



RESERVE BANK OF AUSTRALIA

PAYMENT SYSTEMS (REGULATION) ACT 1998

EXPLANATORY STATEMENT

STANDARD NO. 3 OF 2016: SCHEME RULES RELATING TO MERCHANT PRICING FOR CREDIT, DEBIT AND PREPAID CARD TRANSACTIONS

The Reserve Bank of Australia (the Bank) has determined *Standard No. 3 of 2016: Scheme Rules Relating to Merchant Pricing for Credit, Debit and Prepaid Card Transactions* applying to designated card payment systems in Australia. The Standard replaces each of Standard No. 2 *Merchant Pricing for Credit Card Purchases* which applied to the MasterCard System and the VISA System; and clauses 9 and 10 and sub-clauses 12 (i), (ii) and (iii) of *The Honour All Cards Rule in the Visa Debit and Visa Credit Card Systems and the No Surcharge Rule in the Visa Debit System* Standard.

The standard applies to:

- the American Express Companion Card system
- the EFTPOS Debit and Prepaid card systems
- the MasterCard Credit, Debit and Prepaid card systems
- the Visa Credit, Debit and Prepaid card systems.

Background

In the early 2000s, the Bank began implementing a series of reforms to card payments regulation. These reforms included measures that changed the relative prices cardholders faced when using debit and credit cards, reducing the incentives to use higher-cost payment methods. The Bank's reforms also required changes to certain restrictive rules in card systems, including to allow merchants to apply surcharges on card transactions so that cardholders were more likely to face prices that reflected the cost of the card they were using.

The Bank's payments system policy is determined by its Payments System Board (the Board). In 2007–08, the Board conducted a review of the Bank's reforms. The review concluded that the reforms had improved access, increased transparency and had led to more appropriate price signals to consumers. This review also explored a number of options for possible changes to the regulatory framework, including stepping back from formal regulation and relying on industry undertakings. However, the industry was unable to arrive at suitable undertakings, so in August 2009 the Board decided against stepping back from interchange regulation and noted that the regulatory framework would remain under review. In 2012, the Bank modified its standards relating to surcharging with changes that became effective in 2013; allowing the card schemes to use their rules to limit surcharges to the reasonable cost of acceptance. There was, however, limited effective enforcement of these rules.

The first major review of the financial system since the 1997 Wallis Inquiry was announced by the Government in 2013. The Final Report of the Financial System Inquiry (FSI), released in December 2014, endorsed the reforms undertaken by the Board since it was established. It also recommended that the Bank further consider elements of card payments regulation, particularly in relation to interchange fees and surcharging. The Bank had also raised concerns about aspects of the interchange fee system and merchant surcharging practices in its submission to the FSI, including a decline in transparency for some end users, perceptions of excessive surcharging in some industries, and questions around whether existing regulation was fully competitively neutral.

The Bank's Review of Card Payments Regulation commenced in March 2015 with the publication of an Issues Paper that sought the views of stakeholders and interested parties on the regulatory framework,

including on issues that the Bank had raised in its March 2014 submission to the FSI and on issues that the FSI had identified in its Interim and Final Reports.

These issues identified by the Bank included a number of issues related to the level and transparency of interchange fees, along with a concern that card surcharges may be excessive in some cases.

The Bank's reforms that took effect in 2003 required schemes to remove no-surcharge rules and rules that prevented merchants from steering consumers to lower-cost payment methods. The ability of merchants to levy surcharges on different types of payment instruments is an important mechanism for promoting the efficient allocation of resources in the payments system. It allows merchants to signal the costs of different payment choices and to pass on these costs to users, aligning end users' private costs more closely to social costs and thereby contributing to a more efficient payments system. The outcome is that merchants are able to set prices for goods and services lower than would be the case if surcharging was prohibited, and the extent to which users of lower-cost payment methods subsidise users of higher-cost methods is reduced. The ability to surcharge also potentially improves merchants' bargaining position in relation payment methods, which can help keep downward pressure on merchant service fees and interchange fees.

The ability to surcharge has been a valuable reform, but practices have emerged in some industries where surcharge levels on some transactions appear to be well in excess of merchants' likely acceptance costs. The Bank's 2012 changes that took effect from March 2013 sought to address these cases by enabling schemes to limit surcharges to the reasonable cost of acceptance. However, there is wide agreement that the enforcement of this framework has been ineffective. This was highlighted during the recent FSI, which received over 5 000 submissions on the topic as part of a public campaign. The FSI Final Report cited the complexity of calculating merchants' reasonable cost of acceptance and the associated lack of transparency as factors that have contributed to the limited enforcement of the current regime by schemes and acquirers.

The Bank's March 2015 Issues Paper discussed the issue of excessive surcharging and invited stakeholder views on how to deal with the issue, including on the feasibility of a three-tiered model suggested in the FSI Report. In October 2015, the Government released its response to the FSI, indicating that it would phase in a legislated ban on excessive surcharges, with enforcement to be undertaken by the Australian Competition and Consumer Commission (ACCC). It also indicated its expectations that the Board – through this Review – would provide clarity around what constitutes excessive customer surcharging on card payments. Amendments to the Competition and Consumer Act 2010 were passed by Parliament on 22 February to give the ACCC enforcement power over surcharges which are above the 'permitted surcharge' defined in a Reserve Bank standard or in a regulation. Accordingly, the implementation of the new legislation, as it relates to card payments, depends on the Bank adopting an amended standard that addresses this definition.

Purpose and Effect

The objective of the Standard is to promote efficiency and competition in the Australian payments system by providing for scheme rules that require participants to give merchants the freedom to make a charge for accepting payment of a particular kind that reflects the cost to the merchant of accepting that payment type.

This standard applies to the MasterCard and Visa credit card systems, the American Express companion card system and the eftpos, MasterCard and Visa debit card and prepaid card systems. Each will be treated as a separate scheme for surcharging purposes, except that debit and prepaid cards will be treated as a 'scheme pair', subject to a single surcharge. The standard prevents the card schemes from imposing no surcharge rules, but allows them to cap merchant surcharges at the 'permitted surcharge', which is defined in terms of a merchant's cost of acceptance for a particular scheme. The permitted surcharge is also used to determine excessive surcharges under the Competition and Consumer Act.

The 'cost of acceptance' embodied in the 'permitted surcharge' is narrower than the 'reasonable cost of acceptance' measure used in the previous standard (and the associated guidance note). It includes fees paid to the merchant's acquirer or payment facilitator plus fees paid to any other payment services provider for (i) fraud-related chargeback fees paid to the merchant's acquirer or payment facilitator; fees

paid to any other payment services provider for (ii) terminal rental and servicing, (iii) gateway services and (iv) fraud prevention services; as well as (v) any cost of insurance for forward delivery risk on accepting cards. Costs internal to the merchant are not included.

The permitted surcharge for an individual merchant will be based on an average of its costs over a recent 12-month period as evidenced by contracts, statements or invoices (or, if these are not available for a 12-month period, good faith estimates can be used). A merchant can surcharge each card scheme separately or, if it chooses to apply the same surcharge to more than one scheme, the permitted surcharge must reflect only the cost of the lowest cost scheme. Surcharges must be percentage-based or, if expressed as a fixed amount, must not be excessive for any relevant transaction amount.

In order to facilitate greater transparency of permitted surcharges, acquirers (and payment facilitators) will be required to provide to merchants in their regular statements details of the average cost to the merchant of accepting each scheme or scheme pair, along with some component data. The final statement for a financial year must provide the average cost for each scheme over the preceding year. A merchant wishing to rely on a simple statement of acceptance costs will be able to rely on this statement for around a year after it is issued. A merchant wishing to include additional eligible costs would need to be able to provide invoices, contracts or statements to verify them.

Given that many smaller merchants are likely to be reliant on simple acquirer statements to determine acceptance costs, the 'permitted surcharge' measure will not apply to merchants below the size threshold described below until 1 September 2017, after the new statements have become available. Until that time, card schemes may use their rules to limit surcharges for smaller merchants to the existing 'reasonable cost of acceptance' measure. The permitted surcharge measure will apply to large merchants from 1 September 2016. The threshold for determining whether a merchant is a large merchant will reflect a combination of consolidated gross turnover (above \$25 m), consolidated gross assets (above \$12.5 m) and employees (above 50).

Other measures in the Standard include an obligation for acquirers to notify merchants as soon as practicable of the provisions of the new Standard; an obligation for debit cards and prepaid cards to be physically identifiable as such (from 1 July 2017 in the case of prepaid cards); and for schemes and acquirers to make available Bank Identification Number (BIN) lists that will allow credit, debit and prepaid cards to be electronically identifiable. Card schemes' rules will be prevented from making the availability of acquiring services conditional on the merchant's decision to surcharge.

Consultation

The Bank consulted extensively about the reform of payment cards regulation. In March 2015 the Bank published the *Review of Cards Payments Regulation: Issues Paper* identifying the policy problems. Following this, the Bank received more than 40 submissions from financial institutions, merchants, card schemes, consumer groups and individuals. Around 30 parties took up the invitation to have discussions with the Bank, with some major stakeholders having follow-up meetings. The Bank also convened a 'payments roundtable' in June 2015, moderated by the Deputy Chair of the Payments System Board. Thirty-three organisations were represented at the Roundtable, including schemes, card issuers and acquirers, merchants, government and regulatory agencies, and ministerial staff. In December 2015, the Bank published the *Review of Cards Payments Regulation: Consultation Paper* which included options for reform and draft standards for cards regulation. The Bank received substantive submissions to the Consultation Paper from over 40 stakeholders, with a number of parties providing both a public submission and additional confidential information. Following the Consultation Paper, Bank staff held around 50 meetings with interested parties to discuss their submissions.

Documents

Reserve Bank of Australia (2015) [Review of Card Payments Regulation – Issues Paper](#), March

Reserve Bank of Australia (2015) [Review of Card Payments Regulation – Consultation Paper](#), December

Reserve Bank of Australia (2016) [Review of Card Payments Regulation – Conclusions Paper](#), May

A Regulation Impact Statement was prepared and submitted to the Office of Best Practice Regulation (ref 19235) and assessed as best practice.

Reserve Bank of Australia
26 May 2016