RBA Consultation on Merchant Card Payments Costs and Surcharging

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1. The MRC

The Merchant Risk Council (MRC), is a global non-profit membership association, founded in 2000, that represents professionals in payments and payment fraud prevention.

The MRC organization comprises over 750 members – including merchants, banks, PSPs/acquirers, solution providers and law enforcement agencies – spanning North America, Europe, Latin America, and Asia.

Approximately 66% of MRC members are merchants, and we are committed to working collaboratively with payments industry stakeholders to ensure the merchant perspective remains central in discussions surrounding the continuous evolution of payments.

A key component of the MRC's mission is focused on industry advocacy efforts that consider the perspectives of all stakeholders in the ecosystem. The MRC focuses on data-driven discussions that objectively reflect the needs and experiences of our diverse membership – ensuring that changes in the global regulatory landscape are executed in an informed, well-rounded and transparent manner.

2. Introduction

The Reserve Bank of Australia (RBA) is reviewing card payment costs and surcharging amid concerns about the cost of living and changing payment preferences.

The RBA recognise that Australians rely heavily on card payments, but rising focus on payment costs and surcharges has prompted a review.

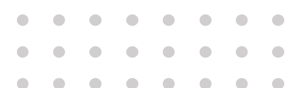
This review aims to assess whether it is possible to further reduce merchant card payment costs by enhancing competition and efficiency, and whether the current surcharging framework remains effective.

An issues paper (see Appendix 1) outlines the RBA's review scope and invites stakeholder feedback on existing regulations and potential changes. Key areas of focus include:

- The effectiveness of current regulations on interchange fees, scheme fees, least-cost routing, and surcharging.
- The potential for greater transparency in fees to encourage competition and lower costs.
- Broader issues influencing card payment policies.

Stakeholders feedback is requested by December 3, 2024. The RBA will then analyse submissions and consider next steps in progressing any regulatory reforms.

The RBA, in conversation with the MRC, recognized the opportunity to reflect lessons from outside Australia within the local market, and explicitly requested input from the wider global stage. They also requested that feedback, as far as is possible, is practical and constructive.



This MRC paper summarizes the merchant response to this consultation.

3. Some high level background on the Australian market for context

The Australian payments market is regulated by the Reserve Bank of Australia (RBA) and benefits from mature international card scheme acceptance as well as a mature domestic debit card system and developing P2B and P2C payments solutions.

- **Risk environment**
  Australian Risk is generally well controlled, with a strong EMV environment at POS and secure ecommerce solutions being deployed where high risk is experienced. Increased fraud is seen in cross border business (inward and outward) and, like many developed countries, social engineering and first-party fraud is a growing concern.

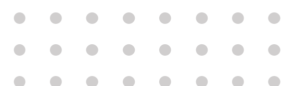
- **Interchange Caps are already in place**
  Previous legislation has already defined caps to domestic interchange rates which have been in place for some time. It is, however, notable that the rate caps are set higher than some other markets (e.g. Europe).

- **Low-Cost routing**
  Australia benefits from low-cost routing requirements, meaning that merchants are allowed to determine how they would prefer to route transactions, accepting that different networks represent different capabilities and pricing.

- **Surcharging rules**
  In line with the Low-Cost routing rules, merchants are permitted to surcharge transactions to cover processing costs. This creates a scenario where the merchant can choose the routing, but the consumer/purchaser may be asked to cover the costs of this routing decision.

- **Surcharging based business models**
  Australia has recently seen the implementation of a processor business model where merchants can agree a low (or potentially nil cost) merchant processing fee in return for agreeing a set surcharge amount which is passed to the processor together with delegation of routing decisions.

- **Tokenisation and PAR**
  Australia has embraced token-based payments and has set requirements for token interoperability, security and efficiency in support of low-cost routing and to help evolve secure payments across Australia. RBA supports the use of PANs for the immediate future but is reviewing the use of PAR to replace PAN usage in due course.



- **3DS Migration and mandate**
  A proposed roll-out of 3DS tied to a merchant fraud performance of 20bps is in place.

4. MRC feedback

The remainder of this paper looks at potential areas of merchant concern, with each section setting out a high-level issue and proposals for the RBA to consider.

4.1. Interchange Fee Rates

Interchange fees are intended to redress a perceived imbalance in the services, costs, and risks provided in card payments between the issuing and acquiring businesses. Mostly the balancing fee (the interchange fee) is judged by the card scheme to flow from the acquirer/merchant side towards the issuer, although in some rare circumstances fees can be judged to flow in the other direction.

It is not possible for most merchants to negotiate interchange fee rates and the methodology for calculating the rates is unclear. This, by its nature, should therefore represent a fee which should be of interest to regulators.

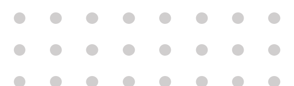
Merchant positioning:
Merchants expressed a range of opinions regarding interchange rates and the need for RBA focus:

- Merchants generally considered that interchange fees are probably set higher than they should be, and it is noted that regulators in other markets (such as Europe) have set lower interchange fees without apparently damaging the card payments business.

- There was general concern that the model utilised to set interchange fees is not published, and as such there is no way in which a third party can reasonably determine that costs are appropriately attributed nor what actions a merchant can take to reasonably control these costs (thus helping reduce interchange in the future).

- Some merchants would support a reduction to the weighted average interchange fees for credit and debit transactions. This would reduce payment costs for merchants and further reduce the argument for surcharging. Others, however, argued that the current caps for domestic fees are already appropriate (see also 4.3 and 4.4).

- It is noted that in theory interchange fees can be set bi-laterally between issuers and acquirers to reflect the differing costs between these parties, which will differ based on the transaction types, risks and channels utilized. However, in practice given that the card scheme publishes a default rate if parties do not agree a rate between them, it is therefore always in one party's interest not to agree a bi-lateral rate. As such bilateral arrangements are therefore rarely utilized and scheme fallback interchange rates become the de-facto standard.



Merchants would be interested in the RBA ability to encourage bilateral interchange agreements, as this would allow competition to enter the interchange arena. Over time, this should help drive competition and therefore reduce interchange fees.

4.2. Interchange Hierarchy Tables

Hierarchy interchange tables are utilised to adapt interchange rates either higher, or lower, based upon the way a transaction is being progressed.

For example, a scheme can determine that a 3DSecure (3DS) ecommerce transaction should attract a lower fee than those processed without 3DS. Or a tokenised transaction could attract a lower rate than a non-token transaction.

Merchants broadly acknowledge that pricing to encourage reduced risk is beneficial, but there is concern that such granular pricing is not always offered to smaller merchants. As such, a major merchant will be offered, and see benefits from, investment in security architecture, whilst a smaller merchant may only see the costs.

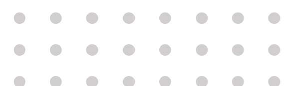
Merchant positioning:
Europe requires acquirers to be able to offer pricing models, where acquirer agreements set out the core costs to allow transparency. A similar approach in Australia, if required by the RBA would allow merchant pricing to be split (for each card scheme a merchant accepts) as follows:

- *Interchange:* Detail the costs of interchange for the merchant, based on the transactions they process, and the monies paid away. Not blended, but in detail by interchange level and card type (e.g. Domestic Debit v International Debit, POS v Ecom et al).

- *Scheme fees:* Set out the card scheme fees paid away relating to these transactions and any other similar card scheme costs incurred under this contract that are being distributed across merchants (it is accepted that granular costs are impractical, but the acquirer cost allocation methodology for generic scheme costs should be published and available).

- *Acquirer/Processor/Gateway costs:* This could set out the costs directly payable to the acquirer for providing the card scheme service, including value added services and their profit margin

This approach would require acquirers and their agents to offer granular pricing. This would allow merchants to understand the breakdown of the fees they are being asked to pay, force acquirers away from blended rates (unless a merchant wishes to accept such), and ensure pricing incentives are available in all merchants to drive appropriate behaviour.



4.3. Strategic Merchant Interchange Rates

Card schemes do, on occasions, enter negotiation with major merchants to allow reduced interchange rates, sometimes in return for volume commitments and even in some environments exclusive acceptance of their brand (where competition law allows).

As has already been noted in 4.1 above, interchange fee rates are set using models which are not open to public scrutiny, but if cost based, it is unclear why a major merchant's transactions would be cheaper to process than transactions from a smaller merchant. From an issuer perspective, a gold ring purchased at a large merchant has the same processing requirements, risk issues and therefore costs as one purchased at a small merchant.

The disparity between the rates negotiated by major merchants and those offered into smaller merchants are understood to be significant. This could indicate that there is far more margin in the rates utilised than may be anticipated, and that perhaps all rates should be lower, rather than just for some major merchants.

Merchant positioning:
It is inevitable that in some circumstances volumes can and will result in economies of scale, and the major merchants who are able to do so, appreciate the ability to negotiate and achieve such benefits regarding the scheme fallback interchange rates which apply.

However, the lack of any ability for a smaller merchant to negotiate such rates, and the lack of clarity over why an issuer cost should be so much higher or lower based on the size of an individual merchant, again calls into question whether rates are appropriately subject to competitive drivers.

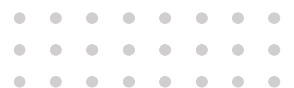
RBA are asked to review the models utilised with the card schemes to assess whether they are being implemented fairly and to explore opportunities for lower cost models.

4.4. Cross-border Interchange Fees:

Cross border interchange fees are understood to typically operate to significantly higher rates, than the rates charged domestically. Many of the concerns expressed at 4.1 also apply here with the rationale for these increased rates being far from clear.

Merchants would like to better understand why such high rates are necessary, and again the extent to which these rates are appropriate for the costs involved.

Merchant positioning:
If no clear rationale can be presented, merchants would ask that the RBA consider the opportunity to work with regulators in other markets to agree appropriate interchange caps for



cards used inside and outside Australia.

It is noted that within Europe a cap on international interchange fees has been successfully deployed to balance cross-border transaction costs, without apparent problems.

4.5. Scheme Fee Levels

In most businesses, as volume increases, economies of scale come into play which tend to reduce operating costs to the benefit of all players.

However, the international card schemes continue to enjoy significant growth in profitability and revenue and there is a concern among retailers that the major four party card schemes are not impacted by market forces that impact their pricing policies (particularly as the fee burden only ever appears to increase).

It is noted the card schemes tend to advise of continued investment in infrastructure (fraud detection solutions, tokenization, 3D Secure, et al) but it is noted by merchants these tend to be either of direct strategic interest to the card scheme, or a fee-paying service which creates a new revenue line for the card scheme, or their subsidiary companies (see 4.9).

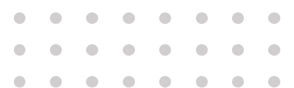
It should also be noted that the card scheme fee model was introduced when the four party card schemes were 'not for profit' businesses and were owned by their participants (the issuers and acquirers, then known as members) who utilised them. In this environment, the fees were limited and controlled.

But now that the card schemes are 'for profit', publicly listed companies, it is not clear whether this commercial approach has ever been fully reviewed and reassessed, or whether the subsequent increases in fees levied are justifiable. The international card schemes now have stock market valuations that massively exceed the great majority of their previous owners. This indicates a very strong ability to create revenues and shareholder returns.

Merchant positioning:
Merchants argue the RBA should review card scheme pricing and consider the need for a full transparency and justification on all fees, including from subsidiary companies.

It is accepted that the card scheme model in practice means that card schemes operate across many different regulatory jurisdictions. However, it is unclear whether any regulator considers this within their remit, and as such it could be that that the fee levels in effect have no effective oversight.

The RBA could take a first step in correcting this for Australia.



4.6. Surcharging

Surcharging is a complex subject which drives many different opinions from merchants depending upon the business sectors in which they operate, how they undertake business and the value of the transactions they accept.

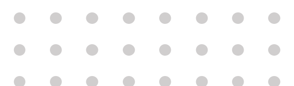
Merchant discussions highlighted a number of issues, which argue both for and against surcharging for card payments:

- Surcharges do tend to be unpopular with customers. They do create customer dissatisfaction during purchases, as the value of the item being purchased is then increased when the purchase actually occurs.
- Surcharging rates differ significantly between merchants with consumers not always being aware of a surcharge fee amount until payment has been completed – again driving consumer dissatisfaction.
- If surcharging is removed, some merchants will reflect the additional processing costs as price rises for the goods and services. This will mean that non-card purchasers will, in practice, be subsidising those using cards.
- It should be noted that in various points above, this paper has highlighted concerns regarding the level of interchange and card scheme fees which are being levied. A reduction in such fees would inevitably reduce the need for surcharging at all. As such, fee levels and surcharging are interlinked.
- There has been a growth in merchant proposition from some acquirers/processors where card facilities are offered subject to fixed surcharge rates and the delegation of routing decision is then given to the acquirer/processor. The fixed surcharge, therefore, pays for all card costs and the merchant no longer retains interest in routing, interchange or related fees.

  It seems unlikely that existing surcharging rules were intended to result in such a business model, or that it drives appropriate behaviours anticipated. However, given that small merchants tend to incur far higher card transaction costs (as previously discussed), the evolution of such a model is not surprising.

Merchant positioning:
On balance, merchants argue that:

- Surcharging for domestic debit transactions no longer appears necessary and the removal of surcharging in this space would reduce complexity and improve consumer trust.
- Surcharges for domestic credit could be retained, but if so a simplified model should be adopted with surcharge rates (where utilised) either consistently defined, or set at a rate that appropriately and fairly relates to the processing costs incurred.



- Given the significant cost of internationally issued payment cards, surcharging for these should be permitted, although also set at a rate that appropriately and fairly relates to the processing costs incurred.

- Regulation should require that merchants are transparent and upfront with consumers regarding the value of any surcharge that will apply prior to payment. This will allow consumers to make an informed choice of how they choose to pay.

Merchants ask that any reforms consider the varied capacity and needs of merchants operating in Australia and that timelines and approach reflect these.

4.7. Pricing control: Blended Merchant Service Fee (MSF) Rates for Small Merchants:

Whilst the impact of blending pricing on smaller merchants has already been touched upon earlier in this feedback paper (particularly 4.2), it is worth setting out in further detail some of the implications of blending as a separate concern, and propose some remediations.

Blending of pricing, by its very nature, removes granularity and means that merchants can neither understand nor appropriately negotiate fees:

- Costs are obscured, and this makes merchant processing approach difficult to optimize.

- Lowest cost routing and related cost reduction methods can become hidden.

- Blending domestic debit, credit and international card fees means transaction mix changes are not understood; for example, a merchant expecting 10% international cards but only processing 3% would significantly overpay in a blended fee model.

- Smaller merchants lack the negotiating power to insist upon unbundled prices that a larger merchant would be able to access, to their detriment.

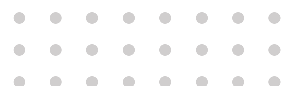
Merchant positioning:

It is proposed that:

- Acquirers/processors/gateways should be required to offer itemized pricing models, such as the approach suggested at 4.2, to allow transparency on cost and allow merchants to optimize approach.

  Bundling may in some circumstances make commercial sense (e.g. for micro merchants), but an unbundled version should be available for merchants if they wish to utilise such.

- Smaller merchants (say $2m - $10m annually) would welcome the introduction of tailored



fee structures, such as capped blended rates. Regulatory frameworks could limit the extent to which small merchants subsidise larger ones through blended pricing.

- RBA could require that PSPs implementing blended rates provide tools or reports showing how Low-Cost Routing and other factors impact their cost structures. This would enable merchants to verify that transactions are being processed efficiently.

4.8. Cross-Subsidization

Merchants remain concerned that given the lack of granularity in card scheme fee and interchange models, that it is in practice not possible to easily determine whether cross subsidization is occurring between different parts of the business.

If such is occurring, this may be unbalancing competition both between merchants (we have discussed negotiated interchange rates above) and even between schemes (domestic debit versus international debit).

Some merchants are concerned that cross subsidization may be utilised to suppress fees in one area by leveraging profits in another to distort the competitive landscape.

Merchant positioning:
It is proposed that:

- **Regulatory Oversight of Cross-Subsidization:**
  The RBA should review and, if necessary, intervene to prevent international schemes from using revenue from credit and international services to subsidize domestic debit fees.

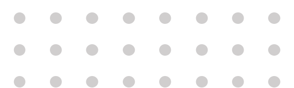
  Schemes should be required to justify their fee structures and revenue allocations to ensure a level playing field for all schemes and merchants.

- **Mandatory Transparency:**
  Increase visibility into fee structures to identify and address potential cross-subsidization.

- **Protect Smaller Merchants:**
  Introduce tailored policies or fee caps to prevent smaller merchants from indirectly subsidizing large merchants' preferential rates or artificially suppressed fees in other areas.

4.9. Mandated or preferred scheme services

A sometimes overlooked cost for card scheme participants are the direct and indirect fees and subsidies created as a result of a card scheme mandating the use of a particular solution that they, or one of their subsidiaries provide.



It is recognized that there are occasions where card schemes should be able to require a specific service to address a risk gap, or to drive strategic change. But this is a significant capability which by its very nature allows a card scheme service to be adopted at the prices and terms the card scheme defines, usually without competition or negotiation.

There is a perception amongst merchants that this card scheme approach is open to abuse. Examples highlighted by merchants of products/services which are scheme price defined, or scheme preferring are:

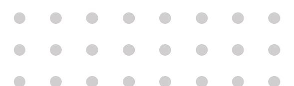
- The new Visa Acquirer Monitoring Program (VAMP), which provides benefits if merchants use Visa's own dispute management tools that are not available to merchants who utilise competitor dispute management solutions.
- The Mastercard Authorisation Optimiser, a tool which is mandated for use by merchants with no opt out capabilities even if the data is not available for the merchant to utilise it. Some merchants claim outcomes represent a questionable return on investment even if the data is available.

Merchant positioning:
Merchants argue that the ability for card schemes to mandate services is open to abuse as they can require use of a product they derive, at the costs they determine and with the cross-subsidization capabilities they deem appropriate.

To be clear, merchants are not against the card schemes building clear, value-based services that are 'voluntary' in nature – in fact, merchants welcome continued innovation by the schemes to develop such voluntary services with a clearly demonstrated value proposition and transparent return on investment. Such an approach would create parity and open competition in the market and increase the range of available choices, allowing the most effective products and services to realize commercial value that is commensurate with effectiveness and measurable benefit.

Given the monopolistic style nature of some of these services, with no choice but to use them if the card brand is to be accepted and limited or no capability for utilizing competing solutions, this requires as a minimum:

- A clear demonstration and criteria set forth for when a mandated service is justified. As such, this should as a minimum be shared and agreed with the relevant card scheme regulators and preferably subject to public scrutiny.
- Regulatory oversight of the product/service offered in terms of performance, cost, price and implementation approach. Forcing participants in a scheme to take and pay for a card scheme service is a monopolistic style action and should therefore be subject to a high regulatory bar.
- Where fees are taken to drive behaviour (such as risk fees), these fees, after operational costs, should be ring fenced and utilised for other purposes, rather than be used to create a



profit center for the card scheme.

These could, for example, be utilised to cover the costs of regulatory oversight, or compensate those who have been operationally impacted by the higher risks created that resulted in the risk fees being levied.

- The creation of an environment that promotes open competition by third-party solution providers for the solutions deemed as essential by a card scheme. It is not a given that such services must always be provided by the card scheme (or its subsidiaries) at the price the scheme considers appropriate.

5. In conclusion

The Merchant Risk Council and its members continue to support the evolution of payments and would like to thank the RBA for this opportunity to provide comments.

The MRC believes there is always scope in any system to enhance capabilities and improve performance, but it should be noted that payments involve many different stakeholders from the end consumer through banks and payment systems, with various support entities along the way to the merchant / payee often providing innovative goods and services.

Complex payments allow complex offerings, which offer a range of products and services to consumers which could not have been envisaged a generation ago.

But complexity also creates restraints in that it is too easy to create unintended consequences or imbalances to the competitive playing fields. It is also possible for commercial models derived many decades ago to no longer operate effectively as the payment systems and the stakeholders utilizing them evolve.

So, whilst the MRC embraces the continued evolution of payment solutions, and supports increased competition, security and evolution, we are also passionate to ensure that the payment solutions remain reliable, resilient, sensibly priced and efficient.

We would welcome the opportunity to continue dialogue with the RBA and associated bodies to help support the further evolution of payment systems in Australia.

If it would be helpful to discuss the positions highlighted in this paper, please feel free to contact the MRC via the contacts below:

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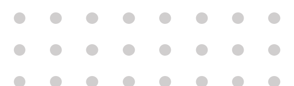

APPENDIX 1

RBA Consultation document

https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/2024/issues-for-consultation.html