



# DCC: HOME OR AWAY?

In a guest article for *Insights*, Eric Grover of Intrepid Ventures outlines his belief that consumers are being ‘fleeced’ by modern dynamic currency conversion practices

Consumers take for granted the enormous convenience and security of using credit and debit cards worldwide and that they’re a great deal. But there’s a fly in the ointment.

Tourists, business travellers and shoppers at e-retailers abroad are being systematically fleeced, lured into making card payments in their home rather than local currency. The practice called dynamic currency conversion (DCC) sounds great but is deceptive and horrendous value.

Merchants take a currency-conversion fee of two to four percent – often more. Paying in local currencies, cardholders receive a wholesale conversion rate through networks such as MasterCard and Visa. However, most consumers pay in their home currency because it’s familiar and they may be unaware they’d enjoy a better foreign-exchange rate paying in the local currency.

Players across the retail payments value chain – card issuers, networks and merchant acquirers – have long harvested rich cross-border fees as a result.

American card issuers reaped supra-competitive cross-border fees because they were hidden, buried in transactions on cardholders’ billing statements. A 2006 settlement of a consolidated class action suit against MasterCard, Visa and bank-card issuers including BofA, Capital One, Chase, Citi and Wells Fargo ended the practice. US issuers now disclose and separately itemise foreign-transaction fees.

Former US Supreme Court Justice Louis Brandeis observed: “Sunlight is said to be the best of disinfectants”. Full disclosure, competition and consumer choice work. Capital One has no foreign-transaction fees.

Amex, Chase and Citi offer select cards not carrying them. But for most Americans foreign-transaction fees aren’t a primary decision criterion when choosing a credit card. BofA, Chase, Citi and Wells Fargo all charge three percent and Amex charges 2.7 percent for foreign payments on most of their cards.

Across the pond, British issuers typically take just under three percent in curren-

cy-conversion spread above the wholesale foreign-exchange rate and itemise and disclose it separately on cardholder statements.

Barclays charges 2.99 percent for non-sterling transactions, Lloyds Bank 2.95 percent and HSBC 2.99 percent. But British consumers who want to use payment cards overseas have choices and can avoid non-sterling transaction fees. Nationwide offers foreign-transaction-free and commission-free allowance cards.

MasterCard and Visa also earn juicy cross-border transaction fees, which account for a whopping one-third of their revenue.

Visa charges issuers 100 basis points and acquirers 85 basis points on most cross-border transactions, more than ten times the licensing and processing fees for a typical domestic payment.

In 2006, Visa converted its issuer foreign-exchange conversion fee to a cross-border processing fee preventing DCC disintermediation. MasterCard charges issuers 80 basis points for

cross-border processing and 20 basis points in currency conversion fees and it charges acquirers 85 basis points in support and processing fees.

Payment network cross-border transaction fees are fully disclosed and their licensees and members are sophisticated financial institutions.

There's enormous value in parties unknown to each other being able to spontaneously and securely transact and enjoy wholesale currency-conversion rates, anywhere in the world. Even multinational financial Gargantuas like Barclays and HSBC can't match MasterCard's and Visa's global acceptance networks (and would be foolish to try).

Not to be left out of the cross-border fee bonanza, many merchant acquirers turned to specialists such as Planet Payments, Monex, Fexco, Global Blue, Pure Commerce, Cambridge Mercantile Group and Fintrax to deliver DCC to merchants, enabling them to capture currency-conversion fees at the point of sale. US Bank's Elavon delivers its own DCC service. But DCC doesn't stand the sunlight test.

Nobody in the payments industry would advise a French friend holidaying in London or New York to pay in euros using DCC.

The system-wide consumer rip-off, however, hasn't incited ire from politicians, regulators, consumer activists or trial lawyers because it's foreigners who are being fleeced, and local merchants who are benefitting. Nevertheless, the practice is utterly deceitful.

MasterCard and Visa require merchants offering DCC to give cardholders a choice and disclose the amount in the merchant's currency and in the cardholder's native currency, the exchange rate used and additional fees assessed.

In practice merchants, having ample incentive, frequently simply execute payments in the consumer's home currency. Consumers are often not aware it happened and rarely know that they've been gouged. On the spot, who but a foreign-currency trader would know?

Mimicking the payment schemes' rules governing DCC, the European Commission's Payment Services Directive 2 article 52 would require that payments "be made in the currency agreed between the parties" and "the party offering the currency conversion service to the payer shall disclose to the payer all charges as well as the exchange rate to be used for converting the payment transaction".

However, given the knowledge asymmetry between the merchant and a one-time foreign consumer, limited disclosure and merchant incentives, the payment schemes' rules don't – and the Commission's regulations wouldn't – prevent cardholders from continuing to be system-

plain and most US issuers prevent disintermediation by DCC because they earn foreign-transaction rather than currency-conversion fees.

They should rethink. Proactively defending their cardholders' welfare, and being seen to be doing so, is in banks'

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Meaningful disclosure would present the cardholder with the estimated price in his home currency with a wholesale foreign-exchange rate side-by-side with the price using DCC. Few cardholders would knowingly elect to pay up to four percent more just to have a receipt in their native currency.

Consumer activists and regulators are hostile to pricey overdraft fees, payday lending, and subprime credit cards. But, with full disclosure of all the material facts, some consumers think they have value.

In contrast, if a London merchant presented a cardholder with the option of paying £1000 that converted at today's wholesale foreign-exchange rate would be billed at \$1690 or of paying \$1758 with DCC, what cardholder would see value? It's a blemish on the payments industry.

Unfortunately competitive dynamics on the acceptance side of the network harm consumers.

Merchant acquirers that don't offer DCC are disadvantaged. It's enormously profitable. In 2013, DCC specialist Planet Payments' gross foreign-currency markup, shared with acquirers and merchants, was four percent. And, unfortunately, some merchants love nothing better than to be able to trick one-time foreign customers into paying an extra three or four percent.

If no one complains, why leave it on the table? Bank acquirers, DCC specialists and merchants share rich conversion fees and are therefore highly motivated to promote it. The costs are hidden and widely dispersed.

Bankcard issuers generally have turned a blind eye to DCC because cardholders, unaware they've been shafted, rarely com-

interest. Banks should energetically warn cardholders to avoid DCC.

Curating open global payment ecosystems, MasterCard and Visa have to take a holistic view of value. MasterCard imposes a 40 basis point penalty fee on DCC transactions – not nearly enough to deter merchant acquirers and retailers making eight times more on currency-conversion fees.

A few years ago Visa attempted to ban future DCC programmes but backtracked due to pressure from merchant acquirers. Global retail payment schemes own the payment products and are consequently in the best position in the payments industry to take the lead on curtailing DCC.

The networks could ban the practice, increase penalty fees, or, best of all because no one could object and it would solve the problem, require merchants offering DCC to disclose the estimated price with wholesale currency conversion side-by-side with the DCC price.

Besides gouging cardholders, there's an industry opportunity cost. Entrepreneurs, capital and industry bandwidth devoted to developing and promoting DCC could otherwise be deployed in real value-creating activities developing the next PayPal, Stripe, Mercury Payment Systems or Clover.

The payments industry should curb DCC because it's the right thing to do, would be good for and build trust with consumers and would pre-empt more action by regulators.

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