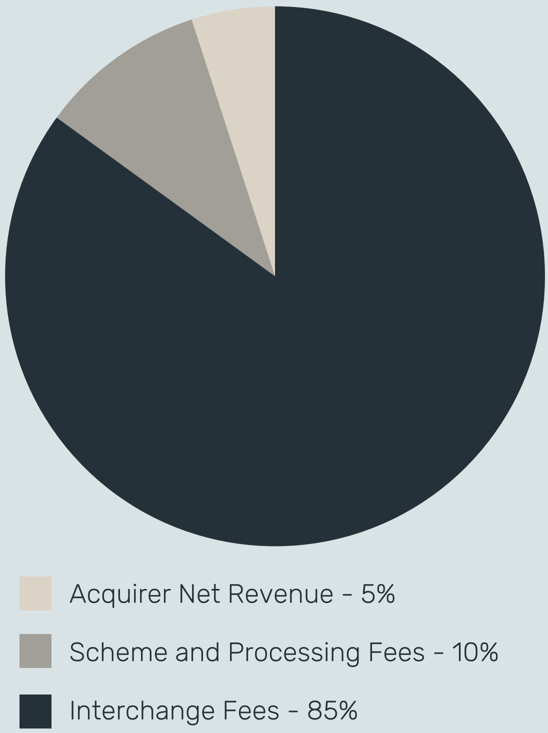
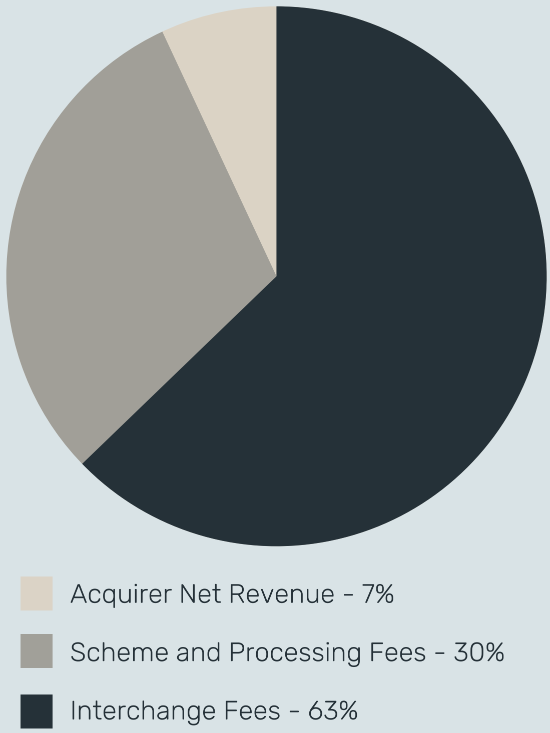


Figure 7: Constitution of fees within the MSC (post-IFR)



Source: PSR Card-Acquiring Market Review and ACT Campaign Analysis Data

THE CARD TAX

The ACT Campaign regards the Interchange Fee and the Scheme & Processing Fees as a tax on card payments across the UK.

The Interchange Fee

The interchange fee is set by the card schemes and paid *by* the merchant's card acquirer *to* the bank issuing the card of the customer (the 'issuer'). Since issuers want to get the most interchange income possible, the card schemes compete by increasing the level of interchange fees, in a form of 'reverse competition': it is a race to the highest fee to attract issuers.

Ultimately, retailers foot the bill.

Regulation was needed to address this structural problem and in 2015, the European Union introduced a cap on the interchange fee through the IFR: for debit card transactions, the interchange fee cap is 0.2%, whilst for credit card transactions the interchange fee cap is 0.3%.

Post-Brexit, with the UK sitting outside of the EU politically, its retailers now legally sit outside the IFR, and the Interchange Fee (Amendment) (EU Exit) Regulations 2019 came into force, replacing the previous IFR. As a result, payments made between the UK and EU are no longer covered by the caps, though materially nothing has changed.

The major card schemes did not wait to take advantage: for debit card transactions made in the UK using an EU issued card, the interchange fee is now 1.15%, whilst for credit card transactions of this type, the interchange fee is now 1.5%. Estimates from the payments consultancy CMSPI have suggested that this change has added around £30.8m in annual costs for UK retailers.[6]

While the PSR is currently scrutinising the rationale for these UK-EEA cross-border fee rises, Chris Hemsley, Managing Director of the PSR, has already said in response to the House of Commons Treasury Select Committee that he has not seen any cost justification for the interchange fee increases.[7] In other words, an increase in interchange fees did not have to occur.

In the meantime, the level of the interchange fee for domestic transactions has also recently come under scrutiny. Firstly, in 2020, the UK Supreme Court ruled in favour of major UK retailers that Visa and Mastercard's UK historical domestic interchange fees were unlawful.[8] This did not result in any substantive action by either the PSR or the Treasury.

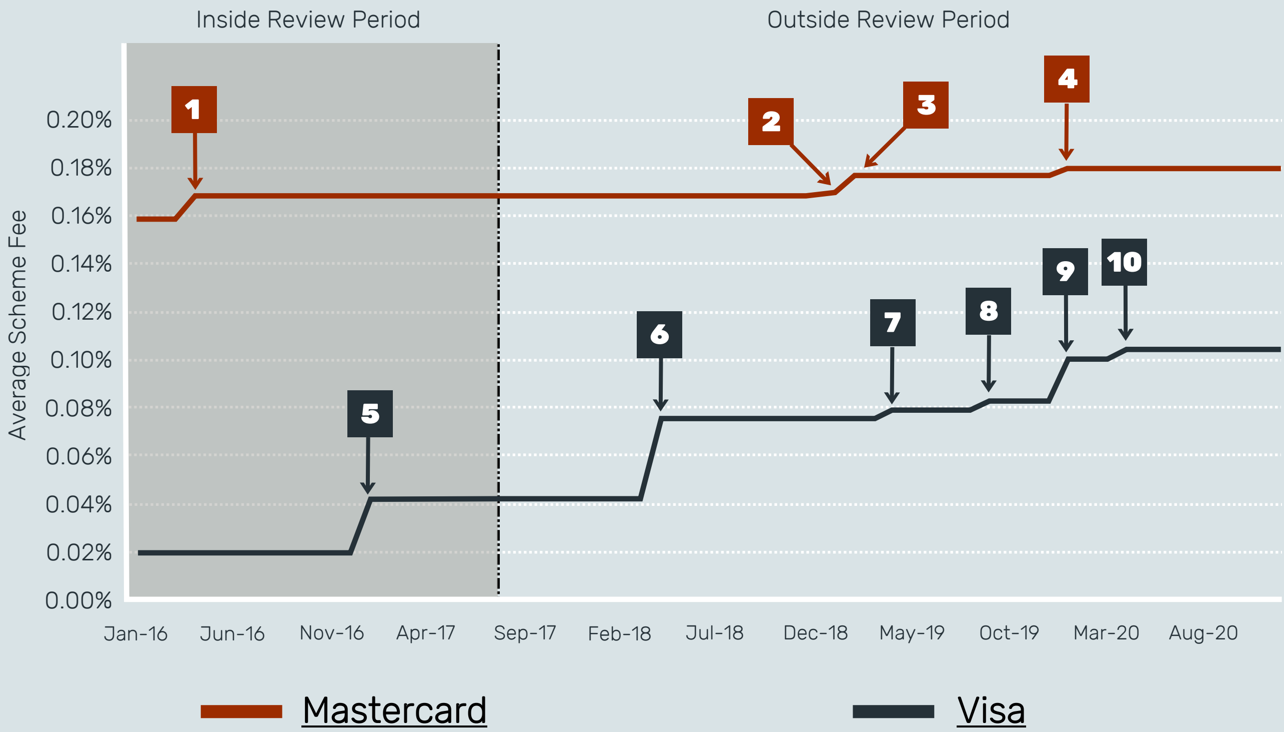
Secondly, the post-Brexit changes to the IFR stripped away any requirement to review the level of the interchange fee. This was raised by Lord Adonis, amongst others, at the time, however has not been changed.[9] While this means that, on the one hand, fees will not adjust to reflect changing economic contexts, this also means that the opportunity was missed to examine if the interchange fee cap is functional *as it is today…*

Indeed, given the interchange fee's original rationale of incentivizing card usage, there is a question of whether the current cap levels make sense for such a developed card market as the UK. To contrast, when the original interchange fee caps were being set by the European Commission, they had to compromise the fee cap at a level that would work for very different economies. As a result, the UK, with a card penetration of near 90% today, has the same level cap as cash-dependent countries like Italy, Croatia, and Hungary, which have less than 40% of transactions taking place via cards.[10] Reviewing the caps is therefore a prime opportunity to ensure that onshored European legislation works best for a post-Brexit UK.

The Scheme & Processing Fees

Scheme and Processing fees are incredibly complex, opaque and inaccessible to businesses, particularly smaller ones. They have also risen steadily since the introduction of the IFR.

Figure 8: CMSPI Analysis of Scheme Fee Increases since the IFR



1. New Acquirer Authorisation Fee (€86m)
2. New CNP Inter and Intra-Regional Fees (€11m)
3. Restructured Acquirer Clearing and Authorisation Fees (€61m)
4. 3DS Scheme Fee (€28m)
5. Increased Ad Valorem Component of Fee (£314m)
6. Increased Fixed Component of Fee (€464m)
7. CNP Inter-Regional Fee Increase (€54m)
8. 3DS Scheme Fee (€28m)
9. Increased Acquirer Association Fee (€241m)

Source: CMSPI, 2021 Card Fee Changes: Impact Assessment, 2021

Estimates from CMSPI suggest that these scheme and processing fee rises have increased UK retailers' average costs by £519 million up to 2021, surpassing the benefits of capping the interchange fee. Furthermore, CMSPI also estimates that the broader reclassification of EU originated transactions post-Brexit has also increased scheme and processing fees for these transactions, alongside the interchange fee, leading to £60 million in additional fees since the UK left the EU.[11]

The IFR explicitly prohibits the use of other fees and pricing tools charged to acquirers and merchants to circumvent the cap by giving more money to issuing banks. The ACT campaign believes there could be evidence to suggest that scheme and processing fees may be being used in this way, and support the ongoing PSR investigation to examine if this is the case. When the IFR was introduced in 2015, Treasury explicitly stated that the IFR, as implemented in the UK, would prevent "substitution" of interchange fees with "alternative fees".[12] It is vital for this to be enforced.

Critically, one of the systemic solutions to mitigating, or avoiding, continued fee rises in a market is to ensure that competition enables customers to shop around. In a healthy, functioning market, fee rises of 600% in eight years would be met by customers voting with their feet to cheaper, or better value, providers. In the card market, however, there are limited options for customers (i.e. retailers). Visa and Mastercard own 99% of the card market and are known as having "must take" status for retailers.[13]

As outlined in the introduction, there are limited to no alternative technologies widely available, meaning retailers must take cards and pay up.

THE CARD TAX IN 2023

At the start of 2023, the ACT campaign estimates that the Card Tax could be as high as 0.57% of every card transaction. This may appear small, but this is 0.57% of 4 in every 5 payments made in the UK economy, every day.

This works out as a total cost to UK businesses of £5 billion every year.

THE IMPACT OF THE CARD TAX

High, and Rising, Costs

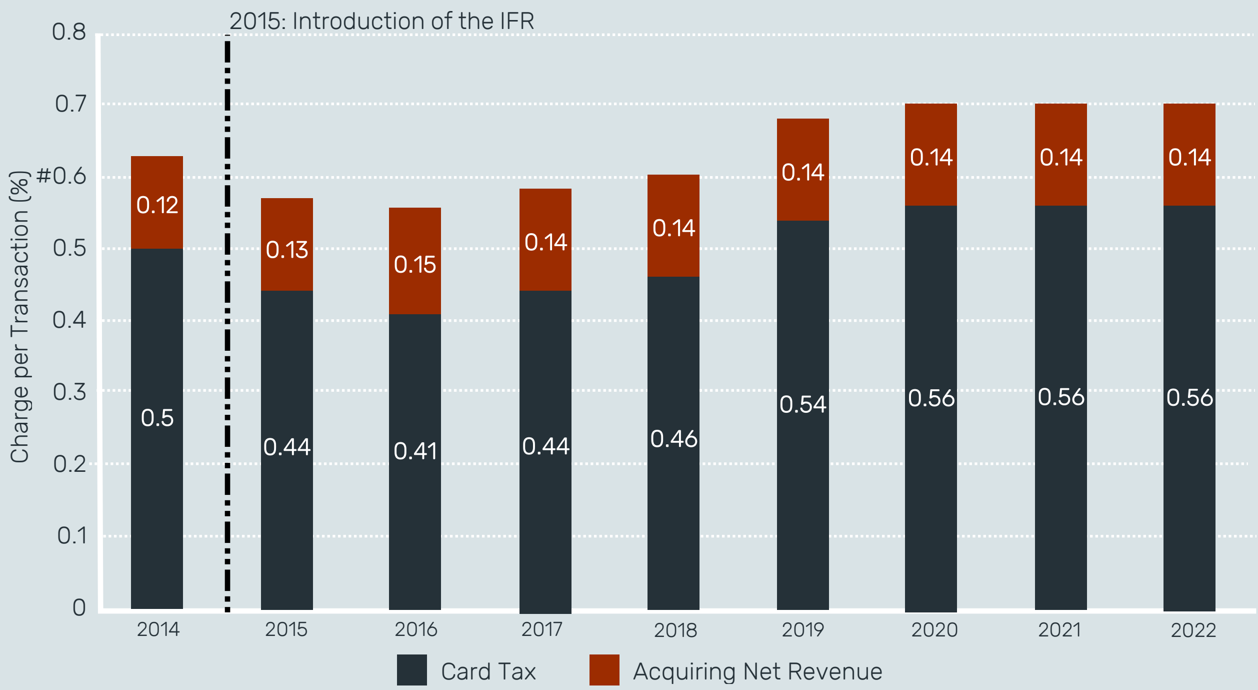
The Card Tax costs UK retailers money every year. While this has long been an issue, with the BRC launching its first official complaint about the fees in 1992, the significant increase in both the use of cards and the increase in card fees in the last decade has particularly impacted British businesses. This trend was exacerbated by the Covid-19 Pandemic, with more UK businesses forced to accept card payments and more consumers using cards than ever before.

The ACT campaign estimates that since 2016 the card tax has increased by up to 40%, with card scheme and processing fees primarily responsible, having increased by up to 600% since 2014.

Today, the average cost of a card payment to the retailer can be up to 0.6% on average on every card payment, and likely much higher for smaller businesses which can't negotiate with the schemes.

This equates to an annual card tax paid by businesses of up to £5bn.

Figure 9: The Card Tax 2014 - 2022



Source: PSR Card-Acquiring Market Review and ACT Campaign Analysis Data

Critically, this 'average' includes multiple providers, multiple transaction types, and multiple types of issued cards at play: it is very challenging to understand exactly what is being paid. What is clear is that the fees are rising, and are disproportionately higher for small businesses.

Entrenchment of the Status Quo

The Card Tax has entrenched the dominance of card payment technologies and, as a result, the dominant card firms. While card schemes don't receive the interchange fees they set, because the revenue goes to their clients, they have a financial incentive to set the fee at the highest rate possible to keep and win clients, all at the expense of retailers. Naturally, they also have the incentive to find other ways of getting more money to issuing banks, which could explain the increase in "alternative fees" after the Regulation.

he European Commission has previously identified that this is the result of 'reverse competition' due to the fact that the actual interchange fee charged is the responsibility of the card schemes. The card schemes compete with each other to increase the level of interchange fees, in order to attract and/or retain card issuers and their cardholders, leading *"to ever higher interchange fees (and consequently, MSCs). Interchange fees are revenues offered to banks by card schemes in exchange for issuing their cards rather than the cards of the competitors. Therefore, an increase in MIFs offered by one card scheme leads banks to issue the cards of this particular scheme."*[14] This was also acknowledged in the IFR Impact Assessment.[15]

This interchange fee income is significant. The annual income is estimated to be around £3bn for UK banks (and other UK card issuers). Indeed, the Competition and Markets Authority (CMA) has estimated that debit card interchange amounts to 10% of UK bank personal current account income.[16]

This perverse incentive to increase interchange fee is also reproduced when the card schemes set scheme and processing fees. Given they want to win more business and have more transactions running through their network, they can raise scheme and processing fees paid by acquirers and merchants, offsetting fees paid by issuers to the schemes. These incentives, which come in many forms, could be seen as an indirect form of interchange fees. They help explain the continuous increases we have seen in scheme and processing fees despite the IFR attempting to prevent this type of circumvention. Ultimately, both direct and indirect interchange fees represent a wealth transfer from merchants, and small businesses in particular, to issuing banks.

An Unlevel Playing Field

With banks making a healthy profit from direct and indirect interchange fees, there is a powerful financial incentive for them to continue working with the major card schemes. This presents a barrier to entry for alternative innovative forms of payment.

Despite the introduction of the Interchange Fee Regulations in 2015, this reverse competition means interchange fees remain lucrative for banks, which is doubly important when alternative technologies require the banks to invest, and also do not yet present a comparable revenue stream.

For alternative providers, particularly fintechs who have finite resources, a limited runway and smaller scale, this incentive barrier looks insurmountable. The answer cannot be to replicate an equivalent fee structure, as this is evidently not working today. This challenge is further exacerbated by the prohibition of surcharging introduced in 2012 that consequently makes it harder for retailers to steer consumers to payment methods that deliver better value for merchants.

If the Treasury is serious about supporting the UK's burgeoning fintech sector, it must tackle this incentive issue head on.

But how is the Card Tax perceived by those who foot the bill, the UK's small businesses themselves?

EXPERIENCES OF THE CARD TAX: A FOCUS GROUP WITH SMALL BUSINESSES

In February 2022, ACT coalition member Coadec commissioned Public First to conduct a focus group with 7 small business owners, each with fewer than ten employees. The objective was to understand how the cost of doing business crisis was impacting their business; their online and bricks and mortar experiences; card fees; and other payment services.

Crucially, an overarching theme from participants was a concern that falling expendable incomes was impacting their customers, with confidence and optimism about the future generally low. Participants said:

“I am very worried. But mainly because my target audience is the part of the group that’s most pinched.”

“People's average spends are going down, I can really notice it. And I noticed people are coming in, and they're really comparing our prices and supermarket.”

Food refill store owner, Female, 51

“On card payments, I’m gonna say that it really seems to have gone from being a lot more open to trying to squeeze out every penny.”

Artwork, homeware, cards store owner, Female, 46

The group consisted of a mixture of businesses based solely online, alongside those who also had a physical presence. For those with less online presence, the biggest barriers to ‘getting online’ identified were time and skills: as small business owners, these were people who have to be jacks-of-all-trades. Those who weren’t online understood the opportunity but didn’t have time.

Participants in the group reported that most of the payments they accepted were through cards, but importantly, none would consider going cashless. They suggested that a cashless society would be quite dystopian, and a number actively encouraged cash payments for low-value transactions:

“I kind of encourage [cash], because I don’t think customers realise that if they’re coming in for a packet of crisps or an apple for 50p, I get charged for a single transaction”

Delicatessen owner, Female, 50

“It just feels like cash is going to disappear, and that feels like a bit of a scary, strange world.”

Food refill store owner, Female, 51

"I would say that a lot of customers are quite mindful about how much they will spend on the card, if it is under a pound or three pounds...I think a lot of them are quite aware that we were paying the charges if it is a small transaction."

Food refill store owner, Female, 51

The participating businesses were hyper-aware that "card costs money and it does add up" but they were also very aware of how important cash was to a "vocal minority" and would keep taking cash for them. While there was some usage of alternative digital payment methods to card payments, participants were clear that they had limited time to meaningfully adopt new payment methods.

The group were clearly confused and lacked awareness about payment fee structures, they were muddled when talking about the details of payments, and there was a general sense that it was hard to understand and navigate. There was a sense of unease and unfairness about the industry as a whole:

"I feel like that's (transaction fee) a lot of money to pay out...it seems incredibly high and I haven't go the time to go through all that and check with the right people – I just sort of trust them."

Toy Store owner, Female, 45

"It's like when you get your electric bill and it tells you how many watts and you know, Visa debit, Visa, MasterCard, debit is more than credit and then if someone pays over the phone that's a different price, every type of transaction has a different price. I think they do it to bamboozle you a little bit. That just seems unfair, that they're taking money, you're taking their cards and you're getting charged."

Delicatessen owner, Female, 50

When participants were taken through the different fees involved in card payments, they expressed surprise that some elements were outside of the regulatory caps:

"I can't believe it's an unregulated service...I'm not financially unaware, I did or used to be an accountant and auditor and I've got caught out twice on contracts that have changed midway through and it's made me so furious."

Artwork, homeware, cards store owner, Female, 46

CASE STUDY: BLACK NOVA DESIGNS

Since it was founded by Kyle Holmes in April 2015, Chippenham based Black Nova Designs have specialised in providing IT solutions for over 1,000 homes and businesses all over the world.

1) Do you find it clear how much you are paying each time a customer uses a card and do you know where these costs are going?

"We use x for card payments, so we usually just know the percentage cost, we have no idea what it's for or where it is going."

2) Each time a customer pays using their bank card a portion of the fee goes to the card schemes (e.g., Visa or Mastercard). Are you aware of these fees? If so, how do these fees impact your business?

"I wasn't aware of this, as we use one card payment function online, we just see the percentage taken per transaction."

3) Whenever cards are used there is a fee attached, paid by the business. If more consumers were aware of this fee to local businesses do you think they would be more likely to request to pay with methods that cost the business less?

"I do believe, in most cases, consumers would change their minds if they knew how much was taken in fees. 'People buy from people' and for us as a smaller business we believe we are here to support each other rather than just accept the fees."

4) Do you have any views on whether card fees should be capped, or more should be done to support small businesses at this time?

"Capping card fees would make a huge benefit to small business. When cashflow is so very precious so for all small businesses it would make it easier to forecast cashflow, profits, and, of course, prices."

5) Would you be open to accepting other digital payment methods? What would you need from these alternatives?

"We always try to offer BACS as a payment option, many of our clients do pay this way especially B2B clients who know the cost of cards and are happy to use BACS to avoid these charges."

6) Lastly, how much are you paying in card fees, and if possible, specifically to the card schemes (e.g., Visa or Mastercard)?

"I am unaware of the mastercard/visa split however in total across the year we pay around £4k in card fees."

CASE STUDY: MOORE'S CAMPERS

Moore's Campers Ltd is based in Gloucestershire and offers campervan conversions, campervan hire and sells camping and caravanning accessories.

1) Do you find it clear how much you are paying each time a customer uses a card and do you know where these costs are going?

"Everything is online on a portal that I had no access to for around 18 months. I have recently sorted this but before this I had no idea what we were paying. It's still a frustrating process to log in to find rates and I would rather have things on paper."

2) Each time a customer pays using their bank card a portion of the fee goes to the card schemes (e.g., Visa or Mastercard). Are you aware of these fees? If so, how do these fees impact your business?

"Yes we are aware of the fees, although not certain on exact amounts. Our card machine bill is around £200-350 every month which is a huge impact on a small business just for card processing fees."

3) Whenever cards are used there is a fee attached, paid by the business. If more consumers were aware of this fee to local businesses do you think they would be more likely to request to pay with methods that cost the business less?

"Yes, I think more people would opt to pay by other methods, we try to encourage bank transfer where possible as we often deal with larger amounts of money. I have seen things circulating social media recently about opting to pay small businesses with cash and so many are surprised how much businesses lose from card payments."

4) Do you have any views on whether card fees should be capped, or more should be done to support small businesses at this time?

"I believe that charges should be less or that there should be a terminal/processing fee and minimal transaction charges. £350 seems a lot of money just for processing a payment that we don't see for 5-7 days when a bank transfer is free and instant."

5) Would you be open to accepting other digital payment methods? What would you need from these alternatives?

"I'm open to discussing other methods, i.e. bank transfers that we already accept."

6) Lastly, how much are you paying in card fees, and if possible, specifically to the card schemes (e.g., Visa or Mastercard)?

"I mentioned in the other questions - we pay around £200-350 per month. We have recently made a formal complaint to our card provider and had a percentage of fees refunded as we had no access to our online portal, no correspondence about a rise in fees and issues with compliance questionnaires. We were refunded around £500 in total but this is minimal against the thousands we've paid in processing fees over the last 9+ years."

CASE STUDY: TO THE RISE BAKERY

To The Rise Bakery is a small sister run artisan bakery in Eastbourne, East Sussex. They started their business focusing on sourdough bread at the very start of the Covid pandemic in a homemade micro bakery space. Since then, they've expanded the products they offer and opened up a permanent shop and bakery at the end of March 2022, right by the sea.

1. Do you find it clear how much you are paying each time a customer uses a card and do you know where these costs are going?

"The cost is very clear for us as it is all on the web. However, when we were looking at which provider to use, there were many different ones and comparisons were not that easy and they were all formulated in a different way. A comparison chart table or something, would have been helpful to compare what was the best for our business. Once you are with one system it is hard to change so making the right decision at the beginning is very important."

2. Each time a customer pays using their bank card a portion of the fee goes to the card schemes (e.g., Visa or Mastercard). Are you aware of these fees? If so, how do these fees impact your business?

"It costs us 1.75% every contactless payment to process and 2.5% for online payments on our website. I don't believe that there is an extra charge for cards such as Amex, however we are charged 2.9% for non UK cards and being in a seaside holiday destination this can add up to be a little more over summer."

3. Whenever cards are used there is a fee attached, paid by the business. If more consumers were aware of this fee to local businesses do you think they would be more likely to request to pay with methods that cost the business less?

"We don't often have a choice at all how customers pay and often people only come out with their phone in order to pay. We love the ease of card payments but the price seems a little high especially how we have to pay for the system and also add ons to run the business in the first place."

4. Do you have any views on whether card fees should be capped, or more should be done to support small businesses at this time?

"I think card fees should be lowered or capped, especially for small businesses in order to help them grow. We noticed that they are higher when someone pays via chip and pin or invoice compared to contactless, and to have the different rates doesn't seem fair as we cannot choose how our customers pay."

5. Would you be open to accepting other digital payment methods? What would you need from these alternatives?

"We are always open to accepting new methods, however this often comes with more training for both the staff and customer which can take time, especially if you work in a place like Eastbourne where the population can be a little less efficient in taking up newer methods.

We would like to have centralised systems that can accept all payment methods and as we move into a more paperless system encouraging quicker, cheaper and more efficient solutions are necessary."

6. Lastly, how much are you paying in card fees, and if possible, specifically to the card schemes (e.g., Visa or Mastercard)?

"It costs us 1.75% every contactless payment to process and 2.5% for online payments on our website."

While businesses are bearing the brunt of the Card Tax, it is also critical to understand what consumers think about the cost of payments to the shops they buy from. If action is taken to increase the number of alternatives, what would consumers want to see?

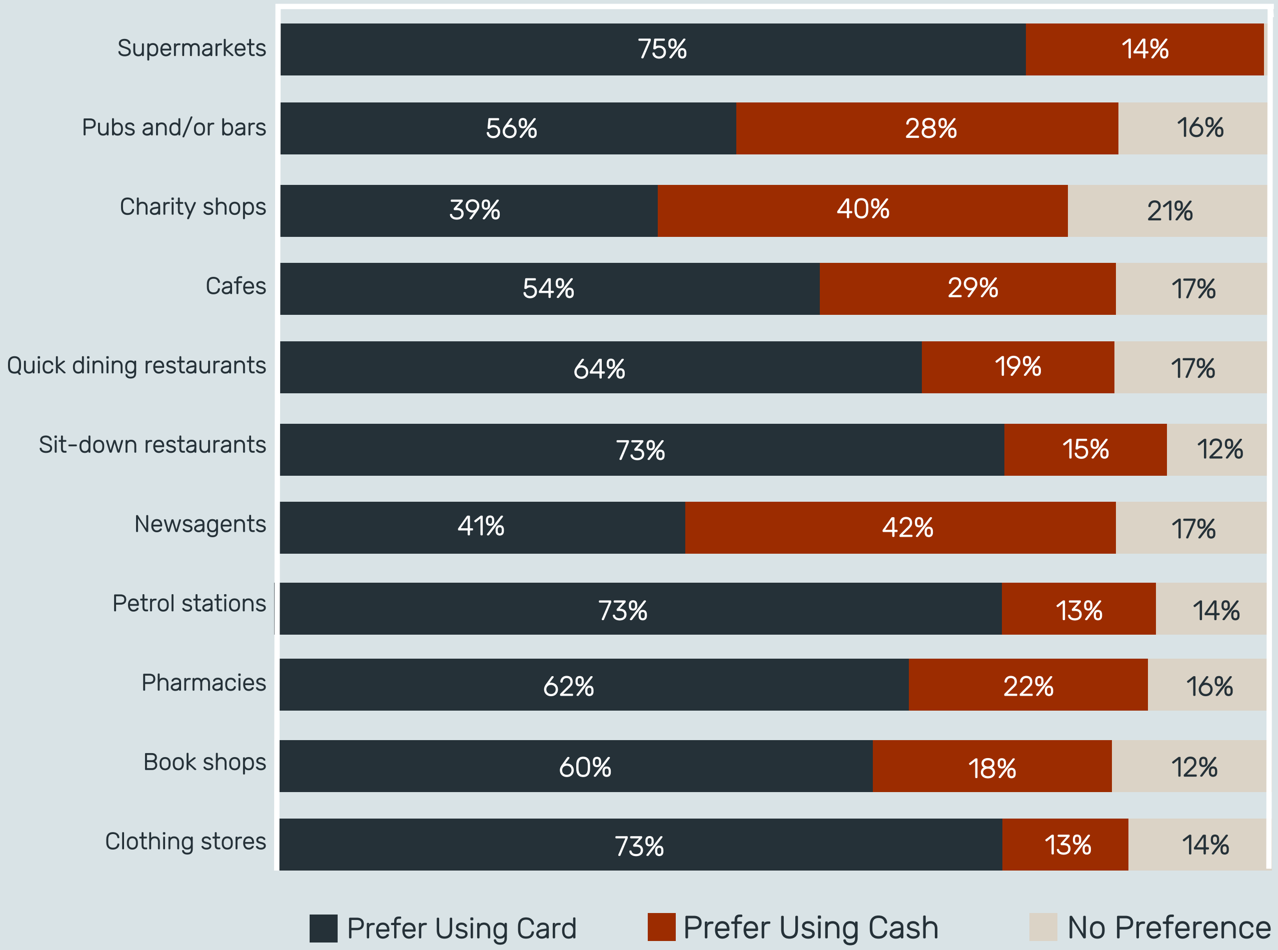
WHAT DO CONSUMERS THINK?

In January 2023, ACT coalition member Coadec commissioned Public First to poll 1,008 UK adults online. This was a nationally representative poll. The questions were a combination of questions about their shopping behaviours, questions about how they pay, and their appetite for alternative payment options to cash and cards.

About the Respondents and How They Pay

As was expected, the majority of respondents owned cards, with 97% of respondents owning a debit card, and 65% owning a credit card. In today's day and age, consumers overwhelmingly choose to use cards to pay: when asked about a range of different types of retailer, in almost all cases consumers preferred to pay with a card than with cash. The only exceptions were charity shops, where 40% preferred cash, while only 39% preferred cards, and newsagents, where 42% preferred to use cash, and 41% preferred to use cards.[17] Despite this, cash usage remained high among the respondents, with over three quarters (76%) having paid with cash within the last month, and a majority (53%) having paid with cash within the previous week.

When making purchases at the following stores, do you prefer to pay using card or cash?



A minority of our respondents reported using different payment methods to cash and cards in stores, with the most popularly used alternative being paying with their phone. Crucially, this often is a proxy for paying with their card, however, and with direct debit, the most popular non-card alternative payment method, only used by 24% of respondents in store. 39% of respondents answered they had not used any of the listed alternative payment methods in store, and over half (56%) answered that they had seen a “card only” sign at a checkout in a shop in the last month.

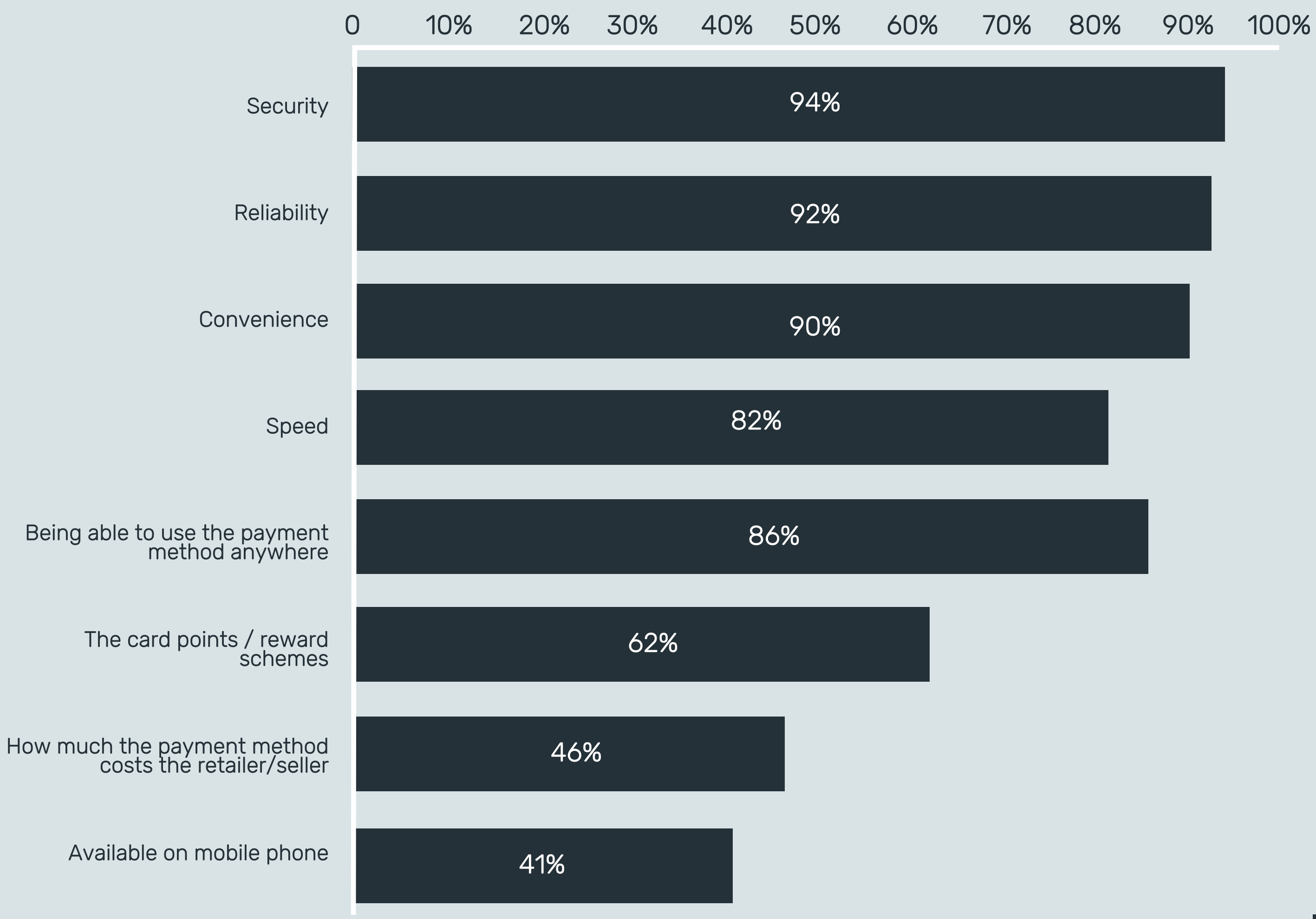
More respondents answered that they had used at least one of the alternative payment methods when asked about shopping online, however. Nearly half (49%) had used direct debit to pay online, while one in five (22%) had used Buy-Now, Pay-Later. One in three had paid using a bank transfer (32%), while only 7% of respondents answered that they had paid using “Open Banking”.

When asked about the reasons for choosing how they pay, the following were the most important factors:

- Security - 94% answered very or somewhat important
- Reliability - 92% answered very or somewhat important
- Convenience - 89% answered very or somewhat important

Nearly half (47%) of consumers said that the cost of accepting the payment to the retailer was very or somewhat important to them, but nearly two-thirds (63%) agreed that they wanted to pay in a way that the retailer receives as much of the payment as possible. Importantly, 44% of respondents reported being open to alternative ways to pay than cash or card, with only 27% not open to the idea.

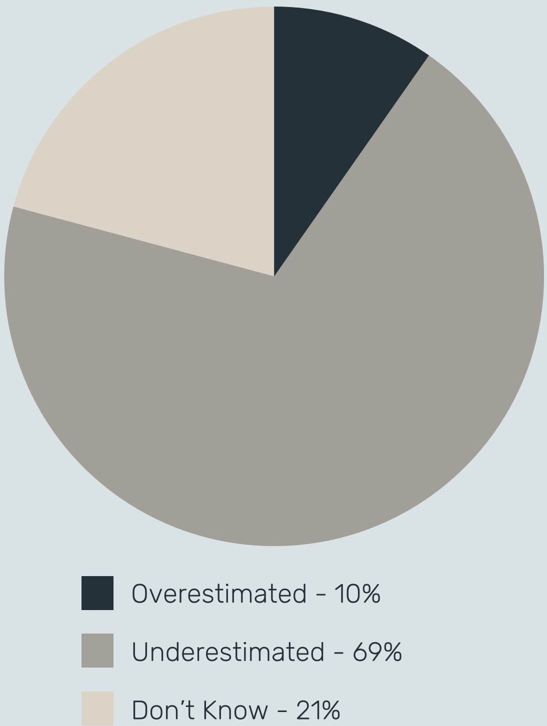
<u>How important or unimportant are the following things when you are choosing a payment method for a purchase? (Total important)</u>



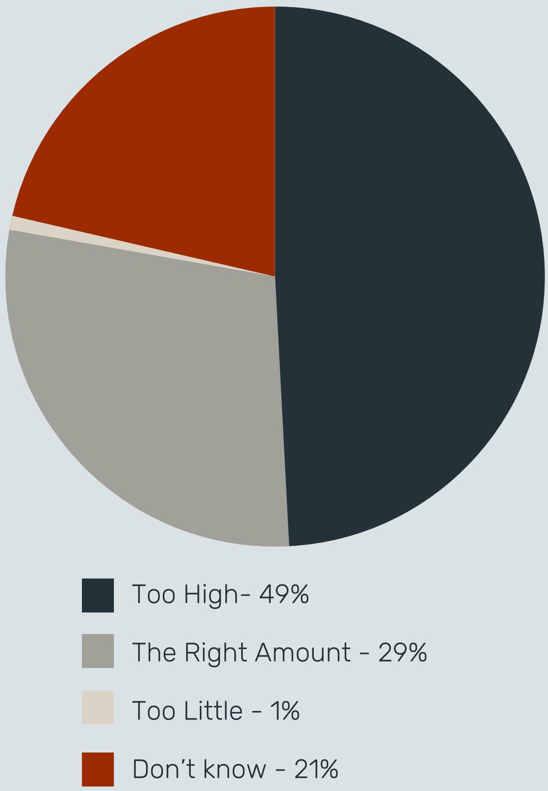
Knowledge of the Fees Associated with Card Payments

While seven in ten (71%) respondents were aware that card schemes charge a fee on every transaction paid for on cards, when asked to estimate the cost of these fees, 81% either underestimated the cost on a £1,000 transaction, or answered that they didn't know.[18] An even larger percentage (90%) of respondents either underestimated or answered that they didn't know what the absolute monetary cost of the Card Tax was to UK retailers each year.[19] When told the true rate of the Card Tax, half (49%) thought that the level was too much, while only 29% said it was about the right amount.

Estimates by respondents of what proportion of transactions are card scheme fees in a £1,000 transaction



Currently, payment schemes charge retailers anywhere between 0.5% and 3.5% for every card transaction they process. Do you think that they are charging too much, too little, or the right amount?



Whilst respondents acknowledged that there may be circumstances where it is reasonable to charge a higher rate for transactions (34% said international customer transactions should carry a higher fee, whilst 26% said that larger ticket transactions should be charged more), 30% of respondents said that it would never be justified to charge a higher fee.

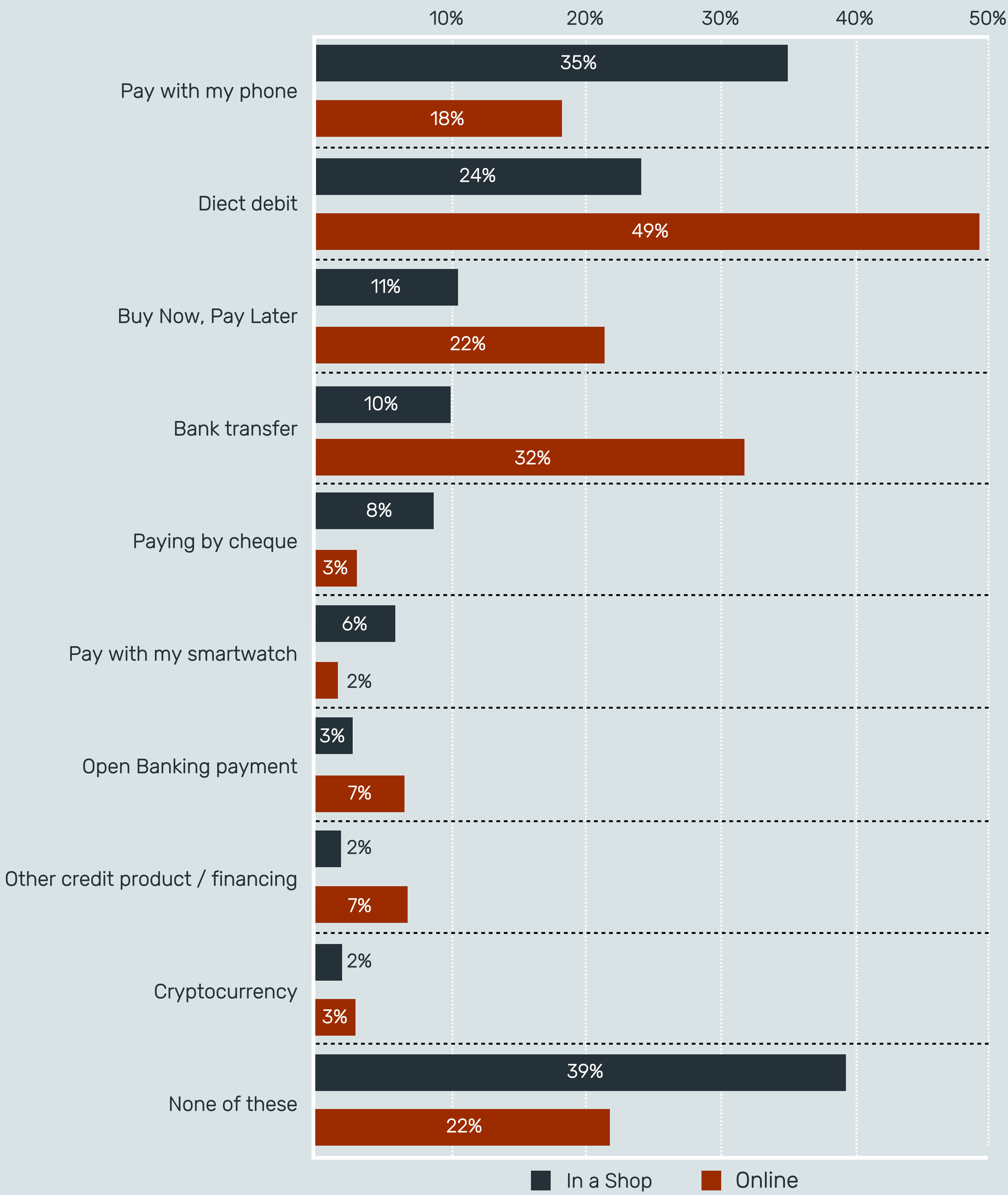
When informed that the interchange fee was increased fivefold post Brexit, 45% of respondents said that the fee should be reversed to the same as domestic transactions, while 20% said that they thought it should be higher than domestic, but lower than it is today.

Crucially, 80% of respondents said they would support schemes, like Visa or Mastercard, committing to lowering the fees they charge retailers to help them deal with the economic pressures they are currently under.

Awareness of alternative ways to pay

We asked respondents about whether they had heard of a range of alternative ways to pay for goods and services other than using cash or cards. Two-thirds (66%) of respondents had heard of open banking, but only 28% know what it is, and only 9% had ever used it to make a payment. 32% of those who reported that they were not interested in using Open Banking payments said they would need more information before they would reconsider. 96% of respondents had heard of Buy-Now, Pay Later, while 92% of respondents had heard of a QR code. 94% of respondents had heard of cryptocurrencies.

Have you used any of the following methods when paying in a shop / online?



Rising fees, a market dominated by a few firms, and ever-increasing pressures on businesses during a time of economic turbulence… Why isn't this a bigger story and why haven't the regulators done anything about it?

If you're asking yourself this question, we don't blame you. But just like the Card Tax, the journey to where we are today is a complex one.

A TIMELINE OF THE CARD TAX

1992

The BRC submits its first complaint to the European Commission that Visa & Mastercard interchange fees unlawfully restrict competition.

DECEMBER 2015

The Interchange Fee Regulation comes into force and caps the interchange fee charged per transaction at 0.2% for debit cards and 0.3% for credit cards.

JUNE 2016

Mastercard buys Vocalink, the infrastructure provider of account-to-account scheme Faster Payments.

JULY 2017

The BRC submits a formal complaint to the PSR about increases in Scheme & Processing Fees.

JANUARY 2018

The Payment Services Regulations 2017 comes into force, updating and expanding the ban on surcharging.

JANUARY 2020

The Supreme Court rules that multilateral interchange fees applicable to card payments restrict competition.

OCTOBER 2020

The BRC, UK Hospitality, The British Independent Retail Association, the ACS and the FSB launch a joint call for action to combat excessive card costs.

DECEMBER 2020

The Interchange Fee (Amendment) (EU Exit) Regulations 2019 comes into force, removing the review requirement.

JUNE 2022

PSR launches investigations into Visa and Mastercard's cross-border interchange fee hike and rising scheme & processing fees.

OCTOBER 2022

Card Acquiring Market Review remedies published.

DECEMBER 2022

The Edinburgh Reforms & Building a smarter financial services framework for the UK are introduced, classifying the PSRs as Tranche 2, and the IFR as Tranche 3.

THE PSR INVESTIGATIONS

What has the regulator done to date?

The Card Acquiring Market Review (CAMR)

Following a multi-year investigation, in October 2022, the PSR published its final remedies for issues it found in the card acquiring market. These included:

- The introduction of summary boxes containing bespoke key price and non-price information.
- The creation of an Online Quotation Tool using the information provided in the summary boxes to make comparisons with different providers online.
- Trigger messages to prompt businesses to shop around and/or switch.
- The introduction of a maximum duration of 18 months for Point of Sale (POS) terminal lease and rental contracts with a rolling monthly contract thereafte

These remedies will likely have a positive effect on empowering retailers to switch between acquirers, though they are only scratching the surface of the cost of accepting card payments. As shown in Figure 7, the acquirer revenue fee constitutes a mere 7% of the total MSC today, and, per Figure 5, has remained flat in absolute terms since 2017.

Whilst important, this should not be the focus of efforts to reduce the cost of accepting card payments.

The 2022 PSR Investigations

The Axe the Card Tax campaign is a supporter and contributor to the PSR's ongoing investigations into the fees associated with card payments. Specifically these are:

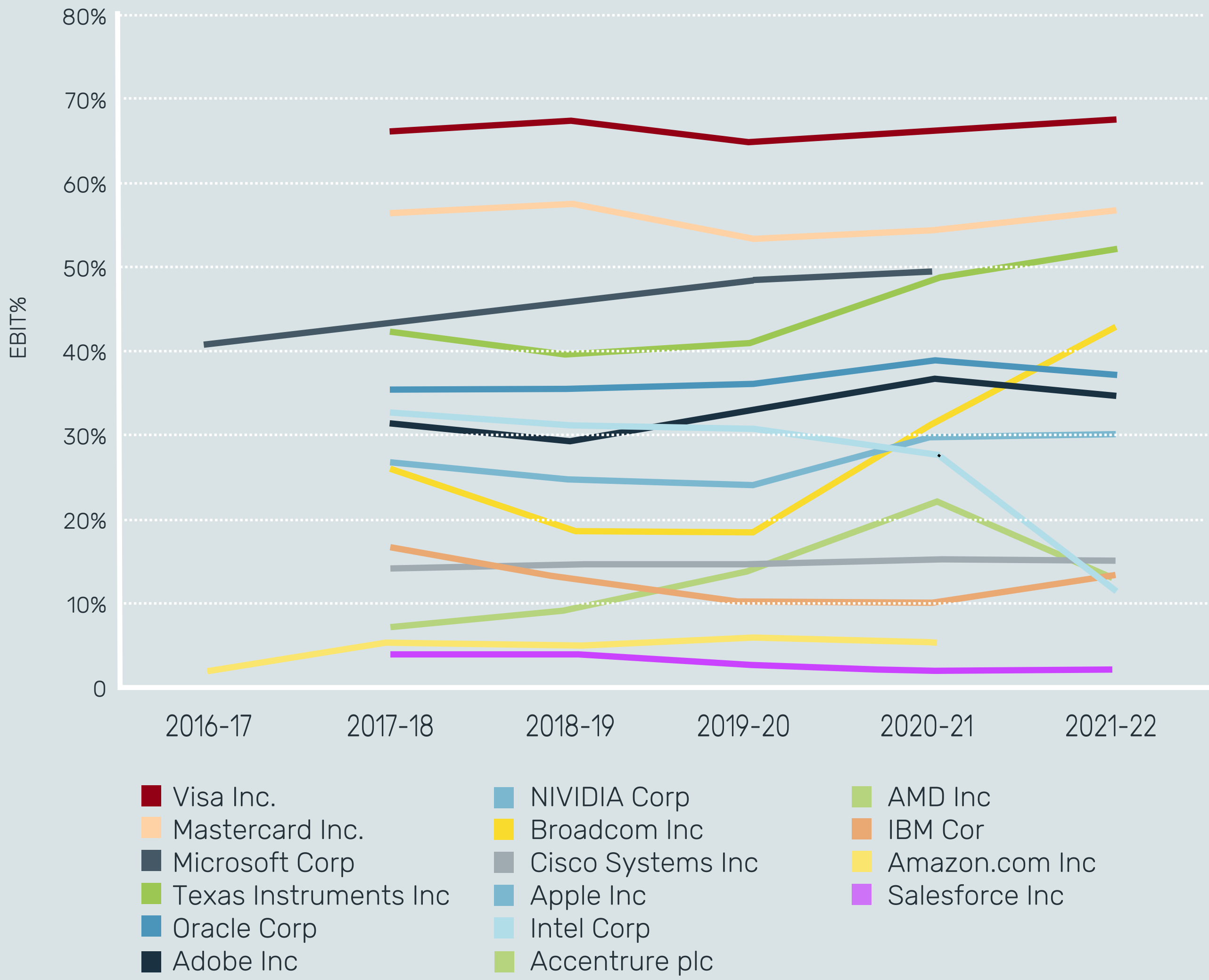
- MR22/1.1: Market review of card scheme and processing fees
- MR22/2.1: Market review of UK-EEA consumer cross-border interchange fees

In February 2023, the PSR published a supplementary call for evidence on the competitive constraints in card payment systems which captured four "themes" of competition that will underpin its investigation into card scheme and processing fees:

1. The intensity of competition and innovation in the payments ecosystem.
2. Differences in the competitive dynamics on the issuing and acquiring sides.
3. The impact of transparency on competitive pressure at all levels of the value chain.
4. The 'must-take' status of Mastercard and Visa-branded cards (in many retail environments).

The PSR also published a working paper on its approach to profitability analysis of Visa and Mastercard, which included its working analysis of card scheme profitability. Visa and Mastercard have had a five year average earnings before interest and taxes (EBIT) % since 2016 of 66% and 56% respectively, captured in Figure 10.

Figure 10: EBIT for major NYSE IT sector companies 2016/17 to 2021/22



Source: MR22/1.5: Approach to profitability analysis working paper, Figure 9

Whilst welcome, these reviews are insufficient on their own to combat the Card Tax. The PSR investigations are useful in ascertaining whether the fee hikes are in compliance with the current regulations, but they will not go far enough in charting the path for the future regulation of UK payments competition for the benefit of end-users.

Further, the PSR reviews are limited in their technical scope:

- They exclude domestic interchange fees. As outlined above, the interchange fee requires enhanced scrutiny, in general, including that applied to domestic transactions.
- They exclude commercial card interchange fees which are currently unregulated in the UK (and the EU). Commercial card interchange fee rates are generally much greater than consumer cards, totalling up to 2.5%. Such interchange fees impose a substantial cost on retailers, especially those with a high share of commercial card transactions, such as wholesale and travel sector merchants.
- They exclude UK to rest-of-world (ROW) interchange fees. Under commitments made by Visa and Mastercard to the EU, merchants in the European Economic Area (EEA) benefited from reductions in cross-border interchange fees between the EEA and ROW. The UK's withdrawal from the EU has also meant a failure to secure the continued reductions in UK-ROW interchange fees.

Finally, these PSR reviews are unlikely to sufficiently address how card fees interact with the broader competitive market, including how they affect the emergence of alternative retail payment methods, which is absolutely vital to ensure the sector is set up on a level playing field. Even the February 2023 supplementary call for evidence will necessarily focus on competition within the card sector, rather than *within* payments.

In sum, the existing work undertaken by the PSR is welcome, but it is insufficient to solve the structural inequities and flawed incentive structures at play. Instead, there is political action required in parallel.

WHAT MUST BE DONE?

Swift action to mitigate the short term impacts of the card tax is necessary, including reducing fees paid by retailers, whilst also laying the groundwork for competing alternative technologies to thrive. In the longer term, we envisage multiple ways in which the government could create the conditions for a world-leading, competitive payments sector in the UK.

THE SHORT TERM: REDUCING FEES FOR RETAILERS

1. No Further Fee Rises

As shown in this report, card fees have risen extensively for both cross-border interchange and scheme and processing fees. Whilst the PSR's investigations into these fees are ongoing there should be no further fee rises from the card schemes at all, including interchange and scheme and processing fees. The existence of these investigations demonstrates concern that fees are not rising justifiably, and it therefore makes sense to mandate that fees are frozen until the investigations are complete.

Where legitimate concerns are evidenced, such as in cases of fees to support counter-fraud infrastructure, we acknowledge that there may be exceptions; however, other fees should be specifically frozen, such as where fees are associated with 'opt-out' product deployment.

2. Reverse the Cross-Border Interchange Fee Hike

The ACT campaign cannot see a reason for the increase in cross-border interchange fees between the UK and the EU aside from the effects of reverse competition and opportunism. The hike should be reversed until the point at which the card schemes can prove it is justified.

3. Launch a Treasury Review on the Cost of Card Payments

For the reasons set out above, the PSR's investigations are unlikely to lead to the change required: they will inherently conclude whether or not the card schemes are acting in compliance with the current regulations, not whether the current regulations are sufficient.

Launching a parallel political review of the regulatory regime underpinning card payments in the UK does not, therefore, jeopardise or pre-empt the outcome of these investigations; it will necessarily complement them. Indeed, the current PSR investigations also exclude domestic interchange fees, commercial card interchange fees, and the fees charged on card transactions where the issuer is based elsewhere in the world from the EU.

Further, we have not yet utilised the new opportunity presented post-Brexit to reform the Payment Services Regulations, as well as to improve the Interchange Fee Regulations. Whilst the Treasury is currently consulting on the former, the latter were placed in Tranche 3 of the 'Building a smarter financial services framework for the UK' paper released by the Treasury in line with the Edinburgh Reforms in December 2022. This suggests that ensuring the IFR works best for the UK post-Brexit is not a priority.

The IFR introduced in 2015 was a piece of EU legislation that had to consider all member states, including those whose card markets are significantly less advanced than the UK. It would be nonsensical to simply map this to UK law without ensuring it is appropriate for the UK market. As we have articulated throughout this report, reform of the payments sector requires action across many pieces of legislation, but must include the IFR. This must be in scope of the Treasury Review.

Finally, this review would also be more targeted than the Payments Landscape Review, which did not probe interchange and scheme and processing fees to any degree of depth in 2020.[20]

An assessment of this sort would be trailblazing and rapidly demonstrate to investors and innovators that the UK is the place to come and start a payments business.

THE MID-LONG TERM: SEIZING THE OPPORTUNITY

4. Level the payments playing field and unleash innovation

The UK is home to one of the world's leading fintech markets, attracting $12.5 billion in fintech VC investment in 2022, second only to the US globally.[21] Within the sector, there is a plethora of innovative firms inventing and iterating next generation ways for consumers to pay retailers. This can include using cards, but also includes new technologies, including open banking, direct debits, Buy-Now, Pay-Later, and even stablecoins and a potential digital pound.

The Axe the Card Tax campaign does not advocate for any particular technology to prevail.

Instead, we believe that the most value, innovation and efficiency is achieved where the market is designed to enable retailers to test, trial, switch between, and offer a variety of ways to pay. Today, these alternative technologies are not competing on a level playing field: that is why a Treasury review into the cost of accepting card payments must also examine the incentives at play to support and cultivate new technologies.

Fundamentally, if actors gain revenue from one technology, but not from another, there is a critical mismatch. However, the design of future payments regimes should seek to eliminate the risk of reverse competition by enabling business models based on value delivered to end users, namely businesses and consumers.

But this also means looking at another major trend that has moved in the opposite direction to card payments over the last decade: the decline of cash.

Crucially, the Axe the Card Tax campaign believes that another critical aspect of levelling the playing field is to ensure that cash remains accessible. To that end, we support the elements of the Financial Services and Markets Bill that enshrine access to cash in legislation, including introducing the power for the Financial Conduct Authority (FCA) to intervene with actions that may deny access to cash. For rural settings in particular, this is vital.

Ensuring the Payments Market is Competitive

The PSR has three statutory objectives that underpin everything it does:

- Ensure that payment systems are operated and developed in a way that considers and promotes the interests of all the businesses and consumers that use them
- Promote effective competition in the markets for payment systems and services - between operators, PSPs and infrastructure providers
- Promote the development of and innovation in payment systems, in particular the infrastructure used to operate those systems

The Axe the Card Tax campaign endorses these three objectives wholeheartedly, but believes that the rising card fees we have experienced in the last eight years run counter to all three. Indeed, in addition to Objective 2 above, in parallel with the CMA, the PSR has the responsibility for enforcing UK competition law in the payments sector.

The experience of the last eight years tells us that something is wrong. While the PSR's reviews are a welcome first step, it is vital that necessary action is taken to fix the issues at the source. The payments market is broken. It is long overdue that the government and our regulators take this seriously to ensure a competitive environment exists; both within the existing card scheme landscape, and within the wider payments ecosystem, removing barriers to entry for new technology and supporting innovation.

CASE STUDY: ACCOUNT TO ACCOUNT PAYMENTS

Account-to-account (A2A) payments can offer an alternative solution to merchants who are feeling the burden of growing card fees. A2A payments include payment methods that move money directly from one account to another. In addition to reducing the number of parties involved in a transaction, increasing efficiency and likely reducing costs, A2A payments are also secure and can be, in the case of methods like open banking, instant. Additionally, there are no interchange fees involved with A2A payments, which further reduce costs for retailers.

A2A payments come in multiple forms, and are already being used by a number of retailers today. One of the most established A2A methods is Direct Debit, which is used for recurring payments, such as to pay utility bills, club fees and regular invoices. The introduction of Open Banking payments enables instant payments; this means A2A are a viable alternative for businesses, such as a broadband company, that want to receive a payment before providing a service or sending a product. Open Banking also involves the pre-population of a retailer's bank account information, and can therefore reduce payments going to the incorrect recipient, whilst also countering authorized push-payment fraud.

The regulations that introduced open banking are in a period of transition and, currently, they are limited to only certain types of transactions. In order for the technology to be a serious option for many businesses, it will need to expand. This requires further action from the banks, who may not have the same commercial incentives to support the further development of the technology in the absence of an 'interchange fee', which are currently not allowed on Open Banking payments.

A future A2A payment method that could evolve as part of the next chapter of Open Banking is Variable Recurring Payments (VRP) for e-commerce. VRPs would enable a customer to consent to a series of payments within agreed parameters and could function in the same way that 'card on file' does today. Done well, VRP could recreate the simplicity and convenience of 'card on file', at a lower cost.

Gravity Active Entertainment's Experience: Saving 50% on Collecting Payments

Gravity Active Entertainment operates an international chain of trampoline and leisure parks. It currently runs 17 sites in the UK with others in Germany and Saudi Arabia, and its offering has diversified to include a range of additional activities from eSports arenas to karting through to climbing walls.

Among Gravity's key routes to market is the Very Important Bouncer (VIB) scheme. For a monthly subscription, customers can make unlimited use of their chosen facility for less than the cost of a single trampoline session and gain access to other discounts.

Gravity wanted to avoid the high cost of processing card payments, so it chose GoCardless, a direct bank payments company, to collect subscription payments using Direct Debit. "Collecting payments via GoCardless is 50% cheaper than credit cards," said Shane Williams, Commercial Director, Gravity Active Entertainment. "That quickly adds up. 97% of subscription customers now pay via GoCardless and since its introduction in September 2021, we've saved over £3,600 a month in card fees."

GoCardless has also helped Gravity protect its revenue. Williams explained, "When the VIB scheme first launched we unfortunately saw some customers taking advantage of the lag between signing up and the 14 days it takes to collect a direct debit, gaining free access by canceling the mandate after their visit." Gravity saw a hit to its bottom line, with up to 33% of VIB customers failing to pay. By introducing open banking payments through GoCardless, Gravity completely eliminated this behavior. With the savings accrued through switching from card to A2A payments and the revenue it has protected via open banking payments, Gravity has been able to invest in growth. Over the past 12 months it has secured further sites at Liverpool One and Westfield Stratford, and opened more venues internationally.

And growth is not only good for Gravity. The presence of its leisure centers has been shown to boost footfall for entire retail areas, with an 21% increase in traffic at Wandsworth Southside after its site opened. This has generated more opportunities for other local businesses.

Pat Phelan, UK MD and Chief Customer Officer at GoCardless, said: “The Gravity story highlights what businesses can do if they shrug off the tax that cards levy on the economy. Not only have the savings generated by A2A payments powered its own growth; Gravity’s journey also accelerates shared success in the community, from creating more jobs to creating more opportunities as other businesses benefit from the ‘halo effect’ of its venues. It’s a powerful reminder that merchants can and should take advantage of new technologies, to great effect.”

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