EXPLANATORY MEMORANDUM TO

THE INTERCHANGE FEE (AMENDMENT) (EU EXIT) REGULATIONS 2019

2019 No. 284

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Act.

2. Purpose of the instrument

2.1 This instrument is being made in order to ensure that Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions (commonly known as the Interchange Fee Regulation or "IFR") can continue to operate effectively as direct retained EU law after the UK's withdrawal from the EU. This instrument will achieve this by using the EU (Withdrawal) Act Section 8 powers to fix deficiencies in the IFR and related domestic legislation (namely the The Payment Card Interchange Fee Regulations 2015).

Explanations

<u>*What did any relevant EU law do before exit day?*</u>

2.2 The IFR implements two main policies. Firstly, it sets caps on the level of consumer card payment interchange fees. These are the fees which are paid by the merchant's acquirer (i.e. the Payment Service Provider which enables the merchant to accept card payments) to the card issuer (the Payment Service Provider which issued the cardholder's card, normally but not necessarily the cardholder's bank) every time a consumer debit or credit card is used to purchase a good or a service. These caps are set at 0.2% of the value of the transaction for debit cards (including prepaid cards) and 0.3% for credit cards. These caps currently apply to any transaction where both the merchant's acquirer and the card issuer are located within the European Economic Area (EEA). Commercial cards, cash withdrawals using debit or credit cards at ATMs or at the counter in a bank, and transactions with payment cards issued by three party payment card schemes[1], are excluded from the caps.

2.3 Secondly, the IFR imposes a number of business rules on card schemes, card issuers, acquirers and merchants. For example, it requires the separation of the four party card schemes (which set the rules for that particular card network) and the processing entities (which actually undertake the processing of the transactions within this card network) in terms of accounting, organisation and decision-making processes. It allows merchants to decide what kind of cards they want to accept by preventing card schemes and acquirers from requiring merchants to accept all categories of cards (i.e. debit, credit, prepaid and commercial). For example, a merchant could decide to only accept debit cards and not credit cards. This is intended to increase competition between card companies and reduce costs for merchants and, ultimately, consumers. The IFR also allows merchants to encourage customers to use a particular form of payment, e.g. a cash payment or debit card.

[1] However, there are circumstances where the IFR treats three party payment card schemes as four party card schemes such that the IFR interchange fee caps are applicable.

Why is it being changed?

2.4 Once the UK has left the EU, direct retained EU law may no longer operate effectively as domestic law immediately after exit day. This instrument seeks to fix the deficiencies in the retained IFR to ensure that it continues to be legally operable as domestic law after exit day. If these deficiencies are not addressed before the UK leaves the EU, then some aspects of the IFR would become legally inoperable, rendering the UK regime ineffective.

2.5 After the UK leaves the EU, EU law (including the IFR) will only apply in the EU27, and the EEA. That means that issuers in the EEA will be able to charge interchange fees greater than the capped amounts to any acquirer outside the EEA, including acquirers in the UK. Conversely, the direct retained law will only apply in the UK. That means that issuers in the UK will not be subject to the cap when charging acquirers located anywhere outside the UK – whether in the EU27, the EEA, or anywhere else in the world. However, where both the acquirer and card issuer are located in the UK, then the caps on interchange fees will continue to apply as described above in paragraph 2.2. In this way, the position for transactions wholly within the UK will be the same as for transactions wholly within the EEA, but neither EU law nor UK law will apply to cross-border transactions between acquirers/issuers the UK on the one hand, and issuers/acquirers in an EEA country on the other.

What will it now do?

2.6 This instrument makes amendments to ensure that the IFR continues to operate effectively within the UK after the UK leaves the EU.

2.7 This instrument reduces the scope of application of the IFR in UK legislation from the EEA to the UK. The result of this is that transactions which take place solely within the UK (where both the acquirer and the card issuer are located in the UK) would continue to be covered by the IFR, but cross-border card payments between the UK and the EU will no longer be within scope of either the retained UK Regulation or the EU Regulation.

2.8 The practical impact of this is that payments made within the UK (with a UK-based acquirer, and a UK-based card issuer) will continue to have a cap on interchange fees, as described in paragraph 2.2 above. Transactions that take place wholly within the EEA (with an EEA-based acquirer, and an EEA-based card issuer) would continue to be governed by the EU IFR. However, cross border card payments between the UK and the EEA, where the acquirer or card issuer are based in different jurisdictions, would no longer be subject to the caps established under EU or UK law, and the card issuer could receive higher interchange fees. This means, for example, that if a consumer used a UK-issued card to make a purchase from an EEA-based merchant acquirer, then neither the UK IFR or the EU IFR would apply, because the UK would be a third country vis-à-vis the EU.

2.9 This instrument transfers the function for making regulatory technical standards regarding the requirements for separation of card schemes and processing entities (Article 7 of the EU IFR) from the European Commission to the Payment Systems Regulator (PSR). This is in keeping with HM Treasury's general approach of delegating responsibility for technical standards to the appropriate UK regulator.

2.10 More detail on the specific changes being made in these areas can be found at Section 7, specifically under paragraphs 7.10 to 7.14 inclusive.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument includes Scotland and Northern Ireland.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is to the whole United Kingdom.

4.2 The territorial application of this instrument is to the whole United Kingdom.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding Human Rights:

"In my view the provisions of the Interchange Fee (Amendment) (EU Exit) Regulations 2019 are compatible with the Convention rights."

6. Legislative Context

6.1 This instrument amends the directly applicable IFR and the Payment Card Interchange Fee Regulations 2015 (SI: 2015/1911) to correct deficiencies arising from the UK's exit from the European Union.

7. Policy background

What is being done and why?

7.1 The UK will leave the EU on 29 March 2019. The UK and the EU have agreed the terms of an implementation period that will start on 29 March 2019 and last until 31 December 2020. This will provide time to introduce the new arrangements that will underpin the UK-EU future relationship, and provide valuable certainty for businesses and individuals. During the implementation period, common rules will continue to apply. The UK will continue to implement new EU law that comes into effect during the implementation period and the UK will continue to be treated as part of the EU's single market in financial services. This will mean that access to each other's markets will continue on current terms and businesses, including financial services firms, will be able to trade on the same terms as now until 31 December 2020. UK firms will need to comply with any new EU legislation that becomes applicable during the implementation period.

7.2 The government is seeking a deep and special future partnership with the EU, which should be greater in scope and ambition than any such agreement before and encompass financial services. Given the highly regulated nature of financial services, the volume of trade between UK and EU markets, and a shared desire to manage financial stability risks, the UK proposes a new economic and regulatory arrangement that will preserve mutually beneficial cross-border business models and economic integration for the benefit of businesses and consumers. Decisions on market access would be autonomous in our proposed model, but would be underpinned by stable institutional processes in a bilateral agreement and continued close regulatory and supervisory cooperation.

7.3 While the government has every confidence that a deal will be reached and the implementation period will be in place, it has a duty to plan for all eventualities, including a 'no deal' scenario. The government is clear that this scenario is in neither the UK's nor the EU's interest, and the government does not anticipate it arising. To prepare for this unlikely eventuality, HM Treasury intends to use powers in the European Union (Withdrawal) Act 2018 (EUWA) to ensure that the UK continues to have a functioning financial services regulatory regime in all scenarios.

7.4 The EUWA repeals the European Communities Act 1972 and converts into UK domestic law the existing body of directly applicable EU law (including EU Regulations). It also preserves UK laws relating to EU membership – e.g. legislation implementing EU Directives. This body of law is referred to as "retained EU law". The EUWA also gives ministers a power to prevent, remedy or mitigate any failure of EU law to operate effectively, or any other deficiency in retained EU law, through SIs. These contingency preparations for financial services legislation are sometimes referred to as 'onshoring'. These SIs are not intended to make policy changes, other than to reflect the UK's new position outside the EU, and to smooth the transition to this situation. The scope of the power is drafted to reflect this purpose and is subject to further restrictions, such as the inability to use the power to impose or increase taxation, or establish a public authority. The power is also time-limited and falls away two years after exit day.

7.5 Wherever practicable, the proposed approach is that the same laws and rules that are currently in place in the UK would continue to apply at the point of exit, providing continuity and certainty as we leave the EU. However, if the UK does not enter an implementation period, some changes would be required to reflect the UK's new position outside the EU from 29 March 2019.

7.6 In the unlikely scenario that the UK leaves the EU without a deal, the UK would be outside the EU's framework for financial services. The UK's position in relation to the EU would be determined by the default Member State and EU rules that apply to third countries at the relevant time. The European Commission has confirmed that this would be the case.

7.7 In light of this, the approach in this scenario cannot and does not rely on any new, specific arrangements being in place between the UK and the EU. As a general principle, the UK would also need to default to treating EU Member States largely as it does other third countries, although there are cases where a different approach would be needed including to provide for a smooth transition to the new circumstances.

7.8 HM Treasury published a document on 27 June 2018, which sets out in more detail HM Treasury's approach to financial services legislation under the European Union (Withdrawal) Act. (https://www.gov.uk/government/publications/financial-services-legislation-under-the-eu-withdrawal-act).

7.9 This instrument makes amendments to the retained IFR and domestic law which implements some aspects of this to ensure that the regime continues to operate effectively once the UK has left the EU.

7.10 The main changes made reduce the scope of the IFR to the UK. Regulation 4 of this instrument amends the scope of the IFR, by amending Article 1 of the IFR and replacing references to the EU to the UK. This will result in transactions which take place solely within the UK (where both issuer and acquirer are located in the UK) continuing to be covered by the IFR, but cross-border card payments will no longer be within scope.

7.11 Article 3 of the IFR enables member states to set a per transaction interchange fee for domestic debit card transactions that is lower than 0.2% of the value of the transaction, or to apply a per transaction fee no more than EUR 0.05, or the equivalent in the member state's local currency. Regulation 6 of this instrument therefore amends Article 3 to give HM Treasury a power to set this fee by regulations subject to the negative resolution procedure, and apply a cap which is no more than the equivalent amount in sterling of EUR 0.05, at the time the regulations are made. This is not a change of substance, but it does make the language in the retained law more appropriate for a UK-only law.

7.12 Article 4 of the IFR sets a cap on credit card transaction fees of 0.3% of the value of the transaction, and allows member states to define a lower per transaction fee cap for domestic transactions. This instrument amends Article 4 to give HM Treasury a power to set this lower cap by regulations. These regulations will be subject to the negative resolution procedure.

7.13 Regulation 9 of the instrument transfers the function for making technical standards regarding the requirements to be complied with for separation of card schemes and processing entities from the European Commission to the Payment Systems Regulator (PSR). This is in keeping with HM Treasury's general approach of delegating responsibility for technical standards to the appropriate UK regulator. In this case, the PSR is the appropriate regulator because it currently has responsibility for monitoring and enforcing compliance with the EU IFR in the UK, and for enforcing most other regulation of the UK payment systems industry, and therefore has the appropriate technical expertise to take responsibility for these technical standards.

7.14 Regulation 11 of the instrument removes Articles of the IFR that will be deficient in their entirety after EU exit, because they either make reference to EU concepts that would become obsolete once the UK becomes a third country, or because they would have no practical application or consequences.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument is being made using the power in section 8 of the European Union (Withdrawal) Act 2018 in order to address failures of retained EU law to operate effectively or other deficiencies arising from the withdrawal of the United Kingdom from the European Union. In accordance with the requirements of that Act the Minister has made the relevant statements as detailed in Part 2 of the Annex to this Explanatory Memorandum.

9. Consolidation

9.1 There are currently no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 HM Treasury has not undertaken a consultation on the instrument, but has engaged with relevant stakeholders on its approach to Financial Services legislation under the European Union (Withdrawal) Act 2018, including on this instrument, in order familiarise them with the legislation ahead of laying. In particular, we have engaged extensively with the PSR.

10.2 The instrument was also published in draft, along with an explanatory policy note, on 16th November 2018, in order to maximise transparency ahead of laying. (https://www.gov.uk/government/publications/draft-interchange-fee-amendment-eu-exit-regulations-2018)

11. Guidance

11.1 No further guidance is being published alongside this instrument. The PSR will consult on changes to their guidance to reflect changes made through this SI.

12. Impact

12.1 The impact on business, charities or voluntary bodies will primarily consist of one-off familiarisation costs for Payment Service Providers, card schemes and processing entities andpotential additional compliance reporting costs, which have been assessed as minimal.

12.2 Businesses may potentially face more significant costs as a result of the scope of the regulations reducing to UK-only, but this is a function of the UK leaving the EU, and of commercial decisions taken by card schemes, as opposed to the onshoring approach taken in this instrument.

12.3 In the event of no deal, the UK would automatically be outside the scope of the EU IFR. Therefore EEA card issuers would be permitted to charge higher interchange fees to UK acquirers, as the caps set in the EU IFR would no longer apply to UK-EEA card transactions. The most significant effect is that the interchange fee caps on transactions between EEA and UK payment service providers would no longer apply; any decision to adjust interchange fees thereafter would be a commercial decision.

12.4 It is technically possible that, in this instrument, the UK could mandate interchange fee caps that apply to the interchange fees that UK card issuers would be permitted to charge to international transactions. However, this would place asymmetrical obligations on UK businesses vis-à-vis third countries, whereas the current situation provides symmetry with EEA countries. The default onshoring approach to fixing deficiencies relating to the scope, is therefore to reduce the scope of the regulations to UK-only, rather than extending the scope worldwide.

12.5 Data on card transactions is not routinely held by HM Treasury. The Payment Systems Regulator collects sensitive data from card issuers for compliance purposes. This data includes the value of transactions where the issuers and point of sale are based in the UK but the acquirer is in an EEA territory that is not the UK (a cross border transaction as defined in Article 2(8) IFR), but is not available at the aggregate level. In the past, the interchange fee has been higher than the current caps for debit and credit cards. The potential impacts on consumers as a result of interchange fee caps not applying to cross border transactions, in the event of no-deal, would be a function of the UK leaving the EU and would result from the commercial decisions of businesses to adjust interchange fees, as opposed to the onshoring approach taken in this instrument.

12.6 The potential costs noted in 12.2 could also impact on the public sector. Separately, there will also be an impact on the public sector resulting from the transfer of functions from the EU to the UK.

12.7 An Impact Assessment has not been prepared for this instrument because in line with Better Regulation guidance, HM Treasury considers that the net impact on businesses will be less than £5 million a year. There is potential for limited costs relating to compliance reporting. Due to this limited impact, a de-minimis impact assessment has been carried out.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses if they are Payment Service Providers. In practice, the Government would not expect many Payment Service Providers to be small businesses.

13.2 The intention of this instrument is to ensure that the IFR continues to operate as intended when the UK leaves the EU. This instrument is therefore aimed at minimising the impact of these regulatory changes on all firms, including small businesses.

14. Monitoring & review

14.1 As this instrument is made under the EU Withdrawal Act 2018, no review clause is required.

15. Contact

15.1 Andrew Clemo at HM Treasury Telephone: 0207 270 1187 or email: andrew.clemo@hmtreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 David Raw, Deputy Director for Banking and Credit, at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Economic Secretary to the Treasury, John Glen, can confirm that this Explanatory Memorandum meets the required standard.

Annex
Statements under the European Union (Withdrawal) Act 2018

Part 1
Table of Statements under the 2018 Act

This table sets out the statements that may be required under the 2018 Act.

Statement	Where the requirement sits	To whom it applies	What it requires
Sifting	Paragraphs 3(3), 3(7) and 17(3) and 17(7) of Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) to make a Negative SI	Explain why the instrument should be subject to the negative procedure and, if applicable, why they disagree with the recommendation(s) of the SLSC/Sifting Committees
Appropriate-ness	Sub-paragraph (2) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	A statement that the SI does no more than is appropriate.
Good Reasons	Sub-paragraph (3) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain the good reasons for making the instrument and that what is being done is a reasonable course of action.
Equalities	Sub-paragraphs (4) and (5) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2	Explain what, if any, amendment, repeals or revocations are being made to the Equalities Acts 2006 and 2010 and legislation made under them. State that the Minister has had due regard to the need to eliminate discrimination and other conduct prohibited under the Equality Act 2010.
Explanations	Sub-paragraph (6) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9 and 23(1) or jointly exercising powers in Schedule 2 In addition to the statutory obligation the Government has made a political commitment to include these statements alongside all EUWA SIs	Explain the instrument, identify the relevant law before exit day, explain the instrument's effect on retained EU law and give information about the purpose of the instrument, e.g., whether minor or technical changes only are intended to the EU retained law.
Criminal offences	Sub-paragraphs (3) and (7) of paragraph 28, Schedule 7	Ministers of the Crown exercising sections 8(1), 9, and	Set out the 'good reasons' for creating a criminal offence, and the penalty attached.

		23(1) or jointly exercising powers in Schedule 2 to create a criminal offence	
Sub-delegation	Paragraph 30, Schedule 7	Ministers of the Crown exercising sections 10(1), 12 and part 1 of Schedule 4 to create a legislative power exercisable not by a Minister of the Crown or a Devolved Authority by Statutory Instrument.	State why it is appropriate to create such a sub-delegated power.
Urgency	Paragraph 34, Schedule 7	Ministers of the Crown using the urgent procedure in paragraphs 4 or 14, Schedule 7.	Statement of the reasons for the Minister's opinion that the SI is urgent.
Explanations where amending regulations under 2(2) ECA 1972	Paragraph 13, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement explaining the good reasons for modifying the instrument made under s. 2(2) ECA, identifying the relevant law before exit day, and explaining the instrument's effect on retained EU law.
Scrutiny statement where amending regulations under 2(2) ECA 1972	Paragraph 16, Schedule 8	Anybody making an SI after exit day under powers outside the European Union (Withdrawal) Act 2018 which modifies subordinate legislation made under s. 2(2) ECA	Statement setting out: a) the steps which the relevant authority has taken to make the draft instrument published in accordance with paragraph 16(2), Schedule 8 available to each House of Parliament, b) containing information about the relevant authority's response to— (i) any recommendations made by a committee of either House of Parliament about the published draft instrument, and (ii) any other representations made to the relevant authority about the published draft instrument, and, c) containing any other information that the relevant authority considers appropriate in relation to the scrutiny of the instrument or draft instrument which is to be laid.

Part 2

Statements required when using enabling powers under the European Union (Withdrawal) 2018 Act

1. Appropriateness statement

1.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view the Interchange Fee (Amendment) (EU Exit) Regulations 2019 does no more than is appropriate."

1.2 The changes to the law made by these Regulations are limited to those that fix deficiencies arising out of EU Exit, or those that provide for the revocation of obsolete legal provisions, or which provide for the stability of the financial system.

2. Good reasons

2.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view there are good reasons for the provisions in this instrument, and I have concluded they are a reasonable course of action to ensure the UK cards regimes can continue to operate effectively from Exit day."

3. Equalities

3.1 The Economic Secretary to the Treasury (John Glen) has made the following statement(s):

"The instrument does not amend, repeal or revoke a provision or provisions in the Equality Act 2006 or the Equality Act 2010 or subordinate legislation made under those Acts."

3.2 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In relation to the instrument, I, Economic Secretary to the Treasury (John Glen) have had due regard to the need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010."

4. Explanations

4.1 The explanations statement has been made in section 2 of the main body of this Explanatory Memorandum.

5. Legislative sub-delegation

5.1 The Economic Secretary to the Treasury (John Glen) has made the following statement regarding use of legislative powers in the European Union (Withdrawal) Act 2018:

"In my view it is appropriate to create a relevant sub-delegated power in the Interchange Fee (Amendment) (EU Exit) Regulations 2019."

5.2 The Regulations give the PSR the responsibility for making Regulatory Technical Standards associated with the IFR after exit from the EU (in the event this RTS is not agreed prior to Exit Day, and therefore not covered by the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018). This is in keeping with HM Treasury's general approach of delegating responsibility for technical standards to the appropriate UK regulator. In this case, the PSR is the appropriate regulator because it has responsibility for monitoring and enforcing compliance with the EU IFR in the UK and for regulation of the UK payment systems industry, and therefore has the appropriate technical expertise to take responsibility for these technical standards. This is in line with the approach that the government has set out in which legislative responsibility for Level 2 technical legislation in financial services will be transferred to the financial regulators, while the Treasury will have responsibility for changes to Level 1 legislation which Parliament will approve.