

## Ending the debit card merchant fee rip-off for small and medium businesses

An important and urgent building block in the recovery of small business in the COVID-19 environment

February 2022

### Executive Summary

One of the major business trends during the COVID-19 pandemic has been the move away from cash to debit cards and mobile wallets at point of sale, along with the large increase in online purchases. This is resulting in small businesses having to pay whenever these transactions occur. Unacceptably, when consumers use dual network debit cards, these transactions default to the higher rather than the lowest cost card scheme. This means that small businesses often have to pay thousands of dollars more a year in debit card fees than they should.

With the move to debit cards to continue, it is important that this rip-off is addressed as small businesses struggle with a raft of additional costs during the transition out of COVID-19. This can be achieved by a regulation that requires debit card transactions across all form factors (tap-and-go cards, mobile wallets, online) to default to the lowest cost scheme for the mix of transactions of the particular business. This change, which comes at no cost to government, needs to occur as a matter of urgency, because for every day it is delayed, struggling small businesses continue to pay more than they should for debit card transactions.

### Background

In the year to November 2021, there were over 9 billion debit card transactions with a total value of more than \$400 billion. Accelerated by the COVID-19 pandemic, debit cards have become the main way in which Australians transact when they purchase goods and services. Increasingly, people are using their mobile devices to make these debit transactions as well as continuing to make contactless payments by tapping their physical cards at point-of sale and using their debt cards online. There is no evidence to indicate that this trend will not continue as the economy transitions from COVID-19.

### Issue

The vast majority of debit cards are dual network (i.e., they link to two card schemes - one of either Visa or Mastercard plus eftpos). When consumers tap their debit card or wave their mobile device at point-of-sale or make an online debt card transaction, the merchant pays a transaction fee. Currently, these contactless debit transactions default to the global card schemes (Visa, Mastercard) which in most cases charge higher transaction fees than the Australian scheme (eftpos). With mobile transactions, in most cases there is no choice but to use the global card schemes where wholesale fees may be up to seven times higher than for normal routed card transactions.

While larger merchants are able to negotiate individualised arrangements with their banks, it is harder for smaller merchants to do so as they do not have the same bargaining power. As a result, these businesses are forced to pay significantly higher fees for debit card transactions than they otherwise should, increasing their business costs and making it more difficult to compete. These high fees can cost small businesses many thousands of dollars a year, simply because dual network debit cards default to the higher cost global card schemes rather than the lowest cost scheme. In other areas of the economy like telecommunications and electricity, such rip-offs have been addressed with requirements to default to low-cost offerings – the same needs to happen with debit card transactions.

## Solution

Debit card payments should default to the lowest cost card scheme in all form factors including mobile. This is known as Least Cost Routing (LCR). In its 2021 Review of Retail Payments, the Reserve Bank recognised the excessive debit card costs incurred by merchants and encouraged banks to make LCR available to merchants. However, it stopped short of recommending regulatory intervention, rather relying on the banks to maximise access to LCR. For commercial reasons, the banks are reluctant to do so with fewer than 10 per cent of current transactions least cost routed.

The solution is to make LCR the mandated default for all debit card transactions, whether they are tap-and-go, online or utilise mobile devices. Effectively, this moves away from the current default of the usually higher-cost global card schemes to the lowest cost scheme. As well as reducing debit card transaction costs for merchants (and ultimately consumers), making LCR the mandated default will encourage greater price competition between card schemes. To assist small businesses that are struggling with the economic impact of COVID-19, this should happen immediately for tap-and-go debit card payments at point-of-sale quickly followed by online debit card payments and then mobile transactions where some technical preparatory work is required.

## Benefits

The main beneficiaries of making the lowest cost scheme the default for debit card transactions are the small and medium size businesses whose transaction fees would be materially reduced. This would be of particular benefit to regional and suburban businesses which are often smaller, family owned, and operate on lower margins. To the extent that these higher transaction fees are passed on, consumers would benefit indirectly as well. Defaulting to the lowest cost scheme would also foster greater competition between the card schemes, putting further downward pressure on transaction fees as well as encouraging innovative payments providers to enter a more open and competitive environment.

Independent analysts estimate that if all debit card transactions in Australia used the lowest cost payment scheme, merchants could save at least \$800m and up to \$1.28 billion annually in fees<sup>1</sup>. This would be a serious saving for individual small businesses currently paying thousands of dollars extra a year in transaction costs.

Various business organisations have analysed the impact of switching to LCR on individual businesses, including:

- A regional WA newsagent saved \$700 a month in the first few months after switching to LCR.
- A Brisbane newsagent saw a decrease of 35% on its merchant fees after switching to LCR.
- An outer suburban butcher in Sydney is saving around \$2,000 a year on their merchant fees through LCR.
- A shoe shop in Sydney's north recently switched banks to save almost \$2,500 a year on merchant fees through LCR annually after their previous bank wanted to charge more.
- A Victorian taxi technology company saved over \$50,000 within a year of switching to LCR
- Three medium sized grocery stores in WA saved \$90,000 per annum from LCR before being told their savings would be eroded as other rates across their banking facilities would go up.
- A fashion retailer achieved a 33% fee saving (over \$2,000 p.a.) by changing payment service provider and moving to terminals that enable LCR at point of sale.

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<sup>1</sup> CMSPi - Review of Payments Consultation - July 2021 Report.

## Who supports the change?

During 2021, a significant number of business organisations advocated across the political spectrum for LCR to be the mandated default for debit card transactions. These organisations include:

- Council of Small Business Organisations Australia (COSBOA)
- Australian Association of Convenience Stores (AACS)
- Australasian Convenience and Petroleum Marketers Association (ACAPMA)
- Australian Chamber of Commerce and Industry (ACCI)
- Australian Lotteries and Newsagents Association (ALNA)
- Australian Retailers Association (ARA)
- Franchise Council of Australia (FCA)
- Master Grocers Association (MGA)
- National Retail Association (NRA)
- Pharmacy Guild of Australia (PGA)
- Restaurant and Catering Industry Association (RCA).

Since then, these business groups have continued to advocate with the Treasurer, the Small Business Minister, the Australian Small Business and Family Enterprise Ombudsman (ASBFEO), the federal opposition and cross-benchers, interested members and senators, and relevant government departments. They have been provided with independent data on the cost of high debit card transaction fees as well as real-life case studies of the impact on individual small businesses.

In September, the Treasurer publicly announced that he had written to the Reserve Bank asking them to address this issue, and that he supported Least Cost Routing (LCR) as the default for debit transactions. While the Government's December 2021 response to Treasury Review of the Australian Payments System did not focus on high debit card transaction fees, we are encouraged that the issue remains under active consideration and has support across the main political parties.

As debit cards are the primary means of transacting, high merchant fees impact a very large number of small and medium size businesses in suburbs and towns around Australia. Requiring that the lowest cost scheme be the default will be supported strongly by grassroots businesses, given the substantial financial benefits it will deliver for them.

## What needs to be done?

In the context of the looming election and Budget preparation, and with small businesses struggling with a range of additional costs coming out of COVID-19, it makes absolute sense that a regulation should be put in place as soon as possible that makes the least cost card scheme the mandated default for all debit card related transactions.

Under this regulation, banks and other acquirers would be required to offer a merchant the least cost card scheme for their debit card transaction requirements, on all form factors including mobile. Businesses that have different mixes of transactions (e.g., high volume/low cost, low volume/high cost) may have different least cost card schemes.

The regulation would require the immediate introduction of default LCR for debit card transactions at point-of-sale, quickly followed by online debit card transactions and the fast-tracking of the preparatory work required for enablement on LCR for debit transactions using mobile devices.

This change would come at no budgetary cost to the Government and would be widely applauded by small business organisations and individual businesses around Australia. It is likely that the enabling

regulation will receive cross-party agreement given the levels of support for LCR provided by the political parties to small business organisations during the mid-2021 advocacy phase.

## SUMMARY: THERE IS LOW LEVELS OF UNDERSTANDING AND HIGH LEVELS OF APATHY TOWARDS PAYMENT PROCESSING NETWORKS USED BY MERCHANTS

1

One in two (54%) Australians claim to be **aware of debit cards being able to be routed** through a Domestic or an International payment network – no change in awareness since 2018

Current levels of deep knowledge of Merchant routing and tap and go payments is low – only **1 in 10** could identify all the correct statements.

2

Since 2018 there is an increasing belief that merchant choice is more important.

77% of consumers believe it's **important that Merchants have choice**

An even higher proportion (83%) believe it is important that **Merchants have choice over using a lower cost network**

45% **believe that Merchant's will be likely to pass on costs savings** to customers. An increase of +12% in 2018 (33%)

3

66% of consumers have no preference in network or would prefer to use eftpos, with only 34% preferring the international schemes.

**28% would choose the eftpos network** – slightly higher amongst non big 4 MFI customers (32%).

4

MND holders see a **number of benefits to using the eftpos payment network**. The key benefits are **avoidance of surcharging** (for 54%) and **cost savings** for Merchants (for 51%) as well as being an **Australian owned and operated** company (52%).

5

Vast majority MND holders (91%) believe Merchants processing via the eftpos network would **not have a negative impact on their payment experience**.

## Real customer choice does not exist in mobile payments

1. Consumers choose cards & accounts, not networks. Most (>80%) don't have a choice, and want SMEs to have it\*
2. Small business customers need network choice because they pay the fees – currently they have no choice at all.
3. If customer choice does prevail, then the default should be to the lowest cost scheme when customers do not make an active choice

### How big is this problem?

- Roy Morgan (Mar 2020) says 10.8% of Australians use mobile payments but merchants say its higher post COVID (20-30% & growing).
- According to RFI Payment Diary insights (March 2021), there are 1.2B mobile transactions a year and growing. (>800m debit).
- With no competition or regulation, fees are higher for both Visa/MasterCard and eftpos

**FACT**  
All dual network debit cards in mobile **default to Visa or Mastercard**

**FACT**  
Fees are **significantly higher on mobile\*\*** because there is no LCR and no competition

**FACT**  
Small **businesses are bank customers too** and they have **no choice at all**

**FACT**  
< **20%** of debit cards in mobile have eftpos as an option for consumers.

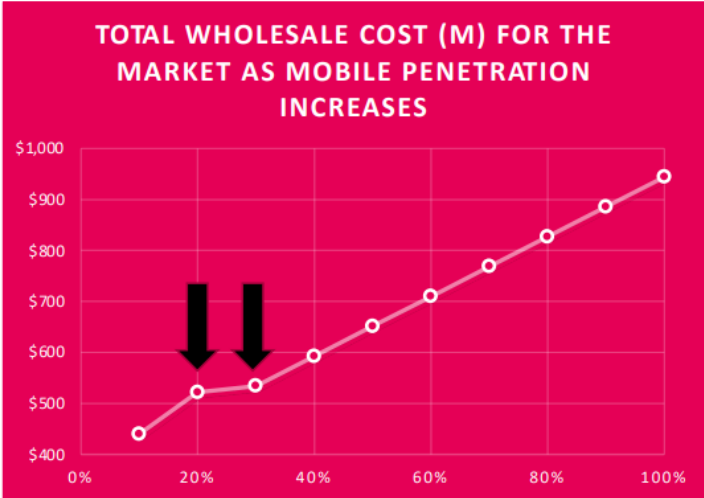
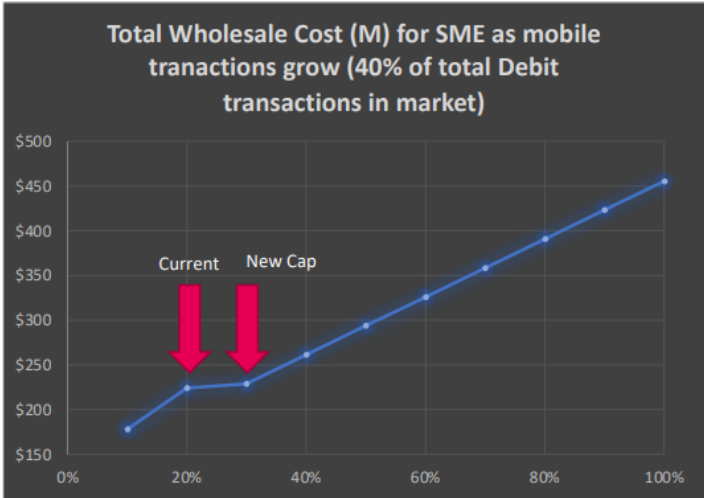
**FACT**  
Only **27%** of mobile payments users know they can change the default (RFI March 2021).

\*FiftyFive5 2021  
\*\*Scheme interchange tables

# Cost to economy of Mobile default to Global Schemes & no LCR

The graphs below show the potential impact on wholesale debit card cost\* to merchants (both SMEs and entire market) if current default settings to Visa and Mastercard are not rectified, and competition remains non-existent due to the absence of LCR.

As you can see, SMEs bare more than their fair share of cost due to special deals with large merchants.



\*Interchange and scheme fee assumptions based on published interchange and market insights  
 \*Modelling based on new interchange cap of 10c from 1 February 2022.  
 Estimated Mobile wallet transactions penetration at 30% by February 2022.

## Three options for a better competition outcomes in mobile

Least cost routing in mobile is essential for competition in Australia and to keep costs down for merchants. It can be done in two ways, or alternatively cards could default to the least cost provider if customers don't actively choose.

<b>Option 1 – European-style LCR implementation via Mobile Wallets</b>	<b>Option 2 – Adopt US-style LCR implementation at terminal</b>	<b>Option 3 – DNDCs default to Least Cost in mobile if customer makes no active choice</b>
<ul style="list-style-type: none"> <li>• Apple/ Google/ Samsung to upgrade wallet app software to present two tokens to terminal</li> <li>• M/V and eftpos payment applications presented to terminal with a software upgrade,</li> <li>• No change to merchant POS solutions from Acquirers</li> <li>• Expect 6-9 months for solution development by Apple/Google/Samsung</li> </ul>	<ul style="list-style-type: none"> <li>• Require a change in token format (so every token has to be reissued) to support routing and then terminal and acquirer development work to support new token format</li> <li>• Expect 12-18 months work with Apple/Issuers per Option 1 plus 2-3 years for Acquirers to plan and develop/deploy merchant solutions</li> </ul>	<ul style="list-style-type: none"> <li>• Likely software change required by Mobile Pays and possibly change by Issuers</li> <li>• Least cost routing decision made by Acquirer based on wholesale price</li> <li>• Industry consultation required to arrive at exact timeframes</li> </ul>