



## COMMENTS ON

### **DRAFT CIRCULAR - RATIONALISATION OF MERCHANT DISCOUNT RATE (MDR) FOR DEBIT CARD TRANSACTIONS**

CUTS International<sup>1</sup> welcomes RBI's circular on rationalisation of Merchant Discount Rates (DPSS.CO.PD.No./02.14.003/2016-17). Reduction of MDR would provide a much needed boost to digital payments by encouraging merchants to willingly accept digital modes of transactions. The creation of a category for small merchants is a welcome amendment and it will incentivise merchants to setup digital infrastructure. However, the MDR structure can be amended in the following ways to further encourage digital transactions, merchant acceptance and most importantly benefit the consumer:

#### **1. The need for cost-benefit analysis of regulations/circulars**

Regulations are protected by and take the force of law once finalised. The consequences of not adhering to regulations are the same as not adhering to the relevant legal provisions. Moreover, all regulations have a resultant effect on the regulated bodies and the marketplace in general. Hence, regulations need to be informed through a cost benefit analysis, which should ideally precede the release of circulars or regulations.

Notably, the Report of the Standing Council on International Competitiveness of the Indian Financial Sector pointed out that mistakes in financial regulation and regulatory uncertainty are important factors that hamper financial market development across market segments in India. Hence, it is important for RBI to recognise the costs and benefits of the regulations which it envisages. A cost-benefit analysis should be inculcated as a mandatory ex-ante procedure before coming out with regulatory actions.

#### **2. Need for uniform mechanism to ascertain MDR for government and private transactions**

The draft circular envisages a flat fee structure for government transactions on one hand and proposes to levy percentage caps for private transactions. The rationale seems to be that lower and fixed MDR would lead to increased volume of government transactions. However, the flat fees structure does not factor in the different types of government transactions, which substantially vary in terms of value. Having a flat fees structure is not

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<sup>1</sup> CUTS International is a 33 year young non-profit, non-government economic policy research and outreach organisation. More details are available on [www.cuts-international.org](http://www.cuts-international.org)

the most optimal solution and can possibly backfire; with higher transactions being subject to the same fees as lower ones (in a particular slab).

Consequently, private parties would be incentivised to provide infrastructural support to private sector merchants, due to the relative advantage of dynamic MDR calculation. The absence of dynamic rate calculation in the case of government transactions would lead to lower competition as companies will not be motivated by the prospect of recuperating costs through a static MDR. This can have serious consequences on efficiency, choice and quality of digital services and can jeopardise uptake of digital infrastructure (which is counterproductive to the current agenda of the Indian government). Hence, it is important to ensure that government transactions are put on an equal footing with others, for the sake of their own success. This can be done by following a uniform methodology of calculation of MDR.

### **3. Transparency and disclosure of MDR to consumers**

Multiple entities are involved in facilitating digital payments and providing infrastructural support. To set up digital payments acceptance the service providers have to incur costs, which are eventually borne by merchants and consumers, in form of charges such as MDR. While this draft circular has been issued with respect to rationalising MDR, there still remains a lack of transparency and disclosure to customer at the time of making transaction. To ensure efficiency of services and to provide competitive services to the consumer, it is recommended that the MDR be disclosed to the consumer at the outset.

Disclosure of MDR before a consumer makes the transaction would help the consumer to make an informed decision as to which service provider suits his requirement. It would also increase competition amongst service providers as they would strive to provide the best services at a reasonable MDR. Hence, before final authorisation of any digital payment, customer should be made aware of the charges involved in the transaction (through mechanisms like a message box on ATM screen/ PoS machine, SMS to customer, etc). Such mechanisms are also expected to increase confidence in the digital payments ecosystem.

### **4. Define the scope of Special Merchant and Government Merchant Categories**

The Annex-1 to the draft circular provides an indicative list of Special Merchants and Government Merchants. However, because the list is not exhaustive, it can lead to legal uncertainties and can become a breeding ground for disputes. Hence, it is recommended that the merchant categories be given specific definitions in order to limit their scope and ensure legal certainty.

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