



24 April 2015

By email: pysubmissions@rba.gov.au

Dr Anthony Richards
Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

Dear Mr Richards,

Review of Card Payments Regulation Issues Paper

The Consumer Action Law Centre (**Consumer Action**) and Financial Rights Legal Centre (**Financial Rights**) welcome the opportunity to comment on the Review of Card Payments Regulation Issues Paper (**the Issues Paper**) published by the Reserve Bank of Australia (**RBA**).

About the contributors

Consumer Action is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

The Financial Rights is a community legal centre specialising in financial services, particularly in the areas of consumer credit, banking, debt recovery and insurance. It fully integrates telephone assistance and financial counselling with legal advice and representation. Financial Rights also operates the Insurance Law Service, a national specialist consumer insurance advice service.

Summary of submission

In reviewing card payments regulation, we urge the RBA to explicitly consider the impact of its regulatory actions on disadvantaged and vulnerable consumers. With these considerations in mind, our submission argues (among other things) that card payments regulation should:

- increase transparency of interchange fees and surcharging;
- promote competitive neutrality;
- lower interchange caps;

- replace weighted interchange caps with hard caps;
- appoint a regulator responsible for enforcement of payment surcharging rules;
- ban surcharging for low-cost payment methods; and
- ensure automatic routing of contactless transactions does not impair consumer choice.

We have addressed each of the issues for consultation in further detail below.

1. Interchange fees

- a. Publishing thresholds for which payment system providers will be subject to interchange or related regulation, possibly based on transaction values and/or market shares*

We agree with the Financial System Inquiry (**FSI**) panel that publishing thresholds for designating system providers for interchange fee standards would give system and service providers, particularly new entrants, certainty about how regulation is applied.¹ Increased transparency is unlikely to have any detrimental effects on consumers, and may even provide benefits for consumers as regulatory certainty can encourage new entrants to join the market and promote competition.

- b. Broadening interchange fee caps to include other payments between schemes and issuers*

As set out in the Issues Paper, companion card arrangements have interchange-like fees that are paid from the scheme to the issuer and may involve other incentive or marketing payments to issuers.² However, these fees and payments are not currently captured by interchange fee caps. We support broadening interchange fee caps to include these other arrangements, as it will promote competitive neutrality between providers.³ There appears to be no real reason for distinguishing between companion card arrangements and traditional four-party arrangements.

- c. Making changes to the interchange benchmark system to reduce the upward 'drift' in average interchange rates inherent in the current three-year reset cycle*

The Issues Paper reports that the combination of "the infrequent and backward-looking nature of benchmark compliance and the schemes' management of their interchange fee schedules has meant that in practice the weighted-average interchange fees for the schemes.... have almost always been above the benchmark".⁴ The Issues Paper also states that there has been an upwards drift in average interchange rates. This increase in average interchange rates, along with an increased use of debit cards for low value transactions, means that interchange fees can in some cases be "very high relative to the value of a small

¹ Financial System Inquiry, Final Report, November 2014, p. 173.

² Reserve Bank of Australia, Review of Card Payments Regulation - Issues Paper, March 2015, p. 32.

³ This position is supported by Financial System Inquiry Final Report at page 173.

⁴ Review of Card Payments Regulation - Issues Paper, p. 30.

payments.⁵ These factors are likely to result in merchants charging consumers increased surcharges and/or prices for goods, particularly in relation to low value transactions. As set out in paragraph 1(e) below, we support replacing weighted-average interchange caps with hard caps, which would help to address these issues.

d. Lowering interchange caps

We note the FSI panel's conclusion that "payments system efficiency could be increased by lowering interchange fee caps." The panel considered that the transitional costs of lowering interchange caps "would be outweighed by lower product prices for all consumers, resulting from lower fees charged to merchants, and reduced cross-subsidisation."⁶ Given the consumer benefits that are likely to result from lowering interchange caps, we support this measure. As set out in the Issues Paper, the reduction in interchange fees for the international systems has not prevented continued strong growth in the card systems in Australia, and may in fact stimulate growth. There are also international examples of card systems that function effectively without any interchange fees.⁷

e. Replacing weighted-average interchange caps with hard caps

As set out above, in practice the weighted-average interchange fees for the schemes have almost always been above the benchmark.⁸ We welcome the FSI panel's recommendation to replace three-year weighted-average caps with hard caps, so every interchange fee falls below the interchange fee caps.⁹ This would also reduce differences in fees paid by small and large merchants. The RBA estimates that the average credit card interchange rate for non-preferred merchants was more than 50 basis points higher than the interchange rate applying to preferred merchants in the December quarter of 2014.¹⁰

In our view, replacing weighted averages with hard caps would be fairer for small businesses struggling to compete on price because of the discounts received by large merchants with large market share. This in turn provides more choice for consumers, and improves competition. In our view, the current weighted average approach to setting interchange fees is unfair, and creates cross-subsidies. As noted in the Issues Paper, the cost of the high interchange rates for consumer premium and commercial cards falls entirely on small merchants and other merchants that do not benefit from special rates.¹¹ In our view, this is an unfair outcome for both merchants and consumers.

f. Applying caps as the lesser of a fixed amount and a fixed percentage of transaction values

The FSI panel noted that "applying fixed-percentage caps to debit systems, in addition to existing fixed-value caps, would ensure low fees for small value transactions. This would

⁵ Review of Card Payments Regulation - Issues Paper, p. 31.

⁶ Financial System Inquiry Final Report, p. 173.

⁷ Review of Card Payments Regulation - Issues Paper, p. 30.

⁸ Ibid.

⁹ Financial System Inquiry Final Report, Recommendation 17.

¹⁰ Review of Card Payments Regulation - Issues Paper, p. 28.

¹¹ Review of Card Payments Regulation - Issues Paper, p. 26.

increase the rate of merchants accepting these transactions."¹² If this is the likely result of applying caps as a fixed percentage of transaction values, this would increase consumer choice, and is likely to lower transaction costs for both merchants and consumers. We are therefore broadly supportive of this recommendation.

g. Including prepaid cards within the caps for debit cards

We agree with the RBA that it would be helpful to clarify how prepaid cards are dealt with under the interchange rules in a review.¹³

h. Allowing for 'buying groups' for smaller merchants to group together (subject to any competition law restrictions) to negotiate to receive the lower interchange rates that are accessible to larger merchants

Reducing the differences in fees paid by small and large merchants, as recommended in 1(e) above, would largely negate the need for 'buying groups' of smaller merchants that group together (subject to any competition law restrictions) to negotiate lower interchange rates that are accessible to larger merchants. However, in principle we see no issues with allowing smaller merchants to group together to negotiate lower interchange rates, provided relevant competition laws are complied with.

2. Surcharging

a. A tiered surcharging system, perhaps along the lines of the FSI recommendations

It is clear that excessive surcharging is a major concern for consumers, with the FSI panel receiving over 5,000 submissions in relation to credit card surcharges.¹⁴ The FSI panel acknowledged that the current reasonable cost surcharge rules are difficult for system providers to enforce, potentially complex for merchants to comply with and can cause frustration for consumers.¹⁵ In response, the FSI panel recommended a three tiered system for payment surcharging. Under this system:

- low-cost system providers would be allowed to ban surcharges. System providers could qualify as 'low-cost' if their interchange fees are below debit interchange fee caps';
- medium-cost system providers would be allowed to set and enforce surcharge limits, which could be set by the Payments Systems Board based on approximate payment acceptance costs. System providers could qualify as 'medium-cost' if their interchange fees are below credit interchange fee caps; and
- higher-cost system providers would be allowed to continue to enforce reasonable cost-recovery surcharging rules.¹⁶

¹² Financial System Inquiry Final Report, p. 173.

¹³ As suggested in the Review of Card Payments Regulation - Issues Paper at page 36.

¹⁴ Financial System Inquiry, Second Round Submissions, available at: <http://fsi.gov.au/consultation/second-round-submissions>.

¹⁵ Financial System Inquiry Final Report, p. 175.

¹⁶ For further details, see Financial System Inquiry Final Report, pp. 175-176.

In our view, the three tiered approach to payment surcharging may be confusing to both customers and merchants. We do not oppose the tiered approach in principle, provided that extensive consumer testing is undertaken before implementation to ensure that both consumers and merchants understand the relevant tiers.

In general, we oppose surcharging for lower cost payment methods (such as eftpos, cash and debit cards). First, these are the least costly point of sale payment instruments.¹⁷ Second, surcharging low-cost payment methods may mean consumers that choose this option would end up subsidising consumers who choose to use higher cost payment methods, such as high-end reward credit cards. Third, we do not believe it is fair for consumers to be surcharged for access to their own funds.

Regardless of whether a 'reasonable costs' or 'three tier' system is adopted, payment surcharge regulations must be rigorously enforced in order to be effective. The Issues Paper acknowledges that there has been 'limited effective enforcement' of the current rules that limit surcharges to the reasonable cost of acceptance.¹⁸ We discuss enforcement of surcharging rules in further detail in section 2(b) below.

b. Targeted changes to reduce particular cases of excessive surcharging

Over-surcharging will continue despite targeted changes unless a regulator is made responsible for enforcement. Without regulatory oversight, rules designed to limit surcharging are likely to be widely ignored. We recommend that a regulator, preferably the Australian Securities and Investments Commission or Australian Competition and Consumer Commission (**ACCC**), be given responsibility for enforcing payment surcharging rules. The regulator would need to enforce these rules robustly in order to send a clear message to merchants that the days of excessive surcharging are over. The regulator should prioritise enforcement activity on sectors that are known for excessive surcharging, such as the airline and taxi industries.

In relation to the airline industry, the market is currently dominated by four airlines: Jetstar, Qantas, Virgin and Tiger. As set out in the Issues Paper, each of these companies impose a surcharge for use of credit or scheme debit cards. Some limited exceptions apply to this rule: Jetstar and Tiger waive the surcharge for some MasterCards, and Qantas waives the surcharge for debit or Qantas Cash cards if departure is within 7 days.¹⁹ Surcharges are now disclosed before any personal details are entered, which is an improvement on previous practice.

However, the cost of these surcharges is still not prominently displayed in the price advertised online, and thus the advertised price is generally not a reflection of the true cost of the service. This is particularly the case with airlines such as Tiger, which offer very few non-surcharged payment options.²⁰

¹⁷ Reserve Bank of Australia, Research Discussion Paper: The Evolution of Payments Costs in Australia, December 2014, p. 17.

¹⁸ Review of Card Payments Regulation - Issues Paper, p. 31.

¹⁹ Review of Card Payments Regulation - Issues Paper, p. 32.

²⁰ The only non-surcharged payment method offered by Tiger is Debit MasterCard payments: Review of Card Payments Regulation - Issues Paper, p. 32.

We also believe that the RBA may need to consider how it can reformulate its standards and other regulatory measures to prevent surcharging being used in an anti-competitive way by merchants in concentrated markets. In certain markets that rely on online payment (such as event ticketing), there is no practical alternative but to pay by credit or scheme debit cards. For example, Ticketek charges a payment processing fee of 1.95%, which applies to all purchases made by credit or debit card.²¹ The online portal appears to only allow customers to purchase tickets using credit or debit card.

In these circumstances, the imposition of a surcharge will not facilitate a switch to other payment methods because no other payment method is practical, given the business models of the traders in the market. In addition, the imposition of a credit card surcharge can (and often does) amount to a 'hidden' cost that distorts competition because it hides the true cost of the good or service from the customer. Consumers are either unaware of the surcharge, or only become aware of the surcharge after a number of online steps have been taken (such as the entering of personal information) by which time the consumer has made a time and emotional investment in the transaction going ahead.

c. Any other changes to enforcement procedures and disclosure practices

We recommend requiring payment surcharge amounts to be prominently disclosed to consumers early in the process of a transaction. The failure to adequately disclose payment surcharges may constitute misleading or deceptive conduct if it creates the impression that no surcharges are applicable.²² The ACCC has taken legal action against a number of airlines for misleading consumers in the way that surcharges are displayed (referred to as 'drip pricing').²³ However, this will not deal with excessive surcharging. It will only deal with the way in which surcharges are displayed.

However, we caution against relying on disclosure exclusively to deal with excessive customer surcharging. Consumers may not have a choice about whether or not they pay a surcharge (for example, when purchasing concert tickets) and in any case surcharges are often only disclosed late in the transaction. By this stage, consumers have committed to buying the product and the decision to pay the surcharge may not actually reflect their economic interests.

Please refer to section 2(b) for our comments in relation to enforcement.

²¹ A 'service/delivery' fee is also separately charged, which can be up to \$10.50 (as per the Ticketek website accessed on 23 April 2015).

²² See the recent example of Aldi supermarkets: Madeleine Heffernan, 'Aldi under fire on disclosure of credit card, tap-and-go fees', Sydney Morning Herald, 23 April 2015, available at: <http://www.smh.com.au/business/retail/aldi-under-fire-on-disclosure-of-credit-card-tapandgo-fees-20150422-1mp4wo.html>.

²³ Australian Competition and Consumer Commission, Media Release: ACCC takes action against Jetstar and Virgin for drip pricing practices', 19 June 2014, available at: <http://www.accc.gov.au/media-release/accc-takes-action-against-jetstar-and-virgin-for-drip-pricing-practices>.

3. Other possible regulatory changes

a. Strengthened transparency over the cost of payments to merchants and cardholders

The Issues Paper says that a consequence of the complex interchange fee schedules is that non-preferred merchants have little transparency over the cost of particular transactions.²⁴ In addition, 'the inability of merchants to distinguish between debit and credit cards appears to be a fairly common phenomenon'.²⁵ The RBA predicts that the issue of the lack of transparency of the cost of payments to merchants is likely to grow due to ongoing changes in payments technology. This confusion makes it difficult for merchants to accurately surcharge under the current 'reasonable costs' rules, which can lead to inefficiency and increased costs for consumers. We recommend that acquirers ensure that credit and debit cards be identifiable to merchants, either visually or electronically (or both).

If the three tiered surcharging system is introduced, it will be critical that categories of cards with different interchange fees be identifiable both visually and electronically, so that consumers and merchants are aware when a low-cost, medium-cost or high-cost card is being used. The RBA should consider whether cards should be labelled in accordance with these tiers.

b. Further easing of 'honour-all-cards' rules to allow merchants to decline to accept cards with high interchange fees

Any easing of the 'honour-all-cards' rules to allow merchants to decline to accept certain cards should be balanced against the need to avoid limiting consumer choice and promoting competition. Increased transparency will also be required to ensure that merchants and consumers can identify whether their card is high-cost, and therefore whether that card can legitimately be declined by the merchant.

c. Facilitation of differential surcharging by merchants

We support increasing transparency of the cost of payments to merchants and cardholders, as set out in section 3(a) above. Although the three tiered system would prescribe the amount of surcharges for low-cost and medium-cost cards, under the FSI panel's proposal merchants would still be able to charge for the reasonable costs of acceptance of high cost cards. For this system to work effectively, acquirers and card schemes will need to facilitate differential surcharging by merchants. We welcome the suggestion in the Issues Paper that scheme rules or contractual terms should be required to allow Australian merchants to inform customers of their cost of card acceptance if they wished to justify their surcharging policies. This would increase transparency and assist consumers to hold merchants to account for their surcharging practices.

²⁴ Review of Card Payments Regulation - Issues Paper, p. 28.

²⁵ Review of Card Payments Regulation - Issues Paper, p. 26.

d. Ensuring that merchants have the ability to choose to route their transactions via lower-cost networks or processors

According to the Issues Paper, until recently debit card users have typically chosen the network used at point-of-sale terminals. However, as contactless (or 'touch-and-go') point-of-sale transactions become more widely used, consumers are no longer choosing the payment type and network at the terminal. These transactions are now routed automatically.

Incentives should be placed into the regulatory framework so that payments are directed to the least cost and most efficient system. However, this should not be done in a way that reduces consumer choice. While this may be good for efficiency (i.e. the merchant can direct the consumer to the cheaper system for the merchant), it is not necessarily good for consumer choice. The consumer may unwittingly be charged credit surcharge and credit card interest thinking that the amount is coming from their debit account, or they may want to use scheme debit rather than eftpos because eftpos may involve a transaction fee by the bank. We agree that more formal 'rules of the game' might be appropriate that balance efficiency and consumer choice, perhaps by allowing consumers to provide their bank with a 'default' routing preference.

e. Clarifying arrangements for competing payment options within a single device or application

Please see our comments in section 3(d) above.

f. Other

We are pleased to hear that the Australian Bankers' Association is working with the RBA and scheme debit card providers to remove the distinction in regulation between direct debit payments from transaction accounts and credit (or scheme debit) cards. In our view, a consumer should be able to instruct their bank to cancel a recurring payment authority on a scheme card, as they can with a transaction account direct debit authority. Further, upon cancellation or closure of a credit card account, a bank should take steps to cancel all regular transactions and other standing authorities. However, if stakeholders fails to deal with this issue within a reasonable period, we recommend that the Government regulate to remove the distinction.

Please contact Katherine Temple, Senior Policy Officer at Consumer Action, on 03 9670 5088 or at katherine@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

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