

Mr Christopher Kent
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Dear Mr Kent,

PayPal appreciates the opportunity to make a submission on the Reserve Bank's *Review of Card Surcharging*. As a leading player in the online payment industry PayPal has a strong interest in this issue, and on the impact it may have in supporting competition and innovation in the payments sector.

While PayPal has addressed each of the specific consultation issues outlined on page 10 of the consultation paper, there are in summary five key elements to PayPal's position on the issue of surcharging:

- 1) PayPal believes that, in principal, **merchants should not apply any surcharges based on the method of payment chosen by consumers**. This belief is driven by several factors, including:
 - a. Addition of further charges, after consumers choose a payment method, is more often than not a hidden cost that is not transparent to consumers during the purchase process,
 - b. Processing payments is, like paying rent and hiring staff, a part of the cost of doing business, and should be absorbed into the final price of goods and services, and
 - c. From a merchant's perspective each alternative payment method has a complex set of costs, and in many cases benefits, associated with it. Merchants are free to utilise, or to not utilise, each payment method based on its costs and benefits to them and to their customers - without needing to pass on any payment surcharges to consumers.
- 2) While PayPal's belief is that there should be no surcharging, we do recognise that **surcharging has become standard practice in some industry segments**. To the extent surcharging has become a commercial reality, PayPal acknowledges that an "in principal" across the board ban on surcharging may be an impractical objective for the RBA and the payments industry to seek.
- 3) Like other industry participants **PayPal has observed a small number of merchants who have, to all appearances, potentially misused their market power by imposing surcharges to consumers that are significantly above the total costs and benefits of accepting card and other payments**. PayPal strongly condemns excessive surcharges by merchants, and would be supportive of practical and effective mechanisms to prevent such abuses of market power.

- 4) PayPal's view is that excessive surcharging by merchants is primarily a competition-related issue, and should therefore be treated in a similar fashion to other competition issues. The most practical and effective method of controlling excessive surcharges is, in PayPal's view, to **task an independent authority that is empowered to determine the appropriateness of surcharge rates levied by merchants that are suspected of abusing their market power, taking into account all of the costs and benefits of card acceptance to those merchants.** This independent authority should, upon investigating specific merchants (or groups of merchants), be able to restrict merchants from imposing anti-competitive surcharge fees. Furthermore, we believe this independent body could be charged with assessing the appropriateness of other hidden costs to consumers levied by merchants and payments providers, such as handling or administration fees (which can be as much as 15% of the price of the underlying good or service).

An independent authority, as outlined above, would be able to **prevent merchants, schemes and banks from engaging in anti-competitive practices or imposing excessive fees**, either as a direct surcharge for payments or repackaged as an additional fee or through cross subsidisation.

- 5) PayPal strongly **recommends against any blanket cap or limit on surcharging, or any mechanism that would place the power to decide the appropriateness of merchant surcharging in the hands of the two major card schemes or their bank distribution partners.** These approaches would place significant power in the hands of card schemes and banks that already have a dominant market position, which they may exploit by setting surcharges lower than the total cost of acceptance and/or cross subsidising merchant service fees with other financial products provided to merchants and consumers. PayPal's concern is that these activities could artificially skew competition within the payments industry and would risk stifling innovation and the entry of new players in the Australian payments industry.

While the five key points above summarise PayPal's overall position with regard to the issue of surcharging, we have over the following pages outlined our responses to the specific issues for consultation outlined on page 10 of the consultation paper.

In addition to this written response to your request for submissions, PayPal would also welcome the opportunity to further discuss these issues directly with Reserve Bank staff.

Yours sincerely,



Frerk-Malte Feller
Managing Director
PayPal Australia Pty Ltd

Issues for consultation outlined on page 10 of the consultation paper

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

PayPal **does not believe it is appropriate for the schemes to be allowed to limit surcharges.** Primarily, this is due to the fact that the Merchant Service Fees (MSFs) imposed by the schemes are just one of the many factors that drive the actual costs and benefits of payment card acceptance by merchants.

While PayPal does not believe there is a case for allowing schemes to limit surcharges, it does believe that an **independent body**, such as the Reserve Bank of Australia or the Australian Competition and Consumer Commission, should be made capable of imposing and overseeing limits on surcharges on a **merchant by merchant basis**.

PayPal strongly emphasises that any such limit must take into account the **net costs and benefits of payment acceptance** experienced by each merchant. The costs and benefits of accepting payments vary significantly from one merchant to another and, within each merchant, from one payment provider to another.

In addition to the scheme levied MSFs, the net costs and benefits of payment card acceptance includes many other factors, such as:

Costs

- Volumes processed (which impact MSFs)
- Strategic merchant rates granted by the schemes
- Additional Bank fees
- Additional Gateway fees (particularly for online payments)
- Differential MSFs and fees for online vs offline
- Chargebacks / losses

Benefits

- The ability of a payment service provider to increase the completion of consumer transactions with a merchant, particularly in an online environment, via:
 - Convenience / ease of use of the payment interface
 - Consumer confidence and trust in the safety and security of the payments provider
 - Innovative payment products and solutions
- Minimisation of chargebacks and losses via enhanced security and risk monitoring services delivered by the payment provider
- Ability for a payment provider to promote a merchant's services to the payment provider's customer base

- Information support and reporting that enables lower reconciliation costs and increased sales by the merchants
- Rapid settlement of the transaction to the merchant's account

PayPal believes that, in principal, merchants **should not apply any surcharges** based on the method of payment chosen by consumers. Given the above costs and benefits of payment processing alternatives, it is strongly preferable for merchants to instead absorb the costs and benefits of payments acceptance into the base pricing of their goods and services. In that sense, payments processing would be similar to the many other input costs (e.g staff, supply chain, advertising, promotions etc) that are part of any business' cost structure.

However, PayPal recognises that, in some industries, it has become standard for payment surcharges to be levied.

In turn, in some instances the surcharging that merchants are levying may be excessive, given the actual costs and benefits of payment acceptance by those merchants.

To the extent that surcharge caps or limits should be implemented, PayPal therefore strongly asserts that they should:

- Take into account all the above factors (that drive the net cost and benefits of payment acceptance),
- Be applied on a merchant by merchant basis, and
- Be implemented by an independent authority, rather than the schemes

In addition, PayPal believes that the independent body overseeing any caps or limits on surcharging should also be responsible for:

- A. Determining whether merchants are charging excessive additional fees, such as "handling" fees and "administration" fees. These fees can range up to 15% of the price of the underlying item in many industries, such as ticketing and events. In some instances these fees can be used by a merchant to steer consumers towards lower cost payment systems which may deter a consumer from using a preferred payment source where rewards or safety (consumer protection) is a dominant motivator.
- B. Determining whether any payments providers are using their market power and multi-product range to engage in uncompetitive cross-subsidisation of charges. For example, some banks may be providing payment acceptance services at "below cost" rates in order to win the broader banking business of a large corporate entity.

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 reasonable related, or equal, to each particular merchant's cost of card acceptance?

PayPal believes that controls on excessive surcharging can be most effectively implemented on a merchant by merchant basis, as outlined in i. above. As such, it would not be appropriate or effective for the Board to set a specific permissible cap in the standards, nor to allow scheme rules to limit surcharges that are linked closely to the merchant's cost of acceptance.

In particular, PayPal does not consider the MSF alone to be an appropriate measure or benchmark for the cost and benefits of payment acceptance. Rather, the independent authority that PayPal believes should be responsible for reviewing the appropriateness of surcharging by specific merchants (or groups of merchants), should take into account the net costs and benefits of payment acceptance by merchants, including:

Costs

- Volumes processed (which impact MSFs)
- Additional Bank fees
- Additional Gateway fees (particularly for online payments)
- Differential MSFs and fees for online vs offline
- Chargebacks / losses

Benefits

- The ability of a payment service provider to increase the completion of consumer transactions with a merchant, particularly in an online environment, via:
 - Convenience / ease of use of the payment interface
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iii. Should there be some level of tolerance allowed around any surcharge cap?

PayPal firmly recommends that there should be a level of tolerance around any proposed surcharge cap. Specifically, this level of tolerance should cover the net cost and benefits of payment acceptance on a merchant by merchant basis, as outlined in i. and ii. above.

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

PayPal does not consider the merchant service fee to be an appropriate measure of the costs (and benefits) of card acceptance. As outlined above, PayPal believes the actual costs and benefits to the merchant of alternative payment cards are driven by factors including:

Costs

- Volumes processed (which impact MSFs)
- Additional Bank fees
- Additional Gateway fees (particularly for online payments)
- Differential MSFs and fees for online vs offline
- Chargebacks / losses

Benefits

- The ability of a payment service provider to increase the completion of consumer transactions with a merchant, particularly in an online environment, via:
 - Convenience / ease of use of the payment interface
 - Consumer confidence and trust in the safety and security of the payments provider
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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 scheme? Are there alternative ways to allow for differential surcharging?

PayPal believes that the card schemes should not be able to prohibit merchants from undertaking blended rate surcharging. The reasons that PayPal believes blended rate surcharging by merchants should be allowed include:

- The total cost and benefits of processing payments are not adequately represented by the (scheme mandated) MSFs alone. Where the total costs and benefits of different payment solutions are similar, even though the MSFs may vary, merchants should be free to apply a blended rare surcharge
- Allowing schemes to mandate a differential surcharging regime may drive increased costs for merchants, particularly small businesses, as the complexity of system developments for merchants to identify different cards within a scheme may be significant, and may require:
 - Significant cost in new terminal infrastructure (offline);
 - Significant cost of new shopping cart and gateway infrastructure (online)
- Differential surcharging may also create a negative consumer experience, with lack of clarity on the final pricing of goods and services based on complex considerations of alternative payment options. This may result in consumers perceiving that they are being misled, in that “sticker” prices may vary from the amount that they are ultimately charged. This is also inconsistent with the more recent moves by legislators to introduce clearer pricing final requirements, such as component pricing legislation.

It is PayPal’s underlying position that, given the above considerations, there are unlikely to be cost effective and consumer friendly mechanisms for differential surcharging. Instead, PayPal believes that the most effective means to ensure fair surcharging is to have it overseen by an independent authority such as the Reserve Bank or the Australian Competition and Consumer Commission, as outlined in section i. above.

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?

PayPal does not believe that the no surcharge standards should require acquirers, such as PayPal, to pass on the cost of acceptance for each different card type. There are several reasons why this requirement would be commercially and practically ineffective, including:

- The cost of acceptance for different card types is information that is "commercial in confidence" data between each acquirer and the schemes / other intermediaries that supply them. It would not be appropriate for this commercial in confidence information, which is the product of many commercial factors, to be shared with merchants who are the customers of card acquirers. To require this would be the equivalent of requiring a merchant to pass on information to their retail customers about the wholesale price they pay to their suppliers (ignoring the costs of distribution, warehousing, working capital, staff etc).
- In addition to card type cost and mix, acquirers have many other merchant-specific costs, mostly related to risks and losses, that determine the price of card acquisition. For example, in high risk industries acquirers will typically charge higher fees, regardless of card price or mix.
- Existing commercial agreements between acquirers and their merchant customers already implicitly reflect the expected differential cost of the alternative card types that acquirers may accept on behalf of a merchant.
- In addition, it is part of the acquirer's business model that they will assume risk around the mix of cards that consumers will use. Most merchants would not want to assume these card mix risks themselves, and therefore make a commercial deal with their acquirer that passes on management of the different cards costs (and mix of the cards) to the acquirer. Merchants and acquirers are already free to negotiate arrangements that are "interchange-plus", and a small number have chosen to do so.
- Building and maintaining the systems and processes to enable the passing on of card acceptance costs would be a substantial imposition for card acquirers, particularly as the mix of cards accepted varies for each of the hundreds of thousands of merchants that the large acquirers support. This cost and complexity would further increase over time as the number of cards in the market proliferates, making it even more complex for acquirers to effectively pass on this information to merchants in a commercially meaningful context and format.

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?

As outlined in responses above, PayPal very firmly believes that the costs and benefits of payment card acceptance are complicated calculations that will vary significantly from one merchant to another. As such, it would be impractical, and serve little commercial purpose, to create a blanket requirement for all merchants to reveal their net costs and benefits of card acceptance.

As an alternative, PayPal proposes that an independent body, such as the Reserve Bank of Australia or the Australian Competition and Consumer Commission, should be made capable of imposing and overseeing limits on surcharges on a merchant by merchant basis.

This would mean that, rather than all merchants having to determine and disclose their cost of payment acceptance, the independent body would require specific merchants, or groups of merchants, to calculate and disclose their costs / benefits of card acceptance, on a case by case basis. This process would be similar to the approach taken by the ACCC in investigating the fairness of commercial practices in specific industries or companies.

In addition, PayPal suggests that there is unlikely to be significant benefit from the Bank collecting and publishing more detailed data on merchant service fees, of the costs of card acceptance on a merchant category basis. There are two main reasons why PayPal believes these activities are likely to have little benefit:

- Merchants service fees are just one of many factors that contribute to the total costs and benefits of payment card acceptance for merchant (as explained in sections i., ii. and iv above). Publishing merchant service fee data in isolation of these many other factors could be misleading to industry and consumers, as it would risk not demonstrating the true costs and benefits of card acceptance on a merchant by merchant basis.
- It would be difficult to measure the costs of card acceptance across merchant categories, as these costs vary significantly from merchant to merchant based on factors such as volumes processed, the strategic value of a merchant to schemes and acquirers, the risk profile of the merchant and numerous other commercial factors. In this complex commercial environment it may be difficult for the Bank to calculate and present meaningful reporting on card acceptance costs