

Payment card fees are ridiculously complex.

When you pay by a card, the merchant pays a fee to its bank. Sometimes it will pass some, all, or more of the fee through to you, the customer, through a surcharge on the price of the product you are buying. But only a few merchants surcharge, meaning that the merchant's costs of customers using cards are often spread over all transactions - credit, EFTPOS and cash. The result is that customers who do not use cards may subsidise those who do.

Even where there is a surcharge, it rarely reflects the actual card costs. Banks set a wide range of card fees and it is often impossible for merchants to know exactly what cost they pay when they accept a customer's card. And some merchants just set a flat fee for card payments, meaning that customers with small transactions pay more than the cost of the card.

The fee paid by a merchant reflects a range of underlying fees. The largest of these is the interchange fee paid by the merchant's bank to the card holder's bank. And this fee is sometimes turned into reward points for the cardholder.

These fees can be gamed. Most obviously, if there is no surcharging, the cost of the card is shared over all consumers, while individual banks can manipulate fees and bonus points to encourage customers to use their card even if it is not the cheapest or most efficient payment method. The end result is bigger profits for the banks and the card systems.

So since the early 2000s, the [fees have been subject to regulation](#) .

But the regulations have only been partly successful. So the Reserve Bank of Australia (RBA) [is reviewing the rules](#) . This is likely to result in tighter regulation. The problem, however, is that the current approach to card regulation is completely backwards.

The aim of the regulation is to make sure that the customer who chooses to pay by card faces

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the true costs of using that card. So the obvious answer is to impose the cost on the customer.

This is the system we use for ATM transactions. If you want to use an ATM that is not part of your bank's network, then you get told the fee and given the option to continue or cancel your transaction. The fee is set by your bank and part of the fee is used to compensate the owner of the ATM machine for its costs. There are no other hidden fees.

So the customer's bank charges the customer and the customer makes the decision.

We can do the same for credit and debit cards. If you have a card from bank X and bank X decides to make you pay a fee, then this is disclosed when you swipe, insert or tap your card. You get the right to continue or switch payment instruments. There is no merchant surcharge, and the merchant does not pay or get paid a separate fee when you pay by card. Your bank uses part of the fee to pay the costs of the merchant's bank.

Why is this a good idea? Because it solves most of the regulatory problems with almost no need for explicit regulatory intervention.

No more excessive surcharging. Indeed, there is no merchant surcharge. Any charge is set by your bank and if the charge is too high, then you complain to your bank or switch cards or switch banks. If you don't want to pay high fees then banks and other finance companies will pretty quickly develop low (or no) fee cards. Really want frequent flyer points? Fine - but you will now see the true cost of those points every time you use your card.

What about the interchange fee? Well - who cares? It is an interbank fee. The banks and card schemes can negotiate what they like. But it doesn't change merchant costs because the merchants will not pay any transaction fee when you use a card.

So competition between the numerous card issuers protects card holders and a simple 'no fee' rule protects merchants.

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We know that this system is possible because it already is in operation for ATMs. And we know that this system works because we have seen it work for ATMs. So 'direct customer charging' solves the RBA's regulatory problems.

The RBA may allow merchants to pay an annual fee (or receive an annual payment) from their bank. But the merchant's do not get to choose the payment instruments on a transaction-by-transaction basis. The customers make that choice. So there should be no transaction fee for merchants.

The banks and card schemes may not like direct customer charging. But it is simple, transparent regulation that removes the current hidden card fees. It empowers the customers. But the choice is with the RBA.

Disclosure

Stephen King has previously provided advice to Visa on competition matters.

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