

25 July 2011

Dr Christopher Kent
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Payments System Board Consultation on Card Surcharging

Dear Chris

We refer to your press release dated 8 June 2011 concerning the Payments System Board's Consultation on Card Surcharging and the request made in the release for written submissions from interested parties.

Indue and its associated members are issuers of both scheme credit and debit and proprietary debit cards and as such have an interest in the PSB's current consideration on surcharging.

In responding to the issues raised in the consultation document, we would like to offer perspectives in four main areas, namely surcharging by payment channel, alignment of surcharging to the cost of acceptance, differential surcharging and disclosure.

Surcharging by Payment Channel

One of the key premises for the introduction of surcharging was to facilitate appropriate price signals to cardholders with respect to the costs associated with the use of the various card based payment products. The merchant under the changes made with respect to surcharging in 2003 can now levy the cardholder for the costs associated with acceptance of the particular payment product selected by the consumer. Generally it was assumed that when confronted with a payment choice, a consumer has a number of payment options available from which to select and as such, can minimise the costs of the surcharge by making an alternative payment choice at the point of sale.

In instances where the transaction is at the point of sale, this assumption generally holds true as at the very least one would expect that a consumer is able to choose either to use a scheme card or cash. However, in the case of a card not present transaction, the payment options available to the consumer today are more limited and in the main the scheme card (either debit or credit) are in practical terms the two key options.

In these situations the costs of acceptance that the surcharge is aiming to recover, is in practical terms the costs of making a particular purchasing channel available to the consumer. In this instance the consumer has a limited range of payment options

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available and hence, the ability to minimise the surcharge by selecting a different payment product is not possible.

With the benefit of time since the introduction of surcharging, and the increase use of online distribution channels by retailers, consideration should be given to payments made on a card not present basis and how surcharging should be applied in these cases. The key consideration in our opinion should be in ensuring that the same opportunity available to consumer to minimise the cost of the surcharge in the physical channels should be available for online purchases.

Alignment of Surcharging to the Cost of Acceptance

Surcharging, when it was introduced, had in the main two key outcomes. Firstly, it was aimed at sending better price signals to consumers about the costs associated with using the various payment products at their disposal. Secondly, it was a mechanism through which merchants could continue to offer the various payment products and recover the costs associated with the acceptance of these.

In practical terms, we believe that the first objective has largely been achieved and now, in as much as where a surcharge is applied by the merchant, this cost is disclosed to the consumer before the transaction is completed. Armed with this information, the consumer is able to make an informed decision as to whether or not the cost associated with the use of a particular payment method will be sufficient to alter the initial payment decision.

In the case of the second goal, this has largely been achieved and as consequence a merchant is now able to recover the cost associated with the consumer's choice of payment instrument. When surcharging was first introduced, while it was not a subject that received wide discussion, in the main it was not anticipated that the cost of the surcharge would reflect an amount in excess of the cost of using a particular payment instrument. Equally as the cost associated with the various payment instruments decreased, particularly with regards to scheme products given that these were a large part of the RBA's overall reforms package of the payment system, it was assumed that the specific level of surcharge applied would equally fall to reflect the increasing efficiency of the payments system.

Since the introduction of surcharging, the cost of acceptance (principally the Merchant Service Fee [MSF]) has decreased, however the level of surcharge applied has failed to follow this fall. Given this trend, it would seem that the cost associated with a surcharge is no longer correlating with the actual cost of acceptance. This trend, if it continues, will become a legitimised means through which margin can be enhanced by a merchant which would in our view undermine the integrity of reforms and no longer serve as a mechanism through which a consumer can receive effective price signals with regards to using the various payment instruments.

One policy option suggested by the consultation document is the use of a cap as a means to gain some correlation between the cost of acceptance and the level of the surcharge applied. We believe this would be an improvement to the current arrangements and would support such as move. We also believe that administering such a change would best be done by the schemes and hence a change to both the relevant standard and the scheme rules themselves would be appropriate.

Simplicity in how this is applied in our opinion is paramount to the successful execution of this change and to this end we believe that the surcharge should be a function of MSF plus an acceptable average margin applied on a cost plus basis to account for other relevant costs not covered in the MSF. To this end, we believe the process for gathering information and determining the relevant margin above MSF would be best left to the schemes to collect, calculate and set in much the same way as the blended interchange rate is calculated across all the various issuing products. We accept that averaging the costs of those costs not covered by the MSF is not an exact science and as such, will not in every instance cover the actual costs incurred, we believe it will be generally fair particularly if the schemes are given the power to make ad-hoc adjustments for particular groups where the gap is considered too great.

Such an approach in our opinion would go some way toward limiting the ability of merchants to use surcharging as a means of improving their margin and as efficiency in the payment system is achieved, the costs associate with surcharging should also decrease proportionally.

This said if we leave the extent of the change at simply capping the level at which a surcharge can be levied, then we believe this will in time also lose currency and in some cases may become irrelevant because of the market power able to be exercised by a merchant as was the case with the use of a scheme card as a payment instrument in taxi's where typically a 10% surcharge is applied.

Surcharges of this level were in force before the reform process commenced and notwithstanding that these contravened the scheme rules of the time, they nevertheless persisted and the schemes conceded on their position.. Such a situation could in fact happen again notwithstanding what may be communicated in either the standard or the scheme rules as the success of such an action lies principally in the market power of the merchant.

Acknowledging the potential for this to occur, we believe that any attempt to control the level of surcharging, must be accompanied with an appeals mechanism where the governing body has legislative power to impose a fine (of some substance) to the offending merchant. This body need not only hear from the industry about unfair practices, but also give the consumer a place to express concern for situations where the practice applied by the merchant was against the spirit of the reforms of the payment system.

As such, we would urge the PSB to consider this change to the way in which a surcharge is applied together with the establishment of a governance body with powers to act against unscrupulous merchant behaviour.

Differential Surcharging

We believe that in principle a merchant should be able to levy a surcharge based on the cost associated with accepting a particular product. This surcharge should vary from product to product based on the specific or unique cost characteristics of the product.

This said in order for a merchant to make such differentiation pricing decisions, information on the costs of the various products must be collated and published. Otherwise it is difficult for merchants to act with integrity. Our concern however, in moving to such a practice is the complexity associated with creating the framework through which the differentiated cost structure is applied. Achieving this would require significant costs for the acquirer and equally may in time prove to be inaccurate should an issuer, for example, issue multiple products under the one BIN.

For now we believe the principle of differential pricing should be upheld and applied where it is practical for the merchant to easily source sufficient information to make that decision.

Disclosure

We believe that in order for surcharging to be applied fairly, the consumer must have some appreciation for cost of acceptance associated with a particular payment instrument. Equally however, we do not believe that a merchant should be forced to disclose the actual level of their MSF to a customer. Rather we would expect the schemes to publish levels of interchange based on average market data both of MSF and also of the average margin above MSF for costs not covered by the MSF. Without this information, it is difficult for a consumer to know whether the fee charged is fair and relevant to the actual costs of using a particular payment system. In this way the original aim of sending price signals to consumers about the cost of using various products is somewhat upheld.

While this practice does not entirely stop a merchant from widening their margin, the opportunity to do so will be narrower than it is now given that data would be collected regularly, and as the costs of acceptance decreases as the efficiency of the payment system increases, the opportunity to widen a margin also reduces.

Overall we support the general direction being explored by the PSB and would welcome the opportunity to discuss our submission further with you.

In the mean time should you require further information please do not hesitate to contact me on (07) 3258 4248 or mswannell@indue.com.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'M Swannell', with a stylized, cursive script.

Michael Swannell
Executive Manager - Payments