

Visa Europe response to the consultation of the Competition and Consumer Section of the Department of Jobs, Enterprise and Innovation on the early transposition of Article 19 of the Consumer Rights Directive into Irish law.

Visa Europe¹ is grateful for the opportunity to express its views on the implementation of Article 19 of the Consumer Rights Directive (CRD) on surcharges. The topic is of high importance to the consumers in the Republic of Ireland given their experiences with surcharges imposed by number of airlines and other operators in the travel sector.

In this submission, Visa Europe highlights that surcharging payment card transactions is harmful to consumers and the overall economy, irrespective of the level of surcharge permitted. Notwithstanding Visa Europe's opposition to surcharging in principle, this paper also sets out key issues that must be taken into account should the government ultimately decide to proceed with legislative proposals to cap surcharges at the point of sale.

Surcharging is harmful to consumers

It is important to note that the reality today is that, where merchants choose to surcharge, it is used primarily as an additional revenue generator for merchants and not as a mechanism for "steering" the consumer to use particular means of payment².

In our view, the only proper solution is to ban surcharging to protect consumers. Surcharging is inherently harmful to consumer interests as it distorts the actual price the consumer needs to pay for goods and services, making comparison of different advertised prices misleading and ultimately reduces the use of more efficient payment means in favour of inefficient and more expensive cash. This arises irrespective of the amount of the surcharge.

Consumers dislike surcharges and will seek to avoid them, even where the benefits of using a particular payment method exceed the cost. There is empirical evidence that demonstrates that consumers react adversely and disproportionately to surcharging. The results strongly suggest that a surcharge of almost any size will cause consumers

¹ Visa Europe is a leading European payment card system and the only European member-owned, Europe-wide payment system open to all regulated institutions. As a membership association Visa Europe is owned and governed by its European members which issue Visa cards and acquire Visa transactions. Visa Europe is independent of Visa Inc, a publicly traded US company, from which it has an exclusive, irrevocable and perpetual licence to operate in Europe. As a dedicated European payment system Visa Europe is able to respond quickly to the specific market needs of European banks and their customers - cardholders and retailers - and to meet the European Commission's objective to create a true internal market for payments.

² *The Which?* super-complaint to the Office of Fair Trading in the UK, *the Ryanair case* in German Supreme Court brought by German Consumer Association; French case at the Cour des Grandes Instances against Easyjet brought by UFC Que Choisir. Furthermore, in Australia there is clear evidence that businesses which surcharge impose charges that are on average three times higher than the fees actually paid in relation to card acceptance. (See "Card users pay dearly", Sydney Morning Herald, 9 March 2011 and East and Partners six monthly "Merchant Acquiring and Cards Market" research programme). Serious concerns relating to the effects of excessive surcharging on consumers have resulted in amendments to the provisions permitting surcharging in Australia by the Reserve Bank of Australia to limit the level of surcharges (See Reserve Bank of Australia "A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement – June 2012).

to reduce card use in a disproportionate manner.³ In particular, surcharging is likely to have a negative effect on efforts to encourage consumers to move to efficient non-cash means of payment, including for low-value or micro-payments.

An increase in the use of cash in Ireland would have negative effects for the economy and would run counter to the objective of the Irish Central Bank initiative to encourage use of the most efficient forms of payment⁴. As well as the high cost of cash transactions for society⁵, cash transactions increase the risk of fraud, tax evasion and facilitate the shadow economy⁶⁻⁷.

Article 19 of the Consumer Rights Directive (CRD), which attempts to resolve the problem of abusive surcharging where surcharging is allowed as per the Payment Services Directive (PSD), is unlikely to succeed in providing a workable solution to the general problem of surcharging. In order for this provision to deliver tangible results, it would need to be implemented in an identical fashion across all EU Member States. The CRD's stipulation that surcharging should be limited to costs does not make it clear exactly which costs should be taken into account (as observed in the Consultation Document), how they should be calculated or measured, how consumers will know or determine what a particular merchant's costs are (and therefore whether or not surcharges are set at a lawful or adequate level) or how cost-based surcharging could actually be enforced in practice. Any measures short of a complete ban on surcharging will create gaps in protection and allow for a continued exploitation of surcharging particularly in the cross-border and online environment.

Further, the enforcement of the proposed Irish rules in a cross-border environment, in particular for online transactions, where surcharging is currently most prominent, will be difficult, if not impossible. The absence of a common legal framework will make it more difficult for consumers to obtain redress or even to know if they have been surcharged at the actual cost. Experience suggests that on-line merchants in particular, have been successful in raising obstacles to enforcement procedures based on complicated rules in relation to both jurisdiction and applicable law.

Visa Europe in particular agrees with the Department's decision to provide in the Regulations which will give effect to Article 19 of the CRD *"that a charge to consumers, however described, that is avoidable where a specific payment instrument*

³ Professor D.McFadden and The Brattle Group *Efficient Interchange Fees*, November 2008, (available on request from the Brattle Group). The results of the empirical work undertaken by the authors indicate that a cardholder surcharge of 0.5% would prompt 60% of consumers to abandon the use of payment cards (see pages 7 to 11).

⁴ National Payment Plan is currently available as a draft.

⁵ The high cost of cash has been recognised by the European Commission on several occasions. See European Commission "Annex to the proposal for a Directive of the European Parliament and of the Council on Payment Services in the Internal Market, Impact Assessment", COM (2005) 603, at page 7 and European Commission: "Sector Inquiry under Article 17 Regulation 1/2003 on retail banking. Interim Report I: Payment Cards" 12 April 2006, page 12. See also Bergman, M. Gabriella G. and Björn S. "The Costs of Paying – Private and Social Costs of Cash and Card" *Sveriges Riksbank Working Paper Series 212* (September 2007).

⁶ The 2006-2007 Fraud Report by the UK HM Treasury highlights an advantage of using electronic payments over cash, stating "the wider use of electronic forms of payment might also reduce the risk of payment fraud" .

⁷ In a recent study by AT Kearny and Professor Schneider of the University of Linz, commissioned by Visa Europe, the shadow economy in Europe is estimated at € 2,2 trillion. The study also shows the significant positive impacts on GDP which will be achieved by encouraging electronic payments. "The shadow economy in Europe 2011" AT Kearny and Professor Friedrich Schneider (University of Linz).

is used shall be regarded as a fee for the use of a means of payment for the purpose of the Regulations.”

The key aspect of Article 19 is the “cost” component on which any limitation will inevitably depend.

There is a significant risk that the proposed manner of implementing the CRD will not achieve any meaningful change to the current situation in which certain Irish merchants are able to impose abusive surcharges. Indeed, it appears that, unless very careful consideration is given to a number of important issues, the current proposals may have unintended consequences that run counter to the Department’s overall policy objectives.

In reference to question 11, we believe all sectors excluded from the scope of the CRD should be covered by the ban on excessive surcharging. Given that the proposed legislation does not ban surcharging outright, but seeks to prevent abusive surcharging only, it is difficult to see why it should apply to some sectors and not others. Surcharging may be prevalent in online environment but it is not exclusively found on the Internet. Moreover, fairness to consumers is a principle that should apply uniformly, regardless of the sector of the economy concerned. Exempting some enterprises and not others, would also send the wrong message to the public that for some sectors it is acceptable to extort extra revenues from consumers.

Surcharges must be differentiated

In practice, different methods of payment, different brands of payment cards and different types of payment cards have very different costs to merchants. In particular, “premium” interchange products, such as those promoted by MasterCard and three-party payment card systems like Amex (but not Visa Europe), lead to significantly higher costs to merchants than the average cost of accepting payment cards. Furthermore, in general, the costs charged by banks to merchants in respect of immediate debit card payments are lower than those for credit card payments.

Accordingly, if surcharges are intended to be a tool to enable merchants to “steer” consumers to use payment methods with lower costs to merchants, it is absolutely essential that **only differentiated** surcharges are applied according to the specific costs incurred by the merchant in respect of different types of card and brand.

If the relevant measure of “cost” was calculated as the *average* cost of accepting all payment cards, or all payment cards of a particular type (e.g. “all credit cards”), leading to a single, overall maximum permissible surcharge that would not lead to surcharges at levels that provide appropriate “price signals” to consumers and would disadvantage cheaper means of payment over more expensive means of payment. (If consumers face the same (average) surcharge for the card type or brand with the highest level of merchant cost as the lowest cost card, consumers will in fact be incentivised to increase use of *higher* cost cards. This is because there are often “rewards” associated with the use of such cards which may not be available in respect of standard payment cards (with lower merchant costs). Unless surcharges reflect actual costs the effect of any cap would run counter to the policy objective that the

Department wishes to promote. It would also be anti-competitive as it would discourage price competition.

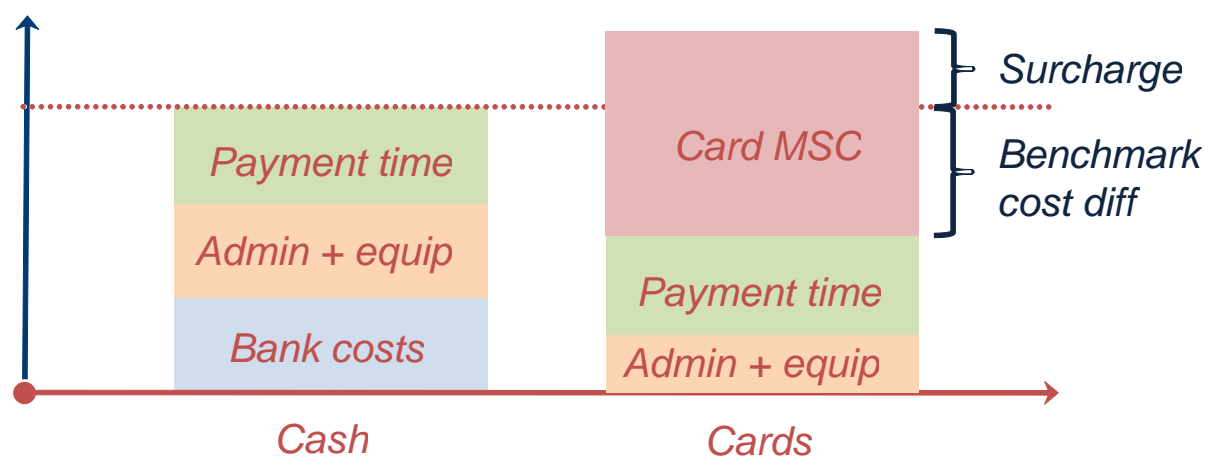
Further, Article 19 of the CRD actually calls for a ban on fees that exceed the cost “in respect of the use of a given means of payment in relation to costs borne by the trader for the use of such means.” While Recital 54 calls on ban on “charging consumer fees that exceed the cost borne by the trader for the use of a certain means of payments.” In view of this wording, Visa Europe would like to submit that these specific phrases seem to indicate that the intention of the European legislator was to allow for surcharging at the cost linked to the use of a particular means of payment. Allowing merchants to calculate a surcharge on the basis of an average of all means of payment accepted by the merchant rather than a differentiated surcharge, would contradict the wording of the CRD and run contrary to the intentions of the legislator.

Merchants should not be able to “profiteer” from surcharging or to exploit consumers

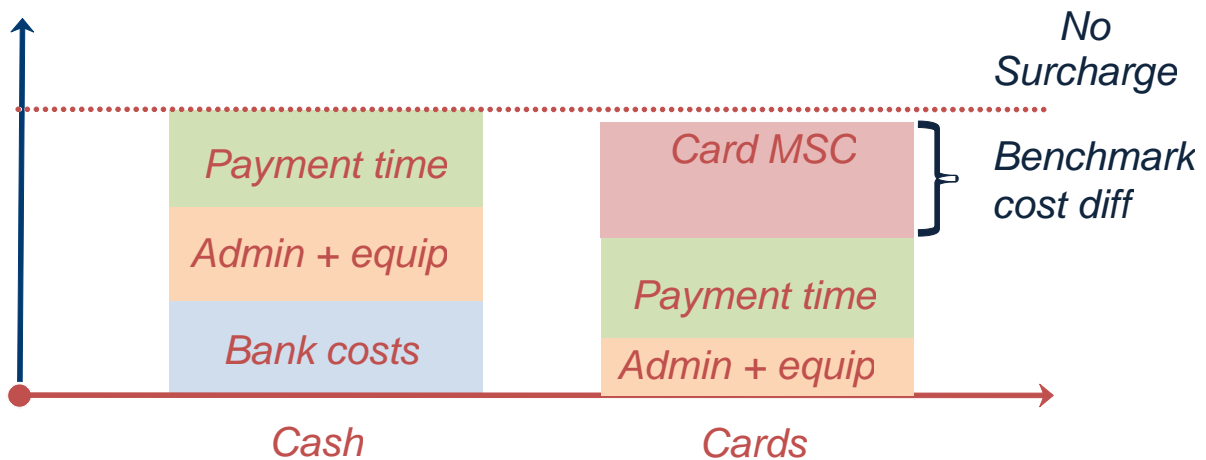
Merchants incur costs in accepting all means of payments, not only card payments. Surcharges, if permitted should therefore be limited to the **additional** cost incurred by the merchant for the acceptance of a particular means of payment chosen by the consumer as compared to the cost of the cheapest payment method accepted by the merchant. Any surcharge above the additional cost level would mean that the merchant would be making a profit from the surcharge at the expense of the consumer.

This is illustrated in the diagram below which suggests that for Card A, a surcharge could be imposed as the merchant’s additional costs of accepting the card exceed those of the cheapest method (assumed, for illustrative purposes only, to be cash in this example). However, for Card B, no surcharge should be imposed. The direct costs to the merchant of accepting the card are lower than the merchant’s costs of accepting cash payments. If a surcharge was imposed in respect of payments made using Card B, the merchant would simply be making additional profits by way of the surcharge.

CARD A at MERCHANT A



CARD B at MERCHANT A



Any workable cost measure in relation to merchants' payment-related costs would require verifiable, independent, data on merchants' real costs of accepting cards and other types of payments in the each Member State. In the absence of such publicly available data, it is unclear how consumers, and merchants for that matter, would be in a position to know for certain whether or not a particular surcharge was at an acceptable level.

Surcharging is most common in the Card Not Present (typically internet) environment. Charging for card payments online appears particularly incongruous, especially when it is considered that many merchants discount their goods and services for transactions conducted online, because of lower overheads and greater efficiency, which includes the ability to receive payments by electronic means.

Only by ensuring that the merchant charges only the extra cost above the cheapest means of payments and applies different rates to different means of payment, can one ensure that consumers will not be subjected to unreasonable level of surcharge.

Visa Europe agrees with the approach proposed by the Department in its Consultation Document in relation to indirect costs, namely, that they should be excluded from the costs to be counted towards the acceptable level of surcharge. However, the approach proposed in relation to direct costs remains excessively wide. This will leave the door open to potential abuse by merchants and does little to address the excessive surcharging currently imposed by certain merchants⁸.

In this respect, Visa Europe does not agree with the categories suggested by the Department as directly linked to the cost of a particular payment as most of the costs listed appear to be general costs of doing business rather than costs relevant for determining which costs can be include in a surcharge. There is a possibility of

⁸ There is a danger that by allowing merchants to pass on any cost incurred as long as it is supported by an invoice, would result in merchants becoming price insensitive to any price fluctuations of their cost of payment services to the disadvantage of the consumers.

potentially opening a door to abuse by merchants and leaving consumers stranded as they will have little or no possibility of assessing whether the costs attributed are proper or not and merchants will have a significant opportunity to continue or extend their current surcharging practices based on spurious arguments on the nature and amount of their direct costs that consumers are unlikely to be well placed to challenge.

Merchant Service Charge (MSC)

The Consultation Document considers MSCs “*the largest single element of the cost*” of accepting card payments for the merchant. As indicated at the beginning of this submission, merchants incur costs for accepting all forms of payment.

There is a possibility of using MSCs (and an equivalent fee in three-party systems) as an indicator of cost of acceptance of different means of payment for the purpose of surcharging. However, it needs to be noted that in order to reflect the true cost of accepting different means of payment, the MSC should be less the cost of handling cash payments as indicated below.

Today, majority of surcharging practices are substantially above the level of MSCs, especially in relation to merchants with a buying power capable of negotiating attractive MSC rates. Provided that the market continues to ensure unblending of MSC rates for merchants, which seems to be the case by scheme as well as by product category, surcharging at the level of the merchants’ MSCs could potentially result in consumers not getting surcharged at abusive levels.

For merchants, it would allow them to surcharge in a clear cut way without having to resort to complicated calculations or having to collect all invoices in case of a potential consumer challenge. Merchants would not have to incur costs of expensive premium products, while allowing consumers to pay with them subject to a relevant surcharge. This would ensure that merchants are far more efficient in dealing with surcharging in terms of time spent on surcharging as well administrative costs of handling surcharging practice. This approach would also empower merchants to decide which, if any, of the means of payment they wish to surcharge.

Crucially, from the Government policy perspective, it would fulfil the objective of protecting consumers from excessive surcharging, while promoting enhanced market competition between various means of payment, products and between different brands. This, in turn, would promote greater market efficiency by encouraging use of the cheapest and most efficient forms of payments while taking into account the realities of existing differences between merchants in terms of their size and buying power. Most importantly, it would ensure that no merchant profiteers from the surcharging.

However, it needs to be stressed that the realities of surcharging at “cost” are very complex. Using MSC seems like a possible option to address various concerns of different stakeholders but it would not necessarily reflect the true cost of acceptance of different electronic means of payment in relation to the cost of accepting cash payments. If the Department truly intended to allow for surcharging at the actual cost, this should be based on the cost of MSCs less the effective cost charged to a particular merchant for handling cash payments by their acquiring banks.

Rebates

In some EU Member States traders attempt to disguise surcharging as a rebate to circumvent overall transparency requirements. As far as Visa Europe is aware, there is no legal definition of rebate. It would be a sensible approach and good legislative practice to define rebating in legislation thus ensuring that no loopholes are accidentally created.

Conclusion

Visa Europe submits that surcharging should not be permitted as it is likely to result in greater use of cash, at the expense of the Irish consumers and the Irish economy.

If surcharging continues to be permitted, but is limited to “cost”, the relevant Regulations must ensure that there is sufficient differentiation of surcharge levels between different types of payment methods, payment cards, including different payment card brands and products. If this is not done, any “price signals” given to consumers as a result of surcharges will actually encourage greater use of higher cost cards at the expense of lower cost cards. It will also be essential to ensure that the rules are carefully drafted to avoid merchants profiting from surcharges which exceed their costs of accepting particular payment methods and to ensure appropriate coordination with other Member States to safeguard cross-boarder transactions in particular given the rapid development of e- and m- payments technology.