# CHOICE REPORT CREDIT CARD SURCHARGING IN AUSTRALIA


The people's watchdog

## Contents



COVER ILLUSTRATION by Michel Streich

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## Introduction

In 2003, retailer surcharges for customers paying with credit and debit cards became permissible. This followed the Reserve Bank of Australia's reforms to the payments system, which removed card schemes' 'no-surcharge rule' and reduced the interchange fees paid behind the scenes. While the initial take up rate of the surcharge option by traders was low, this has increased significantly in recent times. The suspicion in some cases is that surcharges have little correlation with business costs, and that excessive surcharging is being used as a new revenue stream. The increased incidence of internet commerce transactions, which particularly rely on credit card payments, also has important implications for consumers in this context.

With the above factors in mind, the NSW Office of Fair Trading (OFT) approached CHOICE to conduct a joint research project on the application of surcharges on credit card payments for the purchase of consumer goods and services in the Australian marketplace. CHOICE conducted the research and field work, and provided this report.

### The aim of the project is to identify:

- Current market practices;
- Examples of overcharging and consumer detriment;
- Consumer attitudes and experiences of surcharging.

In order to meet the research objectives a number of quantitative and qualitative research techniques are used. These include:

- An online survey of 1435 CHOICE members;
- A two-week diary of credit card activity among 140 CHOICE members;
- Desk research and interviews.

## Key findings

- 88% of the online survey respondents report paying a credit card surcharge in the previous year. More than 50% paid a surcharge between one and five times, while 22% had paid surcharges more than 10 times in the previous 12 months.
- Surcharges were most often experienced by survey respondents in industries such as air travel, telecommunications, holiday travel, restaurants, utilities, taxis and petrol stations.
- There is widespread consumer opposition to and disapproval of surcharges. 68% of the survey respondents believe that retailers and other businesses should not be allowed to charge customers extra when they pay with their credit card.
- The presence of surcharges encourages consumers to use lower cost payments systems. However, when last presented with a surcharge, 64% of the survey respondents report paying the fee. In some cases, this may reflect customers' 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. Some consumers may conclude that a surcharge is worth paying, due to the convenience of using a credit card, the interest-free period or rewards received.
- 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.
- Surcharges are usually ad valorem fees, meaning they're applied as a percentage of the transaction amount. However, there are some cases of flat dollar fees, including airlines and taxis, which often lead to concerns around excessive surcharging.
- The reforms that enabled surcharging are criticised by the card schemes and banks, and often by international research, sometimes sponsored by industry. However, governments in countries including the US and Canada are moving towards similar reforms. In the US alone, the potential savings from Australian-style reforms are estimated at around US$36 billion per year.
- The rationale for surcharges is hidden behind the complexity of the payments system reforms, which are poorly understood, despite their impact on the daily lives of millions of consumers. More easily digestible public information about the consumer benefits of the reforms would be helpful.
- There is much consumers can do to lower their transaction fees, to help retailers to reduce their costs, and to support the uptake of efficient and innovative payment systems. Options include choosing to pay with EFTPOS debit cards, cash, and a range of new online payment systems that don't attract surcharges.

# 1 Payment system reforms

## Paying to pay

Nobody likes being asked to pay new fees, and often our reaction as consumers is to object and find a way to avoid the extra cost. And that has been the response of many consumers to the introduction of credit card surcharges. Anger at the fees is understandable too, especially if they're excessive, if consumers feel tricked into paying a fee that wasn't adequately disclosed, or if no genuine alternative payment option was available.

But surcharges are an efficient way for retailers to recover their costs and to encourage the use of better value payment systems. Surcharges imposed at the counter or petrol pump can be fair – when they relate to the retailers' underlying cost of cost acceptance. To understand the rationale for what may appear an argument in favour of fees, it's necessary to understand some of the background to the famously complex credit card payments system.

## Fixing an inequitable, inefficient system

In 2003 the Reserve Bank of Australia (RBA) introduced sweeping reforms to the domestic payments system. Chief among the regulator's concerns was the level of interchange fees (see A complex market, below), and market dynamics that resulted in higher than necessary costs. Before 2003, interchange for MasterCard and Visa credit card transactions was around 0.95% of the value of each transaction customers made, nearly double what it is today.

The credit card market is different to most markets, in that it is 'two-sided', with two sets of customers – merchants (retailers and other businesses) and cardholders and requires balancing the charges to both. It is based on a platform provided by the card schemes such as American Express, MasterCard and Visa. The card schemes provide a payment service to customers and a card-issuing and payment-processing service to banks. The schemes compete for banks to issue their cards by offering them interchange fees that the banks can pass onto the merchants. Banks issuing credit cards also compete for cardholders through their interest rates, fees and rewards programs. In this market, banks will try to maximise profits by keeping the cost low to their cardholders and recovering that through the charges on merchants.

Unlike most 'normal' one-sided markets, there's often insufficient competitive pressure to keep interchange fees in check. In some cases, the competitive pressure on interchange fees is upward, as card schemes compete for banks to issue their credit cards with interchange fees.

In the US, unregulated and unchecked credit card interchange fees are now in the range 0.95% — 2.95% (for each Visa transaction) and 0.9% — 3.25% (MasterCard), yielding banks and card schemes tens of billions of dollars each year. These fees flow on to higher costs to merchants, which are eventually reflected in higher than necessary consumer prices, which are not only paid by the cardholders who benefit from this system, but by all consumers.

### A COMPLEX MARKET

Interchange is the complex system of payments that goes on behind the scenes each time a credit or debit card is used. In a simple retail transaction example, after a customer swipes their credit card to buy something, the shop's bank (known as the 'acquiring' bank) pays a fee, known as interchange, to the bank that issued the customer's credit card (the 'issuing' bank). To cover this interchange cost and to generate a profit margin for the acquiring and issuing banks, the shop pays a 'merchant service fee' (MSF) to its acquiring bank.

The diagram on page 10 shows a typical flow of fees for a four party system transaction, based on the current interchange fee (0.5%) and an average merchant fee of 1%.

Before surcharges, the 'price signal' to credit card users — telling them they were using a more costly system — was muted.

In Australia, despite technological and other advances, without regulation or caps there was insufficient downward pressure on interchange fees over time. As a result, merchants' overheads were inflated, as were the prices that consumers paid for goods and services.

## Retailers cornered

Meanwhile, the card schemes' 'no-surcharge rule' in their contracts forbade merchants from passing on an explicit fee to customers to cover their credit card processing costs. Retailers that accepted credit cards for payment were forced to include their inflated merchant service fees in the prices of goods and services that all customers paid. Before surcharges, the 'price signal' to credit card users – telling them they were using a more costly system – was muted.

This combination of high interchange fees and an absence of consumer price signals to guide people to lower cost payment methods gave credit cards an artificial competitive advantage over cheaper, more efficient systems such as EFTPOS debit cards and cash. It created a situation where the cost of credit card use was subsidised by the excessive interchange fees that merchants – and therefore all their customers – funded. In fact, many credit card users were effectively paid to use their credit cards – bloated interchange revenue picked up the tab for loyalty points and interest-free periods that a section of society enjoyed at the expense of all shoppers.

This enormous cross-subsidisation was worth hundreds of millions of dollars each year. In 2002, CHOICE labelled it inefficient and inequitable. "The banks have created a system whereby normal pricing and incentive signals are suppressed by cross-subsidisations and bribes, largely in the form of loyalty points, aimed at encouraging cardholders to use credit cards to the exclusion of other payment methods," we stated. "The introduction of loyalty schemes changed the pace and nature of credit card uptake, and has been funded by those who gain little or no benefit from them … this [loyalty points] bribe is being funded by other credit cardholders through high interest rates and by all consumers in higher prices for goods and services charged by merchants recouping the merchant fee they pay to cover the high interchange rate set by banks."

> Bloated interchange revenue picked up the tab for loyalty points and interest-free periods that a section of society enjoyed at the expense of all shoppers.

## Three major outcomes

CHOICE was generally supportive of the payments system reforms which began in 2003, resulting in three major changes to the credit card market.

**Regulation of interchange fees**

Average interchange fees for MasterCard and Visa (the two regulated card schemes) were reduced to around 0.5%, down from around 0.95%. This has had a predictable flow-on effect to merchant service fees, which have reduced, on average, from 1.45% of each customer's MasterCard or Visa transaction, to about 0.86% now. The diagram on page 10 shows this dramatic change.

A lowering of costs for MasterCard and Visa also placed some competitive pressure on the merchant fees for the two unregulated credit card schemes, American Express (Amex) and Diners Club. Amex and Diners are three-party systems, which negotiate merchant fees directly with each business that accepts their cards, rather than with a 'middleman' acquiring bank. Average merchant fees for Amex have reduced from 2.51% to 1.93%, while Diners Club's have reduced from 2.36% to 2.11%.

**Removal of the 'honour all cards' rule**

Before the reforms, the major credit card schemes required merchants that accepted their credit cards to also process the same companies' debit cards when presented for payment, and vice versa.

For example, a shop that accepted Visa credit cards was required to process Visa Debit cards. Since 2006, merchants have been free to choose which cards they accept, allowing them to reject payment cards they feel are too costly. This puts competitive downward pressure on merchant service fees.

Perhaps the most recognisable example of the removal of 'honour all cards' started this year, when Woolworths and its group of stores decided to stop processing MasterCard and Visa ('scheme') debit cards, which are more expensive for retailers to process than EFTPOS debit cards. Woolworths has continued to accept MasterCard and Visa credit cards. It also processes EFTPOS debit cards, which are better value for retailers and more profitable for Woolworths.

**The removal of the 'no-surcharge' rule**

The third major outcome of the reforms, and the primary focus of this report, was the banning of card schemes' 'no-surcharge' rule on merchants. Before 2003, credit card schemes, in their contracts, required that the merchants did not pass on an explicit fee to customers to cover their costs of card acceptance. Rather, these merchant service fees had to be bundled into a retailer's overall costs and prices. If a retailer felt that a particular type of card was too expensive, it could choose not to accept that type of card, but would risk losing customers as a result.

Now, merchants may charge fees to customers using various cards. This means the credit card user, and not everyone, pays the acceptance costs. It also sends 'price signals' to customers – encouraging the choice of payment methods that have lower overall costs.

While only the four–party credit card schemes (MasterCard and Visa) are regulated, American Express and Diners Club provided the RBA with written undertakings to remove merchant surcharging restrictions, too.

## Enter surcharging, "in the national interest"

Initially, the merchant take-up of surcharging was slow. When businesses introduce new fees, they may fear the potential for a public backlash, reputation damage and ultimately loss of business. Consumers often react negatively to new fees, 'fair' or otherwise. It is not surprising that retailers and other businesses were cautious.

By 2006, just 7% of merchants were surcharging, according to MasterCard. This appears to have been a concern for the RBA. "The problem is that surcharging remains relatively uncommon and, given overseas experience and what we have heard from the merchants, this is likely to remain the case," Dr Philip Lowe, the RBA's Assistant Governor, Financial System Group, said at that time. RBA Governor Ian McFarlane praised merchants that had introduced the new fee, even stating "we think [merchants] are acting in the national interest when they [surcharge]."

Since then, the rate of surcharging has increased significantly. A 2007 RBA paper stated that 15% of very large companies were surcharging credit card users; 9% of large merchants; 6% for small; and 5% for very small merchants, leading the bank to state in 2008 that, "while some merchants remain reluctant to surcharge, particularly in a face-to-face environment, the culture against surcharging is changing and is doing so faster than many had expected." The RBA was encouraged that the growing prevalence of surcharging had promoted better price signals, particularly for bill payments.

These trends continued into 2010, with the percentage of companies surcharging rising to between 20% (small or very small merchants) and 40% (very large merchants), according to RBA research, (the actual number of transactions being surcharged is much

### No evidence of lower prices?

Overall, the RBA estimates savings to merchants through lower merchant fees at about $1.1 billion per year. But it is hard to prove that this has led to lower retail prices to consumers, an argument often raised by banks and card schemes. $1.1 billion is worth around 0.1% to 0.2% of the value of the consumer price index, according to the RBA. With underlying inflation running at around 2.5% per annum on average, a 0.2% reduction is not observable in retail prices. But, according to the RBA, economic theory tells us that, ultimately, changes in business costs are reflected in the prices that businesses charge. Arguably, it's impossible to produce evidence showing the impact on retail prices resulting from these cost decreases. Of course, nobody argues that the reverse situation is untrue - when businesses face new costs, such as taxes and levies, the inevitable result in competitive markets is a higher retail price.

smaller), with the average surcharge 2.7% for American Express and Diner's Club transactions and 1.7% for MasterCard and Visa transactions.

Many other companies indicated that they were considering introducing surcharges. And, as our consumer research in the next chapter shows, 88% of consumers surveyed reported paying a credit card surcharge in the past year, with 22% paying these fees more than 10 times.

## Shonky behaviour

When Ian McFarlane said that retailers adding a surcharge were acting in the national interest, he probably wasn't thinking about those accused of profiteering through excessive fees. Some businesses appear to have embraced surcharges as a new revenue stream, and, once the fee is disclosed and avoidable with another payment method, there's nothing to stop them from doing so. American Express, MasterCard and Visa all told us that there are merchants charging customer fees that exceed their costs of card acceptance.

In 2009, CHOICE awarded Qantas the dubious honour of a Shonky award for its $7.70 (including GST) to $25 per passenger credit card surcharges , while Cabcharge, the dominant company in the taxi payments industry, continues to levy a 10% surcharge for all cards (including debit cards that cost just cents to process). The next chapter investigates whether some merchants are profiteering from surcharges.

## Surcharging opposed by card schemes

Unsurprisingly, most credit card schemes, which opposed the payments system reforms, are also strongly opposed to merchant surcharging. These fees directly impact on the likelihood that consumers will use their cards.

Visa thinks merchants should include the acceptance costs in their price, just as a shop does with other expenses such as providing a car park or paying staff more on a Sunday, (even though not all customers drive, or shop on a Sunday). "One of the core tenets of the consumer experience is that the price of an item as advertised or on the price tag should be the actual price paid at the checkout," argues General Manager Chris Clark. "This fundamental consumer protection has been recognised by governing bodies around the world. If more merchants impose surcharges, it will unfairly penalise consumers at a time when they are already facing the challenges of a difficult economy and increased cost of living expenses."

MasterCard's opposition to surcharges is also fundamental – "our core issue is that surcharging passes the cost of accepting payment onto consumers. And that's absolutely not fair," says David Masters, Vice President, Strategy & Corporate Affairs. MasterCard argues that accepting card payments is a normal cost of doing business and shouldn't be separately charged. "Merchants get a lot of benefits from cards that they don't get from cash or cheques. Obviously, instant payment and protection from credit losses and fraud. And, when they accept a payment by card (as opposed to cash) the money goes straight into their account without having to protect and transport it.  And the big difference – the existence of credit cards provides merchants with sales they wouldn't get if people could only spend the cash they could carry in their wallet. Before credit cards as we know them today, the extension of credit was something retailers did themselves – that risk (fraud losses) is now carried by banks."

American Express also told us that it believes the costs of card payments are, like all other costs, already built into the cost of goods sold. And the card industry regularly points out that its main competitor – cash – has associated costs for retailers that are often ignored.

[1] A Qantas spokesperson says, "Qantas strongly rejects any suggestion, including by CHOICE, that its card payment fees are somehow 'shonky' or that Qantas is gaining a windfall from them …". See further comments, page 18.

We only found one credit card scheme – Diners Club – that hasn't taken a public stand against surcharging. Perhaps one factor is because, as the smallest and least-accepted card scheme, it has less bargaining power with retailers than the others. "We have never sought to discourage our merchants from asking for whatever payment method they prefer, so the regulation of surcharging was not an issue for us," it said in 2006 evidence to a House of Representatives hearing.

"We regard surcharging as an issue between the retailer and the customer, not between the retailer and us. If the retailer believes that it is positive for their relationship with their customer to negate and refuse their payment choice, then that is what the retailer should do. Retailers in more competitive situations have chosen not to do that. Our observation is that retailers who feel they are subject to less competitive pressure have tended to surcharge."

## AN INTENDED OUTCOME: REWARDS CARDS LESS ATTRACTIVE

One of the intended outcomes of the reforms was to end, or at least reduce, the cross-subsidies whereby inflated interchange fees, funded by all shoppers, paid for free flights, shopping vouchers, and low annual fees of those with rewards credit cards. And, to some extent, this objective has been achieved – after the reforms, we saw credit card reward programs become more expensive, the value of points reduced, annual fees introduced or increased – for cardholders. CHOICE research has demonstrated that loyalty schemes often aren't worth the additional annual fees that cardholders themselves are now required to pay. This is particularly true for people who end up paying interest, because that cost will cancel out the benefit of any rewards.

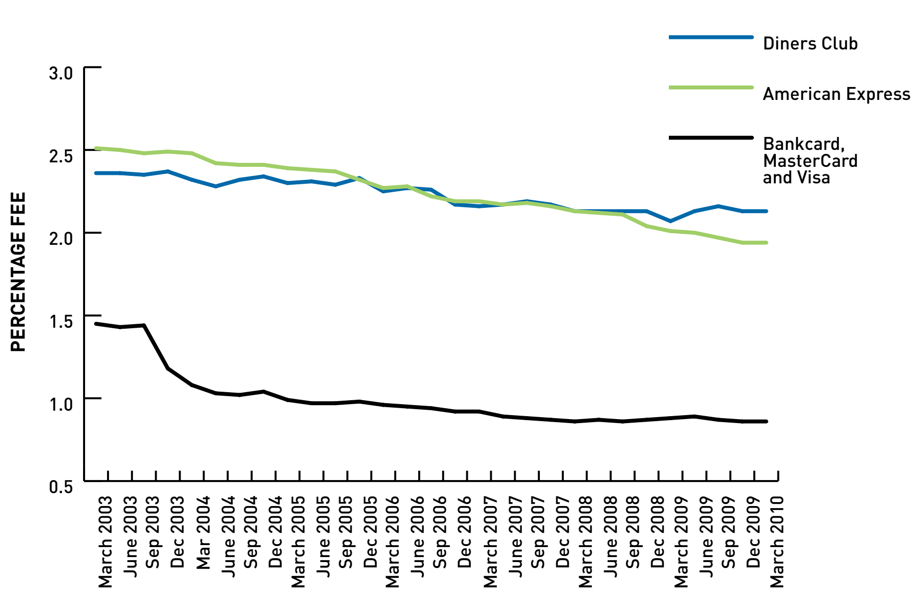
However, in the absence of merchant surcharging, cross subsidisations to fund loyalty points continue. Over 50% of our online survey respondents make a conscious effort to use their credit card to earn rewards points, because they must see a personal benefit in doing so. In most cases, they won't be surcharged.

Merchant fees for American Express and Diners Club cards have reduced in the past eight years, but remain, on average, more than double those for MasterCard and Visa transactions. So one would expect the three-party schemes' cards to provide more generous rewards, loyalty programs and other cardholder benefits than the four-party schemes' standard cards. Higher merchant fees are also used to provide benefits to the other customer in this two-sided market – the merchant itself. For example, American Express may run a marketing campaign aimed at increasing the sales or bringing new business to a merchant / client – for example, an advert enclosed with the customer's monthly statement.

Some see these higher and unregulated merchant fees placing American Express and Diners Club at an unfair competitive advantage over Visa and MasterCard. Indeed, we've seen many banks issuing Amex ' companion' cards to their MasterCard and Visa customers, presumably to cash in on the greater merchant fee revenue that's available. Through their Amex offers, the issuing banks can also entice consumers with higher-value loyalty schemes and rewards.

*Reading some of the overseas literature, it's apparent that, rather than painting the structural change as having created a somewhat more equitable system, critics use the reduction in 'free' credit card benefits as evidence that the reforms have damaged Australian consumers. The trick being played here is equating cardholders with all consumers – but millions of people do not have or benefit from credit cards. The critics often fail to mention that those shoppers without credit cards – and others with no-frills cards that don't come with loyalty programs – now longer cross-subsidise credit card benefits to the extent they did before.

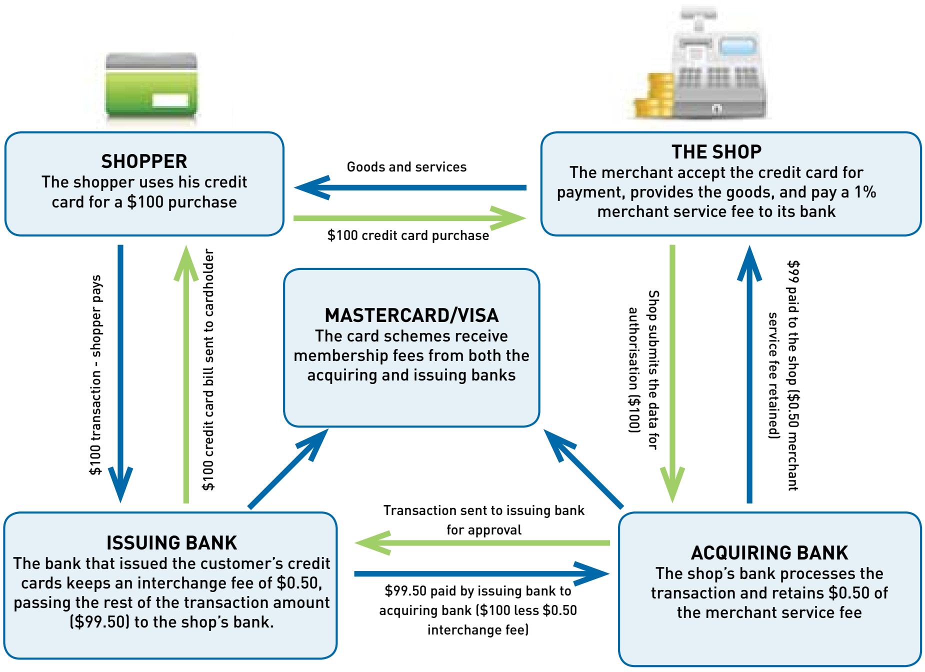
DECLINE IN MERCHANT SERVICE FEES, 2003-2010




EXAMPLE OF A FOUR-PARTY CREDIT CARD TRANSACTION

In this example, a shopper buys an item for $100 from a shop, using his credit card. We assume:

- the interchange fee is 0.5%.
- the shop pays a 1% merchant service fee.



# 2 The surcharging environment

The opening chapter describes the payments system reforms and the increase in the number of merchants choosing to surcharge their customers. This chapter looks at:

- Industries where surcharging has become prevalent
- What fees consumers are being asked to pay
- Whether retailers are profiteering from surcharges
- Level of fee disclosure
- Options for avoiding surcharges
- 'Blended' surcharges
- Special focus on the airline and taxi industries.

## Which industries?

We asked our survey respondents to indicate the industries and sectors where they have witnessed surcharges for credit card payments. Airlines, telecommunications, holiday travel, restaurants, utilities, taxis and petrol were the most common industries identified. Around 64% of respondents had seen surcharges applied by airlines, and particularly when booking online, these fees are hard to avoid. We take a closer look at airlines' practices later.

The survey results may in part reflect the consumption habits of respondents; for example, just 26% had seen surcharges in taxis, but we know the fees are ubiquitous in that industry (a section below focuses on surcharging by taxis, a special case).

## How often are consumers surcharged?

The chart (right) shows that 88% of 1374 online survey respondents paid a credit card surcharge in the previous year. More than 50% paid a surcharge between one and five times, while 22% had paid surcharges more than 10 times in the previous 12 months.

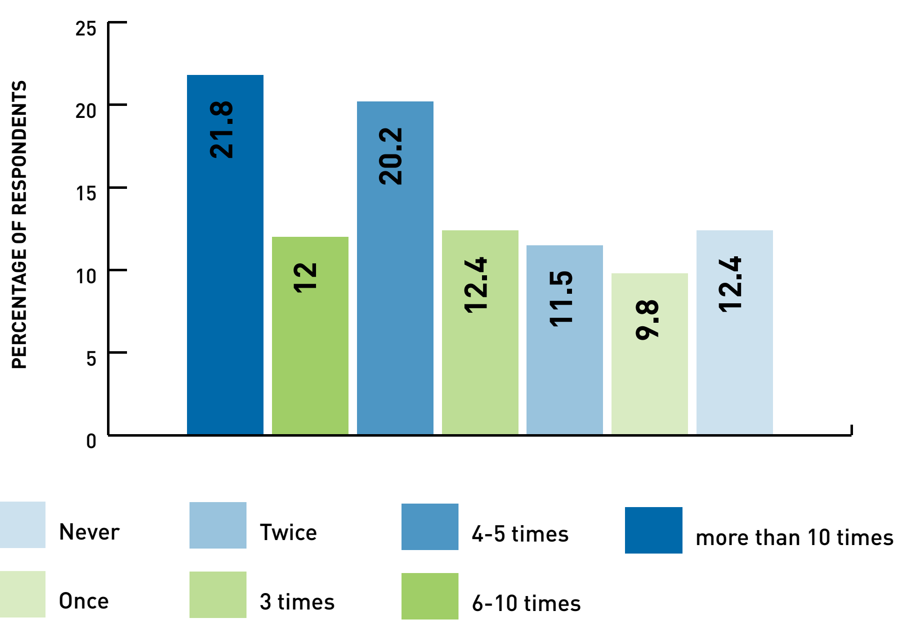
### WHERE DO CONSUMERS SEE SURCHARGES?

**QUESTION:** In which industries have you seen surcharges applied for credit or debit card payments? *(n = 1204, Source CHOICE member survey, multiple responses were allowed)*

| Industry | Response percent |
|---|---|
| Airlines | 63.8 |
| Telephone/Mobiles/Internet | 41.9 |
| Holiday Travel | 36.2 |
| Restaurant/Formal Dining | 32.0 |
| Utilities (e.g. electricity, gas, water) | 27.2 |
| Taxis | 26.4 |
| Petrol | 21.8 |
| Groceries | 18.4 |
| Appliances | 16.2 |
| Council rates | 15.8 |
| Insurance | 13.7 |
| Clothing/Footwear | 12.0 |
| Sporting/Entertainment | 11.8 |
| Take Away/Fast Food | 8.2 |
| Health/Medical Care | 7.9 |
| Education/Childcare | 3.2 |
| None of the Above | 0.7 |

### HOW OFTEN CONSUMERS PAY SURCHARGES EACH YEAR

*(n=1374, Source: CHOICE Member Survey)*



In a 2002 submission to the RBA, CHOICE argued that the Australian Competition and Consumer Commission should be granted a surveillance and enforcement power, "to monitor any instances of direct charging, and take action against merchant profiteering from the abolition of the no-surcharge rule. Double-dipping by the banks on cost recovery must not be replicated in other sectors," we warned. "Less competitive markets, such as aviation, will require monitoring and enforcement action against profit-taking."

## What are the fees?

The appendices [Appendix II, Tables 11-14; Appendix IV, Table 8] list some of the fees that survey respondents recall having paid or witnessed.

Our consumer surveys find that surcharges are usually ad valorem fees, meaning they are applied as a percentage of the transaction amount. However, there are some cases of flat dollar fees, including among airlines and taxis.

Surcharges are more likely to be applied to the costlier American Express transactions, and such fees are likely to be higher than surcharges for MasterCard and Visa.

## Are retailers profiteering?

"A 1.5% surcharge by a hotel, for example, based upon the RBA's published average merchant rates, represents a 70 – 80% margin for the merchant," says Jeremy Griffith, Visa Director of Corporate Relations in Australia, New Zealand and the South Pacific. "For certain retailers and hotels, excessive surcharging is money for jam".

"Some merchants are surcharging over and above the costs of card acceptance," agrees American Express. Even in 2006 the company was stating that "we have numerous cases of merchants that are still charging more than we charge them, with limited controls or consumer protection to our benefit".

But the difficulty in answering the question of whether an individual merchant is profiteering is that, apart from the obvious cases, we need to know the merchant service fee (MSF) that a retailer pays, before knowing for sure whether the surcharge represents an excessive fee. Merchants are under no obligation to publish their MSFs; indeed this information is often considered commercial-in-confidence by the parties involved. If the RBA was to publish more details, such as the specific merchant fees paid, or even the average fees that small, medium and large volume businesses pay, it would be easier for consumers to know if the surcharges are reasonable.

"We don't know the commercial arrangements between merchants, such as Qantas, and their acquiring bank," says Chris Clark, General Manager of Visa. "They're blending their American Express fees with the four-party fees, and we don't know what Qantas is including in its costs, so it is hard to say if they're profiting on surcharges. At present, it is pretty much impossible for consumers to know what a fair surcharge is". Says one survey respondent, "there is no way for the average consumer to know [the average cost that retailers pay to process transactions], because these arrangements are blatantly concealed by commercial providers."

A Qantas spokesperson says, "Qantas strongly rejects any suggestion, including by CHOICE, that its card payment fees are somehow 'shonky' or that Qantas is gaining a windfall from them. Qantas introduced card payment fees following the changes introduced by the Reserve Bank of Australia in 2002, which provided all merchants in Australia with the freedom to charge fees in relation to the use of payment cards to help reduce the level of subsidisation of card users by non-card users. Qantas offers consumers the choice of other methods of payment to avoid these fees. Qantas does not claim that its card payment fees directly reflect the specific amount that a financial institution charges in respect of any particular transaction. This amount varies between transactions and is only one of the costs incurred in providing this service."

## Average merchant fees

Although merchant service fees are not publicly available information, as described in Chapter 1, the Reserve Bank publishes average MSFs. As at June 2010 they are:

- 0.86%: MasterCard and Visa
- 1.93%: American Express
- 2.11% Diners Club

Naturally, you can expect large merchants to pay significantly less than the average (though the interchange fee for MasterCard and Visa is the floor beneath which the merchant fee for those transactions cannot fall). Large merchants and those with higher credit-card processing volumes are in a better position to negotiate good rates with their acquiring bank, or with one of the three-party schemes. And the very largest retailers – including Coles and Woolworths – have set themselves up to 'be' the acquiring bank for these transactions.

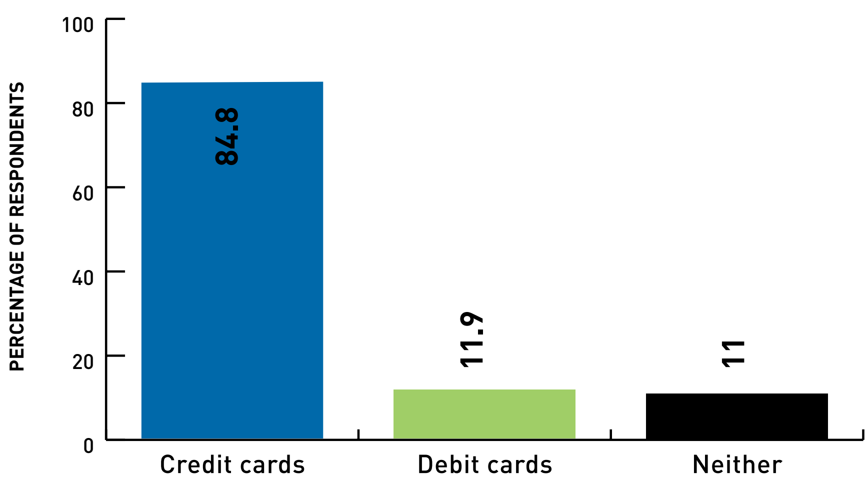
It follows that if an average-sized retailer is charging far in excess of the percentages above, they are probably using surcharges as an extra revenue stream.

On the other hand, small merchants and those processing relatively low volumes of credit card transactions, may pay far in excess of the average merchant service fees quoted above (so, when consumers see a small merchant that isn't surcharging, they may like to consider the various costs retailers face before choosing which card to use).

The MSFs above take account of merchant costs, including annual fees, payment terminal fees, terminal rentals, monthly fees, joining fees and other associated costs charged to merchants. Such costs can impact on particular industries' fees. Card fraud frequently originates in taxis, for example. And one card industry expert told us that "houses-of-ill-repute" pay up to a 6% merchant fee with certain cards, "which entirely reflects the fraud risks". Unsurprisingly, none of the respondents to our consumer surveys provided information about the surcharges that may apply in such establishments.

HAVE YOU PAID A SURCHARGE IN THE LAST 2 YEARS WHEN YOU HAVE USED ANY OF THE FOLLOWING CARDS?

*(n=1359, Source: CHOICE Member Survey)*




*MULTIPLE RESPONSES ALLOWED FOR CARDS

## Debit cards

More than 10% of our online survey respondents had paid a surcharge to use their debit card in the previous two years (see chart below). And this is where the fees can appear very excessive. The card schemes have a range of interchange rates depending on the type of merchant processing the debit card transaction. Here are examples of some of the rates, all of which are available on the schemes' websites:

- 4 – 5 cents: EFTPOS purchases, paid from the issuing bank to the acquiring bank, and in some cases, to some large retailers directly (Coles and Woolworths, for example, account for about 25% of the acquiring market). The interchange fee for 'cash out' – when customers use retailers for cash withdrawals – is at least three times higher than the fee for purchases.
- 12 cents is the cap on the weighted average interchange fee for Visa Debit transactions; MasterCard provided a voluntary guarantee to also adhere to that cap. Individual rates vary. For example: the Visa Debit electronic transaction rate is 8.8 cents, while the supermarket rate is 6.6 cents. The Debit MasterCard rate for all consumer cards containing an EMV compliant chip is 13.2 cents. All of these rates include GST, and are paid by the acquiring bank to the issuing bank.

In general, these are flat fees, irrespective of the size of the transaction. So, when a taxi applies a surcharge of say $3 to pay with a debit card for a $30 cab ride, the fee is around 25 times the average MasterCard and Visa Debit interchange fees, and 60 times the fee that is paid to the taxi's acquiring bank for EFTPOS transactions. However, as explained later, the actual merchant service fee paid depends on the deal negotiated.

"We were charged by a large hotel chain, and the amount seems exorbitant when the small company I work for can negotiate a lower rate with the bank than what we were charged. But who wants to carry around thousands of dollars cash to pay for your holiday?" - *CHOICE Survey respondent*

## Opportunism and market power

It's often reported that high surcharges are more likely when companies enjoy positions of significant market power. This is sometimes the case, though not always; the two major supermarket chains, for example, dominate the grocery market, but neither applies surcharges.

Surcharges are often evident in industries where consumers particularly rely on credit cards to make payments, including websites, and large merchants relying on cardholder-not-present channels of payment (for example, for utility bill payments). "If the customer has no choice but to use a scheme credit or scheme debit card, there's much more propensity to surcharge," says Bruce Mansfield of EFTPOS Payments Australia Limited.

Take, for example, hotels. A few nights' stay in most city hotels can easily lead to bills of $500 to $1000 when the consumer goes to check out. These days, few people use options other than plastic cards to settle such bills. The practicalities and security concerns of carrying that amount of cash make it unattractive for many people. This places hotels in a good position to surcharge, in the knowledge that their guests will have little option to pay the fee, whatever it might be. And CHOICE survey respondents often commented that hotels do apply surcharges. "Hotels are starting to surcharge, but how else do they ever get paid?" asks David Masters, Vice President, Strategy & Corporate Affairs at MasterCard. "When was the last time you stayed at a hotel and paid in cash? In fact, when was the last time you booked a hotel room and they didn't ask you for your card details to secure the booking? How else would they do that?"

A related point is that business travellers often care less about paying a surcharge, because ultimately their employer will cover the expense. The person deciding which payment method may not have a choice (for example, when they are provided with one credit card for business expenses) and in any case are not price-sensitive to surcharges. They may have other incentives – such as frequent flyer points – to use the card.

## How well are surcharges disclosed?

"The number-one complaint we hear from consumers is that they didn't know there was a surcharge until it was too late," says Luisa Megale, a spokesperson for American Express.

To find out how well surcharges are being disclosed to consumers, we asked participants in our 'payment diaries' survey to record what they experienced. We found that, in some cases, disclosure was inadequate, with respondents reporting that, in 12.3% of the 163 recorded surcharging instances, they did not recall being notified at all. Of those who were notified, 25.7% recalled feeling that the method of notification was not prominent enough. In a separate question, respondents who had been notified felt that in 17.4% of 132 recorded cases, the timing of notification was inadequate. Sometimes this was because disclosure was only made after the transaction had gone through. For example, one participant, Susan, only noticed that Origin Gas has a 0.6% fee after she paid – "there's a small notation on the bill about the surcharge – the fee is added to the next bill". Another said of an airline's surcharge notification, which she felt was too late and not prominent enough, "I would have paid cash had I known." As outlined later, cash usually isn't an option when booking flights online, but there are some other ways to avoid credit card surcharges.

When disclosure is verbal, rather than in writing, similar problems can arise. Ken, a diary respondent, found that a 3.5% fee for American Express at a hardware store was disclosed verbally and only as the transaction was being processed. He felt the timing was inadequate, and that he should have been told about the fee much sooner.

## What should merchants disclose?

The Australian Competition and Consumer Commission (ACCC) states that, when merchants charge their customers a credit card fee, they must ensure that consumers know:

- the credit card fee will apply;
- the amount of the fee before they enter into the transaction.

"Businesses should get advice about how to avoid misleading or deceiving consumers about this charge. If in doubt, the sensible thing to do is to err on the side of stronger disclosure," according to the ACCC website. It says options for informing consumers (particularly for retailers) include "clear and prominent messages on bills or tax invoices," and "clear and prominent in-store and/or point-of- sale signage."

American Express is more descriptive in its disclosure requirements to merchants: "Merchants should display clear and prominent in-store and/ or point of sale signage informing customers that a fee for credit card use will be charged, and the amount or percentage of the fee. This also applies to telephone sales, internet-based sales and direct mail catalogues. Any bills or tax invoices issued by your organisation where credit cards are an accepted form of payment should clearly state if a surcharge is to be applied, and the amount of the surcharge."

## Blended surcharges

Often, merchants charge the same surcharge for all payment cards, even though they have very different costs. For example, a hotel might be charged a 2% merchant service fee for Amex and 1% for Visa and MasterCard, so it decides to apply an average 'blended' surcharge to consumers of 1.5%. Airlines also commonly blend their surcharges, with the high use of corporate and premium cards driving up the costs for everyone.

Amex (and its customers) benefit more than MasterCard and Visa customers from blended surcharges. In the above hotel example, the fees of Amex customers are being subsidised by those of MasterCard and Visa. The four-party schemes aren't pleased. "Blended surcharges subsidise American Express users. There's an unfair playing field in favour of the unregulated schemes, American Express and Diners Club," says Visa General Manager, Chris Clark. "Our cardholders are basically subsiding American Express, whose merchant service fees are much higher than those on MasterCard," says David Masters of MasterCard.

Amex disagrees that it has been given an unfair advantage, and, notwithstanding the fact it wants no surcharging at all, believes that "equity is achieved when one fee applies for all cards. All costs are factored into a sale price, it is price discrimination to only surcharge one card scheme on the areas where people are considered more capable of paying," says Luisa Megale of American Express.

From the consumer's point of view, blended surcharges fail to send the price signals that the RBA intended. When all surcharges are the same – or when there's no surcharge at all – there's little personal incentive for consumers to choose the best-value payment system.

We asked online survey respondents whether they support a shop's right to charge different surcharge amounts for different cards, assuming the shop has

Airlines also commonly blend their surcharges, with the high use of corporate and premium cards driving up the costs for everyone.

WHAT DO CONSUMERS THINK ABOUT DIFFERENT SURCHARGES FOR DIFFERENT CARDS?

**QUESTION:** If a retailer has decided to apply a surcharge for credit card payments, how do you feel about different surcharges applying for different types of cards, such as one fee for Amex, another for Visa, etc?

*N = 1435, Source CHOICE member survey.*

| | |
|---|---|
| I support this, because shops have to pay different fees depending on what type of credit card I pay with | 36.1% |
| I would prefer if the retailer had one fee for all types of credit cards | 8.2% |
| They shouldn't be applying any surcharges for card payments | 50.2% |
| Don't know | 2.2% |
| Other | 3.2% |

**QUESTION:** Imagine a shop has the following surcharges: 0.9% for Visa/MasterCard credit cards, 1.9% for American Express, no fee when paying cash or EFTPOS. Which of the following do you agree with most?

*N = 1435, Source CHOICE member survey.*

| | |
|---|---|
| All credit cards should have the same fees | 6.6% |
| There should be no extra fee for cash or cards | 50.6% |
| This is generally a fair way to charge customers | 30.4% |
| The shop is ripping off customers (overcharging for credit card payments) | 7.9% |
| Other (please describe) | 4.5% |

decided to surcharge. The results above suggest that 36.1% support shops that apply different surcharges, but most respondents prefer no surcharges at all.

In a separate survey question, 6.6% of respondents stated their belief that all cards should attract the same surcharge, 30.4% agreed that surcharges close to the average merchant service fees for each card are fair, while again, 50.6% stated that there should be no extra fee for cash or cards.

Banks and retailers could agree to cap surcharges at a reasonable level for consumers.

## Should surcharges be capped?

On several occasions, the RBA looked at whether a capping of surcharges is merited, but decided against it on the grounds that introducing a surcharge cap would reduce the downward competitive pressure on interchange fees.

American Express has advocated greater consumer protection and transparency on surcharges, but doesn't go so far as to advocate a cap. MasterCard told CHOICE that it doesn't believe a regulated cap would work, because that fee would become the norm.

The Australian Payments Clearing Association (APCA), an industry group focused on creating an efficient and competitive payments system, does not oppose merchant surcharging or advocate for a cap. APCA is sympathetic to the RBA argument that surcharges help to keep interchange fees lower, but would like to see sufficiently low barriers to market entry, and competition between payments systems, that would enable interchange fee regulations to be removed altogether. "In APCA's view, the long-term interests of consumers are best served by maximising competitive payment alternatives for them, rather than by pricing regulation," says APCA Chief Executive Chris Hamilton.

During our research, we came across just one country where a cap is imposed (Denmark), although there may be others (see International trends, later).

But, closer to home, we did discover that there is a mechanism for capping merchant surcharges – if merchants and their (acquiring) banks agree to do so. For example, part 9 of Visa's scheme standard (Standard 2 – Merchant Pricing for Credit Card Purchases), set down by the RBA, states that "...an acquirer and a merchant may agree the amount of any such fee or surcharge charged to a credit cardholder will be limited to the fees incurred by the merchant in a respect of a credit card transaction." This means that banks and retailers, could, if they wished, agree to cap surcharges at a reasonable level for consumers.

Yet it seems these parties are unwilling to agree to limit surcharging. Banks may fear that attempts to do so would cause their merchant to look for another acquiring bank that doesn't try to limit its surcharges. So there's no real incentive for banks to limit surcharges. And it is easy to see why retailers wouldn't want to put a cap on their credit-card revenue.

The Australian Bankers' Association (ABA), which opposed the Reserve Bank's credit card reforms, says it is not the banks' role to limit surcharging – "this is the role of the regulator or the merchant itself," says Steven Münchenberg, Chief Executive of the ABA. "It is at the merchant's discretion. The standard says a merchant and an acquiring bank can 'agree', but the bank cannot require a cap on a merchant's surcharge. The option of constraining the surcharge to the fee is decided by the merchant, not the bank. The ABA is unaware if there have been any discussions or agreements made – we have not surveyed our member banks."

Further, banks and card schemes probably need to be careful in their negotiations with retailers. According to the ACCC website, "Part IV of the Trade Practices Act prohibits anti-competitive arrangements between competitors, such as price fixing, market sharing and boycotts. This means that businesses must make their own independent decision on whether to impose a credit card surcharge. Businesses must not engage in anti-competitive conduct. Businesses must not enter into agreements or understandings with other businesses, such as whether or not to impose a credit card fee; or the amount of the credit card fee that they will charge. Such agreements or understandings are contrary to the competition provisions of the Trade Practices Act and significant penalties may apply."

### Amex discourages merchant surcharging

American Express told us that it has been able to dissuade some merchants from surcharging, and to reverse their decisions to do so, by demonstrating figures for the lost sales that it claims surcharges cause. It also argues the benefits to the merchant of accepting American Express, which include marketing promotions, targeted customer communications and referrals. Amex also told us it doesn't reduce the merchant fees for a retailer that doesn't want to accept Amex – it tries to show retailer the benefit of accepting Amex – for example, by running a marketing campaign.

### Industry focus: Airlines

The table on the following page shows surcharge details for airlines in Australia. All apply surcharges, but their strategies and pricing vary. Virgin Blue, for example, charges a flat fee of $3.50 per passenger, per segment (flight), for domestic travel, and $6 per passenger, per segment, for international flights. "We are completely transparent in relation to the fees we charge and we are satisfied they are at a level which covers operating costs while not being excessive," said Colin Lippiatt, Manager of Corporate

### Surcharge Best Practice Code?

There may be an opportunity for banks, retailers and consumer groups to develop a Best Practice Surcharge Code of Conduct, in which merchants agree not to surcharge beyond their merchant service fee, or the MSF plus a reasonable margin. Code displays at point of sale would assure customers of the fairness of the fees.

Communications, Virgin Blue Group of Airlines. The website states that credit and debit card surcharging "is in line with industry practice".

Qantas also charges $7.70 to $25 for each passenger on a single booking. These flat dollar fees may mean the surcharges paid on small-value bookings heavily subsidise those paid on large-value bookings. Also, because all cardholders pay the same blended surcharge, people with less costly cards (such as the regulated schemes' standard cards) subsidise the costs of those with more costly corporate cards, unregulated scheme cards, and so on. In other words, less costly cards continue to help pay disproportionately for the 'free' benefits of those with loyalty programs. A Qantas spokesman says "Qantas offers consumers the choice of other methods of payment to avoid these fees. We believe our approach is straightforward, transparent and ensures consumers are always aware of what the additional cost will be. Where a customer chooses to pay using a card that attracts a fee, it is displayed or advised upfront at the time of payment and is disclosed in our advertising."

Rex is the only airline examined that applies percentage fees, which vary depending on the card. "Rex has applied the various surcharges in line with the merchant fee applicable, as we believe this is a fairer way, as opposed to lumping a standard surcharge into the fares," a spokesperson said.

We don't know what merchant fees Rex pays, but its surcharges far exceed the average merchant fees published by the RBA.

## Is there a genuine alternative?

"It drives me nuts that the car hire companies force you to pay by credit card and then charge you for it." – CHOICE member.

When a surcharge applies and is not included in the price of goods and services, customers must be given a way to avoid that fee. As the airline table above shows, the alternatives presented to online customers are not always practical.

For example, Qantas allows customers to avoid credit-card surcharges by using Debit MasterCard, or by making a BPAY bank transfer – but the latter has to happen at least seven days before flying. For the

| AIRLINE | SURCHARGE *(DOMESTIC SURCHARGES INCLUDING GST WHERE APPLICABLE)* | HOW IT IS APPLIED | ALTERNATIVE PAYMENT TO AVOID SURCHARGE |
|---|---|---|---|
| Jetstar | $3.50 (domestic)<br>$5 (international) | Per flight<br>Per passenger | Jetstar MasterCard<br>Jetstar Platinum MasterCard<br>Jetstar Voucher<br>Internet Banking (POLi)<br>Direct Payment<br>(14 days before flights) |
| Qantas | $7.70 (domestic and trans-Tasman)<br>$25 (international) | Per booking<br>Per passenger | BPAY 7 days before flights<br>MasterCard Debit |
| Virgin Blue | $3.50 (domestic)<br>$6 (international) | Per sector<br>Per passenger | Internet Banking (POLi) |
| Rex | 1.76% (Visa/MasterCard)<br>2.86% (Diners Club)<br>3.96% (American Express) | Per booking | Cash |
| Tiger | $7.20 (domestic) | Per sector<br>Per passenger | MasterCard Debit |

WHICH NEW PAYMENT METHODS DO CONSUMERS USE?

**QUESTION:** Which of the following payment methods have you used in the past 12 months?

*N = 1435, Source: CHOICE member survey, multiple responses were allowed.*

| | |
|---|---|
| Bpay | 92.1% |
| Pay anyone from your internet banking account | 73.4% |
| Paypal | 66.7% |
| POLi | 1.5% |
| Paymate | 0.7% |
| NETELLER | 2.2% |
| Moneybookers | 0.6% |

segment of customers flying within a week of their booking – presumably quite common, particularly for late 'specials' – this is not an option. Indeed, another intermediary website that specialises in these late bookings told CHOICE that 48% of its domestic flight bookings made through the website are for travel within seven days.

Rex allows customers to pay in cash at its airport counters to avoid surcharges, but it is not clear how internet customers could do this.

Virgin Blue customers can use an internet payments system called 'POLi' to avoid surcharges (see New payment systems, below). While it is encouraging to see new competition for payments enter this space, consumer awareness and use of the systems is often very low, and some survey respondents were critical:

- "There is some other system but it requires you to use a windows computer to make the transaction – doesn't work for a Mac."
- "There was another option, but it wasn't available on my computer."
- "Their POLI system doesn't link to my bank account, so I can't use it."

Jetstar provides a number of ways to avoid payment surcharges, but, again, they're not always practical. Direct payments (for example, bank transfers) must be made at least 14 days before flying, while the only credit cards without surcharges are the airline's branded Jetstar MasterCard and Platinum MasterCard.

## New payments systems

Innovation in the payments system is providing new ways to avoid surcharges and the use of credit cards, particularly for online payments. According to a 2008 report by the Australian Payments Clearing Association (APCA), the availability of a range of alternatives including recent entrants and product innovation from Paymate (2000), Paypal (2002) and POLi (2007) have contributed to "workable competition" in the online payments system.

2008 Nielsen research found a range of internet payment choices are available to consumers, but credit cards dominate. The research found that credit card had been used at some time by nearly all internet users for online purchases, and remain the preferred method for around 50%. Paypal, BPAY and direct deposits were the next most popular payment methods.

We asked online survey respondents whether they had used some of the newer internet payment systems in the last year. Use of established systems, such as BPAY and internet banking 'pay anyone' was high, and PayPal wasn't far behind. The use of other internet systems such as Paymate and POLi was low.

"We recently hired a car from Thrifty while on holidays. You are required to pay by credit card and are charged 1.5% for the 'privilege'. Apparently, the only exception to this requirement and charge is 'if you are billing back to a trading account'. I'm pretty sure I don't have one of those, nor probably access to one of those."

*- CHOICE survey respondent*

## Industry focus: Taxis

Long before the 2003 reforms, Cabcharge, the company that dominates the industry with payments systems in around 95% of taxis nationwide, charged 10%. The fee applied even before the advent of credit and bank cards and goes back to the time when paper-based payment methods, such as the 'blue dockets' similar to those you still see today, were the only option other than cash. Today, the 10% fee applies whether passengers use the company's own branded paper dockets and plastic cards, or credit cards and debit cards (including EFTPOS).

For Cabcharge, the average 'service-fee margin' on these transactions is staggering – on average, about 90%. For example, for every \$100 of fares paid for with a card, the surcharge is \$10. Of that, \$9 is Cabcharge's margin. The company prefers that the words "profit margin" are not used in this context and pointed out that average fares are about \$21 per trip. It outlined to CHOICE the significant costs Cabcharge faces after the service fee margin is earned, including commissions to taxi networks, costs in running the payments system, research, development and maintenance. The company's net profit after tax has steadily risen over the last decade and in 2009 financial year was \$61 million, providing a 21.6% total shareholder return, much higher than the rest of the ASX share market (7.2%, but it was a bad year for financial markets). Cabcharge is a diversified company, with revenues and profits derived from various sources and ventures, and not just the payments business.

The service fee margin is higher on some payment cards than others. When customers use Cabcharge-branded cards and dockets, there's no merchant service fee (MSF), so the margin is close to 100%. When third-party credit or debit cards are used, the margin depends on the MSF that has been negotiated behind the scenes. Several taxi and card industry sources confirmed that taxis' MSFs tend to be higher than the broader retail industry's fees, mainly due to the extremely high levels of card fraud originating in taxis. But the service fee more than covers the merchant fee. For example, Cabcharge's MSF might be 3% to 4% for an American Express card (so a 60%-70% service fee margin on such transactions), or just a few cents for an EFTPOS transaction (so closer to 100% margin, depending on the amount of the fare). On average, the service fee margin works out at 92% (and has been rising slightly according to the company's publicly available 2009 financial results).

We asked Cabcharge why this fee has remained unchanged for nearly 50 years, despite all the technological and other advances that have taken place in that time. Group General Manager John D'Arcy said the company doesn't know the origins of the 10% fee, but thinks it "probably originally came about because it is easier for passengers to calculate, rather than having to work out 7.72% of the fare, for example. For all we know, the actual costs back in history may have been greater than 10%, but 10% was chosen for ease of information and because it was easy for a passenger to calculate." D'Arcy also disputed that technological advances always lead to lower costs, stating that the introduction of chip cards and compliance have increased the company's costs.

A lack of competition among payment systems may explain how such fees survive. In September 2010, legal proceedings initiated by the Australian Competition and Consumer Commission (ACCC) resulted in declarations by the Federal Court that Cabcharge had misused its market power, contravening s46 of the Trade Practices Act 1974 on three occasions.

Two of the contraventions involved a refusal by Cabcharge to allow competitors to process Cabcharge-branded products, while the third related to meters and updates which were supplied below cost, for anti-competitive purposes.

The Federal Court ordered that Cabcharge pay a pecuniary penalty of $14 million for the contraventions, the highest penalty imposed in misuse of market power (section 46) proceedings brought by the ACCC.

While the ACCC action did not relate to the surcharging, more competition between payment systems used in taxis might help with lowering surcharges.

**Competition increases**

In recent years, Cabcharge's market share of the electronic payment systems in taxis has declined from 70% to around 50%. The financial market analyst, Veritas Securities Limited, stated in a December 2008 report that Cabcharge's monopoly was over. "CAB's historic dominance of its market has allowed it to charge a 10% service fee for transactions, a processing fee that is un-matched in the Australian retail landscape," the report stated. "CAB has a proven business model, a near monopoly position in the Australian electronic taxi payment market and generates above average returns, with ROE [return on equity] averaging 17.8% since FY00 [financial year ended June 2000]. We believe that CAB's near-monopoly position in taxi fare payment processing is unwinding rapidly, in line with improvements in payment technology."

While Cabcharge still sees its major competitor as cash, there are now five electronic payment systems competing in taxis. One is Live Payments, which competes not for passengers through lower surcharges, but for drivers by sharing a cut of the 10% fee. Cabcharge, on other hand, pays a quarter of the fee it receives to taxi networks (some of which it owns), as a commission. But it is up to the taxi network to decide whether to share any of this with drivers.

Another system launched in 2010 by the Australian Taxi Drivers Association, called Transport Australia Xpress, charges 8.49% for credit and debit card payments, and 5% for customers that open an account. The company's website states that other costs may apply "at times of peak demand and congestion." While the merchant service fees it pays are commercial-in-confidence, industry sources say typical taxi industry rates are in the range 2.5% for MasterCard/Visa credit cards, and 5% for American Express. So the new entrant can still make a healthy profit on these transactions while undercutting the dominant company in the market. It will also share about 20% of the surcharge revenue with drivers.

Live Payments says smaller merchants, such as taxi payment services, are unfairly criticised for their surcharges. It says their fixed costs, as a proportion of the money that goes through their terminals, is much higher than that of retail giants such as department stores and airlines. Cabcharge points out that unlike other surcharging industries, such as airlines, taxi fares are regulated and drivers do not have the option to include the costs of credit-card acceptance. It adds that the 10% fee helps to subsidise low sale-volume cabs in regional areas, in what is a low-turnover business.

But the level of the 10% surcharge is almost universally derided – by consumers, card schemes, banks, and so on. It will be interesting to monitor developments in competition and pricing resulting from the ACCC action.

# 3 Consumer understanding, reaction and action

Often consumers' intuitive reaction, when presented with new fees, is to object. In many cases, such a reaction is justified and effective – a backlash over what many saw as unfair and excessive bank penalty fees in the last five years, for example, resulted in major banks reducing or eliminating these fees. And a backlash against surcharges may mean consumers will choose cheaper forms of payment for them.

Reaction to the allowance of surcharging has at times been vehement, and, given the seemingly impenetrable workings of interchange fees and payments systems for most consumers, it's not surprising that a range of parties are blamed for the new fees. Below are some consumer comments CHOICE received:

We designed specific questions in our online consumer survey to find out more about what people know and feel about the surcharging regime, and to gauge public understanding and opinion.

## Is surcharging legal?

When asked whether they think it's legal for retailers and other businesses to charge consumers extra when they pay with a credit card, just over half of the respondents said "yes". 17% said "no", 23% didn't know and 8% didn't pick any of these options. Several commented that they believed surcharging was acceptable legally, but not morally or ethically.

Interestingly, the response was markedly different when survey participants were asked the same question about debit cards. Just 20% of the 1435 respondents believe surcharging for payment with a debit card is above the law, and 45% believe it is illegal. The truth is, debit card surcharging is permissible and has gone on for many years in taxis, for example, where EFTPOS, Debit MasterCard and Visa Debit attract 10% fees.

## Which party pays the highest fee?

Most respondents had a broad understanding of the direction of the flow of interchange fees for credit card transactions. 84% of respondents understand that, when a shop processes a credit card transaction, it pays a fee to its bank or card scheme, rather than the other way around. And 37.6% of respondents correctly identified the closest option we gave for the average merchant service fee that shops pay to process Visa transactions (1%). However, just 28.7% identified the average American Express merchant service fee, rounded to the nearest percentage point (2%), while 32.3% of respondents believed the fee to be 5%. Perhaps this is because consumers are much more likely to see surcharges for American Express transactions.

### CONSUMER COMMENTS

- "I am trying to understand how the RBA allowing credit-card surcharges is good for consumers? I cannot understand why this was allowed. Consumers should not be charged extra for a chosen payment method. It is something I would really like CHOICE to take up."
- "Merchant fees have only been passed on directly in my experience by my ex-telco and airlines. Still I will persevere in having this change reversed for what it is – a profit grab. I cannot believe the nonsense written by the Reserve Bank. Following letters to Treasury, Dept of Communications (after my ex Telco introduced the fee of 1%), it appears that the Reserve Bank sponsored the change. Why is the Reserve Bank involved with social engineering that favours big business?"
- "It's disappointing when a Government puts a surcharge on a bill."

## Are shop signs required?

54.5% of respondents believe that shops must disclose surcharges for credit card payments to consumers before the transaction goes through, with the form of this disclosure at the retailer's discretion. That's correct – the main requirement is that the fee is disclosed before the sale, and that consumers are not misled or deceived about the existence or amount of the surcharge. Just 3.9% of respondents believe that merchants are not required to disclose surcharges verbally or in writing, while 7.7% did not know what is required.

## Who profits from surcharges?

We were also interested in finding out if people know which party stands to gain most from surcharges – for example, the shop, the bank, card scheme, or someone else? From consumer comments received by CHOICE in previous work, it seemed some of the anger over surcharges was misdirected. And this is fuelled by the confusing information consumers receive from retailers. One of our payment diary participants, Adam, was charged 2% to use his credit card by a restaurant that blamed American Express for the fee. That might have been justified, perhaps, but, when Adam visited the restaurant the following week and offered his MasterCard for payment, this time the restaurant "blamed the federal government" for the 2% surcharge.

When presented with the example of a medium shop with a 5% surcharge for accepting Visa, 50.6% of responses indicated that the shop stood to gain the most from this fee. We are satisfied that this was the 'correct' response, given the average merchant service fee for Visa credit card transactions is under 1%, and the interchange fee is about 0.5%. 15.6% of respondents believed that the card issuing bank gained most from this fee, while 13.0% believed Visa was the main beneficiary.

We asked a similar question in relation to taxis surcharging 10%. Interestingly, 45.2% of respondents believe the taxi companies keep the biggest cut of the 10% of this fee, while the most correct answer – 'Cabcharge or another payment system in taxis' - was chosen by just 28.6%. However, the former response is understandable, given that Cabcharge owns many of the taxi networks, including the nation's largest (Combined Taxi Services), while holding close to a very dominant position in the taxi payments industry.

## Strong anti-surcharge sentiment

Most survey respondents disapprove of and dislike surcharges. 68.4% of respondents think that retailers and other businesses should not be allowed to charge customers extra when they pay with their credit card. When given an opportunity to add open-ended comments, the response was clear.

**WHO DO CONSUMERS THINK BENEFITS MOST FROM HIGH SHOP SURCHARGES?**

**QUESTION:** Imagine a medium-sized shop charges customers a 5% surcharge to accept a Visa credit card for payment. Who do you think keeps the biggest cut of this 5% fee?

*(n = 1435, Source CHOICE member survey)*

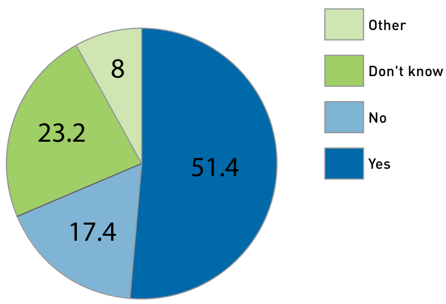
| | |
|---|---|
| The shop | 50.6% |
| The bank that issued the credit card | 15.6% |
| Visa | 13.0% |
| The shop's bank | 10.6% |
| Don't know | 9.3% |
| Other | 0.9% |

**CONSUMER COMMENTS**

- "It is wrong that surcharges need to be paid. When credit cards first emerged, it was stated that this would never be the case. However, convenience in using a credit card often outweighs paying by other means."
- "I just hate paying that extra 1 – 3% for nothing! Airlines are awful. There is always a credit- card fee for online booking, but you can't pay any other way to my knowledge, so they have you over a barrel. It's very unfair and inequitable to my mind. Shops and other services in my experience generally don't charge you any fee."

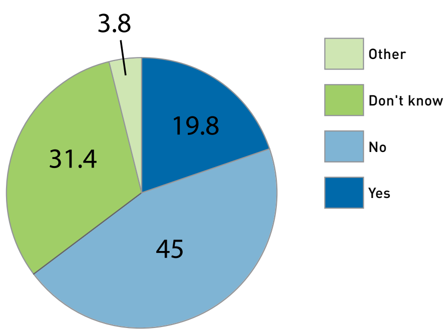
**Do you think it is legal when retailers and other businesses charge customers extra when they pay with credit cards?**

*(n = 1435, Source CHOICE member survey)*




**Do you think it is legal when retailers and other businesses charge customers extra when they pay with debit cards?**

*(n = 1435, Source CHOICE member survey)*



## What do consumers do about surcharges?

As intended, strong anti-surcharge feelings often lead to consumer action and changes in payment behaviour. When last asked to pay a credit-card surcharge, 35.8% of 1246 survey respondents who had been presented with a surcharge stated that they chose another payment method or cancelled their purchase (31.9% and 3.9% respectively). However, that leaves 64.3% of respondents who paid the surcharge.

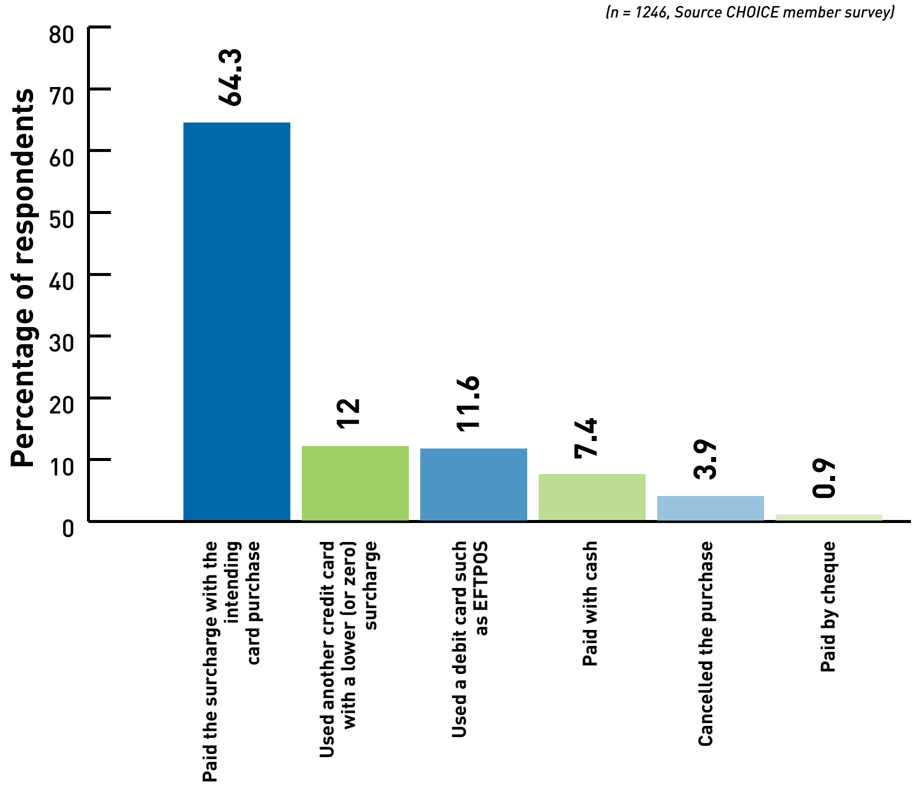
However, the fact that people often pay a surcharge when presented with one doesn't mean they feel positive about this experience. Many told us how they would consider not returning to the surcharging business again. "I don't pay surcharges as a matter of principle – they lose my business," said one survey participant.

## What would you do?

We also asked respondents what they would most likely do if presented with a 2% surcharge in a shop or restaurant. Just 13.8% indicated that they would pay the fee without adding a condition (e.g. "pay once but not return", dependent on amount), while 59.8% stated that they'd attempt to pay with a method that doesn't attract a surcharge. 1.8% indicated that they would cancel the transaction, with 20.7% responding that they would go to another merchant that doesn't apply the surcharge instead.

WHEN YOU WERE LAST ASKED TO PAY A SURCHARGE, WHAT DID YOU DO?

*(n = 1246, Source CHOICE member survey)*



## PAYMENT SYSTEM PRICE SIGNALS IN ACTION

In 2009 ATM 'direct charging' was introduced. This means, when customers use another's bank network's ATM, the fee they pay appears on the screen before the transaction is processed. Customers then have the option to decline the transaction if they don't want to pay the fee.

While initially some consumers objected to being asked to pay such fees, in reality we had already been paying these costs – they just weren't explicitly disclosed. Direct charging now sends a 'price signal' designed to influence behaviour; consumers are told the cost of using another bank's ATM at point of sale, and can decide whether to complete or terminate the transaction. Many customers are now deciding foreign ATM fees are not worth paying; in 2005, around 47% of ATM withdrawals were made at other banks' ATMs; by May 2010, the figure had dropped to about 37% (source RBA statistics, Table C4).

## CONSUMER COMMENTS

- "A lot of stores impose a surcharge for Amex, if so I use MasterCard instead".
- "Amex often attracts surcharges, which I refuse to pay, instead opting to use my Visa card, which rarely, if ever, attracts surcharges."
- "I normally refuse to pay a surcharge and use other means when I'm asked to do so."
- "I usually ask if there is a surcharge. I try not to use the card if there is a fee."
- "If a surcharge is involved, I make an alternative payment."
- "Amex-accepting shops sometimes ask for a surcharge, so I use Visa instead."
- "I did not return to the store. When given the choice (extra to pay by credit card), I have opted for use of the EFTPOS card."
- "I will go out of my way to avoid surcharge. Have only paid it by accident (missed the fine print). Have worked out that the rewards points I get are approximately equal to 1% surcharge on Visa and 2% surcharge on Amex."
- "American Express is the worst offender and so I often choose Visa over it."
- "These days, I generally ask if there is an extra charge for using credit cards. Our insurer GIO, and broker AFM Insurance brokers, charge for credit cards. Telstra started charging for the use of credit cards a couple of years ago. In these and similar cases, my general response is to use an alternative method of payment, direct deposit via internet banking, cheque or scheduled repayments from our savings account."

"I normally refuse to pay a surcharge and use other means when I'm asked to do so."

# 4 International developments

## A 'test case' for the world

Most countries have not moved to regulate credit card interchange fees, or to legislate against the schemes' 'no surcharging' and 'honour all cards' rules. However, such reforms are being considered in many other countries. In recent years, more than 50 lawsuits concerning interchange have been filed merchants against the card networks in the US, while in about 20 countries, public authorities have taken regulatory actions. Meanwhile, investigations related to interchange fees are happening in many more countries. The section Selected country analysis details some results.

## Criticisms of Australian reforms

It's no surprise that foreign regulators, industry and consumers are taking a keen interest in the impact of Australian regulatory changes. Government reviews in countries such as the US and Canada have recommended similar reforms, with variations.

During our research it also became evident that much of the third-party (non-government) commentary and research overseas, sometimes sponsored by the card or banking industry, is highly critical of the RBA's reforms. Again and again, we found references to Australian consumers having been harmed by the reforms, with criticisms that often contradict the conclusions of the 2006 House of Representatives review, and the 2008 RBA assessment of its own reforms. The criticisms invariably focus on:

- The absence of evidence that retail prices have reduced in Australia, despite a billion dollar cut in merchants' annual interchange costs. Note, such reports don't generally claim the prices are not lower than they would have been without the reforms, just that there's no evidence to prove it.
- Credit cards becoming more expensive or reward programs less attractive. Of course, such outcomes were among the aims of the reforms – to shift the cost of card use, interest-free periods and rewards programs to the people actually benefiting from these features (those with credit cards) rather than all consumers.
- Surcharges harming consumers. In relation to excessive surcharges, this is valid – we've described how some merchants appear to be surcharging in excess of the costs they're likely to face.

In many cases, it seems that what at times appears to be a campaign against the Australian reforms has worked overseas. It's quite rare to see reports or commentary that support the lowering of interchange fees, allow the introduction of surcharges or remove the honour-all-cards rule, even from some consumer groups. Of course, that the card schemes would put time and resources into this area should come as no surprise; it's estimated that a reduction of the interchange fee to 0.5% in the US alone would be worth $36 billion ($US) per year. "The card schemes are fighting these battles overseas, but they're increasingly losing," says one Australian payments system expert. "Since their demutualisation, the international card schemes' point of view [as stated in Australia] is understandably driven by their commercial objectives, which may be global in nature" says another expert, Chris Hamilton of the Australian Payments Clearing Association. It seems that what at times appears to be a campaign against the Australian reforms has worked overseas.

## Selected country analysis

**UNITED STATES**

**No surcharges** MasterCard and Visa are the two largest card networks in the United States, controlling 80% of the credit and debit card market. They do not allow for surcharges on any of their payment card transactions. These prohibitions are stated in the card networks' rules, similar to the situation in Australia before 2003. Merchants must abide by the rules in order to accept these network-branded cards.

Further, 10 US states have passed laws to prohibit surcharges on credit-card transactions: they are California, Colorado, Connecticut, Florida, Kansas, Maine, Massachusetts, New York, Oklahoma and Texas. In the last year, a number of states have introduced legislation or have pending legislation which would prohibit debit-card surcharges (including prepaid cards). The consumer advocacy group, Consumers Union, has either sponsored or supported this legislation in California and in New York.

**Interchange fees** Interchange fees for Visa and MasterCard range from 1% to 3.5%, and average 1.5% to 2% per transaction (compared with around 0.5% in Australia). This is estimated to yield about US $48 billion (around A$55 billion in July 2010) per year in interchange revenue. "Merchants pass along much of these fees in higher prices, which all consumers bear, regardless of how they pay for their purchases," says a 2010 report by Consumers for Competitive Choice, "a diverse national coalition of Americans who support a strong, vibrant and consumer-focused economy". The report, written by former US Under Secretary of Commerce Robert J Shapiro, and Jiwon Vellucci, says "much of this fee revenue goes to support rewards programmes that disproportionately benefit higher-income households." Its report states that for one retailer, Target, merchant service fees have become its second highest store-level cost, behind payroll.

"If the United States were to reduce the interchange rate from 2.0 percent to 0.5 percent, the savings would be (US) $36 billion per year, less some relatively small offsets," wrote consumer advocate Albert A Foer, in an April 2010 opinion piece for the New York Times. "All consumers pay more at the store and more at the pump because of unfair, non-negotiable non-transparent merchants interchange fees imposed by the card networks," said Ed Mierzwinski, Consumer Program Director at the US Public Interest Research Group. And a report by The Merchants Payments Coalition, a group of retailers "fighting for a more competitive and transparent card system that works better for consumers and merchants alike" and with member associations collectively representing 2.7 million stores with 50 million employees, claims that US consumers would have saved US $125 billion in four years if similar reforms to Australia had been introduced in the US (details at UnfairCreditCardFees.com).

Legislation to reduce interchange fees has been proposed by Richard Durbin, chair of the US Senate Subcommittee on Financial Services and General Government and author of an interchange amendment to a financial-overhaul bill. A June 2010 US Treasury report found that the federal government alone, in the credit card fees it pays through its agencies such as rail services (Amtrak), defence forces and postal services, could save $36 to $39 million annually if it was able to negotiate interchange fees with MasterCard and Visa.

Interestingly, MasterCard US Chief Executive, Robert Selander, reportedly

"A handful of large financial institutions and dominant credit card companies have long set these interchange fees by fiat, and then divided them among themselves. To maintain these fees at five times their transactional and operational costs, the card companies have had to insulate them from normal market pressures ... and so they have done, in arrangements which economists recognise as sharing many of the characteristics of a classic cartel."

*- Robert Shapiro and Jiwon Vellucci, Consumers for Competitive Choice (US)*

claims that consumers would be disadvantaged by such measures to reduce interchange fees, citing supposed consumer detriment in Australia. "Selander said consumers in Australia saw their annual fees and finance charges increase when regulators adopted rules to reduce interchange fees," according to a Fox Business report. "Moreover," he argued, "there is no evidence that merchants pass on their savings to consumers."

As explained, Selander's comments do not accord with the conclusions of an Australian independent House of Representatives review of the reforms.

**US debit card changes mirror Australia**

US Congress passed legislation in June directing the Fed to regulate fees and charges for debit cards. Robert Shapiro, former Under Secretary of Commerce in the US, told us "we modelled it largely on Australia."

## CANADA

In June 2009, a Standing Senate Committee on Banking, Trade and Commerce recommended significant changes as part of wider reforms to the credit-card and debit-card payments systems. Similar to the RBA's reforms, they would:

- Permit merchant surcharging (with no cap), and discounts;
- Require merchants to display surcharges at point of sale;
- Permit merchants to tell consumers about relatively lower cost payment options;
- Prohibit the card schemes' honour-all-cards rule.

Perhaps surprisingly, a paper published by the Consumers' Association of Canada opposed these reforms, citing supposed consumer harm in Australia. "The Australian experience has demonstrated that government-imposed price controls on those merchant fees end up harming consumers," CAC stated in a June 2009 report. It also sees surcharging as harmful. "Surcharging means higher prices for consumers. One clearly displayed price should apply regardless of payment. Our concern is that merchant surcharges will not be clearly explained to consumers and will far exceed the cost of card acceptance to the merchant. There are disturbing examples of this already happening in Canada."

The report also argues against the ability of merchants to decide which types of cards to accept – for example, refusing to process cards with excessive merchant fees. "When a consumer is told that a merchant accepts Visa, they want to know that their particular Visa card will be accepted by the store," the CAC report states. "Allowing merchants to accept some Visa credit cards but not others will create massive consumer confusion. This recommendation is unworkable and anti-consumer."

Nevertheless, the Canadian Senate recommends the changes outlined above. It is now up to the Canadian parliament to decide whether to enact these recommendations.

## NEW ZEALAND

As a result of August 2009 settlements reached with the card schemes and bank defendants, following legal action by the Commerce Commission, merchants can now surcharge for MasterCard and Visa credit card transactions. Previously, as in Australia, surcharging was prohibited through the various contractual arrangements between the schemes, banks and merchants.

Nevertheless, according to CHOICE's sister organisation in New Zealand, Consumer, surcharging is currently limited to a few industries and firms. Here are a few we found:

- Taxis routinely apply surcharges.
- A group of five independently-owned BP service stations in Wellington started surcharging in 2010, introducing $0.60 for purchases under $30 and $0.90 for every transaction over $30.
- The phone utility company, Telecom, charges the following 'convenience fees' for credit card payments, Visa

and MasterCard: 3%, American Express and Diners Club: 2%. Telecom claims it "does not receive any part of this additional fee".
- The police charge an extra 3% for people paying fines by credit card.
- A large car park operator charges customers a flat 50c fee for paying by credit card.

As in Australia, card schemes and banks are free to enter into agreements with merchants requiring their surcharges to bear a reasonable relationship to the cost of accepting the credit card. MasterCard's scheme rules now state that "surcharges must bear a reasonable relationship to the merchant's costs of accepting MasterCard products." But any such condition and its potential enforcement are contractual matters between the relevant schemes, banks and merchants, and not the responsibility of the regulator (the Commerce Commission).

**EUROPEAN UNION (EU)**
In the EU, there are two distinct levels of laws: European law and national law. Interchange and surcharging are two distinct issues and should be treated separately, as we describe below.

**Surcharging** Before the EU Payment Services Directive, which came into force in November 2009, rules on surcharging were set at member state level – some allowed it, most did not. The Directive's main provision on surcharging, Article 52, seeks to allow surcharging or discounting generally throughout the EU. Section 52(3) states "the payment service provider shall not prevent the payee from requesting from the payer a charge or from offering him a reduction for the use of a given payment instrument."

However, EU member states can opt out, as described in the second part of Section 52(3). "Member States may forbid or limit the right to request charges taking into account the need to encourage competition and promote the use of efficient payment instruments."

According to EuroCommerce, an organisation representing the retail, wholesale and international trade sectors in Europe, many member states have made use of this opt-out to forbid surcharging in various ways, to the disappointment of the European Commission. Some of the surcharging practices in various European countries are detailed below.

**Interchange fees** Action at EU level has been under Article 81 (now 101) of the Treaty on the functioning of the European Union (EU competition rules). Therefore any decisions apply directly to cross-border multilateral interchange fees only.

At member state level, some EU member states have taken separate action against multilateral interchange fees under their national version of Article 101. This action is generally taken by the competition authorities in member states.

In some other member states, 'deals' have been reached between retailers and banks. In France, there is a recent move towards regulation by legislation.

**EU level actions** The European Commission (EC) has taken several actions against the four-party schemes, mainly for alleged anti-competitive behaviour in how these fees are set. Some governments of member states have also taken action at a national level.

In 2007 the Commission stated that MasterCard's multilateral interchange fees (MIF) for cross-border payment card transactions in the European Economic Area violate competition rules because they increase the cost of transactions without passing on the benefits to consumers.
The Commission concluded that "MasterCard's MIF, a charge levied on each payment at a retail outlet when the payment is processed, inflated the cost of card acceptance by retailers without leading to proven efficiencies."

MasterCard disputed this claim but eventually agreed to drop the interchange fee to 0.3% for credit cards and 0.2% for debit cards. Both are cross-border weighted averages, and only apply to cross-border transactions, not to the interchange fees applying in the same country that the card was issued in. MasterCard still disputes the Commission 2007 decision: it is under appeal to the European Court. The settlement is provisional (on Commission costs of cash study and on results of appeal, of course).

In 2008 the Commission started formal competition proceedings against Visa Europe Limited in relation to its MIF for cross-border point of sale transactions within the European Economic Area, and the honour-all-cards rule as it applies to these transactions. The proceedings will seek to establish whether these practices constitute infringements of European legislation forbidding restrictive business practices such as price fixing.

Previously, in 2001 the European Commission had cleared Visa's honour-all-cards rule, and in 2002 exempted Visa's proposed MIF after the company offered substantial reforms – a progressive reduction of its average interchange fee from 1.1% to 0.7% until the end of 2007, and a cap on the MIF at the level of costs for specific services.

Visa has now offered partial commitments in response to the 2008 Commission action (the exemption provision from which Visa benefited in 2002 no longer exists).

## UNITED KINGDOM

Surcharging for any form of payment has been allowed since 1991. Discounting for cash and all other payment methods is also allowed.

According to the consumer group Which?, while most retailers don't surcharge, fees are common in certain sectors, namely train ticket booking, travel agents, airlines and concert/event ticket sellers. "Some retailers impose a set charge of, say, £4 per transaction, whilst others charge a percentage of, say, 3%," says Which? principal researcher, Martyn Saville. "Concert and event ticket sellers are probably the worst in this area, as they often charge a per-ticket surcharge, even where multiple tickets are being purchased in one transaction."

Similar to Australia, retailers don't have to include the credit or debit card charge in the advertised price of a service or product, as long as they offer at least one payment method that doesn't incur a surcharge.

2010 research by Edgar, Dunn & Company Management Consultants found that surcharging in UK has become prominent only in the last three to five years, and that:

- Almost a quarter of the 50 retailers contacted applied a surcharge for online card-not-present transactions, but almost none for over-the-counter (cardholder-present) transactions. Ikea was the only retailer from the sample applied an in-store surcharge, at £0.70 (around $1.23) for credit-card transactions.
- Online card surcharges are standard practice in the following industries: ticketing for cinemas, entertainment, sporting and theatre events; airlines; travel agents; and government.
- There is "some anecdotal evidence" that merchants that are not surcharging have increased their retail prices.
- There is concern about merchants surcharging in excess of their acceptance costs.

As in Australia, UK airlines have been the subject of criticism. The table below shows some UK airlines' surcharges, which at times are higher than in Australia. Budget carrier Ryanair has come in for particular criticism in the media, with a £5 per passenger per flight surcharge. "Even if you pay with Ryanair's own branded credit card, they still charge you the £5 fee!" says Martyn Saville of *Which?*

## DENMARK

Surcharging is allowed, but the government is one of the few to place a cap – according to the Danish consumer group's Tænk Penge (Think – Money) magazine, the fees are limited to a maximum of 3.75%.

TABLE: UK AIRLINE SURCHARGES

| AIRLINE | £ SURCHARGE PER RETURN TICKET | $A EQUIVALENT (1) |
|---|---|---|
| BA | 9.00 | 15.85 |
| BMI | 4.50 | 7.93 |
| Easy jet | 8.00 | 14.09 |
| Thomson Flights | 2.5% | 2.5% |
| Ryanair | 10.00 | 17.61 |
| Virgin Atlantic | 6.30 | 11.10 |

***Source:*** *Edgar, Dunn & Company Management Consultants, Potential Introduction of Surcharging in France – Impact Study, Summary of Findings, March 2010. (1) CHOICE calculation using the exchange rate A$1 = £0.5677, source RBA, 19 July 2010.*

**FRANCE**

Surcharging is currently prohibited by the card schemes. Credit card use is not widespread in France.

In 2010, the French banking Federation (Fédération Bancaire Française, FBF) asked Edgar, Dunn & Company (EDC) to conduct an independent impact study about the potential introduction of surcharging in France. This study took place between January and March 2010. The report states "The observations and conclusions in this document are entirely those of EDC and are not intended in any way or form to reflect the views or perspectives of the FBF." After interviews with the finance industry, retailers and seven consumer representative groups, it found that:

- Consumers in France are "strongly against surcharging", the rationale being the "negative impact for consumers because of likely retail price increase or at least an increase in retail price complexity."
- Consumer groups expressed "strong concern about surcharging making consumers more "captive" (i.e. harder to compare retail prices across merchants). There was also strong concern that there might be potential abuse in sectors where merchants have high bargaining power; for instance, where the merchant has a very high market share or a "temporary" monopoly (e.g. taxis).
- Concern that large retailers will benefit from surcharging but not small local retailers (one consumer association believes that surcharging will have a major negative impact on these small local retailers).
- There was consensus that surcharges should be capped to avoid merchant abuse. There was no consensus about how to set this maximum limit.

**GERMANY**

Retailers and other merchants usually accept credit and debit cards without surcharges. However, according to the consumer group, Stiftung Warentest, surcharges are common for online air travel bookings, and, to a lesser extent, in the taxi industry. "Airlines charge between €4 and €10, says Stiftung Warentest. "Berlin taxi drivers charge €0.50, but they want to be allowed to charge €2".

**THE NETHERLANDS**

Since 1994, the schemes' no-surcharge rule has been prohibited, so merchants and retailers are permitted to add a surcharge when accepting payment cards. According to Consumentenbond, a consumer group with 500,000 members, the practice for over-the-counter payments is very rare, but more likely to happen online, particularly with credit cards.

"The Dutch don't like to pay for paying," Consumentenbond Financial Services advisor Ben Schellekens says. "Surcharging for small amounts paid with debit card was quite common up until two years ago. Retailers and banks launched a campaign, klein bedrag pinnen mag, which translates 'Small amount, debit card payment allowed free of charge'. When a retailer or merchant already accepts debit cards, additional payments with debit card cost less than cash payments."

It's worth noting that the use of payments systems in the Netherlands has marked differences to that of Australia. Consumentenbond says the Netherlands payments system is Europe's second cheapest, after Bulgaria. 38% of over-the-counter payments are made with a debit card, while credit-card payments account for just 1%. Cash accounted for 61% of over-the-counter payments in 2009. Electronic (internet) banking is widely used; cheques are regarded as obsolete.

**BELGIUM**

"Despite the fact that our regulation has not limited or banned surcharging, consumers are not really faced with this problem," Test-Achats, the Belgian consumer group, told us. "There are just a limited number of retailers who surcharge (a very small amount: generally five or 10 cents) for small payments (generally less than €10) made by debit card".

Test-Achats considers that the price paid by the consumer to purchase a good or a service must be the same and should not vary depending on the mean of payment used. "This principle ensures transparency and allows the consumer to compare prices knowingly."

The EU's Payment Services Directive provides that Member States can decide to forbid or to limit the right to surcharge taking into account the need to encourage competition and promote the use of efficient payment instruments. In Belgium, the national regulator has not transposed this option, but Test-Achats foresees a possibility to use this option in the future by means of a Royal Decree.

# 5 What consumers can do

As has been shown, the experience of surcharging in Australia is widespread, with 88% of online survey respondents paying a surcharge in the previous year and 22% doing so more than 10 times. However, despite payments systems reforms impacting daily on the lives of millions of consumers, there is often confusion about the rationale for surcharges and the complex way in which they operate.

Of all parties involved in a credit-card transaction, it is the consumer who is most likely to be disempowered by a lack of information. Inadequate awareness of options for dealing with surcharges, and of avenues of redress when it is felt that the charging has been unfair, may contribute to the feelings of distrust, dissatisfaction and entrapment frequently expressed by consumers. As recorded above, such sentiments came through clearly in our survey results, with 68% of participants believing that retailers and other businesses should not be allowed to charge customers extra when they pay with their credit card.

Payments system reforms are intended to empower both retailers and consumers to choose cheaper forms of payment. To lower transaction fees, help retailers reduce their costs, and support the uptake of efficient and innovative payment systems consumers can:

- **Ask how to avoid surcharges:** When retailers and other merchants state a price, if there is a surcharge it must be included in the price, unless there is a way to avoid it. If that doesn't happen, make an official complaint to the Australian Competition & Consumer Commission (ACCC) and the Australian Securities and Investments Commission (ASIC). Alternative payment methods without surcharges might include a debit card, cash, or another newer online payment method. However, some companies make consumers jump through hoops to avoid the surcharge – for example, a bank transfer a week in advance of flights, or a fairly obscure internet payment system.

- **Compare surcharges:** Many merchants charge different amounts for different payment cards. When surcharges are cost-based, one would expect debit cards to have zero or very low surcharges, and MasterCard and Visa credit cards to be cheaper than those of American Express and Diners Club.

- **Report non-disclosure:** Businesses that surcharge must ensure that consumers know a fee will apply, and the amount of that fee, before the transaction occurs. If this doesn't happen, it could be misleading or deceptive conduct and a breach of the requirement to disclose the full price including non-optional surcharges. Consumers can make a complaint to ASIC.

- **Help retailers to reduce their costs:** Despite being allowed to surcharge, many retailers don't, because they fear the potential customer backlash and loss of sales. Even when consumers are not presented with a surcharge, by choosing the most efficient payment method they'll not only help retailers keep their overheads down, but they (and all consumers) will save money in the long-run, due to less inflationary pressure.

- **Use EFTPOS and other debit cards:** There's often no surcharge, and the interchange and merchant fees are lower than those of credit cards.

- **Question the value of rewards cards:** In 2008 CRA International claimed that, as a result of the reforms cardholders in Australia were paying around $480 million more in additional fees for credit cards each year (its calculations were based on 2006 data). In 2007, the Australian Bankers' Association estimated the annual figure at an additional $1 billion, reflecting "increases in fees and charges and a dilution in the value of credit card loyalty points". We don't know who is correct, but we do know that loyalty and rewards programs are worth less now than in the past, because there's less interchange revenue in the system to subsidise their costs. The real value of rewards is often illusory anyway – if you ever pay interest on your credit card that will probably cancel out the benefit of any rewards consumers later receive. And, if cardholders are now paying retailer surcharges to use their rewards card for goods and services, they should try to work out if they're benefitting at all.

- **Find a better-value credit card:** Credit card fees may have increased overall, but that doesn't mean consumers have to stick with a poor value card. Many are available with up to 55 interest-free days and no annual fee.

- **Pay lower bank fees:** As a result of Woolworths' decision to process EFTPOS but not MasterCard and Visa Debit cards, attention turned to the fees that banks and credit unions charge customers for EFTPOS transactions. Some charge anything from $1 to $2.50, when their processing cost for EFTPOS purchases is just 4-5 cents. Of course, the rip-off here lies in the bank or credit union's court, and not with Woolworths. Again, consumers don't have to put up with paying high EFTPOS fees to their financial institutions. 2010 CHOICE Best Buy low-fee bank accounts from NAB (Classic Banking) and ING Direct (Orange Everyday) have no fees for an unlimited number of EFTPOS transactions, and no fees for most other everyday transactions.