NATIONAL AUSTRALIA BANK SUBMISSION

Review of Retail Payments Regulation: Merchant Card Payment Costs and Surcharging

December 2024

Introduction

National Australia Bank (NAB) welcomes the opportunity to provide a response to the Reserve Bank of Australia (RBA)'s Payment System Review (Review) Merchant Card Payment Costs and Surcharging Issues Paper (Issues Paper).

NAB's response and focus is guided by the questions in the Issues Paper. NAB has responded to each of the 15 questions and has thematically grouped responses where appropriate. As a member of the Australian Banking Association and the Australian Payments Network, NAB has also contributed to their respective responses.

Executive Summary

NAB supports the RBA's desire to consider whether its existing regulatory framework relating to merchant card payment costs and surcharging remains fit for purpose.

As Australia's largest bank for business, NAB believes it is important to continue supporting Australian businesses through changes that support competition, transparency, efficiency and consistency. In particular, NAB would welcome changes which promote a simpler and clearer framework for merchants and a more consistent, transparent experience for consumers. NAB does not support a blanket ban on all surcharging, as costs would disproportionately fall on businesses rather than costs being equitably distributed across both businesses and consumers. If a partial ban – such as one limited to debit transactions – is pursued, then it should cover all debit schemes and measures should be enacted to ensure other costs are not disproportionately adjusted. NAB does not believe requirements for Payment System Providers (PSPs) to provide further information on fees, costs or market share would necessarily benefit merchants or consumers. Instead, the focus should be on a simpler and clearer framework which is easier for merchants and consumers to understand, rather than requiring additional disclosure of information that may not add to understanding on fees and costs associated with payment. If the provision of any additional information is to be required, its purpose, expected use and the benefits it is designed to deliver must be clearly defined.

Competition in the payments ecosystem, particularly in relation to debit transactions, is intense and has been aided by initiatives such as least cost routing (LCR). NAB expects the availability and enablement of LCR will continue to increase and believes the current LCR regulatory settings are appropriate.

NAB notes the RBA's review is a partial review of the payments ecosystem. NAB suggests the issues raised within this paper should be considered together with all other elements of the payments value chain. This approach will help preserve the positive attributes of the existing framework, such as principles-based regulation, with specific reference to financial stability and prudential capacity.

Australia's Payment Ecosystem

The Federal Government has previously stated that "the ability to transfer value safely, efficiently and effectively is fundamental to the operation of the Australian economy."[1]

A stable and sustainable payment ecosystem requires user confidence, resilience, trust and security. It must also ensure strong identification of payment initiators, assurance of payment receivers and robust exception and dispute handling (including strong fraud prevention measures) to protect consumers. Such a system requires continuous maintenance and investment to remain fit for purpose.

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[1] The Australian Government the Treasury, '*A Strategic Plan for Australia's Payment System*' (June 2023), p8. <https://treasury.gov.au/sites/default/files/2023-06/p2023-404960.pdf>.

Card Payments

Card payments offer a flexible, efficient, secure and reliable payment method for consumers, merchants and the economy. Compared to other payment options, contactless transactions provide a quick and seamless experience at the point of sale for merchants and consumers. Other benefits include improved operational efficiency, with reduced wait times, improved throughput and reduced risk, especially in comparison to merchants handling cash.[2] Cards often offer ancillary benefits such as loyalty programs, travel insurance and warranty extensions which are valued by customers.

Cards now represent a larger share of payments than cash,[3] accounting for 76 per cent of all payments in 2022.[4] In contrast, only 13 per cent of consumer payments were made by cash in 2022 and this is expected to decline further.[5] The shift towards card payments has accelerated due to near ubiquitous card acceptance, the introduction of new payment technologies, such as contactless functionality, and the effects of the COVID-19 pandemic.[6] Debit cards are the most utilised card payment method, with debit transactions comprising "over half of all payments in 2022 – more than three times their share in 2007."[7] The increase in debit card payments, compared to other payment methods, can be attributed to factors such as consumers' increasing preference to use their own funds, greater aversion to fees and reduced credit card eligibility. Younger consumers have shown a "greater preference for using their own funds" compared with other generations.[8]

NAB notes the growing impact of emerging card payment methods such as mobile payments and Buy Now Pay Later (BNPL) services. These innovations have been enabled by technological advancements and new providers utilising traditional payment infrastructure to offer new services. Mobile payments accounted for nearly one-third of in-person card payments in 2022, having increased from eight per cent in 2019.[9] NAB anticipates that by mid-2025, more than half of all card payments will be made via mobile wallets for both online and in-person transactions.

Costs of payment systems

Payment systems require continuous maintenance and development to remain fit for purpose. PSPs are responsible for funding, developing, building and implementing changes to their payment systems, including fraud monitoring and prevention capabilities, to maintain a secure, resilient, and competitive payment proposition. The economic structures for each payment method have evolved differently over time. Card payment costs include interchange, scheme fees, ecosystem processing and system maintenance costs. The Merchant Service Fee (MSF) is paid from the merchant to its PSP to help cover the costs of interchange, scheme fees and PSP costs, all of which have a significant impact on overall returns for the PSP. Mobile payments and BNPL services, which are becoming more popular, are more costly to PSPs and merchants. Cash payments generate their own costs, including those associated with equipment, secure storage, labour and transport. A 2024 Boston Consulting Group whitepaper on costs for different payment methods reported cash as costing 3.9% (compared to 1.8% for cards and 5.3% for BNPL).[10]

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[2] Visa '*Response to the Reserve Bank of Australia on the Australian Debit Card Market: Default Settings and Tokenisation'*. (19 July 2023) https://www.rba.gov.au/payments-and-infrastructure/submissions/the-australian-debit-card-market-default-settings-and-tokenisation/visa.pdf.
[3] Nguyen T, Watson B '*Consumer Payment Behaviour in Australia'*. (Bulletin, Reserve Bank of Australia, 15 June 2023) <https://www.rba.gov.au/publications/bulletin/2023/jun/pdf/consumer-payment-behaviour-in-australia.pdf>.
[4] Reserve Bank of Australia, '*Payment Systems Board Annual Report: The Evolving Retail Payments Landscape'*. (15 September 2023) <https://www.rba.gov.au/publications/annual-reports/psb/2023/the-evolving-retail-payments-landscape.html>.
[5] Ibid.
[6] Livermore, T, Mulqueeney, J, Nguyen, T, Watson, B. '*The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey*.' (RDP 2023-08, Reserve Bank of Australia, November 2023) <https://www.rba.gov.au/publications/rdp/2023/2023-08/full.html>.
[7] Ibid.
[8] Ibid.
[9] Ibid.
[10] Stewart S, Dobbeni J, Folch F, *The Hidden Cost of Cash and the True Cost of Electronic Payments in Australia, Europe, New Zealand and the UK – Addendum* (White Paper, Boston Consulting Group, August 2024).

Regulatory Change

In considering changes to its regulatory framework, NAB encourages the RBA to prioritise improving transparency and fairness for all participants (consumers, merchants and providers). These measures will help drive a more efficient digital economy, foster competition and innovation, and maintain a secure payments ecosystem.

NAB reiterates the importance of five key themes in evolving the regulatory framework of the payments ecosystem. These were outlined in NAB's response to the Department of Treasury's consultation on Payments System Modernisation: Regulation of Payment Service Providers in February 2024:

- **Simple and sustainable** – where possible, the Government should aim to avoid unnecessary regulation or overlap with existing regulation.
- **Clear boundaries** – the framework should make it simple for a licensee to identify the applicable obligations for their functions.
- **Consistency of coverage** – having all parts of the ecosystem covered by a single regulatory regime will help protect the entire ecosystem, including end users, and increase confidence in the system.
- **Ease of adoption** – the framework should make it efficient for licensed entities to meet compliance requirements with new obligations.
- **Sovereign importance** – acknowledgement that the stability, resilience, competitive dynamics and sustainability of the payments ecosystem are relevant drivers of Australia's economic wellbeing and resilience.

Any revised regulatory framework should consider the differing interests of participants within the payment flow, including consumers, merchants, PSPs, payment schemes, government and software providers integrating payment solutions. Regulatory changes should recognise the need to maintain commercial incentives for participants to maintain a fit-for-purpose system while pursuing innovative solutions to meet the future demands of the economy. A less commercially viable payment system may present trade-off decisions for PSPs, including a reduced ability to invest in its efficiency, management and development.

1. Is there a case for lowering the level of interchange benchmarks or caps? Should the difference between the interchange fees paid by big and small businesses be limited in some way?
2. Should interchange regulation be extended to foreign card transactions in Australia?
3. Is there a case for reducing the complexity, and/or enhancing the transparency, of interchange fees? If so, how?

As noted in the Issues Paper, interchange fees can help to rebalance costs between each side of the market to ensure that both sides of the market have an incentive to participate.[11] Revenue generated from interchange helps facilitate the ongoing maintenance of the payment ecosystem, enables investment in innovation and provides ancillary card benefits and fraud prevention for both credit and debit cards. It also helps to fund building infrastructure, operational expenses and new features, such as additional security.[12] These costs are consistent across debit and credit card transactions.

Downward pressure on interchange fees and associated revenue, including via a cap or ban on certain fees, or higher compliance costs, may present trade-off decisions for PSPs.

NAB would welcome a simpler interchange structure, particularly after the significant increase in complexity over recent years. Potential changes to the interchange structure could include a reduction in the overall number of interchange categories, alignment of interchange categories back to card types or form factors, and/or removal of the split between single and dual debit network cards. If a decision was taken to extend interchange regulation to foreign card transactions, which carry higher interchange costs, consideration would need to be given to appropriate caps.

A comparison with international markets highlights Australia’s highly competitive interchange rate. Additionally, interchange rates for consumer and commercial cards are more closely aligned in Australia than in other markets.

The differences in interchange, in particular between small and large merchants, have fallen with the introduction of small business programs which require PSPs to enrol merchants. This has added another level of complexity within the interchange hierarchies.

4. Is there a case for further transparency of scheme fees to promote efficiency and competition? If so, what additional information would be beneficial?
5. Is there a case for regulatory action to reduce the complexity or growth of scheme fees? If so, what form should this take?
6. What other regulatory action should the RBA consider to increase the competitive pressure on scheme fees?

NAB would welcome simplification of scheme fees, which are complex and change regularly in structure and value. Complexity, particularly regarding how scheme fees are charged, has increased in recent years. A single debit or credit transaction generally attracts between two to five different fees, however there can be more. The exact number of fees is determined by factors such as the product, card type and form factor. At a minimum, one *ad valorem* charge and one dollar fee per transaction apply.

Any additional transparency requirements related to scheme fees would need an industry-aligned overlay to ensure the information provided is useful and easily understood by merchants. Under current interchange ++ pricing, for example, the approach taken by acquirers varies. Consideration should also be given to the cost of increased compliance for PSPs, and the trade-off decisions such additional costs may present, as well as the existing commercial arrangements in place between schemes and PSPs. Scheme fees are essential for

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[11] Reserve Bank of Australia, *‘Backgrounder on Interchange and Scheme Fees’* (Web Page, Date unknown, 2024) <https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/2024/backgrounders/backgrounder-on-interchange-and-scheme-fees.html>.
[12] Ibid.

delivering benefits into the payments system, but should also be proportionate to those benefits and be evaluated against global benchmarks. There is a need to carefully balance simplicity and transparency.

7. How do stakeholders assess the functioning and effectiveness to date of LCR for in-person transactions? Is further regulatory intervention needed? What might that look like?

As a result of many PSPs taking a proactive approach in enabling LCR, significant progress has been made in enhancing its functioning and effectiveness. For card-present transactions, NAB has increased enablement for its customers from 14 per cent in December 2022 to 52 per cent in June 2024, with further progress anticipated in the coming months. In addition, significant focus has been placed on enabling LCR for NAB's card-not-present solutions. Since 1 July 2024, NAB has also started transitioning to an LCR opt-out approach across its product suite.

LCR is also becoming increasingly effective as eftpos is progressively enabled across additional form factors, including mobile wallets.

The market for debit transactions, particularly across scheme partners, is highly competitive. NAB believes focus should be on overall value creation for the entire ecosystem. LCR is a single component of the cost of acceptance for merchants.

8. Is there a case for greater transparency of fees, wholesale costs and market shares for some payment services? If so, what form should this take? What benefits or drawbacks might arise from implementing any of these measures?

Greater transparency of fees, wholesale costs and market shares may not necessarily benefit merchants and could introduce added complexity in relation to the interpretation of the information. If changes were made to the requirements for transparency of these elements, there should be clarity on the purpose of the information and how it will be used. There is a risk that the information could be misrepresented or not align to the profile of a specific business, and the responsibility for interpreting and deriving value from such information should not fall on businesses.

NAB questions the value of presenting further market share data, as this could be mistakenly construed as an indicator for the best available solution, potentially misleading merchants and other payment system participants. The publication of market share data would be a unique requirement for the industry.

The varying economic models across PSPs may impact how pricing and its components are presented. The delivery and maintenance of end-to-end payment solutions present many other costs in addition to interchange and scheme fees, and involve multiple large and small market participants, often governed by numerous commercial arrangements.

9. Should PSPs be required to provide individual merchants more detailed information on their regular statements (or through other channels)? How could this information be presented without creating additional complexity for merchants?

NAB believes fee structures for merchants should be as simple as possible, with corresponding statements that are similarly simple and easy to interpret. Current requirements for publishing the cost of acceptance to merchants are fit for purpose and NAB does not consider that further details beyond the current market standards are required.

The level of information provided to merchants regarding fees depends on the merchant's chosen pricing model. Where merchants have selected a pricing model which includes varying interchange and scheme fees, these fees are detailed on their statements. Where the chosen pricing model does not on-charge scheme fees or interchange separately – such as for merchants who have selected a blended pricing model – this information is not detailed on the statement. Currently, each merchant receives a cost of acceptance table at least annually, and in many cases monthly, which provides a point of reference for the merchant on their total cost per transaction type.

10. Should PSPs be required to publish standardised information on their pricing and services for merchants (in line with reforms introduced in the United Kingdom)?

The focus of the United Kingdom's approach is to show a high-level comparison based on a blended rate for a 'common merchant' using key information points.[13] Some PSPs publish further detailed information on scheme fees. While this approach can provide an indication of what costs a merchant may expect, it offers no certainty over the ultimate end price point, except in the case of Simple Pricing models (if offered by the PSP).

The standard practice currently is to publish cost of acceptance information on a merchant's statement, and it is not clear to NAB that standardised disclosure would offer any improvement on the current approach.

11. What other regulatory measures should the RBA consider to improve competition between PSPs?

NAB considers there is a healthy level of competition between PSPs in the market. In recent years, NAB has seen an increasing number of PSPs enter the market and take market share from existing providers. Competition, as well as market economics, have resulted in NAB's overall merchant acquiring profit margin being slim, with the majority of MSFs collected paid out in interchange, scheme fees and transaction processing costs. The remaining amount is predominantly invested in maintaining the security and efficiency of the payment system.

NAB supports ensuring consistent and appropriate regulation of PSPs and better targeting of regulatory obligations based on the level of risk they pose to merchants and the wider financial system.

It is important that competition and regulatory frameworks work together to ensure that PSPs are appropriately incentivised to invest in lower-cost channels, while merchants are supported to adopt alternative options.

12. Is there a case for revising the RBA's surcharging framework? If so, which options or combination of options would best address the current concerns around surcharging? What other options should the RBA consider?
13. What are the implications for merchant payment costs from changes to the surcharging framework? Could the RBA address these with other regulatory actions?

NAB welcomes the RBA's review of the existing surcharging framework and encourages a review of the cost of acceptance framework, including the exploration of possible opportunities for further simplification and clarification to ensure consistency and transparency across the industry. Any new or revised regulatory frameworks should consider the differing interests of participants in the payment flow, including consumers, merchants, PSPs, schemes, government and software providers integrating payment solutions. Providing choice to merchants and consumers is critical to supporting their needs. NAB notes that surcharging in relation to BNPL will be considered separately, subject to the passing of legislation to update the Payment System (Regulation) Act 1998.

Merchant surcharging has been permitted in Australia since 2003, with its prevalence increasing since 2019.[14] Surcharging provides merchants the ability to pass on the cost of accepting card payments to customers who

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[13] Payment Systems Regulator United Kingdon. *Specific Direction 14 (card-acquiring – provision of information (summary box))* (6 July 2023) <https://www.psr.org.uk/media/dlgl0ibz/sd14-summary-boxes-online-calculators-varied-may-2024.pdf>.
[14] Livermore, T, Mulqueeney, J, Nguyen, T, Watson, B. '*The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey*.' (RDP 2023-08, Reserve Bank of Australia, November 2023) <https://www.rba.gov.au/publications/rdp/2023/2023-08/full.html>.

choose those methods.[15] The banning of surcharging would prevent merchants from recovering these costs. If MSFs were also banned (to avoid cost impacts to merchants), it would impact PSPs' ability to cover the costs associated with maintaining and developing the payment system.

The cost for PSPs of accepting debit card payments is generally lower than for credit card payments. Accordingly, distinguishing between debit and credit card payments in surcharging rules is an option. A change to apply surcharging based on payment type needs to ensure it is simple for consumers and merchants to understand what rules will apply (for example, distinguishing between eftpos compared to scheme debit).

Surcharging is a merchant decision; merchant costs and MSFs operate independently of the surcharging framework. NAB has limited data on merchant surcharging, as specific detail on surcharging and surcharging amounts are often not available in its transaction data. Unless surcharging is tied to the pricing or product construct, PSPs should not be held responsible for overseeing merchant compliance with surcharging rules. NAB does not believe a reduction in fees charged to merchants would necessarily stop them from surcharging.

Clarity, transparency and consistency on surcharging and the costs of payment methods such as debit, credit, BNPL services and cash are essential. As NAB CEO Andrew Irvine told the House of Representatives Standing Committee on Economics on 30 August 2024, the current surcharging regime is confusing for merchants and consumers and needs to be "simpler, more transparent and [more] consistent."[16] Merchant confusion on surcharging rules may have contributed to instances of overcharging. While NAB notes there is regulatory guidance available to merchants to assist in determining acceptable surcharging rates, an opportunity exists in the guidance to provide clarity to PSPs that MSFs should only include payment-related costs and not, for example, other expenses such as reward costs or business management costs.

Results from the RBA's 2022 Consumer Payments Survey indicated respondents have become more likely to accept surcharges. [17] However, this likely relates to experiencing surcharging more frequently, as opposed to tolerance of inflated or hidden surcharges.

Any regulatory changes should ensure there is consistency in approach across all payment types (including cash) while supporting simplicity and ensuring any technology is fit for purpose, and capable of meeting requirements. Inconsistent approaches could result in unfair outcomes for consumers. For example, the banning of surcharging on eftpos but not other schemes (i.e. Visa or Mastercard), could create a confusing and opaque experience for any customer tapping a multi-network debit card (the majority of cards), as the outcome would depend on whether the merchant had enabled LCR and, if a digital wallet was used, on specific settings and approaches from Apple and Google.

NAB acknowledges the Government's stated preference to ban surcharging on debit cards, subject to this Review.[18] If this is the end outcome, the following issues should be considered:

- ensuring it is clear to consumers and merchants that only credit transactions can be surcharged;
- ensuring that debit costs are not recovered through higher credit surcharging;
- even within credit surcharging, considering the variance in surcharging across schemes (for example, in relation to American Express or BNPL transactions); and

[15] Reserve Bank of Australia, *'About Card Payments Regulation – Questions and Answers'* (Web Page). < https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/q-and-a/ >.
[16] Evidence to House Standing Committee on Economics, Review of Australia's Four Major Banks, Parliament of Australia, Canberra, 30 August 2024 (Andrew Irvine, Chief Executive Officer, NAB).
[17] Livermore, T, Mulqueeney, J, Nguyen, T, Watson, B. '*The Evolution of Consumer Payments in Australia: Results from the 2022 Consumer Payments Survey*.' (RDP 2023-08, Reserve Bank of Australia, November 2023) <https://www.rba.gov.au/publications/rdp/2023/2023-08/full.html>.
[18] The Hon Anthony Albanese MP, The Hon Dr Jim Chalmers MP, The Hon Stephen Jones MP '*Reducing card surcharges for Australians and small businesses*' (Media Release, 15 October 2024) <https://www.pm.gov.au/media/reducing-card-surcharges-australians-and-small-businesses>.

- continuous monitoring of any changes to other charges in the payment system such as scheme fees, digital wallet fees and BNPL fees to ensure ongoing competitiveness and relevance of the costs incurred.

The potential impacts on businesses need to be carefully considered with a transition plan that allows time for businesses to review and implement necessary changes.

NAB does not support a blanket ban on all surcharging as a result of this review, as the costs of card payment acceptance would disproportionately fall on businesses rather than costs being distributed equitably across both businesses and consumers. Instead, any changes should seek to balance the imposition of costs along with encouraging innovation and establishing a regime with more transparency and that offers a more consistent experience for consumers and merchants.

14. Are there any other regulatory actions that the RBA should consider taking in response to the issues raised in this paper?
15. Are there any issues in, or implications for, the broader payments ecosystem that the RBA should be aware of when designing a regulatory response to any of the issues discussed in this paper?

Any new or revised regulatory frameworks should consider the differing interests of all payment system participants, whether end users, such as consumers and merchants, or service providers.

The regulatory framework should support the competitive landscape of the Australian payments ecosystem, while also recognising the cost of maintaining it and the commercial incentives required for participants to continue to innovate and deliver effective and secure solutions for end users. The initial private investment of established participants created the networks upon which all participants now rely. This has resulted in these participants having legacy systems to maintain and uplift to support ongoing innovation, security and efficiency for the benefit of end users.

Any regulatory response should enable participants to scale, future-proof, adequately enforce, and sustain the broader payments ecosystem. It should also address key market challenges related to fraud prevention and security, to ensure resilience and integrity of the system.