

MasterCard
Australasia
Level 8, 100 Arthur Street
North Sydney NSW 2060
Australia
tel +61 2 9466 3700
fax +61 2 9959 3296
www.mastercard.com.au



24 April 2015

Dr Tony Richards
Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
Sydney NSW 2001

pysubmissions@rba.gov.au.

Dear Dr Richards,

MasterCard is pleased to provide this response to the Reserve Bank of Australia (RBA) Issues Paper of March 2015. The Issues Paper raises a number of concerns regarding the payments system in Australia, with accompanying suggestions of regulatory reforms that it considers may address perceived market failures and costs in the system. This paper follows the Final Report from the Financial System Inquiry (FSI) published December 2014 which seeks to address the issues created by regulation (including excessive surcharging, cost disparity between small and large merchants and the inequitable application of regulation within the Australian payments system). This response should be read in conjunction with MasterCard's submissions to the FSI, available at www.fsi.gov.au.

In principle, MasterCard contends that the regulation of fees in the Australian payments system has not achieved the intended outcomes. Evidence, both from Australia and similar jurisdictions, shows regulatory efforts to artificially lower interchange rates does not lead to lower prices for consumers. Indeed, it is more likely to lead to higher prices. The cost of regulatory compliance for most of the stakeholders may also be significant and can potentially stifle innovation in the industry.

MasterCard further maintains that the inequitable application of regulation to some, but not all, payment providers in the system has created additional cost in the system by incentivising both issuers and their cardholders to favour generally higher priced, unregulated providers.

Having made these in-principle assertions, MasterCard is committed to working with the RBA to address the issues identified in the FSI Final Report and RBA Issues Paper, and welcomes the opportunity afforded by the RBA Issues Paper to resolve outstanding issues in the current regulatory regime. In particular we welcome the opportunity to create more efficient outcomes for all participants in the system than those delivered under the current regulatory settings.

We recommend the RBA convene an industry round table. Doing so would ensure these issues could be openly and constructively discussed, with a view to effective solutions being found with optimal outcomes for all users of, and participants in the payments system. We would welcome the opportunity to further explore this idea of a round table, along with our submission, with the RBA.

Yours sincerely,

Eddie Grobler
Division President, Australasia

MasterCard Submission

Benefits of Electronic Payment Systems and Interchange fees

In submissions to the FSI, MasterCard has provided considerable evidence to illustrate the value of the electronic payments system to the Australian economy. The RBA itself recognises the value and efficiency of electronic payments and the inherent costs of cash in the Issues Paper¹.

MasterCard takes seriously its role in setting interchange fees in the Australian payments system. These fees facilitate the secure and efficient functioning of the 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 is low enough that merchants realise the economic benefits of accepting cards at a cost which is justified by the value delivered and issuers are compensated fairly for the costs involved in issuing cards to consumers, businesses and government employees.

Given the value of electronic payments to the economy, and to consumers and merchants in particular, MasterCard contends that Government and regulators should agree to a regulatory framework which advances the ongoing development of the payments system over cash payments.

Addressing regulatory disparity

MasterCard asserts – and the evidence has borne this out – that regulatory oversight of interchange fees does not produce optimal economic outcomes. Where regulatory regimes are not equitably applied across all providers which provide similar services in the payments system, economic outcomes are further negatively distorted. Instead of continuing to amend existing regulation where it has caused concern in the market, consideration should be given to removing regulation to allow competitive forces and economics to govern pricing.

MasterCard addresses these concerns in its submission to Treasury in response to the FSI Final Report.

Interchange fees by four-party payment providers (MasterCard and Visa) are subject to regulation by the RBA, whereas three-party payment providers (most notably American Express and Diners' Club, but also China UnionPay, JCB and PayPal) are not subject to regulation *even when those providers are operating as a four-party scheme*. In the Australian context at present, this manifests itself primarily through 'companion cards' which are issued by financial institutions and are switched through the American Express network.

Because American Express is not regulated by the RBA with respect to interchange, this scenario allows American Express to operate a four-party scheme in which it provides higher-interchange like fees to the issuers – these fees incentivise issuers to further expand the use of such 'companion cards'. As a result, American Express cardholders are provided with more generous reward points, which provide further incentive for cardholders to utilise companion cards. In addition, merchants pay much higher fees to American Express to accept both proprietary and companion American Express cards.

Regulation of MasterCard and Visa has had the consequence of granting a commercial advantage to American Express and expanding the use of companion cards that operate

¹ Reserve Bank of Australia, 'Review of Card Payments Regulation Issues Paper March 2015', in Reserve Bank of Australia website, viewed on 24 April 2015, p. 13

outside the regulatory regime. This is evident in RBA data which reveals that American Express and Diners' Club have increased their market share of Australia's credit card transactions from 13.8% in 2002 to 18.7% in 2015².

Even when three-party system providers behave as traditional three-party payment systems they still charge fees that have the same object and effect as interchange fees. These fees are observable and quantifiable, and should be captured by regulation to ensure equitable application of the regime.

An effective and simple way to control these interchange-like fees for (proprietary) three party payment systems would be to require separate accounting (P&L) between the issuing and acquiring business of the three-party-schemes and to cap those flows. The second step would then be to ensure that any internal transfer received from the issuing part of the business is lower than the regulated cap on the interchange. Steps should also be taken to prevent any circumvention of this new regulation by three party payment systems as a means of avoiding regulatory action.

Addressing the RBA's analysis of interchange fees, customer surcharging and merchant service fees

As addressed in the Issues Paper, we acknowledge that Merchant Service Fees (MSFs) have declined since regulation was introduced in 2003. This is a logical result of lower interchange fees, as interchange is a component of MSF.

MasterCard disagrees with the RBA's assumption that reductions in MSFs "have mostly flowed through to lower retail prices for consumers". The RBA itself cites no evidence to support this assumption; to the contrary, according to an IPSOS poll conducted between September and October 2014, up to 75% of business owners would not pass on any potential savings in interchange fees to customers by reducing prices³.

Moreover, MasterCard further notes MSFs for American Express remain more than double those applied by MasterCard and Visa⁴. Inequitable application of the regulatory regime has allowed this dramatic disparity in MSFs to perpetuate.

Whilst falling MSFs are a result of lower regulated interchange fees, they do not in themselves validate the existence of regulated interchange fees. Rather than lowering overall costs in the system, regulated interchange fees instead shift fixed costs away from merchants to other parties that participate in the system, and in particular to consumers. There is further evidence to indicate that these costs in fact flow back to consumers in the form of higher annual fees and/or banking costs⁵.

Finally, this shift in costs to other parties in the system further undermines the ability of payment providers to ensure safe, reliable and efficient operation of the broader system for which they are responsible.

² Reserve Bank of Australia, 'Payments Data – C2 :Market Shares of Credit and Charge Card Schemes', in Reserve Bank of Australia website, viewed on 24 April 2015, <http://www.rba.gov.au/payments-system/resources/statistics/>

³ IPSOS merchant survey (October 2014), commissioned by MasterCard

⁴ Reserve Bank of Australia, 'Review of Card Payments Regulation Issues Paper March 2015', in Reserve Bank of Australia website, viewed on 24 April 2015, p. 22

⁵ See for example Evans, David S. and Chang, Howard H. and Joyce, Steven, (October 23, 2013) 'The Impact of the U.S. Debit Card Interchange Fee Caps on Consumer Welfare: An Event Study Analysis'. University of Chicago Coase-Sandor Institute for Law & Economics Research Paper No. 658

Addressing the Specific Issues for Consultation

MasterCard addresses the RBA's specific issues for consideration below.

1. *Publishing thresholds for which payment system providers will be subject to interchange or related regulation, possibly based on transaction values and/or market shares.*

MasterCard supports the principle that payment system regulation should apply equally across the industry regardless of the size of a participant or their market-share. However, should regulation apply only once a particular threshold has been met, that threshold should be set at a low number (if not at market entry) and it should be clear and objective. It should capture all payment system providers operating in Australia today, including those which are currently unregulated, (American Express, China UnionPay and PayPal). This will establish equity in the system, protect consumers and businesses from the uneven application of regulation and ensure that the regulatory objectives are being met by the maximum number of participants in the system.

Currently, those payment schemes which fall under the regulatory regime are identified through a designation system that has proven to lack transparency and certainty, and has led to unproductive and inequitable outcomes. Over the last decade undesignated schemes and payments system providers have substantially grown reach and share at incremental cost to merchants and consumers.

Publishing low thresholds for determining the application of regulation would address the disparities which have arisen in the designation system. Low thresholds would allow regulation to capture new entrants to the market and ensure that advances in technology in the payments system do not compromise safety for participants.

2. *Broadening interchange fee caps to include other payments between schemes and issuers.*

We note that the FSI Panel has recommended that companion card systems should be regulated as other four party systems are, moving at least some way towards a level playing field.

Whilst the FSI Final Report recognises the importance of this move, we are concerned that the proposed mechanism to achieve fairness in the regulatory system (that is, to broaden interchange fee caps) is misguided. Interchange fee cap regulation cannot be expanded because interchange is a specific payment as defined in the RBA's Standard as "payable by an acquirer, directly or indirectly, to an issuer in relation to credit card transactions in a Scheme"⁶ and in the RBA's Review of Card Payments Regulation: Issues Paper, March 2015 as "charged by the financial institution on one side of the payment transaction to the financial institution on the other side of the transaction".

The RBA describes in detail the costs associated with interchange fees at <http://www.rba.gov.au/payments-system/reforms/cc-schemes/cc-fees-benchmark/guidance.html>.

⁶ Reserve Bank of Australia, 'The Setting of Wholesale ('Interchange') Fees in the Designated Credit Card Schemes', viewed on 24 April 2015, <http://www.rba.gov.au/payments-system/legal-framework/standards/interchg-card-schemes.pdf>

MasterCard asserts that interchange-like fees are applied in proprietary three-party payment schemes. These interchange-like fees functionally serve the same (or essentially the same) purpose and cover the same (or essentially the same) costs as interchange, but are not subject to regulation because they fall outside the RBA's definition.

Consequently, we urge the RBA to ensure that both companion cards and three-party scheme 'proprietary' cards are included in any regulation which applies to MasterCard, Visa and eftpos.

In order to capture companion cards within the current regulation, the RBA could monitor the total amount of compensation received by the issuing partner, over a certain period of time, along with the total amount of the transactions made by the corresponding cards.

To ensure that unregulated three-party payments system providers are captured in the regulation, an effective and simple way to control net compensation would be to require separate accounting (P&L) between the issuing and acquiring business of the three-party-scheme, and to cap the flow of interchange-like payments.

The second step would be to ensure that any internal transfer received from the issuing part of the business is lower than the regulated interchange cap. Payment systems must be able to demonstrate that payments from merchant service providers to the customer service providers sit within the regulated level (i.e. 50 basis points weighted average). This would be analogous to monitoring transfer pricing. Once again, care would need to be taken to ensure these were not opportunities for three party payment systems to avoid or circumvent the objectives of the regulation.

This regulatory change would be popular among Australian businesses. An October 2014 survey undertaken by IPSOS of 300 Australian businesses identified that 94% believe all payments systems should be regulated consistently⁷. In addition, only 4% of these businesses noted that the cost of accepting regulated cards such as MasterCard and Visa were 8'very high' compared to 76% who noted that American Express was either 'very expensive' or 'expensive'. This reflects the RBA's own data on the average cost of acceptance of American Express (1.69%), Visa and MasterCard (0.83%) for businesses in Australia.⁹

3. *Making changes to the interchange benchmark system to reduce the upward 'drift' in average interchange rates inherent in the current three-year reset cycle.*

In principle, MasterCard recognises the RBA's intent here and understands the machinations driving this perspective. In submissions to the FSI we have suggested an annual reset cycle to ensure the drift remains slow and the average interchange fee stays closer to 50bps and for credit and \$0.12 for debit. However, consistent with our stated principles, MasterCard only supports changes to the interchange benchmark system on the basis that regulation is applied to all providers in the payments system at the same point in time that annual resets would commence.

⁷ IPSOS merchant survey (October 2014), commissioned by MasterCard

⁸ IPSOS merchant survey (October 2014), commissioned by MasterCard

⁹ Reserve Bank of Australia (2015), 'Payments Data – C3 : Average Merchant Fees for Debit, Credit and Charge Cards', in Reserve Bank of Australia website, viewed on 24 April 2015, <http://www.rba.gov.au/payments-system/resources/statistics/>

4. Lowering interchange caps.

MasterCard does not support lowering interchange caps.

Lowering interchange fees would lead to more consumer detriment, as well as additional negative impacts for many merchants. Evidence from other jurisdictions where regulators have lowered interchange fee caps has illustrated the consumer impact of such proposals:

- In the United States, reductions in interchange on debit transactions as a result of the Durbin Amendment to the Dodd-Frank Act, left consumers paying more in banking costs and with no reduction in retail prices. Analysis by University of Chicago Law School economists David S. Evans, Howard Chang, and Steven Joyce found merchants collectively gained \$7 billion yearly starting in 2011.¹⁰
- Research on interchange regulation in Spain has also demonstrated the link between lowering interchange rates and consumer detriment. A gradual reduction in interchange fees by more than 55% between 2006 and 2010 actually led to an increase in Spanish consumer costs by 50% (€2.35 billion in absolute figures).¹¹

Further details on the detrimental impacts of lowering fee caps are discussed in our submissions to the FSI.

MasterCard notes that the RBA relies on 2009 report from the US Government Accountability Office to illustrate increasing prices of payment services for merchants. The analysis by University of Chicago Law School economists relies on more recent data and the impact of regulation on retail prices¹².

5. Replacing weighted-average interchange caps with hard caps.

MasterCard does not support the replacement of weighted-average caps with hard caps. Hard caps represent price setting and remove flexibility in the system – something that is required to incentivise innovations investment.

The current regulation of interchange does allow for some flexibility in terms of ability to provide a range of card products to meet the needs of different consumers whilst promoting innovation (such as adoption of contactless payments). This flexibility has previously been used to introduce payments innovation including contactless and security measures where a lower interchange rate allows for incentives to be provided to merchants to invest in infrastructure.

As indicated above, we consider that a more frequent (e.g. annual) interchange reset for the industry combined with a level playing field of regulation, would be a more appropriate way to meet the RBA's objectives.

¹⁰ Evans, David S. and Chang, Howard H. and Joyce, Steven, (October 23, 2013) 'The Impact of the U.S. Debit Card Interchange Fee Caps on Consumer Welfare: An Event Study Analysis'. University of Chicago Coase-Sandor Institute for Law & Economics Research Paper No. 658

¹¹ Juan, Iranzo and Pascual, Fernández and Gustavo, Matías and Manuel, Delgado (2012): *The effects of the mandatory decrease of interchange fees in Spain*. http://mpa.ub.uni-muenchen.de/43097/1/MPRA_paper_43097.pdf

¹² Ibid.

Commercial Cards

If there is further regulation of interchange, there is international precedent for commercial cards to be excluded, given commercial cards deliver significant efficiency gains and cost savings when compared to the alternative payment processes (in particular invoicing). The main benefits include, but are not limited to:

- Better cash-flow management, since merchants receive money faster for cards transactions compared to payment terms following invoices process
- Working capital benefits (paying suppliers earlier/on time) by single future dated payment to the bank/issuer
- Better visibility of transactions
- Minimal administrative costs to recover/solicit late payments
- No risks of bad debt as issuer guarantees payment in case of cardholder/ company not paying
- Process efficiencies and lower administrative costs due to reduced processing time of card payments (vs. handling cash/cheques or recording and reconciling of invoices) and streamlined reporting
- Making e-commerce easier

Australian businesses significantly benefit from using commercial cards:

- Commercial "suppliers" are both receivers (merchants) and payers (card holders) in the commercial cards space. They acknowledge the advantages of paying (free) but not receiving (fees).
- Merchants reduce customer payment risk significantly by accepting card payments
- Merchants can remove debtors risk entirely by have a cards-only policy (many examples exist in the travel management companies, distributor models etc.). This savings is usually between 1-1.5%.
- Commercial merchants participate in tenders and subsequent negotiated arrangements on the purchase/supply of products and services to entities – this includes payments terms, products, servicing and other KPI's – the price is set based on agreed deal parameters including payment timing and methodology
- Accounts receivables departments at commercial suppliers benefit significantly from streamlined receivables reconciliation facilitated by card payments – even more so where payment is at the invoice level as opposed to statement level
- Supply discounting (and dynamic discounting) is reduced through card acceptance, ensuring earlier payment, reduced administration and quicker funds flow
- There are significant cost advantages for merchants with card acceptance vis a vis debtors factoring (largely used by smaller/mid-market business to aid cash flow)
- E- commerce solutions are increasingly popular and can easily be introduced by taking advantage of online payments functionality of cards
- Supplier sales benefit (through increased volume and less leakage) from card "controls" that steer spend (per negotiated agreements) and prevent other non-preferred merchants from participating (when out of corporate policy) in the commodity category supply
- Data advantages, analytics and insights are provided from card spend to both merchants and buyers

It is essential that there is equal regulation of commercial cards between four party and three party systems. Without an exemption of both four and three party commercial cards three party schemes would be the only ones to benefit, in particular American Express given their already relevant market share in the commercial card sector.

Finally, commercial cards provide significant value to SMEs as a source of funding and working capital in the form of additional unsecured credit, as an instrument to grow

commerce between SME's and governments. Should commercial cards be regulated, banks will have no option but to increase card fees and restrict access to credit to SMEs.

6. *Applying caps as the lesser of a fixed amount and a fixed percentage of transaction values*

While this recommendation purports to further reduce the costs for merchants, at present there is no technology that would support the implementation of this system. It has not been used in any interchange program in any market globally. There is no guarantee that the technical abilities within the system would be able to execute the recommendation and meet the expectation of the regulator.

In addition, applying a cap of a fixed maximum amount for interchange fails to recognise the value that an electronic payment via a MasterCard system provides, especially for a high value transaction. That value has multiple component parts, including the avoidable variable cost of cash acceptance, the margins on incremental sales which would not have been made without the option of electronic payments, the payment guarantee for credit and fraud losses, the prompt payment which is made directly into a business's bank account, and the significantly reduced operational costs from a reduction in cash takings.

Electronic payments enable faster, more secure and traceable transactions and have been a key element in promoting greater integration of the world economy. The growth of e-commerce and internet shopping would have been inconceivable without the introduction of electronic payments. Payment cards have reduced the impact of liquidity and other constraints which previously limited consumer purchases to the amount of money in a consumer's wallet. Both merchants and consumers have benefitted from sales which previously would not have been made if cash was the only option. Those sales have arisen primarily as a result of three factors:

- Ticket lift: consumers are not limited by the amount of money in their wallet, or a need to travel to a bank or an ATM. They make short-term sales and special discounts more effective. In Australia average debit and credit transactions have been estimated to be between three and eight times larger, respectively, than cash purchases;
- Faster throughput and greater safety: electronic payments allow businesses to process transactions faster than cash, while also reducing the need for physical security; and
- Outsourcing of credit risk: credit cards allow merchants to pass on the costs and risks of offering their own credit facilities to financial institutions. This has enabled small businesses to grow and compete without having to run their own expensive credit operations¹³.

Not only would this option be difficult for acquirers, it would be complex and confusing for businesses, and is unlikely to yield beneficial policy outcomes.

¹³ Zywicki, T., Manne, G., and Morris, J. (04 June 2014), 'Price Controls on Payment Card Interchange Fees: The U.S. Experience', International Centre for Law and Economics

7. Including prepaid cards within the caps for debit cards.

Currently MasterCard sets Prepaid interchange within the identified policy arrangements for debit. MasterCard therefore does not see any necessity to further adjust the regulation of Prepaid interchange.

8. Allowing for 'buying groups' for smaller merchants to group together (subject to any competition law restrictions) to negotiate to receive the lower interchange rates that are accessible to larger merchants.

In our submission to the FSI MasterCard acknowledged the cost disparity between large and small merchants that has been created by regulation and encourages the RBA to investigate options that reduce the disparity, while maintaining flexibility for the system. Creating "buying groups" to negotiate collectively on interchange rates would not effectively reduce this disparity for merchants in Australia. Similar to our reasoning around merchant service fees, the ability for collective negotiation would simply shift fixed costs in the system to other participants, most notably to consumers.

In order to address the cost disparity for large and small merchants that has been one of the unintended consequences of regulation, we suggest that the RBA convene an industry round table where each of the stakeholders are represented and can discuss ways in which the industry could address the disparity that has been created with mutual understanding of the needs of all end users and participants in the payments system.

9. A tiered surcharging system, perhaps along the lines of the FSI recommendations.

As identified in the FSI Final Report, the challenge of the current surcharging policy is that there is no enforcement of a 'reasonable' level of surcharging and some merchants are able to continue to charge unreasonably high fees¹⁴. In practice, the more complex surcharging policies become (e.g. through different tiers), the more difficult it will be enforce.

MasterCard has long supported the removal of surcharging, particularly for regulated cards, where the cost of acceptance for merchants is considerably lower than that of unregulated cards. Should a surcharge ban be re-introduced, schemes and acquirers would be able to enforce the policy. This would remove the need for a government regulator to monitor and enforce a 'reasonable' level of surcharging. Whilst the FSI recommendations for surcharging have merit, they would result in increased confusion for both merchants and their customers, and would also present a technological challenge.

Consequently, MasterCard does not support the introduction of a tiered surcharging system. Such a system would require considerable regulatory oversight; the capacity of regulators to consistently and fairly apply such rules is uncertain.

As previously indicated in our submission to the FSI, MasterCard fully supports the removal of surcharging when a debit card is used to make a purchase. MasterCard further supports the ability for merchants to apply a surcharge on unregulated and high cost payment system providers.

¹⁴ The Australian Government the Treasury (2014), 'Financial System Inquiry Final report', Commonwealth of Australia, p. 169

MasterCard does not support the application of a 'fee cap' determined by the Payments System Board for 'regulated' systems. While a fee set as a cap would likely lower 'exorbitant' surcharges, it may result in more merchants applying a surcharge for card payments, with the capped surcharge becoming the default surcharge rate in Australia.

10. Targeted changes to reduce particular cases of excessive surcharging

Similar to the tiered surcharging regime, the capacity of regulators to consistently and fairly enforce excess surcharge regulation is uncertain without a specific government agency being assigned responsibility and resources for enforcement.

11. Any other changes to enforcement procedures and disclosure practices.

The surcharging regime in Australia is discussed in detail in MasterCard's FSI submission to Treasury.

MasterCard would support any changes which enforced the surcharging regulations to ensure that consumers were not paying excessive amounts to merchants which did not reflect the cost of acceptance. However, we strongly advocate that any changes must be practical and easily implemented and must be able to be enforced.

As raised in the FSI final report, the challenge of the current surcharging policy is that there is no enforcement of a 'reasonable' level of surcharging and some merchants are able to continue to charge unreasonably high charges. In practice, the more complex surcharging policies become (e.g. through different tiers), the more difficult they are for consumers and merchants to understand, and the more difficult they will be enforce surcharging regulations.

12. Strengthened transparency over the cost of payments to merchants and cardholders

MasterCard actively supports the principle of transparency over the cost of cards by publishing the different interchange fees related to cards on its website. However, this practice is not undertaken by all payment systems – notably the unregulated payment system providers.

Whilst the principle of transparency broadly in the payments system is worthy of consideration, MasterCard does not support efforts that burden consumers with complex detail on the payments system. Such detail could unintentionally misinform consumers on the functioning of the system and lead to suboptimal outcomes. For example, increased transparency could incentivise customers to route through a payment system that does not provide optimal security or fraud prevention. Cost should be one of several elements, not the sole factor, which consumers consider when choosing a payment system. Furthermore, the cost of payments is complex and dynamic. This is both an innate feature of the system as well as a consequence of the regulatory regime. A mechanism to provide timely and accurate detail on cost of payments does not currently exist and would require substantial investment; these costs would be borne by all participants in the system, including consumers.

13. Further easing of 'honour-all-cards' rules to allow merchants to decline to accept cards with high interchange fees.

MasterCard in principle supports the rights of consumers to choose their method of payment; as such, MasterCard does not support easing of the "Honour-All-Cards" rules.

The Honour All Cards rule ensures that every MasterCard cardholder, regardless of what type of card they choose to use, can purchase goods and services at any participating merchant, anywhere in the world. Without it, cardholders would lose the security of knowing that the MasterCard card they hold will necessarily be accepted and financial institutions would find it more difficult to offer a broad range of payment options to consumers. By undermining the benefits of universal acceptance, merchants will threaten the benefits that the Honour All Cards rule provides.

14. Facilitation of differential surcharging by merchants.

MasterCard has stated consistently its support for merchants to apply a surcharge on unregulated and high cost payment system providers. Further, MasterCard has outlined in a number of submissions to the RBA and the FSI that we do not support blended surcharging which does not differentiate between regulated cards, such as MasterCard, and unregulated card schemes.

Once again, the challenge of the current surcharging policy is that there is no enforcement of a 'reasonable' level of surcharging and some merchants are able to continue to charge unreasonably high charges. The capacity of regulators to consistently and fairly apply any new rules to the surcharging regime is uncertain.

15. Ensuring that merchants have the ability to choose to route their transactions via lower-cost networks or processors.

MasterCard fully supports the rights of consumers to choose their method of payment, and as such does not support this proposal.

Some cards in Australia have what is referred to as 'combo-card' functionality, that is, the card can operate both as a credit card (when the credit button is pressed) and as access to some form of a deposit account (when either the CHQ or SAV buttons are pressed). While nothing today prohibits a merchant from force-routing a MasterCard transaction down a competing network, as a basic principle, MasterCard believes routing decisions should rest with cardholders. As well as being technically problematic and expensive to implement, any removal of that principle, would likely lead to poor consumer experiences. Allowing merchants to choose how a transaction routes has the very real potential to affect consumer choice and remove benefits received when using MasterCard's network, including MasterCard's Zero Liability consumer protections. There are some real examples which are worth noting here:

- Woolworths – in 2010 Woolworths decided to 'force route' scheme debit cards (including Debit MasterCard cards) through the eftpos scheme. There was industry

and consumer backlash to this decision¹⁵, and Woolworths ultimately ceased their force-routing practices; and

- KleenMaid – in 2009 KleenMaid became insolvent in circumstances where many consumers had made upfront payments for goods which never arrived due to the insolvency. Similarly, Ansett Airlines became insolvent in 2001 in circumstances where many consumers had made upfront payments for flights which they weren't ever able to take. If a consumer had purchased KleenMaid kitchen appliances in advance using a scheme debit card (e.g. a MasterCard debit card), and the transaction was force-routed down an alternate network at the merchant's discretion, then those consumers would lose the consumer protections provided within MasterCard's Zero Liability policy. MasterCard anticipates that this could lead to significant, costly and widespread legal contest potentially involving all of the participants in the payment system.

MasterCard makes considerable investments in innovation, consumer protection, security, our acceptance network and brand. These investments help promote and improve electronic payments across the world, increasing positive consumer experiences while also driving commercial outcomes for our business. Merchants making routing decisions could result in other networks effectively 'free riding' off investments which MasterCard has made.

Rather than allowing merchants to force route transactions, merchants have the ability to determine which card brands (and whether credit and/or debit cards) they choose to accept. This solution is already in place, and is fair to both merchants and consumers.

16. Clarifying arrangements for competing payment options within a single device or application.

MasterCard does not support this proposal. Consumers are already rightly afforded the option of choosing their preferred payment system at a point of sale.

Conclusion

MasterCard welcomes the opportunity to further participate in constructive dialogue with Government and regulators around the payments system in Australia. Along with the submissions and analysis presented by stakeholders via the FSI, the RBA Issues Paper provides a further forum for discussion on these critical issues.

In principle, MasterCard continues to assert that regulation of fees associated with the payments system does not achieve optimal economic outcomes; further still, the inequitable application of regulation has led to detrimental outcomes for the payments system broadly. Additional regulatory efforts must not further penalise some players in the system while creating artificial advantages for unregulated parties, to the detriment of consumers.

Electronic payments are a critical function of the Australian economy; regulatory efforts must not further undermine the security, reliability and efficiency of this system.

¹⁵Customer Owned Banking Association (2010), 'Woolies denies customers payment choice', 1 April, <http://www.customerownedbanking.asn.au/media-a-resources/media-release-alerts/641-woolies-denies-customers-payment-choice>

Finally, MasterCard strongly recommends that there is a need for the RBA to convene an industry round table with representation from both participants and end users to explore alternative solutions in an open and constructive environment.

IPSOS Merchant Survey (October 2014)

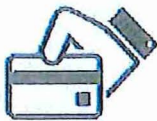


Survey: Australian business perspectives on Card Fees



Businesses in Australia believe American Express and Diners Club should be regulated in the same way as Visa and MasterCard.

In a recent survey conducted by Ipsos amongst Australian businesses, 59% were not aware that Visa and MasterCard are regulated for merchant related payment costs in Australia, but American Express and Diners' are not. A very large majority (94%) are in favour of all payment systems being regulated in a consistent way.



Business perspective on regulation of the costs of card acceptance

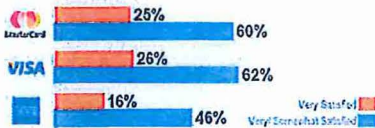


Know that currently Visa and MasterCard are regulated for merchant related payment costs in Australia, but American Express and Diners' are not.



Think that all payment systems should be regulated in the same way.

Satisfaction with Processes and Support
Businesses are more satisfied with the network processes and support received from MasterCard and Visa than from American Express.



Base: All accept American Express (164) MasterCard (291) or Visa (295)
Q. Currently, how satisfied or dissatisfied are you overall with the processes and support (such as call center support, problem resolution, and settlement terms) associated with accepting each of the following payment card types?

Up to 75% of businesses would not pass on any potential savings to consumers by reducing prices.

Would use the saved money...



25% To reduce the retail prices for my customers



24% To increase my revenue



43% To invest into/innovate my company

8% Don't Know

Q. If the costs of accepting payment cards were reduced, what would your business do with the money saved?

Fees Associated with Card Payment Types

	Don't know	Very Low	Fairly Low	Average	Fairly High	Very High
American Express	3%	2%	4%	15%	38%	38%
Diners Club	3%	4%	9%	31%	22%	31%
MasterCard	4%	4%	12%	56%	18%	4%
Visa	5%	4%	13%	57%	17%	4%

Q. Thinking specifically about the fee charged on card payment transactions, how would you rate the fees associated with using each of the following card payment types?

American Express is accepted by more than half of businesses (55%). Diners Club is accepted by a quarter (23%). Both American Express and Diners are correctly* perceived to have higher fees than other cards: Almost 40% of Australian businesses say American Express fees are *Very High*, compared with only 4% who say the same thing for MasterCard or Visa.

*<http://www.rba.gov.au/stability/tables/tables/c03bis1.xls>

Survey Methodology: This survey is based on 300 telephone interviews conducted by Ipsos Public Affairs on behalf of MasterCard with managers and owner/proprietors from a selection of business sectors across all Australian states and territories. Sectors were selected based on likelihood for having relatively high volume of credit card transactions and include: retail, healthcare, food, entertainment, accommodation, automotive, travel, transport, education, utilities, insurance and telecommunications. Fieldwork was conducted between 10 September and 3 October 2014. The survey has a confidence interval of ± 5.7%.

Reference List

Australian Government the Treasury, Financial System Inquiry Final Report, Commonwealth of Australia, Canberra, 2014.

Customer Owned Banking Association, '*Woolies denies customers payment choice*', 1 April 2010, <http://www.customerownedbanking.asn.au/media-a-resources/media-release-alerts/641-woolies-denies-customers-payment-choice>.

Evans, D.S., Chang, H.H. and Joyce, S., '*The Impact of the U.S. Debit Card Interchange Fee Caps on Consumer Welfare: An Event Study Analysis*', 23 October 2013, University of Chicago Coase-Sandor Institute for Law & Economics, Research Paper No. 658, Chicago.

Iranzo, J., Fernandez, P., Matias, G. and Delgado, M., '*The effects of the mandatory decrease of interchange fees in Spain*', 2012, http://mpa.ub.uni-muenchen.de/43097/1/MPRA_paper_43097.pdf.

Reserve Bank of Australia, '*Payments Data*', in Reserve Bank of Australia website, 2015, Reserve Bank of Australia, viewed on 24 April 2015, <http://www.rba.gov.au/payments-system/resources/statistics/>.

Reserve Bank of Australia, '*The Setting of Wholesale ('Interchange') Fees in the Designated Credit Card Schemes*', 2015, Reserve Bank of Australia, viewed on 24 April 2015, <http://www.rba.gov.au/payments-system/legal-framework/standards/interchg-card-schemes.pdf>.

Reserve Bank of Australia, Review of Card Payments Regulation Issues Paper, March 2015, Reserve Bank of Australia, Sydney.

Zywicki, T., Manne, G., and Morris, J., '*Price Controls on Payment Card Interchange Fees: The U.S. Experience*', 4 June 2014, International Centre for Law and Economics.

IPSOS merchant survey (October 2014), commissioned by MasterCard