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BusinessNZ
GROWING PROSPERITY AND POTENTIAL

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

Dear Sir/Madam

<u>Re: Regulating to Reduce Merchant Service Fees</u>

<u>Background</u>

I am writing to you regarding the Ministry of Business, Innovation & Employment (MBIE) Issues Paper, *Regulating to Reduce Merchant Service Fees* (referred to as "the Issues Paper").

<u>2016/2017 MBIE study into retail payment systems</u>

BusinessNZ took the opportunity to submit on the 2016 MBIE Issues Paper entitled *Retail Payment Systems in New Zealand*. In it, we took the view that any future options paper outlining solutions to rectify significant market failure should follow the regulatory pyramid model and emphasised that there should be no rush to more heavy-handed regulation. We supported industry-led, rather than government-led, action as a first step.

To that end, we outlined a possible way forward, involving various steps, including greater transparency regarding unbundled Merchant Service Fees (MSFs), and schemes publicly clarifying intentions in relation to charging for swiped and inserted debit payments.

Looking at where things currently stand, particularly in the light of COVID-19, the question must now be asked how much further does New Zealand need to move up the pyramid to ensure a best outcome?

Initial Observations/Comments

Approach to Regulation

We believe Chapter 2 of the current Issues Paper does a good job in identifying the problem, objectives, range of feasible options and how these will be analysed. At the very least, we would encourage other government issues/discussion papers to provide a similar clear initial approach to regulatory proposals. We were especially pleased to see one of the points taken from the 2016/17 Issues Paper all but adopting a regulatory pyramid approach to identifying feasible government and non-government options for addressing retail payment systems.

Paragraphs 21-25 outline the pathway beyond the Issues Paper, including a proposal to carry out a further round of consultation. It is expected that a further consultation round would deal with one or more of the options in greater detail. As stated, this would also include the "*advantages/benefits and disadvantages/costs of the options relative to the counterfactual*".

On the face of it, we fully support the process outlined. However, we also believe any further round of consultation before a Bill is introduced needs to allow adequate time for submitters to provide their views and comments. While we understand how the effects of COVID-19 have hastened the need for certain regulatory changes, we believe there is still adequate time available to ensure any further steps are well thought through from a policy standpoint.

Overall, BusinessNZ supports the policy approach and procedure outlined in the Issues Paper. However, as we will discuss below, there is a disconnect between the policy approach outlined and the policy outcome proposed.

Changes since the 2016/17 Issues Paper

Following on from the 2016/2017 Issues Paper, the current Paper outlines how fees have changed since then. While overall, merchant service fees still have limited visibility, it is noted that weighted average credit and debit interchange fees have decreased over the period by around 11 percent. Also, a number of banks have announced that merchants will be charged no more than 0.7 percent to process contactless debit card transactions (compared with close to 3 percent for smaller merchants).

Furthermore, research by Retail NZ shows how banks working to unbundle the fees offered to merchants and more favourable contactless debit fees compared with Australia and the U.K., represent positive steps towards the lowering of fees overall.

More recently, an Associated Press release from the Ministers of Commerce and Consumer Affairs have pointed to the move made by banks early in the pandemic to temporarily waive fees for small businesses on contactless debit card transactions and the raising of the contactless purchase limit from $80 to $200 per transaction.

We wholeheartedly agree with the view of the Minister of Small Business that the banks showed empathy and understanding for New Zealand businesses and consumers during a difficult time for the country. Looking more broadly, so too did the non-banking finance and lending sector, who also assisted customers experiencing financial stress as a result of lockdown and beyond.

However, one should remember that when the Minister states that *"there is nothing to stop banks starting to charge their fee structure right now on card payments"*, what the banks did was due to a government enforced lockdown of the entire country, preventing a large proportion of small businesses from operating.

We accept the fact that there have been Government concerns about the level of fees charged for card payments for some time, exemplified by the previous Issues Paper in 2016. However, from our perspective, it seems highly unusual that a decision by an industry to provide temporary relief for other businesses during a government enforced lockdown should eventually be met some months later by a government call for harsher regulation on those very businesses helping others. At the very least, we would have expected a discussion between the Government and the banks around next steps to see how some of the temporary measures might continue in some future capacity, rather than a swift decision to introduce heavy-handed regulation. This point is discussed further below.

Options to Address the Issues

Chapter 6 outlines both the key proposal, as well as supplementary options which we wish to comment on.

The key proposal

Regarding the initial proposal, paragraph 106 states that *"The Government has therefore directed MBIE to develop regulatory measures to reduce merchant service fees for debit and credit cards, such as through direct regulation of interchange fees"*. However, the key proposal outlined on page 32 represents a particularly strident approach, namely *"Interchange fees for open party credit and debit schemes (MasterCard and Visa) will be regulated with hard caps. The hard caps for each transaction type will be set applying principles linked to the objectives outlined in chapter 5 and may be targeted for different classes of merchants".*

From BusinessNZ's perspective, the above constitutes a significant shift up the regulatory pyramid. While the Issues Paper also points out that a full assessment will be carried out in the next stage of the project, this primary proposal does seem to bypass the potential for a more cooperative set of options between the Government and the private sector. At the very worst, this could be seen as regulatory overreach for a number of reasons, but not least of which because the international schemes who operate in New Zealand have typically demonstrated a willingness to engage with end users to find solutions to challenges that meet the needs of the majority of participants.

Supplementary options

Regarding the supplementary options outlined, the Issues Paper points out the importance of taking a 'systems' approach to retail payments system regulation. These include other price regulations, information disclosure and collective bargaining, as well as a suite of additional options.

Collectively, a sizeable number of the Government's regulatory options cut across the regulatory spectrum. Given the Issues Paper states that a future regulatory approach must include some of the options, the consultation process could potentially result in an overwhelming number of supplementary regulations, effectively fuelling regulatory overreach.

In addition to our concerns about the end outcome (although we recognise that government has expressed a preference to regulate interchange more directly), we are disappointed the Government has chosen what could only be described as the most heavy-handed option as its first choice for change, rather than one or other of the supplementary options. For instance, providing options in relation to information disclosure and collective bargaining would logically be the place to start in terms of next steps up the regulatory pyramid. Other options, such as setting requirements relating to product development and technology, would involve more cost, but not to the extent of a hard cap imposed on each transaction type. While paragraph 17 of the Issues Paper sets out steps for feasible options to meet the Paper's objectives, an emphasis on the key proposal and particular supplementary options does nothing of the sort.

Instead, BusinessNZ believes that a more measured and consistent process for regulatory change is required. While we consider there is scope for movement in merchant service fees, we consider moving to heavy-handed regulation is unjustified, especially as the Issues Paper notes the positive steps already taken together with the goodwill shown during lockdown.

We believe the range of supplementary measures outlined in the Issues Paper provides a basis for any future regulatory change to merchant service fees and should be considered alongside, rather than supplementary to, interchange regulation. This would provide an opportunity for the industry players affected to explain the changes they could make to balance off the need for lower fees without a propensity for regulatory overreach. As we will discuss below, regulatory overreach would do much to prevent the technological innovation that would make heavy-handed regulatory options largely redundant.

Recommendation: That MBIE considers the range of options outlined in the Issues Paper equally alongside direct interchange regulation as a next step.

<u>Other Issues</u>

Notwithstanding our primary recommendation above, BusinessNZ also wishes to address a number of other matters in the Issues Paper that we believe have the greatest relevance for the business community.

<u>Parallel Studies & Technological Disruption</u>

It is often the case that technological innovation means heavy-handed industry regulation can quickly find itself behind the times and at present, much ongoing policy work in both the public and private sectors is complementary to merchant service fees. Two areas looking to further promote open banking are referred to in the Issues Paper.

<u>Consumer Data Right (CDR)</u>

As outlined in paragraph 63, the then-Minister of Commerce and Consumer Affairs sought options for establishing a Consumer Data Right (CDR) given current dissatisfaction about the speed with which open banking is progressing.

BusinessNZ submitted on the CDR Discussion Document released by MBIE in October 2020[1] recommending that the development of any CDR provide opportunity to both harness innovation and improve New Zealand's standing as a place to do business. A CDR should also be something the private sector can make greater use of through its own initiatives.

<u>Application Programme Interfaces (APIs)</u>

In addition to the initial exploratory work around a CDR, the Issues Paper also discusses the work by Payments NZ to facilitate the development of a shared "*Application programme interfaces (API) framework to support new and improved methods of payment and easier that would enable bypassing of scheme infrastructure are being explored through work by Payments NZ and others"*.

Paragraph 98 of the Issues Paper again looks towards the potential future benefits of the work carried out by Payments NZ, and states that "*These solutions would be more akin to seamless bank transfers, and may not require cards at all, providing greater convenience and security when consumers are shopping in stores or online. These alternatives would likely provide competitive tension on merchant service fees*".

Furthermore, paragraph 108 of the Issues Paper points out that *"any introduction of a consumer data right or other steps to speed up open banking would be complementary to this project"*.

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1 https://www.businessnz.org.nz/__data/assets/pdf_file/0009/203976/201019-Consumer-Data-Rights.pdf

While we are always cognisant of the potential regulatory implications of policies such as a CDR and APIs, we also believe there is a rapidly growing opportunity in the digital data space for the private sector to harness new frameworks that improve both business-to-business and business-to-consumer transactions and information sharing. This means we should be very careful not to jump the gun when considering heavy-handed regulation since technological options can rapidly make such an approach obsolete. As we mentioned in our submission in 2016/17, at best, regulatory intervention can delay the speed at which innovation can improve a sector's outcomes, while at worst, it can simply block technological innovation because of regulatory hurdles too high to overcome and/or an inappropriate fit.

Last, when considering both APIs and a CDR, it is important that the payment ecosystem operates as much as one, and not be played off against each other. A level of consistency should be applied, instead of trading off one set of payment rails for another. This should provide ease of access and limit burdens as business is enabled to make the best decision for its situation.

Therefore, overall, we believe open banking has the potential to provide sufficient competitive discipline on scheme debt and credit fees over the long-term compared with a regulatory clamp down on existing mechanisms.

Recommendation: That innovative avenues involving technological change are considered the best long-term solution in respect to merchant service fees.

Rewards programmes and passing on of costs

We note that paragraphs 82-85 of the Issues Paper discuss how the higher prices for all goods and services faced by consumers are offset for the holders of credit cards by offering credit and rewards. Holders of such credit cards may, in some cases, receive rewards greatly exceeding any overall increase in price. This, in turn, can mean a strongly regressive wealth transfer from users of low-cost payment options.

First, we would like to note the irony of the point made in paragraph 82. Specifically, the point there is that merchants face constraints in both steering consumers to low-cost payment methods and surcharging for high-cost payment methods. Ultimately, this requires constraints on merchants to be treated as a cost and included in the price of goods and services with, in turn, all consumers paying those costs, regardless of payment method.

Putting aside the fact that the total cost of any good or service involves a multitude of factors, on the one hand the Government is concerned about small margins being passed on to all consumers but not all experiencing the benefit. However, on the other hand, there appears to be little concern about the direct and indirect effects of significantly increasing the minimum wage from $18.90 to $20 on 1 April this year. Apart from the relativity effect on all wages due to the increase, the only way businesses can deal with their labour bill's larger total cost is either by reducing staff numbers or increasing the price of goods and services supplied to consumers. This tends to suggest the current government does not give equal consideration to all policies that lead to an increase in consumer prices.

We also note that the existence of rewards as a reason to regulate merchant fees was also included in the 2016/17 Issues Paper. Back then, we submitted that many of MBIE's assumptions created an unequal weighting of costs vs benefits and meant that the possibility that rewards schemes resulted in higher overall prices and cross-subsidies could not be confirmed. Therefore, we concluded that further information was needed on the significance or otherwise of the assertion that rewards schemes result in higher overall prices and cross-subsidies in New Zealand.

However, despite a gap in consultation of approximately five years, no such additional research has been presented to support MBIE's assumptions. Instead, what is discussed in the Issues Paper is a view without any detailed data to support what is claimed. Therefore, BusinessNZ believes there is no credible reason for rewards schemes to be used as a justifiable reason to introduce stringent merchant service fee regulations.

Recommendation: That rewards programmes are not considered as a reason to introduce regulations with a hard cap.

Small business merchants

BusinessNZ agrees that small business merchants are more likely to bear higher merchant service fees than larger businesses, due to a lack of bargaining power with their acquirers, given the small volumes and values of the transactions they deal with. However, an uneven balance in knowledge and information is nothing new when comparing the size of businesses. Smaller sized businesses are not, and never will be, on a level playing field with larger businesses, mainly due to the additional resources of capital and labour the latter possess. However, if we look further afield, it can be argued that large New Zealand businesses face that same kind of issues when competing with much larger offshore enterprises.

As we stated in our 2016/17 submission, BusinessNZ's membership is very broad, from micro-sized SME enterprises through to large corporates. Therefore, balancing the needs and issues of the entire business community can be complex, especially given the general cut and thrust of business competition. BusinessNZ's stance looks to provide the best outcome for the business community and therefore the New Zealand economy overall. Often, this means examining issues more broadly to determine the kind of regulatory environment which will best see New Zealand improve its growth rate.

Last, BusinessNZ also believes it is important that the Government considers safety and security of the retail payments system, including for SMEs. CERT NZ have reported that cyber security incidents were up 33% in Q3 2020 compared to Q2, with $6.3 million in direct financial loss. Given the accelerated move we have seen by many New Zealand businesses to online transactions because of COVID-19, it is important that the retail payments system is able to continue to invest in the resilience of that system. We believe interchange plays a key role in doing this – and although there is a cost, there is also a significant value to businesses of this protection.

Future regulatory governance?

Paragraphs 99-100 of the Issues Paper discuss whether there is a gap in the regulatory governance of the retail payments system relating to the promotion of competition and outcomes of long-term benefit of end-users. BusinessNZ would not support moves towards clear regulatory governance but would, instead, want to see the current, relatively light-handed approach continue, with Payments NZ having the lead role.

The Issues Paper points out that *"Payment's NZ's ownership by the banks that derive profits from the debit and credit card schemes mean that it is poorly placed to oversee issues related to pricing and business models"*. However, we take a different view, for two primary reasons. First, in relation to our discussion of future technological change, above, we believe the establishment of Payments NZ and its responsibilities is the correct mechanism for developing payment systems' long-term pathway. Shifting management and responsibility to a regulatory body such as the Commerce Commission would likely produce a more rigid regulatory system that would do little to promote industry-led solutions.

Second, we would question any fundamental change in the regulatory structure when opportunities around technology are becoming increasingly apparent. As discussed above, there are many examples of how technological progress can quickly make regulatory measures largely redundant. We would be especially concerned if a change in regulatory overseeing led only to stifled opportunities.

Recommendation: That no statutory mandate should be introduced allowing for intervention in and the regulation of retail payments.

Thank you for the opportunity to raise these matters and we look forward to further discussions[2].

Kind regards,

Kirk Hope
Chief Executive
BusinessNZ

[2] Retail NZ and Hospitality NZ do not in any way support the position being taken by BusinessNZ. Both will make their own submission in support of regulation.