

Black Economy Report - Least-Cost Routing

Credit Card Fees and Least-Cost Routing

Strangely, the Black Economy Report provides **6+ pages** of detailed information about credit card fees and 'least cost routing'.

I believe this may be directly related to the New Payment Platform. This group of banks, in connection with the RBA are using peer to peer technology to offer seamless low cost transaction fees. The Black Economy Final Report suggests that "... In particular, where debit cards allow for the authorisation of the transaction to occur via two different networks, merchants should be given the ability to send the transaction **via the lower-cost network.**" (Which I assume is provided by the banks in the NPP!) I assume to compete with Visa and MasterCard, and any other banks not part of the NPP.

Some of the information from this section of the Black Economy Report **is directly copy and pasted from the RBA's website:**

<https://www.rba.gov.au/payments-and-infrastructure/debit-cards/least-cost-routing.html>

Direct quotes from the Black Economy Final Report:

- In its next review of card payments regulation, RBA should consider whether there are further actions it could take to put downward pressure on interchange fees that would be in the public interest.... An interchange fee is a fee charged by the financial institution on one side of a payment transaction to the financial institution on the other side of the transaction
- The RBA has made a number of interventions into the card payments market
- The rise of electronic payment methods and **peer-to-peer payment options** has meant individuals and businesses have more choice in how they choose to transact. Increased moves to non-cash payment should not be undermined by **inappropriate or inefficient fees** in the electronic payment environment.
- These fees should be explicit, and should not be **used to cross-subsidise benefits or incentives aimed at encouraging use of one system over another.** This kind of pricing structure hides from consumers the true costs of a particular payment type and **may lead to the overuse of particular payment methods;** this **introduces inefficiency** into the payments system. (For the NPP to compete with credit cards offering incentives to consumers to use them?? Also this is anti-competitive!!)
- In particular, where debit cards allow for the authorisation of the transaction to occur via two different networks, **merchants should be given the ability to send the transaction via the lower-cost network.**
- The RBA should also seek to ensure that **effective price competition among**

payment networks is maintained for dual-network debit card usage **in the context of mobile wallet technology.**

- Where debit cards provide access to a customer's transaction account via two different networks, banks providing card acquiring services to merchants enable merchants to **ensure that their contactless transactions use the lower-cost network.** Cardholders retain the ability to send the transaction via their own preferred network by dipping the card and pressing the relevant terminal button.
- However, with the introduction of contactless cards, **the cardholder and merchant no longer influence the routing of the transaction** — it is **determined by the network priority that is pre-set by the card issuing bank** when it sends the card out. Initially, the international schemes were the only networks with contactless functionality, so a contactless debit transaction could only go via their networks. However, eftpos has now rolled out contactless functionality on almost all debitcards and **almost all terminals are now enabled for eftpos contactless transactions.** However, **banks have not yet begun to offer least-cost transaction routing** to their merchant customers. As a result, some merchants express a reluctance to move away from cash to greater use of card payments.
- Consumers need to be better informed about the real costs of the different cards available when they are choosing what product is right for them. Often the cards **which provide the most 'bells and whistles' in terms non-cash benefits** are ultimately more expensive to the consumer over the longer-term. Consumers should be encouraged to choose lower cost cards. (Which I assume is the NPP...)

This is weirdly detailed information in the Report:

The Taskforce recognises that there are sometimes small differences in the cardholder experience or terms and conditions depending on whether transactions are routed via the eftpos network or the Master Card or Visa networks. **If so, it would seem appropriate that the merchant should disclose it is using least-cost routing** and that consumers should be able to **'override' a merchant's network preference.** Accordingly, where a merchant chooses to exercise least-cost routing for contactless transactions on dual-network cards it **may be appropriate for them to display a sign along the following lines:**

'At [Merchant Name] we care about holding down our costs so that we can hold down prices for our customers. Accordingly, we prefer to send contactless debit card transactions to customers' banks via Network X as opposed to Network Y or Z. If customers prefer that their debit transactions are instead sent via another network, they can insert/dip their cards and push the button or keypad for their preferred network.'

We consider that such a framework would be a **reasonable balance between the rights**

of merchants and consumers, and that consumers would quickly become used to the concept that their transactions could be sent via different networks at different merchants.

No regulation if someone is already providing least-cost routing (I wonder who that is...)

We understand that some banks argue that it would be costly or take time for them to provide least-cost routing to merchants. **However, the RBA has indicated that a number of acquirers are currently considering providing this functionality to merchants.** (This would be the NPP!) While it is recommended that the RBA commence a regulatory consultation process, **in the event that least-cost routing was being brought to market** and provided a realistic and competitive alternative to more established acquirers, **there might be a case for the RBA to hold off from implementing a regulation, not least because such a regulation could have the effect of removing a point of competitive differentiation for any acquirers** that are planning on implementing least-cost routing without being required to do so.

(So no regulation required because NPP is providing least-cost routing to market already!!)

They want to use the RBA to stop other banks competing with them

We understand that there may be **opposition to the provision of least-cost routing** from **two other groups of stakeholders**. First, banks that are card issuers **may prefer the status quo** where contactless transactions **default to either Visa or MasterCard and the banks earn higher interchange revenues**. Second, the international schemes could potentially lose a significant share of their debit transactions. Ideally, they might respond by competing to be lower-cost schemes by reducing interchange or scheme fees.

However, they could also seek to respond in ways that might be anti-competitive.

Given this **potential opposition to least-cost routing** from these two groups, we recommend that the RBA, ACCC and Government **monitor, and respond to, any anti-competitive behaviour in this regard**.

The ACCC has the power to investigate and take action in relation to **anti-competitive or cartel conduct** that contravenes the *Competition and Consumer Act 2010* (Commonwealth). (Will the ACCC be investigating the RBA and the NPP??)

Black Economy Taskforce Final Report

Source

P61 In its next review of card payments regulation, RBA should consider whether there are further actions it could take to put downward pressure on interchange fees that would be in the public interest. This consideration should take account of the effect of its recent decision on fee benchmarks, along with the lower regulatory caps for consumer cards applied in the EU and other jurisdictions. The option of moving away from weighted-benchmark averages to hard interchange fee caps for credit and debit cards should

also be explored. The benefits of lower merchant service fees for small businesses and of encouraging a further move towards non-cash payment methods should also be taken into account.

P61 An interchange fee is a fee charged by the financial institution on one side of a payment transaction to the financial institution on the other side of the transaction. They are most commonly seen in card transactions, although can arise in other payment methods.¹⁴ In card transactions, interchange fees are typically paid by the merchant's financial institution to the cardholder's financial institution. **These fees are set by card schemes (such as EFTPOS, MasterCard and Visa), subject to regulatory benchmarks established by the RBA.**

P61 A consumer makes an in-store purchase using their debit card. The transaction is sent via the card scheme to the cardholder's financial institution which will provide authorisation for the transaction, and the merchant will provide the goods or services purchased. The merchant's financial institution will subsequently make payment into the merchant's account, and the cardholder's financial institution will debit the cardholder's account. The merchant's financial institution pays a fee to the cardholder's financial institution — **this is the interchange fee**. This is determined by the card scheme and factored into the net settlement of obligations between financial institutions. Because the interchange fee is paid by the merchant's financial institution, it effectively sets a floor under the 'merchant service fee' that is charged to the merchant.

P61 **The RBA has made a number of interventions into the card payments market, including initial reforms to interchange fee arrangements that approximately halved the level of credit card interchange rates and subsequent reforms to debit card interchange arrangements.** The RBA should continue to monitor the impact of the recent changes to the interchange benchmarks.

We observe that there are a number of debit card systems in the world where interchange fees are set at zero.

P62 To ensure that interchange fees remain low and efficient **as the payments system continues to mature.**

P62 The RBA has noted that interchange fees can be appropriate in some circumstances, particularly in the establishment of new systems where they may be necessary to rebalance costs and ensure that both sides of the market have an incentive to participate.

P62 The payments system is continually evolving. The rise of **electronic payment methods and peer-to-peer payment options** has meant individuals and businesses **have more choice in how they choose to transact. Increased moves to non-cash payment should not be undermined by inappropriate or inefficient fees in the electronic**

payment environment. While it is justifiable for providers to recover the costs of developing and operating these systems, these fees should be explicit, and **should not be used to cross-subsidise benefits or incentives aimed at encouraging use of one system over another.** This kind of pricing structure hides from consumers the true costs of a particular payment type and **may lead to the overuse of particular payment methods; this introduces inefficiency into the payments system.**

In considering the case for further changes to the regulatory regime, the RBA should consider overseas experience, **particularly the EU.**

P62 In the EU, hard interchange caps apply to both credit and debit transactions, for all consumer cards. The credit card caps are lower than those in Australia. For credit cards, the weighted-average interchange fee cap in Australia is 0.50 per cent and the maximum interchange fee is 0.80 per cent. By comparison, the EU maximum is 0.30 per cent (in practice all consumer card fees have tended to be set at this rate). However in the EU commercial cards are excluded from regulation, and interchange rates on these can be much higher (for example 1.88 per cent in Germany).

P63 The RBA's Payments System Board should consider regulating to ensure downward pressure on the cost of debit card payments. In particular, where debit cards allow for the authorisation of the transaction to occur via two different networks, **merchants should be given the ability to send the transaction via the lower-cost network.**

By reducing the cost of card payments, **there will be an additional impetus for businesses to accept cards and move away from cash.** It will also contribute to holding down business costs, which can lead to lower prices of goods and services for consumers.

The RBA should also seek to ensure **that effective price competition among payment networks is maintained for dual-network debit card usage in the context of mobile wallet technology.**

P63 Fostering greater use of non-cash payments, including the use of debit and credit cards, **requires that these payments are relatively inexpensive for merchants** (or for consumers where merchants choose to pass on the cost of some payment methods by surcharging).

The RBA's Payments System Board is the primary regulator of the payments system and has undertaken various regulatory measures over the past 15 years which have had the effect of bringing down the cost of card payments relative both to many other countries and to the levels that existed in Australia prior to the reforms. However, regulators in some other countries have taken steps in this area recently which go further than the RBA's measures. In addition, some recent developments in the Australian marketplace have had

the effect of driving up payment costs to merchants, despite the strong growth in card transactions.

P63 Following consultation with stakeholders, we recommend that the RBA consider introducing regulatory measures to ensure that:

Where debit cards provide access to a customer's transaction account via two different networks, **banks providing card acquiring services to merchants enable merchants to ensure that their contactless transactions use the lower-cost network.**

Cardholders retain the ability to send the **transaction via their own preferred network by dipping the card and pressing the relevant terminal button.**

- Card-issuing banks and card schemes do not take any steps to prevent or discourage acquiring banks or merchants **from implementing such network choice.**

The RBA should consult with stakeholders on such measures and in its consideration of the public interest should take account of the Government's aim of reducing the size of the black economy.

P65 Ensure card acceptance services provided by banks better meet the needs of businesses.

For businesses to reduce the costs associated with accepting cards and increase the incentives for businesses to take cards as opposed to cash.

Introduce greater competitive pressure on merchant payment costs.

Contribute to downward pressure on the cost of goods and services bought by consumers.

P65 Problem this recommendation seeks to address¹⁵

Merchants frequently express a desire to move to greater use of electronic payments, including cards. However, electronic payments are sometimes quite expensive. Different types of cards have different costs for merchants, with debit cards usually having lower merchant service fees than credit cards. **In addition, debit transactions that are processed through the domestic eftpos system are on average less expensive than transactions processed through the international MasterCard**

P66 The majority of debit cards in Australia are **dual-network debit cards, which allow contact transactions to go via the eftpos network (if the cardholder pushes CHQ or SAV) or the international network (if they push CR);** the different networks can

largely be thought of as different sets of pipes for the authorisation messages from the merchant's bank to the cardholder's bank and back again. However, with the introduction of **contactless cards**, the cardholder and merchant **no longer influence the routing of the transaction** – it is determined by the network priority that is pre-set by the card issuing bank when it sends the card out. Initially, the international schemes were the only networks with contactless functionality, so a contactless debit transaction could only go via their networks. However, eftpos has now rolled out contactless functionality on almost all debit cards and almost all terminals are now enabled for eftpos contactless transactions.

P66 However, **banks have not yet begun to offer least-cost transaction routing to their merchant customers**. As a result, some merchants express a reluctance to move away from cash to greater use of card payments.

P66 Some merchants have indicated that their existing banks (the merchant's bank is called the 'acquirer') **have indicated that they are unable or unwilling to provide least-cost routing**. In some cases merchants attribute this unwillingness to the fact that most acquirers are also card issuers and may be looking to protect the **higher interchange revenues that they earn from transactions that are routed via the international schemes as opposed to eftpos**. In other cases merchants attribute the unwillingness of banks to policies of the international schemes to discourage least-cost routing. Accordingly, **merchants have expressed a desire for regulatory intervention to ensure the provision of least-cost routing, which would help hold down the cost of non-cash payments**.

P66 Our recommendations should result in a **continuation of the shift that is occurring from cash to non-cash payments. The banking sector will be a primary beneficiary of this shift**. We consider that it is reasonable to expect that as the volume of card payments rises, there is scope for reductions in the average cost of payments. At the same time there is a need to better educate consumers about the real cost of card and other non-cash alternatives.

P66 *'It's really unfair that consumer spending patterns have changed but the banks are not adapting with those changes. It's just another hit that a small business takes.'* Member of Restaurant & Catering Australia, as reported in their submission

P67 We note that other jurisdictions (the EU, Malaysia and the US) have taken various regulatory actions to encourage the use of lower-cost payment networks for debit card transactions. For example, the recent reforms in Malaysia require that acquiring banks must provide merchants with the ability to route transactions via their preferred network. **These interventions in other jurisdictions have typically been directed at taking decisions about network routing away from entities such as banks and card**

schemes, which may have no incentive to reduce the cost of payments, and empowering those end-users of the payments system who have the greatest incentive to reduce payment costs.

P67

Consumers need to be better informed about the real costs of the different cards available when they are choosing what product is right for them.

Often the cards which provide the most ‘bells and whistles’ in terms non-cash benefits are ultimately more expensive to the consumer over the longer-term. Consumers should be encouraged to choose lower cost cards.

P67 The Taskforce recognises that there are sometimes small differences in the cardholder experience or terms and conditions depending on whether transactions are **routed via the eftpos network or the MasterCard or Visa networks**. If so, it would seem appropriate that the merchant should **disclose it is using least-cost routing and that consumers should be able to ‘override’ a merchant’s network preference**.

Accordingly, where a merchant chooses to exercise least-cost routing for contactless transactions on dual-network cards it may be appropriate for them to display a sign along the following lines:

‘At [Merchant Name] we care about holding down our costs so that we can hold down prices for our customers. Accordingly, we prefer to send contactless debit card transactions to customers’ banks via Network X as opposed to Network Y or Z. If customers prefer that their debit transactions are instead sent via another network, they can insert/dip their cards and push the button or keypad for their preferred network.’

We consider that such a framework would be a **reasonable balance between the rights of merchants and consumers, and that consumers would quickly become used to the concept that their transactions could be sent via different networks at different merchants**. Furthermore, we stress that this recommendation relates only to debit cards with two networks enabled, and that our recommendation does not in any way mean that a consumer could find that a transaction they intended to fund from their debit account has instead been funded from their credit account, or vice versa. Nevertheless, it will be important that the RBA consult with consumer organisations before deciding on any new regulation in this area.

We understand that some banks argue that it would be costly or **take time for them to provide least-cost routing to merchants**. However, the RBA has indicated that **a number of acquirers are currently considering providing this functionality to merchants**. While it is recommended that the RBA commence a regulatory consultation

process, **in the event that least-cost routing was being brought to market and provided a realistic and competitive alternative to more established acquirers, there might be a case for the RBA to hold off from implementing a regulation, not least because such a regulation could have the effect of removing a point of competitive differentiation for any acquirers that are planning on implementing least-cost routing without being required to do so.**

We understand that there may be opposition to the provision of least-cost routing from **two other groups of stakeholders**. First, banks that are card issuers **may prefer the status quo** where contactless transactions **default to either Visa or MasterCard and the banks earn higher interchange revenues**. Second, the international schemes could potentially lose a significant share of their debit transactions. Ideally, they might respond by competing to be lower-cost schemes by reducing interchange or scheme fees. **However, they could also seek to respond in ways that might be anti-competitive.** Given this **potential opposition to least-cost routing** from these two groups, we recommend that the RBA, ACCC and Government **monitor, and respond to, any anti-competitive behaviour in this regard.**

The ACCC has the power to investigate and take action in relation to anti-competitive or cartel conduct that contravenes the *Competition and Consumer Act 2010 (Commonwealth)*. In particular, the amendment of the misuse of market power provision¹⁶ will provide the ACCC with additional scope to investigate unilateral conduct by a firm with substantial market power that has the purpose, effect or likely effect of substantially lessening competition, for example, by raising barriers to entry or hindering competitive conduct by a lower-cost provider. While such a contravention would depend on the particular facts at issue, the amendment is likely to improve the capacity of the ACCC to tackle anti-competitive conduct in this area.