NATIONAL BILLING GROUP PTY LTD

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SUBMISSION TO THE RESERVE BANK OF AUSTRALIA

PAYMENT SYSTEMS BOARD

"REVIEW OF CREDIT CARD SURCHARGING CONSULTATION"

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WHO ARE WE AND WHY WE HAVE AN INTEREST

National Billing Group Pty Ltd (NBG) trading as CabFare has been in the Taxi market since early 2008 offering services to operators in the taxi and limousine (Hire Car) markets.

Our primary focus has been to offer simple, fast and secure electronic transaction services to our customers. NBG partners with Tyro Payments (an APRA licensed ADI) providing customers with a fast and secure real-time EFTPOS payment system. As a result, this means our customers enjoy a very fast and secure transaction processing experience. Our online real-time transaction reports allow Taxi and Limousine Operators to better manage their fleet of cars and drivers.

The Payment Systems Board (PSB) has sought views from the community on a variety of issues relating to the pass through of surcharges to customers using credit, debit and charge cards to purchase goods and services.

National Billing Group's CabFare is a “merchant” operating in the Taxi and Limousine industry offering a third party EFTPOS solution to the industry as an alternative to Cabcharge.

The PSB has issued its consultation paper in response to criticism by consumer interest groups alleging overcharging by Merchants for service fees charged on consumers using cards particularly in on line transactions. Application of service fees by merchants has increased in some industries following the implementation of the so called “no surcharging” regime.

The Board has posed a range of questions on which it is seeking advice.

In this submission *we have commented generally on the matters associated with Surcharges in the Taxi and Limousine industries and we have provided our perspective on the specific matters on which the PSB has sought comment.*

INTRODUCTION

By way of background it is appropriate to flag the previous positions of various regulators on the mater of surcharges in Credit Card Schemes.

In 1980 the then Trade Practices Commission authorized the Bankcard scheme under the Trade Practices Act on the condition that scheme members not impose restrictions on Merchants determining the prices charged to customers paying either with cash or Bankcard.

In 1992 the Prices Surveillance Authority's report on "Inquiry into Credit Card Interest Rates" concluded that there was an in principle case for giving merchants the freedom to set prices reflecting the method of payment.

The RBA, as part of the implementation of the so called "no surcharging" arrangement publishes Draft Standards for Merchant pricing for Designated Credit Card Schemes and specifically states that the purpose of the standards is to "promote efficiency and competition in the payment system by ensuring that a merchant accepting a credit card of a designated card scheme for the purchase of goods or services is free to recover from the credit cardholder the cost of accepting that card".

In other words there is a long tradition extending back 31 years of regulators seeking to enable Merchants to pass through the costs of providing a customer with access to credit facilities using a card.

It is worth noting that the standards that accompanied the implementation of the "no surcharge" regulations were determined after exhaustive study, consultation, and comment by industry participants and their advisors.

The current discussion paper seeks to reshape the regulatory environment without any comprehensive analysis of the likely competitive outcomes and whether the imposition of surcharge caps will deliver a competitive or efficient outcome. It appears to be a knee jerk reaction to a perceived problem without adequate dialogue and analysis. Competition theory and practice with "price setting/surveillance" mechanisms and caps would suggest that this will deliver inefficient outcomes with a resultant diminution in "community welfare" long term.

Accordingly the PSB, as Industry Regulator, should tread warily before embarking on imposing caps as part of the regulatory regime it has suggested. Further it may be beneficial for a more detailed examination of the likely implications of the mechanisms proposed and the competitive implications in a further joint study with the ACCC, as the national economic regulator.

ISSUES ARISING FROM THE PSB PAPER ON CARD ACCEPTANCE COSTS

No Explanation of the need for Change

The current discussion paper does nothing to explain why there needs to be a shift in the regulatory regime other than a perception that for some consumers they feel that credit card surcharges are "too high" and exceed the merchant service fee charged by the scheme. This position is both naive and simplistic in its analysis and is not supported by the actual costs faced by many merchants in providing credit and charge card facilities. This is particularly the case in the Taxi and Limousine (Hire Car) industry.

No evidence of Market Failure presented

The proposals by the Board seem to assume that there is some form of "market failure" arising from the imposition of "surcharges" by merchants. What the nature of the failure is not detailed other than "consumers" objecting to paying a surcharge. Unless the market failure can be demonstrated then NBG believes that there is no justification for intervention in the market in the forms canvassed in the PSB's Discussion paper.

In the absence of any demonstrated market failure the issues that needs to be addressed is the "consumer perceptions" on surcharges on the quantum the surcharge applied by some merchants. The consumer perceptions outlined in the paper can be traced to a number of factors. These are:

(i) The use of the terminology of "No surcharges" in the regulatory vernacular has given rise to a populist belief that the consumer faced no surcharges when in fact the purpose of the regulatory arrangements was to free merchants from the provisions that prohibited surcharging so that the costs of card acceptance could be recovered. Previous practice distorted the provision of goods and services with the cost of accepting a credit card being smeared across the price paid by all consumers whether they paid by cash or card.

(ii) It is assumed that the "Merchant Service Fee" is the only cost incurred by a merchant in the provision of credit/charge/debit card facilities. In practice there are a wide range of costs imposed on Merchants that fall outside that "Fee". Card acceptance costs vary between Merchants and industries. But as a minimum they include data charges, EPAL surcharges, terminal financing costs, payment system development costs, and fraud costs (including Charge backs from scheme operators). To lump the total costs associated with the provision of a service under the banner of "surcharge" is erroneous and leads to misunderstanding by organizations such as CHOICE. Further in the taxi and limousine industry there is a range of additional costs associated with delivering the benefits of second EFTPOS networks to consumers.

(iii) Consumer advocacy groups appear to assume that the provision of card facilities by a merchant is a "free good" with no acceptance costs save for the Merchant Service Fee. As the RBA noted in its 2001 report "Credit card services are more costly to provide than most other payment instruments" but that simple truth has not been understood across consumers. The RBA needs to educate consumers as to the full cost of merchants providing them with access to EFTPOS credit, charge, and debit card facilities.

Ideally the cardholder should be the party who bears the full cost of provision of the facility associated with the card, including the costs of so called loyalty schemes and NOT the Merchant subsidizing the cardholder. The issue of cost attribution is further clouded when card issuers are the acquirer. They are unwilling to fully price their card to the consumer preferring to transfer this cost onto the Merchant. This is because the Merchant is the party who is best positioned to collect the charges as they are the last point between the "system" and the cardholder and bear the full costs of the system.

No analysis of Transparency and Smearing of the total Merchant Cost of offering Card Payment Systems

Missing from the existing surcharging and service charge regime is transparency. Only a limited number of industries provide the transparency that regulators assumed would flow from the "no surcharging" decision. The PSB's own market research confirms that transparency of surcharges prompts changes in consumer behavior in purchasing. It is when the charges become transparent that the information asymmetry between consumers/merchants and card issuers that used to exist has been addressed. The taxi and limousine industries do provide transparency of cost reflective pricing on total cost incurred by the merchant in the provision of EFTPOS services.

Now that transparency is in limited operation it has prompted suggestions that charges should be capped or some other form of regulatory intervention is required. Such a response is premature rather what is necessary is to address the failure of all merchants and industries to make the cost of card acceptance visible to the consumer.

Further it is clear that because of the lack of transparency many merchants continue to "smear' the cost of the provision of card acceptance across all customers and bury the costs in the overall price paid for goods and services. (e.g. Most major retailers have not made the cost of the provision of card services transparent to consumers).

The lack of transparency on card acceptance costs afforded by the majority of merchants has lead to commentators and critics to target those merchants and industries where the costs of card acceptance are overtly transparent. These industries and Merchants are soft targets because they are open and transparent in their charging. Consumer advocates are misguided in their attacks. That is, they target the wrong merchants. *It is the merchants and industries that smear and hide costs of card acceptance that should be the target.*

Requiring all merchants to advise customers of the "service charge" being applied to their purchase as a separately itemized component on all EFTPOS invoices with the GST applied to the fee would deliver transparency across the industry and not simply for those few merchants who do so at present. The PSB's stated regulatory objectives that such transparency is applied for all credit/charge/debit card transactions. Whilst this may require some minor changes to the systems of the acquirers it is a relatively small change and easily implemented in our experience with Tyro Payments. It should be up to the individual Merchant to set the fee for offering the service. The customer can then make an informed choice whether to pay by card or cash.

Cross Subsidizing is Occurring when Card Issuers, Acquirer and a Merchant's Bank is effectively the same Entity or are related.

There is evidence to suggest that cross subsidization occurs where the entity which is the acquirer and the provider of a merchant's banking and business services are one and the same. In that instance the provision of EFTPOS facilities, particularly to small merchants, can be bundled into a merchants overall banking arrangements. There is a question as to whether such practices impede the penetration of lower cost acquirers with more technically sophisticated solutions, as they are unable to offer the full “suite” of services that the merchant’s bank offers.

As a Regulator the PSB may need to be more rigorous to identify cross subsidizing and if necessary enforce structural separation of the functions of the various entities in the Credit Card, Charge Card and Debit card industry. Further the proposals by EPAL should be subjected to wider scrutiny by regulators in particular the ACCC.

The absence of structural separation in payment systems is analogous to the situation that has applied between wholesale and retail elements in telecommunications and other network industries before regulatory intervention.

No discussion of Fraud that is a key element in Cost of Card Acceptance

The PSB’s Consultation paper does not deal with the direct and indirect costs of fraud in the Credit/Charge/Debit card systems. Yet the PSB’s “Consumer payments Use Study” published in June 2011 flags that fraud is the most significant concern of consumers and NOT surcharges. The absence of a strategy or policy on pricing fraud is a significant omission in the debate on this matter. Currently cardholders are shielded from the full cost by Schemes because to do otherwise would have a negative impact on card acceptance. Rather they target merchants through risk premiums for specific industries and high “charge backs” costs often well in excess of the transaction value.

Accordingly Merchants seek to pass through the “risk” premium to consumers. This clearly is the case in on line transactions, where there is no face to face contact with the consumer, and industries that are service based and the customer interface is very transitory (e.g. Taxis and Limousines). Accordingly addressing the risk as part of the surcharging discussion needs to be considered. For Example this may require mandating of security standards such as PCIDSS (Payment Card Industry Data Security Standard) and PADSS (Payment Application Data Security Standard) or encouraging Issuers and Acquirers to offer discounts to Merchants who are PCIDSS and PADSS compliant. This would be an effective mechanism to encourage the industry to address the Consumers No 1 concern about Card usage, Fraud.

The impact of volume discounting to large merchants

The practice of volume discounting by both issuers and acquirers increases the costs of card acceptance to small merchants compared to large merchants in the same industry classification. The impact of the volume discounts in Merchant card acceptance costs can be quite significant. There are no reasons advanced by Card Issuers to support the practice other than "ability" of the Merchant to deliver more transactions to the Card Issuer and its acquirer and thus drive up their revenues. That is, volume discounts are used as a "marketing tool".

The impact of the practice on the PSB's proposals for a cap on surcharges will be to place additional cost pressures on small merchants, as they do not receive the volume discounts afforded to large merchants. It is small Merchants targeted by CHOICE who are facing the highest risk transactions and who do not have access to volume discounts.

The impact of selective risk allocation by Merchants to obtain lower Merchant Service Fees

NBG is aware that some Merchants may seek to "by pass" the risk pricing mechanisms of a Card issue to obtain a lower Merchant Service Fee by reclassifying their business. Schemes differential price risk into the Merchant Service Fees according to industry fraud risk. NBG supports the pricing of risk through the Merchant Service Fee but it is aware of the practice of some Merchants to reclassify their business to attract lower merchant service fees. (e.g. classifying a high risk Taxi fare as a lower risk Auto Service). This practice distorts the competitive landscape and increases the potential for fraud to both the cardholder and the scheme. It also brings the reputation of the scheme into disrepute. The issue of Fraud and the pricing of risk needs to be addressed in surcharging standards and policy by the PSB. *At an operational level the matter of Merchants seeking to by-pass a scheme's risk mechanisms needs to be addressed by the PSB with Schemes as it threatens the credibility of the payment system.*

Whilst the PSB Consultation Paper accepts that there may be a large variation in card acceptance costs faced by Merchants, the PSB tacitly accepts the CHOICE position without any research or analysis of industry costs and practices. This cannot be accepted as a solid basis of policy formation on this matter. The practice of volume discounting to large Merchants, the cost of fraud to Merchants, and the practice of bypassing scheme risk mechanisms by some Merchants needs to be addressed before any policy is determined.

Consumer Choice.

There is an argument advanced that consumers do not have a choice when acquiring an item. In fact there are a number of choices that they make:

i. The first is to not make the purchase. This requires them to either defer gratification that is a behavioral response that generally is within their control.

ii. To seek out another provider for the equivalent or similar service

iii. To pay cash or EFT and perhaps negotiate a discount in the price to compensate for the lower costs incurred by the Merchant. This is difficult when the cost of providing the Credit Card service is not transparent and is smeared across all purchasers. This is a function of information asymmetry facing consumers with most merchants on card acceptance costs.

iv. To use a non bank payment system e.g. PayPal.

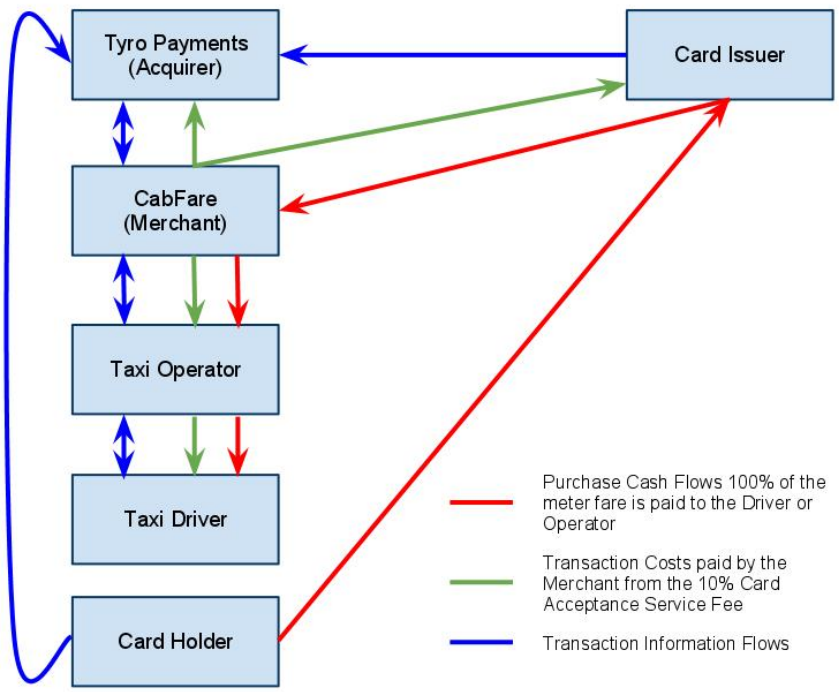
In the long term if a Merchant faces a significant loss of business or a card scheme provider loses market share because of its higher merchant service fees then the competitive process will deliver an outcome where there is a reduction in fees and charges. Mandating a cap on a surcharge will deliver an inefficient market outcome.

TAXI AND LIMOUSINE INDUSTRY SPECIFIC ISSUES

There is much ill informed criticism leveled at the Taxi and Limousine industry by consumer groups citing the 10% card acceptance service charge as an excessive surcharge. We can comment on the specifics of Taxi and Limousine industry from the perspective of a new entrant Merchant and a third party provider in the industry.

The analyses undertaken at the time of determining the “no surcharging” regulations assumed that credit and debit card transactions were either 3 or 4 party transactions. To understand the taxi industry it is necessary to be aware that it involves 6 parties and not 3 or 4 and hence the analysis is considerably more complex than has been described in the literature or in the media or by CHOICE. The parties in this industry are:

Taxi & Limousine Transaction Flow



This Figure demonstrates the number of participants and the information flows (blue), cash flows for the service provision (red) and transaction cost flows from Card acceptance (green) paid by the Merchant to various parties. In addition there are cash flows between Tyro and the Issuers that are recovered as part of the transaction processing costs paid by the Merchant.

CHOICE is focused on the fact that historically Cabcharge has been one provider of EFTPOS terminals, charge cards and payment systems in the industry.

Recently new entrants have entered offering Merchant services to the industry for non-Cabcharge cards. It is the existence of a service charge for card acceptance that new entrants have emerged. Without the surcharge and technology changes there would be no competitive offering in the industry for consumers. Unfortunately they have been prevented by the incumbent (Cabcharge) from competing effectively by processing Cabcharges own cards across their third party EFTPOS payment systems.

Cabcharge has established its significant position in Taxis over 30 years as a result of its wider industry arrangements including the provision of equipment to taxi operators, ownership of dispatch systems, ownership of Taxi Networks (including brands) and ownership and leasing of taxi licenses. Further it has in place specific arrangements with various State Governments who have mandated that Cabcharge equipment to be installed in taxis for a variety of reasons. This ensures that third party EFTPOS providers face high costs of entry and high barriers to entry that need to be recovered.

New entrants have had to offer alternative equipment and arrangements based around a 10% service fee with a share of that being provided to the Taxi or Limousine operator and driver. Further the new entrants have sought to offer equipment that is often technically superior and more secure than the Cabcharge systems.

As a result consumers and the industry now have available to them a choice of eftpos terminal and payment systems with enhanced features. The Taxi and Limousine industry is the only industry where Operators have a choice of equipment and EFTPOS network provider. The Merchant, such as CabFare funds the cost of providing the cost of the additional network and terminals from the "surcharge" on taxi fares. This is part of the overall bundle of costs associated with the cost of card acceptance faced by the Merchant in the industry. The Merchant also pays part of the service fee to the Taxi and Limousine Operator and Driver to overcome the barriers to entry faced on the new entrant by the incumbent, Cabcharge and its legacy systems.

The benefits of the development of competing EFTPOS networks in Taxis and Limousines have been:

i. Consumers face lower fraud because of the elimination of “paper” emergency dockets because if there are two EFTPOS networks in operation. It eliminates claims that the “Cabcharge” system is not operating exposing the consumer to paper emergency dockets with significantly increased fraud.

ii. Consumers face lower fraud because of the elimination of need for Cabcharge’s backup mechanism called “store and forward” for transactions where their network isn’t in radio range. The second EFTPOS network offers redundancy in order to complete lower fraud card present transactions. This is not an issue facing Merchants in retail outlets with static landline communication protocols.

iii. Drivers are protected from stolen and cancelled cards via the NBG/Tyro system as it is consistently updated for stolen and cancelled cards.

iv. Taxi and Limousine Operators and Drivers now receive improved financial compensation from the new entrants.

These arrangements contrast with the USA where the Taxi Operator/Driver is forced to pay 5% of the fare to the scheme operator when accepting a credit card. That is, the operator is subsidizing the cardholder for the benefit of paying by card rather than cash. Whilst this has some attractions from the perspective of regulatory economic theory it leads to card refusal in Taxis and is reported to give rise to significant disputation (often violent) between drivers and cardholders. This is because of a mismatch between the cardholder’s desire for the convenience of a cashless and simple transaction experience and the Taxi Operator who faces a loss of revenue. The use of a surcharge in Australia, which is paid by the cardholder, has removed this potential conflict.

COMMENTS ON THE SPECIFIC PSB ISSUES

ISSUE	NBG COMMENTS
Should the Standards be modified to allow Schemes to limit Surcharges	This would be a retrograde step. The PSB has not made any case for the imposition of such a standard nor has there been any evidence of demonstrated market failure to move from the current position. Price Regulation at the best of times is difficult and we believe that structural alternatives exist to effect greater transparency for consumers in relation to the costs of card acceptance across all merchants. Requiring all merchants to separate out the costs of card acceptance is preferable to imposing caps. This will afford consumer choice and deliver the transparency the PSB's original regulatory changes were designed to deliver. If a cap were introduced as a piece of policy it does not address far more fundamental issues confronting the EFTPOS system. These include: • Addressing Consumer's number 1 concern namely Fraud by mandating the standards required for system security at all levels. • Merchants by-passing the risk pricing signals by falsely classifying services and bringing the EFTPOS system into disrepute with consumers • Addressing the structural issues associated with bundling of services by issuers/acquirers and in merchant banking packages so as to limit a merchant's access to alternative EFTPOS networks particularly those with more technically advanced and lower cost infrastructure. Addressing these fundamental issues should be incorporated into a wider reform package of EFTPOS designed to bolster system integrity and consumer confidence.

(i) Is the PSB best placed to set a transparent and specific permissible Cap OR (ii) Should the Standards allow scheme rules to limit surcharges to reasonable merchant costs of card acceptance	(i) Price Regulation at the best of times is difficult and will only establish a costly and lengthy regulatory process. It is unlikely to deliver any discernable consumer welfare benefit and over time lead to gaming of the regulatory system. Further it flies in the face of decades of regulatory commitment to enable Merchants to charge costs of card acceptance. Again there is no evidence provided of market failure. The PSB has not canvassed the feasibility of increasing transparency at the point of sale by requiring the service charge of card acceptance to be identified by all merchants as a mechanism to inform consumers. (ii) Again this proposal is fraught with dangers. It is unclear how schemes will differentiate between Merchants and industries. If the current practices of offering volume discounts, cross subsidizing, pricing risk on a blanket basis without any regard to the security posture of a Merchant's IT environment were to be extended to include "reasonable surcharges", then small Merchants will be disadvantaged. Of the two options proposed it is the least objectionable as it places the onus on the Merchant to be able to justify the costs of acquisition and has the potential for self regulation.
Should there be reasonable tolerance around any surcharge cap	This opens up the whole issue of regulatory discretion and potentially would require the PSB to determine what is reasonable for industries and specific Merchants. The question presupposes that the imposition of a cap is a credible policy option when clearly it is not. Requiring transparency of card acceptance costs by all Merchants with separate charging (including GST) is a preferable outcome leading to an informed market.
Blending of surcharges and differential surcharging	In the Taxi and Limousine industry blending is essential to avoid costly and excessively complex IT systems development costs which differential surcharging would impose. Our analysis of the differential surcharging indicates that it would deliver negligible benefits to consumers in this industry. We note that some Merchants already offer this because it can be applied at the time of transaction. Such flexibility is not available in Taxi and Limousines as the transaction

	costs are calculated separately by the acquirer from the fare costs and pushed to the EFTPOS terminal or preconfigured on the EFTPOS terminal. To move to differential surcharging will open the consumer to potential fraud and overcharging.
Disclosure of information to Merchants by acquirers	We have no comment on this item
(i) Should Merchants be compelled to disclose the cost of card acceptance or (ii) Is the RBA publishing of Merchant Service Fees adequate to inform consumers?	(i) As we have flagged, requiring transparency of card acceptance costs by all Merchants with separate charging (including GST) is a preferable outcome leading to an informed market. (ii) The publication of Merchant Service Fee rates by the RBA will only continue to confuse the market and not inform. The existing "surveys" give rise to false expectations. The aggregation of this data hides the true cost of card acceptance faced by Merchants.

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