

NATIONAL BILLING GROUP PTY LTD
ACN 107 408 579

**SUBMISSION TO THE RESERVE BANK OF AUSTRALIA
PAYMENT SYSTEMS BOARD**

**“A VARIATION TO THE SURCHARGING STANDARDS:
A CONSULTATION DOCUMENT”**

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National Billing Group Pty Ltd (NBG) Comments on RBA Response to Review of Surcharging:

Introduction:

The RBA's paper review of responses to its consultation paper on Credit Card Surcharging has sought comments from interested parties on its proposed change to the Scheme Rules with respect to Surcharging.

The RBA has examined three policy options and has proposed a recommended Policy option. That Option 3 is reflected in the proposed amendments to the Standard for Merchant pricing for Credit Card Purchases. In particular the RBA proposes to:

1. Introduce a concept of "reasonable cost of acceptance of credit cards"
2. Clarifies, for the avoidance of doubt, that a merchant can charge fees or surcharges to credit card holders to recover all or part of the reasonable costs of acceptance of credit cards.
3. Further the RBA has proposed that merchant's reasonable cost of acceptance is NOT limited to the "merchant service fee" but should include a wider basket of costs related to the costs of acceptance.

In developing its preferred policy option the RBA's Consultation Document has recognised that the costs of acceptance varies both across industries and between merchants. These costs need to be factored in when pricing a Credit Card surcharge.¹

NBG Comments in Response to proposed Rule Changes:

Whilst NBG's preferred position is that there is NO need for any variation to the existing standards we do agree with the broad thrust of the RBA's proposals. In doing so we flag the following:

Approach to Regulation

1. The RBA's proposal is a light-handed form of regulation in the circumstances relying on competitive market outcomes and this is to be applauded.
2. The RBA has chosen a "cost of service" regulatory model, and rather than attempt to determine the rates for different industries or merchants it has left that to the market to resolve. Again that is to be applauded as it avoids the RBA, as regulator, engaging in

¹ Wisely the RBA has steered away from the introduction of Caps on surcharges with the attendant risks of "tacit collusion" and loss of consumer welfare benefit.

extensive and costly exercises of Cost of Service Regulation as occurs in the Regulation of the following industries along with equally complex access arrangements. (viz; Utilities, Rail, Ports and Airports, whether by way of Direct Price Setting such in the cases of Telstra or Australia Post or Regulated Rate of Return in Gas and Electricity distribution and Transmission, Rail and Ports.)

Reasonable Cost Issues

3. The RBA has provided some guidance on the “costs” to be recovered but has stopped short of defining these costs. Clearly we have available to us a body of literature on price regulation in utilities to guide the formulation of what should be included in the “building blocks” and determine what “reasonable cost” that can be recovered by way of a surcharge by a Merchant on Credit Card acceptance.
4. The Office of Fair Trading (OFT) in the UK in its June 2011 response to the “Which? Super complaint on Surcharging” commenced the process of specifying the real costs of credit card acceptance². OFT’s 2011 surveys of costs in the Rail, Ferry and Airline industries starts to quantify the underlying costs to those merchants, and service providers of accepting payments by credit card. This work reveals that the costs are far more complex and extensive than the Merchant Service Fee (MSF) charged by a Card Company. This work has gone some way to address the popular misconception enunciated by some consumer groups and some card companies that the MSF is the sole measure of the reasonable cost of Card acceptance to a Merchant.
5. The work by OFT addressed some of the “Operating Expenses” in a small number of industries. Unfortunately it does not address the total “cost of service” that must be recovered by a Merchant not only to recover its costs but also to earn a reasonable return on the capital invested (including depreciation) in providing card payment systems within an industry.
6. *NBG believes that both the “expense” and the “allowable Rate of Return” elements need to be recognised in any determination of the “reasonable cost” of card acceptance levied by a merchant in the form of a credit card surcharge.³ We are not comfortable that the Card Issuers and Schemes have sufficient depth of understanding of either the concepts underpinning “cost of service” regulation or the costs faced by merchants and payment*

² Office of Fair Trading (June 2011) “Payment Surcharges Response to the Which? Super complaint” at Appendix C outlines some of the costs and structural arrangements which characterise Credit Card payments in one industry sector.

³ As Comacho and Menezes work on “Price Regulation and the Cost of Capital” (2010) Uni of Qld identifies an entrepreneur will only invest in an unregulated market if the expected profit “with effort” will exceed the expected profit “without effort” and the expected profit is greater than zero. Investing in a payment system needs to pass that test. It is also instructive in considering the assignment of the cost “moral hazards”.

systems providers.⁴ In addition, in most cases Merchants do not have a direct commercial relationship with the schemes in order for the schemes to truly understand the total cost of service. In most cases Merchants deal directly with their Bank or Acquirer. A Guidance Note, from the RBA accompanying the “rules” that indicates that both the “expense” and the “allowable Rate of Return” elements are to be factored into determining a “reasonable cost” of card acceptance would assist Merchants and lessen the potential for conflict with “Schemes” and Card Issuers on this matter.

7. Similarly ASIC, as the consumer regulator of Credit Cards should reiterate for Merchants the need for a Consumer to be alerted to the potential for a surcharge well before completing the transaction, the cost of the surcharge is disclosed at the time of purchase, and ideally have available an alternative payment mechanism. ASIC’s current advice to both Consumers and Merchants covers most of these elements but may need to be refreshed to bring it into line with current practice.

Asymmetry and Potential for “Refusal to Deal” needs to be addressed

8. The matter of the asymmetryⁱ (We provide an example of the Asymmetry in practice at this End Note) in the economic incentives between the scheme and the Merchant has the potential to open small Merchants to conduct by schemes which could lead to ‘refuse to deal’ with Merchants who do not accept the Scheme’s view on “costs”. Accordingly the RBA needs to identify the protection/appeal mechanisms available to Merchants when they are unable to reach agreement with a Scheme recovery of “reasonable costs” by way of a surcharge.⁵

Public Benefits of the No Surcharging Rule are evident and need to be enunciated

9. The RBA has been silent on the demonstrable public benefits that have occurred as a result of the “no surcharging” rules. These benefits have improved the “Payment System” and need to be recognised by the RBA in its final determination so that they are evident in the public record.
10. We believe the public benefits to be the new models of service delivery that are emerging in the payment system. We have seen the beginning of shifts in the old

⁴ The Submissions to the RBA’s June 2011 Paper by the “Schemes” demonstrate that the Scheme’s have prescriptive concepts as to “reasonable cost” which fall well short of the RBA’s perspective and the reality. Both Visa and Mastercard are remarkably similar in their approach and arguments. They seek to turn back the clock and entrench their market positions and the traditional structural arrangements with Banks in relation to payments, banking and retail transactions. Thus they do not allow for the paradigm shifts that have occurred in the market in the past 10 years and from which consumers have benefited.

⁵ Whilst it is recognised that Section 46 of the Competition and Consumer Act provides a Merchant with legislative protection recourse can be time consuming and expensive for a small Merchant and thus of limited benefit in situations where the Merchant is in dispute with a Card Issuer.

paradigm that would NOT have been possible if the no surging regime had remained in place. These changes include:

- i. The emergence of lower cost and high technology acquirers (e.g Tyro and GE)
- ii. The emergence of a group of Payment Aggregators (e.g. NBG, PayPal etc) offering high security, value added services to micro capital and small businesses⁶ in industries characterised by issuers as high risk and therefore falling outside their parameters. Without the services of the “Aggregator” those parties would be denied access to credit card facilities and forced to rely on cash only payments. Conversely the Card Issuer has been able to pass on the risk associated with these businesses to the Aggregator.
- iii. Providing end users with direct access to a raft of new online retail sales channels. This has changed radically industry structures and delivered lower consumer costs in a wide range of goods and services by being able to transact with electronic payments. Those retail channels have also provided transparency on transaction costs hidden previously by most established retailers. The consumer benefits derived from lower pricing for goods and services more than outweigh any perceived “cost” associated with surcharges.

All the above have added to “community welfare benefits” and promoted economic growth. Returning to the past arrangements will stifle innovation and growth.

RBA still needs to address the issues of structural separation

11. We know that the Old Paradigm encourages:

- i. Smearing of costs where the Financial Institution undertakes multiple functions
- ii. Cross subsidising of transactions within Financial Institutions
- iii. No effective public structural separation with transparency as to costs. This is particularly the case where a merchant interfaces with a Bank where the Bank is the Agent of the Scheme, is the Acquirer, and the merchant’s lender. These multiple roles have the potential for cross subsidising, higher merchant costs, and higher consumer costs with “card financing costs” being used to extract above market interest revenue streams.
- iv. No business incentive to refresh and enhance old technology and banking practices

⁶ The EC defines a microenterprise, as an enterprise, which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total, does not exceed EUR 2 million. (AUD2.4m); and a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. (AUD 12.2m). In Australia a micro business is one with no more than 5 employees.

- v. The undermining of Australia's EFTPOS system with underinvestment by Banks conflicted in their role as "scheme members".

12. *We believe that the RBA still needs to address the issues of structural separation and the potential for smearing and cross subsidising both within banks and at the merchant level by banks. If these forces are at play then it has the potential to understate the true costs faced by consumers and merchants of the "schemes" and lead to card holders paying higher "borrowing" costs.*

More active Consumer Education needs to be pursued

13. *Further, the RBA's education of the wider community that the provision of card payment services is NOT a free good needs to be considered.*

14. *Similarly, the RBA needs to brief Government Consumer agencies on the "reasonable costs" of providing payment services and that it flows well beyond the popular misconceptions of a Merchant Service Fee so those agencies are better briefed to undertake their face to face dealings with consumers and their advocates on the matter of "surcharges".*

Non-Scheme Products and Charge Cards

15. The RBA paper is silent on the way "non-scheme" cards and proprietary cards will be addressed. The cost of processing these products may be well in excess of a "Scheme's" costs and the card issuer may be willing to accept the Merchant charging a higher surcharge than that which a "Scheme" is willing to agree. In addition, charge cards such as American Express, depending on the industry, apply Merchant Service Fees that can be four times the Merchant Service Fee applied by Visa and Mastercard therefore increasing the Merchant's costs per transaction. As the RBA has identified in its paper, there are a range of technical difficulties faced by Merchants if different surcharge rates are to be applied at the point of sale. The higher surcharge for the "non-scheme" cards and charge cards like American Express thus become the default surcharge for an industry irrespective of what a Scheme believes is reasonable. (e.g. the Scheme may believe that a surcharge of 5% is "reasonable" where as the other Card Insurer may believe that a 10% surcharge is reasonable given the characteristics of the industry. In that instance the "industry" reasonable cost surcharge has to move to 10%.

16. *A Guidance Note, from the RBA accompanying the "rules" that addresses this matter will assist Merchants and lessen the potential for conflict with "Schemes" and Card Issuers on this matter.*

End Note

ⁱ The asymmetry of the relationship between a card issuer and a merchant is most evident in the practices associated with Disputed Transactions and Charge backs. A cardholder has a contractual arrangement with a card provider. Once a cardholder pays for a good or service with a credit card the payment arrangements between the Merchant and the Customer are terminated and payment arrangement is solely one between the customer and their card issuer. The Merchant in accepting payment by Credit Card is accepting that in lieu of cash to be provided by the Credit Card issuer. Card issuers can adopt "heavy handed" approaches to dealing with Merchants which devalue the "cash surrogacy" of "plastic". The practice of "Full Recourse" is one in which a Merchant is unilaterally deprived of its "cash" by the Card issuer. This practice occurs even though the transaction was a legitimate one. The Merchant has no avenues of appeal and bears the full cost of the loss of income as well as any investigations it is required to undertake. Further customers frequently make the Merchant the first point of call to resolve transaction concerns because they face a fee of \$50.00 from the Card Issuer if it investigates the Cardholder's enquiry. The Merchant provides this service free of charge for both the cardholder and the Card Issuer to investigate and resolve the cardholder's complaints as part of it's cost of card acceptance.

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