Charges in Credit Card Payment System

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Standing on the shoulders of a giant: The potential of credit cards

The credit risk and interest cost on credit card transactions should be delinked from the MDR. The credit cost (interest) should be billed directly to customers by the card issuing bank. This would lead to savings for those merchants who are already accepting credit cards. To boost sales, such savings can always be passed on through discounts to customers. Broad basing the acceptance of credit cards to small and micro merchants, in absence of the above delinking proposal, would have an inflationary impact. Today on a Rs 1,000 transaction the merchant pays Rs 5-10 as MDR for debit card payments and more than Rs 20 if it is by way of credit card, while merchant pays nothing for receiving the money via UPI. Since these MDR costs cannot be passed on to customers by way of payment-surcharge, they get built into the overall costs of business and reflect in the higher price charged by merchants from all customers. Thus, if the credit cost is stripped out of the MDR by banks, there will be no hesitance by small and micro merchants to accept credit card based payments (including credit card on UPI). Any apprehension of the delinking proposal adversely affecting the merchants due to lower sales is unfounded since most of the *transactors* would migrate to debit cards and UPI, while *revolvers* would continue to use credit cards as usual.

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The credit card payment system is not exclusively a payment system since in it is embedded a camouflaged loan product. An avoidable element in the cost of the credit card payment system is the credit cost that piggybacks on payment cost. Here, we dwell in depth the credit card payment system and how it burdens the cost of credit onto retail merchants, polluting the digital payment space. We showcase how this inhibits the promotion of small credits for the true credit aspirants and how digital payments through credit cards takes a back seat for its acceptance by small and medium merchants.

1. Introduction

1. India has strived for payment and settlement systems that are not just safe and secure, but also efficient, fast and affordable. The government, Reserve Bank of India (RBI), National Payments Corporation of India (NPCI), mastercard, VISA and the banks (along with the fintech companies) have contributed significantly towards the country's goal to bring in a digital environment in the payments space, as the people of India move towards a less-cash society.

2. Unlike yesteryears, when cash and cheques were the sole means for monetary transactions, today with our technological advancement, we have developed several alternative and efficient digital means to carry out similar transactions. As India strives to move from paper-based payments to digital payments, apart from ease of transacting, a crucial aspect that will drive acceptability is affordability of making and receiving digital payments.

3. Compared to the cost involved in operating and managing the cash and the cheque payment systems, the digital payment systems cost far less. Therefore, as the country moves into the era of digital payments, the comfort of affordability for the users is very crucial.

4. The regulatory intervention for charges in the payment systems, for users and others, has to be judiciously carried out. As highlighted by RBI, an efficient payment system requires that the fees/

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charges/ prices are appropriately determined, to ensure optimal cost to users and appropriate return (revenue/ earning) to operators. On August 17, 2022, RBI brought out a "*Discussion Paper on Charges in Payment Systems*" with an intention to seek answers to few questions from the public and other stakeholders.[1]

5. In an attempt to address the questions posed by RBI, we present a three-part report addressing all questions. In Part-I of the report[2], we had taken up all digital payment systems considered by RBI, other than those related to credit card and Unified Payments Interface (UPI). Here, we dwell in depth the credit card payment system and how it burdens the cost of credit onto retail merchants, polluting the digital payment space. We showcase how this inhibits the promotion of small credits for the true credit aspirants and how digital payments through credit cards takes a back seat for its acceptance by small and medium merchants.

2. Merchant payments through credit cards

6. Merchants happily accept payments through less expensive debit-based modes (like cash/ debit cards/ UPI/ etc.), where consumer funds are used instantly. However, the much expensive merchant discount rate (MDR) associated to credit cards dissuades small and medium merchants to accept the same. Credit card payments are deferred payments in the sense that card user defers the actual payment of funds to a later date. In the interim the card issuer bank extends a loan and pays the merchant. The cost of deferred funds is borne by the merchant. Thus, the credit card payment system is not exclusively a payment system since in it is embedded a camouflaged loan product, making credit card acceptance for merchants very expensive.

7. Though, both instant and deferred payments run through the same operations of digital payments, in the case of credit card payments an additional cost of credit is thrust onto the merchants in case they are willing to accept this digital means of payment. This has always remained a point of contention resulting into many merchants, having influence or negotiating capacity, removing the *piggybacked* credit of their back. Such a removal of the credit load is achieved through what is called credit card payment surcharge. In the absence of strong desire, a more practical and logical solution to the credit card payment system has been avoided by the market participants and the regulators worldwide.

8. For merchants, there is a cost to handle cash as it is to be secured, time invested to count the same (or install cash counting machines), efforts required to deposit the cash, etc. Though it costs the merchants to manage cash, they do not impose a separate charge to receive cash. Similarly, there is a cost to handle digital payments in form of installation of digital payment solutions, managing a SIM and phone/ sound box for receiving payment confirmations, installing POS

[1] *Discussion Paper on Charges in Payment Systems*. (Available for public comments up to October 3, 2022). RBI. August 17, 2022. https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=21082

[2] Das, Ashish (2022). Charges in Payment Systems in India. IIT Bombay Technical Report. October 2, 2022. http://www.math.iitb.ac.in/~ashish/workshop/DPSS-ChargesPS-2022.pdf

terminals, etc. The merchants build their cash handing costs and digital payment costs into the net cost price. Thereafter, the selling price is arrived at by adding a profit margin to their net cost price.

9. Unless it is an essential commodity, the country's economic system has given the freedom to merchants, in general, to determine their selling price as per the economies of supply and demand. On similar lines, while providing payment solutions to the merchants, banks and fintech companies have the freedom of decide on their selling price of the payment solutions. However, the pure payments aspect of the payment system being an essential service, it is closely regulated by laws and RBI regulations. Nevertheless, RBI or the government should never make the banks and fintech companies liable to provide such services by paying from their own pockets. Their business model while providing such services in form of payment solutions must be remunerative and this remuneration has to get derived from those who are being served, whether the merchants, consumers, RBI, or the government.

3. Credit card transactions and MDR

10. Though as of July 2022, there are about 8 crore[3] credit cards outstanding, the number of distinct users of credit cards is around 3 crore only. There has been a steady growth in the number of credit cards and their usage.[4] However, there are only few players in the credit card business who dominate the issuance of such cards and have a major pie in the transaction volume and value. HDFC Bank, ICICI Bank, SBI and Axis Bank constitute the Big Four in the space of credit card business. They contribute to more than 71% of the credit cards outstanding and 76% of the credit card transactions in volume and value terms (Table 1). The Big Four thrust a heavy credit cost burden on the acceptance infrastructure. Chart 1 shows the share of credit card transactions within The Big Four.

Table 1: Outstanding credit cards and Transactions done by cards issued by the bank - July 2022

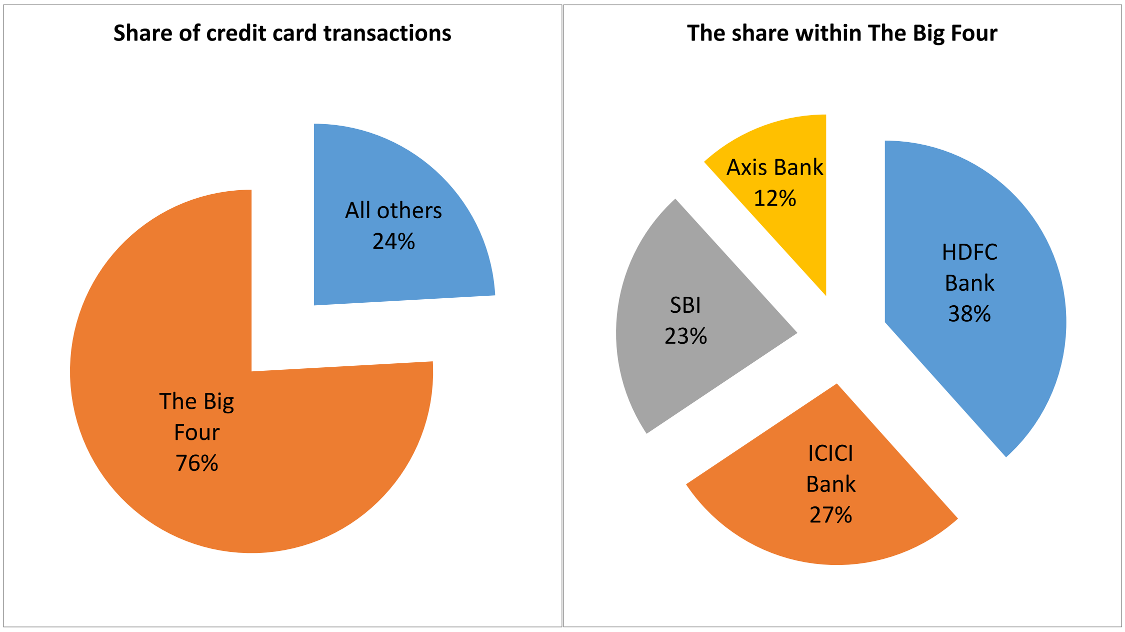
	Credit Cards		
	Outstanding cards (Crore)	Volume (Crore)	Value (Rs Crore)
HDFC Bank	1.79	5.95	32844.87
ICICI Bank	1.37	4.62	23346.24
SBI	1.45	4.18	19367.77
Axis Bank	0.99	2.67	10065.23
The Big Four	5.61	17.43	85624.12
Total (excluding Amex)	7.89	23.06	112837.58
The Big Four as a % of Total	**71**	**76**	**76**
Total (including Amex)	8.03	23.48	115855.66

Data Source: RBI "BANKWISE ATM/POS/CARD STATISTICS"

- Total is based on all banks excluding American Express which issues only Amex credit cards.

[3] 1 crore = 100 lakh = 10 million

[4] The August 2022 data on credit card has shown a reduction in the number of outstanding cards by over 22 lakh. This is attributed to the RBI Master Direction on credit card, effective July 1, 2022, which states "*If a credit card has not been used for a period of more than one year, the process to close the card shall be initiated after intimating the cardholder. If no reply is received from the cardholder within a period of 30 days, the card account shall be closed by the card-issuer, subject to payment of all dues by the cardholder.*"



Data Source: Table 1

Chart 1: Share of credit card transactions (in value terms)

11. We observe that in the month of July 2022 alone, there had been over Rs 1.1 Lakh crore worth of credit card transactions (Table 1). Even for an average MDR of 1.5%, this amounts to revenue collections of Rs 1700 crore a month, i.e., more than Rs 20,000 crore a year.

4. Balancing the cost of credit in the digital payment space

12. The issue of sanitising credit card distortions in India's digital payments space has been dealt thoroughly in Das and Das (2016) and Das (2019).[5] Today with credit cards being an important and relatively expensive mode of digital payments, do merchants have a level playing field while accepting such credit cards vis-à-vis debit cards or UPI? If not, this needs to be addressed appropriately to avoid disadvantaging merchants while accepting at par the credit cards and the other forms of digital payments (debit cards/UPI/mobile wallets, etc.).

13. Card networks mastercard/ VISA/ Amex are pioneers of credit cards business since they set the business model in absence of other cashless retail payments. Initially credit cards did not have the flavour of being in the league of digital payments. However, later with technological capabilities, the card networks could effectively develop an efficient credit-based digital payment system. They became the giants of the digital payments through well researched strategies on interchange. However, with the inception of several alternative and efficient digital means of

[5] Ashish Das and Praggya Das. "*Sanitising Distortions in Digital Payments*" of November 28, 2016. http://dspace.library.iitb.ac.in/jspui/handle/100/18430
Ashish Das. "*To surcharge or not to surcharge! The plight of small and medium merchants*" of March 3, 2019. http://dspace.library.iitb.ac.in/jspui/handle/100/25212

payment, is it time now to have a fresh relook at the credit card payment system in India and possibly, worldwide.

14. As a financial product, credit card is a combination of the payment system and the credit system. Until debit cards came into being, credit cards were primarily the only digital payment product available. Unlike credit cards, the debit cards and UPI are pure payment products.

15. For the average credit of 38 days[6] provided for credits enjoyed through credit cards, the credit card issuing bank, as per the RBI mandates, has to necessarily receive interest for the credit. Accordingly, the cost of credit for the unsecured loans being provided through credit cards for the 38 days works out to be at least 1% of the credit card transaction amount. This 1% cost has to be part of the interchange and thus of the MDR. This makes credit cards an expensive payment product as against debit cards or other credit-less payment products. It would be unfair to thrust such a credit loaded payment product in the name of digital payments. However, to retain such an excellent digital-credit product for the payment needs, it would be fair to see that the beneficiaries of credit facility bear the interest burden and that the cost is not passed on in a camouflaged manner to the digital payment systems' cost.

16. **Even if we consider a conservative estimate of the true average differential of MDR between credit cards and debits cards as 1%, data from Table 1 suggests that credit card system is burdening the payment system users by over Rs 13,000 crore annually.** From whose pocket does this amount come from? Indeed, the consumers, since this amount adds to merchant's cost price and thus attribute towards the selling price. Users of the payment system (consumers) are unknowingly and mostly unnecessarily bearing this avoidable cost, even though other cheaper and equally efficient modes of digital payments (like debit cards/ UPI) exist alongside credit cards. On a more serious note, this means that the non-credit card users transacting digitally are cross subsidizing for the expensive credit card system. However, from a banker's perspective, the interest revenue generated through interchange is healthy for the bank because that is exactly their business, except that the loan is taken by the card holder and not the merchant, while the merchant bears the interest burden.

17. One has to be careful to address the concerns of the merchants, where though a merchant is happy to accept cheaper modes like debit cards/ UPI (and accordingly price his products), he develops a negative impression of the electronic payment modes just because he is forced to accept a premier credit card with an associated MDR as high as 3%. Going by the current practice of honouring debit and credit cards at par, if the selling price is uniformly hiked by the merchant, it becomes unfair and discriminatory for the users of debit card and UPI.

18. None of us who are the users of debit card and UPI questions the merchants (and the government and RBI) as to why on a purchase of Rs 30,000, the selling price of the product is the same whether a credit card or a debit card/ UPI mode is used to making the payment. Given that

[6] Based on average of the number of days of credit, i.e., 24 days through 52 days.

their net cost price differential is around Rs 600 when a credit card is accepted vis-à-vis debit card/ UPI, it is important to understand as to why the merchants have the inertia to earn more from debit card/ UPI users than credit card users? In other words, why does there exist digital means of payments where the non-credit card users transacting digitally are cross subsidizing for the expensive credit card system? How do we address this? Would payment-surcharge be the solution?

5. Payment-surcharge

19. RBI has put a section on "Surcharging and Convenience Fee". At the onset, it is important to clarify that the terms have a special meaning in the payments space. There is a clear distinction in what is meant by a surcharge and a convenience fee. The statements made by RBI may mislead the general public of what is surcharge and what is convenience fee.

20. As such a surcharge may be completely different from a payment-surcharge. We may have Income-tax department imposing a surcharge, Indian railways imposing a surcharge, electricity provided by Discoms imposing a surcharge, Airlines imposing a surcharge for fuel or congestion, etc. All such surcharges may be legitimate and is not in question. Our concern is with surcharge imposed by merchants onto the consumers that is related to payments alone and thus we should be specific in mentioning it as *payment-surcharge* rather than surcharge alone.

21. As such surcharge and convenience fee are not necessarily additional charges levied on customers while undertaking digital transactions. Unless it gets clearly depicted that the charge is specifically because of making a payment using certain payment modes, it is not a contentious issue. Thus, we concentrate only on those charges expressed as a charge that is being imposed for using the payment system alone (and which can be easily demonstrated).

22. Payment-surcharge arise in order to pass on the cost of MDR incurred by the merchants onto the customers. Such a practice of payment-surcharge has been strongly opposed by mastercard/ VISA when credit cards had been the only means of digital payments. Now with other non-credit based digital payments available, the downward risk of hurting the overall digital payments no longer stands even if payment-surcharge is allowed for credit card payments. Many countries have accordingly legalized credit card payment-surcharge. [7] Indian regulators have not intervened yet on this aspect.

6. To surcharge or not to surcharge digital payments

23. Should we allow payment-surcharge on credit cards to balance out credit-less payments cross subsidizing the expensive credit card system? Merchants being given the freedom to surcharge only on credit cards could lead to misuse, given the gullible nature of customers. It will also be difficult to implement, since it would be a challenge to assess merchants overcharging, etc. Thus,

[7] Australia and New Zealand are the major ones among a few countries, to have given freedom to their merchants to surcharge separately when payments are made through credit cards. The European Union and several states in the US also allow the same.

for credit card transactions, merchants being given the freedom to surcharge based on the differentials in MDR (that exist vis-à-vis debit cards) does not appear to be a good idea.

24. Instead MDR for credit cards should be made same as that for debit cards (or similar forms where there is no credit cost involved) and let issuing bank be given the freedom to impose their Board-approved credit fee onto the credit card users when the credit card monthly statements are generated (compensating for the decreased interchange that the issuing bank would receive).

25. Such a move would impact the domestic credit card usage (and the credit card business). One would see decline in the usage by explicit credit-cost conscious customers, but they would migrate from credit card payments to other non-credit based electronic payments which are seamless, secure and cheaper for merchants with no apparent cost to consumers.

26. However, non-credit based digital transactions initiated by the merchants should be devoid of any payment-surcharge. Such a practice is prevalent worldwide and we see laws and regulations put in place for the same in India.

7. Credit card on UPI and BharatQR

27. With the linkage of '*credit card on UPI*', customers will benefit from the increased opportunity to use their credit cards, and merchants will benefit from the increase in consumption by being part of the credit ecosystem with the acceptance of credit cards using asset-lite QR codes. A credit card will be linked to a UPI ID, enabling UPI based payment transactions. Though currently 'credit card on UPI' is operational only for RuPay credit cards, but credit card on BharatQR is operational on all the three major networks, i.e., mastercard, VISA and RuPay.

28. We would need to internalize the potential inhibitors of acceptance for Person-to-Merchant (P2M) transactions through UPI. Also, though radical, there is a potential for designing Person-to-Person (P2P) transactions through 'credit card on UPI'.

29. UPI-based credit is believed to have the potential to be a game changer in the field of micro and small retail credits taken, with its associated credit costs paid for by the credit card holder. However, to achieve this potential, the present model of credit cards that had been initially created by the pioneers, for the well-off customer base, needs a relook. How do we truly enhance the benefits of credit and UPI to a large section of the population? We would need to create an environment to facilitate those who are tight pocketed and have requirements for micro and small credits, and who are usually not seen shopping at brick-and-mortar merchant locations who accept credit cards.

30. With the linkage of accounts of physical and virtual credit cards to UPI, all streams of the population would have greater access, benefits and increased opportunity for the use of credit to avail retail merchandise and services. The merchants will also benefit from the increase in consumption by being part of the UPI-based credit ecosystem at no additional cost.

31. While linking all credit cards to UPI is meant to give more options to the consumers, it will also help in market expansion. The objective is to provide the facility of micro and small credits to majority of the 30 crore plus UPI users. The rich transaction data (UPI) would allow analytically filtering out potential users of micro, small and medium credits through 'credit card on UPI'. The concern of enabling 5 crore plus merchants to start accepting UPI-based credit becomes a non-issue when there is no extra burden on the merchants, just like accepting present day UPI payments. The burden of the credit cost would happily be taken by those who are in real need of credit and thus use the UPI-based credit accounts.

32. Thus, we see that the need of the hour is to sanitize the credit-blended model in the credit card digital payment system. By unburdening the cost of credit onto retail merchants (that is currently polluting the credit card digital payment space), would promote micro and small credits for the true credit aspirants and encourage acceptance of 'credit card on UPI' by small and medium merchants.

8. E-commerce merchant payments

33. With technological changes, systems have developed in the payments space where payment transactions can be done remotely and instantaneously. This has been a boon for the e-commerce sector's online sale of services and commodities. The e-commerce industry runs under a model that just requires a warehouse/ kitchen to distribute their sales. As such, to enable sales there is no need for a formal brick and mortar shop for walk-in customers. This reduces costs on physical infrastructure but it increases costs on IT driven sales operations. One of such costs arise due to the services provided by the payment solution providers. The banks and fintech companies should provide efficient payment solutions for the e-commerce industry and charge for the same. The services rendered by the payment solution providers have to be remunerated well in form of fees. This is completely acceptable for the e-commerce industry as payment solutions are not only their backbone of business continuity but are also part of their business costs that is accounted for to run the business.

34. Accordingly, focusing only on e-commerce transactions, the use of debit card, prepaid card, prepaid wallets and UPI (and also credit cards once the credit related costs are no longer thrust) are analogous since the payments-solution provided are on an integrated platform. Thus, the MDR related price that needs to be borne by the organized sector of e-commerce merchants and institutions should be at par for all these modes. Restricting to e-commerce related transactions, there is a potential to introduce a uniform fee of 0.3% (or a more judiciously arrived rate) across all these modes. Such a fee imposed on e-commerce merchants and institutions who cannot transact in cash (or has inconvenience to transact in cash) would be more in line with digital payment facilitation fee. However, such a suggestion is premature as this would need a more thorough understanding of the pros and cons and more importantly, the government has to be on board.

9. Concluding remarks and point-wise answers to the questions posed by RBI

35. It is prudent to compare the costing structure of credit-based and credit-less payments. The cost burden of the perceived 'free' credit that is embedded in the payment system needs to be addressed, for which RBI has suggested a possible solution. For transiting to a fair and non-discriminatory pricing, merchant preference and consumer perception on credit cost in the digital payment system needs to be internalized. There has been a significant increase in the growth of debit card and UPI usage for P2M transactions. While this augurs well for digital inclusion of the lower spectrum of consumers, a negative fallout is that the hidden credit burden in the payment system gets indirectly shoved to small customers in the regions where credit cards, debit cards and UPI prevail simultaneously.[8]

36. Among the potential solutions suggested by RBI for MDR and interchange, our feedback is one – make credit a conscious credit rather than polluting the digital payment system. Let the credit card system bring on board the micro, small and medium credit takers who are truly in need of credit and are also happy to pay for the corresponding credit cost. Thus, in RBI's words, India should leap forward and take the approach of

> "*Delinking cost of performing transactions from the cost of funds (credit) and credit risk: The merchant may be charged only for the cost of enabling payment which is similar to that for a debit card; the other element of cost (i.e., the cost of providing interest-free credit) is recovered by the issuer from the credit cardholder separately. However, this scenario is not witnessed across any jurisdiction and may lead to significantly reduced usage of credit cards which, in turn, may as well adversely affect the merchants (due to lower sales). It is also true that some merchants recover the cost of a credit card transaction from customers by levying surcharge for credit card usage or by giving more discount on cash payments as compared to credit card payments, thereby leading the customers to opt for cash payments or end up passing onto them the cost of accepting the transaction. In such situations, the merchant is compensated by the customer, sometimes more than her / his outgo.*"

Though internationally this may be a radical step vis-à-vis allowing payment-surcharge, however, for the good of the credit card digital payment system – both for the whole gamut of merchants and the true credit takers – such a step is most advisable in today's world when India has several alternative means of digital payments. Such a move would be more efficient than its surrogate, payment-surcharge; recall payment-surcharge is legal in Australia, New Zealand, the European Union and several states in the US. India taking the first step of delinking the credit cost of the interchange would be a lesson for the world. And for this to see the light of the day the government and RBI both have to steer it through.

[8] The premium credit cards also enjoy freebies like reward points, lounge facilities, etc. The cost for these freebies is recovered in the form of even higher interchange fee. With about 90% of credit cards being premium cards, this effectively increases the subsidy rich clients receive from the poor. Our assessment of the cost burden is, therefore, an underestimate as we do not account for this additional burden.

37. In RBI's suggested approach above, a vital aspect that is missed is that even without a payment-surcharge, the credit cost imbedded in the interchange that is paid by the merchants, in-turn gets passed on to all her customers through increased selling price of goods and services.[9] Thus, credit-less payments cross-subsidize the hidden cost of credit embedded in the payment system. Regarding more discounts on cash payments, a simple litmus test would be to identify merchants in the e-commerce space who give a discount for using debit card/ UPI over credit cards? Practically none.

38. RBI's impression that

> *"... the scenario may lead to significantly reduced usage of credit cards which, in turn, may as well adversely affect the merchants (due to lower sales)."*

is similar to mastercard/ VISA's old argument against payment-surcharge. Yes, it is true that this would indeed reduce usage of most such credit cards held by those who have the capacity to instantly pay through their bank accounts, but that will not lower sales due to availability of other digital payment options. Most of the credit card users are not the real credit takers since they are the ones who pay off their monthly outstandings well within the due dates (they are called *transactors*). Currently *transactors* contribute towards 70-75% of credit cards' overall monthly transaction value.[10] This means that the balance amount of transactions is of credit card users (called *revolvers*) who carry the credit card balances from one month to the next. These *revolvers* are the real credit takers. *Revolvers* as a group are a major source of revenue for credit card issuers because they pay interest on their outstanding balances. For India, such a credit card based loan business primarily comes from 25-30% of credit cards' overall monthly transaction value. And the rate of interest applicable to such *revolvers* is typically as high as 30-40% per annum because of the high delinquency risk that the creditors carry.[11] Credit card business should earn from conscious credit offered in the hands of the card holder and the scope of more credit utilization through revolving credit. **Any apprehension of merchants being adversely affected due to lower sales is unfounded since most of the *transactors* would migrate to debit cards and UPI, while *revolvers* would continue to use credit cards as usual.**

39. The burden of credit pollutes the digital payment space. An avoidable element in the costs of digital payments is the credit cost that piggybacks on payment cost and raises the overall cost burden. For small and medium merchants – the largest in number among the merchant community – this cost hurts. Such merchants hesitate to accept credit cards, since for them credit card MDR is 2-3%. However, they are happy to accept debit cards and UPI that bear no or

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[9] Increase in product price by merchants to adjust for high card payment cost has been noted among others by the European Commission 2013, the European Union 2015, Government of India 2016, and RBI March/September 2016.

[10] Against the current contribution of 70-75% by the *transactors*, during pre Covid times this used to be of the order of 75-85%.

[11] *Transactors* do not carry a balance from month to month; they always pay their credit card bills in full by the due date, so they are not required to pay high interest of 30-40% per annum or late fees. However, irrespective of the number of days of credit enjoyed within the due date, card holders could be charged interest @ 1% of the transaction amount by the issuer bank (leading to loan interest not even exceeding 12% per annum for deferring payment by 30 days or till the due date). Alternatively, interest @ 12% per annum can be charged only for the number of days of credit enjoyed within the due date.

minimal MDR. While for many merchants who are not ready to bear this credit cost, the banks resort to facilitating payment-surcharge; for small and medium merchants, who have no bargaining power, the cost burden continues to be theirs. With the credit component of the interchange being removed, the *residual* interchange in the credit card MDR would be the same as that of debit cards.

40. Finally, the related questions on charges in credit card payment system is taken up below. In this process we also address the questions posed by RBI on 'Surcharging' and 'Other Aspects'. To understand the answers better, it is advised to go through the details presented in the relevant sections of this report.

Credit Cards

i. Are credit card MDR charges reasonable?

Merchants have to honour and accept debit and credit cards at par. For them, the ease of receiving money is the same for both debit and credit card. However, the high MDR for credit card acceptance overburdens small and medium merchants. Thus, from a merchant's perspective the rules of credit card MDR need to be aligned with the rules of MDR applicable for debit card and UPI. Accordingly, the extant rules and regulations set towards MDR/ interchange/ acquirer commission for debit cards and UPI should apply for credit cards as well.

ii. Should RBI regulate MDR for credit cards?

YES. Make the credit card MDR at par with the debit card MDR. Similarly, make the MDR at par for UPI and 'credit card on UPI'. The interest and risk component of the credit involved in a credit card transaction should be borne by the credit card users. In case the merchants would want to absorb this cost, they have the freedom to offer a discount while selling their merchandise/ services. This would be a boon for both merchants and credit card users (who do not have the required balances in their bank account). The approach would be ideal for linking credit cards to UPI.

iii. Instead of MDR, should RBI regulate interchange for credit card transactions?

NO. With interchange being made devoid of the credit cost, the *residual* interchange in the credit card MDR would be the same as that of debit cards. *Residual* interchange being a part of the regulated-MDR, the quantum of *residual* interchange can be left to the card networks to decide. However, if the banks are not satisfied with the approach adopted by the networks, the regulator can pitch-in.

iv. Should RBI regulate both MDR and interchange for credit cards?

NO.

Surcharging

i. Are surcharges justified? Are they desirable?

YES, payment-surcharge is justifiable (if merchants so desire) for credit cards alone to the extant credit card MDR is in excess of debit card MDR. To arrive at an unbiased pricing of a product or service, such a payment-surcharge at the hands of the merchant may be desirable only for credit cards. However, this does not imply that we allow merchants to surcharge the card holders when instead, the issuer bank can do the same more effectively by imposing the credit cost directly. Any apprehension that the merchants would be adversely affected due to lower sales is unfounded since *transactors* would migrate to debit cards and UPI, while *revolvers* would continue to use credit cards as usual. Moreover, lower sales due to reduced usage of credit cards resulting from credit cost being directly imposed onto the credit card user by the issuing bank can be overcome through merchants offering discount, if they so desire.

ii. Should merchants be allowed to levy surcharge on customers?

NO for credit cards, and NO for any other non-credit based digital payments. However, the cost of credit associated with credit card usage should be borne by the credit card user and not the merchant (who is presently bearing it by default). We should not allow merchants to surcharge for credit card usage since surcharging in the hands of a merchant has a potential of misuse by the unregulated merchant space and may not only be retrograde to the use of digital payments but also negatively impact customer sentiments. Issuer banks alone should be allowed to impose any additional fees (the cost of loan) on to their credit card users for credit card transactions and this should reflect in the credit card monthly statements.
The credit card issuing bank should keep credit card holders informed of their Board-approved schedule of credit fees depending on the credit card type.

iii. Should surcharging be regulated? By whom?

YES, RBI should regulate the surcharging through a "no payment-surcharge rule".

Other Aspects

i. Should the levy of charges for a digital payment transaction be independent of the value of the transaction?

NO for merchant payments involving common digital payment modes like credit card, debit card, UPI, 'credit card on UPI', prepaid card, and the like. When factoring in the extent of risk and other associated cost of funds, we would tend to favor charges for digital payments to be value based.

ii. Should the levy of charges for a digital payment transaction be the same irrespective of the number of seats / tickets booked?

If this question relates to convenience fee, it is outside the purview of the payment system. However, if this relates to the payment-surcharge, we refer to the relevant section on payment-surcharge for answers.

iii. Should the levy of charges by merchants be marginal cost-based, meaning that only the additional costs incurred by them for facilitating a digital payment transaction should be recovered from the users?

We have already elaborated on the payment-surcharge related to the cost of credit that is built in the credit card interchange. No charges for accepting payments should be showcased by the merchants even if they may be paying a price for accepting payments through any mode of payment (cash or digital). Such expenses incurred by the merchants should be built in their cost price for doing business and should be accounted for while arriving at the overall selling price.

iv. Should the charges for digital payment transactions be market determined – based on demand and supply – without any regulatory or sovereign intervention?

Payment system is not a commodity for retail consumption that it can be left to the market to determine its pricing in an unbounded fashion. RBI as the regulator of the payment systems should intervene as required, and where it fails, the government should pitch-in.

v. What more transparency could be brought in for such charges?

Bring in more transparency on the cost of cash. Transactions in cash appears to be free even if we use Rs 1 lakh for transacting in a month. Showcase cost of cash through value-based rather than volume-based withdrawal charges.
The present nation-level exercise that is being carried out by RBI to receive inputs from the public/ other stakeholders would generate enough data and RBI should be transparent in summarizing and presenting the same for the consumption of the nation. Else there would remain questions of RBI being short on the transparency front. The responses to the questions posed by RBI would be mostly a YES or a NO with some inherent explanations provided. Even if the responses may not gel with RBI's thought process, in order to be transparent, summary statistics should still get presented by RBI. Just to illustrate, RBI had always been against imposition of MDR caps and if left to them, we would not have seen the 2012 regulations on debit card MDR. But for the government's intervention, the genesis of MDR caps would have eluded all. And now for UPI the same thing happened since RBI on their own was unable to appropriately decide on the UPI charges. This led the government to intervene and make UPI free for all.

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