

Taken for a ride?

REVIEWING THE RESERVE BANK'S SURCHARGING REFORMS

In this briefing, we examine the likely implications of the Reserve Bank of Australia's reforms to card surcharging practices. Difficulties applying the new regulatory Standard to taxis provides a useful illustration of why such measures are not likely to be effective in lowering surcharges for consumers.

Credit and debit cards have become a standard way to pay for goods and services. The convenience of cards is, however, coming at a price – merchants now commonly charge consumers fees for paying for goods and services by means other than cash. These fees are commonly known as merchant surcharges.

The practice of merchant surcharging, and the tendency for merchants to surcharge more than their costs of accepting cards for payment, is under fire. The Reserve Bank of Australia has recently consulted on merchant surcharging practices and proposed measures to rein in 'excessive' surcharging – meaning those unjustifiably above the cost of accepting cards. Many sectors were cited as being subject to these practices, including accommodation and travel; entertainment; restaurants, dining and takeaway; retail; taxis; and telecommunications.

The Reserve Bank's proposals

The Reserve Bank has regulatory powers over the operation of payment (card) schemes in Australia. These payment schemes include Visa, MasterCard, American Express and Cabcharge¹.

Historically, the payment schemes had rules (a 'no surcharge' rule), which prevented any form of surcharging by merchants. The Reserve Bank's reforms in 2002 included a Surcharging Standard which outlawed 'no surcharge' rules; and, indeed, surcharging by merchants was actively encouraged so as to send better price signals to consumers about the true cost of using cards. At the time, excessive surcharging by merchants was thought unlikely, but during the following decade, the practice caused the Reserve Bank increasing concern.

In *A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement* (June 2012), the Reserve Bank revised its Standards to allow payment schemes to stop 'excessive surcharging' by merchants who process transactions using their cards. The new Standards allow the card schemes to limit surcharges

to ‘the reasonable cost of acceptance’, which includes, but is not limited to, the merchant service fee.

What is meant by ‘reasonable costs’? The Reserve Bank has issued a Guidance Note providing more details, indicating that reasonable costs are limited to:

- Other costs payable to acquirers, including fees for the rental and maintenance of payment card terminals
- Costs payable to other payment service providers, including certain fees for the provision of equipment or services required to accept card payments.
- Merchants' own costs related to card acceptance, including scheme fees and communications costs
- Fraud costs related to card acceptance.
- Other fixed costs associated with compliance with scheme rules.

The Reserve Bank expects that the payment schemes themselves will be responsible for monitoring and taking action against merchants who surcharge above their reasonable costs.

Expecting compliance would be ambitious

So how effective are the new standards likely to be?

A review of the categories of costs above suggests that enforcing compliance will be a significant challenge. It is far easier to assess compliance when no surcharges are allowed! Opening the door to recovery of ‘costs’ means that the onus will be on Visa and MasterCard to assess whether a merchant’s approach to calculating costs is reasonable. Such a task looks practically impossible given that the scale of business and therefore costs are likely to be different for every payments processor or merchant. Supplying electronic payments in a travel agent is very different from supplying them in a flower shop, or in Woolworths.

Even if such costs can be reasonably estimated, a second issue is that Visa and MasterCard actually have little direct contact with merchants. They rely on banks and other financial institutions (who acquire transactions on behalf of merchants) to enforce their scheme rules with merchants. While Visa and MasterCard have some leverage with these financial institutions, ultimately enforcement only seems likely where there is a common interest in enforcing the rules. Will the banks really have the appetite to punish their merchant customers that excessively surcharge when that (potentially large and profitable) customer might well run to another bank for softer treatment?

These issues with enforceability suggest that any changes to surcharging practices will be slow, and probably token.

Taxis will remain a consumer bugbear

Taxis provide the extreme example of surcharging practices. The Reserve Bank suggested that, on average, merchants are surcharging consumers at a rate of 2.5 per cent, which was a premium of 1 per cent over merchant service fees. Taxis have long charged 10 or 11 per cent—a premium over merchant service fees of 6 to 9 per cent.

The Victorian Taxi Industry Inquiry, headed by Professor Allan Fels AO, recently reviewed merchant surcharging practices in taxis. The Inquiry noted that consumers were deeply dissatisfied with surcharging practices, and put forward evidence that 10 per cent appeared to be well above the costs incurred by suppliers of these services. For a trip to Melbourne airport, the surcharge could amount to between five to eight dollars from common origination points against merchant service fees of less than a dollar for some popular card types.ⁱⁱ

How could such a high surcharge be defended? Cabcharge, the largest supplier of payments processing services in taxis, offers two lines of defence.

Cabcharge's first line of defence is that it is not subject to the same rules as other merchants.ⁱⁱⁱ It says it does not levy a 'surcharge' but a 'fee'. To understand this argument, we must recognise that Cabcharge provides two distinct services: the first is providing payments services directly to corporate customers via its Cabcharge-branded cards (so in direct competition to Visa, MasterCard and other cards); and the second is providing processing services for consumers wishing to use their Visa or Mastercard or other third party card (so acting as a merchant). Cabcharge levies a charge of 10 per cent (Cabcharge cards or vouchers) or 11 percent (other cards) including GST.

Cabcharge therefore claims it is not subject to the Reserve Bank's rules on 'surcharges' because it provides payments services directly to corporate customers via the Cabcharge-branded cards. For these transactions, it bundles payments processing with other card services such a line of credit, and so cannot be said to just offer a payment processing service. However, Cabcharge's argument has no force in relation to the surcharging of third-party cards like Visa, MasterCard and American Express; when consumers use those to pay their taxi fare, it is doing so in a merchant role.

So why does Cabcharge maintain the argument that it does not surcharge and is therefore not subject to the Surcharge Standard? It seems a key plank of Cabcharge's strategy is to promote its own branded cards by excessively surcharging Visa and MasterCard cards – it could hardly charge consumers 10 percent to use a Cabcharge card while surcharging Visa and Mastercard card at a much lower rate.

It even seems possible that instead of complying with the Standard, Cabcharge might bolster its argued position as a direct provider of payment services by

preferring to cut off Visa and MasterCard entirely (as it did to Visa in the late 1990s).

The second line of defence is that it is more expensive to offer payments services in taxis. However, Cabcharge (as well as its competitors) rebate part of the 10 per cent fee to taxi networks, taxi operators or drivers as a loyalty bonus – implying that 10 per cent is more than enough to recover the actual costs of supplying the services. For these reasons, the Victorian Taxi Industry Inquiry suggested that Cabcharge, as well as other suppliers of payments services, should be subject to limits on surcharging practices, which would be enforced by the Victorian government.

Conclusion

Reducing excessive surcharges paid by consumers for card payments may be an honourable goal. However, expecting the payment schemes to monitor excessive surcharging by merchants, and subsequently enforcing compliance with the Reserve Bank's Surcharge Standard, seems unlikely to be an effective means to achieve this. It would come as no surprise if further reforms are attempted. While the general effectiveness of the Reserve Bank's proposals is questionable, they will almost certainly be ineffective in changing the practices of Cabcharge. Taxi users are unlikely to find relief from inflated surcharges any time soon.

July 2014 update: *In late 2013, the Victorian Government legislated to reduce the surcharge able to be levied by suppliers of taxi payment services to a maximum of 5 per cent of the fare, to be reviewed by the Essential Services Commission. The reductions came into force in February 2014. The NSW Government has also announced its intention to legislate later in 2014 to reduce surcharges to 5 per cent.*

ⁱ The new scheme rules do not apply to American Express or Cabcharge directly as the RBA has not 'designated' them as payment schemes (as it has done to Visa and MasterCard).

ⁱⁱ With approximately 32-35 million trips taken in Victoria each year, at the average Melbourne fare of \$23 (which is typically a lower fare than the average fare of trips paid for electronically) – and based on 40 per cent of all fares being paid electronically – the Inquiry estimated that the service fee generates at least \$30 million in revenue each year. (*Victorian Taxi Industry Inquiry Draft Report*, May 2012, p. 252.) Cabcharge's 2012 annual report suggests that its 'taxi service fee income', derived from taxi payments turnover through the Cabcharge Payment System, increased to was \$89.6m in the 2012 financial year.

ⁱⁱⁱ Certainly, Cabcharge was able to maintain its 10 per cent surcharge all through a period when other merchants were prohibited from doing so.

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