# MasterCard Worldwide

## Response to Reserve Bank of Australia Review of Card Surcharging

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## 1. Introduction

MasterCard and our cardholders have been increasingly concerned with the growing trend by Australian merchants to levy excessive and/or blended surcharges. This trend is not consistent with the original intent of the Reserve Bank of Australia (RBA) in allowing surcharging and are clearly detrimental to consumers.

As the RBA has stated, surcharge regulation was intended to 'improve price signals' to consumers about the relative cost of different payment options. We are in strong agreement with the RBA's observation that there has been increasing evidence to suggest that it is now becoming more common for merchants to set surcharges at levels higher than the average merchant fees and that the increasingly widespread nature of this practice has the potential to distort price signals to consumers and thereby undermine the RBA's stated purpose for permitting surcharging.

We also agree with the RBA that this situation has become pervasive in Australia. According to East & Partners data presented by the RBA, about 30 per cent of merchants surcharge the cards of one or more of the payment network brands, ranging from 25 per cent for small merchants to well over 40 per cent for larger merchants. Only 20 per cent of merchants have no plans to surcharge and there is no evidence that these levels have plateaued. There is limited data on the proportion of transactions that are surcharged, with the RBA reporting a range of 5 per cent overall to up to 44 per cent in the holiday travel industry.

The ability for merchants to give so-called 'price signals' by surcharging for some payment methods but not for others (such as cash and cheques) is a failure of common sense. This arrangement is based on the assumption that cash transactions are cheaper than card transactions and this is clearly not always the case. A number of independent studies from around the globe put the cost to merchants of a cash transaction at anywhere from 1.3% to upwards of 2.5% of the value of a purchase. The cost of cash to society is even higher, since cash usage results in additional costs to governments (e.g. for printing and distributing money and from lost tax revenue) and to consumers (from loss and theft).

The regulation of the past decade has resulted in many unintended consequences. The most critical of which sees consumers now paying more (for paying).The RBA has made a slow (but consistent) retreat from specifically linking the package of regulations (which included the Standards that allow unrestricted surcharging) with savings passed through to the community (consumers) in the general level of prices.

- In 2002, the RBA said savings (as a result of regulation) would be passed "through to the community in the general level of prices"[1];
- In 2005, the RBA's Payment Systems Board (PSB) said they believed there had been "smaller price increases [for consumers] than otherwise would have occurred"[2] in the absence of regulation;
- In 2006, the RBA stated that the flow in savings for merchants on to consumer prices was "difficult to measure"[3];
- In 2007, the PSB acknowledged that merchants saved a considerable sum "which in the normal course, would be passed through into lower prices for goods and services"[4] but did not suggest there had been any savings for consumers;
- In 2010, the PSB said, since "the introduction of the reforms, decreases in merchant service fees across all four schemes are estimated to have produced cumulative savings to merchants of around $6 billion…"[5], but again, did not mention any pass through of

[1] RBA Media Release, 27 August 2002 "Reform of Credit Card Schemes in Australia"
[2] Payment Systems Board, Annual Report 2005 (http://www.rba.gov.au/publications/annual-reports/psb/2005/html/credit.html)
[3] Payment Systems Board, Annual Report 2006 (http://www.rba.gov.au/publications/annual-reports/psb/2006/html/reform-card.html)
[4] Payment Systems Board, Annual Report 2007 (http://www.rba.gov.au/publications/annual-reports/psb/2007/html/reform-card.html)
[5] Payment Systems Board Annual Report 2010

these savings to consumers nor specifically mentioned any consumer benefits from surcharging

- Now, in 2011 in this latest consultation, the RBA states *"merchants have increasingly been adopting a number of surcharging practices that have the potential to distort price signals and thereby reduce the effectiveness of the surcharging reforms."*[6]

In addition to the lack of quantitative evidence supporting benefits as a result of surcharging, consumer perceptions – both in Australia and in other global markets – strongly suggest that consumers don't perceive they are better off with surcharging – cardholders are paying more and non-cardholders don't believe prices have declined.

*Excessive surcharging*
While the details of merchants' costs to accept various payment options are complex, a simple comparison of surcharge levels and Merchant Service Fees (MSF) over the past three years well illustrates how some merchants have been able to abuse the surcharging regulations. In 2007 the average surcharge[7] for both general-purpose credit cards and charge cards was roughly consistent with costs, as measured by the MSF. In 2010 surcharge levels[8] were about 1 per cent higher than MSF which is a 100% greater than the four party payment system MSF, for both general-purpose credit cards and charge cards[9].

In the Australian market, the MSF typically represents the merchant's cost to accept card payments and it is unlikely that other costs related to card acceptance increased during this period in a manner that resulted in the excessive increase in the surcharge fee level above the MSF. The inevitable conclusion is that merchants are surcharging well above their cost to accept card payments and are using the excess surcharges to subsidise their business operations. These practices distort the price signals that were the RBA's stated reason for allowing surcharging.

Given the ample evidence of excessive surcharging and RBA's prediction that an increasing per cent of merchants are, or are planning to surcharge, suggests that revisions to surcharge regulations are timely, warranted, and in the best interests of consumers.

*Blended surcharging*
The apparent increase in blended surcharging is another unintended consequence of regulation. We agree with the RBA's concern about this practice. Among the RBA's goals in establishing the Standards was to enable merchants to provide an incentive to consumers to use a lower-cost payment card brand instead of a more expensive one, or to use another form of payment altogether. Where a merchant applies the same surcharge to all card schemes, this ability to provide 'price signals' is eliminated. A consumer is not being given an incentive to use the card of one brand instead of another; rather, the merchant is simply recovering its costs of the higher-cost scheme while deriving additional revenue from users of lower-cost payment cards. We are aware that the increased prevalence in blended surcharging has been actively encouraged by the higher cost and unregulated schemes through financial incentives and/or contractual obligations with merchants.

MasterCard has continuously worked with the industry and government to understand the negative impact that surcharging has on the price that consumers pay for goods and services. To that end, we welcome the Reserve Bank's review into current surcharge regulations, and appreciates the opportunity to provide a formal submission.

Of course, we would be happy to be involved in any further consultative processes.

**Eddie Grobler**
**Division President, Australasia**

[6] RBA Consultation Paper, June 2011 "Review of Card Surcharging: A Consultation Document"
[7] RBA Reform of Australia's Payments System, Preliminary Conclusions of the 2007/08 Review, April 2008
[8] RBA Consultation Paper, June 2011 "Review of Card Surcharging: A Consultation Document"
[9] RBA Chart C3 - Merchant Fees for Credit and Charge Cards (www.rba.gov.au/statistics/tables/xls/c03hist.xls)

## 2. Summary of MasterCard's Position

MasterCard has long held the view that current Australian regulations that allow merchants to add a surcharge to a card payment with no caps and limited effective transparency to consumers, have resulted in consumers being adversely impacted. Some merchants, particularly those in dominant geographic, market or channel positions, have inappropriately used card surcharges to supplement revenues and widen margins in their mainstream business.

One of the best systemic examples of this is payments to online merchants, where merchants often surcharge for card acceptance, despite the fact that cards are regularly the only form of payment accepted. In an environment where all payment options are surcharged, the consumer has no choice but to pay the additional fee. It simply becomes an additional 'tax' on top of a consumer purchase. The recent Office of Fair Trading (OFT) document on surcharging[10], which focuses on the UK travel industry, provides insight on how surcharging can occur in instances where market power is not necessarily evident. Surcharging consumers for transactions through the online channel – which exists in no small part due to the work of card schemes to facilitate payments for these merchants – is particularly insidious.

Because the current RBA Standards allow unrestricted surcharging, without regard for the different costs merchants incur to accept different forms of payment, they do little to promote the RBA's stated goals of transparency, efficiency, and competition. In announcing the reforms in 2002, the Governor of the Reserve Bank, Ian Macfarlane said:

> *"The Payments System Board has endorsed a balanced set of reforms which will ensure that normal market mechanisms work in a more transparent and effective way in the Australian payments system, to the benefit of the Australian community as a whole."*[11]

In their latest consultation the RBA identifies two primary concerns – that blended surcharging masks cost differences amongst different payment options; and that surcharging in excess of costs is too prevalent and distorts price signals. MasterCard believes there are in fact additional points that must be considered. Firstly, that the merchants' ability to recover payment costs via surcharges has had no demonstrable downward effect on consumer prices (as claimed would occur by both the RBA[12] and retailers[13]); and secondly that all other forms of payment have associated costs – including cash – which impacts the reference point to which the price signals apply. Both these points are important in any discussion as to a way forward.

In this submission we look at these four areas and what is needed to get to an improved and more equitable outcome for consumers while still allowing merchants, should they so chose, to apply surcharges that are actually related to the different costs of acceptance of different payment instruments.

### a. Cash is an important consideration in any payments system

In our response to the RBA's December 2001 Consultation Document, MasterCard stated:

> *"The cost to merchants of handling cash is high. For example, the Prices Surveillance Authority of Australia has reported that, 'the security and administrative costs to merchants of holding cash means that cash transactions are not necessarily less costly than credit or charge card transactions. Myer Stores and the Retailers Council of Australia submitted that costs of cash sales (in-store collection from cash registers, counting in the back office,*

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[10] "Payment surcharges, Response to the Which? Super-complaint", Office of Fair Trading, June 2011
[11] RBA Media Release, 27 August 2002 "Reform of Credit Card Schemes in Australia"
[12] RBA Consultation Review. '*The Schemes' No Surcharge Rule "contributed to the subsidisation of credit card users by all other customers, with the uniform prices charged by merchants for goods and services needing to cover the relatively high costs associated with credit card acceptance*"', May 2007
[13] Australian Retailers Association Submission "*All consumers pay indirectly for the use of credit cards through higher prices that are charged by retailers to recover the MSFs levied by financial institutions. This leads to inequity for consumers as credit card users are being subsidised by non-credit card users through the averaging effect of higher prices, irrespective of the method of tender used.*" September 2001

*security transport services, inaccuracies, etc.) were only marginally less than the costs associated with credit cards.'"*[14]

The RBA has never adequately considered the cost of cash in their comments or consultations related to regulation of payment methods. As described in previous MasterCard submissions, the 'relevant market' for an analysis of the four-party schemes is the total payments market, which in addition to the four party schemes includes cash, cheques, payment cards (including pre-paid, debit and store cards) and the three-party payments schemes. By not adequately considering the cost of all payment methods and specifically cash, the RBA has often presented a truncated analysis that can lead to incorrect conclusions and actions. For example, the traditional role of cash in the payments system is an important element in the OFT's review of surcharging[15] and, in particular, its recommendation related to surcharging and payments to online merchants.

This submission is not the place to go into the relative cost of cash versus other payment methods but it is important to acknowledge that cash has a cost to merchants, consumers and the wider economy. The cost of cash as a payment method  should be a consideration in any ongoing and future regulation. MasterCard's position remains that payment card surcharging is not warranted because merchants are allowed to offer discounts for cash. Payment card surcharging has clearly led to abuses, as evidenced by this consultation. The cost of cash continues to be important because it can impact any reference points for setting surcharge caps and affects surcharge considerations for payments to online merchants.

**b. The introduction of surcharging has not reduced consumer prices or improved price signals.**

Successful and efficient four-party networks require an appropriate, interrelated commercial framework. Historically the most appropriate surcharging policy is one that allows the payment schemes (including MasterCard) to enforce their No Surcharge Rules. However, in Australia, the RBA has given no indication that it will lift the abolition on the No Surcharge Rules and most likely will continue to permit merchants to seek to recover the transactional cost of accepting cards.

MasterCard has always held the view that, in those countries where merchants can surcharge card-based payments, relatively few merchants do so for a number of reasons. Merchants acknowledge they receive a valuable service (including substantial benefits like the payment guarantee, virtually immediate payment into their account and incremental sales that in most cases far exceed their cost of acceptance) at a fair price; a basic cost of doing business is offering customers choice and accepting all forms of payment (including cash); consumers can pay with cash, which has its own cost of acceptance for the merchant; and generally competitive markets provide considerable consumer choice. Further, accepting cards as payment is a decision that merchants make in the full knowledge of cost and not a compulsory requirement of doing business. Merchants have a clear choice either to accept cards as payment or not. Indeed, many merchants do not accept cards, as is their right.

An exception to the above has emerged in payments to online merchants, where the incidence of surcharging, whether measured by merchants that surcharge or number of transactions surcharged, is substantially higher than for brick and mortar merchants. The reason for this lies in the unique nature of ecommerce transactions. As reported by the OFT, merchants can 'drip price', masking the surcharge until well into the purchase process. Further, practicably real-time pricing changes and the inability in most instances to pay with cash can restrain the customer's real or perceived ability to shop around. Online commerce has changed the nature of the retail transaction process – and as an evolving retail innovation, merchant practices and consumer behaviour has been demonstrably impacted. In many markets the consumers' perception is that, in online commerce and other situations in which the consumer is 'captive', merchants surcharge 'because they can'.

Regardless of the degree to which surcharging is occurring or whether it is an important aspect

[14] MasterCard Submission, March 2002 "Reforms of Credit Card Schemes in Australia"
[15] "Payment surcharges, Response to the Which? Super-complaint"

of the payment systems framework, the RBA's stated expectation has been that revenues from surcharging would in effect be passed through to consumers in the form of lower prices. Contrary to the RBA's early assertions, there is no evidence to support, nor reason to believe, the assumption that unconstrained surcharging leads to a general reduction in consumer prices, or that it leads to better 'price signals'.

The general consumer perception is that where surcharging occurs, merchant revenues have gone up to the benefit of merchants, but consumer prices are not reduced. This point was well stated by Choice in their September 2010 report:

> *"Overall, the RBA estimates savings to merchants through lower merchant fees at about $1.1 billion per year. But it is hard to prove that this has led to lower retail prices to consumers."*[16]

In addition to the impact (or not) of surcharging on consumer prices, surcharging as it is now implemented actually leads to price distortions even though the RBA has argued that surcharging would provide better price signals. As the RBA correctly points out, surcharging was slow to develop.[17] However once merchants learned that consumers did not always have choices and flexibility to avoid surcharges they began to levy surcharges well in excess of costs. A merchant surcharge above the costs of card acceptance does not result in more accurate price signals to consumers but instead creates price distortion.

### c. Blended surcharges are inconsistent with the RBA's stated goals

As MasterCard has indicated to the RBA, we have long been concerned with a growing trend by Australian merchants toward the practice of charging consumers the same surcharge amount (a blended surcharge) regardless of the card brand used (MasterCard, American Express and others). As the RBA is aware, the average MSF in the first quarter of 2011 for a MasterCard and Visa transaction was 0.86%. The same figure for American Express was 1.89%[18]. The stated intent of the regulations to allow unrestricted surcharging was to provide merchants with the ability to provide better price signals by assessing a surcharge for their cost of accepting cards. Given that the current MSF differential between MasterCard and American Express is 1.03%, a merchant's assessment of the same surcharge to each card brand does not achieve the RBA's stated goals: it does not accurately inform consumers of the merchant's cost of accepting the card of a particular payment brand, and it does not provide a consumer with an incentive to use one payment brand instead of another. It does however disadvantage MasterCard to the sole benefit of American Express. To that point, MasterCard's concerns in this regard are not just reputational. By charging a higher MSF to merchants, American Express is able to promote usage of their product by reinvesting the additional funds they receive from a higher MSF in programmes to stimulate use and acceptance of their cards. These efforts have stimulated substantial growth of American Express, as is evident in the RBA's tracking of market share; American Express reached over 20% in the value of all credit and charge card spend in October 2010 compared to 14% in January 2002[19].

The fact that the most expensive card scheme managed to increase market share despite offering a higher cost product should be a strong indication that the reforms resulted in the unintended consequence of higher costs to the payments system and ultimately the consumer.

In short, the longer this practice of blended surcharges is allowed to continue and merchants are not limited in the amount they can surcharge, the more damage is done to Australian consumers, who are paying ever increasing surcharges resulting from these distorted price signals.

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[16] Choice and NSW Fair Trading, "Credit card Surcharging in Australia"
[17] "Review of Surcharging: A Consultation Document", RBA, June 2011
[18] RBA Chart C3 – Merchant Fees for Credit and Charge Cards (www.rba.gov.au/statistics/tables/xls/c03hist.xls)
[19] RBA Chart C2 – Market Shares of Schemes (www.rba.gov.au/statistics/tables/xls/c02hist.xls)

We believe there are avenues available to the RBA to make merchant costs more transparent in a manner that does not facilitate the unfair situation that we are seeing today. We cover these later in our response to the questions raised by the RBA.

**d. Excessive surcharging damages the consumer**

Some merchants, particularly those in unique or dominant geographic, market or channel positions, have inappropriately used card surcharges to supplement and extend their margins by surcharging in excess of the costs of payment acceptance. Where surcharging exists today, there is a high likelihood that it is well in excess of the cost to accept payment cards.

- In 2007 the average surcharge for general-purpose credit cards was 1% and the average MSF was 0.89%. For American Express cards the average surcharge was about 2% and the average MSF was 2.18%. In both instances the surcharge amount was 'roughly' consistent with costs, as measured by the MSF[20].
- In 2010 the average surcharge for general-purpose credit cards was 1.8% and the average MSF was 0.87%. For American Express cards the average surcharge was about 2.9% and the average MSF was 1.93%. In both instances the surcharge amount was about 1% higher than costs, as measured by the MSF[21].

The degree of the excess is even higher if the merchants' cost of accepting cash serves as the cost reference point (e.g. the MSF (net of the cost of cash) would be lower and thus the 1% differential will be higher).

In our initial submissions in 2002, MasterCard's concern that surcharging would lead to price 'gouging' of credit card users by merchants was, at the time, dismissed by the RBA without regard to the evidence. The RBA stated that taxis in Australia were not exploiting their customers when Cabcharge imposed a 10 per cent surcharge for use of credit cards (and all other cards) because the taxi industry was simply "protecting its own" payment system. This was troubling logic at the time (to the extent the RBA was suggesting it is permissible for an industry to overcharge the customers of a competing payment system in order to protect their own payment cards) and the ACCC has since acted to mitigate this practice.

Regardless of past perceptions about whether abusive pricing practices would result from the current surcharge regulations, the evidence strongly confirms that some merchants have taken advantage of the regulations to enhance their own margins. As with blended surcharging, MasterCard agrees with the RBA that current surcharge regulations should be amended to limit these abusive practices.

[20] RBA Reform of Australia's Payments System, Preliminary Conclusions of the 2007/08 Review, April 2008 and RBA Chart C3 - Merchant Fees for Credit and Charge Cards (www.rba.gov.au/statistics/tables/xls/c03hist.xls)
[21] RBA Consultation Paper, June 2011 "Review of Card Surcharging: A Consultation Document"and RBA Chart C3 – Merchant Fees for Credit and Charge Cards (www.rba.gov.au/statistics/tables/xls/c03hist.xls)

## 3. Overview of Global Surcharging Policies and Impacts

There are relatively few markets where surcharging has been broadly taken up (across many merchant categories) to any significant extent (with a significant number of transactions surcharged). In those markets where surcharging is allowed the information available on the impact of surcharging is limited but we have provided below a summary of recent items related to surcharging in a variety of global markets. What is generally common across those markets where surcharging is allowed is that cardholders pay more; consumers don't perceive any benefits; and most surcharging occurs in market segments or industries where consumers are in some manner restricted from alternatives (such as online retailing).

In the UK, *Which?* filed a super-complaint with the OFT regarding three detrimental impacts of surcharging in the passenger transport sector. Their concerns related to:

- A lack of transparency because merchants did not disclose the surcharge until late in the purchase process;
- A lack of a reasonable and practicable alternative to avoid the fee; and
- Surcharging that appeared to exceed reasonable estimates of retailers' costs of processing payments.

The OFT has responded[22], focusing particularly on payments to online merchants and will recommend measures to prohibit retailers from imposing surcharges made by debit card and to improve transparency of surcharging in the transport sector. The OFT made a number of observations that appear consistent with other studies on surcharging.

- Surcharging is much more prevalent for online transactions than face-to-face transactions, suggesting consumer behaviour and options are different between the two channels.
- Consumers strongly object to 'paying for paying', suggesting there are no benefits, perceived or real, for paying to use payment cards.
- While the number of merchants that surcharge is not widespread, it does appear significant in the travel sector (e.g. airlines, rail, ferries) and other sectors including taxis, event tickets, cinemas, car dealerships and hotels, and the online channel.
- Surcharging has persisted in sectors (e.g. the airlines) despite customer dissatisfaction
- While cash is the standardised payment mechanism in the face-to-face channel, this is not the case in the online channel, where payment cards are *de facto* taking on that role.
- Market power is not always the primary driver of persistent surcharging. Rather, persistent and excessive surcharging has occurred in merchant sectors where consumers make infrequent purchases, incur search costs to discover the surcharge, undertake complex transaction processes, and purchase products that are time or quantity limited.
- Addressing excessive surcharging will be pursued separately through the European Commission's Consumer Rights Directive (CRD), which 'prohibits traders from charging consumers…fees that exceed the cost borne by the trader for the use of such means', where the 'cost borne' might logically be restricted to the merchant's marginal costs.[23]

The Fédération Bancaire Francaise (FBF) conducted a study of surcharging[24] in other markets (UK, Denmark, Portugal, US, and Australia) in order to understand better an appropriate framework if surcharging was permitted in France. Observations made in that study include:

[22] "Payment surcharges, Response to the Which? Super-complaint" *op cit*
[23] European Commission "Consumer Rights: 10 ways the new EU Consumer Rights Directive will give people stronger rights when they shop online"
http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/450&format=HTML&aged=0&language=EN&guiLanguage=en
[24] "Potential Introduction of Surcharging in France – Impact Study" Edgar, Dunn & Company, March, 2010

**UK**

- Most surcharging occurs where there is little competition, through online channels, or where there are few alternative payment options (e.g. travel, cinemas, local taxes, parking penalties).
- There is limited surcharging in face-to-face channels such as food retailing because of competition and multiple payment options
- Consumers are concerned that surcharges are excessive.

**Denmark**

- The introduction of surcharging for domestic debit cards, coupled with new Merchant Service Fees, resulted in wide-scale consumer opposition.
- Shortly thereafter surcharging was prohibited, except for foreign issued cards.
- For online purchases surcharges are effectively capped at the amount of the MSF.

**US**

- Surcharging is generally prohibited.
- 'Convenience fees' have been permitted in secondary payment channels for sectors such as bill payments and government taxes.
- Other sectors such as education and other government payments (registrations, licenses) are increasingly looking at imposing 'convenience fees' for using the online payment channel.

**France**

- Most consumers surveyed are against surcharging, while merchants are in favour and banks were neutral.
- Most stakeholders do not expect a reduction in retail prices.
- Consumers and banks were very concerned about merchants surcharging in excess of costs.

The FBF developed a set of recommended 'safeguards' if surcharging was implemented that included:

- Merchants must accept at least one widely used payment method that is not surcharged.
- Where merchants are in some manner 'captive' and cannot readily access a non-surcharged payment method, surcharging should be prohibited.
- The surcharge amount should be limited, possibly to the amount of the MSF.
- Merchants should be permitted to surcharge all payment methods (e.g. cheques).
- Disclosure of surcharge fees must take place at the start of the buying process.

The 2010 Choice report on surcharging[25] in Australia was consistent with the emerging view on surcharging. Their findings included:

- A vast majority (88%) of respondents had paid a surcharge within the past year.
- Surcharges occurred most often in the air travel, telecommunications, holiday travel, restaurant, utility, taxi, and petrol station sectors.
- A majority (68%) of respondents do not believe retailers should be allowed to charge extra when using a credit card for payment.
- When faced with a surcharge, 64 per cent paid the fee. Lack of options and delayed fee disclosure likely mitigated the ability to avoid the fee.
- Consumers have no way of knowing if the surcharges are fair and reasonable.
- Flat fee surcharges lead to concerns about excessive surcharging.

All of the above points in a very clear direction. While the RBA may not be willing to step back from the Standards that provide for unrestricted surcharging which have had limited and questionable benefit at best, it is certainly clear the Standards that allow unrestricted surcharging should be amended to make surcharging practices fairer and more transparent to consumers.

[25] Choice and NSW Fair Trading, "Credit Card Surcharging in Australia"

## 4. MasterCard's Response to the RBA's Seven Questions

### 1. Is there a case for modifying the Standards to allow schemes to limit surcharges?

MasterCard continues to oppose the abolition of its No Surcharge Rule in Australia. However, assuming the RBA intends to maintain the Standards, there is no doubt that they should be amended; the only questions are how and to what extent. There is significant evidence that the Standards that allow unrestricted surcharging have not achieved the RBA's original intention to make the costs of alternative payment methods more transparent through price signals, without further price distortions, as the RBA has itself made clear in its consultation paper. The Standards in their current form have clearly provided an opportunity for numerous merchants to use blended and excessive surcharges to intentionally obfuscate and mask the costs of different payment options, to their own benefit, as opposed to the consumers' benefit.

### 2. Is a surcharge cap best implemented by the Board setting a transparent and specific permissible cap that is specified in the Standards, and may then be imposed in scheme rules? Or, should the Standards allow scheme rules to limit surcharges to an amount that is either reasonably related, or equal, to each particular merchant's cost of card acceptance?

Clause 9 of the Standards that allow unrestricted surcharging, which was clearly intended to provide for a surcharge cap, fails because it requires a bilateral agreement, which, in reality, had no chance of success. In stating that "an acquirer and a merchant may agree that the amount of any such fee or surcharge charged to a credit cardholder will be limited to the fees incurred by the merchant in respect of a credit card transaction" the RBA could have predicted that requiring agreement from both parties placed all the negotiating power in the hands of the merchant. If the acquirer requested a cap, the merchant could readily turn to alternative acquirers in the competitive and low-margin MasterCard and Visa four-party scheme environments. No incentive existed for the Merchant to enter into such an agreement. It's worth noting this is not the case for American Express, which retains considerably more power in their negotiating position with their merchant customers because they are the sole acquirer of their transactions. If a merchant wants to accept American Express, they are not able to shop around for the best acquiring terms.

However, the establishment of a fee ceiling, or cap, on a surcharge for each scheme's cards, will not result in an outcome that meets the desired transparency and cost-based price signal objectives.

We believe the cap would in effect become the default surcharge. Numerous examples exist of cases where regulators have set ceiling rates or fees in different industries which has effectively removed the subject fee as an incentive to stimulate competition. (For example, since the early 1980s, price cap regulation has been adopted in a wide range of countries. In Australia, price caps have been used in the telecommunications, energy and transport industries.)

In many of these cases, the rate or fee set by the regulator becomes the default. As a simple illustration, if a surcharge on MasterCard transactions was capped at 1% the likely outcome would be the majority of merchants moving to that ceiling, thereby removing it as a means for competitive differentiation (whereby one merchant may set the surcharge at 1% and another merchant may not surcharge at all).

With no incentive for merchants to surcharge below the cap, it is not clear how a cap would promote competition. While the RBA has previously argued that in a competitive market two merchants would use the surcharging as a competitive point of differentiation, in fact evidence shows that has not been the case – merchants are reluctant to initiate surcharging (for fear of consumer reaction) but once one merchant is able to do so successfully, its competitor's quickly follow.

An example of the nature of surcharge competition in Australia occurred in December 2010. On the 1st of that month, Qantas announced an increase in their card surcharge for international bookings by 20 per cent (from $25 to $30) – an increase that occurred in the absence of an increased MSF (as evidenced by the RBA's numbers). If the RBA's competitive assumption was correct, their competitors would have 'made something' of the Qantas announcement. In fact, quite the opposite happened. Virgin quickly moved to increase their own surcharge by 30 per cent. This is further evidence – if it was required – that merchants don't use lower surcharges as a competitive weapon and/or as a way to recover the cost of accepting cards, but as a way to increase their margins.

MasterCard believes the schemes – working with our acquiring partners – are best placed to monitor and enforce surcharges so that where they are imposed they are reasonably related to the cost of accepting that transaction.

There are a number of countries where MasterCard does precisely this today, including in New Zealand and parts of Europe. Our Rules provide clear guidance in those markets where we allow surcharging and provide protection for cardholders from merchants surcharging in excess of the cost of acceptance. For example, in Europe, MasterCard's Rule 5.11.2 states:

> *"If a Merchant applies a surcharge for payment by Card, the amount or method of calculation of the surcharge must be clearly indicated to the Cardholder at the POI location and must bear a reasonable relationship to the Merchant's cost of accepting Cards."*

This rule could be replicated simply and quickly within an Australian context and MasterCard would be willing to do so.

### 3. Should there be some level of tolerance allowed around any surcharge cap?

In MasterCard's view, allowance for a tolerance has contributed to the situation consumers confront today, where what appears to some as an 'excessive' surcharge would be portrayed by others as cost-reflective 'within tolerances'. Given the PSB's statement that they are "concerned that in recent years some surcharging practices, including surcharging well in excess of card acceptance costs, may have reduced the effectiveness of previous surcharging reforms" we believe building an allowable level of tolerance would in effect, further legitimise the continuation of surcharging above transactional costs.

As contained in our approach referenced above, the use of the phrase 'reasonable relationship' appropriately and adequately provides the ability for merchants to demonstrate that the cost of some transactions may be higher or lower than others. In Australia this is most likely to occur for merchants with 'interchange plus' commercial arrangements, where costs do vary by card type, as opposed to 'blended MSF' arrangements where the merchants cost is the same across all cards, which is the most prevalent commercial arrangement in Australia.

### 4. Is the merchant service fee an appropriate measure of the cost of card acceptance (that can be applied consistently across all merchants)?

Given the realities of the current Australian market, the MSF is the most practicable way of measuring the cost of accepting cards. The MSF reflects the costs borne by acquirers, including terminal rental fees and other types of costs that the RBA has indicated are sometimes priced for separately or provide by the merchant itself. It is a regular occurrence that even in these (relatively rare) cases of merchant-owned terminals, they have been subsidised by investments from banks and schemes.

We are aware that some merchants consider additional costs (e.g. their internal costs) when calculating a surcharge, but we believe this adds a complexity that does not need to exist. It raises numerous questions: What costs to include? How will they be measured? Who will measure them? If these costs are to be included, then a corollary issue would need to be addressed as to whether the costs of card acceptance that the surcharge is intended to recover should be the merchants incremental costs to accept cards as measured against a baseline payment option such as cash. Rather than addressing these issues at this time and delaying changes to mitigate the substantial, known issues with the current Standards, it would be best to take the simpler, albeit perhaps less elegant approach, of using the MSF as the indicative cost for the merchant cost of accepting a card payment.

**5. Should the no-surcharge Standards clarify that, notwithstanding any surcharging cap, scheme rules cannot prohibit merchants from applying a surcharge that is either a blended rate for each card scheme or the cost of accepting each card *within* a card scheme? Are there alternative ways to allow for differential surcharging?**

MasterCard believes that to the degree practicable and available a surcharge, if allowed, should reflect the cost of the payment transaction. Different instances of surcharging are discussed below.

*Surcharges – Blended Across Multiple Brands*
As noted earlier, the existence and increased prevalence of blended surcharging across multiple brands is creating issues for consumers, banks, some merchants and the four-party schemes. The only winner from blended surcharging across brands is the more expensive three-party schemes that have actively pursued a strategy to motivate merchants to blend surcharges in order to subsidise their own brand acceptance either through incentives or contractual obligations.

If the RBA moved to provide that a surcharge should be the average MSF of the brand of the card used, then the issue of blended surcharges across multiple schemes is effectively removed because the MSF differential between the three-party schemes and MasterCard would be reflected in any resulting surcharge. MasterCard encourages the RBA to amend the Standard to explicitly remove the ability of merchants to use one scheme to cost recover against another scheme by prohibiting blended surcharge fees where a cost differential amongst scheme, as reflected in the average MSF, exists.

*Surcharges – By Programme or Card Type*
Surcharging by programme or card type (Debit or Credit; Gold or Platinum; Consumer or Commercial) is permissible today under the current Standards. But MasterCard is not aware of any examples of it happening (and the RBA in their consultation document state that “there appear to be few, if any, instances where merchants apply different surcharges for different cards within a scheme”). That is likely to be for two primary reasons.

Firstly, and as previously indicated, the vast majority of merchants have a ‘blended MSF’ arrangement with their acquirers. Under that arrangement their acquirer charges them an agreed ad valorum fee based on the card scheme used. So a MasterCard card presented at these merchants would have a specific ad valorem fee charged to the merchant. The RBA’s statistics[26] indicate that in the first quarter of 2011 that rate was 0.86 per cent while the equivalent American Express rate is 1.89 per cent. In this commercial arrangement the merchant could charge a single surcharge rate for all cards of the brand because there would be a single MSF applicable to a transaction, regardless of card type or card programme.

The second issue relates to those few merchants who have an ‘interchange plus’ MSF arrangement, where the interchange fee for a specific transaction[27] is added to the agreed cost for terminal rental, acquirer margins and so forth to arrive at an MSF for that specific transactions. Surcharging at the scheme level in this environment requires the merchant to establish their weighted average cost per transaction, based on the mix of cards they accept to apply a surcharge based on that weighted cost.  This would be extremely difficult to accomplish at the programme level. In any event, surcharging at the programme level risks harming the

[26] RBA Chart C3 – Merchant Fees for Credit and Charge Cards (www.rba.gov.au/statistics/tables/xls/c03hist.xls)
[27] The specific interchange fee can be based on merchant or card type, method of transmission, transaction value, the way the terminal interacts with the card, and other factors.

network brands by creating consumer confusion, among other things, and MasterCard sees no benefits to consumers warranting any promotion of the practice.

*Surcharging – By Merchant Category*
If the RBA believes differential surcharging guidelines by merchant category are required, MasterCard can assist in the implementation. While MasterCard does not set, nor have visibility of, the MSF paid by individual merchants in Australia in total, there are a number of MasterCard merchant categories – including charities, government, utilities, petrol stations, schools and educational institutions – that have their own interchange category, which means establishing the approximate cost of acceptance in these merchant sectors is a relatively simple equation. Taking the weighted average interchange of 0.55 per cent for a MasterCard transaction (including GST), and removing that from the 0.86 per cent of the average MSF as tracked by the RBA, we can assume the added costs (including margin) for acquirers to be 0.31 per cent. Therefore, for example, transactions at petrol stations are subject to interchange at 0.374 per cent (including GST) so if we add the margin, we can establish the cost of accepting a transaction at a service station is approximately 0.684 per cent ($0.68 cents for a $100.00 purchase). This of course would not take into account any particular arrangements an acquirer might have with large volume merchants but it would provide visibility as to whether a surcharge, if applied, was in a reasonable relationship to the merchant's cost of acceptance.

**6. Should the no-surcharge Standards require acquirers to pass on information about the merchant's cost of acceptance for each different card type if it is requested by the merchant? And, for those on 'interchange-plus' pricing, should the no-surcharge Standards require acquirers to pass on information about the weighted average merchant service fee if it is requested by the merchant?**

In March, MasterCard implemented a Rule change that, if requested by a merchant, acquirers must provide merchant pricing that separates their MasterCard Debit and Credit merchant service fees, to allow greater understanding of acceptance costs. It has been a long-term ambition of the RBA to drive greater transparency in the payments industry. One benefit of this recent rule change is to make it difficult for merchants to justify the application of the same surcharge on Credit and Debit cards as the surcharge rate for Charge cards, given the significant difference in the cost of acceptance of these various payment options. We believe this change is likely to reduce the surcharge fee levels for Debit MasterCard cards.

There is some argument to suggest that Debit card transactions should be excluded from Standards that ban MasterCard from enforcing our No Surcharge Rule given fact that debit is a lower cost option for merchant acceptance (indeed it can be argued lower cost than accepting a cash transaction). Debit cards are also ubiquitous with the vast majority of consumers carrying some form of Debit card in their wallets and indeed, they have become the preferred payment method for many types of transactions.

In summary, MasterCard does not object to allowing acquirers to provide to merchants information on the costs of acceptance of different products, particularly in light of the fact that our Interchange Rates are already published online.

**7. Is there a case for disclosure of the cost of card acceptance by merchants? Or, would it be sufficient for the Bank to collect and publish more detailed data on merchant service fees, such as the range and average of merchant service fees across merchant categories for each card scheme?**

At the core of MasterCard's regulatory philosophy is that markets should set price. At its simplest, that means striking the correct balance between price and demand and this needs to take into account the very important interplay between costs and margins, which has been a contributing factor in MasterCard's concerns about over-regulation.

MasterCard believes markets operate best in an environment that economists refer to as 'symmetrical information', where both sides of the relevant market have about the same information and neither side has an advantage as a result of knowing more than the other party. We have considered this concept in terms of what the RBA is trying to achieve with regulation to allow surcharging.

In order to help consumers (cardholders) understand the amount they may be surcharged, they should be fully aware of the costs that the surcharging merchant is recovering. This also has important benefits for the merchant in that the price they are being charged by their acquiring bank is visible to all. This is likely to have a positive effect on their ability to negotiate with their acquirer and secure a lower MSF.

To that end, MasterCard does not oppose the RBA's suggestion that those merchants who choose to surcharge should display the Merchant Service Fee they are charged alongside the surcharge fee. Alternatively (or in addition), the RBA could seek further detailed MSF information by merchant category from acquirers. While this would have an incremental cost to banks and the RBA, it would facilitate a better understanding of transactional acquisition costs.

## 5. Recommendations

MasterCard continues to believe that permitting the networks to restore the No Surcharge Rules in Australia will best protect the interests of consumers. Recognising, however, the high likelihood that the RBA will maintain the Standards in some form, MasterCard's recommendations as to how the existing Standards must be amended to appropriately provide improved protection for consumers are summarised below.

**The Standard must be amended to allow the schemes to enforce a cap on surcharges so that any surcharge levied against cardholders bears a direct and reasonable relationship to the Merchant's cost of that transaction.**
We believe this relatively minor amendment to the existing Standard builds an appropriate level of consumer protection, whilst still allowing those merchants who choose to surcharge to do so in a way that recoups the actual costs associated with that transaction. Further, given the realities of the Australian market, the cost of the transaction should be defined in the Standards as the Merchant Service Fee (MSF) given it is the most practicable way of reflecting the costs borne by acquirers, including terminal rental fees and other related costs.

**The practice of blended surcharges must be banned.**
The Standard must be amended to explicitly require that any surcharges applied must reflect the cost of accepting each scheme's cards in way that reflects any price differential that exists. That is to say, where there is a differential between the prices paid by the merchant to their acquiring bank to accept different card brands, any surcharge applied should reflect the cost differential. Within this scenario the ability for merchants to give price signals will not be distorted and the arrangement will support the PSB's strategic intent under the surcharge standards.

**The RBA should consider banning surcharges on Debit card transactions.**
There is a strong public interest argument to exclude Debit cards from regulation allowing surcharging. The Office of Fair Trading in the UK has recently recommended to the government there that surcharges on debit cards should be banned. They have made a number of compelling arguments, outlined in their response to the *Which?* Super-complaint[28] including the fact that Debit is a lower cost option for merchant acceptance (indeed it can be argued lower than the cost of accepting a cash transaction). Also contributing to their view is the ubiquitous nature of Debit cards in the UK (as they are here in Australia) where the vast majority of consumers have access to a Debit card in the form of either an EFTPOS card or a Scheme Debit card (including Debit MasterCard). They have become the preferred payment method for many types of transactions. In an environment that is seeing an increase in cash displacement, banning surcharging on Debit cards (the primary vehicle for this displacement) helps mitigate consumers' concern about 'paying for paying'.

**The RBA should consider banning surcharges on card-not-present (CNP) transactions.**
MasterCard believes the RBA should ban surcharging for card-not-present transactions, including online, particularly where there is a lack of a practical alternative method of payment that allows the customer to avoid paying the surcharge. In these occasions, surcharges are – as the UK's OFT states in their response to the *Which?* Super-complaint – an example of consumers "paying for paying"[29]. Should the RBA choose not to go down the route of a blanket ban on surcharging in CNP environment, it may consider doing so in those areas where electronic transactions are the 'dominant' payment form. This could be a simple and easily monitored and would be a positive outcome for consumers and businesses in Australia.

**The RBA should consider requiring merchants who choose to surcharge to clearly disclose the average MSF paid and on which the surcharge is based.**
We believe that this would help achieve full transparency at all stages of the value chain – from acquirer to merchant and from merchant to cardholder. It could be achieved relatively simply and without costly systems work for merchants, acquirers and schemes.

[28] "Payment surcharges, Response to the Which? Super-complaint"
[29] "Payment surcharges, Response to the Which? Super-complaint"

**MasterCard must be allowed to monitor and enforce cost-related surcharges.**
MasterCard (and our competitors) have the capacity (and the motivation) to act on excessive surcharging when we see it because we can readily monitor it through our direct relationship with our acquiring customers. We have experience in other markets – including New Zealand – where we are able to ensure any surcharge levied by a merchant on a cardholder is consistent with the cost to the merchant of accepting that transaction (using the MSF as the measure).

## 6. About MasterCard

MasterCard Worldwide is a leading global payments solutions company, enabling global transactions and bringing insight into the payments process to make commerce faster, more secure, and more valuable to everyone involved. As a critical link between thousands of financial institutions and millions of businesses, cardholders and merchants worldwide, we provide services in more than 210 countries and territories. We advance commerce worldwide by developing more secure, convenient and rewarding payment solutions, processing billions of payments seamlessly across the globe, and building economic connections that accelerate business.

MasterCard does not issue cards, set annual fees, determine annual percentage rates on cards, or solicit merchants to accept cards. MasterCard's customers, a myriad of financial institutions worldwide, directly manage the relationships with their cardholders and with merchants accepting the cards.