Mastercard response to Commerce Commission consultation: Retail Payment System

2 September 2024

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Mr Matthew Lewer
Head of Payments, Market Regulation
Commerce Commission NZ
By email: PaymentsTeam@comcom.govt.nz

Dear Mr Lewer,

Submission on Payments Pricing Consultation Paper

Mastercard appreciates the opportunity to contribute to the Commerce Commission's consultation paper "*Retail Payment System - Costs to businesses and consumers of card payments in Aotearoa New Zealand: Consultation Paper*".

Mastercard is supportive of the objectives of the Retail Payment System Act which is to promote competition and efficiency in the New Zealand retail payment system. In preparing this response, Mastercard has considered the interests and perspectives of consumers, businesses, industry participants and other stakeholders in the payments system.

In undertaking this consultation, we urge the Commission to consider the objectives of competition and efficiency of the Retail Payment System Act and to:

- (i) better consider the outcomes for New Zealand consumers and business cardholders,
- (ii) assess the true total cost of payments, and true value to all users and the New Zealand economy, and
- (iii) retain a market for investments into, and fintech use of, payment schemes, innovation, safety and security.

Electronic payments play a critical role in the everyday lives of the citizens of New Zealand and its economy. Mastercard has invested significant resources to maintain system security and resilience, deliver value to our customers and partners, protect merchants and consumers, and provide meaningful solutions to our customers and partners that detect, mitigate, and prevent fraud.

All payment methods have a cost attached. An independent analysis into the Cost of Acceptance by Boston Consulting Group (BCG) 2024, a summary of which we provide in this submission, shows that the cost of acceptance for in-person card payments in New Zealand is amongst the lowest in the world and the end-to-end cost for a merchant to accept card payments is lower compared to other payment methods including cash. Interchange fees only represent a small part of the true total cost of acceptance but play a significant and important role to cover costs of real, valuable services for consumers and business cardholders, and deliver incremental value to the merchants who accept them.

Further interchange fee regulation may result in unintended consequences which we elaborate on in our response.

Excessive surcharging needs to be urgently addressed through regulation and enforcement. The most immediate savings to consumers can be made by enforcing surcharges by merchants so that they do not exceed the direct cost of acceptance (i.e. the cost to a merchant of accepting each payment method). The payments market will continue to evolve and innovate quickly. New entrants, technologies, payment options and the introduction of new products and innovations are proof of a competitive, dynamic sector that needs a regulatory framework to promote this evolution rather than inhibit or deter it, especially in smaller market economies.

We look forward to working with the Commission to develop a regulatory framework that promotes competition and efficiency in New Zealand, and we would be pleased to discuss any aspects of our submission and explore how we could provide further data to assist the Commission. Please liaise with our Vice President for Government Affairs, Tanya Stoianoff to discuss these arrangements.

Yours sincerely,

Ruth Riviere
Country Manager
New Zealand & Pacific Islands

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Executive Summary

When assessing a range of issues and impacts, in our view the Commission should ensure that it accurately positions and balances the value of card payments in national productivity, innovation and competition.

Our core commentary on the consultation paper is centred on the following areas:

1. Card payment networks enable companies and consumers from all over the world to transact securely and conveniently, regardless of the time and place of the transaction. They create trust between parties that may not know each other, guarantee settlement for merchants, monitor and combat fraud, and resolve disputes between cardholders and merchants where needed.

    - All payments have costs attached – an independent analysis into the Cost of Acceptance by Boston Consulting Group (BCG) shows that in-person payments in NZ are amongst the lowest in the world, and the end-to-end cost for a merchant to accept a card payment (2.1%) is lower than cash (3.6%)[1] and Buy Now Pay Later (4.9%).
    - Interchange fees are an important part of a healthy electronic payments ecosystem, covering costs of real, valuable services for consumers and business cardholders, and delivering incremental value to the merchants who accept them.
    - New Zealand's global-facing enterprises, including tourism, rely on being able to provide international customers with convenient and familiar transaction tools.

2. Further interchange fee regulation may result in unintended, unfavourable and unpredictable consequences which may impede other important policy and technology developments in New Zealand.
    - Interchange is a driver of retail bank competition in NZ, and lowering the fees will stop new entrants from recovering costs, offering customers important services or driving innovation in the market.
    - Loss of ability to recover real costs of services covered by interchange will drive system participants to recover costs from consumers and business cardholders in other ways, or reduce services offered. This has occurred in other jurisdictions, such as Germany, the Netherlands and France.
    - Policy developments in open banking and retail banking, and payment approaches using technologies such as Near Field Communication (NFC), are all likely to bring about competition, efficient delivery, and new services. The consultation does not consider the ways in which these could be impacted by the proposal, or ways they may deliver the consultation's outcomes without needing further interchange regulation.

[1] Which the consultation refers to as 'low cost' in 3.7

3. Excessive surcharging needs to be addressed through regulation and enforcement.

    - Excess surcharging is the real problem; a dead weight on competition and efficiency, which is costing, frustrating and discouraging consumers. The Commission has not yet established how to ensure lower interchange fees lead to lower merchant surcharges.
    - The consultation itself finds (in Section 3.12) that the average surcharge is 2% while the average merchant fee is only 1%. We estimate that excess surcharging by merchants costs New Zealand consumers more than $90 million annually[2].
    - The Commission proposal will cut interchange fees by $250m – with no guarantee on how much this reduces fees charged by acquirers to merchants, or if any corresponding reduction would be passed on to consumers or would result in reduced surcharges. In fact, there is no evidence that surcharging rates have reduced in New Zealand when interchange was reduced by the Commission through the Initial Pricing Standard (IPS) so we would not expect a different outcome.
    - The Retail Payment System (RPS) Act requires both merchants and consumers to each pay no more than a reasonable proportion of fees for payment services, with clear guidelines for merchants, yet that is not being adhered to adequately across New Zealand. In research commissioned by Mastercard over July and August 2024, independent mystery shopping of 182 merchants found that 71% of in-person businesses fail to comply with the Commerce Commission's expectations on surcharging – based on rate of surcharge and/or how it was communicated to consumer[3].

[2] Based on RFI Global and Mastercard mystery shopping of 500 NZ merchants.
[3] Mystery shopping conducted by: The Lab Insight & Strategy | Brilliant Leaps For Brandkind (thelabstrategy.com)

Regulatory good practice[4]

We invite the Commission to measure the consultation against the NZ Government's guide to regulatory good practice.

- **Clearly identify the problem**. The paper does not clearly identify an operational problem and its underlying cause, nor provide evidence of a connection to the solution it arrives at. It goes straight from wondering whether consumers are paying too much for card payments to considering how to reduce interchange fees[5].
- **Take appropriate time**. Timelines should be clear and appropriate. The IPS was introduced less than two years ago. This consultation was unheralded, and common practice in New Zealand and internationally is for longer time periods between reviews – for example 5 yearly reviews by the Reserve Bank in Australia[6,7].
- **Use existing options and powers**. Not all regulatory options have yet been explored, in the interests of proportionate treatment across regulated parties and to improve competition and productivity in the system.
- **Evidence for improvement**. The report needs evidence for believing lower interchange fees will flow through to lower surcharges by merchants, and for establishing how lower interchange fees would lead to more efficiency and competition.
- **Consideration of effects**. The paper needs to consider the effect of forcing reduction in recovery of business costs. Interchange fees represent the real cost of a real service. The paper does not consider how payment services may need to be reduced if their costs cannot be recovered. Nor does it consider how reducing interchange fees will disincentivise innovation and new fintech entrants to the market. Karen Silk, Assistant Governor of the Reserve Bank, noted the risk of undue regulation stifling healthy competition, impairing market efficiency and limiting innovation, in November 2022, when the RPS Act was introduced[8].
- **Consideration of context.** The paper should show consideration of the effect of other parallel policy workstreams and technological activity— such as open banking – on meeting its objectives, and on the working environment of Mastercard and Visa.

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[4] Good Expectations for Good Regulatory Practice, NZ Government, April 2017.
[5] s2.8, Commerce Commission Retail Payment System consultation paper.
[6] https://www.reuters.com/business/finance/key-recommendations-australias-review-rba-2023-04-20/
[7] https://www.grantthornton.com.au/insights/blogs/rba-releases-retail-payments-regulation-review/
[8] https://www.bis.org/review/r221109c.pdf

Cards bring significant value to NZ, and costs are in line with comparable markets

Electronic payments play a critical role in the everyday lives of Kiwis and Kiwi businesses. There is no greater driver of competitiveness and efficiency than consumer choice, transparency and safety. Mastercard is proud of its global investment and innovation in the NZ market through the rollout of more secure EMV international standards, contactless capabilities and tokenisation, when other payment types have stood still.

The interchange business model associated with the four-party model has allowed issuers to bring to life Mastercard scheme capabilities (e.g. zero liability, chargebacks) by investing in secure and seamless digital payment experiences for their cardholders and allowed merchants to realise value in accepting cards to drive their businesses, driving productivity.

According to the Ministry of Business, Innovation and Employment (MBIE)'s Reliance on Tourism data, international tourists spent $3.8b on their cards in NZ over the last 12 months ended June 2024. As a tourism-reliant market, New Zealand benefits from the ability to receive guaranteed payment from inbound travellers, most of whom now expect to make contactless payments, especially with their mobile phones. Tourists can be confident to book ahead with all tourism providers and services because of the protections that card payments offer.

An independent study and analysis into the cost of acceptance by Boston Consulting Group (BCG) (2024) for New Zealand has found that cost of card acceptance is in line with comparable markets globally. The study also found that indirect and back-office costs, were more than twice that of direct cost, i.e., merchant service fee. Please see attached.

The focus of this consultation is on direct costs associated with scheme payments for merchants. But to truly drive better outcomes for merchants and consumers, the Commission must assess and focus on the end-to-end cost of acceptance across various payment methods, and look for larger opportunities to bring overall costs down. For example, if a retailer switched from a standalone payment terminal where staff key in the transaction amount manually, which is prone to error, to an integrated terminal where payments are rung up automatically, overall payments costs could fall by 30-50% - more than total direct costs.

More details from the BCG research can be found later in our submission.

Further interchange reductions will reduce competition and innovation in retail banking

The Commission has been clear about its desire for more competition in retail banking, but the proposal in this consultation does not align with that objective.

Innovation from new players is critical to efficiency and competitiveness of our financial system. That's why the word 'fintech' appears more than 150 times in the Commission's final competition report on Personal Banking Services [9]. Yet the word does not appear once in this consultation.

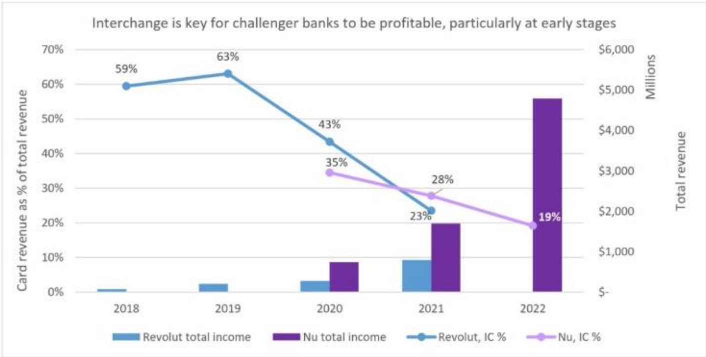
NZ is already a challenging market for retail banking innovation and competition. It is a highly concentrated, small market, with a requirement to issue plastic cards because contactless acceptance is patchy. There are high costs in EFTPOS if businesses want to offer debit transactions. Innovation and competition require a business case to be sustainable - this is particularly true in payments, where continued investment is made essential by changing consumer preferences, technology and security threats.

Mastercard is the proud partner of many great Kiwi startups trying to disrupt and compete, but they need business models and regulatory certainty to attract investment, compete, and grow. Interchange is a critical key revenue line in these business models, covering costs associated with processing transactions, unauthorised use, customer service, card benefits and other operational expenses.

Neobanks, digital banks and fintechs around the world have almost all started their transactional banking businesses with scheme cards. Prepaid is often the early product of choice, and has enabled companies like Monzo, Revolut, N26, and Chime to benefit from enhanced revenue while they got started, before moving onto debit once they scaled. Figure 1 shows how important interchange is at the start of a challenger's journey.

[9] Final-report-Personal-banking-services-market-study-20-August-2024.pdf (comcom.govt.nz)

Figure 1 – Interchange is key for challenger banks[10]



The Commission's proposal to further reduce this revenue line will be more acutely felt by new and smaller players compared to established banks with a more diversified revenue base, entrenching the status quo and reducing competition.

The Commission recognises in the consultation that reducing interchange may impact the success of new payments in NZ – e.g. account-to-account payments powered by open banking. Consider the current published merchant rates from Blinkpay (95bps) and EFTPOS Online (100bps). These are broadly in line with current debit online Merchant Service Fees (MSF), and already higher than card-present debit MSF. Suppressing interchange to rates lower than the value delivered limits the opportunity for these new innovations to grow and compete.

Account-to-account payments powered by open banking is likely to be more efficient if it can leverage existing infrastructure, rather than building new parallel infrastructure. It is exciting that New Zealand is named as one of only eight markets where Apple is opening up the NFC capability, which could be leveraged for account-to-account payments. But this only works if contactless is available, business models can be built around the flow of value, and consumers aren't excessively surcharged every time they try and use it.

Given the prominence of open banking in the Commission's broader vision for payments and competition in NZ, it is therefore important to allow more time for open banking to establish business models and scale so that links to interchange are better understood, and unintended consequences can be addressed.

[10] Mastercard analysis built from publicly available resources

The consultation paper understates implications for the consumer

The Commission has estimated that the Initial Pricing Standard (IPS) has delivered to merchants "a saving of over $130 million to acquirers with $105 million estimated to be passed through to businesses in lower merchant service fees".

For in-person transactions alone, surcharging has resulted in a transfer of $90 million[11] per year of merchants' value rendered to them in receiving electronic payments and passed it on as cost to consumers (if guidance was appropriately followed).

The Commission has set expectations, however, to date has not enforced guidelines that require merchants to surcharge only at the cost of acceptance, which has enabled an *additional* $90 million[12] of merchant profit for in-person transactions, paid for by cardholders.

So, a conservative estimate of the result of the IPS has been $285 million advantage for merchants, but consumers have worn direct costs of $180 million. Consumers and small business cardholders are being ripped off and have no recourse.

It is important to note that in the global interchange comparisons outlined in Chapter 4 (4.27) of the consultation, surcharging treatment has been omitted, which undermines usefulness of the comparison. The UK/EU benchmark data is not clear that surcharging was banned, distributing cost and value across the ecosystem and giving an immediate benefit to consumers. The consultation paper is not contemplating the same approach, so will not realise the same benefits for consumers.

In 2.11 it is noted that card issuers 'may use interchange for a range of matters', but in the proposal the Commerce Commission states that they 'are not aware of any adverse impact from the lowering of interchange fees' – suggesting that you can remove $250m from a two-sided market without consequences. We would argue that experience in other markets clearly shows that these costs don't disappear but are put onto consumers.

The following is critical evidence that there are costs for consumers when interchange fees are reduced:

In Europe in the 6 months following regulation capping interchange fees:

- In Spain, Portugal, France and Italy, almost half of the top five to six issuers have raised their annual card fees. In France, Credit Mutuel and BNP Paribas

[11] Based on RFI Global mystery shopping of 500 NZ merchants. This showed that approx $9B of card present volume is surcharged today (out of $54B of card present scheme volume – 16.3% of card present volume). Assuming average MSF of 1% per the consultation

[12] As above using 2% average surcharge per the consultation – and in line with Mastercard's own mystery shopping

have increased annual fees on cards by 2% on average. In Spain, the average increase was as high as 26% (Caixa Bank and Banco Popular) for cards that saw an upward price adjustment.
- In Spain other fees have also been increased, such as those charged to consumers for overdrafts and debt claims. Consumers saw their card rewards and promotions reduced in addition to paying more for these reduced benefits.
- In Germany, where interchange reductions particularly impacted credit cards, several large, well-known issuers are now charging on average 20% more for some of their card offerings than they did in the beginning of 2016. Additionally, one of the largest banks in the Netherlands has increased fees on some of its credit cards by 60%.
- Issuers have also continued increasing credit card Annual Percentage Rates (APRs) since January (see Figure 1 and 2 in footnote) to compensate for the revenue lost from interchange regulation. Markets where most issuers have increased their APRs include Portugal, Poland, and Italy, where rates have increased by 30 bps, 100 bps, and 131 bps, respectively.[13]

Consumers have paid the price in Australia since interchange regulation, and now pay up to 50% more for their cards[14]. In the last ten years, average annual fees have increased by 25%; the highest annual fees have almost doubled. Meanwhile, credit card interest rates have increased to as high as 27.49%. There was no card with interest 25% or higher a decade ago[15].

In the US, many no-cost or low-cost bank accounts were eliminated, and consumers now pay increased fees for basic deposit account services. The flow through to consumers in the US has increased instances of consumers being unbanked. To correct the issue, there is currently a bill in the Senate from Ted Budd to delay further interchange changes pending a full impact study[16].

The consultation paper says (X9) that cuts in interchange fees will be passed through in a reduction in the price of goods and services, but we are not aware of any evidence the Commission has on this, or any market which has experienced this flow through reduction. In the "Study on the Application of Interchange Fee Regulation" by the EU, pass through savings by acquirers to merchants was 45% of total interchange savings made by the acquirer. However, at the consumer level, the savings realised across all 28 member states averaged only 3.94 Euro per household

[13] Six months after interchange regulation: have card products changed? (paymentscardsandmobile.com)
[14] The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia. HOWARD CHANG, DAVID S. EVANS, AND DANIEL D. GARCIA SWARTZ* LECG, LLC. Forthcoming in Review of Network Economics. September 26, 2005.
[15] Credit card interest bills drop as borrowers are behaving better | The Australian
[16] https://www.budd.senate.gov/2024/06/18/budd-introduces-bill-to-force-federal-reserve-to-pause-debit-card-proposal-that-hurts-consumers/

per year – the same as would be achieved by ensuring surcharging moved to the cost of payments on only $800 worth of spend[17].

The Federal Reserve of Richmond found that "averaging across all sectors, it is estimated that the vast majority of merchants in the survey (77.2 percent) did not change prices post-regulation, very few merchants (1.2 percent) reduced prices, while a sizable fraction of merchants (21.6 percent) increased prices".[18]

As a final note, the debate around card costs on small businesses has been one dimensional. The answer to the question "Do you want to pay less?" is always "Yes". But most small business owners are also cardholders. The impact of the proposed reduction on the value of the cards described above is equally applicable to business cards but is not presented as part of the equation.

[17] $800 which is surcharged above the cost of acceptance (2%) $16, then reducing that surcharge to the cost of acceptance (1%) would save the consumer $8 – Approx 4 Euros.
[18] Did the Durbin Amendment Reduce Merchant Costs? Evidence from Survey Results (richmondfed.org)

Excessive surcharging needs to be addressed through clear guidelines and enforcement

Merchants receive significant value from accepting cards and the associated cost should rightly be borne by them. Globally, Mastercard does not permit surcharging on our cards unless there are local laws allowing otherwise – such as in New Zealand.

Electronic payments boost retail sales, simplify accounting and the provision of credit to customers, and reduce operating and security costs for merchants. They also provide fraud protection, traceability, and the greater security of guaranteed payment.

Surcharging conceals this value exchange by repackaging it solely as a cost that can be passed onto consumers and entice time-poor and cost-pressured merchants to over-recover, unfairly blaming extraordinary card acceptance costs.

Surcharging reduces competitive pressure on the market as there is no incentive for a merchant to seek out a better acquiring deal to reduce their overall costs. It reduces the need for acquirers to compete on price, leading to ultimately higher MSF and surcharges. A weighted surcharge also removes consumer price signals as all transactions are surcharged the same.

We appreciate that in some markets (i.e. NZ and AU), there has been a long-standing decision allowing the cost of payments to be passed on to consumers in the form of a reasonable surcharge limited to the cost of acceptance. But, for the large part, consumers in New Zealand are increasingly bearing the full weight of the MSF and are also being charged more than the cost - the consultation paper itself finds (3.12) that the average surcharge is 2% while the average merchant fee is only 1%. There is no evidence to suggest that the IPS has reduced surcharging. RFI Global research of 500 NZ merchants in August 2023 shows that 50% of them surcharge. This was 49% in August 2021, and 49% in August 2022. The interchange changes brought about by the IPS had no impact on the number of merchants surcharging.

In reading the consultation paper we are concerned that the Commission is assuming an outcome when the evidence to date points to the counterfactual – when interchange was reduced 18 months ago, surcharging did not decrease. It is proven to not have realised the intended effect. To assume a different outcome without any certainty on flow through and/or enforcement first, is misplaced and unhelpful in a regulatory context. Even when Commission Chair, Dr John Small was recently interviewed and pressed on the effectiveness of the interchange proposal he said "it's hard to know" whether retailers will absorb it or pass it on to customers. To make such a significant proposal without any certainty of flow through and/or enforcement is imprudent at best.

Surcharging in other jurisdictions

The issue of excessive surcharging is not unique to New Zealand. In Australia, an upcoming RBA review will seek to understand whether surcharging is still fit for purpose as an instrument to improve efficiency in competition. Extensive commentary so far suggests that surcharging is no longer supported. The Australian Competition and Consumer Commission (ACCC) says it will investigate complaints of excessive payment surcharging and take enforcement action where necessary[19].

When the UK banned surcharging, one rationale was transparency of pricing for the consumer, outweighing any marginal increase in prices. (UK Govt PSDII Impact Assessment doc[20]).

Surcharging for consumer card payments, or discounting for non-card payments, is not permitted for payments from within Europe. The Payment Services Directive (PSD2) makes it illegal for any business to charge extra for using a debit or credit card in the EU.

Mastercard is not necessarily arguing for a ban on surcharging in New Zealand as SME penetration, current economic climate and historic context are factors to consider. This is why we advocate for proper enforcement of the current regime to address the scourge of excessive surcharging.

Complexity of fees

The Commission paper suggests that the excess surcharges are due to merchant confusion, which would be erased by changing interchange fee types. It is incorrect to assert that it is too complicated for someone running a business to find or use the MSF rate so they can surcharge correctly.

While there is complexity, acquirers have made changes to statementing – including messaging about surcharges. The average merchant service fee is now very clear. Acquirer websites include additional instructions about how to surcharge and where to find the relevant rate on the statement. The 'Surcharging fees' section of Westpac's policies does not leave room for confusion[21], as they have provided written guidance that surcharging should not exceed 1.59%[22].

[19] https://www.accc.gov.au/about-us/news/media-updates/ban-on-excessive-payment-surcharging
[20] https://assets.publishing.service.gov.uk/media/5a81eaa0e5274a2e87dc02ab/PSDII_Impact_Assessment.pdf
[21] Merchant Guide | Business Banking - Westpac NZ
[22] https://www.interest.co.nz/banking/124516/commerce-commission-receives-120-complaints-about-payment-surcharges

Better Enforcement is Needed

In research just commissioned by Mastercard over July and August 2024, independent mystery shopping of 182 merchants found that 71% of in-person businesses fail to comply with the Commerce Commission's expectations on surcharging – based on rate of surcharge and/or how it was communicated to consumer[23]. The Commission wrote to a number of merchants with concerns about excessive surcharging but only 41% made any sort of subsequent change. If the Commission cannot force significant compliance, then the chances of consumers doing so are much less. They cannot do so usefully at the point of sale, and while there is a complaints process, this is not a dispute resolution for each consumer. This will be one reason why consumers have chosen instead to complain over social media and to media.

Enforcement on surcharging must be implemented before further changes to the NZ regime are contemplated. Better guidance and enforcement is required outlining:

1. what components can be added onto a surcharge and what constitutes excessive surcharging,
2. how surcharging should be done, enhancing transparency to consumers prior to payment; and,
3. what happens if guidelines are not followed.

The surcharging expectations published by the Commerce Commission[24] is a good starting point. The way to calculate appropriate surcharging makes sense, and should be easy enough to follow. However, without enforcement, attempting to reduce the amount surcharged to consumers by reducing interchange will simply not work.

The Commission paper does not address the role of terminal providers in the chain of efficiency. The absence of information about the impact of surcharging rates suggested by terminal providers, or requirements to cite MSF before implementing a surcharge rate, means the Commission is completely overlooking a source of potential merchant confusion or mismatch between card costs and surcharge rates.

Excessive surcharges also discourages the use of innovative payment methods like contactless payments, which could otherwise enhance both consumer and merchant experiences, and be leveraged by other payment types to drive faster adoption of new payments options. By overcharging, merchants disincentivise innovation and adoption in the market.

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[23] Mystery shopping conducted by: The Lab Insight & Strategy | Brilliant Leaps For Brandkind (thelabstrategy.com)

[24] https://comcom.govt.nz/__data/assets/pdf_file/0013/321700/Retail-Payment-System-Appropriate-payment-surcharging-explained-July-2023.pdf

After 15 years unresolved, the Commission should now prioritise fixing surcharges over interchange fees capped only two years ago, as it will better achieve the Commission's stated efficiency and transparency objectives.

Mastercard and other participants in the payment ecosystem could help improve matters. For example, Mastercard could potentially help collate information on the surcharge amount by requiring its members to include it in the data element during transaction processing.

Our recommendations to the Commerce Commission

This consultation paper, and a review of interchange fee regulation applying to the Mastercard and Visa networks, should not continue.

We believe the consultation paper does not make a strong, evidenced case to suggest that the problem could be remedied by lowering interchange fees, especially less than two years after they were capped.

The Commission itself is not confident that the dramatic changes it proposes in interchange fees will flow evenly through to consumers. And it has not provided evidence to suggest that the benefits would outweigh costs and distortions imposed on the system.

Mastercard recommends that:

1. The Commission allows for the proper implementation of the 2022 interchange caps under the IPS, to ensure that consumers realise the intended benefits, by having the Commission enforce that surcharges by merchants do not exceed the direct cost of acceptance / cost of payments.
2. The Commission meets with Mastercard to discuss these matters and explore ways we could assist in the provision of data and insights.

Our rationale is that:

Businesses require certainty and continuity in regulatory parameters

- It is important for the NZ Government and regulator to have a steady, consistent, long-term approach to regulation, to allow businesses (especially new fintechs and innovators) to plan and invest with some degree of certainty.
- It is premature to consider further interchange fee regulation before assessing if the RPS Act has achieved its intended objectives: to promote competition and efficiency in the retail payment system for the benefit of merchants and consumers.
- The Commission should allow sufficient time to assess all the impacts of the regulation and explore powers given to it by the RPS Act to regulate surcharging and issue enforceable guidelines to address excessive surcharging. This will ensure any future decisions on interchange fees are considered and appropriate.

More time and rigour is needed to better understand the effects of the IPS and its broader impacts on consumers, competition and innovation

- The proposed reductions would have dramatic impacts on the retail payments system that work against the objectives of other policy setting changes currently being contemplated – particularly around competition in retail banking and new payment methods.
- Further changes could decrease the attractiveness of New Zealand for local and international investment into payments and retail banking innovation and competition.

- The Commission must ensure the scaling of new payments methods are not disadvantaged and are evaluated on value delivered to users, not just costs.
- More data and assessment is required on the effect on consumers when scheme providers and banks are forced to cut services provided with payment methods and recover unavoidable costs from consumers in other parts of their operation.

New Zealand needs surcharging regulation and enforcement to address excessive surcharging

- Surcharging ignores the value the merchant has received in accepting electronic payment and then passes it on as a cost to the consumer.
- Mastercard's view remains that surcharging negatively impacts merchants and consumers alike. We appreciate that surcharging will remain due to New Zealand's small market, the role of small businesses, and the current financial pressures on merchants.
- The continuation of *excess* surcharging is especially damaging to consumer welfare during these tighter financial times – it is unfair and unconscionable that it is allowed to continue.
- The presence of surcharging *and* interchange caps creates a decisive difference from comparator countries used in the consultation paper.
- It is therefore critical that the Commission guides and enforces a reasonable share of cost of payments between merchants and consumers, consistent with the RPS Act.
- The reduction in costs to consumers from excessive surcharge reductions will be instant, sizable, and visible to them at the point of sale.
- We welcome the opportunity to discuss how Mastercard could play more of a role in the flow of data through our network to allow better visibility.

Open banking needs more time for business models to solidify

- Open banking and the introduction of a consumer data right (CDR) will drive competition and innovation. The Commission should lend its full support to these developments and end the interchange review while they unfold. At the very least, the Commission should explore how open banking could be helped or hindered by the interchange proposal.
- Open banking in other markets has been used to complement other payment methods.
- The Commission should recognise the importance of cost-covering and profits in attracting new competitors and technology. Open banking is focused on competition – which previous New Zealand experience in sectors such as telecommunications has shown is much more likely to deliver improvements in service and pricing for consumers.
- Delivery of open banking will take time and requires support from the banking sector.

Small businesses are the backbone of the NZ economy, and all of their needs must be considered.

- New Zealand's Small Business Strategy[25] identified how Government should understand the needs of small businesses, including their access to finance and financial tools.
- Small businesses need access to finances, cards (including credit cards to help with expense management), easy reconciliation, and secure ways to pay and receive payments.
- In contrast to this strategy, the consultation paper treats the interchange fees in modern payment transactions as purely a cost to small businesses, ignoring the value of the services they provide.

[25] https://www.mbie.govt.nz/business-and-employment/business/support-for-business/small-business#small-business-strategy

BCG Research

An Independent analysis into the Cost of Acceptance by BCG (2024), looks at the end-to-end cost of acceptance for merchants across 15 markets to understand the real drivers of costs, and opportunities for efficiencies.

All payment methods have a cost attached – even cash and EFTPOS. In New Zealand, the end-to-end cost for a merchant to accept an in-person card payment (2.1%) is lower than cash (3.6%), BNPL (4.9%) and other popular modes of payment. The cost to accept in-person card payments in New Zealand is amongst the lowest in the world, while the cost of cash payments is amongst the highest and will likely only get higher.

Scheme fees, interchange and merchant service fees only represent a small part of the true total cost of acceptance. To deliver against the intended objective of reducing costs for merchants and consumers, the review should broaden its scope to consider the full picture, capturing all direct, indirect and back-office costs.

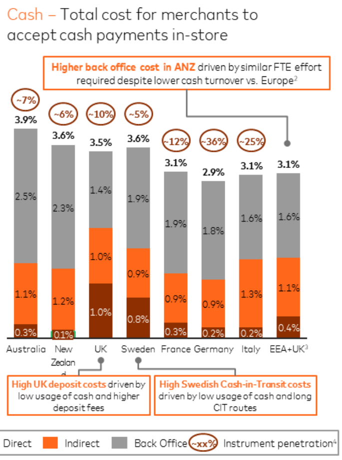
To obtain a realistic, end-to-end view, the BCG study looked at three components:

- Direct costs: For digital instruments, these costs comprise the amount paid to payment service providers (fees are linked to transactions and are invoiced as a percentage, fixed fee, or combination of both). For cash, we defined direct costs as the cost of depositing cash at the bank, or the cost of having the cash collected (cash-in-transit (CIT) cost). For card (four-party) schemes, a merchant service charge (MSC) is applicable.
- Indirect costs: All instruments carry a broad range of costs that are either required to enable the transaction (such as a payment terminal or cash register), or result from the transaction (for example, fraud, theft, or keying errors during the check-out process).
- Back-office costs: These stem from the work required to reconcile payments (such as invoice reconciliation and cash register preparation).

Indirect and back-office costs account for the bulk of merchant payment acceptance costs in New Zealand – aligned to other markets globally.

Contrary to statements in the consultation, cash is not low cost. In fact cash is amongst the most expensive instruments, with a cost of 3.6% for New Zealand, and an average cost of 3.1% in the European Economic Area (EEA) & the UK. (Figure 1). While the direct cost of cash is low, merchant costs emanate from indirect and back-office costs associated with cash handling.

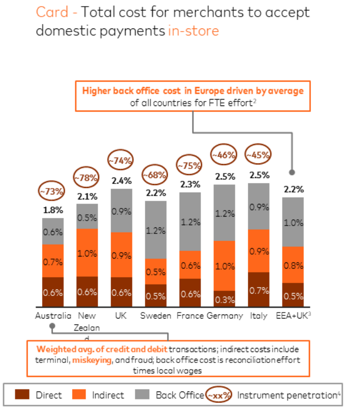
Figure 1 – Merchant's cost of acceptance of cash payments in New Zealand, Australia and European countries



1. 4 party schemes only; 2. Disaggregating the average, ANZ resembles UK, Sweden, France, and Italy; 3. European Economic Area (EEA) countries in reference set are Belgium, Denmark, France, Germany, Italy, the Netherlands, Poland, Spain, Sweden, Hungary, Portugal, and Norway; 4. Share of total transaction value in-store or online according to each instrument, based on Worldpay Global Payments Report; penetration for cards likely underestimated as digital wallets not included, ~70% funded with cards in Australia
Minor differences may exist due to rounding; Source: BCG cost of acceptance survey

The total cost for merchants to accept card payments in New Zealand is in line with global benchmarks, and significantly lower than cash (Figure 2). The figure reported below does include EFTPOS transactions, which have zero direct cost, however, they still face a 1.48% indirect cost. If you remove this component, then card costs in New Zealand still sit below many of the European benchmarks.

Figure 2 – Merchant's cost of card payments acceptance in New Zealand, Australia and European countries



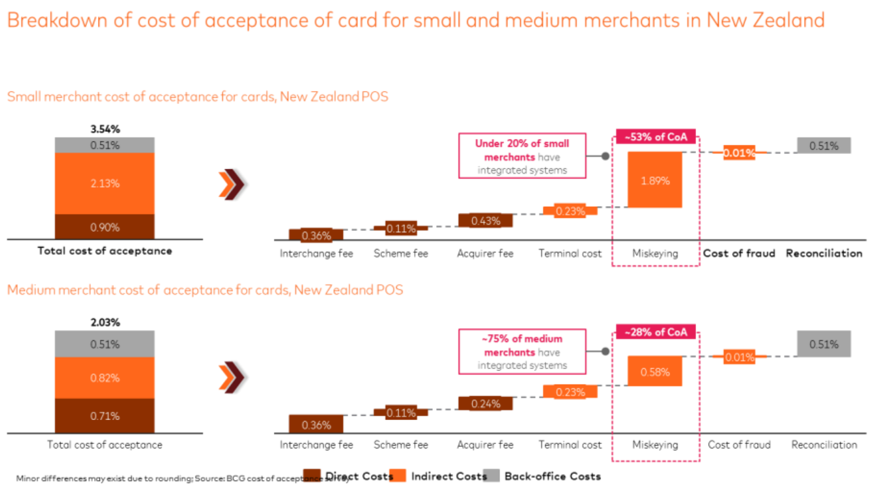
1. 4 party schemes only; 2. Disaggregating the average, ANZ resembles UK, Sweden, France, and Italy; 3. European Economic Area (EEA) countries in reference set are Belgium, Denmark, France, Germany, Italy, the Netherlands, Poland, Spain, Sweden, Hungary, Portugal, and Norway; 4. Share of total transaction value in-store or online according to each instrument, based on Worldpay Global Payments Report; penetration for cards likely underestimated as digital wallets not included, ~70% funded with cards in Australia
Minor differences may exist due to rounding; Source: BCG cost of acceptance survey

It is important to note that direct costs make up a small percentage of the total cost of merchant acceptance.

- Credit card present interchange makes up 24% of the total cost (taking indirect and back-office costs into account) and 57% of the direct cost
- Debit card present interchange makes up 7% of the total cost (taking indirect and back-office costs into account) and 21% of the direct cost

The most meaningful contribution to cost, in particular for small merchants, is miskeying (Figure 3), resulting from fewer small and medium sized merchants having integrated terminals. If these retailers switched from a standalone payment terminal, where staff key in the transaction amount manually, which is prone to error, to an integrated terminal where payments are rung up automatically, overall payments costs would fall by 30-50% - more than direct costs.

Figure 3 – Small and medium-sized merchants cost of card payments in New Zealand



Consultation questions

1. **Merchants: Do merchant service fee complexities drive challenges in determining whether and how you surcharge?**

   <Confidential response redacted for ComCom review only>

2. **Merchants: Would you consider lowering or even ceasing to surcharge if your merchant service fees were less than 1% for in-person card payments?**

   <Confidential response redacted for ComCom review only>

3. **All Stakeholders: Is token portability an issue in New Zealand? If yes, what is stopping the implementation of the Reserve Bank of Australia's expectations here**?

   This question relates to payment tokenisation which is the process of replacing a card's primary account number (PAN)—the 16-digit number on the plastic card—with a unique alternate card number, or "token".

   Network tokenisation and scheme tokens are purposefully designed to maintain a chain of trust and security between the consumer/cardholder, merchant and issuer, and are not meant to be portable by payment service providers between multiple end points or participants, which might introduce vulnerabilities in the chain of trust where a bad/threat actor could compromise data.

   Mastercard is supportive of more competition which includes merchants having the ability to change providers should they wish, however this must not be done at the expense of security.

   With safety and security a priority there needs to be ongoing investment and a sustainable economic model. This ensures the industry's constant investment in security and innovation for the entire ecosystem including acquirers, PSPs, and merchants. It cannot come at low cost/free.

4. **All Stakeholders: We welcome further evidence of any other issues within the New Zealand retail payment system.**

   Mastercard appreciates the Commission's question into the broader ecosystem. Mastercard supports RPS Act objectives in driving competition and efficiency across retail payments. Moreover, Mastercard believes that greater analysis and quantification of consumer benefits and end-to-end acceptance costs are essential. We suggest that the Commission should better describe the costs and benefits of the domestic switch – in the consultation context, for example, EFTPOS costs to issuers are ignored in the context of the ecosystem dynamics.

Mastercard has always advocated for a level playing field and so while Amex and BNPL are outside regulation, competition is asymmetric. This presents issues for the retail payments system, and while we are glad that the Commission is monitoring it, we still think it is an issue in the context of acceptance costs and surcharges for consumers.

Finally, there appears to be less competition in New Zealand's acquiring landscape, especially when compared to Australia. Based on Mastercard data, traditional acquirers (banks) account for 83% market share in the in-store environment in NZ, but only slightly more than 50% in Australia[26].

If true, the Commission should try to understand why, as this may limit the innovation being brought to NZ merchants, including things like integrated terminals, which could bring down a significant cost component linked to miskeying – please refer to the BCG research provided for quantification of the issue.

5. Schemes, Issuers, Acquirers: What do you consider an appropriate methodology for determining interchange fee caps in New Zealand? Why do you think this best meets the purpose of the Retail Payment System Act, and how would it be practically implemented?

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

Our primary interest is ensuring merchants and consumers receive maximum value for electronic payments at the lowest possible cost, and promoting innovation and efficiency. Thus, we are incentivised to set interchange at a level that encourages card payments and (as close to as possible) universal acceptance by merchants in a market, rather than at a level that would discourage consumers and merchants from using cards and their related product innovations.

The interchange level is optimised when it is:

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

[26] Data source: Mastercard processed domestic purchase transactions

Economic arguments favouring lower interchange or removing interchange entirely underestimate the crucial role it plays in supporting the efficient functioning of the payments system. Low or lower cost electronic payments is not the only measure when it comes to assessing whether a market is functioning efficiently and in the best interest of all participants.

The benefits of electronic payments across participants in the payments system include the following:

Consumer	Merchants	Governments
• Cardholders are **protected** in the event of a fraudulent transaction. Mastercard cardholders are protected from fraud or unauthorized transactions under **Mastercard's Zero Liability Policy**. Interchange covers a portion of the cost of that fraud protection. • Consumers and businesses have access to interest free days on credit cards, allowing them to make purchases and **have better cashflow management** without incurring interest immediately • Consumers have access to funds whenever and wherever they want, and provides a **more secure and efficient way to pay, whether in-person or online** – interchange is integral to enabling this Access	• Access to **a global customer base** • When compared to acceptance of cash**, cost of card acceptance is much lower** Merchants **get guaranteed payment** when they accept credit cards, freeing them from the worry of credit risk • Accepting cards **reduces the significant costs** associated **with counting, safeguarding and transporting cash** and the losses that occur when cash from sales is lost or stolen. • **Increased sales:** consumers spend more when they use cards and businesses make more money when they accept cards: On average debit and credit transactions are about two to four times the average cash	• Electronic payments are an important means of **reducing the shadow economy** and increasing taxation revenues. • Provide the **necessary infrastructure** for citizens and businesses to interact in a financial ecosystem which facilitates economic activity. This **includes e-commerce**, which enables businesses to **trade with anyone around the world**. • **Government and the public sector are major beneficiaries** of electronic payments as they utilize many different payment options, including **commercial cards** and often themselves act as issuing institutions that receive interchange.

Issues with the considering further interchange cap

Mastercard's view is that the proposed consideration is rushed, in part because there needs to be assessment of whether the current RPS Act has met the objectives but also, that there are broader issues that require the Commission's considerations:

- There is no evidence that a reduction in interchange has led to lower cost to businesses and consumers; neither that it will lead to lower surcharging
- The cost of acceptance study conducted by BCG in 2024, shows that the cost of acceptance for cards in New Zealand is lower than cash and in line with Australia and European markets
- There are productivity gains to be achieved from further digitisation on the economy which might be hindered due to more regulation
- Surcharging, and excessive surcharging, remains prevalent – enforcement is critical

Reasons to exclude commercial and prepaid cards from interchange regulation

RBR, a global payments consultancy engaged by Mastercard, has estimated that commercial card payments in NZ represented $8.1 billion in 2022 (just 6% of the total market). Businesses across NZ are benefiting from commercial payments both in terms of working capital benefits for businesses who hold the card product and suppliers who are now able to receive payments more quickly and securely than they otherwise may have. Interchange allows issuers to fund these Credit Commercial Card facilities (where businesses typically have better cash flow management due to interest free period) and invest in technology like virtual cards, reconciliation tools, fraud protections and reporting. Capping interchange to 20bps will inhibit innovation in this space, compromise or risk eliminating the benefits received by businesses, cardholders and suppliers.

The same RBR Market Sizing reports show Prepaid card products make up <1% of the total payments market. This is the card product of choice for Fintechs in NZ who have built digital payment experiences intended to compete directly for consumers who are already with NZ incumbent banks. Fintechs do not have access to broader/ more diversified revenue line of businesses that a traditional bank does and as a result Fintechs are typically more dependent on interchange than traditional banks. Reducing interchange on these products reduces these firms' ability to compete in the NZ market.

Prepaid and commercial are excluded from interchange regulation in many markets (such as in EU).

6. **Schemes, Issuers, Acquirers: What is the rationale for the heavy discounting of interchange fees to large businesses and the evidence to support the extent of the discounting observed?**

Mastercard provides a limited number of strategic merchant rates in the market to those merchants who agree to lead the adoption of new technologies, security standards and the promotion of Mastercard to all cardholders.

Mastercard has provided further details on this in prior engagement with the Commission.

7. **Mastercard, Visa, Issuers: What evidence is there to support higher interchange fee rates for credit versus debit card payments?**

Debit and credit cards provide different value to consumers and merchants, and have different costs involved in the provision of those services. Differentiating interchange by product is consistent with global practice and helps to balance this cost and value.

Credit is more valuable for merchants because:

It removes the need for them to provide and manage their own credit lines: We know consumers will need to use credit for some purchases. By securing immediate payment from the issuer through the card, it removes the need for merchants to provide and manage credit themselves. This eliminates the need for costly practices like "factoring without recourse", where businesses sell their receivables to cover cash flow needs. In a credit transaction, issuers settle/ pay typically in T+0 even though they will typically not receive payment from the consumer until on average T+44-55. This means that the issuer is *advancing* payment to acquirer/merchant i.e. providing capital financing. So, unlike a debit transaction which is strictly a payment, a credit transaction is not just a payment it is also financing/ factoring provided to the merchant by the issuer. This is why the Merchant Service Fee is also known as a Merchant *Discount* Rate – it's because the issuer is effectively providing *advance* payment to the merchant *at a discount*.

It drives higher transaction sizes: Credit cards provide access to credit, allowing consumers to make larger purchases. Credit card purchases average $50 compared to $28 for debit and $15 for cash. This makes credit cards valuable to merchants, as they increase sales and offer benefits like guaranteed payments and chargeback protection — benefits that debit and cash transactions do not provide.

Credit is higher cost for issuers to provide because:

There are more risks and costs: Issuing credit cards entails greater risks and costs compared to debit including more involved application processes, credit risk, the cost of funding the account, non-payment, late payment and default. Moreover, credit cards transactions typically have a higher fraud rate than debit, which increases cost to issuers in terms of losses as well as efforts required to prevent and keep up with the evolving threats. Credit card issuers also bear the cost of delayed settlements, paying merchants before receiving payment from cardholders. This requires management of cash flow and credit risk, further supporting the need for higher fees.

There are more consumer benefits: As well as the credit line, credit card products tend to include enhanced consumer, fraud and price protections, emergency assistance, flight delay and travel insurance, and extended warranties. These perks, which can return up to 2% of the transaction value to consumers in New Zealand, are funded in part by the higher interchange fees. Reducing these fees would diminish these benefits, removing peace of mind which consumers enjoy when they use their card.

Fundamentally, credit is more valuable for merchants for many of the reasons expressed above, but that **requires merchants to pay for those realised benefits** facilitating traffic and economic activity. The corollary is that adding costs to issuers for the provision of services to merchants (and customers) **requires that they be appropriately compensated**. Interchange is a mechanism for that, so must be differentiated by product.

8. **Mastercard, Visa, Issuers: We welcome quantitative evidence justifying higher interchange rates on domestic card not present transactions.**

The e-commerce market is growing exponentially in New Zealand with an anticipated value of USD 7.5 billion at the end of 2024. This represents almost a 60% growth in the industry since 2022 when the market was thought to be worth USD 4.69 billion.[27]

For merchants, card payments are the most secure and convenient way to get paid online, with structured liability shift, disputes management and guaranteed payment. But they carry higher risks and costs for issuers compared to Card Present (CP) transactions.

These additional costs to issuers include:

Complexity of card processing environment: Generally, all e-commerce transactions need to be authorised online, by the issuers, to combat fraud and ensure funds are available in the account. Authorisation is critical to help reduce chargebacks and associated costs, where cardholders dispute charges after the fact.

Increased fraud risk: CNP (card not present) transactions are more susceptible to fraud than CP transactions. Card authenticity and cardholder identity can be verified more easily in physical interactions, such as using a PIN. CNP fraud accounts for 90% of all card fraud losses, despite these transactions being a smaller share of the total volume. To combat this, issuers and acquirers invest in advanced security measures such as tokenisation, encryption and multi-factor authentication. In New Zealand, domestic fraud rate in CNP is twice that of CP

Consumer protection: The higher interchange rates for CNP transactions also support robust consumer protection measures, ensuring consumers are safeguarded against fraud and have recourse in the event of disputes. These protections (fraud protection and buyer protection) require significant investment in fraud monitoring, insurance, dispute resolution and experience design. These are much more important where the merchant and the consumer are not present.

Chargebacks: CNP transactions are more likely to result in chargebacks. In New Zealand, more than 97% of all chargeback cases stem from CNP

[27] New Zealand's e-commerce market is soaring. Here's what you need to know. Dunnhumby: https://www.dunnhumby.com/resources/blog/customer-first/en/new-zealands-e-commerce-market-is-soaring/

transactions, despite these transactions representing less than half of all transactions.

Fraud prevention: Fraud is mitigated when transactions are authenticated and tokenised. Mastercard provides solutions (and certifies third parties) enabling merchants to authenticate payment transactions with ease, removing significant costs from the system and improving overall efficiency. For card present transactions, this was achieved for the merchant with enablement of EMV capable terminals, and the issuers were required to move to chip cards. This work significantly reduced fraud in card present, but challenges remain in CNP. For CNP, EMV 3DS enables authentication of the cardholder, and can allow a merchant to transact confidently knowing that they won't be liable for fraudulent transactions when the cardholder has been authenticated.

9. Mastercard, Visa: We are seeking evidence on the rationale and methodology used to set the difference between interchange fee rates on cards issued within New Zealand and foreign issued cards.

To determine the right level of interchange rates, Mastercard takes several elements into consideration including but not limited to: value (e.g. to merchants), costs (e.g. to Issuers), competition, strategy (e.g. technology migration), operations (ability to implement).

Interchange fees—cost-based approach

Card-based payment schemes take into consideration the balancing of benefit and cost on the two sides of the scheme—i.e. the acquiring and issuing sides to set their interchange fees for credit and debit cards. Such approaches take into account factors such as issuer and acquirer processing costs, the costs of the payment guarantee for issuers (including fraud costs), and the benefits that the scheme generates for cardholders and merchants.

There are several differences from an issuer perspective between domestic and cross-border transactions.

- With foreign payment cards, the prevalence of distance sale transactions (such as e-commerce transactions), for which a payment card is not presented, is significantly higher than the rate of such transactions with domestic payment cards. These distance sale transactions have different profiles (including higher average tickets, and higher levels of fraud) and technologies, and therefore have a higher cost for issuers than face-to-face transactions. However, at the same time, they enable merchants to approach a broader customer audience and to thereby increase their sales. In relation to the higher costs involved for issuers:
- Transactions of this sort are riskier as it is harder for the merchant to spot irregularities (and the card issuer generally bears this risk); and,
- Fraud rates and non-fraud chargeback levels on transactions where the card is not presented are significantly higher than transactions where the card is presented. In particular, on average, fraud rates (bps of sales volume) are six times higher, and non-fraud chargebacks rates (% of transactions with

non-fraud chargebacks) are more than ten times higher on distance sale transactions compared to face-to-face transactions.
- These transactions are on average conducted for higher amounts.
- The use of foreign payment cards involves additional costs for issuers including:
    - The costs that some issuers bear in order to stage money in Mastercard settlement accounts outside their own country and in a different currency to their own; and,
    - The costs of funds (which vary from country to country) on the advance payment / financing provided by the foreign issuer to acquirers/ merchants in New Zealand during the interest-free period.

The costs for issuers of international transactions are higher than those that they bear for domestic transactions. Higher interchange on foreign issued cards are necessary for issuers to issue cards that permit international, authorise and take on the increased costs and risks (costs of funds, credit risk/losses, fraud risks/losses, chargeback dispute resolution, international settlement, and other operational costs) associated with cross-border transactions.

Differences in the alternative payment methods available to merchants and cardholders.

Another approach that has been used by regulatory authorities to evaluate the level of interchange fees is the Merchant Indifference Test (MIT).

The MIT is primarily based on a comparison of the costs to merchants of accepting different payment methods. The costs to merchants need to be measured and need to include not only the direct per-transaction fees, but also the costs of other activities that are needed to accept a transaction (e.g. labour costs, the transportation of money to the bank (in the case of cash), the time taken to count cash). As such, the MIT IF (i.e. the interchange fees that makes merchants perfectly indifferent) depends directly on the costs of accepting alternative payment methods.

While in the case of domestic transactions merchants and consumers mostly use cash, and increasingly also mobile wallets and credit transfer-based payment methods as the main substitutes for payment cards, the same cannot be said for cross-border transactions. In this context, the relevant alternatives to four party cards tend to be other types of credit cards (e.g. AmEx, China Union Pay, Diners), digital wallets with international acceptance (e.g. PayPal), BNPL, and bank transfers. The fees for these cross-border transactions tend to be higher than for domestic transactions. The application of the MIT test therefore results in higher interchange fees for cross-border transactions than for domestic transactions. The difference between domestic and cross-border interchange fees under an MIT framework was accepted by the European Commission for example.

Accepting foreign issued cards delivers exceptional value for merchants, with greater risk and complexity than domestic cards.

10. Mastercard, Visa: Why are two categories of rates for foreign-issued cards (inter-regional and intra-regional) necessary?

Intra-regional interchange rates typically apply to merchants' transactions on Mastercard issued cards in markets outside that merchant's country but within the region e.g., merchant in NZ with AU issued card would fall into AP intra-regional. Inter-regional interchange rates apply to different regions e.g., merchant in NZ with US issued card.

Intra-regional rate categories are structured in a way that is fit for that particular region taking into consideration cost and value factors within the region, whereas inter-regional rate category is the single cross border category that has to take into consideration the same factors across multiple regions.

The difference between inter-regional and intra-regional interchange rates for foreign-issued cards is due to varying levels of value, cost, risk and regulatory intervention.

Inter-regional transactions are more complicated (must take into account a higher degree of possible permutations/ corridors including some which - from an economic perspective - may be considered 'exotic' such as a cardholder from Bolivia making a purchase in New Zealand) to process, involves more possible currency conversions and cross-border network interactions. This increases costs and risks for issuers while enabling additional value for merchants compared to transactions within the same region.

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11. Mastercard, Visa, Issuers, Acquirers: Who is liable for the fraud costs associated with transactions made using a foreign-issued card?

Fraud liability framework is determined by Mastercard's Chargeback Rules. These rules apply equally to both domestic and foreign-issued cards.

In most cases, the card issuer is liable for fraud costs, especially when transactions are authenticated through methods such as contactless, PIN, 3D Secure, or Consumer Device Cardholder Verification Method (CDCVM). This applies to both domestic and international transactions. The issuer may pass this liability to the cardholder, depending on the specific terms of the card agreement and the context of the fraud.

For transactions not authenticated through these methods, the acquirer generally bears the fraud liability. The acquirer can, in turn, pass this liability to the merchant based on the terms of their acquiring agreement and the specifics of the fraud situation.

12. Mastercard, Visa, Issuers, Acquirers: We are seeking quantitative evidence of differences between levels of fraud for domestic and foreign-issued cards.

In New Zealand, overall cross-border fraud rate i.e., on foreign issued cards is more than triple of domestic in 2023.

Cross-Border Risks: Cross-border transactions are significantly more prone to fraud, particularly online purchases. The fraud rates for these transactions are more than double those of domestic ones. Cyber threats further elevate these risks, with the average cost of a data breach in Australia and New Zealand reaching $4.88 million in 2023. To address these challenges, Mastercard has invested USD 1 billion globally in cybersecurity, using AI and quantum computing to enhance fraud prevention across its network.

13. Mastercard, Visa, Acquirers: We welcome evidence and rationale for why merchants are treated differently for interchange fee application.

Mastercard sets interchange rates based on the value delivered by the issuing bank as well as the benefits of accepting electronic payments. Setting interchange at the right level is important because if interchange rates are set too high, merchants may choose not to accept cards; and, if interchange is set too low, issuing banks have no incentive to cover the risks of issuing payment cards.

Select merchant categories require lower interchange rates in order to enable and drive card acceptance; this includes charities, petroleum, government and utilities sectors.

14. Mastercard, Visa, Acquirers, Issuers: We welcome evidence of the impact of hard caps and percentage rates on compliance costs.

Implementation of hard caps and percentage rates is only one component of compliance cost given implementation changes are typically a one-off whereas compliance cost is ongoing.

This implementation cost would entail efforts required in relation to system changes, including technical requirements, and administrative efforts in terms of announcement and interchange manual update.

Compliance cost in adherence to the standard is a much broader and an ongoing regulatory burden.

The focus is less of the impact of this implementation cost; rather the implication of these changes to the broader ecosystem including merchants, consumers, and businesses alike in addition to acquirers and issuers.

15. Mastercard, Visa, Acquirers, Issuers: Please provide evidence of any other aspects of the implementation of any changes to interchange fee caps that impacts compliance or other business costs.

Similar as above.

16. Acquirers: How would you reduce merchant service fee rates for your customers on fixed or blended pricing?

Not responding

17. Acquirers: How would you provide your customers with an overview of the intended impact on them of further price regulation?

Not responding

18. Mastercard, Visa, Issuers, Acquirers: How fit for purpose is the current anti-avoidance provision? Please provide evidence of any challenges and whether there are other more efficient solutions.

It is challenging to interpret what counts as net compensation under the IPS. The Commission's IPS guidance provided is broad, and the law has no legal precedent.

We do not provide incentives to issuers for the purpose of compensating for reduction of interchange revenue. But that is subject to interpretation and therefore creates some risks.

There would be advantages in an approach that it is a mathematical exercise (once issuers receipts and issuers payments are clearly defined) and easier to operationalise and to report on an ongoing basis.

19. All stakeholders: Please provide any evidence of other impacts a material reduction in interchange fees for Mastercard and Visa could have on the New Zealand retail payment system.

We have addressed impacts in the body of our submission.