Australian Merchant
Payments Forum

Submission to the
Reserve Bank of Australia

Response to
Review of Card Surcharging

20 July 2011

Contents

This document has been prepared with the assistance of TransAction Resources Pty Ltd

1 Introduction

The RBA introduced a regulation, effective 1 January 2003, which prohibited schemes from having rules preventing merchants from surcharging.

> *"The Board concluded that the no-surcharge rule masked the price signals to cardholders about relative costs of different payment methods and limited the ability of merchants to put downward pressure on interchange fees by threatening to charge the customer for using a credit card. It also contributed to the subsidisation of credit card users by all other customers, as merchants charged a uniform price to all consumers regardless of the payment method used, with this uniform price needing to cover the relatively high costs of credit card acceptance."* [1]

In the RBA's review of the payments system reforms in 2007-2008, it found that abolition of the no-surcharge rule had been very successful and had delivered significant benefits.

> *"In the Board's view, the benefit of the no-surcharge Standard has been substantial. It has improved price signals to consumers and, in time, might be expected to add to the downward pressure on interchange fees."* [2]

However, the RBA has recently expressed some concerns about the perceived increase in "excessive" surcharges and more common usage of blended surcharges. Much of the evidence for the increase of these practices has been based on market research conducted by East & Partners.

The RBA released a Consultation Document[3] in June 2011 requesting comment on a range of proposed changes to the no-surcharge Standard. This document contains the AMPF's response to that document.

The AMPF represents the interests of merchants within the important payments sector of the economy. It is important that the perspective of merchants is considered in addition to those of schemes, issuers, acquirers and cardholders. Merchants invest in payments infrastructure and are an essential component of the payments system. Two of the AMPF members, Coles and Woolworths, are EFTPOS acquirers and members of the Consumer Electronic Clearing System (CECS). They are also represented on the Board of EFTPOS Payments Australia Limited (EPAL). The Australian Retailers Association (ARA) is also a member and represents the views of a wide range of small to large merchants.

2 Executive Summary

The AMPF believes that there is no current need to make changes to the regulations relating to surcharging. Much of the initiative for increased controls on surcharging has emanated from the research conducted by East & Partners and the RBA's paper itself is very reliant on the findings of this research. We believe there are significant anomalies in the research findings and that more accurate research and a better understanding of the current environment is required before any decisions can be made regarding surcharging.

---

1 *Reform Of Australia's Payments System - Preliminary Conclusions Of The 2007/08 Review,* Reserve Bank of Australia, April 2008, p.4.

2 *Reform Of Australia's Payments System - Preliminary Conclusions Of The 2007/08 Review,* Reserve Bank of Australia, April 2008, p.26.

3 *Review of Card Surcharging: A Consultation Document*, Reserve Bank of Australia, June 2011.

The RBA's own recent study of consumer payments use shows that the incidence of surcharging is at a low 5% of credit card transactions and that this is unchanged from 3 years ago when the first study was conducted. East & Partners research also shows that the average surcharge amounts have decreased between June 2010 and December 2010 and by a significant amount.

Five major AMPF members account for 29% of all general purpose payment card transactions in the Australian market. Given that none of these merchants surcharge, their exclusion from the research has the potential to distort the results. This emphasises the need to focus on the number of transactions which are surcharged rather than the number of merchants.

There appears to be no evidence of widespread excessive surcharging. The largest surcharges seem to occur with card not present transactions such as on-line purchases. These merchants frequently have far higher costs of card acceptance, including higher merchant service fees and higher levels of chargebacks, and any surcharges they impose should be considered in light of these higher costs. The AMPF does not support excessive surcharging but sees no credible evidence of any need for further controls.

Card scheme rules should not be allowed to prohibit blended surcharges, either between different card schemes or between different cards within the one scheme. Many merchants have blended Merchant Service Fees (MSFs) and are used to this concept. In the interests of consistency, if blended surcharges were prohibited by the schemes, then the same standards should be applied to MSFs. Similarly if a cap on surcharging was linked to the merchant's cost of cards acceptance, then consistency of policy would demand that MSFs also be capped with the cap in some way linked to the acquirer's cost of providing the service.

Blended surcharges have effectively been used as a negotiating tool by some merchants to lower their merchant fees. Any constraints on blended surcharges would weaken merchants negotiating position, potentially resulting in higher MSFs and in turn higher prices to consumers.

The AMPF believes that any regulation of surcharging should be wholly conducted and controlled by the RBA. Card schemes should have no role in determining or controlling merchant pricing policies.

The AMPF supports further research into surcharging and the collection and publishing of more accurate data, including MSFs. Improved data can only assist in better decision making by all parties for the benefit of all stakeholders in the payments system. The AMPF and ARA are happy to assist the RBA in the collection of such data.

3 Comments on East & Partners Research

The AMPF has serious concerns regarding the key findings on surcharging from the East & Partners reports. This is of particular importance given the reliance of the RBA on these findings as a basis for its recommended actions in its Consultation Document. This is not to suggest in any way that the research has not been properly conducted, but for whatever reason there are significant flaws in the outcomes. There are major anomalies between some data in the research and the RBA's own data, in other instances there appear to be contradictions between different sections of East's own reports and there are other findings which don't seem to be in accord with what can be observed in the market.

We also believe that many of the respondents may not have properly understood the questions and in many cases they are unable to distinguish between credit and scheme debit and/or between EFTPOS and scheme debit because of the data supplied by their acquirers. This issue has undoubtedly skewed some of the responses and consequent findings.

The purpose of this section is to highlight some of these anomalies and to demonstrate that further research is imperative before any decisions are reached on the possibility of further regulations relating to surcharging.

Please note that all references to tables or pages in the research are references to East & Partners' general research report[4] rather than the specific research report provided by East & Partners to the RBA[5] unless otherwise specified.

3.1 Sample Issues

The sample does not appear to include any of the very large retail merchants. None of the AMPF members, which includes Coles and Woolworths, were involved in the research. Given the size and impact on retail sales of these members, their exclusion alone significantly skews the research findings.

To put this into perspective, 5 major AMPF members (excluding the ARA) account for 35% of all EFTPOS transactions in Australia. They also account for 26% of all credit card transactions and 29% of all general purpose payment cards combined[6]. Given that these merchants do not surcharge, their exclusion from the research has the potential to distort the results.

The sample also includes a large number of B2B merchants, particularly in the Institutional and Corporate sectors which contain the largest merchants. In the Institutional sector nearly 30% are B2B-only merchants with a further 46% conducting both B2B and retail business. Only 24% of merchants in this segment conduct business only with consumers.

While this profile of merchants may be eminently suitable for the base research being undertaken, i.e. an analysis of the Australian merchant acquiring market, the inclusion of B2B merchants in the surcharging findings is entirely inappropriate. The original intent of the surcharging regulations, and of the proposed amendments in the current Consultation Document, is clearly aimed at increasing price signals to consumers:

> *"The intent was that the Standards would .... improve price signals facing consumers choosing between different payment methods."* [7]

What businesses charge each other, whether it be by means of surcharges or any other pricing mechanism is a commercial arrangement between these businesses and is surely of no relevance here. Any B2B surcharges need to be excluded from the research findings if the research is to be used to evaluate surcharging levels experienced by consumers.

---

4 *Australian Merchant Payments - Market Analysis Report*, East & Partners, February 2011.

5 *Australian Merchant Acquiring & Cards Markets - Market Analysis Report, Special Question Placement Report for Reserve bank of Australia*, East & Partners, December 2010.

6 This includes all bank issued credit and debit cards plus American Express and Diners Club cards. It excludes store cards and specialist payment cards such as fuel cards.

7 *Review of Card Surcharging: A Consultation Document*, Reserve Bank of Australia, June 2011, p.5.

3.2 Merchants vs Transactions

Another major concern the AMPF has with both the East & Partners research and the RBA's Consultation Document is that the focus is on the number of retailers who surcharge and not on the number of transactions which are surcharged. Equal weighting is given to very large merchants with national networks as is given to a single store. We believe the number of merchants who surcharge is not particularly relevant, it is the number of transactions that are surcharged which is important.

The differential between the number of merchants surcharging and amount of transactions surcharged can be clearly seen from the RBA's own observations during its review of the payments system reforms:

> *"At the end of 2007, around 23 per cent of very large merchants imposed a surcharge; for small or very small merchants, the percentage was closer to 10 per cent"* [8]
>
> <u>and</u>
>
> *"The diary survey results indicated that around 5 per cent of credit card transactions attracted a surcharge"* [9]

This demonstrates a significant variance between merchant numbers and transactions as indicators of the frequency of surcharging.

More importantly, the RBA's own recent research clearly shows that there has been virtually no increase over the past three years in the incidence of surcharging which is actually occurring, irrespective of the number of merchants that surcharge.

> *"the proportion of credit card transactions where a surcharge was actually paid by the consumer was virtually unchanged between 2007 and 2010, at around 5 per cent"* [10]

The flaw in basing any evaluation of surcharging on the basis of the number of merchants is highlighted by the 5 major AMPF members. Although they are only 5 merchants (which would represent 0.2% of the sample size for the East & Partners research and possibly less than 0.001% of all merchants in Australia), they represent 29% of all general purpose card payment transactions in Australia. As stated earlier, none of these merchants surcharge.

3.3 Card Acceptance

There are a number of anomalies relating to the "receivables" or card sales value which are shown in Table 2 (p.13) and also shown in Figure 1 (p.5) of East and Partner's report. According to the research, 67% of debit card receivables are on scheme debit cards. However, the RBA figures for 2010 show a dramatically different picture with 17% of debit transactions and 25% of debit spend on scheme debit, which is considerably less than the figures shown in the research.

---

[8] *Reform Of Australia's Payments System - Preliminary Conclusions Of The 2007/08 Review,* Reserve Bank of Australia, April 2008, p.17.

[9] *Household Payment Patterns In Australia,* Reserve Bank of Australia, November 2007, p.29.

[10] *Strategic Review of Innovation in the Payments System: Results of the Reserve Bank of Australia's 2010 Consumer Payments Use Study,* John Bagnall, Sophia Chong and Kylie Smith, Reserve Bank of Australia, June 2011, p.16.

Further, the research also shows that debit accounts for 65% of the combined credit + debit card spend whereas the RBA figures for 2010 show that total debit spend was only 38% of credit + debit card spend.

Finally, the research shows that scheme debit accounts for greater receivables than credit cards (including Amex and Diners) whereas the RBA figures for 2010 show that scheme debit accounted for only 13% of spend on scheme branded cards (including Amex and Diners).

These variances are so significant, that we believe they throw doubt on the whole surcharging research. One of the major contributing factors to the inaccuracy is probably that a large number of merchants have a blended MSF for all scheme cards. In other words, scheme debit cards and scheme credit cards have the same Merchant Service Fee and the transactions for both are typically reported as a single consolidated figure. In such cases, merchants would be unable to provide separate transaction or spend numbers for EFTPOS compared to scheme debit. This is also an important issue for accurately determining MSFs and which cards may or may not be surcharged (see later).

3.4 Merchant Service Fees (MSFs)

We also have some major concerns about the MSFs shown in the research. Our concerns relate not only to the absolute numbers shown but also to the relativity between various MSFs. These figures directly impact the margin of the surcharge above the MSF and the relativity between these two figures.

Firstly, the overall level of MSFs shown in the research does not seem correct. According to Table 23 of East & Partners research, the average MSF for Visa and MasterCard is 0.7%. However, the average MSF for all Visa and MasterCard in December 2010 was 0.81%[11] and this includes a number of very large merchants (including Coles and Woolworths) who do not surcharge and who have significantly lower MSFs than the overall weighted average. Thus, the average MSF of those who do surcharge should be much higher than 0.81% to achieve a weighted average across the market of this value. The accuracy of these MSF figures has a substantial impact on the ratio of the MSF to the surcharge rate, so it is vital these numbers are accurate.

A further anomaly with the MSFs in Table 23 relates to the overall average MSF of 1.62%. Again, this figure does not seem to make sense. According to RBA figures around 80% of credit/charge card purchase value is on Visa & MC and 20% is on Amex & Diners[12]. Thus if the MSF figures for the individual card types are correct then, if this sample of merchants was representative of the overall market, the weighted average should be around 0.98%, not 1.62%. Similarly, for "Institution" merchants, the weighted average should be around 0.77%, not 1.22%. These are significant variations.

Another major anomaly thrown up in the research is that Table 23 shows the EFTPOS MSF as being 10% higher than that for scheme debit cards. For the largest (Institutional) merchants it shows the EFTPOS MSF as being 50% higher than for scheme debit.

---

11 Table C03, Payments Statistics, Reserve Bank of Australia
http://www.rba.gov.au/statistics/tables/index.html#payments_system

It should be noted that Table C03shows the direct MSF to be 0.81% but the total figure for all merchant fees (including annual fees, terminal fees, etc.) is actually 0.87%.

12 RBA Payment Statistics Table C02 - Credit Card Market Shares

These results seem very dubious. The benchmark for scheme debit card interchange fees is around 16.5 cents per transaction higher than the EFTPOS benchmark interchange fee[13]. Further, as discussed earlier, a large number of merchants have a blended MSF for scheme credit and scheme debit cards, i.e. they pay the same MSF for scheme debit transactions as they do for credit cards. The combination of these factors means that EFTPOS MSFs are typically substantially less than those for scheme debit cards. In fact very large customers often do not pay any MSF on EFTPOS transactions and some even share the income stream that their acquirers receive from EFTPOS interchange. These research figures indicate that the majority of respondents are either not aware of their MSFs or have misunderstood the question. In either circumstance, it exposes significant flaws in the research responses.

3.5 Surcharging Analysis

According to Table 23 of the East & Partners report for the RBA, of those merchants who do surcharge, 90% surcharge all their credit card transactions and only just over 1% surcharge for less than 50% of their credit card transactions. This does not fit with surcharging behaviour that is commonly exhibited in the market.

It is not uncommon for merchants who do surcharge to surcharge only American Express and Diners Club cards and to not surcharge on Visa and MasterCard transactions. Examples of this include JB Hi-Fi and United Petroleum. In these cases, merchants would apply a surcharge on well below 50% of their credit card transactions. American Express and Diners Club combined accounted for around 15% of credit card transactions in 2010 and typically transaction levels for these cards would be even lower at merchants who surcharge only those cards.

This appears to be another example where the research findings don't match what is observed in the general marketplace.

On page 10 of the East report it states:

> *"Credit card surcharging is rapidly becoming the norm in Australia. This latest Merchant Payments analysis shows a continuation of the growth in surcharging across merchants of all sizes."*

However, in the East report to the RBA, Table 28 shows that **between June 2010 and December 2010 the average surcharge actually fell and by quite a substantial amount**. The average surcharge across all sectors fell from an average of 2.3% in June 2010 to 1.5% in December, a drop of 35%. In the Accommodation, Cafes and Restaurants sector the fall was 60% (from 3% in June to 1.2% average surcharge in December). These are significant reductions in the average surcharge, if correct, and do not support the assertion that surcharges continue to grow. If these figures are not correct it raises even greater concerns with the research findings.

In fact the December 2010 figures in East's RBA report (Table 28) show a considerable discrepancy from the figures in East's general report (Table 30). For example, Table 28 shows the average surcharge for Retail to be 1.5% whereas Table 30 shows the average surcharge for Retail to be 2.34%, which is more than 50% higher. This is for the same industry sector for the same period. Interestingly, Table 30 also shows a reduction, albeit small, for the retail sector (which accounts for almost 2/3 of the respondents) since December 2009.

---

13 The benchmark interchange fee for scheme debit cards is 12 cents per transaction and for EFTPOS, the bilateral interchange fees must be between negative 4 cents and negative 5 cents (i.e. paid by the issuer to the acquirer). Unfortunately, the RBA only publishes MSF data for credit and charge cards and there is no published data available on debit card MSFs.

These figures and variances raise major concerns about the accuracy of the research findings and put in doubt any review of the current state of surcharging in Australia based on these figures.

Finally, on page 11 of the East report it states:

> *"Larger merchants, which tend to pay lower transaction fees due to economies of scale, are both more likely to surcharge and apply higher average surcharges than smaller merchants. In this instance, market power and competitive issues influence merchant behaviour. Larger merchants, and those in relatively more concentrated industries, are less likely to fear negative consumer reaction to credit card surcharges, making them more likely to adopt the practice."*

The AMPF strongly disagrees with this finding. In fact, those market sectors which are dominated by very large merchants, such as supermarkets and service stations, are highly competitive and surcharging is either rare or completely absent. As stated earlier, none of the 5 major AMPF members, who account for a significant proportion of Australia's card payment transactions, surcharge on credit or debit card transactions.

4 RBA Consultation Paper Comments

4.1 Beneficial Market Impact

> *"The removal of these rules has allowed merchants to pass on the cost of credit card and scheme debit card transactions to customers via surcharges."* [14]

Not only have merchants used surcharges to recover costs, they have also used them to steer customers towards the use of lower cost cards (for example by surcharging the more expensive American Express and Diners cards but not surcharging MasterCard and Visa). Importantly, many merchants have used the threat of surcharging to negotiate lower merchant service fees and then have refrained from surcharging after gaining a reduced price. Therefore the impact of merchants' ability to surcharge is more widespread than may be seen by the frequency and level of surcharges in the market. Crucially, this has resulted in lower costs of card acceptance for merchants which in turn is reflected in lower prices for consumers. The AMPF believes that setting a cap on surcharging will constrain merchants in such negotiations and thus limit the downward pressure these negotiations can exert on interchange fees and merchant fees.

4.2 Lack of Credible Data

> *"data from East & Partners' semi-annual survey of the merchant acquiring business suggest that almost 30 per cent of merchants imposed a surcharge on at least one of the credit cards they accepted in December 2010…"* [15]

The RBA has relied very heavily upon the twice-yearly survey carried out by East & Partners after failing to obtain its own independent merchant survey results. As discussed earlier, there appear to be some significant questions as to the accuracy of the data collected in the East &

[14] *Review of Card Surcharging: A Consultation Document,* Reserve Bank of Australia, June 2011, p.1.

[15] *Review of Card Surcharging: A Consultation Document,* Reserve Bank of Australia, June 2011, p.2.

Partners research and this leads the AMPF to be concerned that it may not be a reliable basis for analysing market behaviour or for informing the development of public policy.

The East & Partners merchant sample includes a number of merchants that do not sell products or services to consumers. These "business-to-business" merchants represent 18% of the total sample and almost 30% of the larger merchants. The RBA is concerned about the price signals to consumers, not businesses, and therefore the AMPF believes these B2B merchants should be excluded from any future research or analysis of consumer surcharging practices. If these organisations happened to have high levels of surcharge then this would be negotiable between those businesses concerned but could have the effect of significantly impacting averages that are calculated across the payments market while not directly impacting consumers at all.

The merchants sample also includes a large number of retailers (61.5% of the sample) but these are placed in one single category while the remaining 38.5% of merchants are divided into 12 categories. We understand this has been done to get close to a statistically representative sample for the commercial market but it is not ideal when trying to gain an understanding of which merchants are surcharging and what their typical costs of card acceptance may be. These are just two examples of potential issues with the available data. Further issues have been discussed above, including wide variations between the reported data and the characteristics of the Australian payments market as a whole. These variations raise the possibility that the interviewed merchants may have very little understanding of their payments mix or their costs of card acceptance. Current acquirer pricing and reporting practices give most merchants almost no information to allow them to report this type of data accurately.

The AMPF and the ARA would be happy to assist the RBA to obtain a more accurate and reliable set of merchant surcharging data and would also be happy to work with any research organisation selected by the RBA including East & Partners.

> *"In December 2010, almost 30 per cent of merchants surcharged at least one of the credit cards they accepted, compared with just over 8 per cent in June 2007. However, consumers appear to have become more sensitive to surcharges, or better at avoiding them; the proportion of credit card transactions where a surcharge was actually paid by the consumer was virtually unchanged between 2007 and 2010, at around 5 per cent."* [16]

An alternative explanation of this outcome is that the overall proportion of merchant transactions subject to a surcharge has remained at almost the same level regardless of the additional number of merchants applying a surcharge. This may be due to the fact that some of the very large merchants which process a very large proportion of transactions do not surcharge at all while many of the merchants which do surcharge only process a very small number of transactions. The East & Partners research findings are based simply on the number of merchants that surcharge and not the numbers of transactions which are surcharged.

The fact that there has been no increase in transactions being surcharged may also mean that merchants are successfully using selective surcharging to steer customers to lower cost credit cards which may not be surcharged. This was an intended and desired outcome of the surcharging regulations.

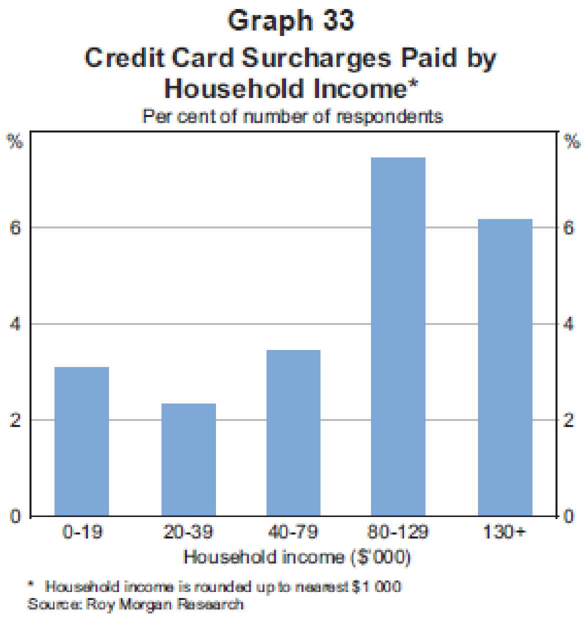
---

[16] *Strategic Review of Innovation in the Payments System: Results of the Reserve Bank of Australia's 2010 Consumer Payments Use Study,* John Bagnall, Sophia Chong and Kylie Smith, Reserve Bank of Australia, June 2011, p.16.

> *"While these scenarios reflect the behaviour of consumers in stores, consumers have less ability to use alternative payment methods when faced with a surcharge for remote payments. Not surprisingly, the proportion of transactions on which a surcharge is paid is significantly higher for payments made over the internet (18 per cent) and via phone (16 per cent), than in person (4 per cent, Graph 32)."* [17]

This provides further evidence that surcharging is a much more common practice among card-not-present merchants but the RBA has no concern about the number of merchants surcharging; it is primarily concerned about "excessive" and "blended" surcharging.

It should also be noted the number of households which actually pay a surcharge is very low, in line with the small number of transactions which are surcharged. According to Graph 33 in the Consumer Payments Use Study, only some 3% of households with an income of less than $80,000 per annum actually paid a surcharge during the survey period.



Both the number of transactions which are surcharged and the number of households actually paying a surcharge are very low and completely at odds with the impression gained from the East & Partners survey of widespread surcharging.

In contrast, it is interesting to compare the situation of interest rates charged on outstanding credit card balances, as the incidence of cardholders paying these interest rates is far more widespread than any surcharges they may face and the relativity between the rates charged by the issuers and their cost of funds is far more dramatic than the relativity between surcharge amounts and card acceptance costs.

The official interest rate set by the RBA is currently 4.75%, typical mortgage rates are between 7.0% and 7.5% and yet credit card interest rates typically have an Annual Percentage Rate (APR) between 15% and 20% with more than 50 credit cards listed on the Cannex web-site having an APR of more than 20%. These figures are up to 4 times the official interest rate and typically more than double the mortgage rates offered by the same institutions which issue these credit cards. To further emphasise the impact these rates have on consumers, according

[17] *Strategic Review of Innovation in the Payments System: Results of the Reserve Bank of Australia's 2010 Consumer Payments Use Study,* John Bagnall, Sophia Chong and Kylie Smith, Reserve Bank of Australia, June 2011, p.32.

to RBA statistics, more than 70% of credit card balances are revolved[18] and thus attract these interest rates compared to only 5% of cardholders who pay a surcharge.

4.3 Excessive Surcharging

The AMPF believes that there is insufficient credible data to suggest widespread adoption of "excessive" surcharging by merchants, even within the card-not-present space. Online merchants are often charged a much higher merchant service fee by acquirers who justify this by claiming fraud levels are much higher for card-not-present payments. Where there are some examples of online merchants with high levels of surcharges, these should be investigated further to assess true card acceptance costs (including high levels of charge backs in many cases). Many online merchants also pay fees to a payments "gateway" company (e.g. SecurePay, PayWay, eWay etc.) in addition to paying a merchant service fee to their acquirer and paying for charge backs. These costs may add up to a significantly higher cost of card acceptance than those faced by high street retailers. Online merchants may also encounter a higher proportion of international cards from overseas customers and these cards nearly always have premium interchange rates compared to domestic cards.

> *"These surcharges were found to be most commonly paid in the holiday travel industry (44 per cent of credit card transactions in that industry)."* [19]

Airlines and holiday travel companies often face heavy additional costs because of the refund liabilities of acquirers. When the Ansett airline business collapsed, the Ansett acquirer was required to refund cardholders who had purchased Ansett tickets in advance but now could not fly as the airline had been shut down. These refunds to Ansett passengers cost the acquirer tens of millions of dollars. As a result of these risks within the holiday travel sector, acquirers now often impose special conditions upon merchants to cover their risk of refunds due to non-fulfilment default. These conditions greatly increase the cost of card acceptance for merchants within this sector, over and above their merchant service fee.

It is extremely important to understand that a merchant's "cost of card acceptance" includes a number of items in addition to the Merchant Service Fee. In New Zealand merchant surcharges must "bear a reasonable relationship to the merchant's cost of card acceptance". If a merchant stands accused of over-charging then it is up to that merchant to demonstrate their cost of card acceptance. It is unreasonable to limit the level of any surcharge to the level of the MSF charged by the acquirer and thereby ignore all the other costs.

Merchants that invest in their own card payments infrastructure pay for card terminals, communications networks, software, certification and development, charge backs, and possibly the staff, equipment and other costs of a payments switching system. Self-acquirers such as Coles and Woolworths do not actually have a merchant service fee at all for those cards they self acquire but they do face considerable costs in accepting and processing card payment transactions. Even the smallest merchants pay terminal rental fees and charge backs in addition to their merchant service fees.

An understanding of merchants' costs of card acceptance should be gained before attempting to ascertain whether any particular level of surcharge should be regarded as "excessive". It is also not possible to apply any kind of cap to surcharges without this understanding across multiple merchant sectors as the costs of acceptance vary widely by merchant and by merchant category. The New Zealand approach is more reasonable than applying some arbitrary cap which tries to make "one size fit all".

---

[18] Table C01, Payments Statistics, Reserve Bank of Australia

[19] *Review of Card Surcharging: A Consultation Document,* Reserve Bank of Australia, June 2011, p.3.

Further data needs to be collected before any reliable conclusions may be drawn. The merchants' ability to surcharge has been extremely valuable in giving merchants some negotiating leverage and has also been responsible for a growing awareness among cardholders that merchants must pay a price when accepting a payment card. Many consumers were previously unaware of this and are beginning to change their payment behaviour accordingly. These were the outcomes sought by the RBA when these reforms were announced in 2002 and should not be jeopardised by weakening the standard now when inadequate evidence is available for the basis of any new policy or standard.

4.4 Blended Surcharging

The RBA is concerned that the practice of applying a single surcharge for multiple card types is masking the correct price signals to consumers. The AMPF understands this concern but current acquirer pricing practices to merchants create a situation where many merchants have no understanding of either their card mix or the different costs of these cards. The RBA has partially recognised this problem:

> *"Most merchants tend to pay one blended merchant service fee to their acquirer for a particular card scheme, with little knowledge of how this blended fee depends on their particular mix of card transactions."* [20]

Many merchants actually have a single, blended merchant service fee for all their MasterCard and Visa cards, regardless of whether they are debit or credit cards. A large number of merchants do not understand there are different cost levels for different card types and their acquirers have no interest to educate them, particularly if they are charging the same ad valorem rate for all scheme credit and scheme debit cards. Merchant reimbursement reports received from acquirers also typically do not offer a split between scheme debit and scheme credit cards so these merchants do not have any real understanding of their actual card mix at all.

This may not necessarily be the merchant's preference but simply reflects the fact that the merchant has never been offered any other option and does not have sufficient knowledge to request it. Small merchants usually get a merchant facility from the bank where they have their everyday banking relationship. These merchants are simply unable to surcharge differentially as they have no ability to understand the pricing complexities which would allow them to do so.

Most acquirers do not give their merchants a report breaking up their cards according to their interchange categories. This type of data is almost impossible to gain from acquirers unless the merchant has negotiated "interchange plus" pricing which is typically restricted to a small number of high end merchants who have access to the level of knowledge required to understand the benefits of such arrangements, and also have the level of transaction volume to make it worthwhile.

Most merchants do not have a method of surcharging according to the card prefix. These merchants typically rely upon their point of sale staff to visually recognise a MasterCard or Visa logo and then apply the surcharge. These shop assistants often do not know the difference between credit and debit cards even though the scheme debit cards now have the "Debit" mark printed on the face of the card.

When a cardholder pays with a scheme debit card they often choose either the [CHQ] or [SAV] account option without understanding they are now carrying out an EFTPOS transaction, not a scheme debit transaction. The shop assistant does not know which account selection key has been pressed. These merchants are not able to consistently apply one level of surcharge for

[20] *Review of Card Surcharging: A Consultation Document,* Reserve Bank of Australia, June 2011, p.6.

Visa Credit, another for Visa Debit, another for EFTPOS, another for MasterCard Credit and another for MasterCard Debit. It is not possible unless their card terminal software alerts them to the card type and has a surcharge programmed to apply by card type. For this to occur in the market as a whole, acquirers would have to be required to provide surcharging software by card prefix and by interchange category within the merchant's card terminal at the point of sale. This could be done but it would take time to deliver.

If this level of work was undertaken by acquirers, then acquirers could also add the surcharge amount as an additional field in the financial transaction request message and could then report this data back to the RBA in precise detail.

For merchants who pay "interchange plus" pricing, if their surcharge was to be directly related to their costs, they would effectively have to post a price at their point of sale for every different interchange category by card scheme, and then would have to explain this to their very confused staff and even more confused customers. These posted surcharge prices would have to be changed every time an interchange rate was varied. Even the most sophisticated merchants would be reluctant to have more than two or three different surcharges to explain to their customers. Anything that adds extra time to processing a customer is a problem for high turnover merchants such as petroleum, fast food, convenience stores and supermarkets.

If the RBA would like to see more differentiated surcharging in order to send clearer price signals to consumers, then an industry workshop with merchants and acquirers represented would be a useful step to discuss how merchants can be given differentiated merchant service fee pricing and differentiated reporting on card mix. Then merchants could discuss ways in which differentiated surcharges could be advertised to cardholders without creating high levels of confusion and misunderstanding.

The AMPF would like to see a standard set for acquirer reporting to merchants that, at a minimum, separates transaction numbers and spend for each separate card type and each separate interchange category. At least merchants would then have more knowledge and understanding of their different costs and could reasonably consider some type of differentiated surcharging. They would also have better data to allow them to negotiate their merchant service fees in the acquiring market. Traditionally, this type of data has been very difficult to obtain from acquirers, even after repeated requests.

Perhaps the RBA could consider reporting to merchants similar to that implemented by the Canadian Government under the Code of Conduct[21] to address this issue. Under this Code of Conduct, scheme rules must ensure that merchant statements from acquirers include the following information:

- effective merchant discount rate for each type of payment card from a payment card network;
- interchange rates and, if applicable, all other rates charged to the merchants by the acquirer;
- the number and volume of transactions for each type of payment transaction;
- the total amount of fees applicable to each rate; and,
- details of each fee and to which payment card network they relate.

[21] www.fin.gc.ca/n10/data/10-029_1-eng.asp

4.5 Card Schemes As Regulators Of Merchant Pricing

> *"The intent was that the Standards would introduce normal market disciplines into negotiations between merchants and acquirers over merchant service fees …"* [22]

The RBA understands that merchant service fees, terminal rental fees, communications charges, charge back levels, stationery charges and other card acceptance costs for merchants are negotiated between merchants and their acquirers, not the card schemes. The card schemes have no visibility of merchants' MSF levels or other costs and should have no involvement at all in regulating merchant prices in any way. Giving control of surcharging to the card schemes is completely unacceptable to merchants.

Perhaps the card schemes could be regulated to ensure that the level of interchange fees is restricted to their cost of processing and clearing transactions. This would be a consistent approach to prevent "excessive" interchange fees being levied upon merchants as they have been for many years by industry participants with demonstrated market power. It is interesting how the card schemes seek to regulate pricing by merchants while at the same time vigorously resisting any attempt to regulate their own pricing.

The card schemes have a consistent history of levying charges upon merchants that bear little relation to their own costs, or the costs of issuers. The "four party" card schemes have direct relationships with both acquirers and issuers but no direct relationship with merchants.

Merchants have accepted the RBA as an independent regulator. The card schemes are heavy regulators but they are not independent and their behaviour consistently demonstrates a desire to maximise income for themselves, their issuers and, to a lesser extent, their acquirers. The AMPF and the Australian Retailers Association will never agree to having their pricing regulated by the card schemes in any way or in any form whatsoever.

4.6 Capping Of Surcharges

The AMPF believes there is insufficient credible data available to demonstrate that there is widespread "excessive" surcharging taking place in the market today. In any case, it is not reasonable to limit surcharges to the level of the merchant service fee and current acquirer practices of charging blended merchant service fees and providing very little differentiated reporting make it almost impossible for most merchants to understand their card mix and their exposure to different interchange rates.

> *"Given the difficulties involved in determining the appropriate scope for other costs, a more transparent and consistent alternative is to define the cost of acceptance as, simply, the merchant service fee."* [23]

The cost of card acceptance includes many items beyond the merchant service fee so this is clearly not a good measure to adopt in isolation. A further issue is that self-acquirer merchants do not have a merchant service fee at all. Before any action is taken to attempt to further regulate merchant surcharging, better data with regard to merchant costs of card acceptance and current surcharging practices is required. The AMPF and ARA are happy to do whatever they can to assist the RBA to obtain such data; this can be done in conjunction with the RBA's preferred market research agency to ensure a statistically valid and independent outcome.

---

[22] *Review of Card Surcharging: A Consultation Document,* Reserve Bank of Australia, June 2011, p.5.

[23] *Review of Card Surcharging: A Consultation Document,* Reserve Bank of Australia, June 2011, p.9.

It is significant that while the AMPF members collectively process a very large proportion of retail payments transactions, not one of them has been approached to participate in the East & Partners research over the last seven years.

If the RBA wishes to be consistent, then it should also consider capping interchange fees and merchant fees at levels that are reasonably related to the issuer's costs and the acquirer's costs respectively to ensure that merchants and cardholders are not subject to excessive charges. Similarly, it would not make sense to ban blended surcharges but to continue to allow blended MSFs.

Imposing a cap on surcharges without understanding the costs of card acceptance would not be reasonable and merchants costs can vary widely. The New Zealand approach of requiring the surcharge to be "reasonably related to the merchant's cost of card acceptance" is more reasonable and more balanced if any change must be made at all. This can be done without defining the elements of the cost of card acceptance which can vary significantly between different merchants. The AMPF, however, believes the key is more research and the gathering of more complete and more accurate data before any decision is made on this issue.

4.7 Disclosure

Each merchant negotiates with acquirers to gain the best possible merchant service fee arrangement they can achieve. In many cases, this is with the intention of arriving at a result that gives a better value outcome than their direct competitors. It is not appropriate to require merchants to publish their merchant service fees which are commercial-in-confidence and would be equivalent to publishing the prices they have obtained from any other supplier.

The RBA has suggested another option:

> *"Alternatively, the Bank could collect and publish more detailed data on merchant service fees, such as the range and average of these fees across merchant categories for each card scheme."* [24]

This is a much more acceptable alternative as it would put more useful information into the public domain without jeopardising the pricing arrangements of any individual merchant. The AMPF would also like to see the costs of card issuers by card type collected and published under a similar arrangement to allow merchants to better determine the reasonableness of interchange fee levels. It is important to embrace the principle of consistency and to treat all market participants in an even-handed manner.

5 Response To Issues

i. Is there a case for modifying the Standards to allow schemes to limit surcharges?

The AMPF does not believe there is sufficient credible evidence to support the view that there is widespread excessive surcharging taking place in the market today. The RBA's own Consumer Payments Use Study shows that the overall proportion of transactions being surcharged has remained at a level around 5% over the last three years. Many of the largest merchants do not surcharge at all. It is not valid to measure the number of merchants surcharging, particularly when many of those merchants only surcharge on a sub-set of credit cards, and to not measure the proportion of transactions being surcharged.

---

[24] *Review of Card Surcharging: A Consultation Document,* Reserve Bank of Australia, June 2011, p.8.

While there may be a small number of card-not-present merchants with higher levels of surcharges these merchants often have higher card acceptance costs, particularly within the travel industry. The data for these card-not-present merchants includes B2B merchants which should be excluded from any analysis of the impact of surcharging on consumers. These issues require more research and more analysis before any valid conclusions may be reached. The AMPF is happy to assist the RBA in the process of collecting more accurate and complete merchant data.

The AMPF and the Australian Retailers Association strongly disagree with any attempt to have merchant pricing regulated by the card schemes who have a poor track record of levying fees on merchants, have no direct relationship with merchants and who also have no direct visibility of merchants' costs of card acceptance.

The AMPF believes there is currently no case to limit surcharges and certainly not by the schemes.

If the RBA decides to cap merchant surcharges then it should also apply a cap to interchange fees and merchant service fees to maintain consistency of policy in the payments market.

ii. Is a surcharge cap best implemented by the Board setting a transparent and specific permissible cap that is specified in the Standards, and may then be imposed in scheme rules? Or, should the Standards allow scheme rules to limit surcharges to an amount that is either reasonably related, or equal, to each particular merchant's cost of card acceptance?

If a surcharging cap is imposed, then it should not be a specific number and should not be tied only to the level of merchant service fees as these fees form only a part of the costs of card acceptance. The New Zealand approach requires merchant surcharges to bear a reasonable relationship to the merchant's cost of card acceptance without attempting to define what those costs may be. As each merchant has widely different cost components depending upon their business model, volume and approach to payments infrastructure ownership, a single definition of costs would be extremely difficult to formulate.

The limiting rules could be included within each merchant's acquiring contract(s) as the merchant has a direct acceptance cost relationship with each acquirer, not with the card schemes who are not involved in these negotiations or agreements at all.

If merchant surcharges were to be limited to the merchant's cost of card acceptance then interchange fees and Merchant Service Fees should be limited to the issuer's and the acquirer's costs respectively for the sake of consistency.

However, to be absolutely clear, the AMPF sees no need at this stage for any cap on surcharges. As the RBA itself said in its recent review of Australia's payments system:

> *"The imposition of a cap would limit merchant flexibility and potentially remove a negotiating tool for merchants who might agree to limit the amount of their surcharge in exchange for a lower merchant service fee."* [25]

[25] *Reform Of Australia's Payments System - Preliminary Conclusions Of The 2007/08 Review,* Reserve Bank of Australia, April 2008, p.26.

iii. Should there be some level of tolerance allowed around any surcharge cap?

If there is to be a cap, then there should definitely be some level of tolerance allowed.

iv. Is the merchant service fee an appropriate measure of the cost of card acceptance (that can be applied consistently across all merchants)?

The merchant service fee is not an appropriate measure of a merchant's cost of card acceptance. Other cost components may include:

- charge backs;
- terminal rental;
- stationery and other consumable charges;
- gateway fees;
- communications charges;
- terminal purchase;
- software development and certification;
- point of sale modifications;
- transaction switch costs;
- payments staff;
- non-fulfilment guarantees;
- PCI DSS compliance;
- cost of meeting mandated scheme requirements such as triple DES, contactless infrastructure; and
- investigation of disputed transactions.

Different merchants with different business models and in different sectors of industry will have different cost components. As discussed earlier, the travel industry is particularly exposed to the risk of non-fulfilment, for example.

A further issue is that self-acquirer merchants have no merchant service fee at all but do face many of the cost components listed above.

v. Should the no-surcharge Standards clarify that, notwithstanding any surcharging cap, scheme rules cannot prohibit merchants from applying a surcharge that is either a blended rate for each card scheme or the cost of accepting each card within a card scheme? Are there alternative ways to allow for differential surcharging?

The AMPF understands the RBA's desire to send correct price signals to consumers, however differential surcharging has a number of issues around it. A primary concern is current acquirer practice of offering blended merchant service fees by default to the majority of merchants who often pay a single price for all MasterCard and Visa cards together, regardless of scheme and regardless of whether they are credit or debit cards. These merchants have no idea of their card mix or what it means to their cost of card acceptance. Acquirers also do not usually split out all the different card types and interchange categories in their reporting to merchants which increases the problem.

Merchants generally do not have the required data to allow them to distinguish at the point of sale between all the different types of cards within a scheme. Cardholders increasingly insert or swipe their card themselves and then enter their PIN without the point of sale staff even seeing the card in many cases. When a scheme debit card is used to make a payment the point of sale staff usually do not know whether a scheme debit or EFTPOS transaction has been carried out.

Acquirers could add software to their card terminals to distinguish between card types and interchange categories using the card prefix and merchants could then have a surcharging table in the card terminal as well. This would also allow acquirers to add the Surcharge Amount to their transaction message for recording and reporting of surcharging statistics to the RBA.

Even if this approach was taken, merchants would be reluctant to advertise a lengthy list of surcharge rates at every point of sale based upon all the different card types and interchange prices. Customers could become very confused by the long list of prices and could require long explanations when making payment and trying to choose a payment card that will give them the best outcome. It is difficult to communicate more than two or three different prices to a consumer in a short period of time.

It may be valuable to prevent scheme rules from restricting a merchant from differential surcharging where it wishes to do so, but in practice there are likely to be few examples of this in a card-present environment. It may be easier to implement on the internet where a surcharge can be shown after the card number has been entered by the customer. Even this may be confusing if the surcharge changes every time a different card number is entered. Internet merchants work very hard to ensure that customers who go to their checkout page actually complete the transaction as many purchases are abandoned at this point by confused customers.

The AMPF is happy to meet with the RBA and acquirers to discuss ways in which more differentiated surcharging may be achieved in a practical manner.

As a first step, a Standard which directs acquirers to offer differential pricing, as in New Zealand, and requires differential reporting to all merchants by card type and by interchange category, as in Canada, would be a move towards allowing merchants to understand more about their card mix and its impact upon their cost of card acceptance. This may lead to more differentiated surcharging in the market over time.

vi. Should the no-surcharge Standards require acquirers to pass on information about the merchant's cost of acceptance for each different card type if it is requested by the merchant? And, for those on 'interchange-plus' pricing, should the no-surcharge Standards require acquirers to pass on information about the weighted average merchant service fee if it is requested by the merchant?

Yes, see above. The Canadian Code of Conduct provides a good template (refer details earlier):

vii. Is there a case for disclosure of the cost of card acceptance by merchants? Or, would it be sufficient for the Bank to collect and publish more detailed data on merchant service fees, such as the range and average of merchant service fees across merchant categories for each card scheme?

The AMPF believes there is no case for the disclosure of merchants' costs of card acceptance unless these were collected by the RBA and published only as consolidated or summary numbers and providing the same was done for issuer and acquirer costs. Many of merchants' component costs are commercial-in-confidence information as are other supplier prices negotiated by each merchant and individual merchant costs should not be published.

The AMPF does support the collection and publication of more detailed data on merchant service fees, particularly for scheme debit and EFTPOS where there is currently no visibility at all, and is happy to assist the RBA with this process.