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20 January, 2017

Competition and Consumer Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140
New Zealand

via email: competition.policy@mbie.govt.nz

Re: Submission to the Ministry of Business, Innovation and Employment's consultation on Retail Payment Systems

Dear Mr Sue,

Mastercard welcomes the opportunity to make a submission to the Ministry of Business, Innovation and Employment (MBIE) for its consultation on the Retail Payments System.

Our submission details Mastercard's views on a range of issues that MBIE has flagged in its issues paper, and highlights the essential role interchange plays in the technological development of the payments system as well as the value it offers to participants.

Mastercard contends that the existing framework for interchange is working effectively and that regulation will create significant unintended consequences, as has been the case overseas. Having seen the wider payments value-chain forced to adapt to regulation in other jurisdictions, we feel we are uniquely positioned to provide the insights set out in this submission.

Mastercard looks forward to an ongoing dialogue with MBIE and to working to ensure the best possible environment is in place in New Zealand to facilitate the growth of electronic payments and deliver the best outcomes for the Government, consumers and businesses.

Yours sincerely,

Peter Chisnall
Country Manager, New Zealand
Mastercard

Executive summary

Electronic payments provide enormous value in New Zealand.

They have provided a safe and innovative way for New Zealanders and visitors to pay while providing businesses with the possibility to take advantage of different payment channels including online, in person and via self-checkout. Each of these options would not be possible without the significant investment by international schemes and banks in the development of new innovations which provide businesses with the ultimate choice of how their customers pay.

As a key contributor to New Zealand's retail payments system, Mastercard takes its role in setting interchange fees seriously. It is important to note that Mastercard does not earn revenue from interchange. Accordingly, there is no incentive for us to set interchange at rates that would negatively impact business acceptance or negatively impact card issuance.

Interchange facilitates the secure and efficient functioning of the payment system. While Mastercard does not directly earn revenue from interchange, we do benefit when interchange is set at the right level through higher transaction volumes.

The right interchange level is one that:

- Recognises the value delivered to merchants when they accept cards; and
- Compensates issuing banks fairly for the costs involved in providing businesses and governments who accept cards with the value they receive.

Considering the interests and perspectives of consumers, businesses, industry participants and other stakeholders in the payments system, Mastercard's guiding principles in making this submission are:

- An efficient and effective payments system;
- Recognition of the value electronic payments deliver to businesses and the wider economy, which is funded by issuers;
- Protection of consumer benefits and mitigation of unnecessary cost impacts; and
- Evidence-based policy, which takes into account the impacts on all system participants (both intended and unintended) of regulation imposed on international payments systems.

Our goal remains to ensure New Zealand has the best possible policy settings that continue to incentivise investment in innovation and the growth of electronic payments, and which deliver the best outcomes for New Zealand, maintaining its position as one of the most advanced retail payments markets in the world.

About Mastercard

Mastercard is a technology company in the global payments industry that connects consumers, financial institutions, merchants, governments and businesses worldwide, enabling them to use electronic forms of payment instead of cash and cheques.

As the operator of what we believe is the world's fastest payments network, we facilitate the processing of payment transactions, including authorisation, clearing and settlement, and deliver related products and services. 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 also provide value-added offerings such as loyalty and reward programs, information services and consulting. Our network is designed to ensure safety and security for the global payments system.

A typical transaction on our network involves four participants in addition to us: cardholder (an individual who holds a card or uses another device enabled for payment), merchant, issuer (the cardholder's financial institution) 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 cardholders by issuers, or establish the rates charged by acquirers in connection with merchants' acceptance of our branded cards. In most cases, cardholder relationships belong to, and are managed by, our financial institution customers.

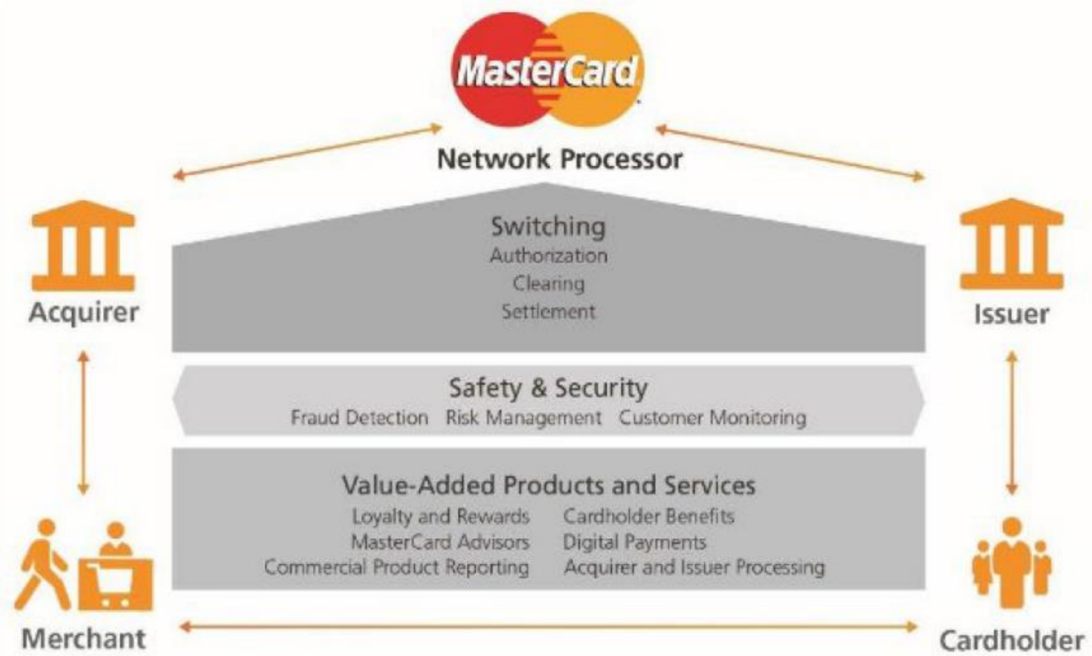
We generate revenue by charging fees to issuers and acquirers for providing transaction processing and other payment-related products and services, as well as by assessing these customers based primarily on the dollar volume of activity, or gross dollar volume ("GDV"), on the cards and other devices that carry our brands.

Our Operations and Network

We operate the Mastercard Network, our unique and proprietary global payments network that links issuers and acquirers around the globe to facilitate the processing of transactions, permitting Mastercard cardholders to use their cards and other payment devices at millions of merchants worldwide.

Our network facilitates an efficient and secure means for merchants to receive payments, as well as a convenient, quick and secure payment method for consumers and businesses that is accepted worldwide. We process transactions through our network for our issuer customers in more than 150 currencies in more than 210 countries and territories.

With a typical transaction involving four participants in addition to us, our network supports what is often referred to as a "four-party" payments network. The following diagram depicts a typical transaction on our network, and our role in that transaction:



In a typical transaction, a cardholder purchases goods or services from a merchant using a card or other payment device. 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 cardholder'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", as further described below), to the merchant.

Recent Business Developments

Product Innovation: We have launched and extended products and platforms that take advantage of the growing digital economy, where consumers are increasingly using technology to interact with merchants. Among our recent developments:

- In 2014, New Zealand became one of the first ten countries to launch MasterPass™, our global digital payments ecosystem, which has since seen further expansion. MasterPass provides an easy and safe way to shop by storing payment information in one convenient, secure place and enabling consumers to access that information to make a payment with a simple click or touch.
- We are using our digital technologies and security protocols to develop solutions to make shopping and selling experiences on mobile devices (like smartphones) simpler, faster and safer for both consumers and merchants. In 2015, we continued to enhance the suite of digital token services we offer through our MasterCard Digital Enablement Service (MDES). We also launched the MDES Express program, a commercial framework that provides financial institutions and digital participants (including large digital companies, merchants and other companies) the ability to quickly scale digital payment offerings to consumers and reduce fraud, allowing connected devices to be used as a safe and secure way to pay for everyday shopping.
- In 2015, we launched MasterCard Send™, a service that facilitates the delivery of funds via financial institutions from business to consumer and from consumers to consumers quickly and securely. We are looking at using this technology to build an alternative remittance network between New Zealand and the Pacific Islands.

Safety and Security: Our focus on security is embedded in our products, our systems and our network, as well as our analytics to prevent fraud:

- We continue to lead the migration to EMV (the global standard for chip technology) to bring its fraud prevention benefits to our U.S. customers, consumers and merchants.
- In 2015, we worked with customers to extend to consumers globally the benefit of "zero liability", or no responsibility for counterfeit or lost card losses, in the event of fraud.

The value of electronic payments

New Zealand is one of the most advanced nations in the world for electronic payment adoption. Its use has grown in recent years to the point where it has begun overtaking paper-based payment methods such as cash and cheques. In fact, cash circulation in New Zealand is the lowest among OECD countries. [1]

Innovation in the payments space has created opportunities for New Zealand's economy and card schemes have acted as major facilitators of these technologies. For example, the development of secure online payment technology has allowed for more businesses and consumers to safely buy and sell goods and services online. This has enabled business to maximise opportunities to sell more products and in some cases, change their business model to participate in the global marketplace. Meanwhile, in-store, face-to-face innovations like contactless payments have enhanced customer and merchant sales experiences, particularly in high-traffic stores where fast transaction times are crucial.

Electronic payments offer benefits that cash and other payment methods simply cannot. They provide increased accuracy and efficiency and avoid operational costs associated with cash handling and security. In addition to the convenience, electronic payments provide the most cost effective means of transacting.

The value of interchange

Interchange represents a sharing of a portion of payments system costs among the issuers and acquirers participating in our four-party payments system. It reflects the significant value merchants receive from accepting our products, which deliver highly valued benefits to cardholders and play a key role in balancing the costs consumers and merchants pay.

Mastercard does not earn revenues from interchange.

Generally, interchange is collected from acquirers and paid to issuers to reimburse the issuers for a portion of the costs incurred by them in providing services that benefit all participants in the system, including acquirers and merchants. In New Zealand, Mastercard is responsible for setting interchange, which facilitates the secure and efficient functioning of the payments system.

The interchange level can be deemed appropriate when it is set:

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

Interchange is set by Mastercard taking relevant considerations into account such as the nature of the particular payment stream, the costs of the recipients of interchange and the levels of cardholder usage and merchant acceptance. Balancing the network of payments is therefore a complex process, which is best dictated by market forces. Artificial limits on interchange such as artificially lowered weighted averages or hard caps upset this balance and distort price signals to system participants.

Benefits for consumers

Interchange delivers major benefits to consumers.

- *Safety and security* – Interchange covers the cost of fraud protection, so cardholders are protected in the rare event of a fraudulent transaction. For example, in the event of a stolen card, Mastercard cardholders are protected from fraud or unauthorised

[1] Payments NZ Research, June 2014: http://www.paymentsnz.co.nz/cms_show_download.php?id=99%E2%80%8B

transactions under Mastercard's Zero Liability Policy. Investment in EMV chip technology has also enhanced the anti-fraud capability of cards, making them almost impossible to counterfeit and adding an extra layer of protection not possible with magnetic stripe cards.

- *Flexibility* – Not only does interchange allow businesses to accept cards, it pays for the interest free days on credit cards – a period that nearly three in four New Zealanders rely on to pay off their credit card bills.[2]
- *Convenience* – Payments also allow consumers to access money whenever and wherever they want, while electronic payments provide consumers with a more secure and efficient way to pay, whether in-person, online or in-app.

Benefits for Businesses

Interchange facilitates the use of electronic payments which pay for the enormous benefits businesses receive. When compared to acceptance of cash, the additional value provided to retailers by electronic payments is two to three times the total cost of acceptance.[3] Via their acquirers, merchants can accept Mastercard transactions with very low associated interchange costs.

As explained below, value is created for merchants through a combination of factors:

- *Guaranteed payment* – Interchange pays for the guaranteed payment merchants enjoy 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. Without cards, retailers would have to provide customer accounts, at a cost which would far exceed that of interchange, or simply refuse certain transactions.
- *Cost efficiency* – 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. The cost of cash is estimated to be 2.3%, comparable to interchange or a merchant service fee.[4]
- *Boosted sales* – Studies show that consumers spend more when they use cards and businesses make more money when they accept cards:
    - Debit and credit transactions are about 2 to 6 times larger than cash purchases[5]
    - Premium credit products result in larger transactions whose revenues and contribution to profit more than offset any additional costs of acceptance
    - Mastercard research from overseas has found that almost half of consumers actually avoid stores that do not accept cards for smaller transactions[6]
    - New Zealand retailers are the main beneficiaries from overseas visitors using their cards, with tourism being the second largest export in New Zealand. Mastercard data indicates that average transaction sizes for tourist transactions are 40% greater than domestic transactions.
    - Cost management – Interchange structures give merchants the flexibility to create card acceptance cost efficiencies where appropriate. That is, merchants are able to present their customers with the payment option that

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[2] Perceptive Research, Omnibus Survey of New Zealanders, 2016

[3] Peter T Dunn & Company Research, 2016

[4] ibid

[5] ibid

[6] Galaxy Research, October 2015

provides them with the strongest financial benefit without compromising any of the benefits the customer receives. For example, Mastercard's interchange rates for contactless can range from $0.004 for contactless debit micropayments (for transaction values below $15) to 0.50% for credit.

Benefits for Government

The use of electronic payments enhances New Zealand's national productivity in several ways:

- *Economic participation* – 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 New Zealand businesses to do trade with anyone around the world.
- *Reducing the shadow economy* – Using electronic payments over cash increases transparency and acts to reduce the shadow economy as well as tax avoidance.
- *Facilitating government payments* – Government and the public sector are major beneficiaries of interchange as they utilise many different payment options including commercial cards.

The international experience of regulation

Interchange is essential to ensure merchants and consumers receive maximum value for electronic payments at the lowest possible costs. Flexible interchange also promotes credit availability for small businesses and is a key driver for ensuring financial inclusion of unbanked consumers in markets around the world.

The MBIE paper makes a number of comparisons between New Zealand and regulated markets elsewhere, inferring that the costs associated with regulated payment systems are lower.

However, when interchange has been lowered by regulation, the costs of the payment system do not disappear. Despite interchange being lowered in regulated markets, evidence shows costs are recovered in another ways, typically from consumers through:

- Higher fees
- Increased interest rates, and
- Reduced cardholder services

In addition, there remains no evidence that businesses pass on any cost reduction they receive via interchange regulation to their customers through reduced prices of their goods or services.

Unfortunately, when governments or regulators attempt to address cost concerns by reducing interchange, consumers and small businesses suffer cost increases and reduced benefits. It is, therefore, essential that the concerns of business about interchange costs be further examined and addressed appropriately – something Mastercard has been doing in New Zealand for some time.

We believe that process will address merchant concerns while protecting consumers and small businesses from the consequences of arbitrary interchange restrictions.

To use Australia as an example, the Reserve Bank (RBA) has asserted that the interchange regulation implemented in 2003 resulted in lower Merchant Service Fees (MSFs) and therefore lower prices for consumers.[7]

Lower MSFs however do not, in themselves, validate the existence of interchange fee regulation. There remains a lack of evidence to support the argument that the cost savings merchants enjoyed through lower MSFs resulted in lower retail prices for consumers, as the RBA assumed they would. In 2006, the RBA acknowledged this, saying the flow in savings for merchants onto consumer prices was "difficult to measure".[8]

The same conclusions have been drawn overseas by academics and consumer groups alike.[9] Rather than lowering overall costs in the system, regulated interchange has shifted fixed costs away from merchants and on to other parties participating in the system, particularly consumers.

Indeed, the RBA has conceded "the higher the interchange fee, therefore, the less the cardholder has to pay".[10]

While the MBIE Paper acknowledges the regulatory framework in a number of jurisdictions, it does not outline the negative and unintended consequences of these regulations. Mastercard, and many other stakeholders, have undertaken research into the negative impacts that have been seen as a direct result of regulation – all of which impact consumers.

These negative impacts are summarised below.

Australia

- Evidence shows that RBA regulation of interchange in 2003 led to cardholders paying approximately $480 million more in additional fees each year.[11]
- Australian banks have reduced their customer rewards programs.[12]

Spain[13]

- A reduction in interchange fees by more than 55% between 2006 and 2010 led to an increase in Spanish consumer costs by 50% (€2.35 billion in absolute figures).
- Research shows lowering interchange rates "disturbed the necessary balance of the electronic payment system market and... damaged the majority of participants and society as a whole".

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[7] Reserve Bank of Australia (2004), 'Merchant Service Fees for Credit Cards', *Reserve Bank of Australia Bulletin*, July

[8] Reserve Bank of Australia (2006) *'Payments System Board Annual Report 2006'*

[9] Joint statement by consumer bodies expressing concerns about the European Commission's proposal to regulate interchange on card transactions. Viewed online at: <http://www.parliament.uk/documents/commons-committees/european-scrutiny/Consumer-bodies.pdf> and Europe Economics (2013), 'The Economic Impact of Interchange Fee Regulation in the UK' p.1

[10] Reserve Bank of Australia, Submission to the Senate Inquiry on Matters Related to Credit Card Interest Rates, August 2015, p.12

[11] Stillman, R., Bishop, W., Malcolm, K., Hildebrandt, N.: "Regulatory intervention in the payment card industry by the Reserve Bank of Australia"; CRA International, April 2008. p.13

[12] Drummond, S. 'Citi First to Cut Loyalty Program Benefits' in Sydney Morning Herald, December 15, 2015

[13] This is supported by Iranzo, J., Fernández, P., and Matías, G., and Delgado, M., 'The Effects of the Mandatory Decrease of Interchange Fees in Spain', 2012, viewed online at: <http://mpra.ub.uni-muenchen.de/43097/1/MPRA_paper_43097.pdf>

United States

- Debit interchange rates were capped in 2011 under the *Durbin Amendment* (as part of the *Dodd-Frank Act)* with the aim of reducing costs for merchants and consumers.
- Instead this led to increased banking costs through higher deposit fees[14] and the introduction of annual debit card fees.[15]
- Few merchants were found to have reduced prices or debit restrictions as their debit cost acceptance decreased. [16]
- Senior members of Congress, including the Chairman of the House Financial Services Committee, are now leading efforts to repeal *Durbin*, claiming that it has artificially shifted revenue in the marketplace rather than promoting technological innovations like enhanced data security capabilities.[17]

European Union (EU)

- The EU recently introduced hard caps on credit and debit interchange.
- This regulation was met with resistance from various stakeholders, including consumer groups who argued that the cap will lead to higher banking fees and no meaningful reduction in merchant prices.[18]
- Following implementation of the caps, issuers have responded promptly by reducing their rewards value, rationalising their product set and relying more on fees to drive product revenues. Research conducted by First Annapolis Consulting[19] has observed the following:
    - *Higher annual fees* – In major markets such as France, Spain, Italy and Portugal for example, almost half of the top five to six issuers have raised their annual card fees. In Spain, the average increase in annual fees was as high as 26%. In Germany, several large, well known issuers are now charging on average 20% more than they did at the beginning of 2016.
    - *Increased APRs* – Issuers in Portugal, Poland and Italy have increased their APRs by 30, 100 and 131 basis points respectively.
    - *Less generous rewards programs* – Czech bank Ceska Sporitelna eliminated its 1% cash back on credit card purchases except for e-commerce and foreign purchases, and Raffeisen has reduced its monthly cash back rewards on premium cards from CZK 1,000 to CZK 250.
    - *Higher fees on associated services* – Some European card issuers have begun raising fees on other services such as when consumers choose their PIN numbers. Others such as KBC (Belgium), Banco Santander (Portugal) and Sydbank (Denmark) have increased ATM cash withdrawal fees on some cards.

[14] Kay, B., Manuszak, M., Vojtech, C. (2013) 'Bank Profitability and Debit Card Interchange Regulation: Bank Responses to the Durbin Amendment', Federal Reserve Bank of Boston, p. 5

[15] McGinnis, P. (2013) 'Misguided Regulation of Interchange Fees: The Consumer Impact of the Durbin Amendment', *Loyola Consumer Law Review*, vol. 25, no. 2, p.306

[16] Study conducted by the Federal Reserve Bank of Richmond and Javelin Strategy & Research, found in Mitchell, N., Schwartz, S., Wang, Z. (2014) 'The Impact of the Durbin Amendment on Merchants: A Survey Study', *Economic Quarterly*, vol. 100, no. 3, p.184

[17] ABA Banking Journal, House Bill Introduced to Repeal Durbin Amendment, June 14, 2016

[18] Joint statement by consumer bodies expressing concerns about European Commission proposal to regulate interchange on card transactions: http://www.parliament.uk/documents/commons-committees/european-scrutiny/Consumer-bodies.pdf

[19] Data sourced from First Annapolis Consulting European Card Research 2016. See: http://www.paymentscardsandmobile.com/six-months-interchange-regulation-card-products-changed/

- In France, Europe Economics research[20] has forecast that interchange caps will:
    - o Create financial instability for issuing banks leading to a €418m increase in cardholder bank fees and no reduction in prices for consumers; and
    - o Deteriorate competitive conditions within the card sector and reduce incentives for issuers to innovate for bank cards.

Further consequences of regulation

- Small banks and credit unions in Australia warned that a further reduction in interchange will result in low-rate cards being discontinued and additional costs being passed on to cardholders through higher interest rates and annual fees.[21]
- Outside of introducing higher annual fees or interest rates, the only alternative for banks to recover costs would be to reduce services like fraud prevention or interest free repayment periods. Research has found that these services are considered very important by the majority of New Zealand cardholders.[22]

Options outside regulation

As outlined in the MBIE Paper, some countries have used other mechanisms to address business concerns regarding the cost of retail payments.

The concept of self-regulation is not new to the financial sector. A self-regulation model is acknowledged by academics as being particularly suited to the financial sector as it is more conducive to innovation and the structure is more nimble and able to adapt to new technological conditions as compared to government regulatory agencies.[23]

Challenges to regulation

While advocates for regulation point to the fact that regulation is part of an 'international trend', it is worth noting that in certain countries where interchange regulations were introduced, lawmakers are now considering their removal. One such example is the United States where the impact of artificially-lowered interchange has been heavily scrutinised. Congress is now looking at the option of repealing the Durbin Amendment with the support of the House Committee on Financial Services.

On September 13, 2016 the Committee approved a bill to be known as the *Financial CHOICE Act*, which if enacted will replace the *Dodd-Frank Act.* The bill includes a repeal of the Durbin Amendment. Congressional criticism of Durbin has centred on its manipulation of the market and diverting revenue away from technological innovation such as enhanced data security capabilities.[24]

The bill is expected to be put before Congress in 2017.

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[20] Europe Economics 'The Impact of Interchange Fee Regulation', September 2014, p. 21-32

[21] Customer Owned Banking Association, submission to the Senate Inquiry into matters relating to credit card interest rates, August 2015, p.4

[22] Supra 1

[23] Stefanadis, F, 2003, 'Self-Regulation, Innovation, and the Financial Industry', *Journal of Regulatory Economics,* Vol 23, Issue 1

[24] See for example comments by Financial Institutions and Consumer Credit Subcommittee Chairman, Randu Neugebauer: http://www.doddfrankupdate.com/DFU/ArticlesDFU/Neugebauer-bill-aims-to-repeal-Durbin-Amendment-67208.aspx

Issue 1: ‘Economic inefficiency in the credit card market’

The MBIE paper purports that there is an element of economic inefficiency in the credit card market. Clearly, we reject that assertion.

However, even if this were the case, it would not necessarily be resolved by regulatory intervention.

Our global experience shows payments systems must be carefully balanced and that a payment network achieves its greatest efficiency and scale when the costs reflect the value that each of the participants receives.

Regulation distorts that balance and leads to significant unintended consequences for the market such as:

- *Harming small businesses* – See Issue 5
- *Increasing costs for consumers* – Despite the implementation of interchange regulations in various markets around the world, there has been no evidence that doing so leads to lower costs for consumers. In many cases, such regulation has led to higher cardholder fees and restricted cardholder services.
- *Market uncertainty* – Given the importance of interchange in funding critical services in the payments system, regulation has a significant impact on the commercial offerings of major financial institutions as shown from the international case studies mentioned above. Uncertainty around the future of interchange can therefore delay investments in innovation as well as anti-fraud or safety and security measures.

Ultimately, these unintended consequences create broader economic inefficiencies by stifling innovation and productivity.

While the MBIE paper reports additional costs for the economy attributed to the use of credit cards, they have not calculated the value that these cards have provided to all members of the payments system including:

- Guaranteed next day payment for the merchant
- Savings for the merchant community in not having to provide credit to their customers via accounts or lay-buy
- Savings via a reduced reliance on cash
- Ability to accept card payments from overseas consumers (either online or in- person from overseas visitors)
- Ability to maximise efficiencies by changing the business model using online payments or contactless
- Continued consumer spending, despite external economic conditions.

In describing inefficiency in this ‘cost focussed’ way, MBIE fails to recognise the element of consumer choice in providing payment. Many businesses focus on providing their consumers ultimate satisfaction by providing a number of different ways to pay. However in saying this, merchants also have the ability to choose which payment systems they accept from customers. And, if a business does not see value in paying merchant service fees (of which interchange is a part), they may choose not to accept cards.

It is also important to note that while Eftpos is seen as a longstanding low-cost (or ‘free’) acceptance option for merchants, having interchange set to zero in its system has not encouraged banks to make the same level of investment in innovation as the international networks. The focus of the international schemes, has been on continuing to make their networks more secure by implementing new technologies that enhance the safety of card payments. EMV chips are now a core safety feature in cards around the world.

Shifting the costs of these security measures via regulation undermines the ability of payment providers to ensure the safe, reliable and efficient operation of the broader system for which they are responsible. Given the importance of payments in driving growth and in the New Zealand economy, Mastercard believes that regulation of the payments system will act counter to the Government's economic objectives.

For example, "taking online payments" and making "internet sales" were identified as opportunities for businesses to extract more value from digital technologies as part of the innovation platform of the Government's Business Growth Agenda.

The document also places a more general emphasis on the need for research and development and creating domestic policy settings that invite companies to invest in research and development (R&D) in New Zealand.

Put simply, the right incentives must be provided for the payments industry to innovate. Doing so not only allows the payments market to function at its most efficient but also provides wider economic opportunities for New Zealand businesses.

Issue 2: 'Increased costs for all consumers, with only higher income customers benefiting from rewards'

We disagree with the premise that "financial incentives [to use cards] are funded by a wider base (all consumers) through slightly higher overall prices on all goods which are difficult to detect (and therefore do not influence cardholders decisions)."

There is no evidence that card payments alone are responsible for higher prices in businesses where cards are accepted, nor is there that interchange is passed on consumers in the form of higher prices. In fact, in a recent court case in the UK, the judge concluded that interchange was not passed on to consumers through higher retail prices.[25]

Furthermore, as has been observed overseas, there is no evidence to suggest that any cost reductions seen by the merchant as a result of interchange regulation will necessarily be passed on to consumers in the form of lower prices.

The MBIE paper also fails to acknowledge that a number of NZ businesses avail themselves of the ability to surcharge (an outcome of the 2009 settlement). Therefore, the costs of a credit transaction are paid for by those who use credit in a transaction.

Mastercard does not support surcharging, but we acknowledge that allowing surcharging means that those who use a particular payment type where there is a permitted surcharge, pay to use that payment type rather than costs being dispersed to all customers, as inferred by MBIE.

Equally there is not a recognition that there are costs associated with other methods of payment. A recent study on New Zealand showed the cost of cash acceptance for a merchant was conservatively estimated at 2.3%[26]. It therefore seems unreasonable to

[25] *Sainsbury's Supermarkets Ltd vs Mastercard Incorporated* [2016] CAT 11
[26] Peter T Dunn & Company Research, 2016

simply isolate the cost of credit card payments without properly considering the costs associated with other payment methods.

Card acceptance can reduce the payment costs for business and in addition, create greater efficiencies. This would mean that consumers are actually paying reduced prices while businesses receive enormous value from accepting cards.

Issue 3: 'Emerging inefficiency in the debit card market'

Mastercard disagrees with the assumption that debit schemes will become subject to the same purported "inefficiencies" as the credit card market.

Many consumers utilise the 'pay now' feature of a debit card as opposed to the 'pay later' construct of credit. However, more and more consumers and businesses see the greater benefit that scheme debit products provide as compared to Eftpos, such as the ability to transact quickly and safely through contactless and the ability to use these products online. Consumers have greater protection when using Debit Mastercard as a result of technology enhancements to prevent card fraud (EMV smart chips and SecureCode), the ability for use via digital wallets and online, settlement guarantees and greater protections for consumers and merchants. Contact (dipped or swiped) scheme debit remains a low cost payment method for New Zealand businesses who choose not to accept contactless transactions.

Furthermore, the underlying presumption that EFTPOS is a 'free' payment method is incorrect, and fails to consider wider cost to merchants.

Rather than perceiving inefficiencies, Mastercard believes the debit payments marketplace is rapidly evolving. The introduction and rapid uptake of contactless debit is a clear illustration of the how both consumer and business preferences are driving innovation in our industry.

Issue 4: 'Barriers to entry in the debit market'

The fin-tech industry is advancing rapidly and new payment technologies that have entered the market are fundamentally reshaping relationships between all participants in the payments ecosystem.

As a technology company, Mastercard invests significant resources ensuring and developing the value proposition of our products. We are continuously evolving and adapting our business model to leverage and compete with new market entrants and existing competitors.

We do not agree that interchange functions as a significant barrier to entry in the debit market. In contrast, Mastercard believes removing or restricting interchange will pose a barrier to entry into the market as it will limit the resources available to new market participants, and has the potential to stifle innovation.

Interchange pays for the tremendous benefits enjoyed by all participants in the payments ecosystem. The value created by interchange through continual investment and improvement of merchant and consumer experience, and the development of new innovative technology, helps ensure that electronic payments continue to develop all aspects of the payments system.

Issue 5: 'Impact on small business'

The MBIE paper outlines the cost differential between large and small businesses but does not consider the impact regulation will have on the Small and Medium Enterprises (SME) sector. As stated above, there is considerable evidence that artificial limitations on interchange harm SMEs in three ways.

First, many SMEs are cardholders who rely on their credit cards as an important source of credit to keep the business running when cash flow is insufficient to cover current expenses. These cards also simplify the process of purchasing inventory and supplies by replacing the cumbersome purchase order and cheque writing process traditionally used for these operations.

While this may seem like a relatively modest benefit, it can be extremely important to small merchants by enabling them to focus on the business rather than administrative tasks. Artificial reductions in interchange have precisely the same impact on SMEs as they have on other cardholders—the costs of their cards go up when merchants who accept cards no longer pay for the benefits they receive.

Second, many SMEs also accept cards. While they may view interchange reductions as potentially beneficial, experience shows otherwise. For example, an RBA paper published in 2013 showed that in Australia (a regulated market) SMEs can now pay up to ten times more to accept card payments than large strategic merchants. In New Zealand, the current disparity between the lowest and highest Mastercard interchange rate is just under five fold – much lower than in the regulated markets against which Retail NZ make comparisons.

Similar results were found in the U.S. This is because of the natural disparity in bargaining position between large and small merchants with acquirers – larger merchants are in a better position to negotiate to obtain the full cost reduction from interchange fee reductions (as they are in most other sectors of business), while SMEs are not. This results in an increased disparity in costs between large and small merchants which causes SMEs to fall further behind in their efforts to compete with larger merchants.

Third, artificial interchange reductions can have an even more painful impact on SMEs – the reduction of credit availability. The flow of interchange enables issuers to take more credit risk and extend more credit than is possible when relying entirely on cardholders to compensate for that risk. When interchange is artificially reduced, issuers can be forced to reduce risk to reduce costs in an effort to offset the reduction in interchange revenue.

Reduced risk means reduced credit availability which harms SMEs as both cardholders and acceptors of cards. Reduced credit availability means less credit extended to SMEs to run their businesses. Given the relatively sluggish lending to SMEs from other sources, reductions in credit card lending would be particularly painful. Reduced credit availability also means cardholders who purchase from SMEs will have less credit available.

Mastercard agrees that industry-led actions can improve the transparency of the card payments system. Transparency is important and we provide a list of all interchange rates on our website.

We also agree the efficiency of the market could be improved if acquirers were to provide merchants with greater information about Merchant Service Fees (MSFs). This would allow merchants to better negotiate with acquiring banks on the mix of payment options and the fees incurred, gain a better understanding of how fees for a particular payment option compares to the value they derive from them, and more effectively consider how to deliver payment options to consumers.

Conclusion

Mastercard strongly recommends the existing payments framework be retained.

It has yielded positive outcomes for not only consumers and businesses, but for New Zealand's broader economic objectives of productivity and innovation. More specifically, current arrangements for interchange rates provide an array of critical services that benefit all payments system participants.

As detailed in this submission, the international experience with interchange regulation has led to significant unintended consequences with no evidence to suggest that consumers, businesses or the industry as a whole has benefited.

We look forward participating in the consultation process and ensuring the best policy settings remain in place.