

19 February 2021

Competition & Consumer Policy Team
Building, Resources and Markets
Ministry of Business, Innovation & Employment
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To the Competition & Consumer Policy Team,

MBIE Issues Paper: Regulating to reduce Merchant Service Fees: Retail NZ Submission

1. Retail NZ is a membership organisation that represents the views and interests of New Zealand's retail sector. Our membership accounts for two-thirds of total domestic retail spending. We have consulted our members in preparing this submission.
2. Retail NZ has been advocating for merchant service fees to come down in New Zealand for many years. The high level of fees in New Zealand is of great concern to us, particularly compared to similar jurisdictions that have regulated to limit fees or increase transparency.
3. This is a serious issue that affects all New Zealanders through the flow on increase to the price of goods and services. It is fundamentally unfair that the high cost of payments is borne by all New Zealanders through higher prices when just cardholders with valuable rewards programmes see any benefit.
4. The flow of wealth from New Zealand consumers and businesses has serious economic impacts beyond higher retail prices. It reduces businesses' ability to invest and grow, to bring on staff, raise wages, and drive innovation and productivity growth.
5. We welcomed the Government announcement last year that it intends to regulate interchange fees and we support MBIE's proposed approach as outlined in the Issues Paper. Additionally, however, we recommend that the Government regulates acquiring fees. Caps on a combination of these will effectively bring fees down.
6. We also recommend that caps be placed on the fees charged by Buy Now Pay Later services, which typically utilise card scheme networks.
7. We look forward to the next stage of the project when we understand a full assessment of the options for regulation will be carried out. However, now that the decision to regulate has been made we urge haste and welcome any opportunities to work with Government or its agencies to advance this project.
8. Our responses to the specific questions within the Issues Paper are attached.

Yours sincerely,



Fiona Mulder
Analyst, Insights and Research
Retail N

Submission template

Regulating to reduce Merchant Service Fees

Your name and organisation

Name	Fiona Mulder
Email	[REDACTED]
Organisation/Iwi	Retail NZ

[Double click on check boxes, then select 'checked' if you wish to select any of the following.]

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I would like my submission (or identified parts of my submission) to be kept confidential, and **have stated below** my reasons and grounds under the Official Information Act that I believe apply, for consideration by MBIE.

n/a

1 Do you have any feedback on our proposed approach to this project?

No.

Retail NZ welcomed the Government's commitment to regulating merchant service fees last year and supports MBIE's proposed approach to analysing options for how this should be done in this paper.

2 Have we described the retail payments system accurately? Is there any additional information that you would like to provide?

Yes.

The paper has correctly identified the key elements of New Zealand's payments system. Importantly, it has identified the 'network effect' which means that normal competition within the market will not bring the costs of accepting payments down, and conversely has led to them increasing.

Over a period of years consumers in New Zealand have been incentivised to move away from (mostly) free EFTPOS cards to credit and debit cards that have additional functions, or benefits, but that have much higher costs. The costs of these cards are invisible to the consumer and it is retailers that are forced to carry these costs. Retailers have almost no control over the cards that they accept because they are so widely used by consumers.

This is a changing area, and new services are constantly developing. An example of this is the rapid uptake of 'buy now pay later' services. These have zero cost to the consumer, but very high costs to retailers. Many of the new services use the 'scheme rails' and incur the costs of merchant service fees on top of the additional service fees.

We note that while there is much innovation happening in this area, there is no framework that would enable discussions and the agreement on a solution for an EFTPOS alternative.

The paper also accurately notes the complexity of merchant service fees and the difficulty merchants have in understanding and controlling the fee level that they are charged. There are large discrepancies between what different retailers pay and very little transparency.

Point 60a notes that the banks agreed to provide a greater level of transparency of fees to merchants after the 2016/17 MBIE issues paper. Retail NZ has not seen improvement in this area and merchant statements remain very difficult to understand for the average merchant.

Overall, we note that the card schemes report average interchange fees to MBIE, but there is no public disclosure. This information is not available to merchants at large, or the general public. Additionally, the information provided to MBIE relates to weighted average *interchange* - it does not include acquiring fees. This means that it does not show the average fees paid by merchants - and is not useful for benchmarking purposes.

In regard to the section on 'steering' (point 55a) we note the impact of COVID-19 on contactless payment uptake. Due to hygiene concerns contactless payments were preferred as they did not require customers to touch any surfaces. Banks supported retailers to turn contactless payments 'on' during the periods of highest risk by waiving the merchant service fee for small retailers. When the risk level reduced, and charging resumed, many retailers have felt pressured to leave contactless on, to provide assurance to customers, and because customer behaviour has changed and contactless is now assumed to be available in many settings.

We are aware that a significant number of small retailers who turned on contactless during Alert Levels 3 and 4 (because it was free or very low cost) have had to turn it off due to pricing reverting to a level these retailers do not feel adds value or is sustainable.

It is positive that the costs of contactless debit payments have come down (point 67), and this is largely because of the MBIE 2016/17 issues paper and efforts to raise awareness of these issues by retailers. However, the voluntary maximum agreed by some banks of 0.7 percent is still significantly higher than EFTPOS, and the cost of contactless debit in other jurisdictions.

On this point, we add that many retailers are not seeing the benefit of a voluntary 0.7 per cent limit on contactless debit because they are on blended rates. Some retailers remain on blended rates because they give them a level of certainty about the costs that they are being charged from month to month, and they do not understand the complexities of the system which might mean that cost come down if they unbundled the merchant service fee and turn contactless on. It can be very difficult to analyse how fees might change in this scenario without detailed information from the bank. It can depend on the type of retailer, the average transaction value, and the ways in which customers want to make payments at that store.

COVID-19 has also resulted in a large increase in online or phone transactions, where payments are made without a card present. These services have an even higher merchant service fee due to the additional security measures that are provided to protect these transactions. The cost of compliance and fraud is continuing to increase (especially online).

Point 55b notes that surcharging is a way that merchants can recover the costs of accepting payment types at the point of sale. We note that this is relatively unusual in store and is not popular with customers. It is generally avoided by retailers, in order not to put themselves at a competitive disadvantage.

3

Please provide information on your understanding of the levels of merchant service fees in New Zealand, any trends in relation to those fees, and how they compare to merchant service fees in overseas jurisdictions.

In past years, Retail NZ has undertaken research into average weighted merchant service fees. This has shown that fees are 2-3 times more expensive for credit and contactless debit than fees in markets like Australia and the UK. Our research has been conducted using the same methodology as that applied by the British Retail Consortium, making research comparable. Since our last research, there has been some downwards movement in interchange rates, and some of this has flowed through to merchants.

Retail NZ did not complete a Payments Survey in 2020 due to the timing coinciding with COVID-19 lockdown in February and March. At that time retailers did not have capacity to undertake the survey while dealing with the impacts of escalating alert levels.

However, we agree with the assessment in the paper that fees have come down because of the scrutiny being applied to the issue since that 2016/17 MBIE discussion paper. However, it is difficult to assess the average level at this point in time due to the complexity of the system. Anecdotally, we believe that retailers that were being charged very high fees have seen good reductions however the base level has not come down significantly.

In December 2020 and January 2021, we gathered information from small retail businesses only, to gauge current merchant service levels. We found that maximum rates for credit remain over 2 per cent for many retailers, and over 3 per cent for ecommerce transactions. Many retailers remain on blended rates over 1.6 per cent for all transactions (including contactless debit) which some banks have otherwise voluntarily limited to 0.7 per cent. We continue to pay very high merchant service fees in New Zealand despite voluntary measures over the past 3-4 years.

In our view, the retail payment system will not perform efficiently without government intervention to limit fees, as has been seen in other jurisdictions.

4 What is your view on charges incurred by cardholders for the use of payment methods?

Cardholders incur very low costs for the card that they use. Debit cards are largely free or may incur a nominal fee for the initial issue or replacement of the card. The fees for credit cards are higher but not prohibitively so and unlikely to deter a customer from accessing the benefits that these cards offer, particularly given that many cardholders receive free, or discounted annual costs if bundled with mortgages etc. While there are benefits for the cardholder, in terms of interest-free periods on credit cards and rewards programmes, these benefits are, in effect, funded by the merchant, not the customer.

5 What impacts do you believe rewards and inducements have on the retail payments system?

While it might seem like cardholders choose which payment method to use, this choice is made by the level of reward or inducement that is offered to them, which is set by the bank, and heavily influenced by the relationship they have with a scheme.

Customers do not typically incur costs based on card use, in fact they are rewarded for using cards more frequently. Cards which have greater rewards, or greater functionality and convenience, attract higher merchant fees. This means that customers are encouraged to use more expensive card types, while not seeing any of these costs, which are all absorbed by the retailer or passed on through higher prices. This is a fundamental issue of fairness within the retail payments system.

6 What is your view on charges incurred by merchants for the use (acceptance) of payment methods?

The charges incurred by merchants in New Zealand for the use of credit and debit cards are too high. We agree with all the points made in this section of the paper – notably that accepting credit cards is essential to a retail business and that it is generally not possible to avoid these costs through steering or surcharging.

7

Please provide your views on barriers to merchants steering consumers to lower cost payment methods and the extent that steering occurs?

It is very difficult to distinguish card types at the point of sale. In a busy retail environment, it is simply unrealistic to expect employees to understand the different card types issued by different banks and schemes and which ones a business does and does not accept.

While customers might understand businesses not accepting the more niche programmes that offer high rewards such as American Express or Diners Club, the large schemes have such large uptake that a retailer could not realistically refuse to accept these cards.

As previously mentioned, cardholders are increasingly resistant to retailers that do not accept contactless payments. Uptake has reached such a level that steering away from contactless is becoming difficult in certain settings (particularly high volume, low value retailers).

8

Please provide your views on the barriers to merchants surcharging and the extent that surcharging occurs?

Customers are resistant to surcharging as they do not understand the costs of accepting payments to retailers. The surcharge is seen as unnecessary or too high and creates a negative impression. It is also difficult to accurately gauge the correct level of surcharge that a retailer can apply if it is on an unbundled rate. Variable surcharge levels would be very confusing for retailers, retail employees, and cardholders. Retailers largely avoid surcharging for these reasons.

The paper also correctly notes that there are technical restrictions on retailer's ability to surcharge because of the limitations of point-of-sale technology (point 80b&c).

9

What is your view of the wealth transfer by merchants passing on merchant service fees in the price of goods and services to all their consumers?

It is fundamentally unfair that the high cost of payments is borne by all New Zealanders through higher prices, when just the cardholders with valuable rewards programmes see any benefit. Those that cannot afford premium cards, receive no benefit, but pay for these schemes through higher prices. As the paper notes – "this wealth transfer is strongly regressive".

10

What barriers do small businesses face to obtaining competitive merchant service fees?

Most small retailers simply do not have the ability or the resources to obtain competitive merchant service fees. In our experience, even small retailers that are asking questions of their banks about how they can negotiate to bring costs down do not get good help. That is because the system is so complex and not well understood even by front line bank employees that are giving advice.

Retail NZ provides advice to small retailers about how to bring costs down, and by providing a discounted rate negotiated with a banking partner. Without this expertise and advocacy, it is very difficult for a small retailer to negotiate with a bank on merchant service fees. The high cost of payments for small retailers creates a competitive disadvantage and certainly impedes its ability to grow (point 89).

11 What information or assistance would assist small business to obtain better deals?

Because the merchant fee structure that is right for a business is likely to be specific to that business based on the mix of card types that customers historically have used, it is not likely that generic assistance or information beyond 'talk to your bank' would be very useful. However, it would be useful if banks were required to provide a detailed summary of transactions by specific card type to merchants. This would then enable merchants to better understand their options.

While additional information about payments fees is useful to help retailers understand the costs of doing business more generally, regulating the maximum interchange and acquiring fee levels is the only way that cost will come down significantly for the majority of small businesses.

12 What cost differences are there for providing merchant services to small businesses compared with larger businesses?

It is difficult to understand how the costs could be higher for a small business when card payments all use the same infrastructure.

13 How much competitive discipline does EFTPOS provide on scheme debit card merchant service fees and are there any barriers to domestic EFTPOS providing more competitive discipline on merchant service fees?

EFTPOS was effective at moving New Zealanders away from cash and toward card payments during the 1980s and 1990s. As an essentially free service for merchants and cardholders it became popular and widely used and as a result New Zealanders use of cards was among the highest in the world.

However, the advent of inserted and contactless scheme debit cards with additional functions have meant that banks have had little incentive to invest in EFTPOS and it has steadily declined. There is little incentive for banks to support EFTPOS today, and conversely, they are encouraged to move away from it because of the valuable relationships they have with the card schemes. It is very possible that cost will come on scheme debit cards as EFTPOS market share continues to weaken (point 93).

14 What impact is product innovation having on merchant service fees?

Retailers support product innovation in the payments area. Making it easier for customers to make payments is an essential part of a retail business. However, the innovation we have seen to date largely uses the scheme 'rails' and therefore attracts significant merchant service fees.

The payments system is dominated by few large players making it extremely difficult for new entrants to the market to gain the level of market share required to be successful. It is highly unlikely that a service which was able to offer lower payments fees to merchants could be successful in New Zealand in the current regulatory environment.

It is worth noting that customers dictate how they pay. Having an innovative (and cheaper) payments solution in the market may be theoretically beneficial - but there is no reason to think customers would adopt such a system, given that they do not bear the costs of payments, yet are often incentivised by rewards programmes to use credit cards.

15

Is open banking likely to provide sufficient competitive discipline on scheme debt and credit fees?

Open banking might create opportunities for new market entrants; however, this is likely to be some years away. The challenge is gaining the scale required to replace the mainstream payments methods, particularly instore. Technology that allows bank to bank transfers has to date been aimed at online payments.

16

Do you agree that there is a gap in regulatory governance of the retail payments system relating to promoting competition and outcomes that are in the long term benefits of end-users?

Yes.

Payments NZ has retained a strict focus on maintaining the technical elements of the payments system, and its co-ownership by the banks means it is not well placed to scrutinise fee levels.

RBNZ has to date taken a hands-off approach to the payments system. The Commerce Commission is only able to investigate breaches on the Commerce Act, and MBIE has a policy focus.

Therefore, there has been no agency with a clear mandate to oversee over the efficiency of the payments system in New Zealand; and as a result, payments fees are higher than many other similar jurisdictions.

17

Please feel free to provide information on any other issues of concern with the performance of the retail payments system.

We do not have any other issues to add.

18

Do you agree with the objectives for the retail payments system in New Zealand?

Yes, this is a clear set of objectives that we fully support.

19

Please provide feedback on the aspects of the proposal for interchange regulation, including any changes that would improve the impact of it, with supporting evidence of any benefits or costs.

We support the initial proposal for the regulation of interchange fees for open party credit and debit schemes with hard caps. We also support the setting of hard caps at different levels for different classes of merchants. As has been seen in Australia, a hard cap is the only way to ensure that small merchants are receiving the benefits of regulation with lower fees.

We also think it is important either that acquiring fees are capped along with interchange, or that a cap is placed on the *total* merchant fee payable. Interchange is a significant component of total merchant fees but is only part of the cost. We know that there is a very significant variation in the acquiring fees paid by different merchants, for no apparent reason. Regulating the total merchant fee, or the acquiring charge along with interchange, would resolve this issue.

Finally, a growing issue is in relation to the costs of Buy Now Pay Later schemes. We additionally recommend that caps be placed on the fees charged by these services. They generally use card scheme networks, but have a significantly higher cost for the merchant.

We note that this proposal is at an early stage and that a full assessment will be carried out at the next stage of the project. When we have further details, we will be able to provide a more detailed assessment of the likely benefits or costs of the proposal.

20

Please provide feedback on which body or bodies would be best placed to act as the regulator for interchange fee regulation.

We would support either a new independent government body, or a separate unit within the Reserve Bank (or alternatively MBIE or the Commerce Commission) be the regulator of interchange fees. It is essential that the new body can act independently and be open to review. The new body should include mandatory representation from a range of stakeholder groups, including large and small retailers at the governance level.

21

Please provide your views on the impacts of the above classes of options, with supporting evidence of the benefits and costs.

Alongside hard caps on interchange fees, we strongly encourage government to legislate to require banks to publish the acquiring fee that they charge merchants (if acquiring fees are not also capped).

Without this only one portion of the merchant fee is regulated, and a significant level of confusion will remain about how the actual fees that retailers are charged are comprised and set.

Collective bargaining could have advantages for small retailers but is not an effective substitute for regulation. We support expanding collective bargaining alongside the proposed introduction of hard caps on interchange and acquiring fees, and compulsory disclosure of bank fees.

22

Please provide your views on any other feasible options that should be considered, with supporting evidence of the benefits and costs of these options.

We support the additional options proposed however the key first step should be the introduction of hard interchange and acquiring fee caps and compulsory disclosure of fees. Likely these will bring costs down and may result in some of the secondary issues being resolved (such as limiting rewards schemes, or the need for additional surcharging and steering rules).

Other Comments

See cover letter attached
