Australian Banking Association

Review of Merchant Card Payment Costs and Surcharging

Consultation

Introduction

The Australian Banking Association (ABA) appreciates the opportunity to contribute to the Reserve Bank of Australia's Review of Merchant Payment Costs and Surcharging *'the issues paper'*. As the backbone of Australia's economic infrastructure, the payments system powers commerce, choice, and innovation. It is central to Australia's standing as a global leader in financial services.

Over the past 20 years, the payments ecosystem has transformed to meet the demands of a digital economy. Innovations like contactless payments and digital wallets have become everyday tools for consumers and businesses, delivering convenience, efficiency, security, and reliability. The modern payments system does more than facilitate transactions, it connects Australians to the world. Whether buying coffee in Melbourne or train tickets in Tokyo, Australians can rely on seamless and secure payments, while modern payment systems unlock opportunities for businesses to engage with global markets in ways that were unimaginable just a decade ago.

This progress has been driven by sustained investment from the banking sector, which plays a critical role in maintaining an efficient, secure, and innovative payments ecosystem. Banks continuously invest in infrastructure, technology, and compliance, ensuring the system evolves alongside consumer needs while remaining resilient to economic pressures and market shifts.

Australian banks are acutely aware of the impact current economic pressures are having on Australians. From supporting households through times of financial hardship, to assisting businesses in navigating rising operational costs, banks see firsthand the impact rising cost-of-living pressures are having on Australians. Rising costs and tightening budgets make efficiency and equity in the payments system more important than ever.

Surcharging was introduced to enhance price transparency by allowing merchants to pass the costs of specific payment methods directly to consumers. While the practice varies across industries and individual businesses, it has become clear that the current surcharging framework is no longer fit-for-purpose. Australians are understandably frustrated by inconsistent, opaque and excessive surcharging practices, which undermine the transparency surcharging was designed to promote. Importantly, banks derive no financial benefit from surcharging. Their role remains centred on ensuring the payments system is secure, efficient, and delivers value to all participants, from merchants to consumers.

While cost is a key measure of efficiency, it is only one piece of a highly complex ecosystem. As outlined in our submission, substantive policy reform must account for the evolving dynamics and intricate interdependencies of the payments landscape. The rise of mobile commerce, the entry of new players, and increasing infrastructure demands have introduced new layers of complexity. Central to this is ensuring the payments system is reviewed holistically, ensuring policy is adaptable and responsive to the payments system of today and the future.

The ABA looks forward to constructive engagement with the RBA and stakeholders to support practical and balanced payments policy, ensuring Australia's payments system remains equitable, efficient, and capable of supporting the evolving needs of our economy.

Submission overview

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About the ABA

The Australian Banking Association advocates for a strong, competitive, and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

Summary of key policy positions

1. **Effective and efficient policy requires the entire payments system be in scope**

   Informed, efficient and effective policy reform requires examination of all participants – regulated and unregulated – including mobile wallets, BNPL, and three-party schemes. Focusing reforms solely on regulated participants will entrench imbalances, drive up costs, and incentivise higher-cost alternatives.

2. **Payment efficiency requires balanced and proportionate policy**

   Structural reforms must target significant and persistent inefficiencies and should have clear causality with intended policy objectives. Payment costs have remained stable relative to other business expenses, and reforms must avoid unintended consequences that undermine long-term investment, innovation, and system stability.

3. **The ABA does not support further reductions to interchange benchmarks**

   Interchange remains essential for enabling critical investments into payments infrastructure and ensuring system resilience. Australia's benchmarks are already globally competitive, and any future review must consider the growing impact of unregulated fees – e.g. mobile wallets.

4. **Reforms should be considered to reduce the cost of international cards on merchants**

   International cards impose disproportionately high costs on merchants. The RBA should explore measures to place downwards pressure on these costs.

5. **The payments system would benefit from greater scheme fee transparency**

   Scheme fees are unregulated, complex and opaque. Reforms to improve the transparency of scheme fee costs, particularly where it is likely increased transparency will support competitive pressures in the market.

6. **Other transparency reforms should be targeted and have a clear purpose**

   Efforts to improve transparency should focus on genuinely opaque areas, such as intermediary fees, without introducing unnecessary complexity or compliance burdens for businesses.

7. **The current surcharging framework is not fit-for-purpose**

   The current surcharging framework is clearly not working and requires targeted reform. Consumers should never be surcharged for bundled costs like POS systems, business software products or other business incentives.

8. **Consumers should always know the cost of an item before they pay for it**

   Australians are understandably frustrated with opaque, inconsistent and hidden surcharges. Regulation and enforcement should seek to improve transparency to ensure consumers have appropriate and timely visibility of any surcharges.

9. **Banning debit surcharges requires careful consideration**

   The ABA wants to see less surcharging. However, prohibiting surcharging would represent an abrupt shift to a practice that has been permitted in some form since 2003. Design and implementation of surcharging prohibitions must ensure competitive neutrality, minimise compliance burdens, and preserve merchant access to the right pricing structures for their business.

Australian Banking Association

Scope of the payments system

The way Australians make and receive payments has changed significantly over the past decade, making the traditional view of the payments system increasingly outdated. Advances in technology have fundamentally reshaped the payments landscape – expanding its size, complexity, and diversity of participants. These shifts have brought greater convenience, choice, and efficiency, but they have also raised important challenges that require attention.

The speed and scale of these changes is stark:

- **Contactless payments** now account for 95% of in-person card transactions[1], compared to less than 8% in 2010. [2]
- **Online payments** as a share of retail payments have grown from 7 per cent in 2010 to 18 per cent in 2022.[3]
- **Mobile wallets** usage has grown from 1 per cent of point-of-sale payments in 2016[4] to 44 per cent in October 2024.[5]
- **Buy Now, Pay Later (BNPL)** services, virtually unknown 8 years ago, are now used by nearly a third of Australians. [6]

Australians now use cards for payments more frequently than consumers in many comparable economies, including those with very low rates of cash usage.[7] These changes have not been limited to consumers though, they represent a significant and ongoing transformation in the structure and dynamics of the payments system itself.

The payments system has moved from a traditionally bank-centric model, supported by core infrastructure providers such as card schemes, to one that includes a diverse range of participants. Fintechs, global technology companies, and other specialised providers have emerged as key players, focusing on distinct elements of the payments process. These include digital wallets, online payment gateways, and point-of-sale solutions. This shift has resulted in a more fragmented and disintermediated system, where multiple specialised providers work together to complete a single payment.

At the same time, major digital platforms are integrating payment services into their ecosystems, leveraging their substantial customer networks to bundle payment options alongside their core offerings. This trend has introduced new competitive dynamics, altered the economics of payments, and increased the ecosystem's complexity.

These changes reflect what the RBA has described as *"significant technological changes"* since the current regulatory framework was introduced over 20 years ago.[8] While these innovations have delivered substantial benefits to consumers and businesses, they have also created new challenges for competition, efficiency, and systemic risk. Implications of these challenges have been widely acknowledged:

[1] RDP 2014-05 *The Changing Way We Pay: Trends in Consumer Payments*
[2] *ibid.*
[3] Table 6. RDP 2023-08: *The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey*
[4] RDP 2017-04. *How Australians Pay: Evidence from the 2016 Consumer Payments Survey*
[5] RBA Statistical Releases: Retail Payments October 2024.
[6] RBA June 2023 Bulletin – *Consumer Payment Behaviour in Australia*
[7] Speech by Ellis Connolly *'The Shift to Electronic Payments – Some Policy Issues'*
[8] RBA Submission to Parliament Joint Committee on Corporations and Financial Services

- In 2021, the RBA noted that the growing complexity of the payments ecosystem and the emergence of new entities – such as BNPL providers, mobile wallet operators, and payment gateways – raise *"a range of policy issues"* relating to competition, efficiency, and risk management.[9]
- In 2023, the RBA reiterated concerns about access, competition, and efficiency stemming from the changes in participation and technology in the payments value chain.[10]
- The 2021 Payments System Review observed that the entry of new, specialised participants and large multinational technology companies presents *"important implications for competition and systemic risk"* within the payments system.[11]
- The Federal Government has acknowledged that new developments are *"testing the limits of the current regulatory framework for the payments system"*, highlighting the need for reforms to address regulatory gaps.[12]

Australia's regulatory framework requires modernisation to respond

The ABA acknowledges that the current Payments System (Regulation) Act 1998 (PSRA) was designed for a different era of payments and limits the RBA's regulatory powers, particularly in addressing the unique implications of new payment technologies and participants such as BNPL providers and digital wallets. Reforms to the PSRA are critical to ensure a comprehensive and modern regulatory framework that reflects the complexities and interdependencies of today's payments ecosystem.

The RBA has emphasised the importance of these reforms, stating:

- *"These reforms will enable the RBA to credibly deal with a wider range of issues associated with new payments technologies and business models."*[13]
- *"It's hard for the Reserve Bank to be able to help set a level playing field across the industry … when you have Buy Now, Pay Later providers and mobile wallets not within that [PSRA] scope."*[14]

The need for reform has also been supported by Government:

- The Commonwealth Government has outlined its intention to update the PSRA to ensure that *"all entities that play a role in facilitating or enabling payments are appropriately regulated."*[15]
- Recommendations made by the Parliamentary Joint Committee on Corporations and Financial Services affirm the importance of reform.[16]

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[9] Review of Retail Payments Regulation 2021
[10] Payment Systems Board Annual Report 2023
[11] *ibid.*
[12] *ibid.*
[13] A Strategic Plan for Australia's Payments System
[14] See comments by Ellis Connolly at: *Appearance before the Senate Economics Legislation Committee on Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023 [Provisions] and a related bill [Provisions]*
[15] A Strategic Plan for Australia's Payments System
[16] Parliamentary Joint Committee on Corporations and Financial Services: Mobile Payment and Digital Wallet Financial Services

A complete view of the payments system, encompassing all participants is a prerequisite to informed, effective and efficient policy

The RBA has long held that regulation should not seek to embed structural advantages for ecosystem participants *'The Board's long-standing principle is that regulation should seek to be competitively neutral.'*[17] The ABA strongly agrees with this position and acknowledges that the RBA's intention had been to conduct a review of retail payments regulation ideally after the passage of the PSRA reforms[18] – critical to addressing imbalances in the system.

While legislative reforms are still pending, the ABA strongly believes they remain an **essential prerequisite for any substantive and effective regulatory review.** In their absence, much of the payments system remains out of scope, inhibiting the RBA's ability to monitor and examine the entire industry. We are concerned that regulatory changes made in this environment, based on a partial review of the payment's system, would significantly prejudice the efficacy, efficiency and competitive neutrality of policy reforms. Without a whole-of-ecosystem scope, the review would be:

1. **Reliant on an outdated view of payment economics**
    - The current framework does not adequately capture the impact of emerging players like digital wallets and BNPL providers on the broader payments system.
    - Digital wallet fees, for example, have significantly eroded interchange revenue, yet their role in funding critical payments infrastructure and services is largely unexamined.
    - This creates a risk that further regulation could unintentionally undermine the sustainability of the payments system by eroding the financial capacity of regulated participants to invest in resilience and innovation.
2. **Unable to properly evaluate of existing policy initiatives**
    - Regulatory gaps affect the efficacy of existing ecosystem policies and reforms, such as issues posed by mobile wallets on Least Cost Routing (LCR). Left unaddressed, these regulatory gaps limit available policy levers and risk suboptimal and inefficient reforms.
    - The Payment System's Strategic Plan identifies this challenge, noting that *"broader reforms to the regulatory framework in the PSRA will also strengthen the RBA's ability to regulate mobile wallet providers by ensuring payments regulations can be applied to the full range of payment systems and participants."*[19]
3. **Agnostic to the impacts of disintermediation and fragmentation**
    - New payment providers frequently leverage existing infrastructure and/or derive revenue from other participants without proportionately contributing to the payment system's maintenance or development.
4. **Unable to consider issues of competitive neutrality**
    - The incomplete scope would entrench regulatory gaps and competitive disadvantages for regulated payment methods while favouring mature but unregulated providers such as BNPL and digital wallets and three-party schemes.

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[17] RBA Review of Retail Payments Regulation Conclusions Paper, October 2021, page 51.
[18] See comments by Ellis Connolly at: *Appearance before the Senate Economics Legislation Committee on Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023 [Provisions] and a related bill [Provisions]*
[19] A Strategic Plan for Australia's Payments System

- Surcharging rules, intended to reflect the cost of acceptance, cannot operate effectively when key cost drivers (e.g. mobile wallets) are excluded from regulation. This skews the market, discouraging investment and innovation among regulated participants.

Without addressing these interdependencies, reforms risk being incomplete, ineffective, or even counterproductive. Ignoring the broader payments ecosystem could lead to:

- Distorted market dynamics that entrench unbalanced incentives and competitive inequity.
- Increased costs and reduced efficiency of the system (e.g. by encouraging use of more expensive and unregulated payments).
- Disincentives for regulated participants to invest in system resilience and innovation.
- Inefficient and ineffective reforms their intended objectives due to an incomplete understanding of the system's costs and functions.

Furthermore, given the rapid evolution of the payments landscape, the long-term impacts of partial reforms are uncertain. Incomplete or narrow reforms risk undermining the aspiration contained in Australia's payments system's strategic plan which emphasises a payments system that fosters fair competition, transparency, consumer choice, and financial inclusion.

> *"A payments system that encourages all types of payment participants to compete in a level and fair manner is fundamental to enabling payment participants to make more informed decisions on their products and services. Catering to consumer preferences through competing services can lead to increased choice, financial inclusion, transparency, and consumer satisfaction."*[20]

The ABA strongly supports the passage of PSRA reforms to equip the RBA with the necessary tools to regulate the modern payments ecosystem. Without these reforms, any subsequent regulatory review will fail to capture the complexities of the ecosystem, undermining the long-term competitiveness and efficiency of Australia's payments framework. Additional comments on mobile wallets, BNPL and three-party schemes have been provided below as tangible examples of the issues posed by a partial review.

Mobile Wallets

Mobile wallets have rapidly transformed Australia's payments system, offering significant convenience and accessibility to consumers. Australians have enthusiastically embraced mobile wallets. In early 2020 they represented 10 per cent of card transactions[21] and are now 44 per cent[22] – up from 39 per cent since June 2024.[23]

While mobile wallets have enhanced convenience, they are embedding substantial structural costs into the payments system. [24] Mobile wallet fees are, on average, twice as high as fees for tap-and-go or insert transactions.[25] Despite relying on existing payments infrastructure, the responsibilities

[20] A Strategic Plan for Australia's Payments System
[21] Payment System Board Annual Report 2023
[22] RBA Statistical Releases: Retail Payments October 2024.
[23] Payment System Board Annual Report 2024
[24] The RBA notes in its submission to the Parliamentary Joint Committee on Corporations and Financial Services that *"digital wallet services may introduce new costs into the payments system…"*
[25] AFR. 'When it comes to how we pay, Apple is coming for the big banks.' March 2024. Available at: https://www.afr.com/business-summit/when-it-comes-to-how-we-pay-apple-is-coming-for-the-big-banks-20240313-p5fc6y

for risks, obligations, and maintenance remain with the card issuer rather than the wallet provider. These costs are growing rapidly without any obligation on wallet providers to contribute to the immense costs of payments infrastructure, disproportionately burden regulated participants to the benefit of unregulated wallet providers.

In Australia, Apple Pay dominates the mobile payments market[26] and is the primary driver of these growing costs, as unlike many competitors, Apple charges fees to card issuers on a per transaction basis for payments conducted through its wallet.[27] In aggregate, the quantum of these fees is material and growing rapidly. The Australian Financial Review reported in 2022 that Australian banks were paying more than $110 million in annual Apple Pay fees.[28] Given these calculations were based on 2022 usage levels (~25 percent mobile wallet share), it is expected total fees paid would be much higher today[29] and will continue to grow.[30]

The RBA and other stakeholders have raised concerns about the market and competitive implications of these fees and called for greater transparency.[31] The Payment Systems Board (PSB) has also acknowledged these issues, noting that *"mobile wallet services can also introduce new costs into the payments chain"* through *"materially higher"* fees, inflating overall merchant costs.[32]

The Australian Retailers Association highlights that mobile wallet restrictions, such as those imposed by Apple Pay, reduce competitive tension between payment schemes. It notes that:

> *"With about half of Australian consumers using Apple iPhones, retailers are directly limited in their ability to develop new payment solutions for their customers, such as streamlining payments within a single app that might link customer loyalty programs, coupon redemption, or additional future innovations to enhance the customer experience in a 'single tap'."*[33]

The economic model of mobile wallets is impacting the sustainability of payments infrastructure. The fees charged by mobile wallets cut into funding that could otherwise be invested in system resilience, innovation, and consumer benefits. This is particularly problematic given that these fees disproportionately affect card issuers, who continue to bear the costs of maintaining the underlying infrastructure.

International observations

Similar challenges have been identified in the United States and the European Union.

[26] E.g. Apple has a clear plurality of users when compared against a wide range of contactless POS payment brands in Australia. Source: Statista. *'Biggest contactless payment brands at POS in Australia as of September 2024'*
[27] 'Market Dominance' section in *Parliamentary Joint Committee on Corporations and Financial Services: Mobile Payment and Digital Wallet Financial Services*
[28] AFR. *'Apple Pay costs for Australian banks revealed.'* December 2022. Available at: https://www.afr.com/companies/financial-services/apple-pay-costs-for-australian-banks-revealed-20221209-p5c527
[29] Roy Morgan research finds Apple overtook Afterpay in average users to become the third most widely used digital payment service in Australia, behind scheme checkouts and PayPal.
See *'Apple Pay overtook Afterpay in average users in 2023 to become the third most widely used digital payment service in Australia'* February 2024.
[30] Article notes calculation was informed by mobile usage data in the Payment Systems Board Annual Review which is assumed to be 25 per cent based on disclosures contained in the 2022 PSB Annual Report
[31] Speech by Ellis Connolly 'The Shift to Electronic Payments – Some Policy Issues'
[32] Payment Systems Board Annual Report 2023; RBA: Submission to Parliament Joint Committee on Corporations and Financial Services
[33] Australian Retailers Association: Submission to Parliament Joint Committee on Corporations and Financial Services

1. **United States**

In the complaint filed in *United States of America v. Apple Inc,* the U.S. Department of Justice identifies the impact of mobile wallet fees on overall payment economics:

> *"Apple's fees are a significant expense for issuing banks and cut into funding for features and benefits that banks might otherwise offer smartphone users"*[34]

In a class action lawsuit brought by Affinity Credit Union[35], Apple was accused of charging *"supracompetitive issuer transaction fees"*, *"even through payment networks handle virtually all aspects of an Apple Pay transaction."*

Subsequently in the same proceedings, a motion to dismiss the class action was denied, with a District Court Judge finding that:

> *"Plaintiffs have plausibly alleged that Apple Pay charges arbitrary and inflated fees to issuers, and that competition in the tap-and-pay iOS mobile market would spur innovation and lead to lower prices."*[36]

2. **European Union**

The European Union's antitrust investigation into Apple resulted in a Statement of Objections in 2022, finding that Apple's restrictive wallet practices may inhibit competition and violate EU competition law.[37]

A report[38] by EY and Copenhagen Economics for the European Commission concluded that mobile wallets have structurally increased payments costs while regulatory restrictions prevent these costs from being passed on. This creates a feedback loop where regulated participants absorb the costs, further limiting their ability to invest in system development.

These international cases reflect the broader concern that mobile wallets, particularly Apple Pay, are undermining competition, driving up costs, and diminishing the capacity for investment and innovation within payments systems.

While concerns raised pertain primarily to mobile wallets given their significant role in Australian payments system, it is important to note that mobile wallets are a subset category of broader digital wallet offerings – these challenges are not limited to 'tap and pay' mobile payments only. For example, research undertaken for the European Commission flags concerns with the high costs of PayPal merchant fees and the impact these types of incremental costs can have on the efficiency of payments.[39]

[34] See filings for: United States v. Apple Inc
[35] Class action complaint for violation of the Sharman Act and Clayton Act: *Affinity Credit Union v. Apple Inc*. No. 22-cv-4174
[36] Affinity Credit Union v. Apple. Inc. Case no. 22-cv-04174-JSW
[37] https://ec.europa.eu/commission/presscorner/detail/en/ip_24_282
[38] See '*Study on the application of the Interchange Fee Regulation – Final Report*' prepared by EY and Copenhagen Economics for the European Commission.
[39] See '*Study on the application of the Interchange Fee Regulation – Final Report*' prepared by EY and Copenhagen Economics for the European Commission.

Buy Now, Pay Later

Buy Now, Pay Later (BNPL) has rapidly become a popular payment option for many Australians and an attractive offering for merchants. With over $20 billion in annual transactions,[40] BNPL now represents a significant portion of the payments landscape. While BNPL provides an innovative and convenient payment solution, its high cost of acceptance and exclusion from key regulatory frameworks create significant challenges for the broader payments system.

The average cost of a BNPL transaction to merchants is approximately 3.5% of the transaction value – three to four times the cost of credit cards.[41] Despite these costs, BNPL providers typically prohibit merchants from recovering these expenses through surcharging. While BNPL remains a small share of overall payments, higher costs and surcharging prohibitions effectively inflates the overall cost of payments, placing an additional financial burden on merchants and distorting competition within the payments system.

BNPL usage is concentrated in certain sectors and categories of purchases – which could suggest that higher acceptance costs are more prevalent for some businesses. For example, BNPL is disproportionately used in for purchases which categorically are more discretionary[42] and compromise a lower share of overall consumer spending (e.g. BNPL is used for 14 per cent of clothing purchases despite clothing comprising less than 4 per cent of overall spending).[43] BNPL is particularly prominent in ecommerce. CMPSI noted in 2022 that BNPL accounted for 14% of ecommerce spending – more than one in every eight dollars spent online.[44] Other sources find BNPL at 15 per cent[45] and 21 per cent[46] of e-commerce transactions by value.

Implications on payments policy

The lack of regulation around BNPL surcharging is inconsistent with broader principles of cost recovery in payments. In its 2021 review of retail payments regulation, the RBA noted its preference for allowing merchants to surcharge for all payment types, including BNPL, to ensure fair cost recovery.[47]

The implications of BNPL on broader payments policy has been widely acknowledged by a range of stakeholders, including by business groups, with the Council of Small Business Organisations Australia (COSBOA) stating:

> *"It is therefore recommended that any examination of BNPL surcharging should form part of a broader review ensuring surcharging is fit for purpose in the contemporary payments landscape."*[48]

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[40] Ellis Connolly *'Online Retail Payments – Some Policy Issues'* June 2024
[41] Source: https://www.rba.gov.au/speeches/2024/sp-so-2024-06-18.html#fn5
[42] PayPal eCommerce Index - Australia. October 2023.
[43] See ABS Household Spending Indicators October 2024. Also summarised by Finder's *'Australian household spending statistics'* available at https://www.finder.com.au/insights/australian-household-spending-statistics
[44] Cmspi 'Payments Regulation in Asia' 2022 report
[45] Statista.com 'Market share of buy now, pay later (BNPL) in domestic e-commerce payments in 41 countries and territories worldwide from 2016 to 2023'
[46] GlobalData. 'Buy now pay later to account for 7.7% of e-commerce payments in Asia-Pacific by 2028, forecasts GlobalData' https://www.globaldata.com/media/banking/buy-now-pay-later-to-account-for-7-7-of-e-commerce-payments-in-asia-pacific-by-2028-forecasts-globaldata/
[47] *Ibid.*
[48] COSBOA Submission to 'Regulating Buy Now, Pay Later (BNPL) in Australia'

The Australian Retailers Association notes:

> *"Not all merchants will or should pass on these costs, but we believe they should have the ability to do so."*[49]

In their submission to the Payment System Review, the Australian Chamber of Commerce and Industry noted that: *"services fees range from 3 to 7 per cent of the sales value which is driving a substantial increase in merchant fees."*[50]

The RBA stated in 2023[51] that removing BNPL no-surcharge rules is essential to limit cross-subsidisation between BNPL and other payment methods.[52] Given that the current review notes the concern over cross-subsidisation between debit and credit, the ABA is concerned that policy formed without consideration of BNPL would entrench and incentivise BNPL to be subsidised by lower-cost payments like debit and credit cards, further distorting the payments market and undermining fairness for both merchants and consumers.

Three party schemes

A comprehensive review of retail payments requires examination of the presence of three-party payment schemes, such as those operated by American Express and Diners Club. Unlike four-party models (e.g., Visa and Mastercard), these schemes act as both issuer and acquirer, overseeing both sides of a transaction. This structure poses challenges for regulatory frameworks that were designed primarily around four-party models and drives disparity within the payments system.

The RBA has previously expressed concerns the exemptions for three-party schemes may undermine the regulatory objective of ensuring competitive neutrality across payment systems.[53] Concerns regarding efficiency and price signalling distortions – notably the acceptance[54] that the *'absence of regulation'* of companion cards had *'influenced the development of the market'* led to the RBA's decision to designate American Express companion cards in 2016.[55]

Despite the lack of direct regulation, the merchant acceptance costs for three-party scheme payments[56] has declined significantly over time to remain competitive with regulated schemes.[57]

However, three-party scheme acceptance costs remain much higher than designated credit schemes. The average MSFs for domestic American Express and Diners Club cards were 1.30 and 1.66 per cent in September 2024 respectively. These are significantly higher than the corresponding MSFs on domestic Mastercard and Visa credit cards – 0.78 and 0.76 per cent.[58] These costs are important in the context of relative share of each scheme – American Express cards have grown in share of payment value rapidly since 2021, now representing almost one quarter of all credit card spend – *Chart A*.

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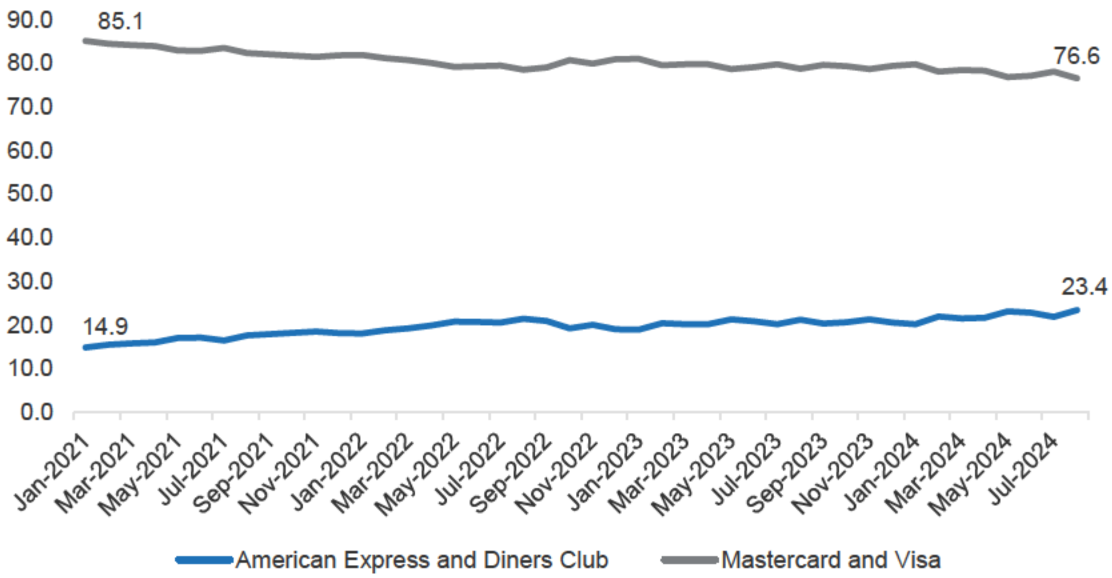
[49] See Australian Retailers Association submission to Buy Now Pay Later regulatory reforms consultation
[50] Australian Chamber of Commerce and Industry submission to 'Review of the Australian Payments System – Issues Paper'
[51] Payment Systems Board Annual Report 2023
[52] *Ibid.*
[53] RBA *'Review of Card Payments Regulation – Conclusions Paper'* May 2016
[54] *Ibid.* Page 26
[55] *Ibid.*
[56] Specifically American Express and Diners Club
[57] RBA *'Review of retail payments regulation – Conclusions Paper'* 2021
[58] RBA Payments Data *'C3: Average Merchant Fees for Debit, Credit and Charge Cards'*

Chart A: Card schemes share of purchases by value[59]
% of total credit card spend



It's acknowledged the structure of American Express fees limits their regulation under equivalent interchange regulation – in outlining these observations, the ABA is not advocating for three-party schemes to be subject to price controls. Rather they are provided to illustrate the complexity of the payments landscape and the inherent difficulty in reviewing one part of the system without considering the implications of other components.

For example, it is commonplace for single rate merchant pricing structures to include acceptance of non-designated schemes without additional cost to the merchant – particularly American Express but also schemes like UnionPay and JCB.[60] Blended pricing structures like these are preferred by many merchants, as they enable them to transact with more customers with certainty and predictability.

However, there are implications for the scope outlined in the Issues Paper. For example, it is unclear how a competitively neutral and informed discussion of cross-subsidisation between debit and credit can be undertaken when simple and predictable pricing models would suggest debit and credit payments are cross-subsidising non-designated, higher cost payments.

There are other implications for competitive neutrality that should be noted – particularly cardholder reward programs. Core three-party scheme cardholder value propositions are the generous reward programs and ancillary benefits, funded through merchant fees. These programs are popular with consumers and merchants alike – providing consumers benefits they value, while merchants benefit from access to more customers and higher sales. In considering any regulatory response, it is important that **competitive neutrality is maintained** – i.e. if the RBA were to conclude that

[59] Data obtained from RBA Payments Data 'C3: Average Merchant Fees for Debit, Credit and Charge Cards'
[60] I.e. reviewing the single rate public pricing of a wide range of leading merchant acquirers shows American Express included in all offerings.

'credit costs such as interest-free periods and rewards should not be borne by the merchant'[61] then this conclusion should be applied consistently across the industry.

Summary of key issues

1. **The retail payments system has experienced an unprecedented level of structural change over the last decade.**
2. **A complete, holistic perspective of the payment system and participants is an essential prerequisite to a substantive and effective review of retail payments.**
3. **Unregulated payment participants impose growing system-wide costs while relying on existing infrastructure. The effect of these dynamics must be in scope as part of any significant review into payment costs.**
4. **Excluding non-traditional and unregulated participants, such as mobile wallets, BNPL, and three-party schemes from review, will greatly limit the efficacy and efficiency of regulatory responses.**
5. **Focusing reforms only on regulated participants risks entrenching imbalances, driving up costs, and incentivising higher-cost alternatives.**

[61] Issues Paper. Page 13.

Balanced Payments Policy

A balanced payments system is essential to ensuring efficiency, fairness, and ongoing investment in innovation and resilience. While costs are a key consideration, they must be assessed within the broader context of shared benefits and responsibilities across all participants. The payments system underpins economic activity and requires a sustainable and equitable framework to support its ongoing development and functionality.

Australians have consistently demonstrated a comparatively strong appetite for adopting new technologies – from VCRs to mobile and smart phones – ranking among the top ten countries globally for digital readiness. [62] This enthusiasm extends to payments – Australians have led the world in their rapid embrace of contactless payments, supported by Australian businesses having one of the highest penetration rates of point-of-sale (POS) devices worldwide.[63]

The innovation underpinning these advancements (e.g. contactless payments rollout) has been possible due to significant and continued investment by ecosystem participants - particularly banks and card schemes.[64] The Payment Systems Board illustrates this:

> *"Besides consumer demand for convenience, the rise of contactless payments in Australia has been supported by the fast rollout of contactless capable cards and terminals by PSPs and card schemes."*[65]

Today, more merchants than ever accept digital payments, and innovation continues to shape a payments landscape that offers convenience and security to consumers while supporting businesses. However, these benefits demand continued investment in infrastructure and innovation – necessitating sufficient investment incentives, including mechanisms to distribute some of these costs. This reflects the economic challenge identified in the Payments system review:

> *"Improvements to payment systems require significant investments, but benefits of the investment can be reaped by the whole system. This means that PSPs have an incentive to not contribute to the upfront cost but still benefit from system-wide improvements."*[66]

For example, the 2021 review of the payments system notes that there needs to be a fair balance of costs between consumers and businesses and observes that *"retail payment systems bring together consumers and businesses that have different needs and preferences."*[67]

The review also highlighted the public interest in payments infrastructure investments, finding that *"Improvements to payment systems require significant investments, but benefits of the investment can be reaped by the whole system."*[68]

It is therefore essential that a balanced approach to the economics of payments is taken to ensure cooperation and investment across a diverse network of participants is supported. The strategic plan for Australia's payments system notes both these challenges and the ongoing investment required by participants:

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[62] AFR. https://www.afr.com/technology/australia-ranked-in-global-top-10-for-digital-readiness-but-some-states-lag-cisco-20180911-h157v4
[63] See Australian Payments Network Device Statistics
[64] Expert Industry Opinion by Lance Sinclair Blockley in relation to the ACCC application on the proposed amalgamation of BPAY, Eftpos and NPP Australia.
[65] Payment Systems Board Annual Report 2023
[66] Review of the Australian Payments System – Final report. June 2021. Page 10
[67] *'Review of the Australian Payments System – Final report'* June 2021.
[68] *Ibid.*

> *"The need to coordinate can result in innovation being slower than desirable and, in some cases, new technologies may not be implemented at all. The diverse range of new payment participants also makes system-wide cooperation more difficult."*[69]

> *"It is important that participants in the payments industry invest in resilient and secure infrastructure, systems and customer services."*[70]

> *"One example is the requirement for continued uplift in system-wide security standards and practices relating to the security standards and encryption methods for card payment systems."*[71]

Separately, an observation by the Payment Systems Board highlights how innovation in product and technology flows across the ecosystem:

> *"In addition, the emergence of new PSPs and payment plans suited for smaller merchants has seen wider acceptance of contactless card payments."*[72]

The cost of payments in the broader system

The ABA recognises payment system costs are naturally a component of payment efficiency, but they should not be considered independent of the broader system. In reviewing Australia's payments system, it is critical to recognise the broader dynamics at play. A singular focus on reducing costs risks oversimplifying the complexities of the payments ecosystem and could lead to unintended consequences that undermine its sustainability, competitiveness, and innovation. Policy reform should be considered holistically – balancing efficiency with the need for ongoing investment and fairness for all participants.

Efficiency requires economic sustainability for all participants

The payments system is not merely a transaction facilitator; it is a critical enabler of economic activity, consumer convenience, and business efficiency. When viewed narrowly as a "cost centre," the system's broader value to merchants, consumers, and the economy is overlooked.

Merchants benefit significantly from electronic payments, including:

- Reduced cash handling expenses, including security, insurance and reconciliation costs.
- Acceptance of a consumer's preferred payment method.
- Access to more customers, including online.
- Faster and more reliable transactions.
- Access to richer data.
- Ability for consumers to make purchases earlier (credit cards).

For consumers, payments are the gateway to seamless commerce. Ensuring Australia's payments infrastructure continues to evolve with global systems requiring significant ongoing investment in technology and risk management controls. Features such as digital wallets, contactless payments,

[69] A Strategic Plan for Australia's Payments System
[70] *Ibid.*
[71] *Ibid.*
[72] Payment Systems Board Annual Report 2023

and BNPL services reflect growing expectations for speed, flexibility, and integration into daily life. These benefits are not "free" to deliver – they require continual investment in infrastructure, security, and innovation.

Pressures on payment economics

The payments ecosystem already faces significant cost pressures and low margins. Reducing payment costs to unviable and uncommercial levels is not in the long-term interests of any stakeholder. Any consideration of payment costs should consider:

1. **Merchant service fees have been in long term decline**
    - Interchange benchmarks and competitive forces have significantly reduced merchant pricing over the past two decades – *'Chart B.'*
    - Increased supplier and scheme fees, coupled with growing operational and compliance costs, are squeezing margins further. [73]
2. **Payment economics continue to erode**
    - Regulatory obligations, cybersecurity demands, and resilience requirements will continue to add further pressure, requiring substantial ongoing investment.
    - Ongoing cost pressures from important industry investments including system resilience and innovation. Large scale industry projects like encryption upgrades (AES), tokenisation.
    - Industry experts observe that margin decline has only been manageable due to growing payment volumes, concluding that *"it is hard to make money out of consumer payments in Australia."* [74]
3. **Whether further regulation of payment costs is feasible**
    - Domestic retail debit and credit payments comprise only a small share of total payments revenue in APAC.[75]
    - Banks and other providers face difficult choices in allocating finite resources. Compared with other financial services, retail payments yield minimal returns, with regulatory and consumer expectations making it challenging to recover costs. [76] This diverts resources from innovation and long-term system resilience.

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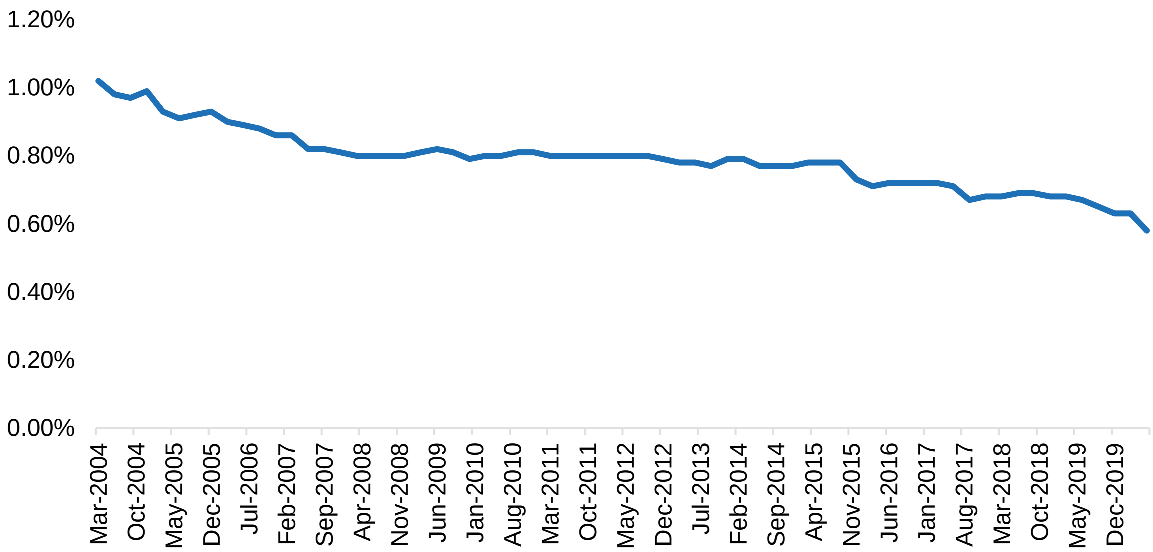
[73] See the expert Industry Opinion by Lance Sinclair Blockley in relation to the ACCC application on the proposed amalgamation of BPAY, Eftpos and NPP Australia.
[74] *Ibid.*
[75] 2023 McKinsey Global Payments Report. [online] https://www.mckinsey.com/industries/financial-services/our-insights/the-2023-mckinsey-global-payments-report
[76] See the expert Industry Opinion by Lance Sinclair Blockley in relation to the ACCC application on the proposed amalgamation of BPAY, Eftpos and NPP Australia.

Chart B: Merchant service fees for Mastercard and Visa (combined all cards), 2004 – 2024[77]
% of transaction value



Payment costs, such as interchange fees, are a vital component of the financial ecosystem, supporting the economics of essential banking services and the functionality consumers rely on daily. Transaction accounts, for example, require significant investment to meet risk, compliance, and regulatory obligations, including AML/KYC requirements, yet they are often provided with minimal or no direct fees to customers. Reductions in interchange revenue would constrain the already finite pool of funds available for these services and must be carefully evaluated within the broader context of its role in maintaining the stability and accessibility of the payments and banking system.

International observations

1. European Union: Interchange fee regulation (IFR)

While reductions in the interchange benchmarks across the European Union were successful in lowering overall interchange costs, research[78] on the impact of the implementation of IFR reforms identified several impacts to the availability and accessibility of banking products:

The IFR led to higher consumer fees, reduced credit card availability, withdrawal of many products from the market and diminished investments in innovation, with noticeable stagnation since the widespread adoption of contactless technology.

> *"Surcharging regulated products was still being experienced by consumers. The reduction of interchange has made the business case for entry into the issuing side of the market more difficult. Innovation has suffered from the reduced revenue potential, especially on the issuing side with the most recent major innovative step being the development of*

[77] Data obtained from RBA Payments Data 'C3: Average Merchant Fees for Debit, Credit and Charge Cards'
[78] See 'Interchange Fee Regulation (IFR) Impact Assessment Study Report' by Edgar, Dunn & Company.

contactless technology for which the investments were incurred well in advance of the IFR."[79]

Others have noted the impacts on investment and cooperation within the industry is noticeable, with payment economics[80] for some issuers becoming unsustainable.[81] [82]

2. United States: Dodd-Frank Wall Street Reform (Durbin amendment) Act

There has been significant attention paid to the impacts of the Regulation II (Durbin amendment) interchange reforms. Studies have found the availability of fee free transaction accounts more than halved, while requirements like minimum balances increased. This occurred even amongst smaller banks that were exempted from Durbin.[83] [84] Research by George Mason University[85] concluded that Durbin reforms had in some aspects been regressive, leading to higher account fees, an increase in the unbanked population, and shifts away from debit cards to more expensive payment methods.

Other research[86] has validated these findings, confirming the intricacies and complementarity interdependencies between debit transactions and the high costs associated with providing transaction deposit accounts.[87] Importantly, studies have shown many of the costs associated with debit accounts (e.g. fraud, AML/CTF) to be both significant and structural – indicating little ability for cost rationalisation in the event of a material shift in payment economics.[88]

Cornerstone Advisors analysed the impact of Durbin reforms and observed these independencies:

> *"Debit cards are a component of checking products and a gateway to the banking system for all Americans. The cost to service customers and provide a growing list of features, such as online and mobile banking, fraud and security protection, money transfer services, branches, call centres and compliance, is quite costly and is bundled into the modern checking account, often at no additional cost to bank customers and credit union members."*[89]

Promoting efficient payments

It is normal that payment costs are reviewed periodically to ensure the system maintains efficiency. However, it is important to challenge perceptions of payments as merely a grudge cost to be

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[79] *Ibid.*
[80] The Effects of Payment-Fee Price Controls on Competition and Consumers
[81] Bolt, W., Jonker, N., Plooij, M. (2016). European Retail Payments Systems: Cost, Pricing, Innovation and Regulation. In: Beck, T., Casu, B. (eds) The Palgrave Handbook of European Banking. Palgrave Macmillan, London. https://doi.org/10.1057/978-1-137-52144-6_7
[82] Siragusa, M., Dolmans, M., Subiotto, R. F., Gilbert, P., & Messent, J. (2019). Payment services in the EU: price regulation to protect a duopoly. *Competition Law Journal*, *18*(4), 175–189. https://doi.org/10.4337/clj.2019.04.06
[83] The Effects of Price Controls on Payment-Card Interchange Fees: A Review and Update
[84] Mukharlyamov, V. and Sarin, N., "The Impact of the Durbin Amendment on Banks, Merchants, and Consumers" (2019). All Faculty Scholarship. 2046. [online] https://scholarship.law.upenn.edu/faculty_scholarship/2046
[85] Zywicki, T., Manne, G., Morris, J. Price Controls on Payment Card Interchange Fees: The U.S. Experience (June 4, 2014). George Mason Law & Economics Research Paper No. 14-18, Available at SSRN: https://ssrn.com/abstract=2446080 or http://dx.doi.org/10.2139/ssrn.2446080
[86] Kay, B. S., Manuszak, M. D., & Vojtech, C. M. (2018). Competition and complementarities in retail banking: Evidence from debit card interchange regulation. *Journal of Financial Intermediation*, *34*, 91–108. https://doi.org/10.1016/j.jfi.2018.02.001
[87] Also see Bourke, Nick, How Proposed Interchange Caps Will Affect Consumer Costs (January 24, 2024). Available at SSRN: https://ssrn.com/abstract=4705853 or http://dx.doi.org/10.2139/ssrn.4705853
[88] Benjamin S. Kay, Mark D. Manuszak, Cindy M. Vojtech. (2018). Competition and complementarities in retail banking: Evidence from debit card interchange regulation. Journal of Financial Intermediation. Volume 34, Pages 91-108. [online] https://doi.org/10.1016/j.jfi.2018.02.001.
[89] Cornerstone Advisors 'The true impact of interchange regulation' [online] https://protectinterchange.com/wp-content/uploads/2024/02/True-Impact-of-Interchange-Regulation_CornerstoneAdvisors_June_2023-1.pdf

minimised. The cost of payments matters, but the level and efficiency of payment costs should be considered against the context of Australia's payments as a critical national asset that requires sustained investment to meet future demands.

Consideration of the system's costs should:

1. **Promote cost-effectiveness and efficiency rather than cost reduction**
    - Efficient systems balance costs with value, ensuring businesses and consumers can access competitively priced payments, and participants can invest in resilience and innovation.
    - A narrow view of cost which does not account for the multidirectional structure of the system risks hollowing out the system over time.
2. **Reflect the nature of ecosystem investment**
    - Investments in infrastructure benefit all participants, enabling faster, more secure, and more convenient payments.
    - However, the costs to support investment in ecosystem-wide development is typically not proportionately borne by all participants and is often concentrated heavily on select participants (e.g. card issuers, card schemes, PSPs). Assessing the efficiency of costs needs to account for the investment demands, ensuring that investments to benefit of all participants (e.g. resiliency, fraud) are not disincentivised.
3. **Recognising the benefits to all stakeholders**
    - Electronic payments offer businesses significantly greater efficiency, lower fraud risks, faster reconciliation, and access to broader markets.
    - For consumers, digital innovation has delivered convenience and accessibility, underpinning the expectations of modern commerce.
4. **Understanding interdependencies**
    - Payments are an interconnected ecosystem, where decisions in one area have ripple effects across others. For example, the connection between debit payments and debit transaction accounts.
    - Policy discussion should reflect these complexities – prioritising fair and equitable distribution of costs across the system, instead of a purely nominal and narrow view.

Summary: key issues

1. **Payment efficiency requires a balanced approach policy – balancing the need for cost effective payments, while ensuring capacity and incentive for critical investments into security, reliability, and innovative solutions.**
2. **The payments system is a complex network of interdependencies. Payment costs reflect shared responsibilities across participants and deliver significant benefits to merchants, consumers, and the economy.**
3. **Competitive neutrality must be maintained to ensure a level playing field. Reforms should address structural imbalances, including the role of unregulated participants and disintermediation, to avoid unfair cost burdens on regulated providers.**
4. **Payment system costs should be reviewed periodically to ensure the system continues to meet the needs of Australians. It is important that payment costs are viewed holistically in the context of the entire payments system.**
5. **Policies must avoid distorting incentives or creating unintended consequences that jeopardise system stability and long-term innovation.**

Interchange

Interchange is an essential component of an increasingly complex payments system

Interchange fees are a fundamental element of Australia's payments ecosystem, supporting secure, efficient, and innovative payment infrastructure. They balance costs across participants, ensuring the sustainability of the system while enabling wide-ranging benefits for consumers, merchants, and the broader economy.

We acknowledge the RBA is considering whether the current interchange benchmarks are appropriate – it is expected payment cost efficiency be reviewed periodically. However, given recent rapid technological and market shifts, and the economic realities of the modern payments system, the ABA is concerned that policies that narrowly focus on specific cost elements, could be ineffective and risk undermining the broader system's objectives.

The ABA considers that further reducing interchange benchmarks in today's payments system is not supported by clear evidence of public benefit and risks destabilising the system by undermining critical economic signals for investment, competition, and consumer innovation.

Interchange fees operate within a highly complex ecosystem involving multiple stakeholders, including card issuers, merchants, consumers, and payment schemes. These fees are not arbitrary; they reflect the costs of maintaining the infrastructure that facilitates secure, efficient, and innovative electronic payments.

Interchange fees are vital for ensuring that the costs of maintaining Australia's increasingly complex payments infrastructure are equitably distributed. This infrastructure supports not only merchants but also emerging players such as digital wallets and BNPL services, which depend on robust card networks to function.

Interchange fees providing funding for a wide range of essential system components and benefits:

- Ongoing investment into fraud prevention. E.g. investment by Australian banks and payments participants into EMV migration has reduced card present fraud,[90] however the rapid growth of card-not-present fraud[91] illustrates how continued industry investment is required to mitigate shifting fraud activities.
- Costs related to card issuance, including replacements, damaged cards, and emergency card services
- Fraud losses, which are typically borne by issuers in EMV environments
- Customer protection services, such as dispute resolution and chargeback rights
- System-related costs, including transaction processing, fraud monitoring, card personalisation, and AML/CTF/sanction screening
- Compliance costs
- Enables global electronic access to customers' accounts, including e-commerce and point-of-sale (POS) transactions

[90] IT News *'Australia's online card fraud problem is the polar opposite of America's. Here's why...'* November 2018
[91] AusPayNet *'Australian Payments Fraud 2024'*

- Investment in innovation, such as contactless cards, mobile payment solutions, and features like lock, block, and limit functionalities
- Customer features, benefits and functionality
- For credit cards specifically – the transfer of non-payment risk from the merchant to card issuer

Beyond funding critical security and fraud protections, interchange fees also support chargeback and dispute protections

Chargeback protections provide a crucial safety net, providing customers recourse in scenarios such as undelivered goods, fraudulent transactions, unauthorised payments, and POS failures.

As the primary advocate for consumers when transactions go wrong, issuers are responsible for managing the dispute, from investigating the claim, to ensuring the consumer is appropriately reimbursed. This process is not without cost: issuers absorb administrative expenses, including the labour and technology required to manage claims, and can incur reimbursement liability for certain transactions, or when funds cannot be recovered.[92]

Recent airline collapses, such as Regional Express (REX) and Bonza, underscore the value of these protections. In both cases, customers who paid by scheme debit and credit cards were generally able to recover their funds through the chargeback process, with card issuers stepping in to resolve disputes and absorb the associated costs.[93] Customers that did not use cards were unprotected. While the Federal Government and other airlines stepped in to support REX customers, the collapse of Bonza has left around 60,000 customers as unsecured creditors, [94] with no indication if they will get their money back.

These examples highlight the relevance of payment costs and their role in supporting consumer protections. Bonza's promotion of account-to-account (A2A) payments as a lower-cost alternative exemplifies the trade-offs inherent in different payment methods. While A2A payments can offer reduced transaction costs, they typically lack the robust dispute and chargeback protections provided by traditional card payment systems.

Ultimately, the choice of payment method for consumers and businesses involves balancing cost with other factors including the level of protection required. The system benefits from more choice, but these incidents underscore the importance of understanding the value that payment costs bring in terms of safeguarding consumers and ensuring consumers can transact with confidence.

[92] Hayashi, Fumiko and Markiewicz, Zach and Sullivan, Richard J., Chargebacks: Another Payment Card Acceptance Cost for Merchants (January 1, 2016). Federal Reserve Bank of Kansas City Working Paper No. 16-01, Available at SSRN: https://ssrn.com/abstract=2720386 or http://dx.doi.org/10.2139/ssrn.2720386

[93] Mastercard and Visa scheme rules

[94] ABC. https://www.abc.net.au/news/2024-05-07/federal-court-bonza-owes-money-60000-customers-staff-suppliers/103813200

Australian Banking Association

Australia's interchange benchmarks are low by global standards

Australia's interchange benchmarks remain competitive by global standards – a view regularly affirmed by the RBA. For example, the 2021 retail payments review conclusions paper noted that *"there is not a strong public policy case for lowering benchmarks at present"*, citing the significant decline in merchant costs over two decades, and Australia's relatively low interchange levels compared with others.[95]

The current benchmarks, which are already among the lowest globally, reflect a trend of long-term decline. Tokenised contactless payments, for example, saw their interchange rates drop from 15 cents in 2021 to 9 cents today.[96] Comparative research[97] by the Federal Reserve Bank of Kansas confirms this, finding that Australia's debit interchange rates are amongst the lowest in the world – *'Chart C.'*

With interchange now accounting for around one quarter of debit payment costs, scope for reducing benchmarks would be limited and yield diminishing returns. It is also important to recognise that interchange is just one fee amongst many in the payments system, as acknowledged by the CEO of Australian payments provider Zeller:

> *"Interchange is now only a minority cost line amongst myriad rising costs."*[98]

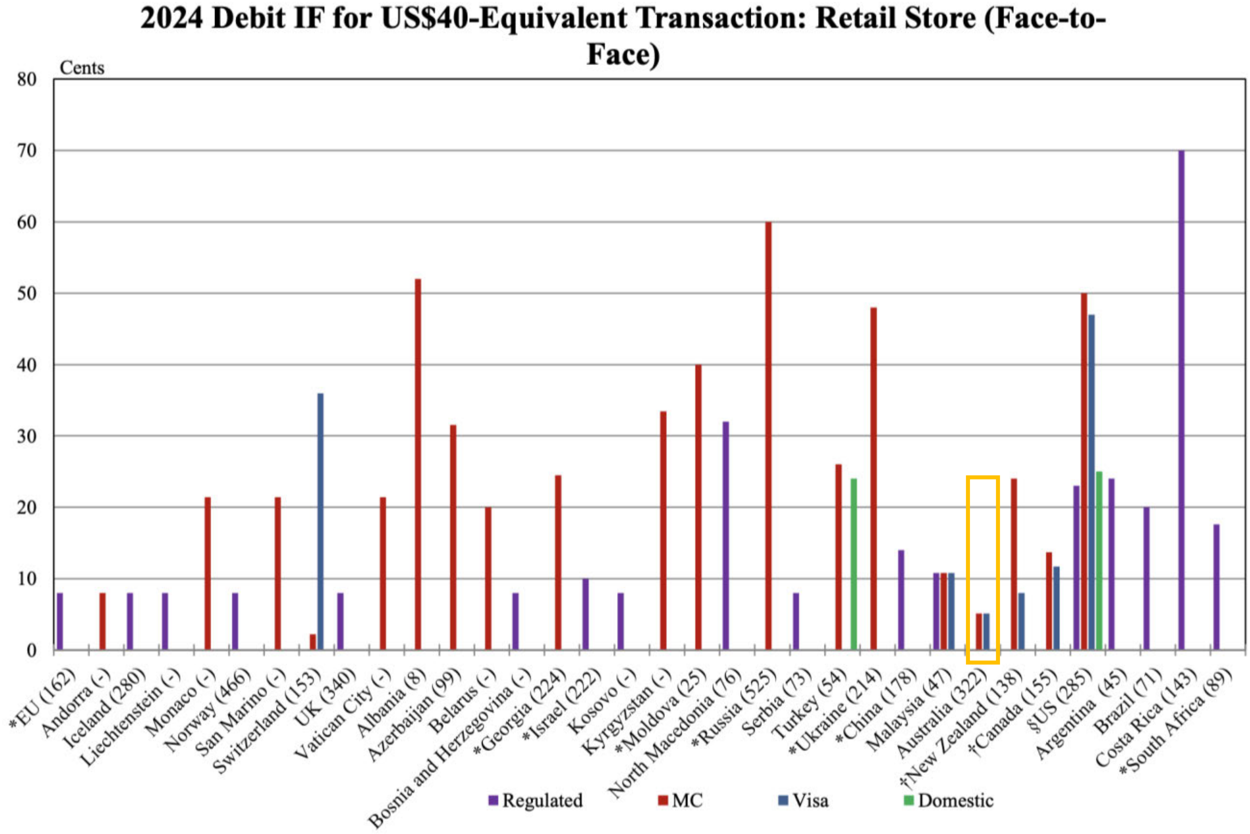
[95] 2021 Review of retail payments regulation – conclusions paper. https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/conclusions-paper-202110/pdf/review-of-retail-payments-regulation-conclusions-paper-202110.pdf

[96] Review of retail payments regulation impact statement. https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/pdf/review-of-retail-payments-regulation-impact-statement-oct-2021.pdf

[97] Credit and Debit Card Interchange Fees in Various Countries. August 2024 Update. Federal Reserve Bank of Kansas City. [online] https://www.kansascityfed.org/Interchange%20Fees/documents/10430/CreditDebitCardInterchangeFeesVariousCountries_August2024Update.pdf

[98] The Australian. https://www.theaustralian.com.au/business/financial-services/card-not-present-industry-calls-for-more-change-after-debit-fee-dump/news-story/462786c576529d091291a2be9f5dff90

Chart C: Comparison of global debit interchange rates[99]
Australia outlined in orange



Further lowering of interchange benchmarks would disproportionately impact small and medium sized banks

Small banks and credit unions rely heavily on retained earnings to meet regulatory capital requirements, which underpin their ability to grow lending. Unlike larger institutions with access to equity markets, smaller banks are often less easily able to raise capital in markets, while mutual banks and credit unions cannot at all.

Without the ability to raise funds externally, they cannot replenish or grow their capital buffers, directly limiting their capacity to extend credit while maintaining compliance with regulatory capital adequacy requirements.[100] For subsidiaries of international banks, the challenge is compounded by their limited autonomy to independently raise capital for local growth, leaving them reliant on parent companies whose priorities may not align with local market needs.

99 Source: Federal Reserve Bank of Kansas City
100 Kentucky's Credit Unions submission to the Board of Governors of the Federal Reserve System [online] https://www.federalreserve.gov/SECRS/2024/July/20240730/R-1818/R-1818-A_051024_159893_516685062931_1.pdf

In general, erosion of interchange income would further skew bank revenue toward interest income. However, for small and subsidiary banks, there are additional challenges to consider from further concentration on interest income:

- **Dependence on lending performance**

  Interest income and retained earnings are directly tied to the size and performance of the loan book. This dependency makes capital generation highly sensitive to reduced credit demand, defaults, or margin compression, constraining the ability to grow lending or absorb losses during challenging economic conditions. Less interchange income would more closely tie the ability of smaller banks to lend to existing lending performance.

- **Procyclicality**

  Interchange revenue provides a stable income stream that helps buffer against economic cycles. Cutting interchange would exacerbate the cyclical nature of interest income, leaving smaller institutions less equipped to maintain lending capacity during downturns when additional capital is most needed.

- **Growth constraints**

  Interchange fees provide a source of income that is delinked from the balance sheet. In contrast, capital accumulation through retained earnings and interest income is slow, incremental, and reliant on balance sheet performance. This embeds less flexibility for small institutions to scale lending or invest in innovation.

- **Relative investment requirements**

  All banks, regardless of size, face demands for continued investment into payments resilience, functionality, safety, and innovation. The cost of these investments, to a certain extent, is fixed – leading to often, relatively higher costs for smaller banks. Interchange is an essential revenue stream to support these investment needs.

These concerns are in addition to the general challenges smaller banks face from lower economies of scale, less opportunities for revenue diversification, and disproportionately higher regulatory/compliance costs. The RBA has noted these concerns as they relate to the ability of smaller issuers to offset the impact of lowered interchange benchmarks:

> *"Lower interchange on debit transactions could make it harder for new debit issuers to enter the market and could **disproportionately disadvantage smaller issuers**, which may have fewer other sources of revenue to offset any interchange reduction."*[101]

[101] RBA 'Review of Retail Payments Regulation' May 2021.

Australian Banking Association

International cards

The ABA supports reforms to reduce the materially higher acceptance costs of international cards for merchants

International cards are far more expensive to process than domestic cards and not subject to any regulatory price controls. International interchange can reach 2.4 per cent - three times the ceiling on domestic credit – with scheme fees adding a further 1.6 per cent.[102] RBA commentary notes that international cards, although comprising only 3% of overall card transactions, drive one third of all scheme fees paid by acquirers.[103] These costs are significant and appear to be growing in relative to transaction value – *Chart D, E.*

It is important context that while the international cards remain a small share of overall payments, the resumption of international travel over the past 2 – 3 years has led to rapid growth in international card acquiring as international card volumes have returned. To illustrate, international cards were used for $455 million in payments in September 2021 (~2 percent of transactions acquired in Australia by value).[104] In October 2024 they were used for $1,800 million (~5 – 6% of transactions acquired in Australia by value).

While this appears to be the normalisation of international card activity, it does represent a significant amount of nominal growth – in the case of value, a four-fold increase in ~3 years. For merchants, this rapid normalisation could have driven significant growth in nominal international card acceptance costs, compressed into a short period of time. For businesses that did not historically accept card payments – e.g. businesses formed post 2020, or businesses that did not accept card payments prior to 2020 – the resumption of these higher cost payments and their rapid growth could be particularly concerning.

The ABA supports reforms to increase transparency of international card costs and reduce the burden of these costs on businesses. It's noted that in the EU, international fees have been subject to reform – international card-present interchange rates have been aligned to intra-EU benchmarks. and international card-not-present interchange rates have been capped at 1.15 and 1.5 per cent for debit and credit.[105] When these controls were first implemented in 2019, the European Commission stated they would lead to a 40 per cent reduction in multilateral interchange fees – a significant reduction.[106]

[102] Ellis Connolly 'Online Retail Payments – Some Policy Issues' https://www.rba.gov.au/speeches/2024/sp-so-2024-06-18.html
[103] *Ibid.*
[104] Data obtained from RBA Payments Data *'C1.1: Credit and Charge Cards – Original Series – Aggregate Data'*
[105] Reuters. *'Visa, Mastercard to extend non-EU card fee caps to 2029, EU says'*. July 2024.
[106] Reuters. *'EU accepts Visa, Mastercard offer to cut non-EU card fees to end antitrust probe'* April 2019.

Chart D: Average merchant service fee for Visa credit (domestic and international)[107]
% of transaction value

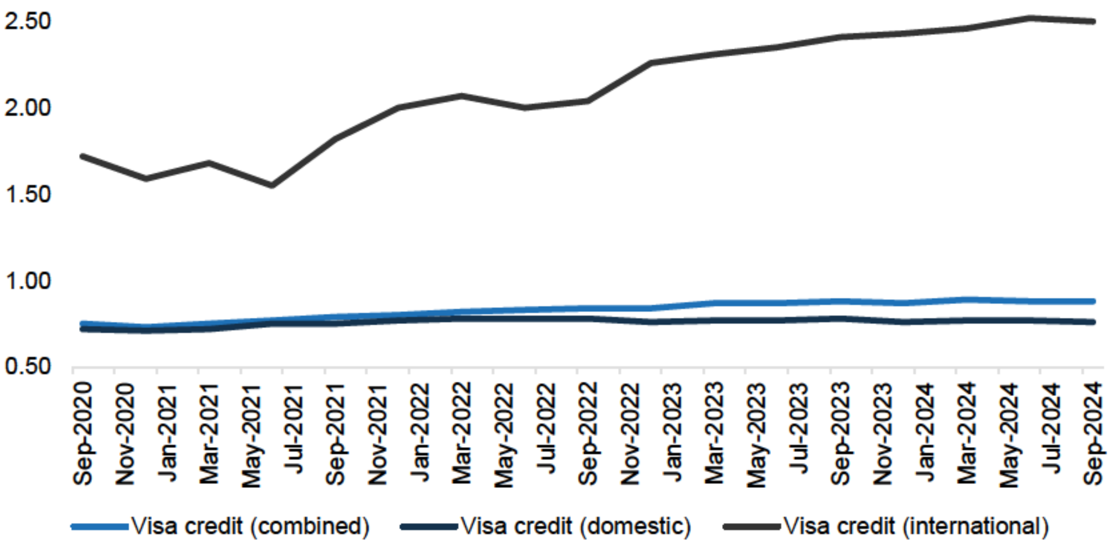
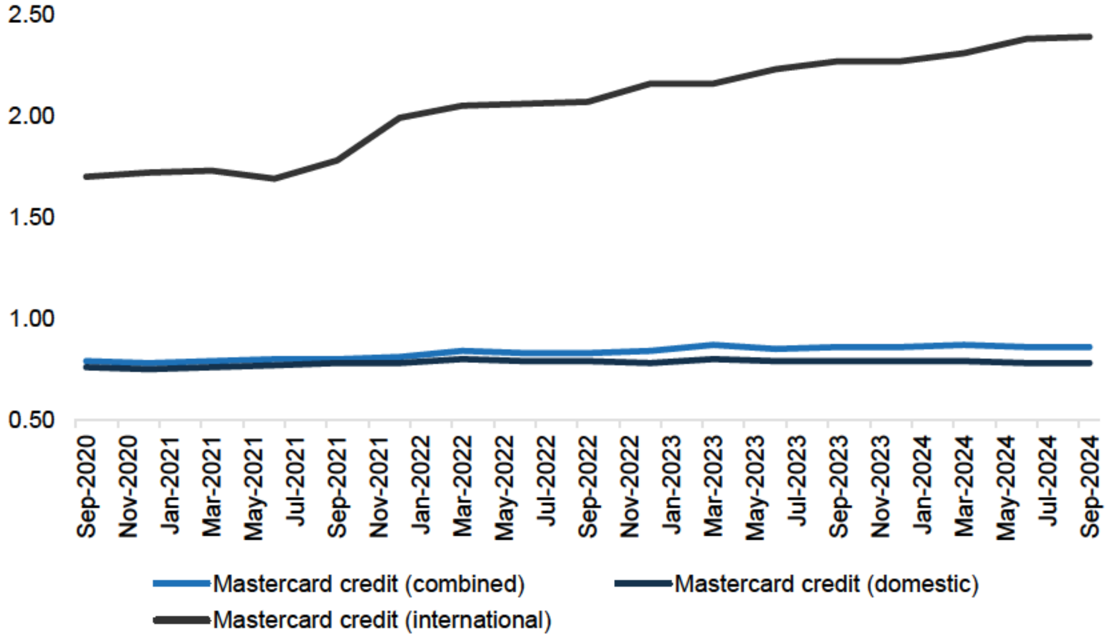


Chart E: Average merchant service fee for Mastercard credit (domestic and international)[108]
% of transaction value



[107] Data obtained from RBA Payments Data 'C3: Average Merchant Fees for Debit, Credit and Charge Cards'
[108] Data obtained from RBA Payments Data 'C3: Average Merchant Fees for Debit, Credit and Charge Cards'

Scheme fees

The ABA supports greater transparency of scheme fees for merchants

Scheme fees are a significant component of merchant payment costs and play an important role in supporting the infrastructure, security, and innovation of Australia's payment systems. However, unlike interchange fees, scheme fees remain unregulated and lack transparency. Their complexity and pass-through to merchants make it challenging for businesses – particularly small merchant – to understand and manage their costs. While these fees are vital for maintaining payment networks, their relatively high growth and opacity can contribute to rising merchant costs.

The ABA acknowledges that scheme fees are necessary to sustain and improve the payments system. However, improving transparency around their structure and application could help merchants better understand and manage their costs without disrupting the balance of the payments ecosystem.

The ABA supports improved transparency of scheme fees to promote efficiency and trust in the payments system. This could include reporting aggregate fee data – such as total revenue by transaction type – and providing explanations for fee changes. However, it is critical that any measures to transparency are proportionate, likely to benefit the ecosystem, avoid the introduction of onerous compliance burdens and preserve flexibility for innovation.

Reflecting our position on payment system costs more broadly, direct intervention into the pricing of scheme fees should be treated cautiously. Instead, the ABA suggests measures such as standardising fee categories and promoting voluntary transparency practices, including consultation with stakeholders before introducing new fees. These actions would balance the interests of schemes, acquirers, merchants, and consumers while maintaining flexibility for competitive and innovative developments.

Australian Banking Association

Summary: ABA perspectives on interchange, international cards, and scheme fees

1. **The ABA is strongly opposed to further reductions to domestic interchange benchmarks. Interchange is an essential component of the payments system and a tested mechanism for enabling critical investment to the benefit of the entire system.**
2. **Australia's domestic interchange benchmarks remain highly competitive globally.**
3. **Meaningful review of payment costs, including interchange, should be undertaken as part of a comprehensive review that includes material but unregulated participants.**
4. **Mobile wallet fees have significant eroded interchange revenue. Any future consideration of interchange benchmarks must consider on this context.**
5. **Scheme fees are unregulated and opaque. The ABA supports reforms to enhance transparency for merchants and improve competitive pressures.**
6. **International cards have a disproportionate and material impact on merchant acceptance costs. The ABA supports the RBA considering measures to reduce the costs of these cards for merchants.**
7. **Policy changes to payment costs must be balanced and consider any impacts to investment incentives.**

Australian Banking Association

Payment costs in context

The issues paper notes:

> *"The average fee that merchants pay for each card payment has declined over the past two decades. However, increased use of cards by consumers has led to overall card payment costs for merchants rising to an estimated $6.4 billion in 2022/23."*

We understand that aggregate costs are important to consider, however, decontextualised nominal cost figures can be misleading.

To illustrate, the referenced nominal figure ($6.4 billion) does not account for growth in overall economic activity, inflation, or the sheer volume of card transactions today compared to two decades ago. For example:

- Overall consumption in the economy increased significantly. Between 2006 – 2021, final consumption expenditure has increased from ~$773 billion to ~$1,635 billion.[109]
- Three quarters of payments were made with cards in 2022 – three times the share in 2007.

Additionally, between 2007 and 2022, online payments have:[110]

- Increased from 4 to 18 per cent as a share of overall consumer transactions; and
- Increased from 13% to 40% as a share of overall payment value.

This is an important distinction to note as they are payments that simply could not have occurred through non-electronic means.

The issues paper also notes that the fixed cents-based interchange rate on certain debit transactions would not have risen relative to transaction value. We agree with this, however, general increases in price levels have additional implications on fixed-rate interchange costs.

Fixed-rate interchange costs were reduced in 2021. A general rise in consumer price levels while these rates remain fixed, would suggest *ceteris paribus*, that debit interchange would decline in real terms per transaction. For example, if an average transaction grew from $40 to $44 due to inflation, effective interchange costs on a tokenised contactless transaction would fall from 0.23% to 0.20%.[111]

It should also be considered whether the increased transaction volume is observed would be expected to continue, or whether it represents displacement of low value cash transactions. While there has been rapid shift from cash to card for lower value transactions, card usage is now broadly similar across transaction values, suggesting a natural ceiling for further relative cash-to-card shifts. To illustrate, from 2007 – 2022, cards have shifted across payment values:[112]

- $1 - $10 transactions have increased from 4% to 72% of payments.
- $11 - $20 transactions have increased from 21% to 78% of payments.
- $21 - $50 transactions have increased from 40% to 79%.

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[109] Source: OECD. Gross domestic product statistics contained in 'National Accounts of OECD Countries'
[110] Table 6. The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey.
[111] Assumed medium value tokenised contactless rate of AUD 0.09
[112] RBA Consumer Payments Survey 2016, 2019, 2022

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Given lower value transaction sizes are broadly just as likely to be on card as higher value ones, it's questionable how much further low value transactions could shit to card relative to cash.[113] In the event that card volumes for lower value transactions near a ceiling on their relative share, general inflationary pressures would lead to lower effective interchange costs over time.

It is possible card transaction volumes are approaching this ceiling already. In 2021/22 the value of debit payments grew twice as fast as the number of transactions.[114] The average transaction size for debit payments in 2019/20 was $46, growing to $50 per cent in 2021/22.[115]

Payment costs include the cost of cash

The issues paper acknowledges that declines in cash-related expenses have, at least in part, offset the costs of electronic payments. This is an important observation that reflects the need for evaluating payment systems holistically, with consideration given to the interactions between different payment methods.

Handling cash carries substantial direct and indirect costs, including expenses for insurance, labour, cash collection, and reconciliation. Research by Square[116] found that small and medium-sized Australian businesses spend an average of 216 hours per year handling, counting, and depositing cash, costing the sector an estimated $9 billion annually in wages. When including both direct and cross-subsidised costs, BCG[117] estimates that cash costs businesses approximately 3.9% of a transaction's value.

Commentary from Zeller aligns with these observations, *"The cost associated with the use of cash is on par with or exceeds the cost of running a business with electronic payments."*[118] These savings from reduced cash reliance highlight the need for a balanced perspective when assessing payment costs. Businesses gain significant operational efficiencies by shifting to electronic payments, which must be factored into any discussion of surcharges and cost recovery.

Responding to macroeconomic pressures

Substantive reforms to payment costs will have material and lasting implications for the ecosystem. The ABA believes that changes to the underlying economics of payments should only be pursued where there is a clear need to address significant inefficiencies or structural barriers.

While inflation and cost-of-living pressures are serious concerns, there are significant risks with structurally reforming payment economics based on transient economic conditions. As macroeconomic conditions change, the core objectives of the payments system – efficiency, fairness, accessibility, innovation and resilience – remain constant.

It is therefore important to consider how payment costs are shifting relatively to other expenses. The cost of payments is a key expense for many businesses, but it is not apparent that these costs have increased disproportionately higher than general prices. In absence of pricing changes, fixed-

[113] See table 3 in RDP 2023-08 The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey
[114] Payment Systems Board Annual Report 2022
[115] Payment Systems Board Annual Report 2020; 2022
[116] *'The real cost of cash for small businesses'.* [online] https://squareup.com/au/en/the-bottom-line/managing-your-finances/cost-of-cash
[117] AFR: https://www.afr.com/companies/financial-services/mastercard-argues-cash-costs-more-than-card-in-bid-to-stymie-fee-limit-20240828-p5k5xf
[118] The Australian: https://www.theaustralian.com.au/business/financial-services/payment-problems-blanket-surcharging-bans-are-not-the-answer/news-story/558934067c237fc8ae81a9a14f63738f

rate models for payments would suggest that relative payment costs would remain stable, even as other costs – such as energy and labour, and materials – continue to climb. While this would be expected, it is important to note that payment costs have continued to decrease in real terms as MSFs have declined and businesses have reduced their costs associated with cash and cheques.

Small businesses are facing amongst the toughest operating conditions in many years. Successive reports from COSBOA highlight energy, labour and general supplies as the primary drivers of greater costs on business.[119]

Summary: payment costs in context

1. **The case for regulatory reform should be based on evidence of significant and persistent inefficiencies. Structural changes based on transient conditions, such as inflation, risk undermining the system's long-term stability.**
2. **Relative payment costs have remained stable compared to broader business expenses, like energy and labour, while merchant service fees have continued to decline in real terms.**
3. **As most low value payments are now made with card, future transaction growth of low value payments is likely to stabilise.**
4. **The decline in cash-related expenses has offset electronic payment costs, delivering operational efficiencies that benefit businesses. These savings should be considered when evaluating payment system costs and surcharging frameworks.**

[119] E.g. 'State of Small Business Data Report August 2024' [online] https://www.cosboa.org.au/post/square-cosboa-report-reveals-two-speed-recovery-as-smes-struggle-to-maintain-resilience-in-a-tough & 'The Small Business Perspective Report 2024' [online] https://www.cosboa.org.au/post/navigating-critical-challenges-cosboa-and-commbank-launch-2024-small-business-perspectives-report

The nexus between costs, pricing and surcharging

Discussion of payment costs and surcharging is predicated on the assertion that there is a direct causal relationship exists between payment costs, merchant pricing, and surcharging practices. This is noted in the issues paper:

> *"Merchant costs and surcharging are interrelated issues: merchants would be less likely to surcharge consumers if card payment costs were lower."*

The ABA agrees that payment costs have implications for pricing and surcharging practices. However, the underlying dynamics of payments are multifaceted and the relationships between costs, merchant fees and surcharging are not straightforward.

The decision to surcharge payments is inherently a business choice, influenced by a range of factors far beyond the costs of payment processing alone. While costs play a role, businesses make these decisions within a broader context of customer preferences, competitive pressures, and operational priorities. Surcharging is less about isolating costs and more about managing the complex trade-offs that define modern commerce.

The payments system, at its core, is an interconnected network rather than a linear chain of inputs and outputs. Costs are not isolated; they ripple across the system in ways that are shaped by competition, technology, and market behaviour. Cutting one cost may shift, rather than reduce, pressures elsewhere, often reliant on how a wide range of parties respond. Interventions that assume a direct or predictable link between payment costs and merchant surcharges oversimplify these dynamics and risk undermining the system's delicate balance.

Experience from overseas illustrates this clearly. In the EU and the US, price controls on specific payment costs have often failed to deliver lower costs for businesses. Instead, they have disrupted market dynamics, constrained competition, and diverted focus from real efficiency gains. These lessons underline the importance of understanding the broader ecosystem when crafting policy.

Policy decisions must account for this complexity. Assuming linear causality between payment costs and surcharging risks misdirected reforms that fail to address underlying dynamics. Instead, policies should aim to enhance transparency and competition while recognising the broader context in which payment systems operate.

While cost is a factor in overall efficiency, the assumption that lowering regulated payment costs, such as lower interchange fees, will naturally result in commensurately lower costs to merchants and consumers oversimplifies a complex relationship.

International observations

Evidence from international jurisdictions suggests that cost reductions at one point in the payments system often fail to produce proportional savings for merchants and consumers.

European Union

While IFR reforms were successful in reducing interchange, the overall impact on merchant costs is more complicated. Notably interchange reductions did not flow through to merchants on a 1:1 basis. For example, the 2020 review of IFR reforms for the European Commission[120] found less than half of the EUR 2,950 million in foregone interchange was passed through to merchants in the years following PSD2 reforms. The study estimated that the pass-through to consumers of lower

[120] EY and Copenhagen Economics – Review of IFR for the European Commission

payment costs was very limited – estimated at a saving per household of EUR 3.83 per year. Other country-level analyses have also observed limited passthrough to end consumers – e.g. less than one fifth of interchange reductions were passed through to consumers in Spain post-IFR.[121]

Furthermore, European Commission research concluded that post-IFR, there was a statistically significant increase in scheme fees paid by both issuers and acquirers. In parallel, acquiring margins expanded, with the study finding minimal observable cost benefit to merchants overall. [122]

Other studies have reviewed MSFs and support this view. Despite observing some pass through of interchange cuts, approximately half of merchants have seen their MSC return to or exceed reregulation levels.[123] Overall, average merchant service fees are now higher in the EU than before the 2015 interchange regulation.[124]

> *"According to CMSPI estimates, increases to unregulated components of the Merchant Service Charge have meant that the average European retailer is paying more than ever to accept card payments."*[125]

United States

Analysis undertaken by the Federal Reserve Bank of Richmond found that only 11% of merchants saw a decrease in their debit costs, while 31.3% saw an increase in costs.[126] Consequently, only 1% of merchants reported passing these savings through to consumers through reduced prices.

Other research has identified that ~75% of the $6.5 billion in annual Durbin savings were retrained by retailers.[127] This was particularly noticeable in measurable industries like petrol retailing where consumers saw no price reductions, despite the industry receiving more than $1 billion in interchange savings per year.[128] This view is supported by analysis undertaken by the University of North Carolina which observes that small merchants have in aggregate experienced an increase in overall fees post-Durbin, with reforms largely representing a net benefit for large merchants only:

> *"While large merchants dealing in big ticket items like electronics and home furnishings realized considerable benefits from reduced fees, cardholders, bank customers, community banks, and small merchants experienced significant losses as a result of the Durbin Amendment and its implementing regulations."*[129]

[121] Shabgard, B., Asensio, J. (2023). The price effects of reducing payment card interchange fees. *SERIEs* **14**, 189–221.
[122] EY and Copenhagen Economics – Review of IFR for the European Commission
[123] Veljan, A., Clark, S., Fagan, F., Langenfeld, J., Clark, S., Langenfeld, J., & Fagan, F. (2021). Regulating the Uncontrollable: The Development of Card Scheme Fees in Payments Markets in Light of Recent Policy Intervention. In *Research in law and economics* (Vol. 29, pp. 89–110). Emerald Publishing Limited. https://doi.org/10.1108/S0193-589520210000029006
[124] See Eurocommerce CMSPI study. Available at: https://brc.org.uk/news/finance/study-shows-interchange-fee-regulation-benefits-cancelled-out-by-other-fee-increases/
[125] See commentary on CMPSI study. Available at: https://thepaypers.com/expert-opinion/are-european-merchants-paying-more-than-ever-to-accept-card-payments--1249170
[126] https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-12.pdf
[127] See Sarin, Natasha, "Making Consumer Finance Work," Faculty Scholarship at Penn Carey Law, 1539 (2019). Available at https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3049&context=faculty_scholarship.
[128] Gas Retailers Gained a $1 Billion Subsidy from Durbin Amendment, With No Evidence of Lowering Gas Prices, BUSINESS WIRE
[129] Steven M. Constantin, The Role of the FTC in the Payment Card Industry -- An Examination of Regulatory Shortcomings and Suggestions for Improvement, 28 N.C. BANKING INST. 79 (2024). Available at: https://scholarship.law.unc.edu/ncbi/vol28/iss1/7

Empirical analysis that has reviewed the overall economic impact from Durbin reforms across the payments system shows consumers are in aggregate worse off.[130] [131]

The link between payment costs and surcharging is complex and non-linear

Effective payment systems are predicated on economic efficiency, however, the experiences in the European Union and United States illustrate that regulatory interventions aimed at reducing payment costs do not automatically result in proportional decreases in merchant costs or consumer surcharges. Factors such as market dynamics, merchant pricing strategies, and competitive pressures play significant roles in determining the actual impact on surcharging practices.

In practice, identifying clear causality between diverse factors influencing surcharging and the observed application of surcharging is not straightforward. While not necessarily conclusive, there is evidence to indicate the relationship between cost and surcharging is nuanced:

- As noted in the issues paper, average payment costs in Australia have been in long-term decline. It is difficult to draw an obvious link between cost and surcharging where surcharging levels increase without any observable increase in underlying costs.
- RBA research in 2012[132] found that surcharging was being used opportunistically in some cases to boost revenue, while also identifying an inverse correlation between average MSFs and average surcharge rates. While this was well before the surcharging reforms in 2016, these observations are important to note as they suggest that surcharging can be influenced by profit maximisation motives (which could exist at varying cost levels) and illustrates a historic unclear impact of MSFs on surcharging.
- Research by Zeller – *chart F* –shows that the propensity to surcharge increases with business size,[133] while RBA data finds that merchant fees decrease by business size. While acknowledging this is a limited dataset, it suggests further examination is needed and is potentially indicative of factors separate to MSFs influencing surcharging decisions.

Chart F: Percentage of Zeller merchants surcharging by business size[134]

Redacted by RBA

[130] David S. Evans, Howard Chang, Steven Joyce, THE IMPACT OF THE U.S. DEBIT-CARD INTERCHANGE FEE REGULATION ON CONSUMER WELFARE, *Journal of Competition Law & Economics*, Volume 11, Issue 1, March 2015, Pages 23–67, https://doi.org/10.1093/joclec/nhu032

[131] Steven M. Constantin, The Role of the FTC in the Payment Card Industry -- An Examination of Regulatory Shortcomings and Suggestions for Improvement, 28 N.C. BANKING INST. 79 (2024). Available at: https://scholarship.law.unc.edu/ncbi/vol28/iss1/7

[132] A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement. June 2012.

[133] Zeller. https://www.myzeller.com/blog/rise-of-the-surcharge-should-you-follow-the-trend

[134] Chart source: https://www.myzeller.com/blog/rise-of-the-surcharge-should-you-follow-the-trend

Acquiring services are available across a range of price points

The pricing landscape for payment services also varies widely, reflecting the diversity of merchant needs. The consultation paper notes that one fifth of small businesses incur payment costs above 2% of transaction value. However, there is wide variance in merchant pricing levels across small businesses – more than half of small businesses incur MSFs below 1.5%, with more than one quarter paying less than 1%.

This suggests there are many price points available to small businesses and may suggest that some businesses are willing to pay more for innovative technologies, streamlined processes, or complementary applications. The success of higher-cost acquirers in the SME market reinforces that cost is not always the primary determinant for merchants.[135]

Commentary from COSBOA highlights this:

> *"Merchants are now looking for solutions that provide simplicity, certainty and functionality as opposed to being focused solely on price. This is demonstrated by the growth of small merchant plans and the uptake of payment aggregators such as Square or Stripe."*[136]

Factors influencing surcharging practices

Beyond cost recovery, there are many possible reasons why businesses surcharge

The decision to surcharge reflects a complex interplay of cost recovery, consumer behaviour, and market dynamics, which cannot be reduced to a linear relationship with payment costs. Several elements may contribute to increased surcharging by merchants, beyond the direct costs of payment processing:

1. **Reduced consumer elasticity**

   As cash usage has declined (from 62% in 2010 to 13% in 2022)[137], and card payments become more prevalent, consumers have fewer alternatives to avoid surcharges. This reduced elasticity diminishes the competitive pressure on merchants to limit or eliminate surcharges, as consumers are less likely to switch to alternative payment methods or providers.

   Issues with transparency can also lead to lower consumer elasticity. For example, if consumers are only made aware of surcharging policies at point-of-sale (instead of before entry to a business), the time and energy already invested by consumers prior to payment can distort and inhibit how they respond to the surcharge. [138]

2. **Zero-cost acquiring and frictionless surcharging**

   The emergence of 'zero-cost' acquiring models and frictionless/automatic surcharging functionality can obscure the true cost of payment acceptance for merchants and lower scrutiny

[135] Banking Day: https://www.bankingday.com/banks-lose-as-stripe-square-carve-out-big-market-share-gains
[136] COSBOA Submission to 'Regulating Buy Now, Pay Later (BNPL) in Australia'
[137] RBA June 2023 Bulletin – Consumer Payment Behaviour in Australia
[138] Bourguignon, H., Gomes, R., & Tirole, J. (2019). Shrouded transaction costs: must-take cards, discounts and surcharges. International Journal of Industrial Organization, 63, 99–144. https://doi.org/10.1016/j.ijindorg.2018.10.004

of payment costs. Studies on this topic have identified that these models can lead to higher aggregate levels of payment costs, which are passed on automatically to consumers.[139] [140]

3. **Commercial objectives**

   Some merchants may view surcharging as an additional revenue stream rather than a cost-recovery mechanism.[141] This perspective can result in surcharges that are set above the actual cost of acceptance, leading to higher charges for consumers.

4. **Regulatory and compliance environment**

   Regulatory enforcement acts as a deterrent to non-compliance with surcharging regulation. Perceived insufficiency in enforcement of surcharging regulations can perpetuate the practice of over-surcharging, as merchants may not be deterred from exceeding permissible surcharge levels. Complexity and ambiguity in surcharging regulation influences this too – particularly where complexity leads to difficulties and uncertainty in compliance.

5. **Industry norms**

   Industries where other forms of surcharging or ad valorem pricing practices are common can serve to normalise surcharging, reducing both consumer resistance and merchant barriers to surcharging. For example, weekend surcharges[142] are common in hospitality venues and single price regulations do not apply to surcharges on food and beverages in restaurants.[143] This correlates to industry research, which finds the 'food and drink' industry to have the highest prevalence for surcharging.[144]

   This has been a long-term trend: the RBA noted in 2012 high correlation between industries with normalised ad valorem surcharges and high rates of payment surcharging.[145] There is significant disparity between surcharging rates across industries.

6. **Economic conditions**

   Higher surcharging in an inflationary environment. Zeller research – *chart G* – shows surcharging rates growing month-on-month from March 2022.[146] On the surface, these trends appear to be correlated with monthly inflation data in Australia, indicating surcharging may be responsive to movements in broader price levels.

[139] Zywicki, T. J., Manne, G. A., & Stout, K. (2017). Behavioral Economics Goes to Court: The Fundamental Flaws in the Behavioral Law Economics Arguments Against No-Surcharge Laws. Missouri Law Review, 82(3), 769-.
[140] Gans, J., & King, S. (2003). Approaches to Regulating Interchange Fees in Payment Systems. The Review of Network Economics, 2(2), 1022–1022.
[141] Zywicki, T. J., Manne, G. A., & Stout, K. (2017). Behavioral Economics Goes to Court: The Fundamental Flaws in the Behavioral Law Economics Arguments Against No-Surcharge Laws. Missouri Law Review, 82(3), 769-.
[142] The addition of an ad valorem charge applied uniformly to a customer's bill on weekends, generally to compensate for increase labour costs from weekend penalty rates
[143] See Competition and Consumer Amendment Regulation 2013 (No. 3) – Schedule 1 Amendments
[144] See: https://www.myzeller.com/blog/rise-of-the-surcharge-should-you-follow-the-trend
[145] A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement. June 2012.
[146] See: https://www.myzeller.com/blog/rise-of-the-surcharge-should-you-follow-the-trend

Chart G: Percentage of Zeller transactions with a surcharge applied[147]

Redacted by RBA

Summary: payment costs, merchant fees and surcharging

1. **The nexus between payment costs, merchant service fees and surcharging levels is unclear.**
2. **Payment costs for designated systems in Australia have been in long-term decline and appear to be uncorrelated to recent trends in surcharging levels.**
3. **The decision to surcharge, and the level of surcharging is a complex decision that businesses make. Payment costs are a factor; however, it is one of several factors that can influence this decision.**
4. **The implications of recent developments in the payments system on surcharging propensity should be considered – including zero-cost acquiring and the bundling of added services into merchant plans.**
5. **The payments system is a complex network that functions to distribute costs amongst its many participants. It should not be assumed that regulatory intervention to lower the price of specific components of the ecosystem will flow through to lower costs elsewhere.**
6. **The experiences in the European Union and United States show the complexity of payments system economics – demonstrating how tightened price controls on individual costs don't necessary pass-through to lower merchant costs.**
7. **The benefits of electronic payments – efficiency gains and cost reduction – have implications on overall payment costs and should be considered in tandem with card payment costs.**

[147] Chart source: https://www.myzeller.com/blog/rise-of-the-surcharge-should-you-follow-the-trend

Transparency of merchant service fees

Take an evidence-backed, proportionate approach to improving transparency

The ABA agrees in principle that greater transparency has the potential to empower merchants and enhance competition, we caution against reforms that may inadvertently undermine market simplicity or impose disproportionate compliance costs, particularly in a market that the RBA acknowledges is already competitive. It is important that the link between any proposed policy reform and its intended objective is well established, and reforms avoid assuming that increased transparency will naturally lead to particularly outcomes.

For example, many small businesses seek payment structures that prioritise simplicity, certainty and predictability. For these businesses, greatly increasing reporting detail may only increase complexity and fail to provide actionable insights, while potentially imposing significant change costs on PSPs.

The ABA encourages proportionate and evidence-based measures where appropriate to increase transparency, underpinned by the following principles:

1. Policy reform should prioritise transparency where there is significant opacity

As there are varying levels of transparency across the payments ecosystem, policy should focus on enhancing transparency over fees and costs where there is little to no visibility currently. Headline merchant service fees are publicly available, enabling a functional level of pricing comparison, and interchange fee schedules are regulated and easily accessible. In contrast, fees charged by intermediaries like digital wallets and payment schemes are often opaque.

The ABA agrees with observations made by the RBA previously that reforms to enhance transparency of opaque fees and costs present an opportunity to improve payment efficiency.[148]

2. Transparency should not undermine simplicity and merchant choice

The issues paper's concerns with blended pricing models must be balanced against the benefits these models provide to merchants, particularly small businesses. As has been noted by PSPs, blended pricing stems from merchant demand for simple, predictable pricing structures:

> *"this blended pricing model wasn't forced upon merchants – it was offered as a new alternative to the confusing, unblended pricing models and grew rapidly as it was instantly appealing to businesses."*[149]

Just as no two businesses are the same, the payments needs and priorities will vary from business to business. For many businesses, priorities like simplicity, technological capabilities and user experience will be more important than the lowest possible pricing. While transparency is important, many small businesses are time poor or lack the resources to analyse unblended fee structures, preferring straightforward solutions that allow them to focus on their core operations.

[148] Payment Systems Board Annual Report 2023
[149] The Australian. https://www.theaustralian.com.au/business/financial-services/payment-problems-blanket-surcharging-bans-are-not-the-answer/news-story/558934067c237fc8ae81a9a14f63738f

Beyond simplicity, it is important to note there are other reasons why blended pricing structures may appeal to merchants. While blended rates are typically more expensive than unbundled rates, blended pricing effectively hedges risk by transferring the cost volatility from changing card mixes from the merchant to the acquirer. For small businesses without significant transaction volumes to smooth out periodic volatility, blended pricing provides consistency and predictability. Blended pricing also often allows for wider payment acceptance (e.g. three-party payments) while merchants continue to pay the same rate regardless of what included scheme is used.[150]

3. Transparency reforms should be balanced against implementation burdens

Any reforms aimed at improving transparency should ensure that compliance costs for payment service providers (PSPs) are proportionate to the benefits they are expected to deliver and sustainable within the broader economic profile of the market. Certain ostensibly positive reforms may be less worthwhile when implementation burdens are considered – e.g. small businesses have flagged concern with well-intentioned reforms: *"Any amendments to the regulatory framework would impose significant costs to industry."*[151]

As payments technology and infrastructure continues to require significant investment from acquirers, issuers, schemes and merchants, new obligations should consider the existing investment pipeline to ensure they do not inadvertently undermine the competitive dynamics that drive innovation and choice. It should also be noted that the technology solutions offered by participants, particularly acquirers, are diverse – reforms promoting conformity or standardisation may impose vastly different costs on different providers.

4. Causality between proposed reforms and the intended policy outcome should be clear

It's important to ensure policy proposals are informed by market dynamics and merchant preferences, with causality between the specific issue and intended outcome well understood. Payments are complex services – as such, policy reforms with the sole objective of improving transparency should be considered carefully and avoid presuming that increased transparency will lead to other outcomes (e.g. more merchant switching). Any reforms to transparency should preserve the flexibility for merchants to choose pricing structures that align with their individual needs.

Careful consideration of market dynamics and merchant preferences is particularly important where transparency reforms are intended to improve competition. Section 2.5 of the issues paper notes the RBA is considering different transparency reforms with the objective of improving competition, e.g. considering whether PSPs should publish average fees, wholesale costs and margins to promote competition in the acquiring market. While information asymmetries can impede competitive, as noted previously, the market is complex, and more information may not necessarily lead to specific outcomes.

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[150] https://www.myzeller.com/blog/rise-of-the-surcharge-should-you-follow-the-trend
[151] COSBOA Submission to 'Regulating Buy Now, Pay Later (BNPL) in Australia'

Where they are perceived transparency gaps, these barriers should be carefully reviewed with industry participants to determine whether they are genuinely symptomatic of weaknesses in the competitive environment or not. For example, higher merchant pricing may be preferrable for merchants that value bundled adjacent services (e.g. POS software) or specific innovative technology offerings. In cases like this where payment providers are chosen due to differentiating factors other than price, it's unclear how more cost transparency would encourage merchant switching.

Summary: transparency of merchant service fees

1. **Transparency reforms should target genuinely opaque areas, such as intermediary fees, while avoiding unnecessary complexity where adequate data is already available.**
2. **Reforms should be informed by the preferences of merchants to avoid inadvertently increasing complexity and volatility for businesses that value simple and predictable pricing.**
3. **Compliance costs for payment service providers should be commensurate to the benefits delivered.**
4. **There must be a clear causal link between the identified issue and the intended policy outcomes, avoiding assumptions that transparency alone will drive competition or switching.**

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Surcharging regulatory responses

The current surcharging framework is clearly not working as intended

Australians are understandably frustrated with surcharging, which as payment preferences shift towards digital payments, can feel increasingly commonplace. It's evident that there are problems in the regulatory framework and how surcharges are applied. While a ban on surcharging is one potential response, the ABA believes initial responses should focus on improving the existing framework before pursuing prohibitions.

Surcharging is not inherently flawed but suffers from issues of implementation, clarity, and enforcement. Shortcomings in the current framework, including the cost-of-acceptance framework – how it is defined and interpreted – opacity, inconsistency, and ambiguity fundamentally undermine the intent and objectives of permitting surcharging. These must be addressed to ensure the framework operates as intended and continues to deliver transparency and fairness across the payments ecosystem.

The ABA broadly agrees with this assessment and supports targeted and proportionate steps being taken to address these challenges. There are several near-term priority opportunities for practical and proportionate reforms to enhance the efficiency of the payments system.

1. The definition of cost-of-acceptance needs to be refined and narrowed

Historically, concerns about the breadth and ambiguity of the COA definition have been raised by stakeholders, including risks associated with generalised or unclear interpretations.[152]
A narrower definition would provide greater transparency, ensure surcharges align with actual payment costs, and reduce opportunities for misuse.

This reform should be implemented carefully, with input from all stakeholders, to minimise complexity and ensure a smooth transition for merchants. Simplicity and consistency benefit all parties, particularly consumers, who rely on clear and fair pricing structures. One option worth exploring is the RBA's previously considered proposal of a fixed, permissible surcharge limit.[153] Such an approach could create a standardised, transparent system, offering significant benefits across the market.

With Australia having more than 2.6 million businesses, we recognise there are significant limitations for regulators in enforcing surcharging rules. Consistency would also likely simplify enforcement significantly as consumers would be far more readily able to confidently challenge excessive surcharging. This approach will be important given that as Zeller has observed[154], some cases of excessive surcharging are intentional *"clearly providers encouraging and facilitating excessive surcharging."* and could be assumed to continue in absence of sufficient deterrence.

[152] A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement. June 2012.
[153] *Ibid.*
[154] The Australian. https://www.theaustralian.com.au/business/financial-services/card-not-present-industry-calls-for-more-change-after-debit-fee-dump/news-story/462786c576529d091291a2be9f5dff90

2. COA should clearly exclude costs unrelated to payment processing

A clearer definition of COA is necessary to address bundled technology and service costs being surcharged to consumers. Many modern payment providers, particularly technology-led platforms, charge higher fees that encompass not only payment processing but also premium software, technology, business support services and merchant incentives like airline loyalty points.

These incentives are often embedded within merchant service fees, making it difficult for merchants to disentangle the true cost of payment processing from the value of bundled benefits. The ABA does not oppose these types of benefits and innovations being available to merchants, including through bundled pricing, however, these costs should not be passed onto consumers.

The pass-through of these non-processing costs to consumers is highly problematic, leading to artificially inflated surcharges, increased market costs, and weakened price signalling for participants. Surcharging these costs also greatly undermines efficiency and fairness, as consumers are required to subsidise business costs unrelated to payment processing, or in the case of airline loyalty points, personal benefits for the business owner.

The Competition and Consumer Act 2010 requires surcharges to *"reflect the cost of using the payment methods for which they are charged"* and *"not be excessive."* The current breadth and ambiguity in surcharging regulations enable wide-ranging interpretations of what is acceptable. Inconsistencies and subjectivity have created room for varying interpretations of what constitutes permissible surcharging and result in practices that obscure pricing impacts, increase consumer costs, and complicate compliance for merchants.

As the regulatory framework evolves, it will be important to ensure consistency across payment methods. Instances cited by ASIC,[155] such as undisclosed charges for BNPL or excessive surcharges encouraged by some providers, highlight the need for tighter and more enforceable standards.

3. Address known enablers of excessive surcharging

Excessive surcharging undermines consumer trust and can distort the payments system by discouraging the use of efficient payment methods. The ABA supports efforts to improve compliance with excessive surcharging and practical reforms in instances where regulatory requirements fall short of public expectations for transparency.

Enforcement is essential to the functioning of surcharging regulation. The ACCC has been provided additional resourcing recently for enforcement activities which the ABA welcomes. However, it should be recognised that there are practical limitations on regulatory enforcement when responding to a diffused and complex challenge like excessive surcharging. In this context, consideration should also be given to addressing issues of surcharging transparency for consumers that clearly enable perceptions of excessive surcharging.

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[155] ASIC. Report 600 *'Review of buy now pay later arrangements'*

For example:

Surcharging where no fee free payment method is offered

- If there is no alternative payment method available, any surcharge effectively becomes part of the base price of the good or service. In this case, the surcharge is effectively mandatory and inherently unfair as consumers are forced to pay an additional fee with no option to avoid it.
- While surcharging regulation requires headline pricing to incorporate any surcharges in these situations, anecdotal evidence and media report indicates there are too many instances of non-compliance.
- As an increasing number of businesses have chosen to only accept electronic payments, any indication of widespread surcharging would likely lead to both deeply frustrating consumers and an inflated perception of surcharging prevalence.

Surcharging cannot facilitate price signals where consumers do not have sufficient visibility of the surcharge prior to transacting

- Surcharging can only provide price signals where consumers have transparency over the existence and cost of the surcharge. In principle, it is difficult to see how certain payment terminals – particularly those where the surcharge is applied after payment, or screenless terminals – can provide this transparency.
- Payment providers should be required to display the full cost of the transaction, including any surcharge, on the terminal before the payment is processed. However, in practice, this rule is frequently overlooked, leaving consumers unaware of the surcharge until after the transaction is complete, undermining their ability to make informed choices.
- While these issues are persistent and should be addressed, we recognise the potential for significant implementation burdens on certain providers. Where this is the case, consultation with affected providers should be undertaken to determine the relative cost/benefit profile of the change.

Where possible, the ABA would encourage a collaborative approach involving all stakeholders to uplifting surcharging practices. This approach recognises regulatory ambiguity, and the inherent complexity of payments can impede the intent of the regulation and acknowledges that most businesses seek to comply in good faith.

4. Prioritise addressing weaknesses in the current surcharging framework

As we have detailed in our submission, the ABA considers there to be several barriers that would inhibit the ability of any review to sufficiency assess the ecosystem and design informed and efficient reform. These include ensuring an appropriate and complete view of the payments system's structure and economics, resolving known weaknesses in the surcharging framework, addressing regulatory or other limitations impacting existing RBA initiatives, and giving time for existing regulatory reforms to be embedded (e.g. LCR). We believe the priority of payments policy should be to address these issues ahead of more transformative or substantive reform.

The ABA supports the intent behind limiting surcharging, reflecting our preference for Australians to see less frequent and lower rates of surcharging. However, changes to the payments system rarely occur in isolation; any adjustment can have ripple effects throughout the ecosystem. Costs in the payments system are interconnected and often shift or redistribute in unpredictable ways, making it difficult to predict the full impact of any given reform. Furthermore, we believe clarity regarding specific problems and underlying causation is required to support effective reform.

We are concerned that banning surcharging – a complex and structural change – as a first response bypasses addressing the known deficiencies in the current framework that are frustrating so many. It remains unclear to what extent the existing challenges reflect the need to ameliorate the current framework, or whether the foundations of surcharging conceptually are no longer fit-for-purpose.

The current surcharging framework has historically provided a strong foundation and led to improved efficiency in the system – wholesale reforms to the entire payments system may not be necessary. In line with this position, the ABA believes outright prohibition on surcharging practices should be treated with caution and not be implemented until the need for such reform to achieve policy outcomes is unavoidable and there is certainty that even an improved surcharging framework is unviable.

It should also be noted that while a ban on debit surcharging may seem straightforward, it may necessitate broader reforms including intervention in merchant models, which could inadvertently undermine the simplicity which many merchants value highly. Any regulatory reform to surcharging would also need to assess how currently unregulated, higher cost payments (e.g. BNPL) would be accounted for and interact with the regulation. The interplay of these factors underscores the complexity of identifying a "one-size-fits-all" solution to surcharging.

Banning surcharging

However, the ABA acknowledges the Commonwealth Government has announced its intention to ban debit surcharges. While we maintain our view that there are critical preconditions to address before such significant intervention should occur, if a ban on debit surcharging proceeds, the ABA urges the following be considered in design and implementation:

Inconsistency between debit and credit poses several challenges

- Differential treatment of debit and credit surcharges would introduce significant complexity and cost for participants, and risk undermining competitive forces. For certain PSPs, implementing a dynamic, hybrid surcharging regime would potentially impose significant change costs to enable new technology and pricing structures.
- It is also unclear how a hybrid regime would impact the viability of simple, predictable merchant pricing structures. As has been discussed previously, small businesses in particular highly value the certainty and simplicity of blended pricing structures and may be inadvertently impacted where a hybrid surcharging policy necessitates complexity and/or volatility be introduced to the pricing structures.

- It is likely that a hybrid surcharging policy would maintain, if not exacerbate the existing challenges with compliance, enforcement and consistency by introducing new forms of variability to when and how surcharges are applied.

If debit is banned only, regulation will be required to protect credit card users from disproportionate and punitive surcharges

- Any regulatory changes must ensure that consumers are not indirectly burdened by higher costs elsewhere. A ban on debit surcharges could incentivise some merchants to recover debit costs through increased credit card surcharges. New regulation and enforcement mechanisms will need to be established to safeguard consumers.
- Banning surcharging on debit cards only should not have the effect of making credit card acceptance costless – instead it should be based on the principle that merchants are able to surcharge only the incremental costs between debit and credit. For example, September 2024 payment data shows the difference between average debit and credit device present merchant fees in September 2024 was 33bps.[156]
- Limiting surcharging in this way would avoid punitive customer surcharges and promote more efficient price signals (otherwise credit card payments would become free to merchants and theoretically more attractive than debit, while disproportionately expensive for cardholders).

Consider the impacts substantive reforms may have on industry competitive dynamics and capacity for investment and innovation

- Over the last decade, the payments industry has seen rapidly intensifying competitive dynamics as a range of new participants – including technology start-ups and large multinationals – have entered the Australian market and delivered significant innovation to merchants. Implementing surcharging bans should weigh the anticipated benefits against any implications on competitive pressures and innovation within the industry.
- Banning debit surcharging should be carefully implemented against current and anticipated industry initiatives and regulatory reforms to ensure that a ban does not preclude any adjustments that may be needed to address emerging challenges or technologies. This should include consideration being given to the commercial impacts placed on participants of any additional or reformed obligations, ensuring the payments system retains sufficient incentives for continued investment.

Ensure reforms promote, not inhibit, competitive neutrality

- The decision to permit surcharging on credit cards would reflect the policy conclusion that businesses should have the right to pass-through the costs of more expensive payments. The ABA considers it essential for competitive neutrality and efficiency that this principle is applied consistently across the ecosystem.
- In practice, achieving competitive neutrality necessitates reforms to address market imbalances. For example, the continued prohibition on merchant surcharging by BNPL providers would invert price signals, permitting surcharging where consumers transact with the

[156] 33bps differential calculated with reference to the average merchant fees for device present Mastercard debit (0.51) and credit (0.84) contained in the October 2024 RBA Retail Payments Statistics.

lowest cost, most efficient form of credit, while prohibiting surcharging of an alternative form of credit with acceptance costs multiple times higher.

A ban on debit should be considered and consulted on inclusive of any corequisite reforms

- The implications of prohibiting surcharging can only be properly assessed alongside any corequisite enabling regulatory changes.
- To illustrate, a ban on debit raises obvious implications for blended pricing structures. However, it is possible that these implications would differ where mandated separate pricing is considered a corequisite reform – in contrast with a scenario where blended pricing is retained and competitive opportunities lead participants to develop separate pricing structures.

Summary: surcharging policy responses

1. **The current surcharging regulatory framework is not meeting its objectives and is no longer fit-for-purpose. Australians too often experience opaque, excessive and unexpected surcharges.**
2. **The cost-of-acceptance standards should be narrowed and refined to ensure they reflect only payment processing costs.**
3. **Bundled costs unrelated to payment processing, including business services and technology, and unrelated incentives should never be surcharged to consumers. Passing these costs onto consumers via surcharging should be clearly prohibited.**
4. **Customers should always know the cost of an item before they pay for it. Surcharging regulations should seek to improve consumer transparency.**
5. **Banning surcharging is a significant policy shift and will have implications on the payments system. These implications and further policy responses can only be appropriately assessed with the entire payments system in scope.**
6. **An optimal response to surcharging should therefore initially seek to address the frequency and level of surcharging by addressing these known weaknesses in the framework.**
7. **The design and implementation of a debit ban must ensure competitive neutrality is promoted, reasonably limit the impact of new compliance burdens on participants and ensure businesses can continue to access simple and certain pricing where preferred.**

Closing comments

As outlined in our submission, the payments system is incredibly complex, and policy reform should be supported by detailed analysis of the specific problem and causality between the problem and potential policy reform.

Effective policy reform must account for the structural costs embedded within the payments ecosystem. Debit payments, for example, are intrinsically tied to the underlying accounts they operate from, and simplistic interventions – such as cutting debit interchange fees – often result in costs being redistributed rather than reduced. These shifts can undermine efficiency without delivering clear benefits to merchants or consumers.

Economic studies repeatedly highlight the importance of understanding the payments ecosystem holistically. The interconnected nature of payment systems—a two-sided market with network externalities—means that changes to one part of the system often have unintended consequences. This has been observed in other jurisdictions, where narrow cost regulation has failed to deliver on its intended objectives. Commenting on the limitations of broad-based, indirect policy reforms, the Federal Reserve Bank of Richmond notes, a deeper understanding of the *"two-sided market nature, network externalities, and the cooperation and competition between payment platforms"*[157] is critical for crafting effective reforms.

The ABA looks forward to supporting the RBA and other stakeholders support continued development of effective and efficient payments policy for Australia.

[157] Wang, Z. (2012). Debit card interchange fee regulation: some assessments and considerations. Economic Quarterly - Federal Reserve Bank of Richmond, 98(3), 159–182.