mastercard

Payments System Board

Review of Retail Payments Regulation

Mastercard Response to Issues Paper

January 2020

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EXECUTIVE SUMMARY

> *Payments are complementary services, integrated in the functioning of all industries, and any incremental improvement in payments has an outsized contribution to make to the economy as a whole.*[1]

Mastercard welcomes the opportunity to respond to the Reserve Bank of Australia's (RBA) *Review of Retail Payments Regulation Issues Paper* (the Issues Paper).

Australia is an advanced, competitive payments market delivering great value to merchants, consumers, banks, governments and the economy. Consumers have access to a range of ways to pay. As noted in the Issues Paper, card payments are now the most frequently used payment method in Australia, with 10 billion debit and credit card payments for a total value of $678 billion made in 2018/19.[2]

When regulation began in 2002, the payments market provided fewer options for users, with a small number of schemes operating primarily in a card present environment, alongside cheques and cash. Since then, the market has evolved rapidly. Today, users enjoy a diverse range of ways to pay and get paid.

The Australian payments market will continue to evolve and innovate quickly. New entrants, technologies, payment options and the introduction of new products and innovations by schemes like Mastercard are proof of a competitive, dynamic sector that needs a regulatory framework to promote this evolution rather than inhibit it.

The increasing number, forms and channels of payments bring with them tremendous opportunities, as well as challenges. The rollout of the 5G communications network, advances in artificial intelligence (AI) and the Internet of Things (IoT) will lead to a very different payments system than the one existing today. In the future, there won't simply be continuing significant growth in card not present transactions; there will be "person not present" transactions, such as a smart fridge ordering more milk because it knows you've run out.

However, our more connected, digitised world also poses greater cybersecurity challenges. The shift to online payments has significantly increased the risk to consumers of fraud and data theft. AusPayNet statistics show card not present fraud costs to the industry are already close to $500 million each year. Threats to consumer information, and the potential for payments fraud against merchants, can occur at more points in the transaction flow as that flow becomes more complex and interconnected.

[1] Oxera Consulting LLP (2020), The competitive landscape for payments: an Australian perspective, p. 19
[2] Review of Retail Payments Regulation: Issues Paper November 2019, p. 1

A more comprehensive approach to managing these risks is needed, focusing on approval, security and, importantly, consumer experience. The nature of the threat is different through the consumer and merchant journey. By using biometrics, data and tools like machine learning and AI, Mastercard protects the ecosystem from the beginning (e.g. at account log in) through to making the payment and finally, to any disputes that may arise. At the same time, we ensure a high-quality consumer experience that minimises false declines, resulting in more sales for merchants. Mastercard looks at the process from end to end in its focus on contributing to safety, efficiency and resilience for consumers and merchants in this new ecosystem.

Mastercard is at the forefront of preventing fraud in all its forms and maintaining system security and resilience. Regulation should support security innovations and capabilities rather than driving a race to the bottom with respect to the costs of electronic payments. Absent incentives to invest, fraud will inevitably rise.

Evidence shows regulation deters investment and inhibits innovation and competition, so caution should be taken to ensure regulatory settings encourage - rather than discourage - these positive outcomes.

Our response to the Issues Paper is informed by three primary themes:

Value – Electronic payments deliver value across the entire payments system, to all users. This value far exceeds the cost for each participant.

Mastercard's investments in technology drive consumer benefit and choice, greater sales for merchants and safer transactions, resulting in a more resilient network with enhanced functionality. Innovations like contactless payments have enhanced customer and merchant sales experiences, particularly in high-traffic stores where fast transaction times are desirable.

The development of secure digital payments technology has allowed businesses and consumers to safely buy and sell goods and services online. As online transactions grow in size and volume, there is a need for more advanced and complex tools, leveraging tokenisation, biometrics and machine learning technologies, to protect businesses and consumers. Mastercard's implementation of tools which drive down fraud and improve security will reduce the significant costs associated with fraud in the system. This will also enable business to maximise opportunities to sell more products and participate in the global marketplace. More information about Mastercard's safety and security products and services can be found at Appendix A.

Mastercard has driven advances in payment technology and will continue to invest in ways to make the network safer and more efficient.

Transparency – Mastercard supports transparency measures that are meaningful and genuinely help users make helpful comparisons between products, services and providers. Visibility of the cost and value of different payment methods is important as it allows all participants in the value chain to understand how much it costs them to use a specific payment form, and the benefits accrued to them.

We recognise concerns raised by some businesses about the costs of accepting electronic transactions. That's why we are continuing to work with merchants and industry associations to make pricing more transparent and to educate that vital audience about the value and benefits delivered by electronic payments.

By increasing transparency, we make it easier for merchants and consumers to understand the benefits, as well as the costs, of electronic payments. For example, information currently provided to merchants from acquirers for surcharging gives merchants visibility of average costs. But this does not indicate the cost of the different networks and payment types, nor does it illustrate the benefits merchants derive from accepting electronic payments. Further, the blending of costs between credit, debit, Mastercard and Visa has resulted in less understanding of the different costs and, usually, higher costs for merchants and their customers.

Any regulatory intervention in this space must ensure the parts of the value chain the intervention is intended to benefit, actually do benefit. Mastercard contends that this has not been the case in relation to interchange regulation. The original intent of this intervention was to benefit consumers. Instead, it has simply seen a rebalancing of revenue between issuers and merchants, with no consumer benefit.

Competition – Australia is a mature payments market with a high degree of competition. Technological trends are reshaping the payments landscape and enabling new entry into the Australian market. The proliferation of new entrants is, at least in part, helping drive that competition.

Competition in the unregulated market is also creating more ways to pay for consumers, and more ways to accept payment for merchants. We have seen the growth of buy-now, pay-later (BNPL) schemes over the last five years. We have also seen the quick adoption of digital wallets, giving consumers a more convenient way to pay as well as greater confidence in the safety of their transactions. Importantly, merchants have choice in which solutions they accept. In the BNPL space, the emergence of Afterpay and similar entities demonstrates consumer demands are changing rapidly. Mastercard is keen to work with the RBA to develop a framework that encourages differing models in the BNPL space given consumer uptake and merchant appetite for this form of payment.

At the same time as new entrants emerge in the market, investment from Mastercard is driving the development of new and innovative payment methods such as contactless and more secure transactions in the form of tokenisation.

Policy measures supporting competition in payments will yield positive outcomes for consumers, businesses and the broader Australian economy by driving investment in customer-focused innovation and improving the productivity of payments as a component of the broader financial system.

The already high level of competition in the Australian payments market suggests that further regulatory intervention should only occur in those sections of the system not exposed to market forces. However, regulatory and policy interventions appear to be having the unintended consequence of reducing competition and potentially increasing risk in the system. Regulatory settings can optimise competition, a theme we discuss in more detail later in our submission. For example, the participation of new entrants, such as neo banks and fintechs, in the issuing market should lead to more competition, both in what is provided to consumers and how it is provided. However, the current regulatory and policy framework is inhibiting the ability of neo-banks and fintechs to issue cards. This is discussed in more detail below.

Conclusion
We make this response with the RBA's mandate in mind - controlling risk in the financial system, promoting the efficiency of the payments system and ensuring competition in the market for payment services, consistent with the overall stability of the financial system.

In providing this response and in the further discussions we hope to have with you, Mastercard considers the interests and perspectives of consumers, businesses, industry participants and other stakeholders.

Mastercard aims to continue to facilitate:
- An efficient and effective payments system;
- Recognition of the value electronic payments deliver to businesses and the wider economy, which is, in the case of cards, funded largely by issuing banks;
- Protection of consumer benefits and mitigation of unnecessary cost impacts; and
- Development of evidence-based policy which considers the impact of regulation on all system participants.

We look forward to working with the RBA and the Payment Systems Board (PSB) to develop policy recommendations that promote competition, efficiency and productivity in the Australian financial system.

Richard Wormald
Divisional President Mastercard
January 2020

ABOUT MASTERCARD

Overview
Mastercard is a technology company in the global payments industry that connects consumers, financial institutions, merchants, governments, digital partners, businesses and other organisations worldwide, enabling them to use electronic forms of payment instead of cash and cheques. We make payments easier and more efficient by creating a wide range of payment solutions and services using our family of well-known brands, including Mastercard®, Maestro® and Cirrus®.

We are a multi-rail network. Through our core global payments processing network, we facilitate the switching (authorisation, clearing and settlement) of payment transactions and deliver related products and services. With additional payment capabilities that include real-time account-based payments (including automated clearing house (ACH) transactions), we offer customers one partner to turn to for their payment needs for both domestic and cross-border transactions across multiple payment flows. We also provide value added offerings such as safety and security products, information and analytics services, consulting, loyalty and reward programs and issuer and acquirer processing. Our payment solutions are designed to ensure safety and security for the global payments system.

A typical transaction on our core network involves four participants in addition to us: account holder (a consumer who holds a card or uses another device enabled for payment), issuer (the account holder's financial institution), merchant and acquirer (the merchant's financial institution). We do not issue cards, extend credit, determine or receive revenue from interest rates or other fees charged to account holders by issuers, or establish the rates charged by acquirers in connection with merchants' acceptance of our branded products. In most cases, account holder relationships belong to, and are managed by, our financial institution customers.

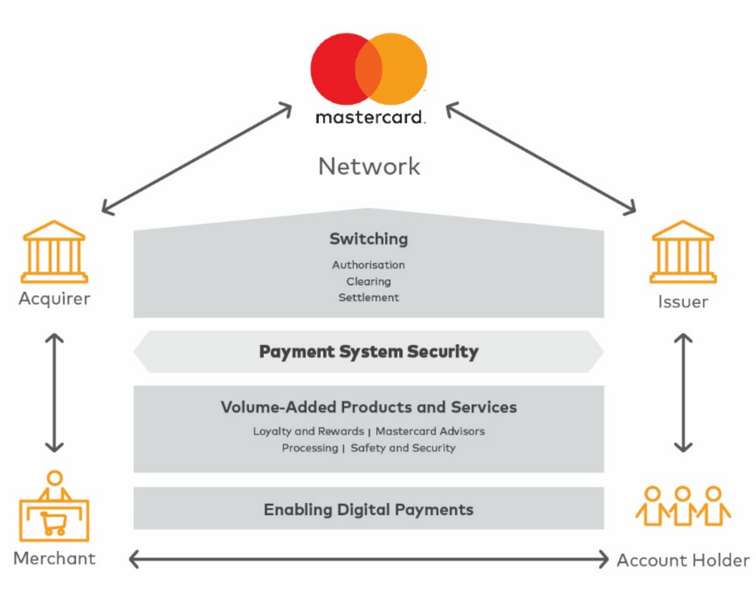
We generate revenues from assessing our customers based on the gross dollar volume ("GDV") of activity on the products that carry our brands, from the fees we charge to our customers for providing transaction switching and from other payment-related products and services.

Our Operations and Network
We operate a unique and proprietary global payments network, our core network, that links issuers and acquirers around the globe to facilitate the switching of transactions, permitting account holders to use a Mastercard product at millions of acceptance locations worldwide. Our core network facilitates an efficient and secure means for receiving payments, a convenient, quick and secure payment method for consumers to access their funds and a channel for businesses to receive insight through information that is derived from our network.

We authorise, clear and settle transactions through our core network for our issuer customers in more than 150 currencies and in more than 210 countries and territories. Vocalink expands our range of payment capabilities beyond our core network into real-time account-based payments.

Typical Transaction. Our core network supports what is often referred to as a "four-party" payments network. The following diagram depicts a typical transaction on our core network, and our role in that transaction:

Figure 1:



In a typical transaction, an account holder purchases goods or services from a merchant using one of our payment products. After the transaction is authorised by the issuer, the issuer pays the acquirer an amount equal to the value of the transaction, minus the interchange fee (described below), and then posts the transaction to the account holder's account. The acquirer pays the amount of the purchase, net of a discount (referred to as the "merchant discount" rate or Merchant Service Fee (MSF)), to the merchant.

- **Interchange Fees.** Interchange fees reflect the value merchants receive from accepting our products and play a key role in balancing the costs consumers and merchants incur. We do not earn revenues from interchange fees. Generally, interchange fees are collected from acquirers and paid to issuers to reimburse the issuers for a portion of the costs incurred. These costs are incurred by issuers in providing services that benefit all participants in the system, including acquirers and merchants, whose participation in the network enables increased sales to their existing and new customers, efficiencies in the delivery of existing and new products, guaranteed payments and improved experience for their customers. We (or, alternatively, financial institutions) establish "default interchange fees" that apply when there are no other established settlement terms in place between an issuer and an acquirer. We administer the collection and remittance of interchange fees through the settlement process.

- **Additional Four-Party System Fees.** The merchant service fee is established by the acquirer to cover its costs of both participating in the four-party system and providing services to merchants. The rate takes into consideration the amount of the interchange fee which the acquirer generally pays to the issuer. Additionally, acquirers may charge merchants processing and related fees in addition to the merchant service fee, and issuers may also charge account holders fees for the transaction, including, for example, fees for extending revolving credit.

Switched Transactions

- **Authorisation, Clearing and Settlement**. Through our core network, we enable the routing of a transaction to the issuer for its approval, facilitate the exchange of financial transaction information between issuers and acquirers after a successfully conducted transaction, and help to settle the transaction by facilitating the determination and exchange of funds between parties via settlement banks chosen by us and our customers.

- **Cross-Border and Domestic.** Our core network switches transactions throughout the world when the acquirer country and issuer country are different ("cross-border transactions"), providing account holders with the ability to use, and merchants to accept, our products and services across country borders. We also provide switched transaction services to customers where the acquirer country and the issuer country are the same ("domestic transactions"). We switch more than half of all transactions for Mastercard and Maestro-branded cards, including nearly all cross-border transactions. We switch the majority of Mastercard and Maestro-branded domestic transactions in the United States, United Kingdom, Canada, Brazil and a select number of other countries. Outside of these countries, most domestic transactions on our products are switched without our involvement.

Core Network Architecture. Our core network features a globally integrated structure that provides scale for our issuers, enabling them to expand into regional and global markets. It is based largely on a distributed (peer-to-peer) architecture with an intelligent edge that enables the network to adapt to the needs of each transaction. Our core network accomplishes this by performing intelligent routing and applying multiple value-added services (such as fraud scoring or rewards at the point of sale) to appropriate transactions in real time. Our core network's architecture enables us to connect all parties regardless of where or how the transaction is occurring. It has 24-hour a day availability and world-class response time.

Real-time Account-based Payment Systems. Augmenting our core network, we now offer real-time account-based payment capabilities through our acquisition of Vocalink, which enables payments between bank accounts in near real-time in countries in which it has been deployed.

Payments System Security. Our payment solutions and products are designed to ensure safety and security for the global payments system. The core network and additional platforms incorporate multiple layers of protection, both for continuity purposes and to provide best-in-class security protection. We engage in many efforts to mitigate information security challenges, including maintaining an information security program, a business continuity program and insurance coverage, as well as regularly testing our systems to address potential vulnerabilities.

As part of our multi-layered approach to protect the global payments system, we also work with issuers, acquirers, merchants, governments and payments industry associations to help develop and put in place standards (e.g. EMV) for safe and secure transactions.

Digital Payments. Our networks support and enable our digital payment platforms, products and solutions, reflecting the growing digital economy where consumers are increasingly seeking to use their payment accounts to pay when, where and how they want.

Further information on our products and services can be found in the appendices to this submission.

THE AUSTRALIAN PAYMENTS MARKET

Q. 1. What major recent or prospective developments in the broader payments industry are particularly relevant to this review? More specifically, are there any gaps in functionality available to end users or any shortcomings in industry governance or operating arrangements that require regulation or coordinated industry action?

Q. 2. Are there aspects of retail payments regulation that lead to market distortions or that create opportunities for regulatory arbitrage? If so, what options should be considered as a means of addressing these? Are there gaps in the regulatory regime that need to be addressed or any elements where regulation is no longer required?

Q. 12. Is there a case for applying regulation to three-party card systems? What form could this take?

Q. 17. Are there potential enhancements to the Bank's regulatory powers and enforcement mechanisms that could improve the effectiveness of retail payments regulation?

One way of assessing the functioning of a market, and whether regulatory intervention is required, is to examine what it delivers for end users – in this case, for customers and merchants.[3] In Australia, Mastercard is confident the payments sector delivers:

- **Choice** – as illustrated by the diversity of payment options;
- **Security** – our payment system has built in safeguards to ensure consumers have confidence in the safety and security of their electronic payments;
- **Efficiency** – payments are facilitated in a quick and efficient manner, which has further improved with the growing use of contactless electronic payments;
- **Quality** – products and services in the market meet the needs of consumers and merchants for secure, efficient and cost-effective ways to pay;
- **Innovation** – demonstrated by the diversity of payment options and the development of new technologies based on other parts of the economy, such as AI and the Internet of Things; and
- **Affordability** – the RBA has acknowledged Australia enjoys a low-cost payments system, particularly in comparison to other countries.[4]

In Australia, there are many ways to make and accept payments, with thriving competition between cash; card schemes; closed loop systems; mobile payments; digital wallets; in-app payments offered by merchants; peer to peer options provided by the New Payments Platform (NPP); direct entry; bill payments; direct

[3] Oxera (2020), The competitive landscape for payments: an Australian perspective, p 40

[4] Tony Richards quoted in Hansard (2019), Hearings of the Senate Economic Legislation Committee into the Currency (Restrictions on the Use of Cash) Bill 2019 at https://parlinfo.aph.gov.au/parlInfo/download/committees/commsen/1f63821a-8028-453f-abd5-a3c30cd67115/toc_pdf/Economics%20Legislation%20Committee_2019_12_12_7452.pdf;fileType=application%2Fpdf#search=%22committees/commsen/1f63821a-8028-453f-abd5-a3c30cd67115/0000%22

debits; and BNPL facilities. Soon, the development of new capabilities of the NPP will see new overlay services.

New providers have successfully entered the Australian payments market through large customer bases established in neighbouring sectors. For example, mobile phone manufacturers have leveraged their handset user bases and near-field communication (NFC) technology to enable in-store payments. Other providers without an existing customer base have also entered the market by meeting a consumer or merchant need – for example, PayPal and Afterpay.[5]

Australian merchants have long been able to 'steer' payments toward their preferred method using tools like surcharging some payments while discounting others. In the Mastercard system, merchants have also been able to use "least cost routing" (LCR) services for in-store transactions.[6]

Mastercard notes much of the development of new payment systems and growth has been in unregulated sections of the payments market.

In relation to regulation, Mastercard's position is:

- We comply with the regulations in force in each jurisdiction in which we operate.
- Regulation, if and where necessary, should increase competition in the payment system rather than acting as a disincentive to investment from incumbent participants and new entrants.
- Regulation should apply equally to all participants in the system, including new entrants, non-scheme players and three-party schemes.
- Regulation should not upset the balance among participants by simply shifting costs or benefits from one part to another without consideration of the consequences on the participants.

Regarding the regulation of card schemes, it is clear regulation is distorting the market, most notably in the areas of LCR, interchange and surcharging. We deal with these issues specifically later in this submission.

Further, if the RBA does not extend regulation to other players, it should maintain the GNS regulations and monitor market behaviour closely to ensure no revenue arrangements effectively amounting to interchange are permitted between unregulated schemes and issuing banks.

Market Structure
Australian payment monopolies in bill payments (BPAY), account-to-account payments (NPP) and eftpos are all majority controlled by the major banks. This market structure creates an inherent conflict of interest and has the effect of reducing competition and minimising investment in innovation among issuers. This lack of innovation is demonstrated by the poor consumer experience and risks associated with some of these monopolies.

[5] Oxera (2020), The competitive landscape for payments: an Australian perspective p.2
[6] Oxera (2020), The competitive landscape for payments: an Australian perspective p.17

Different ownership structures can result in different incentives, which in turn affect market outcomes.[7] The impact of common ownership structure on the incentives to innovate and compete has been examined in other jurisdictions. For example, in the United Kingdom (UK), the infrastructure provider was previously owned and operated by banks who were also active in the downstream market. Although this created a financially and operationally resilient infrastructure provider, the ownership structure protected Vocalink from competition and discouraged alternative infrastructure providers to enter into the market.[8] In addition, the banks lacked sufficient incentives to innovate.[9] As a result, the UK's Payment Systems Regulator (PSR) imposed the divestment remedy. Other specialist payments infrastructure providers in Europe, such as Equens, are also no longer solely owned by banks.[10] It would be useful assess the impact of common ownership structure on the following systems:

- **Bill payments –** Allowing open access to the BPAY bill payments directory would enable development of alternative bill payment solutions by competing providers, increasing innovation and reducing costs for participants.
- **Account-to-account payments –** Mastercard supports the development of alternate account-to-account payments solutions, rather than relying on the NPP alone. Mastercard's real-time capability could enable a competitive service for fast, low-cost payments within Australia, but to facilitate this, the PayID directory should be separated from the NPP and made open-access to enable competitive development.
- **eftpos –** The major banks, alongside major retailers, own and control eftpos, which all issuers are expected by the RBA to support. This distorts competition among debit card issuers in the interests of protecting eftpos' role.

The RBA should consider and continually reappraise what ownership and access structures should apply to the above entities to more effectively minimise market distortions and ensure competition and innovation.

[7] Oxera (2015), 'Governance and ownership of payments systems infrastructure',

[8] Payment Systems Regulator (2016), 'PSR MR15/2.3 – Final report: market review into the ownership and competitiveness of infrastructure provision', para 6.190.

[9] Payment Systems Regulator (2016), 'PSR MR15/2.3 – Final report: market review into the ownership and competitiveness of infrastructure provision', para 6.190., para 6.147.

[10] For example, see https://equensworldline.com/en/home/about-us/organization.html, accessed 11 December 2019.

TRANSPARENCY – ACQUIRING AND SCHEME FEES

Q. 6. Is there a case for further policy action to enhance competition in the provision of acquiring services to merchants? If so, what form could this action take? **Q. 7. Is there a case for greater transparency in scheme fee arrangements, including their effect on payment costs? If so, what form should this take?**

Improved transparency around payment fees
Mastercard accepts some users find the fee structures supporting electronic payments complex and hard to understand and that this contributes to a challenging environment as participants find it difficult to compare service providers.

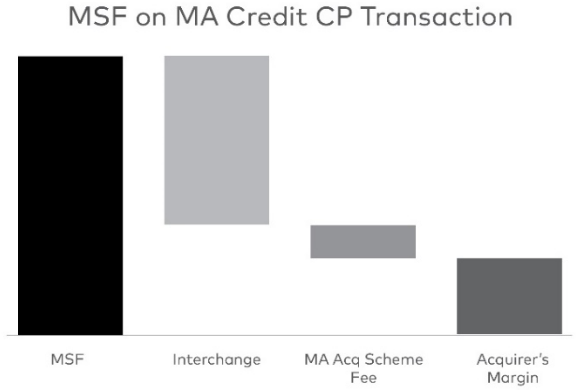
To increase understanding around fees, Mastercard works with the small business community to consider measures that will improve transparency for all market participants. We would be happy to include the RBA in those conversations.

However, it needs to be understood that while payment services comprise an important part of a merchant's relationship with their acquiring bank, there are several other factors that influence their reasoning for engaging with a particular service provider. Merchants rely on banks for a wide range of financial services, including acquiring, lending, cash handling and personal banking.

Further, any transparency measures introduced must serve a genuine need in the market and provide value information which can be used by the intended audience.

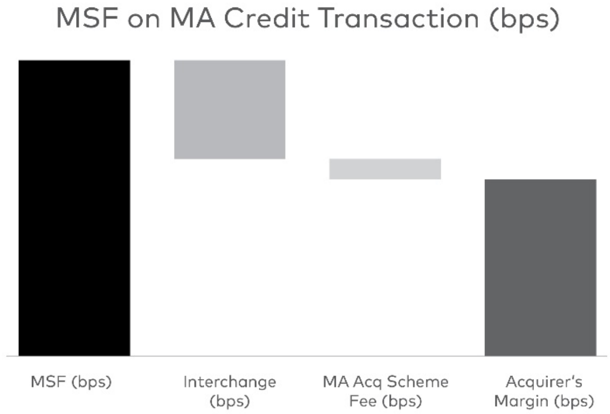
Merchant Service Fees (MSF)
Mastercard urges the RBA to consider the role of the Merchant Service Fee (MSF) holistically. We note the MSF is made up of three key components – interchange, scheme fees and acquirer fees (including margins). These components have markedly different impacts on the total fee. As the example below (based on the 0.84 per cent average MSF published by the RBA, the average credit interchange and the average Mastercard fee for such a transaction) shows, scheme fees comprise a small component of the MSF relative to the other components.

Figure 2: *MSF Breakdown on Mastercard Credit Card Present Transaction (0.8 per cent MSF)*



While the interchange and scheme fee averages remain unchanged regardless of a merchant's agreed rate with their acquirer, the same is not true for the acquirer margin. As the graph above shows, the acquirer fees could be almost significantly higher if a merchant is charged a MSF of 1.50 per cent.

Figure 3: *MSF Breakdown on Mastercard Credit Card Present Transaction (1.5 per cent MSF)*



Acquiring services

Mastercard has commissioned research from The Initiatives Group (TIG) covering different acquiring models, acquirer capabilities and functionality and acceptance fee comparisons. The study surveyed merchants and acquirers of a range of different sizes and market positions.

According to this study, there are more than 700,000 merchants accepting cards in Australia. 98 per cent of these are Level 4 PCI merchants (lowest volume merchants), with the remainder a mix of Level 1 (highest volume merchants) to Level 3. There are over 100,000 online merchants in Australia, with 90 per cent selling less than $1 million per year online. About 85 per cent of card spend sits with the top 10 per cent (75,000) merchants.[11]

[11] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p.14

Acquirers charge individual merchants this MSF in several different ways. There are four main models:

- **Bundled –** Set price plans, which include the cost of the terminal and a certain number of transactions for a fixed monthly cost. All interchange and scheme fees, processing costs and the acquirer's profit margin have been built into this cost;
- **Blended –** A blend of the average of different transaction types (credit and debit) applied as a percentage of every transaction. It includes interchange, scheme fees, acquirer processing costs and the acquirer profit margin;
- **Interchange plus –** Comprising the actual interchange incurred on the transaction, which varies by card type, channel and merchant category; and a margin covering scheme fees, processing costs and the acquirer profit margin;
- **Interchange plus plus –** Comprising the actual interchange incurred on the transaction; the actual scheme fees incurred on the transaction; and, separately, a margin covering processing costs and the acquirer profit margin.

Additional fees may apply for gateway services, value added services, specialised terminals, fraud monitoring and similar.

The study also notes:

- All the acquirers surveyed felt the level of competition in merchant acquiring was increasing.
- Major acquirers have been forced to move away from bundled and blended pricing structures, as new entrants into the acquiring market have been pushing interchange plus and interchange plus plus models. The result is these prices, previously only offered to very large merchants, are now being offered to merchants with lower turnovers.
- The new entrant acquirers, which tend to have new technology platforms, claim to deliver true interchange plus plus pricing and quickly (and automatically) deliver any changes in fees directly into the marketplace.[12]

However, for a range of reasons, it is not clear whether this has led to improved outcomes for merchants.

Major acquirers still have significant market share. Their IT systems generally limit the pricing structure they can offer to customers. They cannot offer real time interchange plus plus pricing except in limited circumstances due to the IT work arounds required.[13]

Smaller traditional acquirers do not have IT systems that will support a move away from blended pricing, and the low profitability of their businesses does not readily support the investment needed to upgrade. This prevents them from competing for the business of larger merchants.[14]

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[12] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p.8
[13] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p.8
[14] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p.8

The study also suggests there is general agreement by acquirers that small merchants prefer simplicity in billing arrangements and that topics such as interchange, routing and similar were complicated and confusing for most small businesses. These merchants tend to prefer bundled and blended pricing. Interestingly, the study also shows that, in some cases, even larger merchants did not regularly market test the cost of acquirer services due to "more pressing priorities." [15]

The study also shows a wide variation in MSFs charged by acquirers based on billing method.[16]

In our experience, there is limited understanding among merchants about how acquiring services are priced. This creates a lack of transparency around MSFs, which subsequently hinders competition, making it difficult to compare 'like for like'. Mastercard argues improved transparency in how acquiring services are priced would increase competition, as it would allow merchants to better understand what they are getting for their services.

Scheme fees

Mastercard understands that information symmetry contributes to better informed participants, more efficient decision-making and better functioning markets from increased competition. We support making scheme fees easier to understand as part of a broader initiative to increase the transparency of acquiring costs, but only if the information provided to merchants is in a form that helps them make meaningful comparisons between acquirers.

At present, there is no visibility or consistency in the way acquirers present scheme fees to merchants. There are several reasons for this, including:

- Acquirers add different margins to the scheme fees for each network and this is not transparent (even on interchange plus or plus plus). This may be because acquirers average out fees for schemes which can do a range of transactions including card not present and cross border transactions;
- Credit and debit scheme fees are often combined and averaged across card present and card not present transactions;
- Scheme fees for Visa and Mastercard are often combined and averaged across all the types of transactions they provide;
- Acquirers often reference international schemes to justify increased prices to merchants; and
- As the scheme fee is paid by the acquirer to the scheme, this is not made public outside the contractual arrangement between the scheme and acquirer.

Some fees are linked to value added services that, for example, increase safety and security, promote incremental sales or encourage customer loyalty. As demand for these services increases and the system becomes more complex and interconnected,

[15] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p. 9
[16] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p.11

the proportion of these value-added services will increase over time as compared to the core services involved in traditional processing activities. This increased value will need to be made clear in any transparency framework. Also, some of these value-added services will only apply to certain types of transactions, so they cannot be applied universally. This may create the perception of complexity and a lack of transparency. Again, it is important to ensure that this is made clear. Otherwise, there is a real risk that unequal comparisons will result in a "race to the bottom" on pricing and consumers will bear the cost - both financially and in regard to their data safety.

Given the attitudes of small merchants, consideration must be given to the usefulness of information provided and whether small businesses can use it to better understand payments and reduce their costs. Simply publishing all scheme fees will not be enough to help small businesses make meaningful comparisons between schemes and acquirers and make informed decisions about managing their costs.

Merchant statements

To provide merchants with a true cost comparison, reform of the merchant statement provided by the acquirers is also required, to clearly separate out international schemes (as is the case for eftpos) and their respective debit and credit products individually (which today are largely bundled into one group). Currently, statements distort competition in the market by not providing accurate price signals. This could also be extended to card present and card not present.

Acquirers would have to pass on the scheme fees as paid by them (without a mark-up) for it to be a fair and accurate reflection of the proportion of the total amount. Again, we support transparency only if the information provided to merchants is in a form that indicates the different costs of transactions and helps businesses make meaningful comparisons between acquirers.

Data

The TIG research indicates most of the merchants serviced by the acquirers in the study were on interchange plus pricing plans, with the three major acquirers having 60-90 per cent of their merchants on such a plan.[17] Part of the reason for this is new acquirers bringing competitive pressure to bear on the majors, which has led them from a blended model to an interchange plus pricing model. So, while market share may not have changed, market structure has. If data used to determine average MSF does not separate out the different types of MSF and distinguish between schemes, then the analysis will not represent a true picture of average fees. Nor will it represent the true average cost of individual scheme MSF.

The change in market structure described above means that over time merchants are likely to be better informed about their costs.

[17] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p.22

LEAST COST ROUTING AND DUAL NETWORK DEBIT CARDS

Q. 4. How do stakeholders assess the functioning to date of least-cost routing (LCR) of contactless debit card payments? Do additional steps need to be taken regarding LCR to enhance competition and efficiency in the debit card market?

Q. 5. Have recent and prospective developments in technology changed the case for promoting the continued issuance of dual-network debit cards? What policy actions might be needed to promote competition and efficiency in an environment where single-network cards were more prominent? Alternatively, would it be desirable to mandate (or incentivise through interchange caps) that all debit cards issued enable at least two unaffiliated/competing networks?

Mastercard believes consumers must always have the ultimate choice of how they pay, and this choice should not be overridden by merchants.

With this in mind, the current framework used to signal the price of electronic payments, including LCR for dual network debit cards (DNDCs) fails to achieve its intended purpose of improving transparency and competition in the debit card market. Practices surrounding pricing are impeding consumers' ability to choose. In addition, with respect to LCR, calculations are not priced consistently, so price information is hard to compare, inhibiting a merchant's ability to make informed decisions. We urge the RBA to consider measures to improve the functioning of LCR to enable all participants to better understand it for contactless DNDC transactions.

Mastercard has been working with customers to support the RBA's efforts relating to LCR of contactless transactions on DNDCs. For those transactions that can currently be routed (debit, card present), Mastercard is already lowest cost, and we intend to remain competitive in a least-cost routing environment.

Any price impact for small merchants because of LCR is unlikely to be material. According to TIG, a typical small merchant might handle $500,000 of card payments per year. A 0.1 per cent saving on acquiring costs would generate savings of about $42 per month.[18]

One industry participant suggests that a shift to least-cost routing could save merchants an average of six per cent on their merchant service fee – with savings varying between merchants and depending on a range of factors.[19] So, based on the RBA's average merchant cost of 0.44 per cent for debit, on the sale of a $3.50 cup of coffee a retailer will save on average $0.00924 in merchant service fees per transaction. On a $10.00 sale a merchant will save $0.00264 and on a $20.00 transaction they will save $0.00528.

[18] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p.58
[19] https://help.tyro.com/s/article/Tap-Save-least-cost-routing-FAQs accessed 21.01.2019

Unclear benefits
Mastercard has not seen any evidence that merchants pass on cost savings from regulated interchange as reduced prices for goods or services. Most likely, major merchants have benefited by exerting their market power to negotiate lower debit card payment costs and have retained these savings to improve their margins. Indeed, anecdotal evidence from industry players suggests this has been the only outcome.

To date, DNDC routing is only possible in card present channels, where both fraud risk payments costs were already low. However, the risks to consumers increase considerably if DNDC routing becomes available in higher risk card not present and person not present channels.

Consumer protections such as chargebacks, insurances and loyalty benefits will not be clear to consumers, or not be provided at all. Cybersecurity risks, system resilience and reputational risk to payment networks will increase significantly, as proprietary fraud tools will not operate if the transaction is processed over another network.[20]

Overall, Mastercard believes the costs incurred by issuers and acquirers to support DNDC routing and additional risks to system resilience do not ensure the best outcome for a secure, efficient and innovative payments system. Single scheme payment tokens are a more effective, providing greater resilience, cyber security protection and supporting competition among issuers.

Unnecessary duplication
DNDCs duplicate functionality for consumers across two payments networks, creating cost and complexity for issuers and acquirers for the short-term benefit of merchants.

Furthermore, investments to support DNDC routing have been prioritised ahead of important investments to protect the payments system for the future (for example, upgrading acquirer processing capabilities, implementing tokenisation or enabling biometric transaction authentication).

Single network cards
There are several issuers for whom supporting two networks, one of which offers significantly less functionality, resilience, security and value to consumers, is unsustainable and unnecessary from a cost, management and compliance perspective. This is yet another barrier to entry and has significantly increased the cost of entering the market. We explore this theme in more detail later in our submission. Additionally, small issuers already in the market are finding it increasingly expensive to offer two debit networks on a card and some are questioning the long-term viability of debit issuing. This is an unintended outcome of the policy requirement for DNDCs and one which may have further impacts on competition in the issuing market, to the advantage of large incumbent issuers. Additionally, given eftpos' ownership structure, mandating DNDC for all issuers

[20] Oxera (2020), The competitive landscape for payments: an Australian perspective p.29

could also reduce competition among issuers, favour the owners of eftpos and lead to poorer outcomes for consumers.

Mastercard supports the issuance of single network debit cards by a set of issuers (determined by criteria such as the issuer's balance sheet, spend volume or net profit), as it lowers the barrier to entry for new market participants and may help increase competition. This will create opportunities for new and innovative products to enter the market, serve the needs of under-represented consumer segments with specific needs (i.e. the elderly and small business) and increase competition more broadly.

We believe the current interchange framework should apply to single scheme cards. However, if a separate interchange rate was applied, the use of a specific interchange cap for single network debit cards (i.e. no lower than $0.05) could incentivise single network debit card issuers. Merchants would also be protected by the lower interchange rate for these products (at present, merchants pay the highest debit rate for single scheme cards). This will recognise the value of investment, competitive drivers and deals in a way that protects merchants from higher costs.

Least Cost Routing
There are different forms of merchant routing available in the market:[21]

- All transactions routed to a specific scheme e.g. eftpos (no intelligent routing);
- Rules based routing (e.g. all transaction under $X routed to scheme Y);
- Intelligent dynamic routing, based on real time least cost for each transaction.

The first two forms of routing should not be described as least cost, given they don't deliver the lowest cost transactions to merchants. Indeed, they may increase merchant costs as changes in interchange and scheme fees will not be reflected for most merchants until or unless the rules are altered (or not at all for the route all to a specific scheme systems).[22] There are no rules for how quickly an acquirer must pass on the least cost when pricing changes at a scheme level.

Additionally, acquirers could add different margins to the scheme fees (as discussed above) for each network. This is not transparent, even on interchange plus or plus plus. Acquirers should have to pass on the scheme fees without mark up as to allow for a fair and accurate comparison in a LCR environment.

Despite the RBA's intention for greater competition, in many instances the international schemes are priced together, meaning any changes an individual

[21] The Initiatives Group (2020), Report on Merchant Acquiring in Australia. p. 10
[22] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p. 59

scheme makes to their pricing is not reflected in the market, with negative impacts for competition.[23]

It is also possible that some acquirers have passed on price increases but have not passed on lower fees and interchange for some transactions at a scheme level, such as recent reductions in debit, card present interchange rates.

TIG data shows that most smaller merchants don't understand LCR.[24] Given the Issues Paper canvasses the benefits to small business of routing, it is unclear how small merchants can effectively benefit from something they don't understand, given the points made above.

One new market participant offers merchants a flat fee of 1.6 per cent for transactions processed through one of their terminals. The terminal can be purchased from electronics retailers or the company directly. A key selling point made by the company is fee simplicity for merchants.[25]

Consumer choice and disclosure

Fundamentally, Mastercard supports choice for consumers when deciding how they pay. Examples of consumer choice of transaction routing could see the cardholder selecting their preference in a banking app or digital wallet or dipping their cards and selecting their account preference at the terminal.

We believe merchants should disclose the network they route to at the point of sale and should not be able to choose to route a transaction if a consumer has expressly chosen their preferred route. If the consumer has not made an active choice, a merchant should be required to inform consumers they route to a specific network.

A recent media report stated that some consumers incurred significant fees when a major retail chain routed payments away from an international scheme to eftpos, as the consumer's debit card issuers imposed fees for eftpos transactions.[26] According to the report, the affected consumers had no way of knowing their transaction had been routed in this way, and were therefore in no position to make an informed choice about how they should conduct the transaction.

Digital technology

In its Issues Paper, the RBA acknowledges plastic cards will not be the dominant form factor soon. Mastercard agrees with that view, noting the proliferation of digital wallets, mobile wallets and increasing card not present transactions.

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[23] This was the case when Mastercard introduced Low Value Pricing which saw a much-reduced interchange category introduced and the majority of acquirer fees set to $0 for transactions below $15. The failure of acquirers to differentiate the pricing of Mastercard from our competitors resulted in Mastercard essentially subsidising those competitors. Today, the tremendous growth in Low Value transactions is driving debit interchange lower to the benefit of the entire industry.

[24] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p. 24

[25] https://squareup.com/help/au/en/article/6109-fees-and-payments-faqs accessed on 22 January 2020

[26] https://au.news.yahoo.com/hidden-card-fee-coles-customers-dont-know-about-065147256.html (accessed on 18 January 2020)

eftpos has recently begun rolling out mobile wallet functionality.[27] Merchant routing should not be allowed to apply in this environment as digital technology means consumers can actively chose their default payment method, and this choice should not be overridden by a merchant.

Additionally, Mastercard has made substantial investments in fraud protection. At present, merchant routing does not account for the cost of fraud. This could lead to an increase in fraud for card not present transactions should merchant routing apply and if transactions are routed to schemes that offer less fraud protection. Merchants have indicated they also require clearer chargeback policies and guidelines for eftpos payments.[28]

The best way to encourage scheme competition in an online environment is for schemes to compete on price for merchant preference such as preferential positioning on a merchant's digital site. Consumers should have the ultimate choice about how they pay. In such an environment, there would be no need for merchant routing.

The issues outlined above highlight the real potential that the current routing framework will simply lead to a 'race to the bottom', inhibiting investment in innovation, competition, security and resilience.

Mastercard has made substantial investments in the development of payments innovation, including improving fraud protection, the development of mobile payments applications and digital wallet technology. Mastercard is largely technology neutral, working with numerous companies and platforms to support access for their customers to new and innovative ways to pay.

Market participants have benefited from Mastercard's investments, as they have been permitted to use technology developed by us for their own customers – often at little or no cost. For example, Mastercard has made considerable investment in the development of fraud mitigation technology through innovations like tokenisation, benefiting the security and resilience of the payments system as a whole.

Similarly, Mastercard has been extensively involved in the development of mobile wallet technology, allowing consumers to safely access their payment credentials using their mobile devices and merchants to reach a much wider potential market. That investment can only continue if it makes commercial sense. An environment that focuses solely on price, with no consideration of value, is not conducive to sustained competition and innovation.

Traditional acquirers will need to undertake significant investment in order to provide the most innovative, competitive and secure services to merchants. However, this competes with other investment priorities as banks ensure they fulfil their regulatory obligations and are competitive in other parts of their business.

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[27] Eftpos Australia website: https://www.eftposaustralia.com.au/industry/acquirers/products/ (accessed on 17 January 2020)
[28] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p. 45

They are unlikely to make investments in acquiring if the returns on these investments are non-existent.[29]

There are also several factors that could improve transparency and support consumer choice for DNDC cardholders making contactless transactions. We recommend the RBA consider the following:

- Networks must be present on the card, associated digital images, and terminals.
- Terminals should be updated to reflect the choices available (e.g. the "credit button" for debit is misleading and confusing for consumers).
- Terminal providers/acquirers should not be able to route transactions without the express approval of a merchant and, even then, it must not override consumer choice.
- Merchants must disclose the network they route to at the point of sale so consumers are both informed and able to make a different choice should they want.
- Even "eftpos only" cards carry a second network (Maestro/Cirrus). However, this has not been enabled by any issuer (please see our earlier comments about market distortion relating to eftpos). Optimising competition involves routing options on DNDC being available whenever they exist. If merchant routing is to continue, acquirers should enable routing for secondary networks.

Challenges with LCR

Outside of the calculation of LCR, there are other issues posed by the current operation of the LCR regime, which inhibit it from delivering on its objectives:

- LCR does not only occur on "like for like" DNDC transactions, meaning the point of comparison between payment methods is inaccurate and unclear.
- Mastercard does not support merchant routing in blended acquiring models which combine the cost for credit and debit and Visa and Mastercard vs eftpos (which is usually separated from the "blend").
- Acquirers should be required to provide accurate fee information about the type of transaction rather than averages across all types of transactions (including blending card present, card not present, credit and debit).
- In the case of digital wallets, consumers have already actively chosen their default payment method, and this should not be overridden by a merchant.

[29] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p. 22

INTERCHANGE REGULATION

Q. 10. Is there a case for a further lowering of the credit or debit interchange benchmarks or any change in the way they are applied?

Q. 11. Should regulation of interchange be extended to inter-regional interchange fees (i.e. interchange fees applying to transactions in Australia using foreign-issued cards)? What is the typical cost of transactions on foreign-issued cards, and how much of this is attributable to interchange fees?

Q. 13. Is the revised net compensation provision in the interchange standards working effectively?

Q. 14. What enforcement mechanisms would strengthen observance of the net compensation provision?

Mastercard does not support lowering the regulated interchange benchmarks.

Interchange plays a critical role in supporting security, competition, productivity, innovation and consumer choice in the Australian payments market. It facilitates safe and efficient electronic payments by ensuring merchants and consumers receive maximum value for making and accepting electronic payments at the lowest possible cost and incentivises the development of new products and technologies.

As one portion of issuer revenue, interchange helps pay for advances in technology that are driving future economic growth by encouraging issuing banks to invest in innovation. The development of secure digital payments technology has allowed businesses and consumers to safely buy and sell goods and services online, maximising opportunities to sell more products and participate in the global marketplace. In-store, face-to-face innovations like contactless payments have enhanced customer and merchant experiences, particularly in high-traffic stores where fast transaction times generate value. Innovation is continuing to reshape when and how payments can be made and accepted – such as tokenisation and digital ID to increase security and mobile and app payments that give consumers more choice.

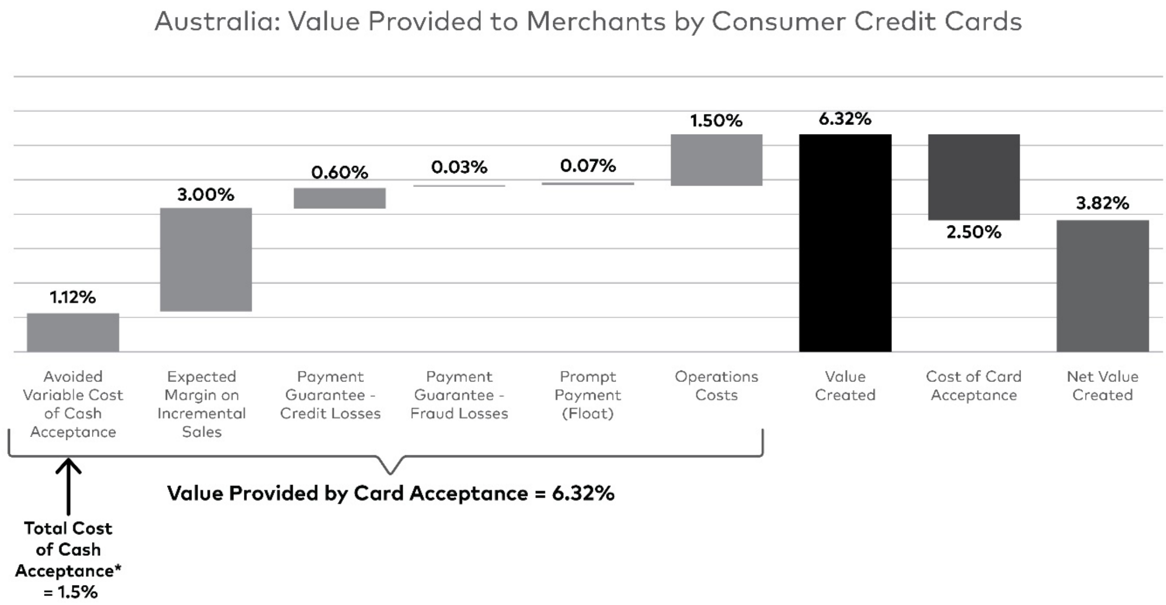
Economic arguments favouring lower interchange or removing interchange entirely underestimate the crucial role it plays in supporting the efficient functioning of the payments system. Low or lower cost is not the same thing as efficient when it comes to assessing whether a market is functioning optimally. There are different dimensions to the question of market efficiency, including allocative efficiency, which requires the alignment of cost and value and dynamic efficiency, which promotes competition and innovation.[30]

[30] ACIL Allen Consulting (2020), Payments systems and interchange fees, pp7-10

Interchange: value in relation to cost

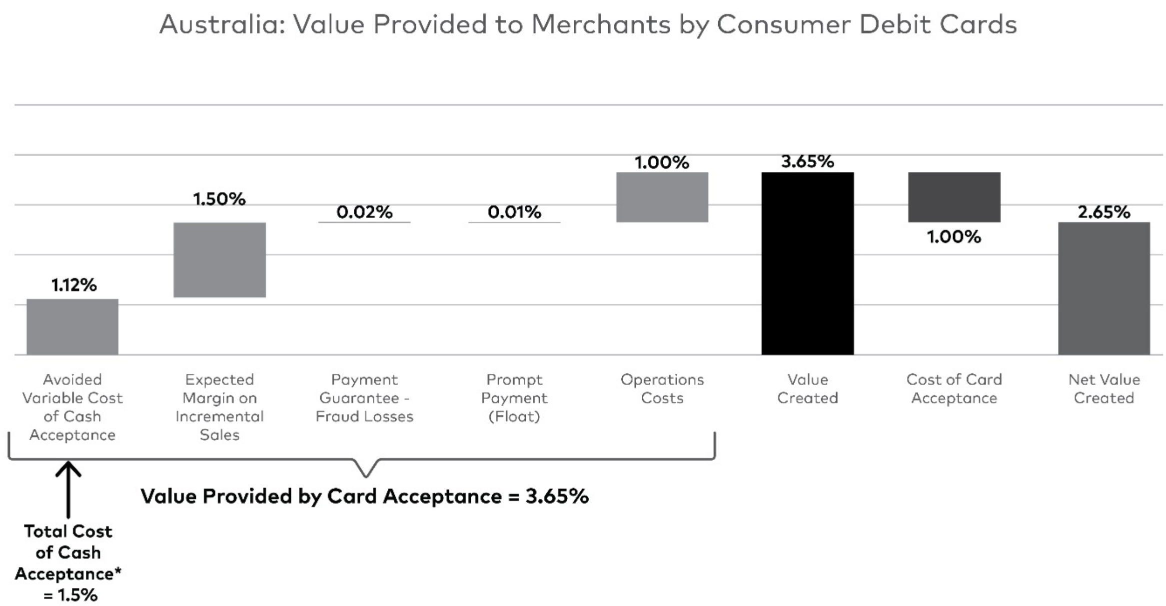
On the question of value in relation to costs, Mastercard data shows consumer credit cards in Australia generate value to merchants which is two to three times the total cost of acceptance - see Figure 4:[31]

Figure 4:



For debit transactions, net value to merchants is over three times the total cost of acceptance:[32]

Figure 5:



[31] Peter T Dunn and Company LLC (2019) Illustrating the Value Provided by Electronic Payment Products Australia p. 10
[32] Peter T Dunn and Company LLC (2019) Illustrating the Value Provided by Electronic Payment Products Australia p. 11
[33] Rodgers, David: "Credit Losses at Australian Banks: 1980-2013"; *Reserve Bank of Australia Research Discussion Paper*, May 2015. p 21.

Rather than concentrating the discussion around costs, emphasis needs to be placed on the tremendous economic value provided by the acceptance of electronic payments. Interchange, for example, is only one aspect of the total cost of acceptance.

Electronic payments provide many benefits for all participants in the payments system.

For consumers:

- Interchange covers a portion of the cost of fraud protection, so cardholders are protected in the event of a fraudulent transaction. For example, in the event of a stolen card, Mastercard cardholders are protected from fraud or unauthorised transactions under Mastercard's Zero Liability Policy.
- Not only does interchange allow businesses to accept cards, it pays for the interest free days on credit cards.
- Electronic payments allow consumers to access money whenever and wherever they want, and provide a more secure and efficient way to pay, whether in-person, online or in-app.

For merchants:

- Merchants have access to a global customer base.
- Interchange facilitates the use of electronic payments which pay for the benefits businesses receive. When compared to acceptance of cash, the additional value provided to retailers by electronic payments is higher than the total cost of acceptance.
- Merchants get guaranteed payment when they accept credit cards, freeing them from the worry of credit risk - that is, the business gets paid within 24-48 hours irrespective of whether the cardholder repays the issuer of the card. Every year, issuing banks write off two to four per cent of credit card balances as losses – a cost which would almost unavoidably sit with retailers without interchange.
- Accepting cards reduces the significant costs associated with counting, safeguarding and transporting cash and limiting the losses that occur when cash received is lost or stolen.[33]
- Studies show that consumers spend more when they use cards and businesses make more money when they accept cards:
    - The average debit and credit transactions are about two to four times the average cash transaction; and
    - Premium credit products result in larger transactions whose revenues and contribution to profit more than offset any additional costs of acceptance. [34]

[33] Rodgers, David: "Credit Losses at Australian Banks: 1980-2013"; *Reserve Bank of Australia Research Discussion Paper*, May 2015. p 21.
[34] Peter T Dunn and Company LLC (2019) Illustrating the Value Provided by Electronic Payment Products Australia p. 4

For Governments:

- Electronic payments are an important means of reducing the black economy and increasing taxation revenues.
- Electronic payments provide the necessary infrastructure for citizens and businesses to interact in a financial ecosystem which facilitates economic activity. This includes e-commerce, which enables Australian businesses to trade with anyone around the world.
- Government and the public sector are major beneficiaries of interchange as they utilise many different payment options including commercial cards.

Interchange: facilitating competition and innovation
In recognition of the value delivered by electronic payments, Mastercard sets interchange taking relevant considerations into account, such as the nature of the payment stream, the costs of the recipients of interchange and the levels of cardholder usage and merchant acceptance.

Mastercard sets interchange but does not generate revenue directly from the rate. Our primary interest is ensuring merchants and consumers receive maximum value for electronic payments at the lowest possible cost and promoting innovation and efficiency. Thus, schemes are incentivised to set interchange at a level that encourages card payments and (as close to as possible) universal acceptance by merchants in a market, rather than at a level that would discourage consumers and merchants from using cards and related product innovations.

The interchange level is optimised when it is:

- Low enough for merchants to realise the economic benefits of accepting cards; and
- At a level that fairly compensates issuers for the costs involved in issuing cards.

At this level, interchange encourages high volumes of card payments, wide acceptance of electronic payments by merchants, as well as competition and product innovation in the card market.

Interchange fees provide revenues that assist with payment for new technologies.[35] Without interchange, there is less incentive for new entrants, especially those outside the traditional banking sector who cannot generate revenue from deposits or other banking fees, to enter the market, which would have a detrimental effect on innovation, competition and consumer outcomes. Issuers receive the fee and pass some of it back to their technology partners. Ultimately, consumers and merchants pay for the technology through merchant service fees, card fees and surcharges. This is an efficient way for the beneficiaries of the technology to pay for the service they are receiving.[36]

[35] ACIL Allen Consulting (2020), Payments systems and interchange fees, p10
[36] ACIL Allen Consulting (2020), Payments systems and interchange fees, p14

Interchange fees can also be used to incentivise the adoption of innovations developed by schemes.[37] For example, schemes can lower interchange fees to encourage the initial uptake of more secure payment methods and reduce fraud via initiatives such as tokenisation. For example, Mastercard's new value pricing model reflects the input costs of different types of transactions. This model is also being adopted by other schemes.

Interchange fees also provide an incentive and source of revenue for smaller issuers to provide their customers with cards utilising the latest technologies.[38] Unlike the big banks, smaller financial institutions – including disruptive new entrants to the financial services marketplace like neobanks – have less scope to offset the costs of operating a debit payments business from their other business activities.[39] Interchange revenues are vital for these institutions to be able to provide card products so they can effectively compete with incumbent banks to attract business.

Without interchange fees, small financial institutions will not be able to offer services customers expect and they will not have the scale to invest in new product or security technologies. Given this, lowering interchange could have the unintended – and undesirable – consequence of discouraging new entrants and entrenching the market dominance of the big banks. Reductions in interchange would hurt these businesses disproportionately and be harmful to competition in financial and payments services.[40] This is inconsistent with the Government's desire to increase competition in financial services and encourage the development of the local fintech sector.

Mastercard suggests the RBA engage with new entrant digital banks and smaller regional banks to understand the costs of operating a debit payments business today. These costs have dramatically increased with the advent of digital channels and the inherently higher cybersecurity risks associated with these channels.

Interchange regulation ostensibly intended to lower overall costs in the payments system has the perverse impact of shifting costs away from merchants and on to other parties participating in the system, especially cardholders and consumers. Research on the impact of interchange regulation, including on the Australian experience, shows regulation imposes further detriments on consumers in the form of higher card fees, higher interest rates and a reduction in the availability of low-cost banking options.[41]

In Australia, the RBA's decision to regulate interchange in 2003 has led to cardholders paying approximately $480 million more in additional fees each year. Australian banks have also reduced their customer rewards programs.[42]

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[37] Oxera (2020), The competitive landscape for payments: an Australian perspective, p71
[38] ACIL Allen Consulting (2020), Payments systems and interchange fees, pp 9-11
[39] Oxera (2020), The competitive landscape for payments: an Australian perspective, p71
[40] ACIL Allen Consulting (2020), Payments systems and interchange fees, p13
[41] Chan, I., Chong, C., and Mitchell, S., 'The Personal Credit Card Market in Australia: Pricing over the Last Decade,' RBA Bulletin, March 2012; Europe Economics, 'The Impact of Interchange Fee Regulation', September 2014
[42] Stillman, R 'Regulatory intervention in the payment card industry by the Reserve Bank of Australia'; CRA International, April 2008, p. 13

Furthermore, there is no evidence merchants pass on cost savings from regulated interchange through reduced prices for goods or services.

Buy Now, Pay Later facilities

Though a recent entrant into the local payments market, BNPL providers have managed to successfully attract both consumer and merchant customers.

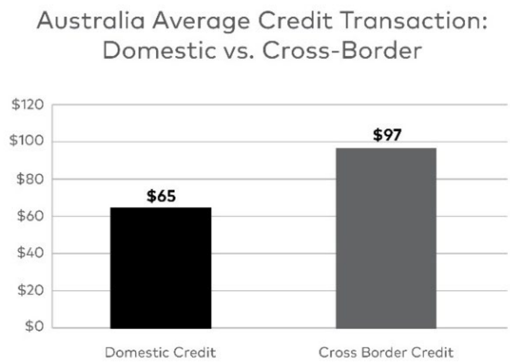
The success of Afterpay and other BNPL facilities demonstrates consumer demands are changing rapidly. Designated schemes should be able to offer new payment solutions outside of the current debit and credit model, in order to meet the customer demand for alternatives like BPNL and introduce more competition into the market. Creation of an instalment category in the Standards with clear rules could spur innovation, lower costs for merchants and create consumer benefits.

Extending interchange regulation to foreign issued cards

Mastercard does not support regulating interchange on foreign-issued card transactions made in Australia. We believe regulating these transactions will have a negative impact on Australia's tourism industry, trade interests and on our full participation in the digitised and globally integrated economy.

According to research commissioned by Mastercard, 94 per cent of Australian credit transactions are domestic. Only six per cent are cross border. However, cross border credit transactions average about 50 per cent higher tickets than domestic transactions.[43]

Figure 6:

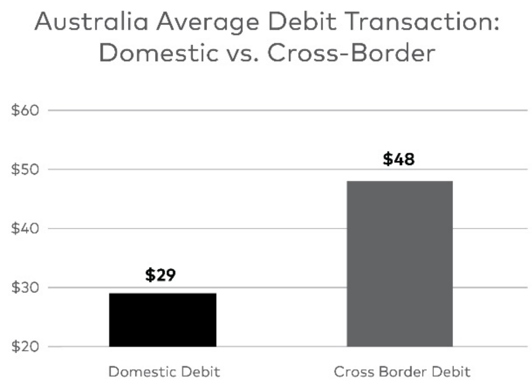


When it comes to debit, only 1.5 per cent of transactions are cross border. However, these transactions deliver approximately 65 per cent higher tickets than domestic transactions.[44]

[43] Peter T Dunn and Company LLC (2019), Illustrating the Value Provided by Electronic Payment Products Australia, p. 10

[44] Peter T Dunn and Company LLC (2019) Illustrating the Value Provided by Electronic Payment Products Australia p. 10

Figure 7:



Foreign issued cards used in Australia are different and more complex products than their domestic counterparts and should not be treated in the same way. The overseas issuer wears the fraud and credit risk on payments made with their cards here while significant value is enjoyed by local merchants in the form of extra business from tourists and digital commerce.

The undesirable consequences of regulation include:

- Overseas banks introducing or increasing transaction fees for cardholders, which would discourage tourist and online spending.
- Any reduction in interchange constrains banks' capacity to provide fraud protection, such as zero liability policies, on payments made in Australia.
- Foreign banks may be more inclined to decline a higher percentage of transactions acquired in Australia if they are not compensated for credit risk.

We are also concerned this type of regulation will be inconsistently applied across electronic payment products and that unregulated competitors like China Union Pay, JCB, Discover and American Express would enjoy an unfair competitive advantage. In the first instance, Mastercard recommends the RBA collect data across all schemes, regulated and unregulated, to better understand the working of the cross-border market.

Net compensation

The RBA's recent changes to the Standards includes welcome clarifications. Notwithstanding this, Mastercard has identified further changes for consideration:

- Definitions of core fees and the definitions of issuer benefits and payments should be tightened in order to provide more clarity, to minimise misunderstandings and to reduce the compliance burden.
- The provision about minimum fees to be a network participant is not practical and should be deleted.
- We already work on the basis that there is an obligation on us to be compliant, but not to ensure compliance by customers.

- The accounting treatment used by a scheme would be a suitable benchmark against which compliance/non-compliance is measured. While other accounting treatments could be used, applying the scheme's accounting treatment would result in consistency. A scheme works with every issuer and the same rules would be applied against each issuer.
- Mastercard works hard during the reporting period to ensure compliance by the reporting date. If, based on the objective criteria proposed above, the agreement is not compliant, then the issuer should have a statutory requirement to make right the non-compliance within a specified date (60 days) after the end of the reporting period.
- The concept should be that the intended outcomes in terms of avoiding net compensation is achieved. Schemes are not advantaged by this; rather proper restitution is made to them as soon as possible.
- There should be guard rails for non-compliance penalties. No party should be found to be non-compliant:
    - if it has applied GAAP, either its own or (in our view better) a standard based of the accounting applied by the relevant scheme.
    - an issue arises because of a party's inability to see the future e.g. from a scheme perspective if a customer takes a future commercial decision to de-emphasise promised marketing on scheme branded activity resulting in incentives effectively being overpaid.

SURCHARGING

Q. 15. Is the surcharging framework working well? Are there any changes that should be considered?

Q. 16. Is there a case for policymakers to require that BNPL providers remove any no-surcharge rules, consistent with earlier actions in regard to card systems that applied such rules?

Mastercard has long opposed merchants surcharging their customers when they choose to pay by card. Merchants receive tremendous value from accepting cards and the cost should rightly be borne by them.

Electronic payments boost retail sales, simplify accounting and the provision of credit to customers, and reduce operating and security costs for merchants, while also guaranteeing they are paid, even if the cardholder doesn't repay their bank. Surcharging conceals this value by repackaging it solely as a cost that can be passed onto consumers, who already pay card fees to cover the costs of the benefits of electronic payments.

Given this value, Mastercard believes the RBA's current approach to the cost of acceptance is too narrow, in that it does not offset costs with the value derived by merchants from benefits such as guaranteed payment and increased sales amounts. Additionally, it erroneously suggests that other payment forms, like cash, are "free."

The RBA's own analysis conducted in 2014 showed the direct cost of accepting a cash transaction was broadly like a card not present credit transaction and more expensive than a card present debit transaction.[45]

Over time, we forecast the cost of accepting cards will continue to decline if innovation and competition is not inhibited, while the cost of transacting in cash will increase as these costs are spread over fewer transactions.

Differential surcharging between card categories (foreign/domestic, standard/premium) would lead to a poor consumer experience, particularly for overseas tourists who may not understand why they are being surcharged while locals are not. Disclosure of all the differing surcharge rates is also likely to be highly complex for both merchants and consumers. Irrespective of this, merchant routing and interchange regulation already helps merchants manage costs.

Further, surcharges are based on the information provided by acquirers regarding their payment costs. If a merchant is on a blended rate (credit, debit, Mastercard and Visa), they pay the same amount for every transaction – despite the underlying cost, and therefore, are permitted to surcharge the same amount for all

[45] Stewart, C, Chan, I, Osslinkski, C, Halperin, D and Ryan, P (2014) *The Evolution of Payment Costs in Australia,* RBA Research Discussion Paper, p. 30

transactions. This does not send a price signal to consumers regarding the costs of different transactions.

While the cost of accepting cash and card payments is broadly comparable, card payments provide tremendous extra value: fraud protection, traceability, and the greater security of guaranteed payment for merchants delivers ease and convenience for both consumers and merchants.

For merchants, choosing to pass on the cost of accepting a card payment may not be a rational business decision. Surcharging is very unpopular with consumers. Research conducted by finder.com.au found that 94 per cent of Australians think card surcharges are a "rip-off" and nearly 70 per cent of consumers would back out of a transaction is they found out a surcharge would be applied.[46]

As surcharging is likely to discourage consumers from paying by card, Mastercard believes Australia's surcharging rules should be re-examined to ensure they are aligned with other public policy objectives, such an reducing the shadow economy, reducing crime rates, encouraging competition and productivity and stimulating economic growth. However, any regulations regarding surcharging should be applied evenly across all system participants.

[46] Finder.com.au (2018), Avoid card surcharges for good with Fee-Free Shops at https://www.finder.com.au/avoid-card-surcharges-for-good-with-fee-free-shops accessed 17 January 2020.

OTHER ISSUES

Q. 3. Are there barriers to innovation and/or competition that may affect the costs of or provision of electronic payments and should be addressed in this review?

Q. 8. Are the existing access regimes working effectively?

Q. 9. What are the implications of the growing importance of mobile devices and digital platforms for the retail payments system in Australia? Are there issues that arise for the Bank's regulatory regime for card payments or that are relevant to competition, efficiency and risk?

Mastercard is technology neutral, working with several different technology companies to support access for their customers to new and innovative ways to pay.

As noted throughout this submission, some recent regulatory and policy interventions may inhibit competition, innovation and cyber security rather than encourage it.

There has been significant change in the market since regulation began in the early 2000s. The RBA must ensure the regulatory framework is fit for purpose. As outlined above, significantly lower interchange and a LCR regime that does not account for value will lead to less competition, entrench the market dominance of the big banks, less incentive to innovate and compromise system resilience and security.

Access regimes are another example. These were established at a time when Mastercard had substantially different ownership structure. Delays to schemes licencing applicants are the result of applicants needing to demonstrate regulatory compliance (for example with anti-money laundering laws), not anti-competitive behaviour by schemes. It is not in a scheme's interest to inhibit access.

APPENDIX A – MASTERCARD PRODUCTS AND SERVICES

Mastercard provides a wide variety of integrated products and services that support payment products that bank customers can offer to their account holders. These offerings facilitate transactions on our core network among account holders, merchants, financial institutions, businesses, governments and other organisations in markets globally.

Core Products
Consumer Credit. We offer a number of programs that enable issuers to provide consumers with credit that allow them to defer payment. These programs are designed to meet the needs of our customers around the world and address standard, premium and affluent consumer segments.

Debit. We support a range of payment products and solutions that allow our customers to provide consumers with convenient access to funds in deposit and other accounts. Our debit and deposit access programs can be used to make purchases and to obtain cash in bank branches, at ATMs and, in some cases, at the point of sale. Our branded debit programs consist of Mastercard (including standard, premium and affluent offerings), Maestro (the only PIN-based solution that operates globally) and Cirrus (our primary global cash access solution).

Prepaid. Prepaid programs involve a balance that is funded prior to use and can be accessed via one of our payment products. We offer prepaid payment programs using any of our brands, which we support with processing products and services. Segments on which we focus include government programs such as Social Security payments, unemployment benefits and others; commercial programs such as payroll, health savings accounts, employee benefits and others; and reloadable programs for consumers without formal banking relationships and non-traditional users of electronic payments.

We also provide prepaid program management services, primarily outside of the United States, that manage and enable switching and issuer processing for consumer and commercial prepaid travel cards for business partners such as financial institutions, retailers, telecommunications companies, travel agents, foreign exchange bureaus, colleges and universities, airlines and governments.

Commercial. We offer commercial payment products and solutions that help large corporations, midsize companies, small businesses and government entities. Our solutions streamline procurement and payment processes, manage information and expenses (such as travel and entertainment) and reduce administrative costs. Our card offerings include travel, small business (debit and credit), purchasing and fleet cards. Our SmartData platform provides expense management and reporting capabilities. Our Mastercard In Control™ platform generates virtual account numbers which provide businesses with enhanced controls, more security and better data.

Additional Platforms. In addition to the switching capabilities of our core network, we offer additional platforms with payment capabilities that extend to new payment flows:

- We offer commercial payment products and solutions, such as the Mastercard B2B Hub, which enables small and midsized businesses to optimise their invoice and payment processes.
- With Vocalink, we offer real-time account-based payments for ACH transactions. This platform enables payments between bank accounts in real-time and provides enhanced data and messaging capabilities, making them particularly well-suited for B2B and bill payment flows.

Value-Added Products and Services

We provide additional integrated products and services to our customers and stakeholders, including financial institutions, retailers and governments that enhance the value proposition of our products and solutions.

Safety and Security. We offer integrated products and services to prevent, detect and respond to fraud and cyber-attacks and to ensure the safety of transactions made using Mastercard products. We do this using a multi-layered safety and security strategy:

- The "Prevent" layer protects infrastructure, devices and data from attacks. We have continued to grow global usage of EMV chip and contactless security technology, helping to reduce fraud. Greater usage of this technology has increased 13 the number of EMV cards issued and the transaction volume on EMV cards. While this technology is prevalent in Europe, the U.S. market has been adopting this technology in recent years.
- The "Identify" layer allows us to help banks and merchants verify genuine consumers during the payment process. Examples of solutions under this layer include Mastercard Identity Check™, a fingerprint, face and iris scanning biometric technology to verify online purchases on mobile devices, and our recently launched Biometric Card which has a fingerprint scanner built in to the card and is compatible with existing EMV payment terminals.
- The "Detect" layer spots fraudulent behaviour and cyber-attacks and takes action to stop these activities once detected. Examples of our capabilities under this layer include our Early Detection System, Decision Intelligence and Safety Net™ services and technologies.
- The "Experience" layer improves the security experience for our stakeholders in areas from the speed of transactions, enhancing approvals for online and card-on-file payments, to the ability to differentiate legitimate consumers from fraudulent ones. Our offerings in this space include Mastercard In Control, for consumer alerts and controls and our suite of digital token services available through our Mastercard Digital Enablement Service ("MDES").

We have also worked with our financial institution customers to provide products to consumers globally with increased confidence through the benefit of "zero liability", or no responsibility for counterfeit or lost card losses in the event of fraud.

Loyalty and Rewards. We have built a scalable rewards platform that enables financial institutions to provide consumers with a variety of benefits and services, such as personalised offers and rewards, access to a global airline lounge network, concierge services, insurance services, emergency card replacement, emergency cash advances and a 24-hour account holder service centre. For merchants, we provide campaigns with targeted offers and rewards, management services for publishing offers, and accelerated points programs for co-brand and rewards program members.

Processing. We extend our processing capabilities in the payments value chain in various regions and across the globe with an expanded suite of offerings, including:

- Issuer solutions designed to provide customers with a complete processing solution to help them create differentiated products and services and allow quick deployment of payments portfolios across banking channels.
- Payment gateways that offer a single interface to provide e-commerce merchants with the ability to process secure online and in-app payments and offer value-added solutions, including outsourced electronic payments, fraud prevention and alternative payment options.
- Mobile gateways that facilitate transaction routing and processing for mobile-initiated transactions.

Analytics Insights and Consulting. We provide proprietary analysis, data-driven consulting and marketing services solutions to help clients optimise, streamline and grow their businesses, as well as deliver value to consumers.

Our capabilities incorporate payments expertise and analytical and executional skills to create end-to-end solutions which are increasingly delivered via platforms embedded in our customers' day-to-day operations. By observing patterns of payments behaviour based on billions of transactions switched globally, we leverage anonymised and aggregated information and a consultative approach to help our customers make better business decisions. Our executional skills such as marketing, digital implementation and staff augmentation allow us to assist clients implement actions based on these insights.

Increasingly, we have been helping financial institutions, retailers and governments innovate. Drawing on rapid prototyping methodologies from our global innovation and development arm, Mastercard Labs, we offer "Launchpad," a five-day app prototyping workshop. Through our Applied Predictive Technology business, a software as a service platform, we can help our customers conduct disciplined business experiments for in-market tests.

Digital Enablement
Leveraging our global innovations capability, we work to digitise payment services across all channels and devices:

- ***Delivering better digital experiences everywhere.*** We are using our technologies and security protocols to develop solutions to make digital shopping and selling experiences, such as on smartphones and other connected devices, simpler, faster and safer for both consumers and merchants. We also offer products that make it easier for merchants to accept payments and expand their customer base and are developing products and practices to facilitate acceptance via mobile devices. The successful implementation of our loyalty and reward programs is an important part of enabling these digital purchasing experiences.

- ***Securing more transactions.*** We are leveraging tokenisation, biometrics and machine learning technologies in our push to secure every transaction. These efforts include driving EMV-level security and benefits through all our payment channels.

- ***Digitising personal and business payments.*** We provide solutions that enable our customers to offer consumers the ability to send and receive money quickly and securely domestically and around the world. These solutions allow our customers to address new payment flows from any funding source, such as cash, card, bank account or mobile money account, to any destination globally, securely and in real time.

- ***Simplifying access to, and integration of, our digital assets.*** Our Mastercard Developer platform makes it easy for customers and partners to leverage our many digital assets and services. By providing a single access point with tools and capabilities to find what we believe are some of the best-in-class Application Program Interfaces ("APIs") across a broad range of Mastercard services, we enable easy integration of our services into new and existing solutions.

- ***Identifying and experimenting with future technologies, start-ups and trends.*** Through Mastercard Labs, our global innovation and development arm, we continue to bring customers and partners access to thought leadership, innovation methodologies, new technologies and relevant early-stage fintech players.