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Dear Dr Richards

Mastercard response to the Reserve Bank of Australia's Review of Retail Payments Regulation Consultation Paper

Thank you for the opportunity to respond to further consultation in relation to the Review of Retail Payments Regulation.

While Mastercard does not believe further regulation of the payments system is needed, we recognise the changes proposed in the Consultation Paper do not constitute a major overhaul of the retail payments regulation. In what can only be described as a fast moving, highly dynamic and competitive sector, we believe regulators should be looking for opportunities to remove the regulatory burden on retail payments, not further regulate.

That view is consistent with the Reserve Bank of Australia's (RBA) decision not to regulate surcharging in the Buy Now Pay Later (BNPL) space. At its most basic, the RBA's approach to regulation should be even-handed and consistent, with decisions to adjust existing regulatory settings being scheme, platform and technology neutral. The regulatory arbitrage that began with the decision to exclude American Express from the initial forms of payments regulation in 2002 continues today with the decision to allow BNPL operators to continue to ban surcharging, while others – including Mastercard – cannot protect our own customers.

Priority should be given to ensuring the payments system remains secure and stable and allows for competition and innovation.

With those principles in mind, our response to the Consultation Paper focusses on four key areas:

- Dual Network Debit Cards and Least Cost Routing
- Interchange
- Transparency
- Surcharging

This response also addresses specific technical matters contained in the Draft Standards.

We look forward to working with the RBA to develop policy recommendations that promote competition, efficiency and productivity in the Australian financial system.

We remain, of course, available to discuss any aspect of this submission.

Sincerely

Richard Wormald
Divisional President

Overview

The Reserve Bank of Australia's (RBA) Review of Retail Payments Regulation (the Review) comes at a critical time for the payments industry. There is a great deal of regulatory scrutiny and political interest in payments policy issues. This scrutiny and interest coincide with, and are likely a result of, rapid and ongoing innovation and change in the global payments industry, and the Australian payments system, over the past decade. This innovation and change have created new opportunities and presented new challenges.

Change: Some Australian financial institutions are divesting or merging, global and mono-line institutions have launched in Australia. More fintechs and neo-banks are offering digital-only mobile payment and banking services to businesses and consumers and, buy now pay later platform providers are partnering with merchants to deliver post purchase instalment payment plans.

Mastercard partners with a range of customers to support and enable competition, whether merchants, acquirers, issuers or fintechs.

New entrants and smaller industry participants are happy to use the Mastercard network since we can meet all of their payment services requirements. Mastercard digital, cyber, data and loyalty services enable feature rich and innovative value propositions and user experiences for governments, businesses and consumers. These system participants do not have the capital to invest to issue dual network cards, nor do they see the benefit, to themselves or their customers, of doing so.

Security: Payment technology continues to evolve, enabling new ways to make safe and secure real time electronic payments with, for example, zero liability to the consumer or without needing to reveal the sixteen-digit Personal Account Number on a card to a merchant. Through ongoing and significant investment in digital secure payment technology Mastercard is now tokenising one in four everyday payments at point of sale. providing frictionless, secure payments using Mastercard security grade tokenisation for a growing number of pay ahead or as-you-go in app payments for online food delivery, entertainment streaming and transport services for example.

Mastercard provides data rich connected intelligence for online transactions through:

- enhanced real time authentication (*so any online merchant can be confident about the transaction*);
- real time transaction scoring (*so the issuer can be confident about the transaction*); and
- transaction alerts for issuers and merchants before online goods are despatched to reduce likelihood of cardholder disputes where a fraud is suspected *(so the cardholder can be confident about the transaction*).

Online “guest check out” with integrated digital provisioning and tokenisation is now live for Mastercard in Australia. Mastercard is continuing to invest in Artificial Intelligence and 5G ready digital security payment solutions. As a key payments infrastructure provider, it is vital we protect against any risk of data compromise in the system.

Growing cybersecurity threats: Mastercard has most recently seen an approximate 25% year-on-year increase in attempted bank identification number (BIN) attacks in the Asia Pacific region. One in four of these attempted BIN attacks were against Australian customers. These attacks have been prevented because of ‘Mastercard Safety Net’ Global Network monitoring.

We continue to invest heavily to constantly monitor and protect the Mastercard network from cyber-attacks. We engage in many efforts to mitigate information security challenges, including maintaining an information security program, an enterprise resilience program as well as regularly testing our systems to address potential vulnerabilities. Through the combined efforts of our global network of Security Operations Centres, Fusion Centres and the Mastercard Intelligence Centre, we work with experts across Mastercard (as well as other stakeholders including law, enforcement, central bank, governments, and the financial sector) to monitor and respond quickly to a range of cyber and physical threats and put in place security standards (e.g., EMV) for safe and secure transactions.

Resilience: Mastercard continuously invests and monitors payment system resilience. We provide "Stand in Processing" for customers to ensure that Australian Businesses can continue to trade and a consumer can complete their purchase when paying with Mastercard, even if a bank processor / third party processor is experiencing a planned or unplanned outage.

Mastercard continuously develops and evolves chip technology and security. We most recently announced we are developing quantum-resistant technologies to develop the next generation of contactless payments. The new Enhanced Contactless (Ecos) specifications are an industry-first. They will help ensure that as our dynamic digital landscape evolves, and new technologies like quantum computing are introduced, contactless technology is future-proofed to ensure consumers continue to enjoy the same high levels of security and convenience.

Regulation: Currently, there are three major regulatory process underway that are likely to have significant implications for the future of payments in Australia. Mastercard is concerned the three major processes underway may be misaligned, leading to unintended consequences and poor outcomes for Australian businesses and consumers.

The proposals outlined in the RBA's Retail Payments Review appear to emphasise a narrow definition of payment system efficiency, overwhelmingly focused on issues related to merchant acceptance costs. This comes at the expense of competition, risk and resilience, and system security. Such an approach benefits large established domestic players rather than considering the needs of all players, including smaller banks, fintechs and consumers. This will have the effect of limiting competition and innovation and seems to be at odds with broader government strategy.

The Treasury Review of Payments on the other hand is looking at *"How to create more productivity-enhancing innovation and competition in the payments system, including in relation to the pace and manner in which the New Payments Platform [NPP] is being rolled out and enhanced by industry."*[1] This review appears to be taking a broader view of efficiency and seeks to ensure the regulatory architecture of the payments system *"is fit-for-purpose and responsive to advances in payments technology."*[2]

Finally, the Australian Competition and Consumer Commission (ACCC) is considering a merger application by eftpos, BPAY and the New Payments Platform. It is important to note Mastercard is not opposed to the merger. Mastercard believes in competition – it drives innovation and better outcomes for business and consumers.

However, we are concerned to ensure there are no unintended consequences should the merger proceed. For example, if a financial institution is required or otherwise feels compelled to implement, enable and utilise products, services and/or capabilities of any of BPAY, eftpos or NPP which are inferior to a third party's capability:

> (a) then competition and innovation between the financial institutions to bring the best payment solutions to the market may be diminished, and it may also prevent those superior third party solutions achieving the necessary network effect, both of which are likely to negatively impact Australian businesses and consumers;
> (b) this also has the potential to foreclose competition from superior products, services or capabilities offered by third parties, or act as a deterrent to implement and utilise these superior products, services or capabilities of third parties; and
> (c) may also mean, contrary to the claimed benefits of the merger, that those financial institutions are less able to compete with "Big Tech" and their 'closed loop' products, services and capabilities given that they have a direct relationship with the financial institutions' customers.

In addition to the implications outlined above, should a financial institution feel forced, or otherwise compelled to adopt inferior technology, consumers and merchants may suffer as well. As outlined in detail in this submission, Mastercard makes significant

[1] https://treasury.gov.au/review/payments-system-review/terms-of-reference
[2] ibid

investments in technology to secure our network and the broader payments eco-system against fraud and data compromise. Peppering this eco-system with inferior technology creates unnecessary risks that may ultimately, and unnecessarily, result in harm to consumers, merchants and other system participants.

In short, it is critical to the future success of the Australian payments system that the outcome of these regulatory activities is aligned to the fullest extent and works to increase competition and innovation in payments, rather than diminish them.

Dual Network Debit Cards (DNDCs) and Least Cost Routing (LCR)

"The Bank would state an explicit expectation that the major banks will continue to issue DNDCs, with both schemes to be provisioned in all relevant form factors offered by the issuer (such as in mobile wallets as well as physical cards)."

Mastercard welcomes the RBA's decision to not regulate for the provision of DNDCs in the market at this stage. However, we believe a number of issues related to promoting broader issuance of DNDCs in the payments system remain.

Impact on smaller banks

DNDCs increase costs and create competitive barriers for smaller banks and new entrants.

As the RBA has noted in its draft conclusions, maintaining two networks on debit cards is unnecessarily costly for smaller players, while bringing little competitive advantage or benefits to the consumer. DNDCs duplicate functionality for consumers across two payments networks, creating unnecessary complexity for issuers. This is further compounded by the mandatory requirement for such cards to carry eftpos as one of the networks included on the card.

Given the ownership structure of eftpos includes the major banks, its inclusion on all debit cards provides no great advantage to end users while ensuring small and new entrants are effectively having decisions about their business operations directly influenced by their larger competitors. Additionally, specific arrangements around the governance of eftpos tend to compound this as large banks are well placed to understand operational and business impacts at their smaller competitors as a result of their role.

These problems are likely to become more acute should the proposed merger of eftpos with the NPP and BPay go ahead. Mastercard contends should the proposed merger be approved by the ACCC, the requirement for DNDCs and, by extension, the RBA's continued promotion of LCR is no longer required. Indeed, this position is supported by the merger applicants:

"The Conduct will not have any effect on the regulation of the Australian payments industry other than, potentially, to remove a need for future regulation to consolidate the industry as has occurred in other countries, such as the United Kingdom, ***or remove the need for regulation to support eftpos' ability to compete with the ICS, as in the case of LCR*** *(emphasis added) … Removing the need for future regulation would be a benefit to the public because it would avoid the costs associated with enacting and enforcing regulation."*[3]

Impact on competition

The current arrangements mandate that the two networks included on a card must be designated schemes. This results in a negative impact on competition.

The passenger network, unlike the main network, isn't competing against other schemes to win issuing market share. As a result, it can increase costs to issuers and use the money to heavily subsidise, or effectively "buy", acquiring volume. This outcome simply acts as a bulwark against competition and significantly impedes innovation.

Mastercard believes if DNDCs are to remain a feature of the market, any two networks should be allowed on a card, such as Mastercard and the New Payments Platform, to facilitate competition.

Issuance threshold

Should the RBA decide to mandate a threshold for DNDC issuance, Mastercard believes the threshold should be set as high as possible.

In our view, it should be based on an issuer's impact on the cost of acceptance for merchants, not other thresholds unrelated to issuance.

Other thresholds, such as Authorised Deposit-taking Institutions (ADIs) accounting for more than one per cent of household deposits, would not be very effective as, for example, they would allow for large, global monoline issuers to enter the market and issue only single network cards.

Mastercard notes that the big four banks in Australia may issue white label cards (cards issued by the bank but branded by a third party). For example, Westpac has announced that it will issue Afterpay branded debit cards to Afterpay's customers through Westpac's new Banking as a Service business.[4] These need to be considered in the context of any threshold that may be set as well as whether such a policy would distort current or future competition in the market for white-label issuance services, in particular whether a white-label issuance to customers of a fintech, merchant or an

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[3] Application by Industry Committee, on behalf of its members who are shareholders and/or members of BPAY, eftpos and/or NPPA, to amalgamate under NewCo- 18 March 2021. pp 86-87

[4] https://www.westpac.com.au/news/making-news/2020/10/westpac-rolls-out-digital-platform-afterpay-on-board/

ADI that is not one of the major banks must be issued as a DNDC because the white-label issuer is a major bank.

"The Board does not see a need for explicit regulatory requirements regarding the provision of LCR at this stage. This reflects the progress that has already been made by acquirers and payment facilitators on developing this functionality and the other policy actions being taken to address specific threats to the viability of LCR."

Based on data available, promotion of LCR with an explicit focus on reducing merchant, and in turn consumer costs, has not proven to be an effective policy measure.

There is no evidence the reduction in acceptance costs has been substantial, nor that it has led to lower consumer prices. As a result of the cost-focused approach taken by the RBA, matters associated with security of the payments system have been neglected.

Effectiveness of least-cost routing

As noted in Mastercard's first submission to the Review, data analysed so far shows the price impact for small merchants who use LCR is unlikely to be material. According to research commission by Mastercard[5], 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.

One industry participant suggests a shift to LCR could save merchants an average of 8.5% on their merchant service fee, with savings varying between merchants and depending on a range of factors[6]. So, based on the RBA's average merchant cost of 0.46% for debit, on the sale of a $3.50 cup of coffee a retailer will save on average $0.00137 in merchant service fees per transaction. On a $10.00 sale a merchant will save $0.00391 and on a $20.00 transaction they will save $0.00782.

As evidenced above, savings merchants make through LCR are minimal and unlikely to translate into lower consumer prices. While at the same time, diverting investment away from things that could actually deliver substantial benefits to merchants and consumers.

Impact on security and resilience of the payments system

Investment to support merchant routing and the provision of DNDCs has been prioritised ahead of important investments to protect the payments system for the future.

The payments system in Australia has gone through a significant transformation because of the rapid innovation and digitisation that has occurred over recent years. The COVID-19 pandemic has sped up this process. Investments to upgrade acquirer

[5] The Initiatives Group (2020), Report on Merchant Acquiring in Australia, p.58

[6] Tap & Save (least-cost routing) FAQs (tyro.com) accessed 27.06.2021

processing capabilities, implement tokenisation, enable biometric transaction authentication and to implement NPP overlay services have not been made because of the singular focus on reducing merchant costs.

This is inconsistent with Australian Government policy on increasing competition and innovation in the financial services sector. Policy and regulatory regimes in the financial services sector should work in concert to achieve desired outcomes, rather than at cross-purposes.

As noted above, should the ACCC approve the merger of the domestic schemes, there is no basis for the RBA to regulate for LCR, a position articulated by the merger applicants.[7]

Additionally, Mastercard has observed instances in Australia with Single Network Debit Mastercards (SNDCs), where merchants are not correctly reading chip settings (due to issues with an outdated centrally managed BIN table system). The result of this is Mastercard branded payment card transactions being declined or incorrectly routed.

This practice is gravely concerning (and contravenes Mastercard Rules). It unnecessarily introduces new risk to the payment system and demonstrates inadequacies in payment system resilience due to an outdated processes and systems outside of Mastercard's control.

"The Bank would state an expectation that the industry will follow a set of principles regarding the implementation of LCR in the device-not-present (online) environment."

The set of principles proposed by the RBA for the implementation of LCR in device-not-present environment will lead to degradation of system security.

The device-not-present environment requires increased consideration of the security and safety of transactions, as risk for fraud and security incidents increases significantly.

The importance of consumer choice in device-not-present transactions
In other jurisdictions, including Europe, where similar initiatives are in place, the decision over the choice of processing infrastructure is in the hands of the consumer.[8] From a consumer protection perspective, the absence of this choice may result in a cardholder's transaction being processed via a weaker, less service-rich route which would result in cardholders having less protection than they believed when initiating the transaction.

[7] Application by Industry Committee op cit pp86-87
[8] Article 8, Regulation (Eu) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions

While the RBA has proposed some principles in the Consultation Paper to address this, the RBA stopped short of providing consumers with decision-making powers. The RBA has not proposed an equivalent mechanism to enable consumers to exercise the same choice in a card-not- present environment that consumers have in a card present environment, namely the ability to insert their card in the payment terminal and select Mastercard or eftpos on a Mastercard DNDC (or Visa or eftpos on a Visa DNDC).[9] Given that ability for cardholders to exercise network preference already exists at the physical checkout, we strongly disagree with the RBA's assertion this would introduce significant friction into the online checkout process.[10] In fact, as Mastercard has repeatedly stated, the online environment allows for far greater competition between schemes compared to a card present environment.

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 for a scheme's logo on a merchant's digital site.

This does not create friction. It creates competition.

With the growth of e-commerce transactions, choice needs to be presented appropriately so consequences and risks of a particular way of transacting are clear to cardholders. When a consumer chooses to pay with a Mastercard, their payment and data is secure.

Mastercard's freedom to operate relies entirely on customers' faith in our ability to provide secure processing, transmission and storage of confidential, proprietary and other information and technology in our computer systems and networks, as well as the systems of our third-party providers. Our customers and other parties in the payments value chain, as well as cardholders, rely on our digital technologies, computer systems, software and networks to conduct their businesses. As a result, cyber security and the continued development and enhancement of our controls, processes and practices designed to protect our systems, computers, software, data and networks from attack, damage or unauthorised access is our highest priority.

Mastercard makes extensive and ongoing investments in cyber security, not only to protect our technology infrastructure and data but across the payment ecosystem, supporting cardholders, businesses and financial institutions.

To maintain the security of our ecosystem, we enable a number of security services when a customer is granted a Mastercard license, ensuring that our customers are taking proactive steps to prevent, identify, detect and respond to fraud and cyber-attacks. We do this using a multi-layered safety and security strategy, supported by integrated security solutions, operating through the complete transaction flow:

[9] As described in paragraph 2 of page 17 of the Consultation Paper

[10] See 4(c) on page 19 of the Consultation Paper.

- **Prevent** - this layer protects infrastructure, devices and data from attacks. Many organisations face challenges identifying and mitigating escalating cyber threats. Organisations often require multiple systems to gather breach data, preventing a complete, comprehensive view of compromised information. As a result, breach information is often limited, fragmented and inadequate, forcing organisations to spend significant time tracking information and investigating the causes and negative financial impact of data compromises.

Mastercard provides financial institutions with an integrated suite of cyber security and risk management capabilities, integrating enhanced capabilities for data compromise detection and a cyber risk rating and enabling issuers and acquirers to proactively detect potential data compromise events and identify cyber threats and vulnerabilities throughout their cyber environment.

Mastercard's tokenisation efforts are advanced in the Australian market, meaning that a Mastercard processed transaction that is tokenised will not expose PANs (the 16 digit card number) in the transaction process.

Mastercard's tokenisation uses cryptograms and is EMV-like in security, further preventing cardholder accounts being compromised. This also has the benefit of increasing approval rates, meaning a better cardholder, issuer and merchant experience.

- **Identify** – this layer allows us to help banks and merchants verify the authenticity of consumers during the payment process using various biometric technologies, including fingerprint, face and iris scanning, to verify card use and reduce fraud.

Our global authentication program, based on the new EMV 3-D Secure standards, provides safe and simple digital transactions and facilitate higher approval rates, by improving the authentication experience for cardholders and merchants for e-commerce channels. We are helping issuers and merchants leverage the additional data exchanged to deliver a smoother, simpler, and safer cardholder experience during authentication and connecting the intelligence from authentication to the authorisation stage of the transaction. A merchant can:

- Eliminate static passwords and security questions—which can be exploited by fraudsters.
- Shift the liability from the merchant to the issuers for authenticated transactions.
- Promote risk-based scoring—only high-risk transactions need verification—while others are managed without consumer impact.
- Help decrease transaction abandonment rate and improve CNP completion rate.

- Help drive approval rates and transaction growth.
- Expand the reach of authentication into mobile devices, which are very likely to dominate the future of ecommerce.

- **Detect** – this layer exposes fraudulent behaviour and cyber-attacks and takes action to stop these activities. Our offerings include alerts when accounts are exposed to data breaches or security incidents and network-level monitoring on a global scale to help identify the occurrence of widespread fraud attacks when the customer (or their processor) may be unable to detect or defend against them.

A solution like the Safety Net helps to protect issuers and acquirers from large-scale fraud events by providing network level monitoring on a global scale. This solution helps identify the occurrence of widespread fraud attacks—providing a secondary layer of defence independent from customer systems—with selective controls that can block transactions for issuers based on multiple criteria, while also alerting acquirers of suspect transactions.

And, as noted above, Mastercard provides continuous global network level fraud monitoring, identifying potential catastrophic fraud attacks perpetrated in multiple, global locations. Mastercard pre-emptively alerts issuers about any adverse behaviours that may be occurring from non-domestic locations on BIN ranges potentially exposing the merchant, consumer and card issuer to cyber-attack that will not be detected or prevented by the domestic network. Unlike domestic schemes, Mastercard can actively monitor to help to prevent "man in the middle" attacks by bad actors outside of Australia, helping to minimise fraud against Australian consumers.

- **Experience** – this layer improves security for merchants and cardholders, for example, by enhancing approvals for online and card-on-file payments, to the ability to differentiate legitimate consumers from fraudulent ones.

Mastercard helps issuers to preserve revenue, minimise risk and safeguard their brand while protecting customer experience. Mastercard Stand-In Authorization authorises transactions when issuers can't.

Mastercard has made significant investments in enhancing Stand-In Authorization to help issuers elevate their business and grow revenue. With Stand-In Authorization, issuers can react effectively when faced with evolving fraud and risk threats to analyse and take action based on authorisation performance.

Mastercard tokenisation (as it is live on the issuer and acquirer side), means that when a cardholder has a change in card number (due to lost, stolen, expiry), their transactions will continue seamlessly. This benefits merchants with higher approval rates and sales, as well as benefiting cardholders with a frictionless and uninterrupted experience for their purchases, utility and insurance bills etc.

For the reasons outlined above, we believe priority within a payment transaction flow should be consumer choice. Our position has always been that consumers should be able to choose how they pay, and this choice should not be overridden by merchants. Where a merchant can choose to route a Mastercard payment transaction, the cardholder should be clearly made aware of what this means and given the option to choose which scheme processes the transaction before it is routed. Routing should only occur without compromise to security or the integrity of the transaction or the payment eco-system.

When a consumer chooses to pay with a Mastercard, they assume Mastercard is what they are using. The cardholder expectation of the Mastercard brand promise and all that involves must not be dismissed or compromised. If a transaction is routed away, this deviation degrades Mastercard's brand promise security. If a cardholder expects a transaction to be processed by Mastercard, but the underlying security the cardholder expects is removed or suspended at any point during the transaction because the payment is routed away from Mastercard, this would be a degradation of the Mastercard brand and security promise.

Should the transaction be compromised, and fraud occur, the cost and consequences could be significant for merchants and consumers in terms of financial cost, brand damage and inconvenience. Additionally, merchant, and consumer trust in the Mastercard brand promise would be badly damaged.

Managing these issues is best served by collaboration between domestic payment schemes and international payment schemes, working together to innovate ways to pay safely and securely and reduce risk in the digital and physical payment environment. For example, should alternative routing of a Mastercard transaction occur, Mastercard should have the ability to apply its security tools to the transaction to ensure it is processed safely and securely for the benefit of the merchant and cardholder.

While in some cases we acknowledge there may be practical considerations that make exercising choice slightly cumbersome for consumers and merchants in a card present environment, this is certainly not the case in an online environment. In fact, it is the exact opposite.

The RBA's approach countenances an environment in which a cardholder can have either choice or transparency, not both. Not only can they have both, they indeed should have both.

"The Bank would explicitly prohibit schemes from engaging in 'tying conduct' involving their debit and credit card products."

Mastercard does not tie credit volumes or transactions to conditions relating to debit volumes or transactions. However, the conduct the RBA is describing could equally occur within the same card product type (i.e. debit) as between card product types (i.e. debit and credit, as well as prepaid). We do not believe Option 2 outlined in the Consultation Paper is necessary. However, if the RBA were to seek such an undertaking, it must apply it to all payment schemes and to all card types outside of DNDCs, so that a merchant's decision to route DNDC transactions can be made without implication to the interchange rates applied to their single network debit card transactions, prepaid card transactions and/or credit card transactions.

We believe the RBA is incorrectly equating LCR to an "all or nothing situation", where all of a merchant's volume is routed to one scheme or the other. This does not accord with the RBA's own analysis which has found that Mastercard (or Visa) will be the cheaper option for certain types of transactions or values, and that eftpos will be the cheaper option for other transaction types or value. We noted with disappointment that the RBA had erroneously excluded Mastercard's tokenised contactless rate of $0.04 on low value at $15 from Table 1 in section 3.2 of the Consultation Paper, despite it being lower than both Visa's and eftpos rates of $0.15 on comparable transactions.

Consequently, if LCR is to mean routing a transaction to the network that is the lowest cost, acquirers should be routing debit transactions based on the interchange fees and scheme fees assessed to that acquirer by the applicable scheme. On a Mastercard DNDC that could be Mastercard for some transactions and eftpos for others.

However, given what we understand to be the issues acquirers are experiencing in building such capability, many of the acquirers that have enabled LCR are merely routing all transactions to eftpos, notwithstanding that eftpos may not be the lowest cost for that transaction type or value. Added to this, where routing decisions are being made based on cost alone, as we noted in "*Effectiveness of least-cost routing*" above, any savings on transactions below $20 would be a fraction of a cent.

We remain of the view that merchant routing decisions should be made based on value and not cost alone, and that unless and until all acquirers:

- price Mastercard transactions based on actual Mastercard fees,
- cease bundling pricing for Mastercard with Visa (and/or other international schemes including China Union Pay, Discover, JCB and American Express) and across different transaction and card types, including card present/card not present, debit/credit and domestic/international, and
- enable dynamic routing to the lowest cost payment scheme,

"Merchant Choice Routing" should be the term used by the RBA and all industry participants to describe such routing, and not "Least Cost Routing".

Interchange

"The Board is proposing to reduce the cents-based debit interchange cap from 15 cents to 10 cents for DNDCs (and all prepaid cards)."

Regulating interchange is another example of a drive to reduce costs, with little consideration for the value of interchange in promoting security, resilience and innovation in the system.

Interchange fees provide an incentive and source of revenue for smaller issuers to provide customers with cards utilising the latest technologies. Furthermore, smaller financial institutions, including disruptive new entrants to the financial services marketplace like neobanks, use interchange to offset the costs of operating a debit payments business, as they have little scope to do so from their other business activities.

Given this, lowering interchange will have the unintended – and undesirable – consequence of discouraging new entrants and entrenching the market dominance of the existing players.

This is contrary to the Australian Government's stated aim of encouraging the development of a local fintech industry and increasing competition in the financial services market.

"The Board is proposing to reduce the cents-based debit interchange cap to 6 cents for SNDCs"

Mastercard welcomes the RBA's decision to focus on high cost debit cards. We expect this cap will apply to all designated schemes.

However, we are concerned the proposed size of the interchange cap reduction is likely to have a negative impact on small issuers.

Interchange fees provide an incentive and source of revenue for smaller issuers to provide customers with cards using the latest technologies.[11] Being able to provision

cards in digital wallets for example, is a critical but costly exercise for smaller issuers competing with their larger counterparts. An interchange cap reduction of the scale

[11] ACIL Allen Consulting (2020), Payments systems and interchange fees, pp. 9-11

proposed will significantly impede the capacity of smaller issuers to keep up with innovation and compete.

We note the RBA acknowledges provisioning DNDCs is costly and cumbersome for smaller issuers. For many smaller issuers, with a heavy reliance on interchange revenue, a reduction like the one proposed will make it even more difficult for them to compete. For these issuers, the capacity to issue economically viable SNDCs is essential if they are to have a fighting chance to effectively compete with bigger players.

Transparency

"Schemes would be required to provide the Bank with access to their scheme fee schedules and all scheme rules, and to notify the Bank promptly of any changes to these.

"Schemes would also be required to provide quarterly data on scheme fee revenue and rebates to the Bank. The Bank would consider publishing some of the aggregate data, to provide stakeholders with greater visibility over the average levels and growth rates of these fees across schemes. Larger issuers and acquirers would also be required to provide annual data on scheme fee payments to act as a cross-check on the data reported by the schemes."

Mastercard's approach to setting fees and rulemaking

Mastercard's rules are largely global and can be accessed by anyone via the internet. We need the ability to maintain flexibility within our fees and rules to be able to react to issues quickly. For example, urgent action may be required to respond to a safety and security issue or newly identified gaps in rules relating to issues such as anti-money laundering or sanctions requirements.

Typically, given the size of our network, Mastercard makes rules and advises customers via a bulletin setting out the new requirements and a due date for implementation. We do not issue draft rules for consultation as this would be impractical given our tens of thousands of customers.

As a global network business, we have a need for a globally harmonised process in relation to scheme Standards. It is not practical to embed a single regulator in what is a global process flow. For this reason, global scheme Standards are not subject to regulator approval requirements. Indeed, the vast majority of Mastercard's Standards relate to technical matters where the outcome of the global process must be that network participants observe identical requirements in relation to the same activity. This is necessary for safety and security, the delivery of our services and the interoperability that Mastercard customers rely on to ensure a card issued in one country, operates in precisely the same way as one issued in another market.

All scheme Standards are, of course, subject to local law and compliance with those laws is required of scheme participants.

Fees and Transparency

Mastercard supports transparency measures that are meaningful and genuinely help users make helpful comparisons between products, services and providers. But, as we have detailed in previous submissions on this matter, simply publishing scheme fees will not be enough to help small businesses make meaningful comparisons between schemes and acquirers to make informed decisions about managing costs.

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.

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.

According to Mastercard analysis, and as shown in the charts below (figures 1 and 2), scheme fees make up the smallest proportion of costs for many debit transactions.

This suggests a focus on scheme fees is misplaced and is unlikely to result in any benefit to merchants, particularly smaller merchants.

Figure 1: Breakdown of Merchant Service Fee | Debit Card Present (excl. X-Pays)

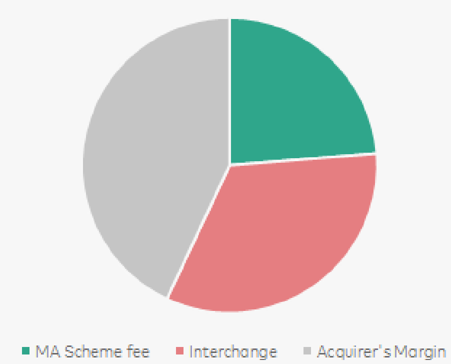
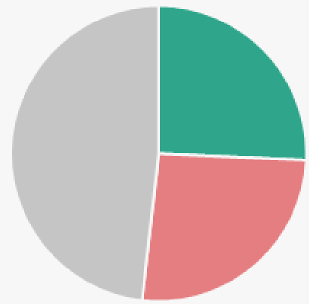


Figure 2: Breakdown of Merchant Service Fee | Debit Card Not Present



As we have pointed out in previous submissions, some of our fees are linked to value added services, such as increased safety and security, promotion of incremental sales or encouraging customer loyalty.

As demand for these services increases and the system becomes more complex and interconnected, the proportion of these value-added services will increase over time as compared to the core services involved in traditional processing activities. Additionally, they will not apply to all transactions, thus creating perceptions of complexity and lack of transparency. Unless this is clearly articulated in any transparency regime, the result will be a race to the bottom on pricing. This will mean poorer outcomes for all system participants.

Given the above, the complexity around calculating the averages, especially across transaction type and to calculate these net of incentives/rebates for each transaction type should not be understated. In some instances, system builds may be required to enable the reporting across product and transaction types. Mastercard is working to estimate these costs of this and would be pleased to discuss this with the RBA. However, as noted above, the RBA needs to consider the usefulness of collecting and publishing such information and to what extent it will assist merchants in decision making about their acquiring arrangements.

This is particularly relevant given that, in many cases, the merchant-acquirer relationship is tied to a broader relationship between a merchant and a financial institution.

Various system participants contribute to complexity in fees pricing

At the moment, merchants do not have clear visibility of all components of price, beyond costs associated with international card schemes.

For example, acquirers add different margins to the scheme fees for each network. That process is not transparent to system participants:

- 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.

We agree with the RBA's view that Option 2 under paragraph 3.3.2 of the Consultation Paper would be inappropriate. We would further add that in addition to the difficulty in analysing and interpreting any disclosed scheme fees, such fees and the rules relating to them are confidential and competitively sensitive. Recent reforms to the *Competition and Consumer Act 2010*, which came into effect in 2017, introduced a new prohibition against concerted practices. This prohibition recognises that the sharing (including publicly) of competitively sensitive information may reduce competitive uncertainty and thereby have an anti-competitive effect. Concerted practices that have the purpose or effect of substantially lessening competition in a market in Australia are now prohibited.

We submit that if an Option 2 disclosure requirement is applied to proposed scheme fees (i.e. fees that are announced but not yet imposed) then this would constitute a disclosure of future price information. A highly granular disclosure (and thereby sharing) of competitively sensitive information would have the unintended consequence of dampening competition as between the schemes and, if there was a requirement to also disclose scheme fee rebates, between issuers and acquirers.

Additionally, we also submit that the Option 3 recommendation as it stands (i.e. for the schemes to disclose fees to the RBA, which the RBA then publishes on an aggregated basis) does not mitigate our competition concerns.

First, where such obligations are not equally applied to all payments systems, schemes and/or networks, this would put the three designated payment system at a distinct competitive disadvantage.

Second, if the purpose of the disclosure of aggregated information is so that industry participants can make informed comparisons between different electronic payment options then those comparisons should cover all payments schemes, systems and/or networks in the Australian market and not just the three designated payment systems. In this regard, a domestic payment scheme, system and/or network with more limited offering does not provide an appropriate comparison point to international payments schemes, systems and/or networks.

Third, and more fundamentally, the increased transparency of scheme fees will not promote the objective of enabling merchants to make more informed routing choices while lack of transparency of acquirer fees remains. In particular, the use of blended fees for the international card schemes obscures the actual costs for different card transactions and sends distorted signals as to the costs of different payment schemes, systems and/or networks.

Mastercard does not believe that the present recommendation on disclosure will serve their intended purposes. It may instead lead to undesirable consequences, bringing about a less competitive environment, and by forcing a comparison between networks with dissimilar geographic coverage, may result in less clarity to merchants.

Mastercard will continue to work with our customers and stakeholders to enable increased understanding by the merchants on the various components of the fees that they pay.

Surcharging

"The Board is not proposing to require any 'buy now, pay later' (BNPL) providers to remove their no surcharge rules at this time but considers that a policy case could emerge in the future and will keep this issue under review."

We note the Payments System Board's (the Board) view is that surcharging promotes payments systems competition and keeps downward pressure on costs through "more transparent price signals" which may encourage consumers to use cheaper payment methods.

The reality is that these price signals are significantly distorted by the way in which merchant service fees are set by acquirers, and the inconsistent application of surcharging. For example, a blended merchant service fee where international schemes fees are combined (Visa, Mastercard, and sometimes also other international schemes) and all card types (credit, debit and prepaid, both issued in Australia and issued outside of Australia) and all transaction types (CP, CNP) together with an acquirer margin, makes it difficult for consumers to perceive any kind of price signal.

The consequence is that the true costs of Mastercard card transactions are distorted and the relative cost of different payment options are misrepresented. The fact is that Mastercard (and Visa) card payments are often surcharged at a rate that exceeds the true cost to the acquirer.

The above is further exacerbated by the fact that merchants often do not have the ability to surcharge eftpos transactions as acquirers have generally not built that capability. Accordingly, while the ban on "no surcharging" rules in theory applies to the three debit schemes, in practice it mainly impacts Mastercard and Visa.

In terms of other payment methods, while acknowledging the concerns raised regarding competitive neutrality, the Board argues that permitting no surcharging on certain payment methods may be justified to promote "a more competitive and efficient payment system". This is the justification given for BNPL. However, BNPL is well established today as an alternative to regulated credit and as a new way to pay; there can be no dispute about the reality of that. In addition, contrary to the Board's aims, BNPL is not a more efficient payment method, it is in fact a high cost payment option for merchants.

Further, this justification is not applied consistently. For instance, bill payments are dominated by BPAY. While Mastercard has been seeking to compete in this segment, card payments are often subject to surcharges whereas there is usually no-surcharge applied to the dominant provider, BPAY.

The current approach which restricts the card schemes from implementing no-surcharge rules provides other participants who are able to implement no-surcharge rules (and do, such as BNPL) with an unfair competitive advantage.

We would also like to address RBA's observation that *"given that surcharging by merchants is not widespread and that only a relatively small proportion of card payments incur a surcharge"*. This does not accord with Mastercard's experience. We are aware of instances where payment using a Mastercard DNDC (or Visa DNDC) is surcharged but a transaction using the same DNDC card where eftpos is selected is either surcharge-free or subject to a materially lower surcharge. In many of these cases the fees charged for a Mastercard DNDC transaction do not warrant the different surcharge practices but for how the acquirer has priced eftpos versus Mastercard (and Visa) transactions.

As made clear in previous submissions, Mastercard believes any regulations regarding surcharging should be applied evenly across all payment system participants. We also agree with the RBA's observation that the *"[r]outine surcharging of debit transactions would also not be a desirable outcome, given that debit cards are now the most prevalent payment method for retail goods and services, and are increasingly replacing cash for low-value transactions."*

With this in mind, Mastercard believes all payment networks should be allowed to impose no-surcharge rules for debit transactions at the least. Merchants are not permitted to impose a cash handling fee on customers (notwithstanding that there are significant costs of managing cash) and should not be permitted to impose a fee for debit transactions.

Debit transactions are very low cost, especially when compared to the cost of BNPL. In other jurisdictions where interchange is regulated, surcharging is banned. We believe Australia should follow a similar approach for debit at the least.

Comments on the Draft Standards

1. **Is the proposed approach appropriate? Does it meet the public interest?**
2. **Do the draft standards achieve what is intended?**

American Express Companion cards

We understand that the RBA's rationale for including the American Express Companion Cards in Standard No.1 was that they operated similar to a four-party network card and involved the provision of "interchange-like" benefits to issuers in excess of the then interchange caps.

We are concerned that simply removing such companion cards products from Standard No.1 without additional clarification will simply enable the same companion card products to be issued again in the future. Consequently, we are of the view the reference to companion cards in Standard No. 1 should remain or, the anti-avoidance terms in Standard No.1 need to be correspondingly amended to prevent any future issuance of such American Express Companion Cards (or any similar companion card products).

3. **Are there factors that have not been properly addressed or considered, either in the general approach or the specific drafting?**

Dual Network Debit Cards

Firstly, in describing Option 2 in the Consultation Paper and the requirement for major banks to issued DNDCs with two card schemes to be provisioned, we note the RBA states *"there would be no presumption as to which two debit networks were included by issuers"* and *"various combinations of domestic and international payment networks might be feasible."* While on the face of it this seems to contemplate that a major bank may issue a Mastercard DNDC where Visa is the secondary card scheme, or vice versa, unless an issuer could feasibly do this then eftpos, as the only other Designated Payment Scheme, would by default remain the secondary scheme on every DNDC without having to compete to be that secondary scheme.

Issuing a Mastercard DNDC with Visa as the secondary card scheme (or vice versa) would only be feasible for a major bank if they could do so without, for example:

1. breaching existing Scheme Rules or contractual arrangements with each of Mastercard and/or Visa; and

2. requiring an authorisation, consent or no action undertaking from any governmental, regulatory and/or competition/anti-trust authority whether in Australia or globally.

At a minimum the RBA should publicly consult with the ACCC on the whether such a construct would be permitted under Australian competition law and/or would require express authorisation from the ACCC and if so, whether the ACCC would entertain granting such authorisation. Without such confirmation from the ACCC, the DNDC market would be remain distorted where only Mastercard and Visa compete with each other to be the first card scheme on the issuer's DNDC. eftpos, as the only other Designated Payment Scheme, would by default remain the secondary scheme on every DNDC without having to compete or provide a compelling offer to the issuer to be that secondary scheme.

Secondly, we note in defining a Dual Network Debit Card or DNDC in Standard No.2 the RBA have provided in paragraph (b)(ii) that second network is the payment network of one or more of another Debit Card Scheme and any other third party payment system enabling payment for goods or services by accessing an account with an ADI, Bank or other financial institution. On the face of it, this would enable domestic payment systems like NPP, BPAY and BECS, or international payment systems such as the digital wallets, to be utilised. If this is the intent then we would view this as a positive development as it would enable Mastercard DNDCs to be issued by major bank that enable payments to be processed on a secondary payment network that is not associated with the two other Designated Payment Schemes, Visa or eftpos, thereby introducing further competition into the debit payment market.

However, it is not clear to us that this approach aligns with section 3.1.2 of the Consultation Paper, and in particular with how Option 2 is described where "two card schemes would be provisioned in all form factors"[12]. If the RBA's intention is to enable payments systems other than:

1. the three Designated Payment Schemes to be the second network; and/or

2. payments systems that operate as both payments schemes and payments networks to be the second scheme;

then this should be addressed by the RBA in further consultation, as well as made clearer in Standard No.2 so the "and" at the end of (b)(i) operates as an "and/or" since the payment network is intended to be one or more of the networks.

New Issuer Certification

We appreciate the RBA providing clarity to the industry over when the reporting obligations for new issuers commence.

We note however that if the RBA intended "first full financial year" in the definition of "Initial Reporting Period" to refer to the 12 month period ending 30 June, we would recommend that this is replaced with "first full Reporting Period" instead given that this defined term has a corresponding meaning. Ideally a worked example would be included as well to illustrate how this is determined. This would ensure there is no

[12] See page 11 of the Consultation Paper

confusion for new issuers, or schemes, in particular those that do not have financial years that that end on 30 June. Mastercard's financial year for example ends on 31 December so could result in Mastercard making its certification for a different time period than the new issuer.

4. **What impact will the proposed policy changes have on your regulatory compliance costs? (Please provide dollar estimates.) Are there alternatives that would achieve the policy objectives at lower cost?**

Mastercard will provide this information to the RBA separate to this submission.

5. **How much time should be allowed between any final decisions being made on the interchange standards and the effective date of any new or revised standards? What factors are relevant to the length of this implementation period?**

Among other things, the issues raised above regarding the need to clarify the competition issues associated with the publication of scheme fees and the "presumption as to which two debit networks were included by issuers" on a DNDC, will take some time to resolve. Accordingly, we believe any changes should be effective from July 1, 2022.