



**Submission to the Reserve Bank of Australia  
Payments System Board  
Consultation on Card Surcharging**

**July 2011**

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## **ABOUT CHOICE**

CHOICE exists to unlock the power of consumers. Our vision is for Australians to be the most savvy and active consumers in the world.

As a social enterprise we do this by providing clear information, advice and support on consumer goods and services; by taking action with consumers against bad practice wherever it may exist; and by fearlessly speaking out to promote consumers' interests - ensuring the consumer voice is heard clearly, loudly and cogently in corporations and in governments.

To find out more about CHOICE's campaign work visit [www.choice.com.au/campaigns](http://www.choice.com.au/campaigns) and subscribe to CHOICE Campaigns Update at [www.choice.com.au/ccu](http://www.choice.com.au/ccu).



## **Executive Summary:**

CHOICE is concerned that the price signals credit card surcharges were intended to send to consumers are being eroded by excessive surcharges which bear little relation to the cost of the transaction. This concern is reinforced by the fact that while consumers are generally not supportive of surcharging, the majority report having paid a surcharge when last presented with one, suggesting the availability of convenient, no-cost payment options is limited.

CHOICE wants credit card surcharges to provide price signals to consumers on the costs of different payment methods, thereby encouraging competition and innovation in the payments system and putting downward pressure on transaction costs.

CHOICE supports enforceable measures to limit credit card surcharges to reflect transaction costs, along with steps to increase transparency, disclosure and reporting around credit card surcharging in all retail environments.

**Recommendation 1:** CHOICE recommends that surcharges for the use of credit and debit cards should be limited to cost recovery and not be an avenue for cost-shifting or revenue raising, i.e. that credit and debit card surcharges be limited to the additional variable cost incurred by merchants for processing transactions.

**Recommendation 2:** CHOICE recommends that the RBA collect and publish data on the total dollar amount of surcharges collected by merchants, and if possible to have this data disaggregated by industry, turnover, and type of customer (business or consumer), and also by type of sale (online or in-store).

**Recommendation 3:** CHOICE recommends that for online merchants that apply credit card surcharges, wherever a headline price is advertised, it is accompanied by clear disclosure of the surcharges that apply.

**Recommendation 4:** CHOICE recommends that credit card surcharges be limited to *ad valorem* calculation, i.e. not a per capita or flat fee.

**Recommendation 5:** CHOICE recommends that surcharge limits be enforced by a single appropriate agency that has clear carriage and provides a clear avenue for consumers to raise grievances and complaints.

**Recommendation 6:** CHOICE recommends that the RBA explore the viability of establishing an online searchable register of surcharges which are considered to be excessive.



## **Introduction:**

CHOICE appreciates the opportunity to provide the following comments to the Reserve Bank of Australia's Review of Card Surcharging: A Consultation Document, June 2011.

Previous communication from CHOICE in 2002 supported the abolition of the 'No Surcharge' rule that was imposed on merchants through their commercial agreements with the international credit card schemes.<sup>1</sup> In particular, CHOICE supported the aim of the reform to end the cross-subsidisation of credit card payments, whereby fees for accepting credit card payments had to be bundled into a retailer's overall costs and prices.

In late 2009 CHOICE and the NSW Office of Fair Trading conducted a joint research project on the application of credit card surcharges.<sup>2</sup> The report, *Credit Card Surcharging in Australia*, found:

Surcharges were most often experienced when purchasing air travel, telecommunications, holiday travel, restaurants, utilities, taxis and petrol stations.

- Consumers widely disapprove of surcharges; 68% of people surveyed believed that retailers and other businesses should not be able to levy surcharges.
- Although surcharges do encourage consumers to use lower cost payments systems, 64% of people surveyed paid the surcharge when last presented with one. In some cases, this reflects the lack of another option at point of sale, particularly for sectors where credit card payments are the norm. At other times, inadequate fee disclosure by merchants means consumers aren't aware of the fee until it's too late. In other cases, consumers believe that a surcharge is worth paying for the convenience of using a credit card, the interest-free period or the rewards program.
- It's very difficult for consumers to know if the surcharges they're presented with are fair and reasonable, or if they're being used as a profit centre by merchants.
- While surcharges are usually a percentage of the transaction amount, there are some cases of flat dollar fees, including airlines, which often raise concerns around excessive surcharging.
- There is much consumers can do to lower their transaction fees, to help retailers to reduce their costs, and to support the development of efficient and innovative payment systems. This includes choosing to pay with EFTPOS debit cards, cash, or one of the online payment systems that don't attract surcharges.

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<sup>1</sup> *Australian Consumers' Association Response to the Reserve Bank of Australia's Draft Standards and Access Regime for Credit Card Schemes*, 15 March, 2002

<sup>2</sup> *CHOICE Report: Credit Card Surcharging in Australia*, prepared on behalf of NSW Fair Trading, 2009



CHOICE continues to believe that credit card surcharges can provide price signals to consumers on the costs of different payment methods, thereby encouraging competition and innovation in the payments system and putting downward pressure on transaction costs. However, CHOICE is now concerned that the price signals credit card surcharges were intended to send are being eroded by excessive surcharges which bear little relation to the cost of transactions.

CHOICE supports the introduction of a limit to credit card surcharges to the extent that it covers the merchant's costs of providing credit facilities and encourages competition in the payments system. CHOICE also notes with concern the level of debit card surcharges experienced internationally. **CHOICE recommends that credit and debit card surcharges be limited to the additional variable cost incurred by merchants for processing transactions.**

While there is no publically available data on the total value of surcharges collected by retailers in Australia, RBA research shows that around 40% of very large merchants, and 20% of small or very small merchants, now use credit card surcharges. CHOICE is concerned that some retailers are charging consumers far more than what it is costing them to process the payment and that surcharges have become a new, and growing, revenue stream. **CHOICE recommends that the RBA collect and publish data on the total dollar amount of surcharges collected by merchants and to have this data disaggregated by industry, turnover, and type of customer (business or consumer), and also by type of sale (online or in-store).**

CHOICE is particularly concerned with excessive surcharges in online transactions. The use of 'drip pricing' distorts the total transaction cost and does not encourage the use of cheaper payment methods or innovation. Without easily accessible payment alternatives and clear entry-point surcharging signals, payment system monopolisation leads to excessive surcharges potentially used for additional revenue raising. This issue has been highlighted in recent research by East & Partners which noted that online surcharges can be up to three times the amount charged by bricks and mortar stores<sup>3</sup>. Some of this difference may be attributable to the additional risk involved in transactions where the cardholder is not present.

CHOICE recognises that the retail environment is fast moving towards a scenario where almost every payment choice may attract a surcharge. In these circumstances, headline prices will become increasingly meaningless and potentially misleading to consumers, and we would encourage the RBA to consider future options for ensuring headline prices are achievable for the vast majority of consumers. In the meantime, to increase consumer awareness and understanding of credit card surcharges, CHOICE believes that there needs to be far greater transparency in the online environment. **CHOICE recommends that for online merchants that apply credit card surcharges, wherever a headline price is advertised, it is accompanied by clear disclosure of the surcharges that apply.**

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<sup>3</sup> [www.east.com.au/mediareleases.asp](http://www.east.com.au/mediareleases.asp) 10 June 2011 - *Merchants differentially surcharging*, viewed 19 July 2011



CHOICE is also concerned about the use of a flat fee for credit card surcharges instead of a percentage amount. As Merchant Service Fees (MSFs) are calculated on an *ad valorem* basis, a flat fee structure for payments by credit means that lower value transactions are subsidising higher value transactions. Flat fees are regarded by many consumers as unfair and as they are mainly seen in the aviation market, consumers understand that cheaper, more price-sensitive private travel is subsidising more expensive less price-sensitive corporate travel. **CHOICE recommends that credit card surcharges be limited to *ad valorem* calculation.**

For consumers to have confidence in the fairness of a cap, any controls over credit card surcharges would need to be accompanied by enforcement provisions. **CHOICE recommends that surcharge limits be enforced by the appropriate agency.** The enforcing agency should also provide a clear avenue for consumers to raise grievances and complaints. As a further aide to transparency, **CHOICE recommends that the RBA explore the viability of establishing an online searchable register of surcharges which are considered to be excessive.**

In the remainder of this submission, CHOICE addresses the specific consultation questions put forward by the Payments System Board.



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

With increasing consumer concerns over excessive credit card surcharging, a limit may provide some confidence that the surcharges sought are fair. CHOICE supports the introduction of a limit to credit card surcharge to the extent that it covers the merchant's costs of providing credit facilities and encourages competition in the payments system. For the surcharge limit to be a win for consumers, it needs to be explicitly, and transparently, limited to the additional variable cost incurred by merchants for processing transactions.

Specifically, a surcharge limit should not be used to recover a merchant's other fixed or transactional costs. Otherwise there may not be a clear price signal between payment methods. In contrast, if the limit is defined at a specific rate cap applicable to all retailers, a legislated cap may well see a 'race to the cap' by merchants and even by acquirer banks (i.e. by merchants' banks as they set merchant service fees), regardless of the actual transaction costs, and provide no incentive to compete.

In addition, a single specific rate cap would also continue the cross-subsidisation of payment options. For merchants whose MSF is above the cap, the portion of their MSF not covered by the single cap would have to be factored into their overall costs and prices. Whereas for merchants whose MSF is below the cap, they would receive additional revenue. The larger the merchant, the greater is the likelihood that they pay the lowest MSF.

A specific single rate cap on credit card surcharges is likely to benefit the larger merchants that are able to negotiate lower MSFs or acquirer banks that are able to increase the MSF to the cap. Unless the additional revenue is used to lower prices, this represents an unnecessary additional costs for consumers.

In its March 2011 super-complaint on credit and debit surcharges to the UK Office of Fair Trading, UK consumer group Which? proposed a methodology for estimating a 'fair' surcharge (section 3.2). While the super-complaint specifically dealt with the market for passenger travel services, the principle elements to calculating a fair surcharge are broadly applicable: any surcharge should be a cost-pass through of the average variable costs imposed by the acquiring bank. Importantly, this excludes fixed costs and any fixed or variable costs that are part of the retailer's own processes (for example, operating check-outs or accounts departments, etc.).

For consumers, a surcharge limit can increase confidence that the surcharges sought are fair; however a universal single rate cap also retains some level of cross-subsidisation of different payment options.



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

There is significant consumer concern that some merchants are using their dominant market positions to apply very excessive credit card surcharges, in effect using credit card surcharges as a revenue stream.

As previously noted, this is a particular concern where merchants charge a flat fee for payment by credit card instead of a percentage amount. It is currently not possible for consumers to know with any confidence if the surcharges sought reasonably reflect additional variable costs to the merchant of accepting credit card payments.

For credit card surcharges to encourage competition between payment options, the price signals to consumers need to accurately reflect the costs of each option. If a surcharge limit is introduced, it needs to truly reflect the cost of card acceptance. This would be in line with the recently adopted European Union Consumer Rights Directive Article 19 which states that:

‘Member States shall prohibit traders from charging consumers, in respect of the use of a given means of payment, fees that exceed the cost borne by the trader for the use of such means.’

As noted above, Which? has set out a methodology for calculating a fair surcharge. CHOICE believes that this methodology can be adapted to the Australian context and give consumers confidence that the surcharges being sought are fair.

**Should there be some level of tolerance allowed around any surcharge cap?**

The need for an allowable tolerance around a surcharge cap depends on the approach taken to define or calculate the cap. However, for consumers to have confidence in the fairness of a cap, any controls over credit card surcharges would need to be accompanied by enforcement provisions.

CHOICE (then the Australian Consumers' Association) recommended in its submission to the 2002 RBA's Draft Standards and Access Regime for Credit Card Schemes:

ACA recommends the Federal Treasurer grant a price surveillance and enforcement power to the ACCC to ensure merchants do not profiteer from the uncapped surcharge, or double-dip on merchant fee recovery from their customers.

While price surveillance may no longer be necessary, CHOICE continues to recommend that surcharge limits be enforced by the appropriate agency. The enforcing agency should also provide a clear avenue for consumers to raise grievances and complaints.



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

The payments industry is at best opaque. Not only is there great variability of MSFs between card schemes, there is also great variability of MSFs between merchants and also between the different types of cards an individual card scheme offers. So, MasterCard's charges are different to those charged by American Express, the rate charged to a corner store by a card issuer is different to the rate charged by the same card issuer to a national supermarket chain, and the rate charged by an issuer for a basic credit card is different to the rate for a premium credit card.

Far greater transparency in MSF's would be a welcome development. As noted above CHOICE believes that any credit card surcharge limit needs to be transparently based on the additional variable cost incurred by the merchant for processing transactions.

The Which? methodology for estimating a 'fair' surcharge, set out in its super-complaint on credit and debit surcharges to the UK Office of Fair Trading, may be adaptable to the Australian context. The principle of any surcharge should be a cost-pass through of the average variable costs imposed by the merchant's bank. This should exclude all fixed costs and any fixed or variable costs that are part of the retailer's own processes (for example, operating check-outs or accounts departments, etc.).

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

We understand that there is some suggestion of a differentiated surcharge cap to reflect the differences in merchant service fees charged by the card schemes. While this provides some price signalling, universal caps are still a fairly blunt instrument as they do not reflect the actual cost of the transaction to the merchant. Again, without full disclosure of the MSF it is not possible for consumers to make an informed assessment of the fairness of a differentiated surcharge cap.

As previously noted, a cap can increase consumer confidence that the surcharges sought are fair; however a universal cap also retains some level of cross-subsidisation of different payment options. Limiting the surcharge to the additional variable cost incurred by merchants for processing transactions provides the best price signal to consumers and removes the need for cross-subsidisation.



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

We do not propose to address this issue as it goes to the relationship between the merchant and its acquiring bank and is not directly relevant to consumers.

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

As stated above, unless credit card surcharges are limited to additional variable cost incurred by merchants for processing transactions, it is not possible for consumers to know with any confidence if the surcharge is reasonable.

To assist with this, in addition to existing data on merchant service fees, we would urge the RBA to publish data on the total dollar amount of surcharges collected by merchants and to have this data disaggregated by industry, turnover, and type of customer (business or consumer) and also by type of sale (online or in-store). As a further aide to transparency, CHOICE also believes that the RBA should explore the viability of establishing an online searchable register of surcharges which are considered to be excessive.