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Commerce Commission
Retail Payment System Team
Draft IPS Guidance submission – Mastercard
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13 October 2022

Dear Retail Payment System Team,

Thank you for the opportunity to participate in the consultation on the draft guidance of the Initial Pricing Standard (IPS) which will come into force on 13 November 2022.

In our experience as a global payment system and technology provider, we have worked with many regulators around the world to implement regulations which reduce interchange. Our submission is based on this experience and provides a practical approach to reaching the goals of the Retail Payment System Act.

We urge the Commission to continue to work with card schemes and banks to ensure the approach taken achieves the principles of the Retail Payment System Act around competition, efficiency and lower merchant costs in a way that is practical and does not create uncertainty on spending that drives continued innovation and security in the payments ecosystem.

We do not seek to respond to all questions individually but rather to set out our views on the key matters that we believe important. We would appreciate a meeting with you to discuss our response. In the meantime, please do not hesitate to contact me if you have any questions.

Your sincerely

Ruth Riviere
Country Manager
New Zealand and Pacific Islands

Interchange

Interchange fees are collected from acquirers and paid to issuers to reflect the value merchants receive from accepting digital payments and to reimburse the issuers for a portion of the costs incurred in providing the product. Digital payments enable increased sales to a retailer's existing and new customers, efficiencies in the delivery of existing and new products, guaranteed payments and improved experience for the customers.

When setting interchange fees, Mastercard considers the optimal level of interchange to drive an efficient payments ecosystem. This is based on it being low enough for merchants to realise the economic benefits of accepting cards; and at a level that fairly compensates issuers for the costs involved in issuing cards. Even within the regulated caps, Mastercard considers the value proposition of the card, the acceptance environment, including the need to drive the right behaviours around safety and security, and the strategic importance of the merchant when deciding an interchange fee. We are not aware of any issuer setting or bilaterally agreeing rates outside of the rates set by Mastercard (Question 5B).

Interchange rates change over time as the payments ecosystem and the products and services in it evolve, in a given market.

Once an interchange rate has been introduced or changed, Mastercard will publish the rate/s in a bulletin to our customers (issuers and acquirers). Mastercard requires at least six months (and sometimes longer) to make the technical changes in our system. We usually give at least six months' notice to our customers, of any additions or changes, to allow any technical changes to be made by acquirers. Mastercard publishes the individual interchange rates on our public website once they are live. The interchange rate is not a dynamic field in any market and our systems are not currently set up to apply different interchange rates for different issuers or acquirers.

Mastercard, or the processing scheme (rather than the issuer or the acquirer), administers the collection and remittance of interchange fees through the settlement process. The acquirer has no ability to determine the interchange rate or to process a rate that is different from that set either by the switch or as a result of bi-lateral arrangement. Further, the acquirer has no influence of the amount of interchange deducted by the issuer (Question 5B).

Example – transaction where the interchange is 0.30%

On a \$100 transaction the switch (e.g. Mastercard) would calculate that the issuer is allowed to keep 0.30% as interchange and would therefore require the issuer to pay \$99.70 to the acquirer (so that, in turn, the acquirer can pay the merchant). This is how the issuer collects the interchange fee that it is entitled to. The switch would therefore instruct the settlement bank(s) at which the issuer has a settlement account to transfer \$99.70 from issuer's settlement account to the settlement account of the acquirer.

Interchange applied to ATM transactions (Question 6F) are paid by the issuer (rather than by acquirers to the issuer), and therefore, should not be brought into the caps.

In relation to erroneous interchange fees (Question 6G), there are systems in place to limit incorrect interchange fees being charged through acquirers assigning the incorrect indicator in the first place including clearing system edits and customer testing before changes. We have no visibility of the acquirer/merchant relationships on this matter.

Impact of the IPS

Globally, we have seen the impact of regulated, lower interchange rates primarily being borne by the consumer. Issuers, as their interchange revenue is reduced, will usually reduce cardholder benefits and product innovation, or increase account costs.

As interchange fees cover costs associated with issuing the card, the business case for the New Zealand market, which is already challenged due to its size, will look less attractive for new transactional banking entrants. This will likely further embed the status quo.

If acquirers pass on the interchange reduction to their merchants, merchants will see lower costs for the same services they previously received (including transaction processing, safety and security and liability shift). This should increase the penetration of card payments in store and online, delivering value to merchants, consumers and businesses.

Goals of the Act

The purpose and principles of the act (Schedule 1 Part 1, Subpart 4) are for competition and efficiency of the retail payment system, for merchants and consumers to pay reasonable fees and for there to be greater transparency.

We believe that there needs to be consideration to how these benefits to merchants and consumers are being measured. The Act, as well as the Commerce Commission's paper, have a strict focus on interchange and any possible circumvention of the interchange standard being determined by net compensation.

However, there is no consideration of how the lowering of interchange rates, set by the schemes, is passed on by both acquirers and then by merchants (both in their cost of goods and lowering of surcharging) and how this will be measured.

Net Compensation

We would like to share our concerns with the Commerce Commission's interpretation of the "net compensation" definition in the Act. The definition has two key parts:

1. A net value is calculated; and
2. (An additional element) what is the purpose of that position having been reached.

In our view, net compensation is universally understood as being a value that is calculated or derived from comparing fees paid by issuers to schemes against payments, rebates, incentives or other compensation made by schemes to issuers.

Example – Net Compensation

If fees paid to schemes by issuers were "A", and payments, rebates, incentives or other compensation made by schemes to issuers were "B"; then:

To comply with net compensation regulatory requirements, the financial value of $A - B$ should be greater than 0 (or at maximum it can be equal).

This concept of net compensation which we have described is foundational in interchange and net compensation regulation where it exists in other markets.

An approach that is based around purpose (which is the second key part of the definition of "net compensation") becomes an administratively unworkable and entirely subjective test. The proposed approach of providing commercially sensitive information to the regulator to assess purpose would be a global outlier.

The application of a combination of mathematical outcomes and applicable accounting principles results in a workable solution for market participants. This also gives schemes and issuers certainty around their commercial relationships.

The value of non-monetary compensation (Question 6B) should be determined in accordance with the New Zealand GAAP or other relevant accounting standard.

As it pertains to Question 7A, the Commerce Commission has not identified information which will enable understanding of how net compensation is to be calculated for both the schemes and the issuers. Attestations regarding compliance with the IPS can then be given by both the scheme and the issuer in accordance with the agreed calculation to ensure compliance.

Returning to the principle of the Act (Schedule 1 Part 1, Subpart 4), the purpose of net compensation, as it's worded today, has no effect on a merchant or consumer paying no more than reasonable fees and the retail system providing a reasonable degree of transparency. Therefore, as it relates to Question 6D, the principles of the Act, particularly competition and efficiency, should be forefront in determining the net compensation calculations.

Business models

In the current proposal, where incentives and interchanged are considered together, two separate business models, which should remain independent, are being conflated. Interchange is set by schemes to balance the whole ecosystem, including both an issuing and acceptance perspective. Incentives that schemes provide to issuers are based on the competition between schemes to win that business, considering the revenue that the business will bring to the scheme. Bringing these two models together creates a potential conflict of interest (Question 6C).

Other comments

Please note that the entity which carries on Mastercard's cards business so far as it relates to New Zealand (including licensing the Mastercard name and marks) is Mastercard Asia/Pacific Pte. Ltd.