



30 June 2008

**By email:** [pysubmissions@rba.gov.au](mailto:pysubmissions@rba.gov.au)

Michelle Bullock  
Head of Payments Policy Department  
Reserve Bank of Australia  
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Dear Ms Bullock

### **Reform of Australia's Payments System**

Consumer Action Law Centre (**Consumer Action**) is supportive of the approach by the Reserve Bank of Australia (**RBA**) to the electronic payments system and we welcome the pragmatism of the RBA in stepping in and regulating interchange fees where it appeared that market forces had not achieved adequate competition.

Consumer Action believes that regulators, such as the RBA, should explicitly consider the impact of their decisions on vulnerable and disadvantaged consumers. In relation to regulation of the electronic payments system, this would include the RBA considering the link between credit card use, debt traps, and personal bankruptcy and possible impacts on economically disadvantaged consumers of the coercive use of direct debit arrangements.

We also believe that the application of the 'no-surcharge rule' as it currently stands has anti-competitive effects that cause detriment to consumers and we recommend modification of this rule.

### **The No-surcharge Rule**

We agree with the RBA that the removal of the prohibition on merchant surcharging by regulation has, in one sense, enhanced competition by reducing the externalisation to all purchasers of the cost of credit card use. However, we believe that the RBA may need to consider how it can reformulate its standards and other regulatory measures to prevent surcharging being used in an anti-competitive way by merchants in concentrated markets. Examples of markets in which the use of surcharges may be anti-competitive are the low-cost airfare market and the taxi market.

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The RBA notes in its review that “some firms operating in very competitive markets are able to offer cardholders the choice of paying by credit card, without all customers having to cover the higher costs of credit card acceptance.”<sup>1</sup> In certain markets that rely on online payment (such as the low-cost airfare market), there is no practical alternative but to pay by credit or scheme debit (eg. Visa debit). That is, the cheapest fares are only offered to purchasers who book online and pay with credit or scheme debit cards.

In these circumstances, the imposition of a surcharge will not facilitate a switch to other payment methods because no other payment method is practical, given the business models of the traders in the market. In addition, the imposition of a credit card surcharge can (and often does) amount to a ‘hidden’ cost that distorts competition because it hides the true cost of the good or service from the customer.<sup>2</sup> Consumers are either unaware of the surcharge, or only become aware of the surcharge after a number of online steps have been taken (such as the entering of personal information) by which time the consumer has made a time and emotional investment in the transaction going ahead.

In relation to low-cost airfares, the market is currently dominated by three airlines: Jetstar, Qantas and Virgin Blue. Each of these companies impose a surcharge for use of credit or scheme debit card.<sup>3</sup> Virgin Blue imposes a \$3-\$5 surcharge.<sup>4</sup> Jetstar imposes a \$6 surcharge for domestic flights but this is only discernable in the fine print once the customer has entered a booking request by entering origin/destination and dates of departure/return and clicking that they have read ‘Fare rules’ and ‘Conditions of carriage’ (neither of which specify the amount of the surcharge) and has entered personal information such as name and telephone number.<sup>5</sup> Qantas imposes a higher surcharge of \$6.60 for domestic and trans-Tasman (Australia-New Zealand) flights and \$18 for international flights. As is the case for Jetstar, the customer only finds out about these surcharges after imputing personal information such as their name and phone number.<sup>6</sup>

For each of these companies, the cheapest domestic flights are only available paying online with a credit card or scheme debit cards. Thus, Australian consumers have no option but to pay credit card surcharges if they wish to utilise low-cost airfares for domestic airplane travel. The cost of these surcharges is not displayed in the price advertised online, and thus the advertised price is not a reflection of the true cost of the service. Similar credit card

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<sup>1</sup> Reserve Bank of Australia, *Reform of Australia’s Payments System: Preliminary Conclusions of the 2007/2008 Review*, April 2008, page 26.

<sup>2</sup> The problem of surcharges, and other charges, ‘hidden’ by the low-cost airline carriers may be partially resolved if the Federal Government implements proposed changes to the *Trade Practices Act* that will require component pricing in advertising.

<sup>3</sup> The amount of the surcharge is typically the same, regardless of whether credit or scheme debit is the payment method.

<sup>4</sup> <http://www.virginblue.com.au/Personal/Bookings/Feessurcharges/index.htm>

<sup>5</sup> To determine this, Neil Ashton of Consumer Action Law Centre, went through the online booking process through <http://www.jetstar.com.au> on 28 April 2008 and proceeded until the point where credit card details needed to be entered.

<sup>6</sup> To determine this, Neil Ashton of the Consumer Action Law Centre, went through the online booking process through <http://www.qantas.com.au> on 29 April 2008 and proceeded until the point where credit card details needed to be entered.

surcharges feature in other online environments, such as the online purchasing of ticketing for events.

Because surcharges can be unilaterally imposed on a captured market, and because they can be used to hide the full cost of the good/service there should be restrictions on credit and debit scheme card surcharges.

*Recommendation:* Where consumers do not have the option of making payment by a method that does not incur a surcharge (on the same price and terms as would be applied if they paid by a method that did incur a surcharge), then a merchant should not be able to impose a surcharge.

The effect of implementing this recommendation would be to allow the card schemes to prevent surcharging in certain circumstances (where, in practice, the use of surcharging would be anti-competitive).

### **Credit cards**

Credit cards are a high-risk borrowing and payment facility for many Australian consumers. Credit card debt is also strongly correlated to financial hardship and bankruptcy.

The link between increases in credit card use and debt and the rates of personal bankruptcy has long been identified.<sup>7</sup> A cause/effect relationship between credit card debt and bankruptcy has been identified,<sup>8</sup> and the relationship between credit card debt and bankruptcy applies outside the United States to a number of Commonwealth countries (including Australia).<sup>9</sup>

Credit cards can and do lead some consumers into a debt trap. This risk extends to the large minority of Australian consumers who do not pay-off the entirety of their credit card balance each month. RBA statistics show that total credit card balances in Australia amount to over \$43 billion and \$31 billion of this is accruing interest.<sup>10</sup> However, in 2001, Visa reported that 32 per cent of consumers had not paid their card off in the previous 12 months,<sup>11</sup> which suggests that interest-bearing debt in Australia is held by approximately only 1/3 of credit card borrowers. In Consumer Action's experience of providing legal assistance to Victorian consumers, credit card debt is one of the main contributors (together with unemployment and relationship breakdown) to financial hardship and unserviceable debt loads.

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<sup>7</sup> Mann, Professor Ronald J, *Credit Cards, Consumer Credit & Bankruptcy*, Law and Economics Research Paper No. 44, The University of Texas Law School, Revised March 2006, ii.

<sup>8</sup> Mann, Professor Ronald J, *Charging Ahead: The Growth and Regulation of Payment Card Markets*, Cambridge University Press, 2006, page 68.

<sup>9</sup> *Ibid*, pages 65-66.

<sup>10</sup> RBA, *Credit and charge card statistics – Table C1*, March 2008.

<sup>11</sup> Nolan Norton Institute (2001), *Credit Cards in Australia: A Research Report*, Sydney: KPMG Consulting

Consumer Action believes the relationship between credit card debt and the financial hardship of disadvantaged consumers should be considered by the RBA in its decisions about the payments system.

We note that, pursuant to the *Payment Systems (Regulation) Act 1998* (Cth), the RBA is only mandated to regulate payment systems where it is in the public interest to do so. Further, the Act defines public interest as financially safe, efficient and competitive. In our view, credit card use that results in large unsustainable debt is not efficient, and will inevitably create social costs that will be externalised onto other areas of government (ie, the welfare system).

Considering this, any dynamics within the payment system that pressure consumers to use credit cards inappropriately should be discouraged by the RBA. The RBA has already taken steps in this direction, for instance by removing the no-surcharge rule. Consumer Action believes that continued efforts should be exerted to ensure Australia's payments system does not unduly facilitate credit card use by consumers who are at risk of falling into a debt trap.

*Recommendation:* The RBA explicitly consider the risk of credit cards leading consumers into debt traps when it makes decisions about the payments system that may impact on the relative use of different payment facilities.

### **Coercive direct debit arrangements and their impact on consumers**

Consumer Action is concerned with the push by many traders to coerce consumers to make payments through direct debit arrangement. While direct debit is an efficient payment method,<sup>12</sup> and is useful for important long-term payments (such as mortgage repayments) the extent of its use raises problems for many consumers.

Consumer Action is concerned at increasing coercive practices by traders. Consumers are often coerced into using direct debit arrangements when a trader does not offer a suitable alternative payment option, and when the trader charges a surcharge for payment by any payment method other than direct debit.

In many contracts with essential services providers (such as utilities), consumers are coerced into paying via direct debit by the imposition of a surcharge for use of any other payment method.<sup>13</sup> Thus consumers who may not want to pay by direct debit are coerced into doing so. In other contracts, discounts and incentives are offered only where direct debit is selected as a payment method.

One problem with this is the way in which direct debits remove control over payment transactions from consumers. In some cases, the terms and conditions of some direct debit authorities provide authority to a trader to make a direct debit from a consumers' account of

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<sup>12</sup> United Kingdom Office of Fair Trading, *Cheques Working Group*, OFT 868, November 2007.

<sup>13</sup> Jackgreen QLD Terms and Conditions, Version 2, 18 June 2007 (consumers who do not pay by direct debit surcharged \$2 per month).

any amount on any date. In 2007, we reviewed the terms of direct debit authorities of a number of energy retailers. This review showed that such authorities provided wide scope for retailers to vary the terms of a direct debit agreement. For example, Origin Energy's direct debit customer service agreement stated:

we will provide you with at least 14 days notice if any terms of the payment arrangement are about to change.<sup>14</sup>

Similar clauses can be found in the direct debit agreements for TRUenergy and Red Energy.<sup>15</sup> AGL's direct debit agreement did not even envisage a timeframe for notice, stating:

AGL may vary the amount and/or frequency of future debits, if it provides me with notice of the change.<sup>16</sup>

While providing notice to customers is important, in practice this has resulted in some unwary consumers finding larger sums withdrawn from their accounts compared with the amount expected.

More significantly, Consumer Action's experience is that unethical traders that ignore consumers' legitimate requests to terminate a service and continue to withdraw sums from the consumers' accounts. In practice, consumers often never recover these amounts.

Another problem is the default fees that economically disadvantaged consumers face when direct debits draw their bank accounts into the red or are otherwise dishonoured. Banks and other financial institutions typically charge large penalty fees (currently in the range of \$20-\$50) whenever a direct debit draws an account into arrears or is dishonoured. Consumer Action has, in many instances, dealt with consumers whose direct debit arrangements have caused them to incur several penalty fees per month.<sup>17</sup> Economically disadvantaged consumers are often catastrophically harmed by incurring such fees. For these consumers, other payment arrangements (such as BPay) would be far less risky.

For those consumers who do not experience hardship, often the very financial incentive that caused a consumer to select the direct debit payment method is offset by incurring a penalty fee. We do not consider this to be an efficient outcome. This is, particularly, the case given evidence that consumer behaviour does not take account of the likely level of a penalty due to failure of a direct debit, as consumers discount the possibility they will incur such a fee (even if they were aware of it).

Consumer Action believes that in order to protect consumers, steps must be taken to ensure that consumers are always given an option to pay by a system other than direct debit without

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<sup>14</sup> Available online at: [http://www.originenergy.com.au/home/files/Direct\\_debit\\_May2005\\_2.pdf](http://www.originenergy.com.au/home/files/Direct_debit_May2005_2.pdf).

<sup>15</sup> Available online at: [http://www.trueenergy.com.au/downloads/Direct\\_Debit\\_Form.pdf](http://www.trueenergy.com.au/downloads/Direct_Debit_Form.pdf) and <http://www.redenergy.com.au/downloads/DirectDebitForm.pdf>.

<sup>16</sup> Available online at: <https://online.agl.com.au/html/epTermsCond.html>.

<sup>17</sup> See Consumer Action & CHOICE, *Submission to the Senate Economics Committee Inquiry into the Australian Securities and Investment Commission (Fair Bank & Credit Card Fees) Amendment Bill 2008*. <http://www.consumeraction.org.au/downloads/CHOICECALCsubmissiontoFairFees2008.pdf>

penalty. To contribute to this, the RBA should collect information about penalty fees charged by banks and other financial institutions in relation to direct debit failures (and other events).

*Recommendation:* That the RBA undertake a comprehensive study of penalty fees charged by Australian financial institutions, using its powers under the *Payment Systems (Regulation) Act 1998* (Cth) to obtain information if necessary, and should report on its findings publicly.

Should you have any questions in relation to this submission please contact Gerard Brody on (03) 9670 5088.



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