Australian Banking Association

Review of Merchant Card Payment Costs and Surcharging

Consultation Paper Response

September 2025

Introduction

The Australian Banking Association (**ABA**) appreciates the opportunity to contribute to the Reserve Bank of Australia's (**RBA**) Review of Merchant Payment Costs and Surcharging (**Proposals Paper**). Australia's payments system should serve consumers, businesses of all sizes, and the regulated institutions that build and safeguard the rails. Reform in such a system ought to be anchored in clear objectives, robust evidence and proportionate, competitively neutral responses.

Australia's surcharging framework is clearly broken. While surcharging may have been merited in the past, it has become increasingly burdensome, opaque and arbitrary for Australian consumers, and detached from its original objective of driving greater market efficiency. The ABA therefore supports the RBA's proposal to ban surcharging. Australians deserve price certainty – the amount shown on the shelf should be the amount paid, online or in-store.

Where we diverge from the RBA's proposed reforms is the decision to pair that necessary simplification with the proposal to take Australia's already low interchange rates, materially lower still, to levels well below any of Australia's peers. These unprecedented proposals would amount to the most far-reaching transformation of payment economics in two decades, without an evidentiary basis that they will achieve the promised outcomes.

In aggregate, the ABA has **four material concerns** with the RBA's interchange proposals:

1. The reforms unambiguously benefit multinational technology and payments companies, while penalising Australian businesses

The proposed reforms will hardwire the payment economics in favour of multinational payments and technology companies at the expense of Australian issuers and, ultimately, Australian households and businesses. The proposals reflect a card market of twenty years ago, not the payments system we have today – one where mobile wallets, three-party schemes and non-bank platforms capture a growing share of economics while sitting outside the regulatory environment of domestic companies. Locking in this asymmetry would accelerate the outflow of ecosystem revenue offshore and push more transactions onto higher-cost, less accountable rails. While we don't presume this is the policy intention, it is the ABA's view that it is difficult to see how such policy reforms reconcile with national interest.

2. There are material flaws in the methodology, assumptions and conclusions underpinning the proposed reforms

We have concerns with how the proposals paper reasons its way to the proposed interchange reforms. Our concerns encompass the methodological approach – particularly regarding issuing costs which are materially understated – the reliance on simplistic assumptions that are asserted, yet not supported by evidence, and significant omissions made, especially where comparisons are drawn between Australia and other markets.

3. The policy proposals will increase costs for consumers

While not necessarily intended as such, there appears to be an explicit policy objective to shift more costs onto consumers. The proposals paper notes the RBA's preference for more costs in payments system to be borne by individual cardholders through increased fees, higher interest rates, and lower interest-free periods. Regardless of policy intent, ABA is concerned that the practical effect of the proposed reforms will be higher costs for Australian consumers and households. In this context, the ABA firmly believes a transparent, public conversation about the cost-of-living impacts of these proposals is warranted, before final decisions are taken.

4. The proposals will not benefit businesses

The proposals do not offer a clear, credible pathway to lower costs for businesses. They rest on behavioural assumptions, especially about how acquirers, schemes and global wallets would respond, that are at odds with the evidence. Frontier's review, together with overseas regulatory findings, shows that at today's settings further cuts to interchange are unlikely to reduce merchant service fees (**MSFs**) in a sustained way, while scheme fees have been rising and have often offset wholesale reductions.

The package also overlooks the role of commercial credit cards in business cash-flow. Treating commercial cards like consumer cards on interchange pushes a key working-capital tool toward unviability – contrary to international practice, where commercial cards are typically exempt from caps. The net effect is not a pro-business reform: it is an uncertain promise of savings for SMEs, with predictable implications for the availability and affordability of essential business credit.

The ABA requested Frontier Economics undertake independent economic analysis of the proposals paper and its evidence base; their report is attached. Our submission draws on Frontier's conclusions where relevant, while being conscious to avoid repetition. Our focus here is on what those findings mean for Australians – consumers, businesses and the national interest, and on the practical policy choices now before the RBA.

Pathway forward

The economic analysis by Frontier Economics concludes the ban on surcharging should proceed yet also finds there is **no public policy case for further reducing debit or credit interchange fees.** The ABA agrees with this finding; however, we recognise the RBA has raised important issues of fairness regarding the disparity in costs between large and small merchants. Our submission outlines a pragmatic and proportionate pathway forward that supports the objectives of removing surcharging and responding to issues of equity, while ensuring that well-intentioned reforms do not inadvertently come at the detriment of Australian consumers, businesses and Australia's payments system. Our submission outlines this further. In summary, the ABA supports the following:

1. Proceed with the surcharging ban.
2. No changes made to the overall level of debit and credit interchange.
3. Consider measured, highly targeted policy levers to reduce variance in costs between large and small merchants, for example, a small business interchange rate.
4. Commit to a whole-of-system review under the RBA's enhanced regulatory powers[1] once the impacts of the surcharging ban on the market are understood (e.g. lower MSFs[2]).

The ABA and its members look forward to continuing constructive engagement with the RBA.

[1] The PSRA reforms passed the Commonwealth Parliament on 4 September 2025.
[2] Frontier Economics concludes the surcharging ban should exert downwards pressure on merchant service fees.

Australian Banking Association

Key issues

The proposed reforms unambiguously benefit multinational technology and payments companies, while penalising Australian businesses

The way Australians pay has shifted dramatically over the past decade. Where payments once flowed mainly through banks and the card networks, today they involve a much wider set of participants. Most notable is the increasing presence of multinational technology and payments companies, and the growing value they are deriving from the Australian payments system. These structural changes, in part, are illustrative of what the RBA describes as *"significant technological changes"* since the current regulatory framework was introduced over 20 years ago.[3] While these innovations have delivered substantial benefits to consumers and businesses, they have also created new challenges for competition, efficiency, and systemic risk.

- In 2021, the RBA noted that the growing complexity of the payments ecosystem and the emergence of new entities – such as BNPL providers, mobile wallet operators, and payment gateways – raise *"a range of policy issues"* relating to competition, efficiency, and risk management.[4]
- In 2023, the RBA reiterated concerns about access, competition, and efficiency stemming from the changes in participation and technology in the payments value chain.[5]

The ABA acknowledges that legislative reform is required for the RBA to appropriately respond to some of these challenges. With the Payment Systems (Regulation) Act (**PSRA**) reforms passing Parliament on September 4, these additional regulatory powers are no longer hypothetical. In that context, it is all the more critical that the most consequential interchange reset in twenty years **does not proceed** without consideration towards the significant and growing power of multinational technology and payments giants, and their impact on the domestic companies that fund and maintain Australia's payments systems. We have provided some further context on these issues as they relate to some of these participants.[6]

American Express

Three-party schemes (American Express) stand to gain where capped four-party issuers cannot sustain propositions that consumers value. The RBA has long recognised that exemptions for three-party schemes cut against competitive neutrality. It was concerns about price signals and market distortion that led to the designation of American Express companion cards in 2016.

RBA data shows the share of spend on American Express cards has risen materially; with fee levels more than 50 basis points higher overall, deeper caps on bank-issued credit would reinforce that trajectory. We believe it is logically incoherent to characterise rewards on lower-cost, open-loop cards as problematic while leaving the higher-priced model structurally outside the cap. Fundamentally, if the RBA decides merchants should not bear the cost of rewards on four-party credit, then competitive neutrality would suggest the same principle should apply to three-party schemes whose entire model is built on merchant-funded rewards.

Europe offers a cautionary example as to how domestic card issuers are impacted. Very low regulated interchange coincided with a relative strengthening of three-party schemes and a retreat

[3] RBA Submission to Parliament Joint Committee on Corporations and Financial Services
[4] Review of Retail Payments Regulation 2021
[5] Payments Systems Board Annual Report 2023
[6] Comments regarding gaps in the RBA's regulatory powers do not necessarily relate to international four party schemes, which are currently regulated by the RBA

by domestic issuers in rewards-oriented segments. We should not replicate that dynamic by design.

Mobile wallets

On a marginal transaction, the fee burden on card issuers is materially higher than the RBA's averaged cost estimates used to justify the proposed caps. Averaging across all transactions obscures the fact that an increasing share of spend attracts additional, non-negotiable wallet charges that issuers cannot influence but must fund. In the case of Apple Pay (the only wallet in the Australian market that currently charges issuers directly) the effect is to siphon a substantial portion of the interchange earned on wallet transactions offshore. Under the proposed settings, issuers face payment economics below cost precisely where consumer adoption is rising, and current bargaining constraints limit any ability to re-price or negotiate those inputs.

We believe it's important that these marginal costs are put in context. As noted in the Frontier Economics report, public estimates place Apple Pay fees at 15bps on credit transactions. Under the RBA's proposed 30bp interchange cap, this suggests card issuers would earn no more than 15bps every time Apple Pay is used, while at least half the interchange paid by merchants flows offshore. It is difficult to reconcile the rationale of such an approach.

International open-loop schemes

International scheme fees are another example of asymmetric regulation. They have grown faster than volumes and, in overseas markets, have tended to accelerate after interchange cuts as schemes recalibrate pricing. The RBA notes widespread concern with scheme fees but appears to cite design complexity as a reason not to propose a policy response. The ABA considers that complexity is not a justification for a reform that bears down solely on regulated issuers while leaving scheme and wallet economics unaddressed.

The national-interest implications are not abstract, nor trivial. Banks fund and maintain critical payments infrastructure under prudential and operational obligations that non-bank platforms do not bear. A framework that enables continued shrinkage of regulated revenues earned by domestic companies while expanding the unregulated offshore share weakens local capability and increases strategic dependence on counterparties whose pricing and product decisions we do not control. Over time, that raises the cost of maintaining universal access, threatens the viability of products that support access to credit and concentrates market power in actors with limited accountability to Australian regulators. If the goal is a resilient, efficient system, reform must be competitively neutral and responsive to market asymmetry; changes to interchange should not be made in isolation from the fees and business models now driving the system's economics.

There are material flaws in the methodology, assumptions and conclusions in the proposals paper

The economic analysis by Frontier Economics concludes clearly that there is no rationale to support further reductions to Australia's interchange rates. In arriving at this conclusion, Frontier Economics identifies significant flaws in the evidentiary basis behind many of the assertions relied upon in the proposals paper and key conclusions made, including the assessment of issuing costs. As many of these issues have been explored in detail in the included report, we have sought to limit duplication. However, we believe there are several findings in this report that should be emphasised.

1. The observed problems with surcharging are not driven by interchange; they stem from a surcharging framework that no longer works as an effective price-signal.

The RBA's own analysis shows the framework is failing for structural reasons: consumers have shifted decisively to cards; many merchants are on single-rate payment plans; and disclosure/enforcement is hard. Together this means surcharges no longer steer customers to lower-cost methods and merchants have become less sensitive to MSFs, shifting competition toward non-price features rather than lower fees.

Because the mechanism (surcharging) is what's broken, cutting interchange is a mis-targeted remedy. The problems pointed to in the proposals paper are not attributable to interchange; even with a surcharge ban, merchants can recover MSFs in base prices – something Frontier notes is done by almost 90 per cent of businesses already – so there's no need to lower interchange to "fix" surcharging outcomes. Debit interchange is already below caps/benchmarks due to competition (e.g. LCR), and recent pressure points relate more to scheme fees/complex pricing than to interchange levels.

2. There is no evidence that Australia's interchange rates are too high and no basis to reduce them further.

Frontier Economics has identified significant deficiencies in the RBA's issuing cost study, which have led to material understatement. Analysis undertaken by Frontier using issuing cost data and the RBA's own categories shows credit issuing costs between **0.42 - 0.62 per cent** and debit costs between **0.21 - 0.28 per cent**. In contrast, the proposals paper relies on a narrow "avoidable cost" approach that strips out material, recurrent costs (including several that the RBA itself has previously treated as eligible), producing artificially low-cost estimates and a false impression of excess card issuing rents. Taken together, the evidence does not support the proposition that Australia's interchange is "too high" in aggregate; cross-country comparisons show debit is already among the lowest globally and credit is well below many developed peers.

Frontier also identifies technical issues in the study – notably, the use of a backward-looking average cash rate that understates the contemporaneous cost of funding the interest-free period – such that correcting the input "*would… push total costs above the RBA calculated value*." It's apparent the original issuing cost study has not demonstrated that current interchange sits "above cost"; rather it has adopted a cost lens that ensures understatement.

3. Pass-through assertions are not evidenced.

The paper's claimed consumer and merchant gains depend on a linear pass-through: acquirers must pass any interchange reduction to merchants one-for-one, and merchants must then reduce prices one-for-one. Frontier notes the paper itself relies on this chain – "*the benefits… entirely rely* *on reductions in interchange fees… [and] assumes that acquirers would pass on changes… one-for-one, and merchants… one-for-one*" – and then shows that empirical evidence in the EU and US is mixed, with acquirer margin changes and rising scheme fees often offsetting wholesale cuts and small merchants seeing little benefit. By the RBA's calculations, the efficiency case is weak: its distributional analysis shows modest net gains achieved via large transfers, a point Frontier underlines in concluding that "*the efficiency justification is not strong*."

Nor is it clear that any interchange differences between Australia and Europe have produced lower end costs for merchants. For example, reviewing the public pricing of UK acquirers – bank and non-bank, and global acquirers with operations in Australia – suggests that UK merchant rates are higher than in Australia. Public UK guides[7] aimed at SMEs describe typical card-processing/MSF ranges of about 1.5 - 3.4 per cent – levels that are not ostensibly below Australia, and which reinforce the complex issue of trying to affect pricing through a subset of wholesale costs.

4. EU/UK benchmarks are misapplied; Australia's structure implies higher like-for-like costs and lower recoverable revenues.

The paper benchmarks Australia to Europe/UK while discounting structural features that make domestic debit-cost and lower-revenue on a like-for-like basis: a much smaller market over which to spread fixed costs; higher distribution and access obligations across a vast geography; and a domestic-debit/LCR regime that both constrains issuer revenue and disciplines merchant costs in ways not replicated in the UK. Frontier concludes the RBA "*downplays the substantive structural differences*" and that, on a comparable basis, Australian networks face higher costs and derive lower revenues than in Europe/UK – meaning EU/UK benchmarks are not appropriate reference points for Australian caps.

5. Cross-subsidisation is treated selectively.

The proposals paper frames cross-subsidisation as a debit-to-credit issue inside the four-party interchange line and proposes to narrow the debit/credit gap to "reduce" it. That is an incomplete lens. In a modern, multi-sided system, the material transfers are not confined to interchange. They run across the whole system – scheme fees, mobile-wallet charges, three-party models and BNPL – and between regulated issuers and unregulated or lightly regulated platforms.

They also run between merchant segments and into system obligations borne by banks (universal access, cash distribution, dispute resolution, fraud/AML controls, and real-time payments infrastructure). Focusing on one regulated revenue line while leaving these larger and growing flows unmeasured does not "reduce cross-subsidy"; it simply reshuffles it.

If cross-subsidisation arguments are to be made, our view is that it must be made consistently and with regard to competitive neutrality. For example, in the case of other forms of credit – i.e. American Express and BNPL – there is clearly a larger cross-subsidy occurring as debit and four-party scheme credit payments cross-subsidise payments with materially higher costs.

6. The efficiency outcomes are weak by the RBA's own assessment, whereas the risks of overshooting are significant.

Even accepting the proposal paper's modelling at face value, the distributional analysis shows large transfers between users to generate modest net gains – gains that may dissipate once offsetting scheme and wallet fees are accounted for. In parallel, the downside risks are concrete: setting caps too low can weaken issuer competition (especially for smaller banks), depress

[7] Credit card processing fees in the UK: a complete guide for 2025 | money.co.uk

investment in shared infrastructure, and shift spend towards less regulated rails (including three-party and BNPL). Frontier's analysis of distributional assumptions is blunt: "***setting caps too low… is more likely to produce worse system outcomes than caps that are too high***," with commercial cards particularly exposed – a product that Australia's comparable peers explicitly exempt from caps to preserve viability and access to business credit.

The policy proposals will increase costs for consumers

The ABA is concerned that the proposed reforms materially misrepresent the net benefit to consumers and will increase, not decrease, costs to Australian cardholders. There are two issues here.

Issue 1: The reforms appear intended to shift costs onto households.

We are concerned that the effect of the RBA's proposals will be consumers paying more for less. Analysis of the proposals leads Frontier to conclude they "*will likely reduce consumer benefits from card holding – higher fees, reduced interest-free periods, fewer rewards etc*."

Frontier also notes the "*RBA's proposed reductions to interchange fees seem designed to push costs onto cardholders*" and that the proposals paper "*appears to indicate a policy preference to shift more payment costs onto cardholders.*"[8]

Their report references comments made by the RBA in the proposals paper:

> *If the cost of these interest-free periods were…**recouped from cardholders, cardholders would bear closer to the true cost of their credit card usage**, which would lead to more efficient decision making in the payments system. Issuers could recover these costs…via **higher cardholder fees or higher interest rates**, or could mitigate these costs by **shortening interest-free periods***[9]
>
> *Costs associated with credit risk and credit losses are standard features of the provision of credit to customers, which are **most efficiently borne by the customer.***[10]

Frontier notes that the RBA appears to see this type of redistribution as desirable, given the following comments made regarding the impacts which followed previous interchange reductions:

> *There has been **strong growth in credit card fees** over recent years and some issuers have **reduced the length of their interest-free periods** from 55 days to 44 days…demonstrating the ability of issuers to adjust these features.*[11]

The ABA has significant concerns regarding the impact of these proposals on consumers, particularly where those impacts are by design. For many of the more than 17 million Australian cardholders, interest-free periods are essential in managing their bills between pay cycles. Shortening those periods or increased fees directly impacts the cost of living – it's not simply an abstract rebalancing act.

While we acknowledge the RBA's view on credit card reward programs, we believe that transparency and discussion with Australians on the likely impacts of the proposals is critical. On conservative estimates, millions of Australians receive more than $1.6 billion a year in rewards and benefits from major-bank credit-card programs alone. For many, these programs feature as part of

[8] Frontier Economics report, page 4
[9] RBA Proposals Paper, page 29.
[10] RBA Proposals Paper, page 30.
[11] RBA Proposals Paper, page 29.

their personal financial strategy to make their money go a little bit further. International experience shows a clear precedent. European caps at, or below, the levels contemplated here coincided with materially weaker consumer propositions – higher cardholder charges, shorter interest-free periods and sharply diminished and eliminated rewards programs – while evidence of lower retail prices is non-existent.

The ABA believes these implications have been greatly downplayed by the RBA in the proposals paper. The ABA urges that given the direct impacts to Australians, policymaking should be informed by a transparent and open conversation with the Australian public.

Issue 2: A surcharge ban does not equate to real savings for households.

A secondary issue arises from the proposal paper's framing of the surcharge ban as a large transfer to households – i.e. Australians will be better off by the amount in surcharging that is no longer permitted. The assertion that a simple, system-wide transfer to households will follow has no reliable grounding and is not how prices are formed in practice. Payment-acceptance costs are part of merchants' cost base; when a surcharge is prohibited, merchants that previously surcharged are likely to re-optimise by embedding those costs in the advertised price. Frontier's analysis finds the net-impact to consumers from the surcharge ban in isolation is likely to be neutral – "*no better or worse off*." Fundamentally, this approach treats a bookkeeping change in how costs are recovered as if it were a real income gain for consumers, which is not the case.

The proposals will not benefit businesses

The ABA is also concerned that the suggested benefits to businesses from the proposed reforms rely on assumptions that are not supported by evidence, nor by precedent in other jurisdictions. The analysis by Frontier highlights a number of these issues and concludes there is little likelihood of any upside for businesses, and significant downside risks.

Issue 1: There is limited evidence that lowering interchange fees from current levels will lower the cost of payment acceptance for smaller businesses.

The proposals paper assumes that lowering interchange will flow through to lower merchant fees for businesses. The evidence of that linear relationship is extremely weak, particularly for small businesses, where most merchants are on simple headline-rate ("standard" or blended) plans that do not automatically pass through wholesale changes. In their report, Frontier Economics finds little empirical evidence to suggest the RBA's assessment of this is realistic.

For example, in the UK, virtually none of the reduction in average interchange fees from the introduction of the IFR cap was passed through to merchants through lower MSFs. Any cost savings flowed to the largest businesses only. Critically, Frontier also notes that the UK shows that:

> *"while interchange fees are shrinking over time (notably falling from 2014 to 2015 due to the 2015 IFR reforms), the overall MSF remains largely constant. The cause for this appears to be that, even as interchange shrinks, Scheme fees absorb the difference. The* ***implication being that the reduced revenue of UK issuing banks is being more-or-less transferred directly to the international card schemes, leaving merchants no better off."***[12]

Issue 2: Impacts on the availability of commercial credit.

[12] Frontier Economics report, page 37

RBA data indicates around 700,000 commercial card accounts and ~2 million cards on issue.[13] For many businesses commercial credit cards are essential for working capital and expense management, smoothing cash flow, providing controlled purchasing, reconciliation and extended terms.

The proposals would compress the economics of issuing precisely these products. Frontier's assessment is that the Bank's framework applies a narrow "user-pays" lens that ignores shared benefits to merchants (assured funds, acceptance certainty, dispute handling), and under-recovers the higher risk, servicing and fraud/chargeback costs embedded in commercial programs.

It should be noted that Australia's approach to commercial interchange is an outlier amongst comparable nations, including all jurisdictions that the RBA considered for comparison.[14] In its July final decision, the New Zealand Commerce Commission determined it would leave commercial interchange uncapped.[15] This common approach indicates widespread acceptance in other jurisdictions that there are significant and unique risks in regulating commercial interchange at too low a level. Australia is effectively proposing the opposite – treating commercial cards like consumer credit while leaving three-party economics largely unchanged; for businesses, **that translates into less access to credit, higher costs of paying and less flexible terms at a time when liquidity management is already tight.**

Pathway forward

Policy reform should be measured, evidence-backed, and transparent. We believe a balanced multi-step approach, with clear expectations and signposting, delivers better outcomes for consumers, businesses and the country.

1. **Proceed with the surcharging ban.**

This will benefit consumers while changing nothing for the ~90 per cent of businesses that do not surcharge currently. Frontier's analysis concludes that this action alone should drive down merchant fees, as the surcharge ban reintroduces pricing elasticity and acquiring competition drives down merchant fees.

2. **No changes should be made to the overall level of both debit and credit interchange.**

Frontier's analysis is clear: there is no basis for any reduction to Australia's interchange levels. Even a conservative assessment of issuing costs shows the existing credit benchmark is in line with issuing costs, while debit costs are already well above both the benchmark and current weighted average levels. There is no clear evidence that further reductions would improve efficiency in the payments system, yet significant downside risks exist.

3. **Consider measured, highly targeted policy levers to reduce variance in costs between large and small merchants.**

The ABA agrees the current level of disparity in payment costs between larger and smaller merchants raises questions of fairness. We recommend the RBA canvas highly targeted responses that could reduce this disparity, without affecting the overall level of interchange and issuing

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[13] June 2025 data

[14] See Appendix B: Review of Merchant Card Payment Costs and Surcharging Consultation Paper

[15] 'Interchange Fee Regulation for Mastercard and Visa Networks – Final Decision and Reasons Paper', New Zealand Commerce Commission, July 2025

economics. While there are a range of potential ways to go about this, the ABA considers one such way could be the design of a targeted small-business interchange rate (SBIR).

A small business interchange rate is a proportionate response that recognises the policy problem is narrow: some small merchants face higher acceptance costs than large merchants. The objective should be to narrow that gap in a way that is simple and quick to implement, while preserving incentives to invest in security, resilience and innovation. It will be important to ensure that any response is simple, consistent and scalable, without imposing new compliance burdens on acquirers or small businesses. A targeted SBIR meets that objective better than system-wide cap reductions, which redistribute costs to cardholders and tilt competition toward unregulated participants.

4. **Commit to a whole-of-system review under the RBA's enhanced regulatory powers once the impacts of the surcharging ban on the market are understood.**

Let changes bed in and, now that the PSRA has passed, commit to run a holistic review. With modernised powers, the RBA can examine the *whole payments system* – schemes, wallets, three-party systems and other international players – not just domestically regulated issuers and Australian cardholders. This review should be evidence-led, competitively neutral, apply functional-equivalence tests, and calibrate any further interventions only if data shows persistent issues.

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About the ABA

The Australian Banking Association advocates for a strong, competitive and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

Disclaimer

The policy positions put forward in this submission reflect the views of the ABA's entire membership, other than Macquarie Bank who have put forward their position in a separate submission.

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RBA consultation on surcharges and interchange fees

A report for the ABA | September 2025

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1 Summary

Introduction

The Reserve Bank of Australia's (**RBA**'s) Consultation Paper on Merchant Cards Payment Costs and Surcharging (July 2025) proposes a further set of regulations on the operation of card payment schemes.[1]

Key proposed changes include approval for the reimposition of card scheme no surcharge rules and very material cuts to interchange fees for credit and debit card transactions.

This report, prepared for the Australian Banking Association (**ABA**), analyses the conclusions drawn by the RBA relating to surcharges and cuts to interchange fees.

We find that the conclusions and subsequent solutions put forward by the RBA are not likely to achieve the RBA's goals of greater efficiency and competition in the payments system. While the analysis in relation to merchant surcharging can be supported, the RBA appears determined to materially reduce interchange fees for four-party card schemes without regard to the likely detriments to the payments system from doing so.

Payments markets continue to evolve rapidly

In Section 2 of this report, we analyse the historical context including the current state, history and trajectory of payment costs over the last 10 years.

The increasing **prevalence of consumer surcharges and the decline in cash payments** are just two, albeit important, factors in the payments landscape. Other relevant contextual factors include:

- Increases in card scheme fees;
- Rapidly increasing use of mobile devices for card payments, which has added a layer of transaction fees to system costs;
- Increasing competition for traditional credit and debit payments from buy-now-pay-later (**BNPL**), peer-to-peer and other forms of payment that avoid traditional banking; and
- Changing merchant and consumer behaviour has facilitated increased surcharging but has reduced merchant sensitivity to the costs of payment instruments.

There is broad recognition that the current regulation of payment systems needs modernisation to ensure that regulation produces a level playing field. Nonetheless, there are **many aspects of the Australian payments system that appear to be working well**. In particular:

- Average Merchant Service Fees (**MSF**s) are falling or stable across all card types;
- The share of transactions on the debit network (**eftpos**) is increasing, in part driven by Least Cost Routing (**LCR**), such that interchange fees on debit transactions are now well below RBA-imposed benchmarks and caps. In real terms, declines in interchange fees are even greater;
- Consumers now have access to a range of free-to-user payment systems (NPP, bank-to-bank or peer-to-peer etc.) which can substitute for, and constrain the pricing of, credit and debit transactions;

[1] See https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/2025-07/ (**RBA Consultation Paper**).

- Surcharging has become common in certain sectors, albeit that this is not occurring precisely as the RBA would wish (including increasing prevalence of surcharging on all transactions at the same prices due to merchants choosing single rate plans from payment service providers[2]); and
- Transactional banking in Australia remains relatively low cost.

Key conclusion

Further RBA interventions need to be measured and careful, as the market is moving rapidly due to competition-driven enhancements in technology.

The RBA's problem definition highlights the challenges and dangers of regulating prices in competitive markets

In Section 3 of this report, we analyse the findings in RBA's Consultation Paper relating to perceived problems in the operation of the payments system. The RBA's main focus in the Consultation Paper appears to be:

- ***The increasing prevalence of surcharging on all transactions***, often levied at the same rate. The RBA's view is that surcharging clustered around a single rate limits the effectiveness of price signals that might otherwise cause consumers to favour cheaper payment instruments.
- ***The differential treatment of smaller/larger merchants***, through differences in interchange fees. The RBA notes that strategic large merchants receive much more attractive terms from schemes keen to compete for their business.

The problems identified highlight that the RBA's regulation of the debit and credit payment system has long struggled with the contrasting notions that:

- It is necessary to free-up processes of competition and make them work more effectively, such as to provide merchants with greater freedom to set prices based on payment method; and
- It is also necessary to directly regulate interchange fees based on the premise that competition among debit and credit card systems works to the detriment of consumers.

Regulating conduct in dynamic, competitive markets to try to increase efficiency is difficult, and we should not be surprised that unintended consequences have emerged. Logically, a full review of the payments system when the RBA has powers to regulate all participants in the system following updates to the *Payment Systems (Regulation) Act 1998*[3] would reduce the likelihood of unintended consequences, such as favouring intermediaries like mobile wallets, and unregulated three-party schemes and BNPL providers.

A careful examination of the problems that the RBA has identified indicates that changing behaviour has led past regulatory interventions in unexpected directions:

- Surcharging was designed to encourage more use of lower cost payment instruments. However, **the steering effect of surcharges has diminished** as, with reduced usage of

[2] RBA Consultation Paper, p. 12.

[3] Through the *Treasury Laws Amendment (Payment System Modernisation) Bill 2025*

cash, consumers increasingly use their preferred payment method and pay the surcharge. This has meant that merchants have become less price sensitive to merchant service fees. This has resulted in changes to competition for merchant acquisition, with differentiation on factors other than MSFs. This may ultimately reverse patterns of reducing MSFs; and

- **Differences in interchange** between larger 'strategic' merchants and smaller merchants have **been driven by card schemes responding to increased competition between debit networks**. For debit transactions, larger 'strategic' merchants can bargain more effectively with card schemes on acceptance fees, providing for a significant discrepancy between interchange fees for smaller and larger merchants. This is also facilitated by the use of weighted average interchange fees rather than caps, allowing for significant complexity in interchange and scheme fees. In principle, LCR should reduce the discrepancy for smaller merchants, but it is unclear to what extent this is occurring given the reported outcomes. Moreover, the full impacts of LCR may take more time to fully emerge.

Key conclusion

Past regulatory interventions can and have resulted in unexpected outcomes, highlighting that the expected effects of regulatory changes should be thoroughly considered.

The proposed cuts to debit, credit and commercial credit interchange fees

While neither of the problems identified by the RBA are directly attributable to interchange fees, a key RBA proposal is to materially reduce interchange fees – reducing the cap by more than half. The RBA argues that interchange fees are 'interrelated' with MSFs such that reducing interchange fees would be expected to reduce MSFs.

It is, however, **far from obvious that interchange fees drive any identified problem**:

- Merchants can increase prices to recover MSFs at current levels without any increase in the overall price level (that is, the price plus the existing surcharge); Based on the RBA estimates that 11% of businesses surcharge, 89% of businesses already do this,
- Interchange fees do not need to reduce overall to reflect a concern that the gap or spread between higher and lower negotiated interchange fees is too large; and
- Debit interchange fees are already below regulated caps and weighted average benchmarks – implying that competition rather than regulation is the effective constraint on fees.

Moreover, we also find that:

- ***Setting caps too low for interchange fees is likely to produce no better, and possibly worse, system outcomes than caps that are too high***

  Reducing interchange fee caps will reduce returns to card issuing activities. As with previous reductions in Australia's interchange caps, this will reduce benefits and increase fees to card users. But the effects are likely to be broader than in just card issuing. Many issuers are retail banks that provide a range of consumer banking services. These banks make complex pricing decisions across their various services, and the impact of lower interchange fees will not necessarily fall purely on cardholders. In other words, the payments system does not strictly function according to a siloed model where all services are provided on a user pays basis. An example is the introduction of the New Payments Platform.[4] And there are good economic reasons to charge in this way.

- ***The RBA proposed reductions reduce credit interchange caps in line with jurisdictions such as Europe and the United Kingdom, but does not recognise key differences between Australia and these markets***

  Australian card issuers would be expected to have higher costs than banks in Europe or the UK, for reasons including that Europe and the UK are far larger markets with higher transaction volumes. Payments system investments require large, fixed costs, so spreading costs over larger bases reduces unit costs. Australia's low density, geographic size and regulatory service obligations also embed a structurally higher cost base for providing banking services essential to the functioning of other parts of the payments system which the RBA also oversees (e.g. cash access and distribution, provision of bank accounts and access to real-time account-to-account payments). EU and UK banks also have a much higher transaction and account fee structure than do banks in Australia, providing alternative sources of payment systems revenue.

- ***There is limited evidence that lowering interchange fees from current levels will lower MSFs and, in turn, lower prices to consumers***

  Interchange fee rates have already been reduced to low levels in Australia, particularly for debit cards, which already have interchange fees below the RBA's caps and below prevailing rates in Europe. This makes the impact of further reductions much less certain. Evidence of increases in scheme fees and (in some instances) acquirer margins should give the RBA some pause. Moreover, it is not clear that MSFs in Europe fell following regulation to reduce interchange rates which casts doubt on there being a direct relationship between the interchange fee level and the MSF level.

- ***Stability and predictability are important to investment decisions***

  The RBA's own analysis highlights the complex nature of relationships between issuing and acquiring activities and understates the significance of benefits to consumers and to issuers of stable fees that facilitate certainty and investment in issuing activities. In our view, to make substantive changes to interchange fees, a strong case would need to be made that cuts would deliver significant efficiency gains.

- ***RBA's proposed reductions to interchange fees seem designed to push costs onto cardholders***

  While we do not intend to infer intent, commentary in the RBA Consultation Paper appears to indicate a policy preference to shift more payment costs onto cardholders. The RBA notes that:

  > *If the cost of these interest-free periods were…recouped from cardholders, cardholders would bear closer to the true cost of their credit card usage, which would lead to more efficient decision making in the payments system. Issuers could recover these costs…via higher cardholder fees or higher interest rates, or could mitigate these costs by shortening interest-free periods"*[5]

  They extend this to credit risk, concluding:

[4] See Box 8

[5] *RBA Consultation Paper, page 29.*

> *Costs associated with credit risk and credit losses are standard features of the provision of credit to customers, which are most efficiently borne by the customer.*[6]

The RBA appears to see this type of redistribution as desirable, noting that following prior interchange reductions:

> *There has been strong growth in credit card fees over recent years and some issuers have reduced the length of their interest-free periods from 55 days to 44 days", "demonstrating the ability of issuers to adjust these features.*[7]

- ***The RBA's distributional analysis highlights the uncertainty of reform benefits***

  Even the RBA's analysis of direct impacts highlights that – even if one is minded to accept that there will be full pass through of cost savings to merchants and then to consumers – the effects are mostly distributional between consumers and card users. The empirical evidence on pass through is mixed as to whether these expectations are realistic. Empirical analysis in other jurisdictions raises questions about the likely behaviour of merchants and the impact of lower interchange fees in delivering increases in a range of banking fees (rather than reductions in cardholder rewards alone).

Key conclusion

It does not appear that the RBA's proposal to cut interchange fees is effectively targeted at the problems the RBA has identified, and the case that it would increase overall benefits from card payment systems is weak.

The RBA's cost analysis based on eligible issuer costs

In Section 4 of this report, we further consider the RBA's cost analysis. We find that:

- ***The costing methodology has an unclear foundation***

  There is some support in the economic literature to cap interchange fees from levels that might be unilaterally set by card schemes. But the literature offers little support for the RBA's approach to benchmarking or capping interchange fees according to the estimation of issuer avoidable costs.

- ***The costing methodology is applied narrowly and sometimes arbitrarily***

  Our review of the Issuer Costing study indicates that the RBA takes an unduly narrow view of relevant costs that is difficult to align with standard costing approaches. The RBA's approach seems to be grounded in identifying issuing costs that would not be avoided in providing card network services to merchants. However, this does not provide clear guidance as to which costs are eligible. Nor does it clearly account for the joint nature of cost and benefit from the use of card payment schemes, though the RBA Consultation Paper does say:

  > *The PSB's view is that the benefits from interest-free periods do not solely accrue to merchants.* [8]

[6] *RBA Consultation Paper, page 30.*

[7] *RBA Consultation Paper, page 29.*

[8] *RBA Consultation Paper, page 29.*

When there is more than one beneficiary of a cost being incurred, a standard approach is for costs to be allocated and recovered using a “beneficiary pays” principle. Costs should be allocated in proportion to the benefits that each beneficiary receives. This is widely accepted in both regulatory and general market contexts for infrastructure, shared services, and similar scenarios.

The RBA’s analysis of interest-free periods highlights that the RBA is loosely applying a beneficiary pays principle. It seeks to exclude financing of interest-free periods as a relevant cost, concluding that the benefits from interest-free periods do not “solely” accrue to merchants. But the benefit is not likely to solely accrue to card holders either – rather, both parties benefit and both parties should bear a share of the cost. The fact that the efficient share is difficult to quantify makes it no less relevant in principle.

- ***The categories of eligible cost should be expanded***

  Further analysis of cost categories suggests that the logic of the beneficiaries pay approach suggests that a number of cost categories currently excluded as ineligible costs should be included, with the proportions of included cost subject to some uncertainty. Nonetheless, even with relatively modest proportions of costs allocated to merchants, we find that the RBA has little basis to conclude that interchange fees are materially above costs and should be reduced.

We summarise our findings in Table 1: our cost assessment suggests a more reasonable approach to eligible costs would produce costs of around 0.5% for credit and 0.25% for debit.

Table 1: Comparison of eligible costs

<table>
<tr><th>Approach</th><th colspan="2">Domestic credit eligible cost (%)</th><th colspan="2">Domestic debit eligible cost (%)</th></tr>
<tr><td>RBA Issuer Cost Study</td><td colspan="2">0.10</td><td colspan="2">0.10</td></tr>
<tr><td>RBA Issuer Cost Study - Adjusted for ABA bank data# (%)</td><td colspan="2">0.16</td><td colspan="2">0.11</td></tr>
<tr><td>Adjusted RBA method plus partial attribution of other beneficial cost categories^</td><td>0.43</td><td rowspan="2">0.52</td><td>0.21</td><td rowspan="2">0.24</td></tr>
<tr><td>Equal split of beneficial cost categories to merchants and acquirers*</td><td>0.62</td><td>0.28</td></tr>
</table>

Source: Frontier Economics

*Notes: # Data is reconciled to match RBA totals across issuer costs. ^ A 25% attribution of currently non-eligible costs is included. * A 50% attribution of all eligible costs is included.*

Given that there are fixed costs in payments costs, the unit costs of smaller banks will be relatively higher again,[9] and lower caps will further harm their competitiveness in card issuing activity. However, this effect is not necessarily linear. It may be mid-sized banks are most impacted as we understand that smaller issuers, such as credit unions and mutual banks, outsource some payment services.

9 The RBA note in their Consultation Paper that evidence from their Issuer Cost Study points towards smaller issuers face materially higher costs than larger issuers.

The RBA also appears to understate the marginal effects of mobile wallet fees (currently levied by Apple) on issuer costs. Estimates based on historical data understate the current marginal costs of accepting mobile payments – with public estimates suggesting these fees may be as high as 6bp for debit and 15bp for credit transactions.

Key conclusion

Our analysis suggests that if interchange fees are to be set on a cost recovery basis, there is no basis to reduce fees from current levels.

Recommendations

The RBA's proposed approach in the Consultation Paper is likely to have significant negative effects on the payments system.

We recommend that:

- Rules relating to surcharge bans should be removed for both debit and credit transactions as surcharging is having a range of unintended consequences;
- Interchange fee caps and benchmarks should be retained at their current level for both debit and credit transactions; and
- The RBA should wait until it has regulatory powers for all payment systems before making any more interventions in the market. They should also assess the observed effect of removing the surcharge ban on MSF as pricing signals are strengthened before making any further changes.

We don't agree with any changes to interchange regulation. However, if the RBA insists, then regulatory changes should be highly targeted and limited to addressing barriers to competition on pricing in the small merchant market and disparities between large/small merchants - without affecting the overall economics of the issuing market

2 Introduction

2.1 The context and scope of this report

The Australian Banking Association (**ABA**) has sought advice from Frontier Economics on matters relating to the Reserve Bank of Australia (**RBA**'s) Consultation Paper on Merchant Cards Payment Costs and Surcharging.

The primary matter on which the ABA has sought advice is the suitability of the RBA's recommendations in the relation to the proposed reduction of credit and debit interchange fees. The RBA is consulting on a reduction in credit caps from 0.8% and the benchmark average from 0.5% to a single cap of 0.3%. Debit caps reduce to 6c or 0.12% from 10c and 0.20% respectively, and reducing the benchmark from 8c to 6c.

The RBA's direct cash flow analysis suggests that domestic card issuers are expected to experience an initial reduction in interchange revenue of around $900 million per year. The ABA is concerned that pulling this amount out of the payments system is likely to have detrimental effects on issuing activity and broader effects on the viability of the payments system.

This report sets out our analysis of the RBA's proposals, based on the views and analysis in its Consultation Paper.

2.2 The structure of this report

The report is structured as follows:

- Section 3 identifies the current market outcomes and trends in those outcomes over the last 10 years. This provides important context for the analysis of problems and responses.
- Section 4 analyses the RBA's identification of the problems and inefficiencies evident in the payments system.
- Section 5 review the RBA's issuer cost analysis and highlights concerns with the analysis being used to cut interchange fees.
- Section 6 provides our recommendations based on our analysis.

3 Current state and recent changes in payments

This section provides an overview of what has changed in the Australian payments space since the RBA's 2015-16 review, and subsequent changes to card payments regulation.

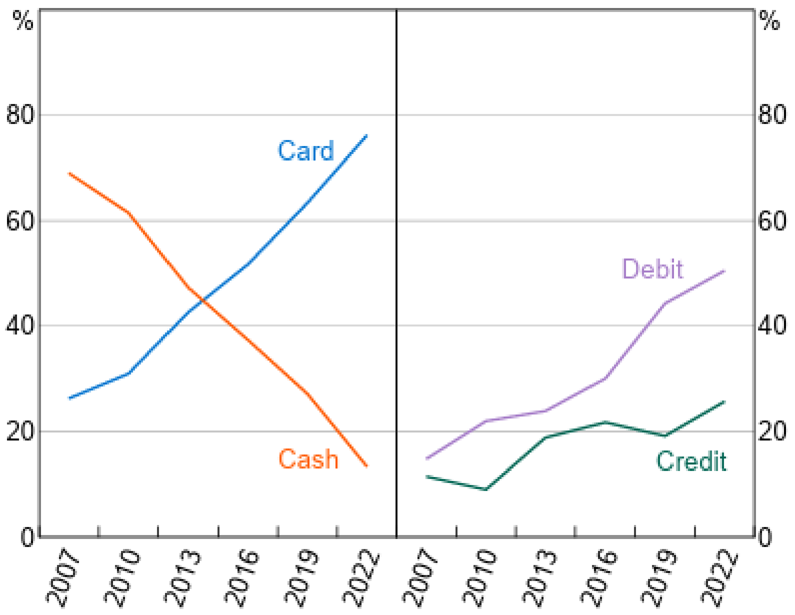
The developments that have occurred over time highlight that technological change and competition in the payments market is evolving rapidly. It is difficult to overstate the materiality of these changes and the significance of the investments that have underpinned them. Of course, these developments and innovations have not all taken place in the banking sector, but are having a deep impact on consumer benefits from the payments system and the way in which consumers use banking services.

3.1 A rapid shift away from cash, mostly to debit cards

A key change trend which has continued since 2015-16 is the shift from cash to card. As can be seen in Figure 1:

- The number of card payments exceeded cash payments in 2016 with similar relative proportions. By 2022 **card transactions outnumber cash transactions** by around **five to one**; and
- Debit card transactions exceeded credit card transactions by a small margin in 2016. By 2022, **debit card transactions outnumbered credit card** transactions by around **two to one**.

Figure 1: Cash and card payments - share of number of payments



Source – RBA (2023), Consumer Payment Behaviour in Australia Bulletin. Specific source for figure is "RBA calculations, based on Colmar Brunton, Ipsos and Roy Morgan Research.

While cash usage has fallen, it should be noted that this trend is not evenly distributed across society. Some demographic groups were more likely to have a higher proportion of high-cash users.[10] The RBA found that:

- 18% of respondents aged 65 and above were high cash users compared to 3% of those under the age of 50;
- 17% of people in the first household income quartile (lowest income) were high cash users, compared with only 2% in the fourth household income quartile (highest income); and
- 9% of people in regional/remote areas were high cash users compared to 7% in major cities.[11]

In the RBA's submission to the Inquiry into Bank Closures in Regional Australia, it suggested that around one-quarter of consumers would face "major inconvenience or genuine hardship if they could no longer access or use cash".[12] This highlights the outsized importance of cash, rather than debit and credit cards, to these more vulnerable parts of society.

Relatedly, the Australian Government announced its intention to mandate cash acceptance in December 2024.[13] The rationale that the Government provided for this decision included to promote social inclusion, enhance payment resilience, be proportionate and achievable; and be transparent and responsive.[14]

The details of the cash mandate are yet to be released, with the scope of the cash mandate expected to focus on "essential items". The government has stated its intention to introduce the cash mandate from 1 January 2026. The implication of this is that cash would remain a payment option for key purchases going forward.

The costs associated with maintaining cash usage are largely falling to banks – see Box 1.

Box 1: Funding the continuation of cash

The aggregate financial burden on banks to maintain Australia's cash distribution and access system is substantial and rising. Beyond the direct costs, it is estimated that banks collectively pay at least $100 million annually to support Bank@Post services, with additional volume-based fees likely adding a similar amount.

The net annual cost for major banks alone is conservatively estimated to be above $1.2 billion, a figure that would significantly increase when including non-major banks. Logically these costs disproportionately fall on banks with larger branch and ATM networks. It is likely that these banks with larger physical footprints effectively cross-subsidise some other banks' cash offering, especially those with few or no branches. As cash becomes an increasingly expensive payment method (in per transaction terms, with cash usage falling), there is a corresponding increasing urgency to find a sustainable solution in this part of the payments system which could form part of a whole of payment system review.

Source: ABA

10 Where a high cash user is defined as someone who uses cash for 80 per cent or more of their in-person transactions.

11 RBA (2023), Cash Use and Attitudes in Australia Bulletin.

12 RBA (2023), Submission to the Inquiry into Bank Closures in Regional Australia.

13 Australian Government: The Treasury (2024), Next steps in ensuring the of cash: Joint media release with The Hon Stephen Jones MP Assistant Treasurer and Minister for Financial Services.

14 Australian Government: The Treasury (2024), Mandating cash acceptance: Consultation paper.

3.2 Increased support for low-cost banking

The banking sector has increasingly responded to consumer expectations regarding the availability of low-cost banking services.

Fee-free banking began to be formally embedded in the Australian Banking Code of Practice with protections and minimum requirements for "basic accounts" or "low or no fee accounts" introduced in the Code updated in March 2020.[15] Key points include:

- The Banking Code defines basic accounts as those with no account keeping fees, free periodic statements, no minimum deposit requirements (except for government benefits accounts), free direct debit facilities, and access to debit cards at no extra cost;
- Basic accounts also offer free and unlimited Australian domestic transactions, although some ancillary services (like bank cheques or third-party ATM use) might still incur fees; and
- For eligible customers, which primarily include individuals holding Commonwealth concession cards such as pensioners or health care card holders, banks must offer additional protections like no informal overdrafts, no dishonour fees, and no overdrawn fees.

As a point of comparison for Australia in EU markets and the UK it is common practice for issuing banks to charge recurring account-maintenance fees to cardholders. By way of example, such fees in Germany have resulted in an average current-account cost of approximately €125 per annum in 2025.[16] Fees of a similar level can be found in Spain at approximately €160 per annum.[17] Some EU markets offer reduced fees for specific types of accounts (€28.9 per annum for online accounts in Italy[18]), but in some instances also charge other additional fees (France charges average account-maintenance fees of €21.13 as of April 2024, but also charges separate debit-card fees of just over €43[19]). In the UK, there are many "free-if-in-credit" accounts available, but paid current accounts are also common, especially "packaged" accounts, which bundle insurance perks alongside usual account functionality. For such accounts, monthly fees can range from roughly £5 to £20.[20, 21]

3.3 Online payments continue to increase

As illustrated in Figure 2, the share of payments made online is increasing. The RBA found that the overall number of consumer transactions made online was 18% in 2022, up from 12% in 2019.[22] The RBA had previously reported the equivalent figure to be flat at 13% in 2013, 2016 and 2019.[23] The latest seasonally adjusted numbers released by the RBA for the number of

15 See https://www.ausbanking.org.au/wp-content/uploads/2021/10/2021-5-Oct-Banking-Code-WEB.pdf.

16 https://www.giga.de/tech/ansage-von-stiftung-warentest-mehr-darf-euer-girokonto-nicht-kosten--01K33W8442V0MB4F99H1QC1X89

17 https://www.asufin.com/coste-comisiones-bancarias-al-alza/

18 https://www.bancaditalia.it/pubblicazioni/indagine-costo-cc/indagine-costo-cc-2024/index.html?dotcache=refresh&dotcache=refresh

19 https://www.banque-france.fr/system/files/import/ccsf/medias/documents/otb2024.pdf

20 https://www.thescottishsun.co.uk/money/14760373/lloyd-bank-fee-changes-millions-affected/

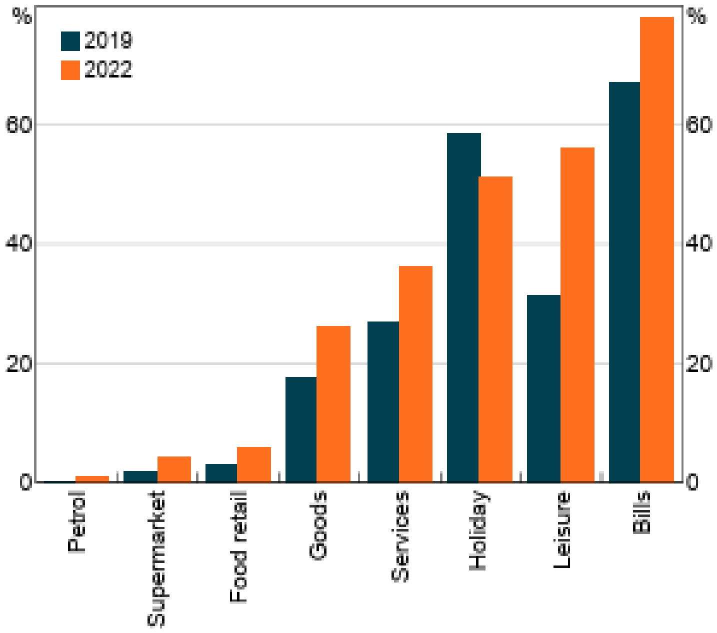
21 https://www.theguardian.com/money/2024/nov/23/packaged-uk-current-accounts-banks-extras

22 RBA (2023), Consumer Payment Behaviour in Australia Bulletin.

23 RBA (2020), Consumer Payment Behaviour in Australia: Evidence from the 2019 Consumer Payments Survey Research Discussion Paper.

transactions acquired in Australia for both debit and credit transactions indicate that in 2025 roughly 27-28% of all card-based transactions occur online.[24 25]

Figure 2: Online payments – share of payments made online



Source – RBA (2023), Consumer Payment Behaviour in Australia Bulletin. Specific source for figure is "RBA calculations, based on data from Ipsos and Roy Morgan Research."

Box 2: Increase in scams and fraud

A big change since 2015-16 has been an increase in the value of scams, with the online scams being a major driver of this change. Data from the Australian Competition and Consumer Commission (**ACCC**) estimated the total value of losses to scams in 2015 at $229 million. In 2024, the National Anti-Scam Centre estimates the equivalent value at $2 billion, which is down from a high of $3.1 billion in 2022.

Scams and fraud costs feature in Section 5 as an eligible issuer cost for recovery through interchange.

Source: ACCC (2016). Targeting scams: Report of the ACCC on scams activity 2015 and National Anti-Scam Centre (2025), Targeting scams: Report of the National Anti-Scam Centre on scams data and activity 2024

3.4 Use of mobile devices for card payments has exploded

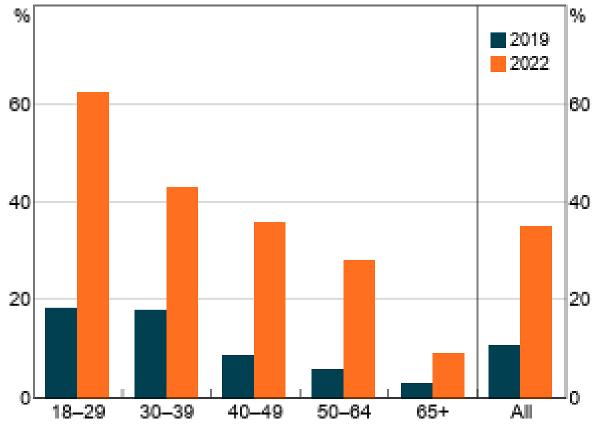
The use of mobile devices for card payments (using a mobile wallet) has increased markedly from 2019.

24 RBA (2025), Payments Data: C1.1 Credit and Charge Cards – Original Series – Aggregate Data

25 RBA (2025), Payments Data: C2.1: Debit Cards – Original Series

Based on RBA calculations from survey data, mobile wallet usage has increased from around 10% usage in 2019 to around 35% in 2022 – as shown in Figure 3 – with particularly strong usage among 18-29 year olds.

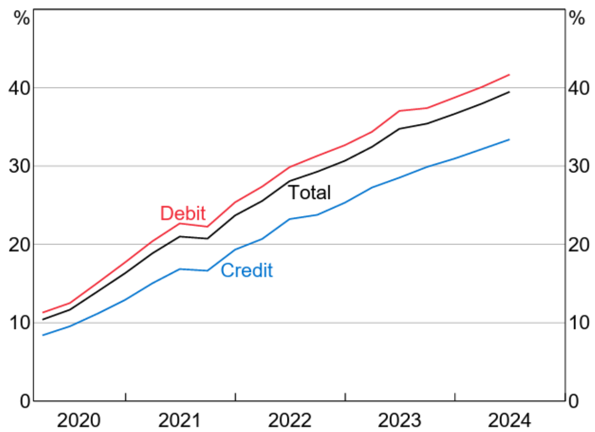
Figure 3: Use of mobile devices for card payments: share of respondents in each age group



Source – RBA (2023), Consumer Payment Behaviour in Australia Bulletin. Specific source for figure is "RBA calculations, based on data from Ipsos and Roy Morgan Research."

Another RBA source – shown in Figure 4 – places the share of card transactions in 2024 via mobile wallets at approximately 40%. The latest data released by the RBA show usage has continued to rise, with the total share of all card-present transactions that occurred through mobile wallets in June 2025 at approximately 50% of card transactions.[26] [27]

Figure 4: Mobile wallet transactions: share of card transactions



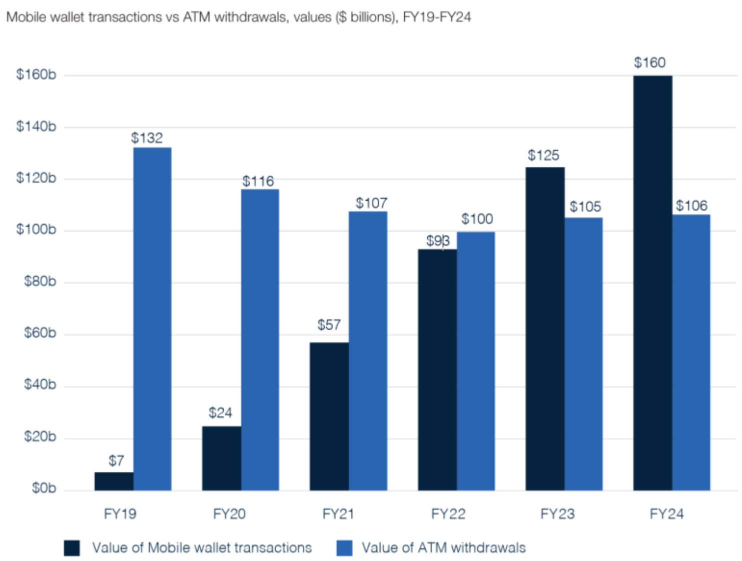
Source – RBA (2024), Payments System Board 2024 Annual Report.

ABA data further highlights that mobile wallet usage has grown rapidly year-on-year – see Figure 5.

[26] RBA (2025), Payments Data: C1.1 Credit and Charge Cards – Original Series – Aggregate Data

[27] RBA (2025), Payments Data: C2.1: Debit Cards – Original Series

Figure 5: Comparison of mobile wallet v ATM withdrawals, FY19-24



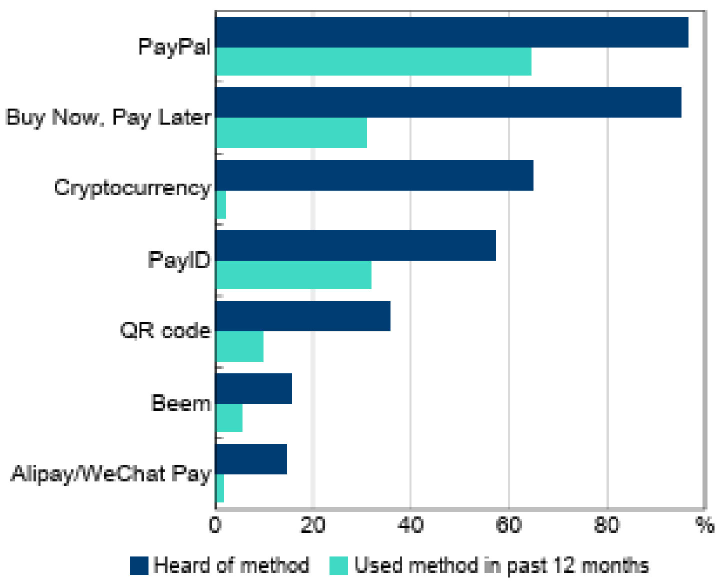
Source: ABA data collection, RBA ATM statistics.

3.5 Continued investment in and an increasing use of alternatives to traditional card-based payment methods

Related to increasing online payments and use of mobile for payments, there is evidence of increasing awareness and usage of alternative payment methods – see Figure 6

These alternative payment methods cover a range of services and technologies, with the key common feature being that they provide an alternative payment method to cash, credit and debit cards. PayID is the addressing service of the New Payments Platform, and other services such as Osko (near real time peer to peer payments) and PayTo (near real time debits) are common payment services that use the New Payments Platform.

Figure 6: Alternative payment methods: share of respondents, 2022



Source – RBA (2023), Consumer Payment Behaviour in Australia Bulletin. Specific source for figure is "RBA calculations, based on data from Ipsos."

Australia is also affected by global payment trends. International innovation in payment methods also continues apace. Examples include the increasing development and use of PayPal, Venmo, Zelle and CashApp in the USA and the use of WeChatPay and AliPay especially in China (with some sources stating each have over one billion active global users). As Box 3 below shows, in India, where there has been significant growth in digital payments using mobile phones, consumers have readily adopted new methods of making digital payments. Given that Australia is also experiencing significant growth in mobile payments, it is plausible that consumers in Australia would be willing to use mobile phone technology to make digital payments in new ways—such as account-to-account payments—if those payment methods are secure and cheaper than existing options.

Box 3: Digital payments in India

Digital payments have greatly increased in India in recent years. Some estimates have India accounting for almost half of global real-time digital payment transactions. There are a number of digital payment products in India including the Unified Payments Interface, National Electronic Fund Transfer, the Immediate Payment System and the Real Time Gross Settlement. Each system offers real time payments with different functionalities and fees. The Unified Payments Interface—which was launched by the Reserve Bank of India in 2016—is the dominant system, comprising around 75% of digital payments in India which equates to processing more than 15 billion transactions per month as of November 2024. The Unified Payments Interface uses technology-agnostic architecture which enables transactions across multiple third-party providers, including initiating transactions through a mobile phone number or QR code. Payments through the Unified Payments Interface have zero-transaction fees for purchasers. The level of uptake of digital payments in India is underpinned by use of mobile phones for payments – an increasing trend that is also being seen in Australia.

Source: Frontier Economics based on Bank of International Settlements Papers No 152: Faster digital payments: global and regional perspectives (2024), The organisation of digital payments in India – lessons from the Unified Payments Interface (UPI).

We note that the RBA is catching up to the changes in payment systems by seeking to broaden its regulatory powers through a proposed amendment to the *Payment Systems (Regulation) Act*.[28] Critically, updates to the legislation would expand the definition of 'payment systems' to regulate digital wallets, BNPL, etc.

3.6 Trends in card surcharges, merchant fees and interchange fees

3.6.1 Surcharging behaviour has changed

Data shows that card surcharging has increased over time. The RBA's 2022 Consumer Payments Survey found that survey participants paid a surcharge on 7.3% of transactions in 2022 compared to 4.7% in 2019. Notably, in 2019 surcharges were more common on credit card transactions than debit card transactions (5.5% compared to 4.3%) but this was no longer the case in 2022 with surcharging occurring on 7.3% of transactions for both credit and debit cards.[29]

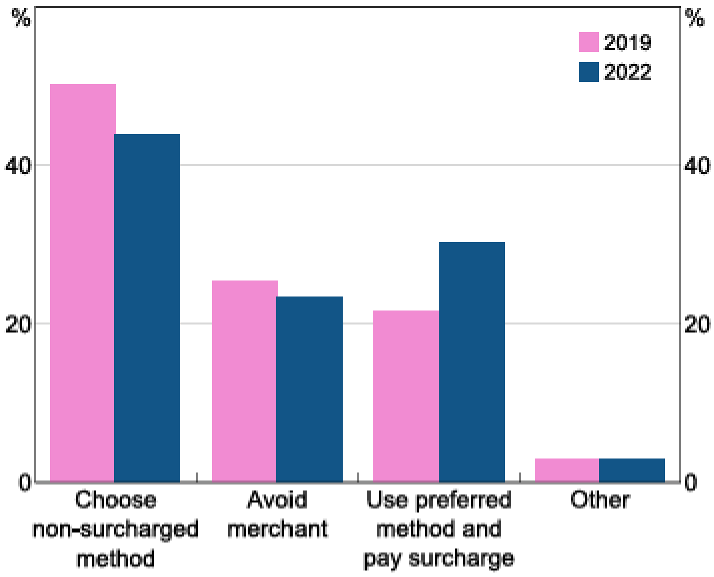
28 Through the *Treasury Laws Amendment (Payment System Modernisation) Bill 2025*

29 RBA (2023), The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey

The fact this gap has closed casts doubt on the extent to which surcharging is reflective of wholesale pricing (unless there has been a rise in fixed rate acquiring).

The 2022 RBA survey also shines a light on changing attitudes towards surcharging – shown in Figure 7. The biggest changes from 2019 to 2022 were a reduction in the share of respondents that would choose a non-surcharged method (from around 50% to around 42%) and an increase in respondents who would use the preferred method and pay the surcharge (from around 21% to around 30%).

Figure 7: Response to potential payment surcharge



Source – RBA (2023), The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey. Specific source for figure is "RBA calculations, based on data from Ipsos and Roy Morgan Research."

As part of the supplementary information provided in its review of merchant card payment costs and surcharging,[30] the RBA provided a snapshot of card surcharging in the 2023-24 financial year. This snapshot indicated that 11% of merchants surcharge. The share of merchants surcharging also varies by industry. It is most prevalent in the hospitality industry, where 33% of merchants surcharge. This is significantly higher than the next highest, which was business services at 12% of merchants. The remaining sectors (retail, travel, transport, government services and professional services) are in a relatively tight band of 6-10% of merchants surcharging.

Increasing propensity to surcharge has arguably contributed to the rise in innovative, albeit higher cost, payment platforms for merchants such as Stripe and Square. Those platforms provide in-person and online payment processing with an emphasis on bundled technology and software solutions and simple, flat fee pricing (in percentage terms) for the merchant, albeit typically at a higher acceptance cost than traditional bank acquirers.[31] However, if merchants can

[30] Specifically, FAQs: Review of Merchant Card Payment Costs and Surcharging. Available at: https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/faqs/review-of-merchant-card-payment-costs-and-surcharging.html and https://www.commbank.com.au/business/merchant-services/eftpos-terminals/single-rate-per-transaction.html [accessed 20/8/25].

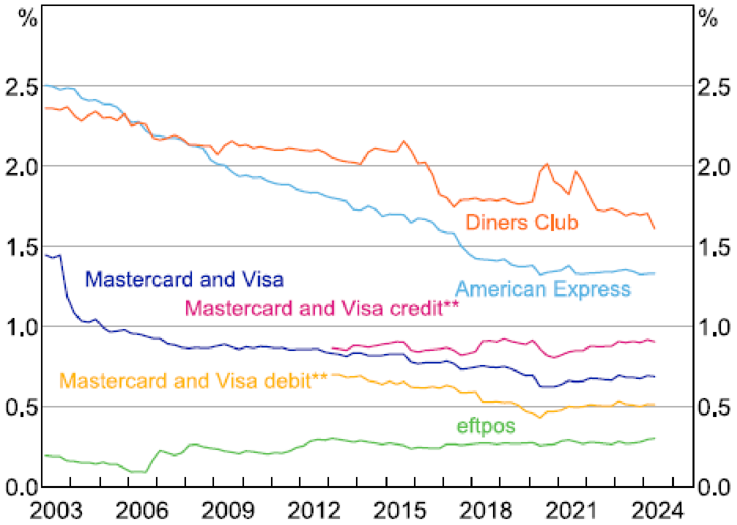
[31] See for example - https://squareup.com/help/au/en/article/5068-what-are-square-s-fees [accessed 25/8/25] and

pass on this additional cost through a surcharge, then the additional cost is likely to be of little concern.

3.6.2 Merchant fees show a long-term decline and recent stability

Trends in total merchant fees over time are shown in Figure 8. This shows a downward trend in merchant fees over time. Since 2016 there has been a fall in Visa and Mastercard merchant fees, albeit this appears to be driven by a reduction debit fees whereas credit has held largely constant. Returning to Figure 1 in Section 3.1, it is notable that, over the same period, the proportion of payments via debit has increased at a higher rate than payments via credit. The result is that, in 2022, approximately double the number of transactions were executed via debit payments compared to credit payments.

Figure 8: Total merchant fees: Per cent of transaction values acquired



* Series break in September 2020 due to change in reporting forms and in December 2022 due to change in collection coverage.

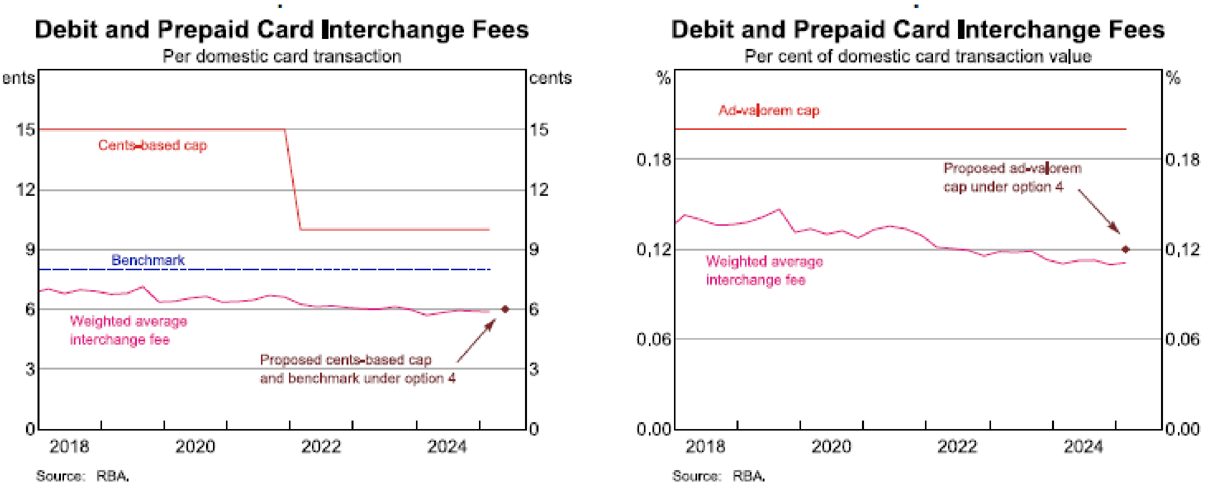
Source: RBA (2024), Merchant Card Payment Costs and Surcharging – Issues Paper.

3.6.3 Interchange fees show a pattern of decline, but it is unevenly distributed

The RBA data shows the weighted average interchange fee for debit and prepaid cards has fallen in both nominal dollar terms and percentage of transaction value terms over the period 2018-2024. However, focussing on the weighted average misses the underlying distribution of the interchange fee. As shown in Figure 10, strategic interchange fees (which are offered to some, typically large, merchants) receive lower interchange fees than non-strategic merchants. Data provided to us by the ABA show an increase in strategic merchants from around ~32-34% of total debit spend in 2020-21 to 36-38% in 2024-25. The equivalent increase for credit and commercial card spend is higher with strategic merchants increasing from ~20-22% in 2020-21 to ~27-29% in 2024-25. This increase in proportion of strategic merchants would reduce the weighted average interchange fee. However, there may still be other transaction with an interchange fee at, or near, the cap. These transactions at, or near, the cap would be negatively impacted by a reduction in the existing cap. It is important that the RBA understand the costs associated with these higher cost transactions to avoid any unintended consequences, such as negatively impacting the competitiveness of smaller banks in card issuing.

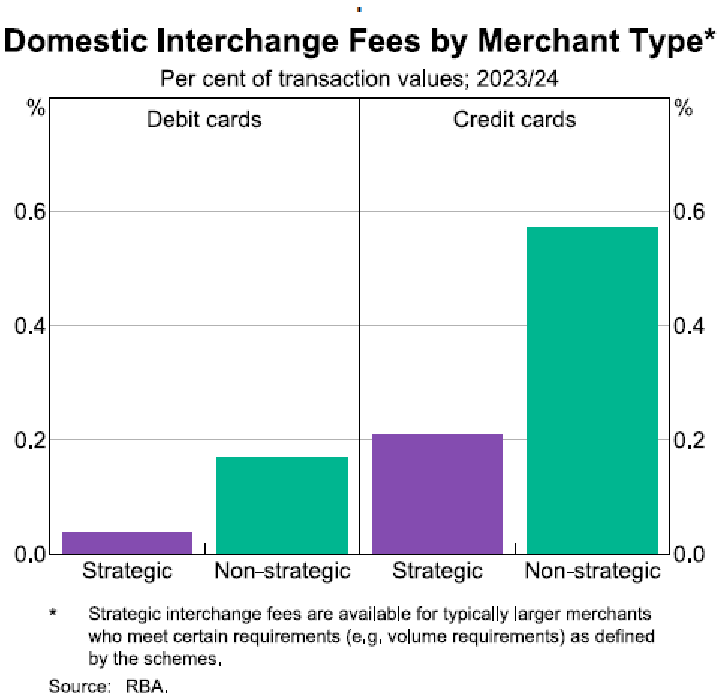
Interchange fees have also been affected by the introduction of least cost routing (Box 4).

Figure 9: Debit and prepaid interchange fees



Source – RBA Consultation Paper.

Figure 10: Domestic Interchange by Merchant Type



Source: RBA (2024), Merchant Card Payment Costs and Surcharging – Issues Paper.

Box 4: Least-cost routing of debit card transactions

Around 90% of Australian debit cards allow domestic payments to be processed by either the domestic debit network (eftpos) or an international debit network (Debit Mastercard or Visa Debit). That is, 90% of debit cards are dual network. LCR is a service provided by payment service providers to merchants to direct debit transactions to the network which charges less.[32]

In person (physical, card-present) LCR has been enabled by 76% of merchants, while LCR for online and mobile wallet transactions is a more recent development with lower levels of adoption.

It is important to note that there are different forms of LCR. There is a binary LCR approach where eligible transactions are routed to one debit network. Another approach is threshold LCR where transactions below a set transaction value are routed to one debit network and above the threshold to the other network. Finally, there is a dynamic LCR approach where lowest cost debit network is assessed and chosen on a transaction-by-transaction basis. The RBA states that most payment service providers use the binary or threshold approach, with "very few" payment service providers offering dynamic LCR. This reflects the complexity of LCR, and payments more broadly. Moreover, the RBA recognises that there may be 10-20% of merchants for which in-person LCR is not suitable for factors such as eftpos not having certain functionalities (such as pre-authorisations) and the merchant being sufficiently sophisticated to make its own routing decisions.

The RBA notes that it is unclear whether savings from LCR are being passed on to merchants, though the RBA does state:

> *There has been strong competition in recent years between the debit networks, which has resulted in reductions in wholesale costs and some convergence in these costs across the networks. The take-up of LCR is likely to have contributed to this competitive environment, with the networks offering new programs with heavily discounted interchange fees for some small merchants.*[33]

Moreover, while the RBA estimates that a formal LCR requirement for in-person transactions could lower wholesale costs by around $50 million per year, it goes on to say:

> *The relatively small size of the savings from a formal LCR requirement reflects the diminishing pool of merchants that could benefit and the very low difference in wholesale costs between eftpos and the international debit networks for in-person transactions.*[34]

The case of in-person LCR provides an illustration of both the complexity of the payments system and there being limited upside to further intervention in competitive markets where costs have been decreasing.

Source: Frontier Economics, drawing on RBA Consultation Paper.

32 "Following pressure from the Reserve Bank over a number of years, most banks and payment providers had introduced some form of LCR functionality for contactless debit card transactions by the middle of 2019." https://www.rba.gov.au/payments-and-infrastructure/debit-cards/least-cost-routing.html.

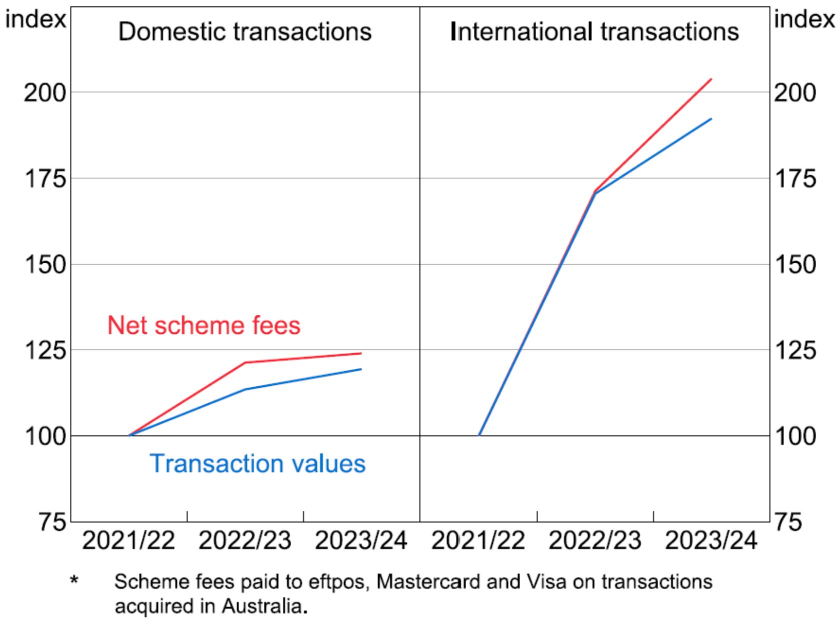
33 RBA Consultation Paper, p. 63.

34 RBA Consultation Paper p. 63.

3.6.4 Card scheme fees have risen over time

According to the RBA, on average, scheme fees account for around one-quarter of merchants' domestic debit card transaction costs and around one-sixth of domestic credit card transaction costs. For domestic transactions, scheme fees are higher (in absolute terms) for credit than for debit card transactions.[35] Data shows scheme fees increasing in recent years. As shown in Figure 11, scheme fees paid on domestic transactions have increased by around 20% from 2021-22 to 2023-24. The RBA has indicated that it is concerned by the current level of scheme fees in the Australian market and the pace of their growth over recent years.[36]

Figure 11: Acquiring scheme fees and transactions



Source – RBA Consultation Paper.

3.6.5 Use of mobile wallets is introducing additional costs

As discussed in Section 3.4, use of mobile devices for card payments has increased markedly in recent years. Customers clearly value the convenience of being able to pay using a mobile wallet. Such payments are also safer, with less fraud for merchants – given the mobile wallet user authentication needed on each transaction.

These transactions via a mobile wallet, incur an additional charge (depending on the mobile wallet provider). The ABA has previously provided data to the RBA on mobile wallet charges.[37] Notably, Apple Pay charges card issuers a per transaction fee whereas Google Pay and Samsung Pay do not charge. This means that a transaction via Apple Pay incurs an additional charge relative to an equivalent debit or credit transaction using either Android Pay or a physical card, making it a more expensive transaction for issuers and creating a risk of cross-subsidisation to cover the additional cost of these transactions.

35 RBA Consultation Paper.

36 RBA Consultation Paper, p. 50.

37 Australian Banking Association, *Review of Merchant Card Payment Costs and Surcharging: Consultation*.

4 Economics of payments and the RBA's problem definition

In this section, we explain that:

- The RBA identifies a number of problems with the operation of the payments system in relation to surcharging and interchange fees;
- This is a continuation of past interventions by the RBA that have highlighted challenges in regulating to increase economic efficiency in a payments system that has considerable economic complexity, is affected by rapid technological change and has patterns of conduct consistent with highly competitive markets;
- While there may be arguments to support the Bank's 'pro-competitive' interventions having regard to the characteristics of the Australian market, the proposals to further reduce interchange fees are both unnecessary and, indeed, may well be anti-competitive; and
- The RBA needs to further clarify its objectives with respect to the regulation of payments systems.

4.1 The RBA's analysis of problems in the payments system

The RBA's Consultation Paper highlights that the surcharging framework is no longer achieving its intended purpose:

> *The RBA's surcharging framework required the credit, prepaid and debit card networks to remove their 'no-surcharge' rules, thereby allowing merchants to apply a surcharge to card transactions. One of the key objectives of surcharging was to provide a price signal to consumers regarding the costs of payments, and incentivise them to choose lower-cost payment methods. However, the framework has become less effective due to a decline in consumers' cash use, the prevalence of single-rate payment plans among merchants and the difficulty of enforcing surcharging rules.*[38]

The RBA also contemplates three other problems that might require further regulation to address:

> *The PSB also recognises the case for addressing the large disparity in card payment costs between small and large merchants, the high costs for Australian merchants accepting international transactions, and the opacity and complexity of pricing across the card payments industry.*[39]

Although these problems do not specifically mention interchange fees, the RBA links payment card interchange costs to the surcharging "problem":

> *The PSB recognises that issues associated with card payment costs and surcharging are interconnected. Amendments to the surcharging framework without corresponding regulatory actions to lower card payment costs would simply redistribute costs in the payments system while allowing inefficiencies to remain.*

[38] RBA Consultation Paper, p. 8.

[39] RBA Consultation Paper, p. 8.

> *Action to lower merchants' card payment costs is therefore necessary, particularly if merchants' ability to surcharge consumers for those costs is no longer available.*[40]

While neither of the problems identified by the RBA are directly attributable to interchange fees, a key RBA recommendation is to reduce interchange fees. The connection between the stated problems and the proposed solution is not immediately apparent. From our perspective, it is far from clear that:

- Interchange fees would need to be lowered in conjunction with the (re)introduction of no surcharging, as even with no change in interchange fees merchants can increase prices to recover MSFs at current levels without any increase in the overall price level (that is, the price plus the existing surcharge);
- Interchange fees should reduce overall to reflect a concern that the gap or spread between higher and lower negotiated interchange fees is too large; and
- Debit interchange fees should be reduced below caps and weighted average benchmarks when these are already below their regulated levels – implying that competition rather than regulation is the effective constraint on fees.

We also note, changes to the *Payment Systems (Regulation) Act 1998*[41] passed parliament on 4 September 2025. This is a key legislative change to expand the RBA's regulatory powers to cover all payment systems, including three-party schemes, digital wallets and Buy Now Pay Later providers. The RBA has stressed the importance of these reforms many times and suggested that there is a *prima facie* case for certain participants to be brought under the broader PSRA regulatory umbrella:

> *the Bank also agrees that the PSRA should be capable of being applied to all entities that play a role in the payments value chain, including entities that facilitate or enable payments. For example, it will be particularly important to capture digital wallet providers, given strong growth in consumer use of digital wallets…*[42]

With the recent passage of the PSRA reforms, the requisite regulatory powers are no longer a hypothetical, there is a strong case for the RBA to conduct a full review of the payments system.

Box 5: RBA comments on costs to be recovered from cardholders

While we do not intend to infer intent, commentary in the RBA Consultation Paper appears to indicate a policy preference to shift more payment costs onto cardholders. The RBA notes that:

> *If the cost of these interest-free periods were…recouped from cardholders, cardholders would bear closer to the true cost of their credit card usage, which would lead to more efficient decision making in the payments system. Issuers could recover these costs…via higher cardholder fees or higher interest rates, or could mitigate these costs by shortening interest-free periods"*[43]

They extend this to credit risk, concluding:

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[40] RBA Consultation Paper, p. 8.

[41] Through the *Treasury Laws Amendment (Payment System Modernisation) Bill 2025*

[42] RBA Submission to Treasury Consultation Paper, 'Reforms to the Payment Systems (Regulation) Act 1998', July 2023

[43] *RBA Consultation Paper, page 29.*

> *Costs associated with credit risk and credit losses are standard features of the provision of credit to customers, which are most efficiently borne by the customer.*[44]
>
> The RBA appears to see this type of redistribution as desirable, noting that following prior interchange reductions:
>
> *There has been strong growth in credit card fees over recent years and some issuers have reduced the length of their interest-free periods from 55 days to 44 days", "demonstrating the ability of issuers to adjust these features.*[45]
>
> *Source: RBA Consultation Paper*

4.2 The economics of interchange and surcharging

Before further analysing the RBA's analysis of problems in the payments system, we briefly highlight some of the important lessons from the extensive economic study into payments systems.

4.2.1 Interchange fees have historically filled an important role in maximising system size and efficiency

The early literature on card schemes and interchange fees identified that interchange fees are an efficient mechanism to provide a means of ensuring that card transactions take place where the combined value to the cardholder and merchant exceeds the costs to issuers and acquirers. The interchange fee can balance the additional value that merchants obtain when cards are used over the alternative (say cash).

More generally, interchange fees were seen as an effective way of ensuring universal card acceptance in the early stages of a card network. Card networks need a way to ensure that merchants will accept their cards regardless of the card issuer, and a centrally set multilateral interchange fee (**MIF**) provides a means for a scheme to provide certainty to merchants and to ensure that issuers cannot use their negotiating position to unilaterally set a high interchange fee.[46]

It is evident that the size of the MIF also has important effects for competition and investment on either side of the issuing and acquiring sides of the card scheme (in a four-party scheme). A high MIF would be expected to encourage more competition and investment in issuing activity, however a low or zero MIF would not be expected to encourage acquiring activity.

[44] *RBA Consultation Paper, page 30.*

[45] *RBA Consultation Paper, page 29.*

[46] As described in Fletcher (2023).

4.2.2 Regulation of interchange fees can be justified but is complex to define and administer

The academic literature highlights that, in principle, surcharging can remove any need for interchange fee regulation.[47] But the conditions required for surcharging to lead to the efficient level of interchange fees are strong and may not be met in practice. Essentially, surcharging needs to be complete and costless for merchants and consumers. In that case, consumers that pay the surcharge are effectively the ones that receive the benefits from the higher interchange fees, so the effect is neutral.

The case for capping MIF is essentially that, with no surcharging, MIFs can be pushed inefficiently high. With no surcharging, schemes and consumers will not account for the externality that consumers using cards impose on consumers that do not use cards (or use a card with a lower MIF). When merchants spread the cost of card acceptance across their prices, customers that pay with lower-cost instruments will pay too much, and there will be little downside for payment schemes that set high interchange fees.

No agreement on how a cap should be set

The literature also suggests that there can be a range of other determinants of the 'efficient' MIF. Hence, while there is general support that MIFs might be set too high, there is much less agreement on how a cap should be set including because:

- Four-party schemes compete with other instruments including three-party schemes and BNPL that have no interchange fees; and
- There are a range of externalities and complexities that mean it is difficult to capture the full effects of interchange reductions on issuing banks.

Importantly, there is no particular support for a cap focused on issuing costs of the kind that is estimated by the RBA. Independent reviews of the economic case for capping interchange fees have concluded that:

> *...existing regulators (such as the RBA in Australia and the Federal Reserve Board in the U.S.) have used narrowly defined issuers' variable costs to determine the cap on allowed interchange fees. The problem with this approach is that it is not supported by any economic theory.*[48]

Indeed, there are good arguments to suggest that an approach based on avoidable or variable costs is neither consistent with fully competitive behaviour (as firms in such markets also need to recover common costs) nor consistent with standard regulatory approaches as used in other regulated sectors such an electricity, gas, rail or telecommunications.

As we discuss in Section 5, nor is it obvious that variable costs can be readily identified, as standard methods of cost analysis based on cost causality are complicated by payment transactions offering benefits to more than one party. That is, it is not just card issuers but also merchants and card acquirers that benefit from more transaction volumes.

47 A recent summary of the literature is provided in A. Fletcher, *Literature Review on Competition, Efficiency and Surcharging in the Retail Payment System*, A report prepared for the New Zealand Commerce Commission, 2023. This draws on earlier key literature from Baxter (1983) that provides an theoretical basis for interchange fees and Rochet and Tirole (2011) that provides a theoretical basis for finding that MIFs can, under certain reasonable conditions, exceed efficient levels, although there are many further aspects that are likely to influence MIFs set by card schemes.

48 Fletcher (2023), p. 47.

4.3 The RBA's problem identification

4.3.1 Is surcharging no longer fulfilling its role?

The RBA's initial intentions regarding surcharging were reliant on an assumption that surcharges would be reflective of merchant service charges and would be sufficiently clear, prominent and timely that consumers would act in a rational and informed way in relation to them.

Regulating conduct in dynamic, competitive markets to try to increase efficiency is challenging, and we should not be surprised that unintended consequences have emerged. A careful examination of the problems that the RBA observes indicates that changing behaviour has sent past regulatory interventions in unexpected directions. There is now evidence that:

- Consumers dislike surcharges, including because there is often no real alternative to card payments and there is a suspicion that merchants charge excessively;[49,50]
- Knowing that customers do not like surcharges but are a relatively small component of the total price, merchants would prefer to avoid drawing consumers' attention to them to increase sales (which the RBA terms 'inadequate disclosure'[51]);
- A small minority of businesses surcharge, yet consumers feel they experience surcharging often. This may be because surcharging is highly prevalent in certain industries (e.g., in hospitality, the RBA estimates that surcharges are levied by 33% of merchants[52] and may be more prevalent in some sub-sectors within hospitality); and
- A rule on merchants related to costs of card acceptance is likely to be hard to enforce given the complexity in merchant service fees (with different card schemes and different size merchants).[53]

The RBA has further noted that other conduct has emerged to thwart the RBA's initial intentions. This includes the increasing prevalence of surcharging on all transactions at the same prices due to merchants choosing single rate plans from payment service providers.[54]

We might also expect that, over time, the problems identified are likely to increase in magnitude. As merchants become less sensitive to higher payment prices (as consumers will bear the higher prices as a surcharge), there may well be more competition for merchants' business. But this competition will not be on the basis of lower merchant service fees but will instead focus on attracting merchants through non-price competition (e.g., free payment terminals) so that the payment services provider can earn higher margins from consumers. This will place upwards pressure on pricing and acquiring margins.

To some degree, we are also seeing elements of this occurring with the increasing success of payment providers that have high share in industries with high levels of surcharging but which

49 In 2019, the RBA noted that around a quarter of customers said they would avoid a merchant that surcharged. See https://www.rba.gov.au/publications/rdp/2020/2020-06/full.html.

50 On the other hand, consumers seem more positively disposed towards discounts. Stavis and Wu (2017) find that consumers' demand is highly elastic with respect to discounts. See Stavins, Joanna; Wu, Huijia (2017), *Payment discounts and surcharges: The role of consumer preferences*, Working Papers, No. 17-4, Federal Reserve Bank of Boston, Boston, MA.

51 RBA Consultation Paper, p. 12.

52 RBA, FAQs: Review of Merchant Card Payment Costs and Surcharging. Available at: https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/faqs/review-of-merchant-card-payment-costs-and-surcharging.html [accessed 2/9/25]

53 RBA Consultation Paper, p. 13.

54 RBA Consultation Paper, p. 12.

offer more expensive merchant plans than do major banks. Yet these providers have taken significant shares from their cheaper competitors.

Ultimately, we think that the RBA's conclusion that removing surcharging on designated card networks would increase competition and efficiency in the card payments system by focusing the incentive to make efficient payment choices on merchants via their choice of payment plan rather than consumers.[55] While we agree with the RBA's analysis and conclusions, we also think that it should give the RBA cause for further reflection: past regulatory interventions can and have resulted in unexpected outcomes, highlighting that the expected effects of regulatory changes should be (more) thoroughly considered.

4.3.2 No necessary connection between surcharging and interchange

The RBA's analysis of interchange seeks to draw a connection between surcharging and interchange:

> *The PSB recognises that issues associated with card payment costs and surcharging are interconnected. Amendments to the surcharging framework without corresponding regulatory actions to lower card payment costs would simply redistribute costs in the payments system while allowing inefficiencies to remain. Action to lower merchants' card payment costs is therefore necessary, particularly if merchants' ability to surcharge consumers for those costs is no longer available.*[56]

It is unclear what inefficiencies the RBA is referring to and there is little evidence that amendments to surcharging will redistribute payment systems costs.

That is, a ban on surcharges would not imply any direct changes in the costs of merchants as MSFs. With the ban, merchants could simply raise 'base' prices to cover revenues that are currently earned through surcharging. If desired, merchants can offer discounts to reflect the lower costs of accepting certain payment instruments. All of this can be achieved with no change in interchange fees; that is, surcharging has no specific connection to interchange fees.

It may also be true that if lower interchange fees were to lead to lower MSFs, then it may reduce the prices paid by consumers. But, again, this is entirely independent of whether surcharging is or is not allowed.

Later in the Consultation Paper, the RBA seeks support for lowering interchange fees based on the general proposition that unregulated MIFs would be higher than optimal – that is, would not maximise economic efficiency:

> *Competition in well-established payment card networks can counterintuitively result in higher interchange fees and thereby lead to higher merchant service fees and costs for consumers (RBA 2007; Fletcher 2023).*[57]

As observed above, we agree that such incentives can exist if merchants have limited ability to resist the continued use of a network's cards. But that is clearly not the same as saying that interchange fees should be reduced from their current levels.

However, the RBA goes on to say that:

[55] RBA Consultation Paper, p. 21.

[56] RBA Consultation Paper, p. 8.

[57] RBA Consultation Paper, p. 28.

> *The PSB has long held the view that this dynamic warrants regulation of interchange fees, which should be set by taking into account the costs borne by issuers in issuing cards and processing transactions, to bring the market closer to efficient outcomes.*[58]

As we also highlighted above, there are no good conceptual grounds for setting interchange fees solely on the basis of the costs borne by issuers in issuing cards and processing transaction, and there is no theoretical or empirical evidence that doing so would bring the Australian market closer to efficient outcomes.

4.3.3 The inequities between big and small merchants

The RBA states that it is concerned about disparities in interchange fees between big and small merchants:

> *Small merchants tend to pay high interchange fees, at or near the current regulatory caps. Lowering these caps would therefore benefit small merchants the most and reduce their cross-subsidisation of large merchants, improving the efficiency of the payments system for the broader economy.*[59]

The argument for cross-subsidy is based on the competitive dynamics within card schemes, which aggressively target strategic, typically large, merchants. Interchange fees play a key role in this competition. By offering lower scheme or interchange fees, card schemes can attract or retain large strategic merchants while shifting some or all of the associated costs to card issuers.

However, it appears that the issue is not that interchange fees are generally excessive or inefficient, but rather that smaller merchants pay disproportionately more compared to large merchants. This raises the question of whether the RBA's concern is primarily about the disparity in fees rather than the level of interchange fees *per se*. Would the RBA still find fault with the current interchange rates if both small and large merchants were subject to similar fee structures?

Furthermore, past regulatory interventions in Australia may have inadvertently contributed to these disparities. For example, the impact of LCR has largely been to incentivise the MasterCard and Visa debit schemes to win volume by targeting strategic merchants with low interchange to capture more scheme fees. While this is not problematic in itself, and functions as an additional source of competition in the payments system, in conjunction with the nature of the benchmark weighted average interchange fee arrangements, this has facilitated higher rates for smaller merchants. This in effect reduces the advantage of competition facilitated by LCR, because schemes are able to simply recover some of their "competed away" costs with higher interchange fees on smaller merchants. While in principle LCR should allow for smaller merchants to divert payments to lowest cost networks, it is unclear to what extent this is occurring given the reported outcomes. Rather than narrowing the gap, LCR has arguably widened the pricing disparity between small and large merchants.

We recommend the RBA further consider the evidence regarding interchange fee levels and the effects of prior policy measures when assessing whether further interventions are appropriate to address merchant fee disparities in the payments system. Past regulatory interventions can and have resulted in unexpected outcomes, highlighting the need for caution when introducing new interventions. In our view, the need for intervention should be established clearly before it is introduced. Even if such a case is made out, it is essential that the potential impacts of such changes are considered carefully before they are rolled out. Neither of these conditions appear to be met under RBA's current proposals.

58 RBA Consultation Paper, p. 29.

59 RBA Consultation Paper, p. 67.

4.4 There is no case for further reductions in interchange fees

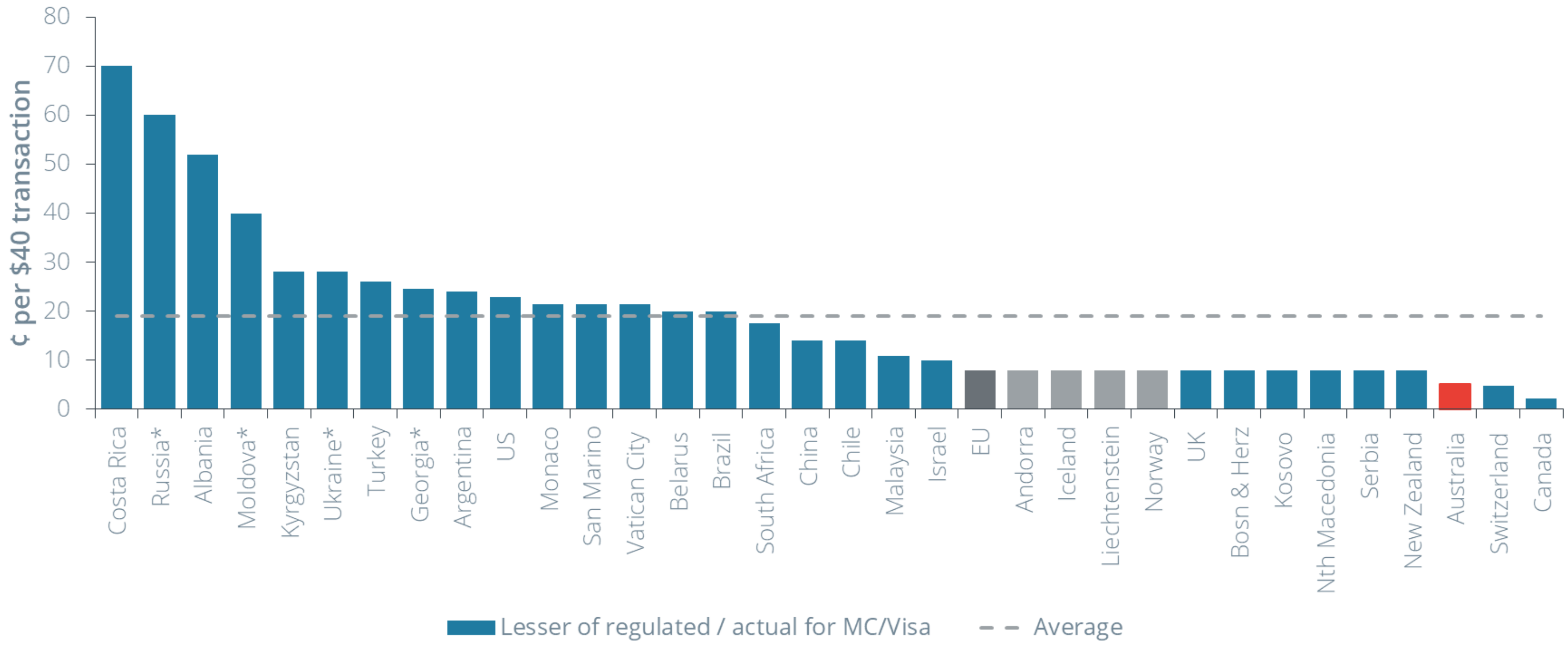
4.4.1 Interchange is not causing market distortions

We have identified that while the RBA may be correct in identifying certain undesirable outcomes in the absence of any regulation of interchange fees, it is a different question as to whether there would be an improvement from a further reduction in interchange fees.

As set out in Section 2 of this paper, there is no obvious evidence to suggest that interchange fees are too high. For example:

- The average level of debit interchange is below benchmarks and falling;
- The average level of credit interchange supports average merchant fees of below 1% of transaction value; and
- Independent comparisons of interchange rates shows Australia's credit rates are not excessive—well below average rates—and its debit interchange rates are already amongst the lowest in the world. SeeFigure Figure 12 and Figure 13 based on data collected by the Kansas City Fed.

Figure 12: Debit card interchange rates (Visa / MC)

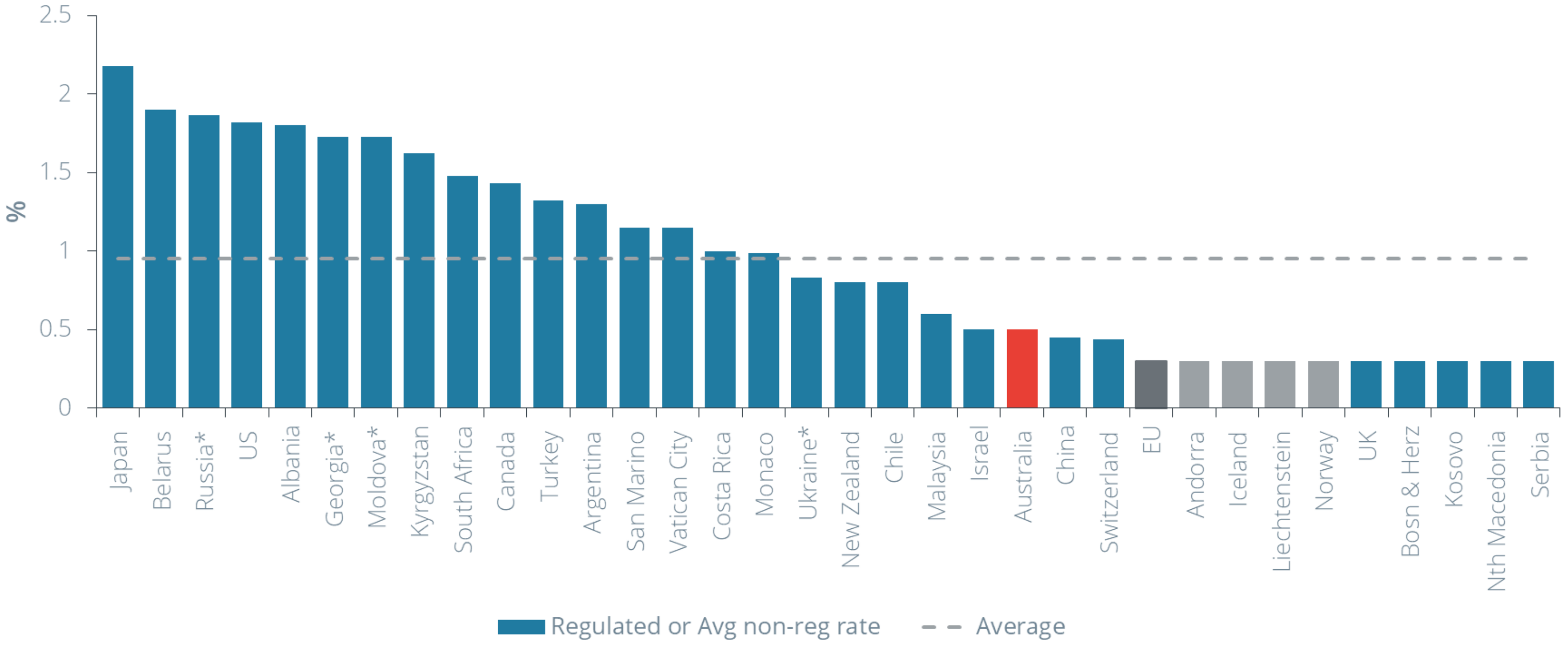


Source: Frontier Economics analysis of Kansas City Fed data

Note – light grey bars indicate European Economic Area countries which are subject to EU interchange regulations (despite not being in the EU)

** - Calculated using combined credit and debit transactions*

Figure 13: Credit card interchange rates (Visa / MC), Retail face-to-face



Source: Frontier Economics analysis of Kansas City Fed data

Note – light grey bars indicate European Economic Area countries which are subject to EU interchange regulations (despite not being in the EU)

** - Calculated using combined credit and debit transactions*

4.4.2 There are key differences between Australian markets and lower interchange markets

In making the case for reducing credit interchange fees, the RBA argues that:

> *These reductions would bring credit interchange fees into line with jurisdictions such as Europe and the United Kingdom.*[60]

The RBA downplays the substantive structural differences between payment systems in these jurisdictions that mean, on a comparable basis, Australian networks:

- have higher costs; and
- derive lower revenues than either comparable system; and, moreover,
- there are other market structural differences that mean issuers in Europe and the UK are in a better position than Australian issuers.

Costs

One of the most significant cost drivers is **volume**. The EU and UK represent vastly larger markets when combined, with hundreds of millions of banking customers and transactions flowing through integrated, often pan-European, payment networks. This immense scale brings substantial cost efficiencies, particularly in areas such as transaction processing, technology infrastructure, and compliance. By contrast, Australia—with a population around 26 million—has a much smaller transaction base. This limit to scale means that both fixed and variable costs must be spread over fewer accounts and transactions, resulting in higher per-transaction costs for payments and banking services.

Another major consideration is the **higher distribution costs** in Australian banking, primarily due to the country's vast and sparsely populated geography. Unlike the densely clustered populations of the UK and the urbanized areas of Europe, Australia's regional and rural communities require banks to support extensive branch networks, ATMs, and service points across great distances and drive higher cash distribution costs.

Revenues

On the revenue side, there are also material differences.

In the UK, one notable feature is higher revenue from fees. UK banks and payments providers historically rely on significant fee-based income streams including monthly account fees, overdraft charges, and transaction fees. Compared to Australia, European banks often maintain a broader spectrum of fee-charging account types, leading to higher overall fee revenue per customer (as discussed in Section 3.2).

International interchange payments represent another key area of difference. Both UK and Australian banks generate interchange revenue from international card transactions, but the level tends to be higher in the UK due to more frequent cross-border payments given the proximity to, and level of economic activity, between Europe and the UK. There is a similar cross-border payments effect in the EU, noting that this includes adjacent European countries not subject to EU interchange rules and, hence attract the much higher cross-border rates (e.g. EU issued cards being used in Albania, Serbia etc.).

[60] RBA Consultation Paper, p. 32

In Australia, regulatory requirements[61] further shape revenue streams. Australian regulations require major banks to provide fee-free basic accounts to customers meeting certain conditions, particularly vulnerable or disadvantaged groups. This requirement—a departure from the general tendency for higher fees found elsewhere in the world—limits the amount of fee income banks can generate from basic transaction accounts and pushes Australian banks to rely more on interest margin or bundled service offerings for profitability. While some Australian banks do still charge fees on premium products or additional services, the regulatory emphasis on providing accessible, fee-free banking means total fee revenue is lower than in the UK, influencing the overall revenue mix for Australian banks.

Other market structure differences

The absence of a national debit network in the UK also has meaningful effects on payments and banking revenues. In the UK, most debit card transactions are processed through international card networks such as Visa and Mastercard, instead of a lower-cost domestic system.

This structure leads to several revenue implications:

- **Higher Revenues for Card Issuers:** With no domestic debit network like eftpos, UK banks and card-issuing institutions earn revenue from interchange fees set by global card schemes. These fees are higher than those charged by domestic networks, meaning banks generate greater income per transaction—particularly for purchases at merchants who must route both debit and credit transactions through international networks. This increases overall card revenues for banks and payments companies.

- **Merchant Costs:** The reliance on Visa and Mastercard increases costs for UK merchants, as domestic routing options with lower interchange are absent. In Australia, eftpos offers a lower-cost alternative for merchants on debit transactions, putting downward pressure on card acceptance costs and, by extension, on the associated interchange revenue for banks.

- **Payments Mix and Consumer Choice:** Without a domestic debit scheme, the UK card market remains tightly bound to international scheme rules and pricing, limiting competitive downward pressures on fees. In Australia, the presence of eftpos enables card routing choice, encouraging competition among schemes and moderating revenue from interchange for issuers.

When compared to EU limits on debit fees, we note that these are capped broadly at 0.2% or 10 euro cents per transaction (AUD 18c), assuming that EU banks operate at, or close to, the cap then this is materially higher than the weighted average interchange of around 0.11% or AUD 6c (as previously shown in Figure 9)

Box 6: Comparison of merchant service fees between Australia and Europe

It is unclear on what basis the RBA is making the assertion that merchant service fees are materially lower in Europe and the United Kingdom when compared to Australia. The RBA has not provided, cited or referenced any data that would validate this claim. Given that, in our understanding, the primary goal of the proposed changes to reduce overall merchant service fees through reduced interchange, it is important that the link between MSF and the level of interchange be strongly established.

[61] Principally the ABA, Banking Code of Practice.

Our own analysis of merchant service fees in Europe and the United Kingdom has raised significant concern that the proposed relationship between MSF and interchange fees that the RBA has presented is, at a minimum, not a significant one. In fact, there is reasonable evidence to suggest that in several countries, despite a lower interchange level, overall merchant service fees are actually higher than those found in Australia.

While a directly comparable cross-country study of credit and debit interchange fees isn't available, it is possible to compare the processing fees of several payment services providers (Square and Sumup) present in Australian and the European/UK markets. Logically these fees must be broadly comparable with standard merchant service fees to remain competitive. That said, even if we avoid drawing inferences from the absolute value of the fees directly, they can still be directionally informative.

Payment Service	Australia [1], [5]	United Kingdom [2], [6]	Ireland [3], [7]	France [4], [8]
Square - Card Present	**1.6%**	**1.75%**	**1.75%**	**1.65%**
Square - Card Not Present	**2.2%**	**1.4% + £0.25** UK Cards **2.5% + £0.45** non-UK	**1.4% + €0.25 + VAT** EU & EEA Cards **2.9% + €0.25 + VAT** UK & Non-EEA Cards	**1.4% + €0.25** EU & EEA Cards **2.9% + €0.25** UK & Non-EEA Cards
Sumup - Card Present	**1.4%**	**1.69%**	**1.69%**	**1.75%**

Where it has been possible, we have also examined the fees of major banks. When comparing the publicly available "simple rates" of Commonwealth Bank, NAB and Westpac in Australia with NatWest, Barclays and Lloyds in the United Kingdom, we see that even the top of the range of interchange fees for Australia bank (a 1.2% flat fee per transaction) is below the lowest of the range for the UK (1.39% + £0.05 per transaction).

Market	Bank/Brand	"Simple rate"
Australia	Commonwealth Bank [9]	**1.10%**
	NAB [10]	**1.15%**
	Westpac [11]	**1.2%**
United Kingdom	NatWest (Tyl by NatWest) [12]	**1.39% + £0.05**
	Barclays (Barclaycard Anywhere) [13]	**1.60%**
	Lloyds Bank (Cardnet) [14]	**1.75%**

Broadly, Australian payment service provider and bank fees are either lower than European equivalents, or are at a minimum roughly on-par, even as interchange fees remain lower in Europe and the UK. Given this, it seems questionable to cite Europe and the UK as evidence that further reduction in interchange fees in Australia would result in lower MSF. If anything, bringing Australian interchange levels "into line" with EU and UK levels might be expected to bring Australian MSF "into line" with EU and UK levels, which is to say that MSF might increase.

Source: [1] https://squareup.com/au/en/pricing, [2] https://squareup.com/gb/en/pricing, [3] https://squareup.com/ie/en/pricing, [4] https://squareup.com/fr/fr/pricing, [5] https://www.sumup.com/en-au/payment-processing-pricing/, [6] https://help.sumup.com/en-GB/articles/4oI3qHHji2I2S9dyvRfec3-pricing-fees, [7] https://help.sumup.com/en-IE/articles/4oI3qHHji2I2S9dyvRfec3-pricing-fees, [8] https://www.sumup.com/fr-fr/tarifs/, [9] https://www.commbank.com.au/business/merchant-services/eftpos-terminals/single-rate-per-transaction.html, [10] https://www.nab.com.au/business/payments-and-merchants/accepting-in-person-payments/eftpos-terminals, [11] https://www.westpac.com.au/business-banking/merchants-and-payments/eftpos/mobile/, [12] https://www.tylbynatwest.com/card-machines/pricing-fees, [13] https://www.barclaycard.co.uk/business/business-matters/merchant-services/compare-card-machines, [14 https://www.lloydsbank.com/business/take-payments-with-cardnet/our-prices.html]

4.4.3 Substantial efficiency gains from further interchange reductions are highly unlikely

The RBA seeks to promote the proposals as increasing economic efficiency. However, the distributional analysis presented by the RBA in the Consultation Paper highlights that the efficiency justification is not convincing as it involves substantial transfers between different types of users to achieve modest efficiency gains. Even these modest gains are open to question.

Table 2: Direct cash flows effects on the Payments System

In the first year of policy changes, relative to status quo

	Preferred package
	$ million
Consumers	1,225
Merchants	
– Small merchants[(a)]	185
– Larger merchants	-260
Payments industry	
– Domestic issuers	-880
– Card networks	–
– Acquirer and PSP implementation costs	-25

(a) Defined as merchants processing less than $10 million in card transactions per year.

Source: RBA Consultation Paper, Table 9.

The RBA's analysis presents consumers as large "winners" from the proposals. In practice, this is unlikely. It is true that, other things being equal, consumers would benefit from no surcharges. But this would only be an equilibrium outcome if all of the merchant surcharging was "excessive" (above the costs of card acceptance). Assuming the current surcharging regulations were having their desired effect, it is far more likely that surcharging merely facilitated cost recovery. Therefore, the lost revenue would need to be made up by merchants in other ways.

With no change to interchange fees, one would simply expect merchants to raise their prices to consumers to recover the costs of merchant service fees that they currently pass on to consumers. Consumers would be no better or worse off.

We can therefore see that the benefits postulated by the RBA entirely rely on reductions in interchange fees. In turn, the RBA relies on the full pass through of interchange reductions through to payment service providers, and then on to merchants. That is, the RBA assumes that acquirers would pass on changes in interchange fees as reduced MSFs one-for-one, and merchants would pass lower MSFs as lower retail prices one-for-one (with the additional layering of changes in interchange fees for small and large merchants).

The empirical evidence is quite mixed as to whether these expectations are realistic. Some observations from empirical work relating to changes in Europe and the United States are offered in Box 7. This work raises particular questions about the likely behaviour of merchants and the impact of lower interchange fees in delivering increases in a range of banking fees (rather than reductions in cardholder rewards alone).

After the Durbin Amendment was introduced as part of the Dodd–Frank Wall Street Reform and Consumer Protection Act in 2010, giving the Federal Reserve the ability to cap interchange fees, it was estimated at the time that the total reduction in fees would be roughly $9.4 billion annually.[62] This annual savings estimate has since been revised downwards in the academic literature to approximately $7 billion in 2015,[63] and more recently to $6.5 billion in 2019.[64] If this reduction in interchange was passed on to merchants by acquirers in the form of lower fees, and then on to consumers by merchants in the form of lower prices, this would represent a substantial benefit to consumers. However, the same literature which provides those estimates is sceptical that much if any of that benefit ultimately made its way to consumers.

Evans et al (2015) uses Event Study Analysis and stock market data to examine the perception of investors regarding the impact of the Durbin Amendment on retailers and banks. It found that merchants passed on some of their savings to consumers through lower costs and better services. However, banks also passed on some of their lost revenue to consumers through higher costs and fewer services. The net results of these two effects were a loss for consumers of between US$22 billion and US$25 billion.[65] The implication of this is that it is not clear whether the RBA's proposed reform would be of net benefit or cost to consumers.

62 https://web.archive.org/web/20130511213215/http://education.cardhub.com/interchange-fee-study-2010/

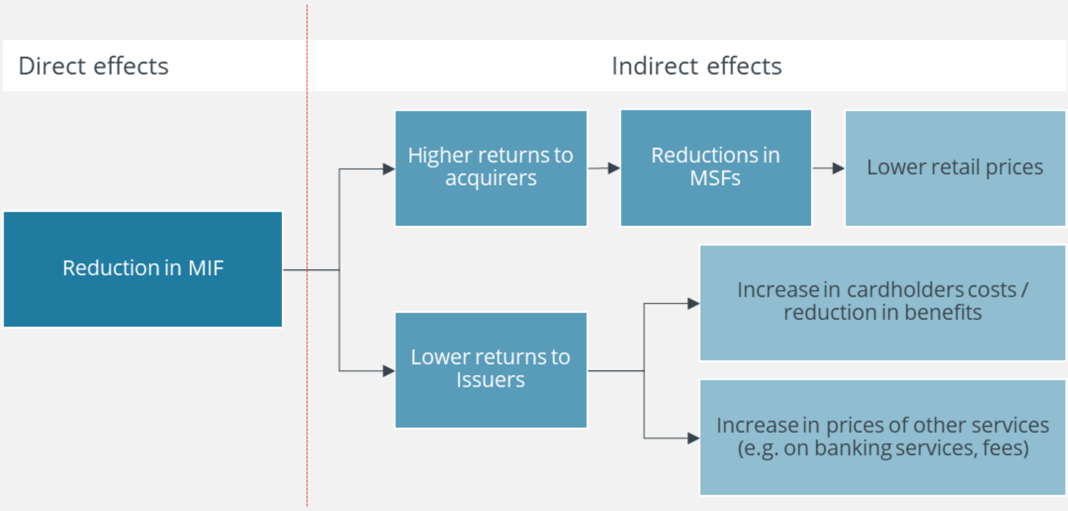
63 Evans, D. S., Chang, H., & Joyce, S. (2015). The impact of the US debit-card interchange fee regulation on consumer welfare. Journal of Competition Law and Economics, 11(1), 23-67.

64 M. Manuszak and K. Wozniak, The Impact of Price Controls in Two-sided Markets: Evidence from US Debit Card Interchange Fee Regulation, 2017, https://www.federalreserve.gov/econres/feds/the-impact-of-price-controls-in-two-sided-markets-evidence-from-us-debit-card-interchange-fee-regulation.htm.

65 Evans, D. S., & Mateus, A. M. (2011). How changes in payment card interchange fees affect consumers fees and merchant prices: An economic analysis with applications to the European Union. Available at SSRN 1878735.

Box 7: Empirical findings on the effects of reductions in interchange in the EU and US

Broadly speaking, we are interested in the empirical literature which highlights the following effects on lower MIFs – on both issuer and acquirer sides of the market.



We have been most interested in identifying studies that have examined reductions in MIFs to levels that are similar to those now proposed by the RBA.

In **Europe**, there are a number of studies of the 2015 reforms:

- A study prepared by Edgar Dunn & Co in 2020 identifies significant downside impacts to consumers and limited policy efficacy post IFR in EU.

  > *The reduction in MSC of 18bps was lower than the weighted average reduction in interchange across credit and debit of 32bps…Where merchants received a lower MSC as a result of capped interchange rates, there is no available evidence of whether merchant to consumer pass through took place.*[66]

- An earlier 2017 EY & Copenhagen Economics review of EU IFR outcomes prepared for the European Commission covers only a limited time period post-reforms. They report that the IFR reduced consumer card interchange fees by around 35%, saving approximately €2.7 billion annually in fees and lowering costs for merchants. However, the report also uncovered some unexpected and negative effects. The decrease in interchange fees did not fully translate into lower merchant service charges because acquirers increased their margins and other fees, such as card scheme fees, partially offsetting merchant savings. These rising scheme fees, particularly from international schemes, eroded some of the cost reductions intended by the regulation.[67]

- In 2025, the UK Payment Systems Regulator released a report on card scheme and processing fees. This report was primarily focused on concerns about the level of competition in the payments system and whether or not Mastercard and Visa were empowered to set excessive fees as a consequence of facing limited competition. While the paper did not specifically address interchange (and in fact noted that the question of interchange was *"outside the scope of this review"*), the components of

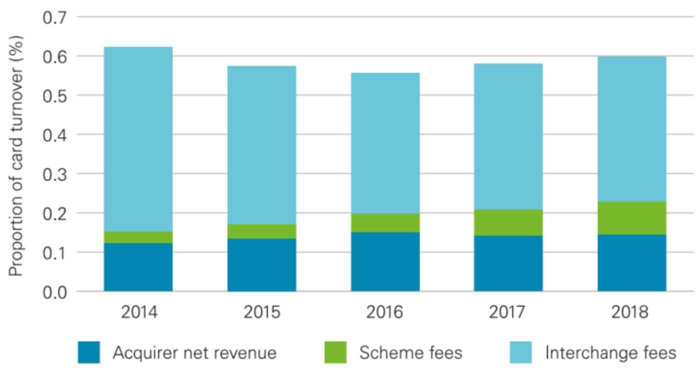
[66] Edgar Dunn & Co, Interchange Fee Regulation Impact Assessment Executive Summary, January 2020. The report was commissioned by MasterCard.

[67] EY / Copenhagen Economics, Study on the application of the Interchange Fee Regulation, Final Report, 2020.

average merchant service fees in the UK over time was explored in the following graphic. It shows that, while interchange fees are shrinking over time (notably falling from 2014 to 2015 due to the 2015 IFR reforms), the overall MSF remains largely constant. The cause for this appears to be that, even as interchange shrinks, Scheme fees absorb the difference. The implication being that the reduced revenue of UK issuing banks is being more-or-less transferred directly to the international card schemes, leaving merchants no better off.[68]

Market review of card scheme and processing fees: final report MR22/1.10

Figure 1: Average merchant service charge as a percentage of card turnover split by acquirer net revenue, scheme and processing fees and interchange fees



Source: MR18/1.8, Card-Acquiring Market Review: Final report, paragraph 5.13 and Figure 11.
Scheme fees (shaded green) in this figure includes scheme and processing fees.

Source: Payment Systems Regulator (2025), Market review of card scheme and processing fees: Final report

- The 2025 review by the UK Payment Systems Regulator built on prior work that directly investigated the effect of the Interchange Fee Regulation, EU legislation that went into effect in 2015 that placed a cap on interchange fees. A distributional analysis examined the degree of pass-through of reductions in interchange fees. In other words, how much of the savings to acquiring banks were passed on to merchants in the form of lower MSF (referred to as MSC in the table below). Consistent with the above figure, it found that except for very large merchants with over £50 million in annual card turnover, virtually none of the reduction in average interchange fees from the introduction of the IFR cap was passed through to merchants in the MSF.[69]

Table 2: Average interchange fees and average MSCs before and after the IFR caps came into force by merchant type

	Small and medium-sized merchants					Large merchants			All merchants
	<£15k	£15k–£180k	£180k–£380k	£380k–£1m	£1m–£10m	£10m–£50m	>£50m	IC++	
Difference in average *interchange fees* before and after IFR caps	-0.19	-0.17	-0.16	-0.16	-0.15	-0.13	-0.07	-0.18	-0.17
Difference in average *MSC* before and after IFR caps	-0.03	-0.02	0.00	-0.00	-0.02	0.01	-0.07	-0.2	-0.02

Source: PSR analysis of data provided by the five largest acquirers.

68 Payment Systems Regulator (2025), Market review of card scheme and processing fees: Final report

69 Payment Systems Regulator (2021), Market review into card-acquiring services: Final report

Source: Payment Systems Regulator (2021), Market review into card-acquiring services: Final report

In the United States, there are several studies of the Durbin amendment that reduced debit interchange fees:

- Research by Federal Reserve Bank of Richmond in 2014 focused on determining whether the Durbin amendment achieved its purpose in lower the prices merchants offered consumers. Its survey of over 400 merchants across 26 sectors of the economy found:

  > *"The majority of respondents (75 percent) reported no price change due to the regulation. For those who had a price change, 11 times more (23 percent over 2 percent) reported price hikes than cuts."*[70]

- 2017 research for the Federal Reserve Board on market adjustments post Durbin reforms shows the market adjusted in response to interchange cuts:

  > *To examine the ways that banks adjusted their account prices in response to the regulatory cap on interchange fees, we exploit the cap's differential applicability across banks and account types, while accounting for equilibrium spillover effects on banks exempt from the cap. Our results show that banks subject to the cap raised checking account prices by decreasing the availability of free accounts, raising monthly fees, and increasing minimum balance requirements, with different adjustment across account types.*[71]

- A 2019 working paper (Sarin and Mukharlyamov) found that the reforms had not had clear benefits:

  > *The objective of Durbin was to increase consumer welfare. For consumers to benefit, banks needed to not offset Durbin losses and merchants needed to pass through savings to consumers. Instead, we find causal evidence that banks fully offset losses by charging higher fees for their products: For example, following Durbin, the provision of free checking accounts decreases by 40 percentage points. On the merchant side, we find that retailers passthrough savings most when debit usage is common and when competitive pressures are highest. However, we find little evidence of across-the-board consumer savings.*[72]

Source: Frontier Economics, references cited.

4.4.4 Setting caps too low for interchange fees is more likely to produce worse system outcomes than caps that are too high

Interchange fees have already been substantially reduced through past RBA interventions. But we understand that the RBA's estimation of 'eligible costs' indicates that it recognises there is a case for positive interchange fees. As we will highlight in the following section of this report, the

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70 Wang, Schwartz, and Mitchell, The Impact of the Durbin Amendment on Merchants: A Survey Study, Economic Quarterly of the Federal Reserve of Richmond, 2014.

71 M. Manuszak and K. Wozniak, The Impact of Price Controls in Two-sided Markets: Evidence from US Debit Card Interchange Fee Regulation, 2017,

72 V. Mukharlyamov & N. Sarin, The Impact of the Durbin Amendment on Banks, Merchants, and Consumers, available at: https://www.law.nyu.edu/sites/default/files/Mukharlyamov_Sarin_2.4.2019_0.pdf.

RBA's estimation of eligible costs is not a precise, scientific exercise – rather, it primarily appears directed at reducing card issuers' ability to offer 'excessive' rewards to card holders. In that light, we consider it is worth asking whether, if the RBA was to err in its approach to regulating interchange fees, would it better for it to err on the high or low side?

Risks of setting fees too low

The most obvious effect of setting caps too low would be that it would reduce the profitability of issuing activities. This will likely reduce consumer benefits from card holding – higher fees, reduced interest fee periods, fewer rewards etc. But there will also be other potential implications that are also important.

The first is that setting interchange too low will likely produce **adverse effects on competition**:

- The most direct effect are adverse effects on competition between issuers, particularly with regards to mid-sized and regional banks who are both likely to have issuing costs that are close to or higher than the proposed cap, and incur significant costs in the provision of banking services – meaning they will be less able to compete in issuing activities. Recent developments in card issuing markets suggest structurally declining profitability is already impacting competition.[73]
- There are also likely to be significant effects on competition between card schemes, three-party card schemes, and BNPL suppliers. This effect could be exacerbated over time as setting the interchange fee too low would discourage investment by impacted issuers.

It would be most undesirable for interchange regulation to undermine the competitive process.

The second effect is that it could reduce the **capability of the broader payment ecosystem**. The connections between interchange and the broader payment ecosystem means the RBA should be alive to how the ecosystem would function under material cuts to interchange. A consequence is that it will heighten incentives for cost recovery in related areas, noting that it may be difficult to recover these costs through transaction banking given regulation.

The RBA has pushed strongly for four-party card schemes to operate under a 'user pays' model, where fees are only allowed to recover certain kinds of eligible costs. But other key elements of the payments system are not user pays. By contrast, cash-handling costs are largely absorbed by banks (with users receiving cash access below its true economic cost), and other payment services (such as the New Payments Platform and free bank accounts) are free at the point of use; arguably 'subsidised' by issuers and the broader system (see Box 8). Equally, merchants routinely benefit from multiple facets of the payment system for which they do not directly pay.

[73] Electronic Payments International, 'CitiBank Abandons Consumer Australian Credit Card Business' September 2021

Box 8: The cost of the New Payments Platform

The development of the New Payments Platform in Australia was a major industry collaboration that transformed the nation's payments infrastructure from legacy batch-based processing to real-time, data-rich settlement. The project began in response to reviews that identified gaps in the country's payments system, such as the need for instant, always-available, and information-rich transfers.

Development was staged over approximately six years from inception to public launch. The main phases included requirements setting, detailed design, internal and industry testing, and implementation. A core investment for banks was the upgrade of internal systems to support 24/7 real-time posting and the RBA's parallel development of a real-time settlement service to enable instant interbank transfers.

Data from the ABA indicates that the NPP has cost the banking industry well north of $2 billion to build, and, for the major banks, ongoing NPP spend on development and operations more than $100 million per annum.

The NPP collects per transaction scheme fees from participants. However, these are small and there is no direct charging for NPP-derived services to customers at this time.

Source: https://www.auspayplus.com.au/solutions/npp-fees-and-pricing and RBA.

The resulting price structure with only some payment services charged for directly is not necessarily inefficient. One reason is that services can have very low marginal costs but high fixed costs. In these circumstances it may not be worth developing the infrastructure to charge each user separately for each transaction, particularly where consumers buy bundles of services from banks and other financial service providers. Banks would rationally assess the returns from customers across the bundle of services provided, not service by service.

The payments system is far more complicated than a simple supplier and consumer relationship. Many of the parts of the payment system have elements of common costs and produce common benefits to various users. Seen in that light, we think there is a risk that setting interchange fee caps too low would hinder investment by issuers not just in infrastructure used for issuing services but also in other costly activities that provide no direct financial return.

Risks of setting fees too high

In contrast, setting interchange fees "too high" would likely result in pass through of benefits to cardholders, and potentially to other payment systems participants, as competition in the issuing market is effective. Data provided by the ABA estimates that the direct consumer value from just major bank credit card reward programs was around $1.6 - $1.8 billion in 2024.

Stability is important to promote investment

Regardless of whether prices might be considered too high or too low, we think there is a further argument for stability in scheme fees such as interchange fees. That is because the consequences of reforming one side of a two-sided market on the other side can be difficult to predict. Lower participation on either side (e.g., less issuing or acquiring activity) will be harmful for the operation of the market. Indeed, the economic literature recognises that unstable platform fees can disrupt the user balance, causing market share to shift or a platform's network to fail. Stable pricing and clear policies help two-sided platforms reach and maintain an equilibrium in which both sides are satisfied enough to continue participating.

4.4.5 Reduction in interchange fees for commercial cards would be particularly harmful

Australia is an outlier in treating commercial cards the same as consumer cards on surcharging and interchange (as noted in Appendix B of the Consultation Paper).

The case for different regulation centres on the distinct nature and the competitive dynamics of commercial customers:

- Commercial cards are typically used by businesses for corporate expenses and have different cost structures and risk profiles compared to consumer cards;
- Commercial cards often involve higher transaction values and more complex risk management and credit functions (including higher risks of fraud and chargebacks), which result in higher issuing costs, and
- Commercial cards compete closely with three party cards such as American Express, which is not subject to interchange fee regulation. As per the RBA Consultation paper, three-party card schemes account for around half of the issued commercial cards.[74]

Because commercial card transactions are less sensitive to price caps and operate in separate markets, regulators (including the EU) usually exempt them from interchange fee caps to avoid undermining the viability of issuing these cards or reducing the availability of credit services to businesses.

In Australia, a further important consideration is the extent to which commercial card spend is subject to interchange regulation. Bank industry data suggests that at least half of commercial card spend is not subject to regulation, largely due to the high prevalence of American Express in the commercial card market.

Imposing further proposed interchange reductions on commercial cards could be particularly harmful to competition.

[74] RBA Consultation Paper, p. 36

5 The RBA's analysis of costs

5.1 The RBA's issuer cost study

The RBA released an Issuer Cost Study as supplementary document to the Review of Merchant Card Payment Costs and Surcharging Consultation Paper.

The Issuer cost study is an update of the cost-based benchmark for all designated schemes in 2005. Based on calculations using the definition of eligible costs, the common benchmark for credit schemes was set at 0.5 per cent of transaction value and took effect from November 2006, subject to regular reviews. Subsequent reviews of interchange regulation have not altered the level of the benchmark for credit interchange.

The RBA stated that:

> *The Issuer Cost Study was a targeted cost study undertaken for the purposes of this Review, seeking to provide estimates of the costs to issuers of providing card payments. The study sought costs data from 13 financial institutions, including the largest card issuers in Australia and some smaller issuers. The RBA received responses from 11 of the 13 institutions. Issuers provided data on costs relating to issuing cards and processing card payments over a 12-month period, including on cost categories relevant to 'eligible costs' as part of the RBA's review of interchange fee regulation. These data were used to estimate issuer costs on a per-transaction basis.*[75]

The RBA then split the received costs into eligible costs and non-eligible costs issuer costs related to card issuing and processing. This split is summarised in Table 3.

Table 3: RBA view of eligible and non-eligible costs

Eligible Costs (Categories from the Issuer Cost Study)	Excluded from Eligible Cost calculations
• Authorisation and transaction processing • Fees and other costs associated with mobile wallet providers • Fraud • Net scheme fees • Cost of funds (for credit)*	• Account set-up, overheads and maintenance • Card production and delivery • Product development • Cardholder reward programs • Disputes, chargebacks and collections and write-offs • Cost of capital

Source: Frontier Economics based on RBA (2025), Review of Merchant Card Payment Costs and Surcharging Issuer Cost Study.

** - RBA present eligible costs with and without cost of funding interest-free periods.*

[75] *RBA (2025), Review of Merchant Card Payment Costs and Surcharging Consultation Paper, page 80*

Box 9: Eligible Issuer Costs Over Time

The issuer costs that the RBA considers as 'eligible' primarily have their roots in the Reform of Credit Card Schemes process that occurred in the early 2000s. Part of this process involved submissions from Australian scheme participants (through the ABA), the international card schemes themselves, as well as retailers. Each proposed different methodologies for regulating interchange fees, either under a cost-based methodology or a "fee-for-service" methodology. The RBA found that "none of these methodologies fully [met] the principles for interchange fee setting", owing to included costs that they did not believe met their standards to be considered 'eligible'. Notably, this includes the cost of providing the interest-free period, which was later included into the 'eligible cost' category, albeit flagged for future review.

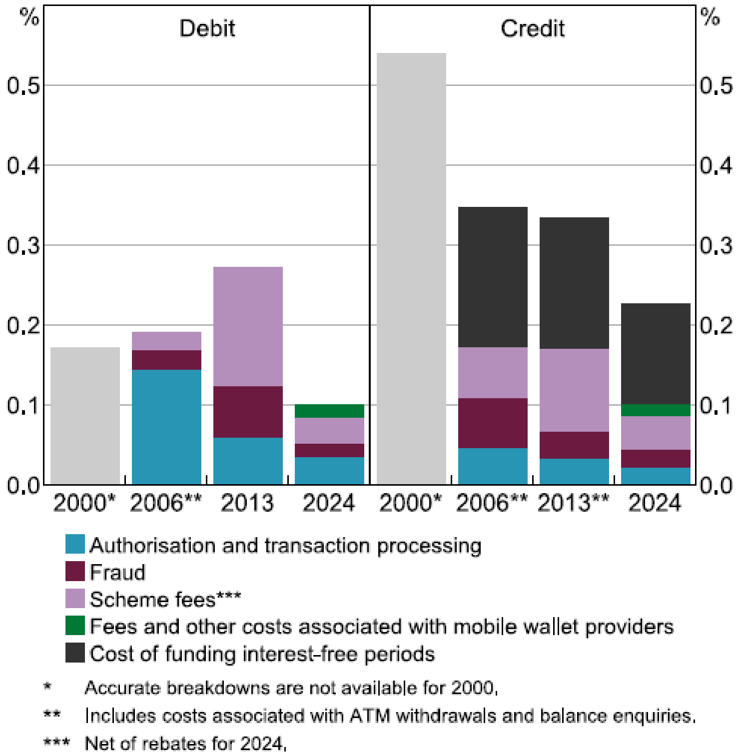
As eligible costs are reviewed for future application, we feel eligible costs should be adjusted to incorporate a system of proportional costs. The RBA seems to at least implicitly accept the possibility of such an approach, noting in the Review of Merchant Card Payment Costs and Surcharging Consultation Paper that not all benefits of the interest-free period are to merchants. The corollary of that statement being that merchants received at least **some** of the benefits.[76]

Source: Frontier Economics (2025), based on RBA (2001), Reform of Credit Card Schemes in Australia I - A Consultation Document, RBA (2002), Reform of Credit Card Schemes in Australia IV - Final Reforms and Regulation Impact Statement.

Based on this split of eligible/non-eligible costs, the RBA reaches an estimate of eligible issuer costs – shown in Figure 14.

[76] We note that while explaining why the cost of capital was not considered as an eligible cost in the Reform of Credit Card Schemes in Australia consultation document, the RBA seems to accept that there "*would be logic*" in issuers seeking to recover some return on capital expended on specifically fraud-related capital costs. Additionally, the primary objection to including the cost of capital seems to have been that the RBA finds it unreasonable that card issuers could seek a return on the total capital spent on card issuing. The statements would seem to suggest that a *proportional* cost system might be appropriate in this case. It does not appear that the RBA pursued any effort to allow a return on capital for fraud related capital costs, and the cost of capital remains an ineligible cost up to 2025.

Figure 14: Estimated Eligible Issuer Costs – per cent of transaction value



Source: RBA Consultation Paper. Figure specific source: RBA; RBA and ACCC (2000); Schwartz et al. (2007); Stewart et al. (2014).

The RBA notes of its estimates that:

> *The Issuer Cost Study estimates the current average cost of processing credit transactions is 0.22 per cent, including the cost of funding interest-free periods, and is only 0.10 per cent if the cost of funding interest-free periods is excluded. Therefore, a domestic credit interchange cap of 0.3 per cent would fully cover the average cost for issuers of processing credit transactions.*[77]

And the RBA concludes that:

> *Reducing the domestic credit interchange cap to 0.3 per cent and abolishing the benchmark (Option 2) would be consistent with the cost-based approach taken historically by the RBA when setting interchange regulations.* [78]

5.2 The RBA's costing of issuing functions takes a very narrow view of eligible costs

To reach its estimate of eligible costs, the RBA conceptually applies an "avoidable costs" approach, based on costs avoidable if the service of card issuing was no longer supplied. We understand the definition is intended to ensure that only costs unavoidable in providing card network services to merchants—those technical and processing overheads directly incurred—are passed through interchange fees.

[77] *RBA (2025), Review of Merchant Card Payment Costs and Surcharging Consultation Paper, page 31.*

[78] *RBA (2025), Review of Merchant Card Payment Costs and Surcharging Consultation Paper, page 31.*

All beneficiaries should contribute to cost recovery

An avoidable cost standard for issuing activities would be appropriate if costs incurred by issuers only benefitted card holders. However, it is not appropriate when costs incurred deliver benefits to other parties (i.e. an entity other than the card holder). Payment systems have costs that deliver benefit to both card holders and to merchants – and it would be most efficient to recover such costs from both issuing (cardholder) and acquiring (merchant) sides.[79]

This thinking does not seem too far away from the RBA's current approach. Indeed, the RBA has already identified a cost which they think of in these terms. It states:

> *"The PSB's view is that the benefits from interest-free periods do not solely accrue to merchants. Cardholders arguably receive the most substantive value from access to interest-free credit by delaying the cost of their purchases. As a result of providing a credit product with an interest-free period, issuers also derive benefits in the form of higher interchange income from larger transaction values than may have occurred otherwise and increased customer attraction and retention."* [80]

The RBA concludes that the "most of the cost" should be borne by the issuer and cardholder. That is, in this instance the RBA appears to accept that there is a *benefit share* which is relevant to the allocation of eligible costs between merchants and card holders. However, this concept is actually more widely applicable across a number of cost categories than appears to be recognised by the RBA. To take one example, the activity of physical card production cards delivers benefits to merchants as without a card there is no means of payment – this means these costs deliver benefits to both sets of users.

Other aspects of the Issuer Cost Study

There are two further aspects of the eligible costs methodology which remain troubling:

- Costs typically considered legitimate in other regulated environments, such as core operating systems, regulatory compliance, or a return on capital, are excluded without clear conceptual justification. If, for example, the RBA considers that merchants benefit to some degree from the interest free periods that card issuers provide to card holders, why would it not be the case that costs of financing account balances (a return on capital) provides some benefit to merchants?
- It does not take sufficient account of forward-looking trends in costs. For example, the cost category of fees and other costs associated with mobile wallet providers is a backwards looking estimate of transaction category which is rapidly expanding and evolving – with RBA estimates in 2024 of between 33-39% of transactions[81], the value of payments increase 28% over the last 12 months[82], and Apple Pay's share in Australia of 65%.[83] On a marginal transaction the costs associated with Apple Pay on credit cards are much higher than the averaged estimates of 0.02% for credit and 0.01% for debit – for example, one source from 2019 puts Australian debit card charges for Apple Pay in the range 0.04-0.06%.[84] This method

[79] This is essentially the insight associated with Baxter's seminal 1983 paper on interchange fees. Baxter, William F. 1983. "Bank Exchange of Transactional Paper: Legal and Economic Perspectives," *Journal of Law And Economics*, Vol. 26, No. 3 (October), pp. 541-588.

[80] *RBA (2025), Review of Merchant Card Payment Costs and Surcharging Consultation Paper, page 29.*

[81] Graph 2.1 in https://www.rba.gov.au/publications/annual-reports/psb/2024/payments-system-regulation-and-policy-issues.html.

[82] https://www.ausbanking.org.au/mobile-wallet-payments-soar-amid-digital-banking-boom/.

[83] https://www.chargeflow.io/blog/apple-pay-vs-google-pay-statistics-adoption-rates-market-share .

[84] https://www.bankingday.com/article/revealed--the-fees-aussie-banks-pay-for-apple-pay

has the potential to significantly underestimate an increasing cost which issuers are unable to control – raising the risk of the RBA imposing a regulatory regime that means that issuers incur a loss on mobile wallet transactions by Apple Pay. It is also possible that other major mobile wallet providers, such as Google Pay, impose a charge in the future.

It is worth noting that this view of the RBA's cost-based methodology being flawed is not new. The following quote, attributed to the ABA in 2006, still provides a good summary of issues:

> *The range of eligible costs allowable by the Reserve Bank is arbitrary and excludes costs that would normally be considered legitimate costs, such as the cost of capital … Without a strong academic underpinning, the cost based methodology used by the Reserve Bank will remain vulnerable to arbitrary change. For the banks this means continued uncertainty.*[85]

5.3 Analysis of issuer costs

Which costs are relevant?

We have undertaken a further analysis of the cost categories of issuer costs related to card issuing and processing. As discussed in Section 5.2, where payment system costs drive benefits to both card holders and merchants, it would be most efficient to recover such costs from both issuing (cardholder) and acquiring (merchant) sides. In Table 4, we analyse each cost category in the RBA Issuer Cost Summary and consider if the issuer costs plausibly provide a benefit to merchants, and, if so, consider whether the benefit to merchants is likely to be material.

85 House of Representatives Standing Committee on Economics, Finance and Public Administration (2006), Review of the Reserve Bank of Australia and Payments System Board Annual Reports 2005 (First Report), page 42.

Table 4: Assessment of whether RBA issuer cost categories deliver benefits to merchants

Cost category	Summary of RBA category definition	Frontier Economics assessment of benefit to merchants
Authorisation and transaction processing	"All the issuer costs incurred in providing authorisation and processing card transactions, including clearing and settlement"	Benefit to merchants – included as eligible cost by the RBA
Fees and other costs associated with mobile wallets	"Includes any fees paid directly to mobile wallet providers for transactions initiated through their mobile wallets"	Benefit to merchants – included as eligible cost by the RBA
Fraud	Includes net fraud losses and prevention, monitoring, mitigation, investigation and remediation	Benefit to merchants – included as eligible cost by the RBA
Net scheme fees	"The net fee paid to schemes for issuing activity, including rebates from schemes"	Benefit to merchants – included as eligible cost by the RBA
Cost of funds (i.e. cost of funding interest-free periods)	"The cost to the issuer for funding interest free balances"	Some benefit to merchants of cardholder having access to credit for purchases – RBA provide values with and without this category
Account overheads, set up and maintenance	"Comprises the costs of setting-up and maintaining relevant deposit/transaction, credit card and prepaid card accounts that enable the payment card transaction types identified"	Some benefit to merchants of set-up and maintenance of card accounts to facilitate card payments
Card production and delivery	"Includes both newly issued and re-issued cards, and covers all aspects from the cards' production to the cards' arrival in the hands or digital wallets of the cardholder"	Some benefit to merchants of cardholder having physical or digital card with which to make a purchase
Product development	"Comprises the development of products that are specific to a scheme or card payment type. An example might be scheme-specific solutions to EMV, contactless cards, tokenisation or 3DS"	Some benefit to merchants of cardholders having access to new card products, such as access to more secure transaction methods which reduce fraud, etc.
Cardholder reward programs	Includes operating costs for cardholder reward programs, rewards, travel insurance, ticket offerings, rebates for corporate clients and other cardholder benefits.	Benefit strongly weighted to cardholders
Disputes, chargebacks and collections and write-offs	"Includes costs associated with managing, processing and pursuing disputes, chargebacks and delinquent accounts/bad losses"	Some benefits to merchants as cardholders feel confident spending with access to fair dispute resolution processes
Cost of capital	Includes the "the cost of capital employed by the issuer to cover the credit risk associated with funding its outstanding credit card portfolio balances" and "the cost of capital employed by the issuer to cover operational risk"	Some benefit to merchants of cardholder having access to credit for purchases and of issuers being able to cover the cost of capital for operational risks

An alternative calculation of eligible costs

Based on our findings of issuer cost categories which provide benefit to merchants, we have undertaken an analysis of issuer costs drawing on data from the RBA, supplemented by bank data provided by the ABA.

As we describe, we first re-weight our bank-supplied data to be consistent with the aggregate RBA results. We then develop two alternative methods of estimating eligible costs:

1. A method that maintains the present eligible issuer costs (excluding interest free periods) but adds a 25% share of other costs as beneficial to merchants; and
2. A method that takes a straight 50% of all issuer costs and allocates this to merchants.

Re-weighting

- To ensure consistency between the aggregate RBA and bank-supplied data outcomes, we first re-weight the RBA estimated issuer costs related to card issuing and processing for domestic card transactions to reflect bank data provided by the ABA. The re-weighting makes relatively modest changes to the balance of costs, with the net scheme fees and account set-up, overhead and maintenance being weighted slightly higher for credit transactions based on the bank data that we received.

Table 5: Domestic credit transaction costs

Costs	RBA Issuer Cost Study (%)	RBA Issuer Cost Study - Adjusted by Bank Submissions (%)
Authorisation and transaction processing	0.02	0.03
Fees and other costs associated with mobile wallet providers	0.02	0.02
Fraud	0.02	0.03
Net scheme fees	0.04	0.08
Cost of funding interest-free periods	0.12	0.10
Account set-up, overheads and maintenance	0.54	0.57
Card production and delivery	0.02	0.02
Product development	0.07	0.05
Cardholder reward programs	0.47	0.45
Disputes, chargebacks and collections and write-offs	0.17	0.18
Cost of capital	0.12	0.11
Other	0.06	0.03
All costs	**1.67**	**1.67**

Totals may not sum due to rounding.
Source: Frontier Economics based on RBA (2025), Issuer Cost Study, and submissions provided by the Australian Banking Association.

Table 6: Domestic debit transaction costs

Costs	RBA Issuer Cost Study (%)	RBA Issuer Cost Study - Adjusted by Bank Submissions (%)
Authorisation and transaction processing	0.04	0.04
Fees and other costs associated with mobile wallet providers	0.01	0.01
Fraud	0.02	0.02
Net scheme fees	0.03	0.05
Account set-up, overheads and maintenance	0.32	0.32
Card production and delivery	0.02	0.01
Product development	0.03	0.02
Cardholder reward programs	0.00	0.00
Disputes, chargebacks and collections and write-offs	0.01	0.01
Cost of capital	0.01	0.02
Other	0.06	0.06
All costs	**0.55**	**0.55**

Source: Frontier Economics based on RBA (2025), Issuer Cost Study, and submissions provided by the Australian Banking Association.

From this point forward, we make one further correction to the figures presented in the Issuer Cost Study. Our reweighting approach assumes that the total costs presented in the Issuer Cost Study are accurate and simply adjusts them to agree with our data from the banks directly. However, the calculation for the cost of funding interest-free periods involves the use of average daily cash rate for the prior three financial years. This backwards-looking approach does not reflect the current environment of the payments system, nor does it represent an accurate picture of the current cash rate. Using a cash rate calculated over the prior three years gives a value of 2.81%, whereas the cash rate within the reporting period of the Issuer Cost Study was 4.32%. Amending this calculation to account for a different cash rate would involve increasing one of the cost categories without changing the value of the others and would therefore push total costs above the RBA calculated value of 1.67%.[86] These corrected figures have been marked with an asterisk for clarity.

Scenario 1: Wholly include the following cost categories:

- Authorisation and transaction processing;
- Fees and other costs associated with mobile wallet providers;
- Fraud; and
- Net scheme fees.

We have also included a conservative 25% split of other cost categories which provide some benefit to merchants, i.e. the remaining cost categories excluding the cardholder reward programs and other categories. The results of this scenario are presented in Table 7 and Table 8.

[86] Given that this correction would not change the amount spent nor the proportion of overall spending on the interest free period by banks, only the impact of this spending, it is reasonable to apply this correction post-reweighting. We note that, as the reweighting process reduced the contribution of the cost of funding the interest-free period to the overall total costs, applying this correction here would have a less significant effect on total eligible costs than if it were applied at the outset, and can therefore be considered as a conservative approach.

Table 7: Estimated relevant issuer domestic credit transaction costs – adjusted RBA method plus partial attribution of other beneficial cost categories

Costs	RBA Issuer Cost Study - Adjusted by Bank Submissions (%)	Adjusted RBA method plus partial attribution of other beneficial cost categories (%)
Authorisation and transaction processing	0.03	0.03
Fees and other costs associated with mobile wallet providers	0.02	0.02
Fraud	0.03	0.03
Net scheme fees	0.08	0.08
Cost of funding interest-free periods	0.16*	0.04*
Account set-up, overheads and maintenance		0.14
Card production and delivery		0.00
Product development		0.01
Cardholder reward programs		-
Disputes, chargebacks and collections and write-offs		0.04
Cost of capital		0.03
Other		-
All costs	**0.32**	**0.43**

Source: Frontier Economics analysis.

Table 8: Estimated relevant issuer domestic debit transaction costs – adjusted RBA method plus partial attribution of other beneficial cost categories

Costs	RBA Issuer Cost Study - Adjusted by Bank Submissions (%)	Adjusted RBA method plus partial attribution of other beneficial cost categories (%)
Authorisation and transaction processing	0.04	0.04
Fees and other costs associated with mobile wallet providers	0.01	0.01
Fraud	0.02	0.02
Net scheme fees	0.05	0.05
Account set-up, overheads and maintenance		0.08
Card production and delivery		0.00
Product development		0.01
Cardholder reward programs		-
Disputes, chargebacks and collections and write-offs		0.00
Cost of capital		0.01
Other		-
All costs	**0.11**	**0.21**

Source: Frontier Economics analysis.

Scenario 2: A 50% split of costs across all cost categories which provide a benefit to merchants

The results are shown in Table 9 and Table 10.

Table 9: Estimated relevant issuer domestic credit transaction costs – equal split of beneficial cost categories to merchants and acquirers

Costs	RBA Issuer Cost Study - Adjusted by Bank Submissions (%)	Equal split for beneficial cost categories (%)
Authorisation and transaction processing	0.03	0.01
Fees and other costs associated with mobile wallet providers	0.02	0.01
Fraud	0.03	0.02
Net scheme fees	0.08	0.04
Cost of funding interest-free periods	0.16*	0.08*
Account set-up, overheads and maintenance		0.28
Card production and delivery		0.01
Product development		0.02
Cardholder reward programs		
Disputes, chargebacks and collections and write-offs		0.09
Cost of capital		0.06
Other		
All costs	**0.27**	**0.62**

Source: Frontier Economics analysis.

Table 10: Estimated relevant issuer domestic debit transaction costs – equal split of beneficial cost categories to merchants and acquirers

Costs	RBA Issuer Cost Study - Adjusted by Bank Submissions (%)	Adjusted RBA method plus partial attribution of other beneficial cost categories (%)
Authorisation and transaction processing	0.04	0.02
Fees and other costs associated with mobile wallet providers	0.01	0.01
Fraud	0.02	0.01
Net scheme fees	0.05	0.02
Account set-up, overheads and maintenance		0.16
Card production and delivery		0.01
Product development		0.01
Cardholder reward programs		-
Disputes, chargebacks and collections and write-offs		0.00
Cost of capital		0.01
Other		0.03
All costs	**0.11**	**0.28**

Source: Frontier Economics analysis.

5.3.1 Results of the adjusted cost approaches and further analysis

Our analysis of the two scenarios highlights alternative cost estimates of:

- 0.43% for credit and 0.21% for debit; and
- 0.62% for credit and 0.28% for debit.

The scenario 1 estimate is reasonable as it merely adds 25% of other cost categories that provide some benefit to merchants. While there is a reasonable logic for adding a conservative estimate of other issuer costs which benefit merchants, it raises the question of why the RBA took a binary approach to inclusion of costs (i.e., either wholly passed to merchants or entirely excluded). This is a problem with seeking to layer a conservative method on top of an existing, arbitrary method.

To address the inconsistency in treatment of costs, Scenario 2 applies a simple 50% split to costs which benefit merchants. This leads to an alternate cost estimate of 0.62% for credit and 0.28% for debit.

As the preferred approach necessarily requires some judgement, we think that the two scenarios are best treated as within a relevant range of figures: between 0.42%-0.62% for credit and 0.21%-0.28% for debit. Comparing these figures to current interchange fee caps and benchmarks, this suggests that the current benchmarks are reasonable, and that any significant reduction in benchmarks and caps risks issuers having to cross-subsidise relevant costs recovered through the interchange fee from other revenue sources.

It is also important to note that there are a further two reasons why these figures should be treated as conservative estimates:

- Given that there are fixed costs in payments costs, the unit costs of smaller banks will be relatively higher again, and lower caps with further harm their competitiveness in card issuing activity; and

The analysis is based on a backwards looking view of fees associated with mobile wallet providers. As mobile wallet transactions increase over time, this value will increase as the number of Apple Pay transactions increase. This highlights the need for any change to benchmarks and caps to be cognisant of key drivers of change over time.

6 Recommendations

6.1 Recommendations

Based on our analysis, the RBA's proposed approach in the Consultation Paper is likely to have significant negative effects on the payments system.

We recommend that:

- Rules relating to surcharge bans should be removed for both debit and credit transactions as surcharging is having a range of unintended consequences,
- Interchange fee caps and benchmarks should be retained at their current level for both debit and credit transactions, and
- The RBA should wait until it has regulatory powers for all payment systems before making any more interventions in the market. They should also assess the observed effect of removing the surcharge ban on MSF as pricing signals are strengthened before making any further changes.

We don't agree with any changes to interchange regulation. However, if the RBA insists, then regulatory changes should be highly targeted and limited to addressing barriers to competition on pricing in the small merchant market and disparities between large/small merchants - without affecting the overall economics of the issuing market

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