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Submission in response to the Reserve Bank of Australia's Issue Paper: Merchant Card Payments Costs and Surcharging – October 2024

Thank you for issuing the Issue Paper and providing the opportunity for community responses.

By way of brief background, I have extensive career experience in the Australian payments market spanning the last two decades. This experience includes roles as Chief Executive, Managing Director, Executive Director and Non-Executive Director of both ASX listed and unlisted Australian payments companies covering ATM's, merchant EFTPOS services and payment transaction switching / processing. These roles have afforded me specific experience and expertise in card present acquiring which directly relates to merchant card payment costs and surcharging – the subject of this review.

I would be grateful if you could consider the following thoughts as you progress your review.

The need for regulation

As an overriding comment, I would like to note that in my experience the Australian payments market has benefitted from regulatory oversight and where required regulatory intervention.

Through my career leading emerging, "challenger" payments businesses, proactive regulator oversight and intervention has had a measurable positive impact on enabling new entrants to challenge the status quo (typically bank dominance across the payments spectrum).

Regulation and intervention, particularly by the Reserve Bank of Australia, has opened access to new entrants and in many areas facilitated a levelling of the playing field where smaller new entrants have been able challenge the large incumbents. This has in turn facilitated substantially greater competition and innovation in payments through better technology, a greater focus on customer service and ultimately lower costs for merchants, consumers and the broader Australian public.

A good example in this context (just one of many) has been the regulation of interchange. With the large Australian banks historically controlling both sides of the card payment spectrum as both issuers and acquirers (in collaboration with the international card schemes), their ability to effectively cross subsidise their acquiring businesses through their issuing businesses held the potential to increase the cost of merchant acquiring. This not only increased the cost of payments to both merchants and consumers, it also raised barriers to new, specialist providers who focused purely on acquiring and did not have an issuing business to offset these high costs.

The capping of interchange costs through regulation in this instance levelled the playing field allowing non-issuing acquirers the opportunity to compete with the large banks. These non-bank acquirers such as Smartpay and Tyro (notwithstanding Tyro's banking licence, I'll consider them to be a "non-bank" acquirer for the purposes of this analysis) brought to the Australian payments market a level of innovation and service unmatched by the incumbent banks. These and other new players brought with them a level of new competition that merchants and consumers benefited from through either lower prices or at the very least keeping prices from raising further.

Card Payment Costs and Surcharging

While the above example is offered as an illustration of the benefits of regulation, it is of course also highly relevant context to the current review given public sensitivity to costs in the payments system of which card surcharging seems to be a focus.

However, as surcharges are purely a mechanism for cost recovery by merchants (typically independent small business owners), to point the finger at surcharges as the "problem" to be solved ignores the underlying cause, the wholesale costs in the payments system, specifically interchange and scheme fees.

As noted in your paper, it can be shown empirically that surcharging has in fact brought payments costs in Australia down through the transparency and price signalling they provide to all system participants.

The other major contributing factor to reducing card payment costs has of course been regulation, particularly the capping of interchange. However, with interchange representing only one aspect of the wholesale costs of payments, the lack of similar capping regulation on scheme fees (essentially a similar fee to interchange) has resulted in scheme fees rising over time as noted in your paper. As also noted in your paper, with the demise of cash and the resultant increase in card payments, there is a scale argument that both interchange and scheme fees should have reduced over time. Of course the current market structure and lack of competition around these fees doesn't lend themselves to an efficient market based fee reduction outcome. So in this instance there is likely a strong case to not only review the level of the cap on interchange (with a view to bringing it down), it is hard to see why scheme fees shouldn't be subject to a similar regulatory cap.

As surcharges are simply a reflection of card payment costs (of which scheme and interchange fees represent the largest portion), the reduction in these fees should be expected to lead to a corresponding reduction in card surcharges through normal market forces.

On the other hand, seeking to address the cost in the payments system through removing the ability of merchants to recover their costs through a corresponding surcharge simply hides the cost, it does nothing to reduce costs. As merchants are unlikely (and increasing unable) to absorb these costs, removing the ability to surcharge will simply see these costs included in the costs of goods and services. Moreover, the removal of the price transparency that surcharging brings has the very real potential to lead to an increase in payments costs (particularly if scheme fees aren't regulated) which would now ironically be subsidised by consumers electing to pay with cash.

The case for and against a partial ban on debit surcharging only

The above analysis is of course as true for either a complete ban on all card surcharging as it is of a partial ban of surcharging on debit transactions only.

In the example of a ban on debit surcharging only, all of the negative potential outcomes highlighted above remain likely. The cost of debit transactions will not simply go away because they are now hidden. They will rather become embedded in merchant's pricing of their goods and services which once again will result in consumers who choose to pay with cash subsidising these debit card payment costs. These now hidden costs are also unlikely to come down. Without the transparency that surcharging affords, there is real prospect that obfuscating these costs could lead to these costs increasing over time.

Importantly while there may appear to be a signalling benefit to banning surcharging on debit transactions to the extent that consumers may then view debit transactions as effectively a "free" form of payment and prefer paying by debit card as opposed to a credit / other scheme card which may be surcharged, its important to acknowledge that debit transactions are not always cheaper than credit / other scheme card transactions. Transaction size for example can often be the determining factor in which card type is cheapest (a key factor in LCR). So driving transactions to the debit network through a crude mechanism such as a debit surcharge ban may in many instances actually increase the cost of the transaction which, while now hidden, will nonetheless manifest itself as a higher consumer cost in the price of goods and services. This is just one example of possible unintended consequences of using regulation as a blunt tool to drive a perceived populist outcome.

Other unintended consequences

A ban or partial ban on surcharging is fraught with potential unintended consequences. Some may be apparent now while others may only appear well after implementation.

One likely consequence that can be expected will be a potential lessening of competition in the payments market, stifling innovation and setting progress back.

As outlined above, non-bank providers not only provide innovation to the benefit of all participants in the payments system, they also rely on innovation to compete and survive. Offering an automated surcharge cost recovery commercial proposition to merchants has allowed some of these emerging providers to differentiate themselves from the banks through a service proposition clearly valued by many merchants for its simplicity and cost effectiveness. To remove this commercial proposition may have an impact on these companies' business models which, if significant, may undermine their ability to compete in the market which would be to the detriment of merchants and consumers, removing innovation and competition, which would lead to higher, not lower, costs in the payments system. The market could essentially revert to a poorer product at a higher price with less transparency and competition.

Considerations for a path forward

A useful datapoint from your paper is the observation that the occurrence of card surcharging in Australia is extremely low with only 7% of card transactions surcharged as of late 2022. While this number may be a bit higher now, it is still unlikely to be material.

Given the key issue driving this review seems to be the cost in the payments system and the resultant impact on cost of living pressures facing the community at large, the question that perhaps should be asked is if changing surcharge regulation would make a meaningful difference to the costs in the system given its relatively immaterial presence?

Said another way, how would using regulation to potentially alter the flow of less than 7% of transactions (and in the case of a debit surcharge ban only – likely materially less than 7% of transactions) achieve a meaningful reduction in the overall cost of payments facing the community (even if it were to achieve its desired outcomes, which as per my thoughts above I doubt it will)?

Surely a more efficient and effective mechanism to reduce the overall costs in the payments system is to address the problem at its source. That is to reduce the foundation costs of interchange and scheme fees which not only represent the majority of card payment costs but would positively impact the cost of 100% of transactions (as opposed to 7% at best, hardly shifting the needle).

Importantly I am not advocating for no regulation on surcharges. Rather, I suggest that the current regulatory framework remains fit for purpose and has largely achieved its intention of lower payments costs through transparency and competition.

If there is any room for improvement with regard to the current regulation, it is more likely to be around enforcement of the current regulation rather than changing it. While the overwhelming majority of payments providers most likely do the right thing and comply with the current regulation around surcharging, there will no doubt be "edge cases" were some flout the regulation for example through non-disclosure of a surcharge prior to the point of transaction and / or through excessive charging beyond the cost of acceptance or for services not directly related to the provision of the payment service (for example including the cost of other point of sale products or services in the surcharge). I would suggest that these type of transgressions can be solved through better enforcement of the current regulations.

Summary

Given the broad audience of the review, rather than delve into the complexity and often obscurity of the multitude of elements of the payments landscape, I have rather focused on what I regard as some of the key areas that most clearly address the cost of payments affecting the community.

The Australian payments system however remains an incredibly complex area where even small changes through regulation are capable of a myriad of potentially significant consequences, often unidentified and unintended at the point of inception.

I would suggest that the emergence of non-bank payment providers has gone a long way to simplify this complexity through innovative products and services which meet merchant and consumer demand. Blended acquiring offerings and automated, regulatory compliant surcharge products are a good example of bringing simplicity and transparency to what is otherwise a minefield of opaque complexity, such complexity often deliberately constructed to avoid price transparency and maintain higher costs in the system.

As noted above, I support regulation to maintain an efficient, open and competitive payments system. I believe, based on a career's worth of relevant experience, that we have in Australia a world leading payments regulatory framework.

Within this context, I believe there is sufficient evidence to support the benefits of the current regulatory framework as it pertains to payment card surcharging. Of course, as any regulation is only effective if enforced, this should be the focus to improve consumer outcomes. Changing the current regulation through either a complete or partial ban on surcharging is more likely to undo the lower cost outcomes achieved to date and lead us down the path of increasing not decreasing costs in the system.

If the desire to is reduce the overall cost in the system, the more effective approach would be to address the main costs at their source through reducing the regulated cap on interchange and introducing a cap on scheme fees.

Finally, given the complexity of the issues involved here, there may well be benefit in some measure of community education around surcharging and how it has and should continue to benefit the community through lowering the costs in the system. Its easy to see how the community could view surcharges as "just another cost" in an environment of heightened concern around cost of living without the background understanding of the benefits it drives and the potential negative outcomes of the alternative.

Thank you for your consideration of my response. I would be happy to be contacted for further discussion should you feel it helpful.