

11 September 2012

Dr Tony Richards
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Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001



By Email to: pysubmissions@rba.gov.au

Dear Dr Richards,

Payments System Issues: Guidance Note for the Varied Surcharging Standards

I refer to the above mentioned Guidance Note released on 12 August 2012. I refer also to the comments provided by the Commonwealth Bank of Australia (the Bank) on 6 July 2012 in response to the Regulation Impact Statement accompanying the variation to the Surcharging Standards (released 12 June 2012).

The Bank appreciates the opportunity to comment on the revised draft Guidance Note.

In the 6 July 2012 comments, the Bank noted that it is

*" broadly comfortable with the contents of the draft Guidance Note ... We do, however, suggest that additional clarification is provided to make it clear that a merchant's fraud costs are not eligible for inclusion in relevant costs used to justify a surcharge. If a merchant were able to include such costs, and effectively pass such costs to cardholders, there would be no incentive for a merchant to invest in fraud mitigation. Such a perverse outcome would surely be unintended."*¹

The Bank was disappointed to note that the 12 August 2012 draft Guidance Note now specifically includes "Fraud costs related to card acceptance" as one of the additional costs that form part of the reasonable cost of acceptance. Specifically, it is proposed that such additional costs can include:

*(d) Fraud costs related to card acceptance. This cost category includes, and is limited to: the transaction value of fraud-related chargebacks; chargeback fees charged by the acquirer or a payment service provider; and any fixed equipment, systems or development costs that are incurred by the merchant as a direct result of compliance with scheme rules or mandated requirements, apportioned over a period of three years from the date when the cost was incurred."*²

We would like to take this opportunity to again argue that many of these "fraud costs" should not be used to justify a surcharge, and in doing so wish to differentiate between two types of fraud costs. We start from the premise that fraud minimisation is a generally accepted goal.

It is useful to consider that the broad area of "fraud costs" is really made up of two components:

¹ <http://www.rba.gov.au/payments-system/reforms/submissions-draft-guidance-note-var-surcharging-stnds/cba-06072012.pdf>

² <http://www.rba.gov.au/payments-system/reforms/cards/201208-var-surcharging-stnds-draft-guidance/guidance-note.html>

- a) fraud mitigation costs (such as systems or development costs related to fraud detection and mitigation); and
- b) losses from fraudulent transactions (the value of transaction charged back because it was fraudulent - or purported to be) - or at least the cost of goods sold on those transactions.

Category (a) above is, we believe, an appropriate “additional cost” eligible for inclusion in a merchant’s determination of a reasonable cost based level of surcharging. Such inclusion of costs associated with preventative measures will help ensure a level of investment in fraud mitigation, provided that such investment is able to be allocated to card based payments only.

However, it is our strongly held view that fraud losses encapsulated in category (b) above should not be included, for the following reasons:

- The value of fraudulent transactions charged back to the merchant is not a cost of card acceptance – it is the result of payment acceptance that can be mitigated, even potentially avoided, by investment in fraud prevention measures contemplated under category (a) above.
- The Reserve Bank of Australia (RBA) “Payment Costs in Australia – A study of the costs of payments methods” November 2007 report³, does not include the value of fraud transactions that are charged back to the merchant in the summary of merchant’s payment costs (refer Table 8 – Merchant Costs for Credit Card, EFTPOS, Cash and Cheque Payments) or the preceding cost study templates. To now include these costs in the Guidance Note would be at odds with the merchant cost categories identified in 2007.
- For other (non card) payment options, the merchant either absorbs such fraud losses or, more likely, includes some level of loss from fraudulent payments in product pricing. If so, a credit card user would be paying for fraud losses of other payment types as embedded in the product / service price, and also for card related fraud losses as part of the surcharge. This strikes us as inappropriate and not reflective of appropriate price signals.
- Within the broader context of ongoing payment systems reforms, the intent of any surcharge is to help enable price signals to the consumer which are more likely to promote a more efficient payments system. While a balanced investment in fraud mitigation ((a) above) contributes to a more efficient payment network, including actual fraud losses ((b) above) in the calculation of surcharge levels provides no incentive to merchants to mitigate fraud, thus distorting the price signals ultimately delivered to consumers. This will potentially lead to laziness in fraud management and a disproportionate allocation of costs amongst payment system participants⁴. This would ultimately be detrimental to the security of the broader system. As noted above, fraud minimisation is a generally accepted, and common, goal and costs attaching thereto need to be borne appropriately.
- Of course, fraud costs are not only incurred by merchants, but also by other participants as well, and it is untenable that one participant in the network is able to shift such costs to customers while others continue to bear their own costs. This creates an unwelcome disparity in incentive and imbalance in the market.
- Also, it is worth noting that we believe there to be a high correlation between those industries who do try to recoup fraud losses and the prevalence of more extreme levels of surcharging. If RBA is keen to limit surcharging to be more reflective of a reasonable level of costs, inclusion of fraud losses will undermine this intent.

³ <http://www.rba.gov.au/payments-system/reforms/review-card-reforms/pdf/pymts-sys-review-conf-2007/costs-au.pdf>

⁴ An alternative way in which to consider this point is that by allowing merchants to recoup fraud losses via a surcharge enables them to be lackadaisical about preventing that fraud, and the whole network relies on participants’ interests being aligned across the industry – in seeking to minimise fraud, not only through investments in systems etc, but also in practical operational practices, training, customer verification etc. By allowing a shift of merchant fraud loss costs to the cardholder, why would a merchant invest in this as opposed to “simply” raising the surcharge?

For these reasons, we suggest that the RBA should reconsider the inclusion of fraud related costs in determining the level of surcharging. We believe that the distinction drawn above is appropriate and as currently proposed, the draft Guidance Note requires amendment by excluding the value of fraudulent transactions.

We also reiterate our concerns, as previously highlighted, over the burden of compliance and monitoring falling to acquirers, via the Scheme rule process. While the Guidance Note will assist in providing clarity and reduced scope for disputes, we remain concerned as to the likelihood of tensions between a merchant, the acquirer and the card Scheme. As previously argued, we would expect RBA assistance in the event that our concerns come to fruition.

Thank you again for the opportunity to comment on these matters; we again urge the RBA to reconsider this aspect of the draft Guidance Note. We of course remain available to discuss these comments at any time.

Yours sincerely

[Signed]

Stuart Woodward
General Manager
Representation