

Regulating to reduce Merchant Service Fees

Your name and organisation

Name	Windcave Limited
Email	Privacy of natural persons
Organisation/Iwi	

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

The Privacy Act 1993 applies to submissions. Please check the box if you do not wish your name or other personal information to be included in any information about submissions that MBIE may publish.

MBIE intends to upload submissions received to MBIE's website at www.mbie.govt.nz. If you do not want your submission to be placed on our website, please check the box and type an explanation below.

Please check if your submission contains confidential information:

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.

This submission contains commercially sensitive information. Public release of such information would prejudice the commercial position of Windcave. Windcave therefore requests that MBIE consult Windcave before this submission is uploaded to the MBIE website so any necessary redactions can be made.

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

Windcave is supportive of the objectives set out in the Issues Paper. Windcave agrees that the focus should be on the underlying causes of the harm rather than its symptoms. Windcave is pleased the Issues Paper recognises the complexities involved in the New Zealand payments system and appreciates the opportunity to provide its distinct insight as a pure acquirer in the New Zealand payments system.

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

The New Zealand payment's ecosystem is comprised of different partners along the value chain including the issuer, acquirer, aggregator, processor, payment gateway, and terminal vendor. Each partner along the chain brings unique value to the system. It is important to understand the entire value chain of the New Zealand payment's ecosystem and what impact regulation would impose on each stakeholder.

The initial proposal raised by the Issues Paper is to regulate interchange fees with hard caps. A cap on interchange fees would focus on the underlying causes of the harm identified in the Issues Paper. Competitive pressures in New Zealand (as elsewhere) have not been sufficiently strong to bring interchange fees into line with costs. The end-users of these services—cardholders and merchants—have no direct influence over interchange fees but must rely on their financial institutions to represent their interests. Large financial institutions have the dominant influence on interchange fee setting; however, since they benefit from the revenue generated, they have little incentive to press for lower interchange fees.

However, the Issues Paper then states (para 112) that overseas approaches indicate the importance of a 'systems approach' and that supplementary options in addition to hard caps on interchange fees could include regulating the whole Merchant Service Fee. The Merchant Service Fee is a symptom, not a cause, of the harm and the overseas approaches cited in the Issues Paper do not support regulating the whole Merchant Service Fee. The Australian ACCC and Reserve Bank study cited by the Issues Paper, for example, expressed concern about the restrictions on entry to the card networks and 'no surcharge' rules and did not recommend regulating the whole Merchant Service Fee.

It is critical that MBIE understand the potential impact of regulating the Merchant Service Fee. 70% of the overall Merchant Service Fee to the merchant is passed through by pure acquirers who act as a vehicle to pass the final rate to the merchant. The fee passed through is comprised of the interchange fee and scheme processing fees. If the resultant Merchant Service Fee is regulated and capped, pure acquirers will continue passing through the same fees and will be obligated to lower the acquiring fee. Banks with both issuing and acceptance branches will dominate the acceptance space. This outcome is anti-competitive and undesirable for the payment's ecosystem, which will suffer from the loss of innovation and investment brought to the acceptance side by pure acquirers.

Regulation of the whole Merchant Service Fee would therefore have the unintended consequence of compounding the harm it was intending to address—the dominant influence of the large financial institutions on setting interchange fees.

Furthermore, it is important that MBIE understand the presence of on-us transactions and their effect on the payment's ecosystem. On-us transactions exist where the acquirer and issuer are the same entity. In an on-us transaction, the interchange fee is not a cost to the acquirer, thereby not a cost passed through to the merchant, as the interchange fee remains with the same entity. Furthermore, on-us transactions incur lower scheme processing fees, which means overall an on-us transaction will cost less for the acquirer in this relationship.

Banking acquirers dominate the on-us transactions space, as they have both issuing and acquiring businesses. Issuing banks already stand to benefit from the symbiotic relationship of the acquiring and issuing segments of the payment's industry. However, a pure acquirer will always price merchants at the comparably higher off-us transaction rate since it cannot benefit from the on-us transaction rate. Windcave concludes that regulating the Merchant Service Fee itself will unfairly disadvantage pure acquirers and eliminate competition in an already concentrated marketplace.

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.

A) DOMESTIC EFTPOS

Domestic EFTPOS has created an uneven payment landscape. Although there is no cost passed on to merchant for the acceptance of EFTPOS debit, it lacks the necessary innovation and security to persist in a market with securer methods of payment. EFTPOS debit runs on outdated magstripe technology, which is vulnerable to skimming attacks and less secure than newer, ubiquitous chip card technology. Further, there is no "Purchase Protection" for the consumer presenting a massive security gap between EFTPOS debit and scheme debit. Consumer protection, well above any legal requirements, is underwritten by the acquirer. It must be covered by the acquirer and there is no fee from the merchant to fund this program for domestic EFTPOS.

Because EFTPOS debit does not support contactless payments, its contactless transactions at the point of sale are processed through scheme rails. These transactions incur a Merchant Service Fee. Due to this factor, many small merchants refuse to accept contactless cards, forgoing the benefits and convenience of a superior transaction method.

Windcave has observed a strategic downward trend of interchange fees, which has resulted in the increased uptake of contactless acceptance at retail establishments. The average weighted interchange fee in New Zealand has decreased with the introduction of strategic interchange rates for contactless transactions.

[REDACTED]

B) INTERCHANGE FEE MAXIMUM

The principal portion of the Merchant Service Fee, or cost of acceptance, is the interchange fee. The maximum interchange fee is set by each card scheme and the issuer may charge up to that amount. The issuer has the option to charge less than the maximum interchange rate, however, this option is rarely exercised by the issuer. The options offered by the card schemes for an issuer to charge less than the maximum interchange are to set up a bilateral agreement directly with an acquirer or to set a rate for the market in which it operates (e.g. New Zealand domestic acquirers). The only exception of which Windcave is aware is a zero-interchange offered by an issuing bank on charity debit cards.

Windcave must note that the interchange fee provides revenue only for the issuer, and this fee is passed through the acquirer to the merchant. The issuer has the option to charge less than the maximum interchange rate, however, this option is not exercised. Windcave's fee as a pure acquirer is generated as a percentage, charged for its services on top of the interchange fee plus the card scheme fees. By regulating the interchange fee, the overall cost of acceptance will decrease as the largest cost of the charges passed through by the acquirer will drop.

The issuing marketplace in New Zealand is distinctly non-competitive. The maximum fees allowable are set by the card schemes and matched by an oligopoly of issuers without external inputs. By way of evidence that the fee setting regime, run by the issuers themselves, is not functioning as a competitive market Windcave offers the following fact: Visa and Mastercard both confirm that every issuer charges the same, maximum fee to be passed on to the merchant*. With the interchange fee representing over 70% of the cost of acceptance to the end merchant, regulating the Merchant Service Fee while leaving the bank issuers free to set interchange amongst themselves, where each issuer charges the maximum fee, seems unlikely to improve the structural cost problems for the merchant.

* The only exception of note is a zero-interchange offered by ANZ on charity debit cards.

C) THE GLOBAL PAYMENTS LANDSCAPE

Windcave operates in the United Kingdom and Australia, two markets which New Zealand regulators are presently eyeing for evidence of how to lower the Merchant Service Fee for end users.

[REDACTED]

In the United Kingdom, the consumer debit card interchange rate is capped at 0.20% and consumer credit interchange is capped at 0.30%. Whereas in Australia, the average weighted interchange is capped at 0.50%, the maximum interchange rate on credit cards is 0.88% and debit cards is 0.22%. This cap has demonstrably dropped the overall cost of acceptance for merchants in these markets. By capping the interchange rate, the final cost of acceptance is reduced.

The cost of acceptance in New Zealand is based on contactless acceptance at the terminal. If contactless acceptance is turned off, no strategic interchange rate will apply, and the merchant will incur high interchange rates for credit card transactions. However, domestic EFTPOS will be free of cost to the merchant. This is quite different to Australian domestic debit transactions, which incur some cost and support contactless transactions. Due to the charges on domestic debit transactions, the schemes continue to drop their interchange max fee limit and processing fees to remain competitive in the Australian payments landscape.

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

Windcave maintains that regulating interchange rates will result in the overall reduction of Merchant Service Fees. Windcave has not seen evidence in other markets that there is an impact to the cardholder on the acceptance side unless the merchant passes through the Merchant Service Fee to the cardholder by applying a surcharge or increasing the overall cost of goods.

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

Merchants may find it difficult to operate their business without accepting widely used payment cards. Windcave recognizes that there are incentives offered by issuing banks that encourage cardholders to use higher cost payment methods. These incentives to use higher cost payment methods, which are also likely to be the payment methods that provide higher returns to issuing banks, drive additional costs into the retail payments system.

Higher cost payment methods typically come in the form of “premium cards,” which offer higher point incentives for regular use and early balance pay-off of the card. The privilege of using a premium card is generally reserved for the wealthiest subset of the population, as premium cards often have high annual fees and/or a minimum income requirement. When a merchant is processing a high volume of higher cost payment methods, this may necessitate an increase of the overall cost of goods and services in order to cover the higher interchange fees incurred.

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

Merchants have little influence over the cards that they accept. The merchant will accept the cards widely used by its patrons to remain competitive. Regulation must focus on the interchange fee, which is passed through to the merchant by the acquirer with scarce input from the merchant. MBIE is contemplating regulation imposed on the merchant, however, regulating the interchange rate will eliminate any need to obligate surcharges for premium card users.

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

Windcave recognizes that merchant card acceptance is driven by patron card usage. If any of a merchant’s patrons choose to use cards from a specific card scheme, the merchant is commercially required to accept that scheme’s cards to secure ongoing business. Merchants are further typically contractually obligated to honour all cards from any scheme they accept, further reducing their power to turn away higher cost payment methods.

The issuer’s business strategy is quite independent from the acceptance business strategy. The issuer incentivizes customers to use its cards which drives increased usage and patronage at merchants’ businesses. The merchant enjoys an increase in sales by accepting more cards so, in practice, the merchant has little influence to steer customers towards lower cost payment method.

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

Surcharging may arise when a merchant is processing a high volume of higher cost payment methods. With no power to prevent a customer from using a card that will charge a higher interchange fee, the only viable option may be for the merchant to charge a surcharge. Such charges may result in loss of business or negative reviews.

The responsibility for subsidizing high Merchant Service Fees should not fall on the merchant or cardholder. Windcave maintains that regulating interchange rates will result in the overall reduction of Merchant Service Fees. With this reduction, Windcave's expectation is that fewer merchants will be compelled to surcharge cardholders for higher cost payment methods.

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?

Higher cost payment methods typically come in the form of premium cards, which offer higher point incentives for regular use and early balance pay-off of the card. The privilege of using a premium card is generally reserved for the wealthiest subset of the population, as premium cards often require monthly balance clearance, high annual fees, high minimum income requirements, and/or a good credit history.

The merchant may choose to raise the overall cost of goods and services to cover the higher interchange fees it incurs. This inevitably results in low-cost cardholders, generally less affluent, subsidizing the incentive bonuses of high-cost cardholders.

If, alternatively, a merchant chooses to surcharge higher cost payment methods, this may affect their customer retention or incur negative reviews of their business.

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

Windcave is uniquely positioned as a pure acquirer to offer competitive rates that can be negotiated by small merchants. Small businesses and businesses with low processing volume lack the ability to negotiate Merchant Service Fees with the major banks. As one of the few pure acquirers in the New Zealand payments market, Windcave sustains competitive pricing with the major banks to remain viable and profitable. Windcave's presence in the market encourages competition and prevents the monopolization of the concentrated acquirer and issuer market.

Lower transactions volumes are an issue for smaller merchants. Acquirers offer a mix of cost components –some portions are fixed while others are variable. The challenge for small merchants seeking competitive rates is their low processing volume that leads to higher acquiring fees to cover upfront costs for services. Windcave is uniquely positioned to consolidate payment services including merchant services. Pricing mechanics are heavily reliant on volume, however, by consolidating the payment solution and providing overall cost saving benefit to the merchant by bundling merchant services, payment gateway services, and terminal vending, Windcave offers a cost saving alternative for small merchants.

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

Windcave is a New Zealand based company with a unique position in the market as an instrument of collaboration for banks and smaller businesses. Small businesses who typically lack the advantage to negotiate with larger banks find that ability with Windcave's team. Windcave has a proven history of working with its merchants, large and small, to negotiate the best merchant service rates for their needs. Windcave keeps its merchant services rates competitive to remain relevant in the payments market. This competition benefits the merchant, who can shop around with non-banking companies for acquiring alternatives.

The presence of innovators, such as Windcave, in the New Zealand payments market enables small businesses to find the best and simplest deal for their merchant service needs. Windcave has introduced a number of solutions to lower the cost of acceptance for merchants. Windcave hosts the Interchange+ billing model resulting in an overall reduction of merchants' cost of acceptance as the interchange continues to reduce. Windcave provides next-day settlement to help small businesses manage their cash flow. However, as a pure acquirer, Windcave must fund the merchant from its float, which incurs costs. This is certainly not an issue for a banking acquirer; however, banking acquirers consider merchant services a loss leader and are not willing to invest in the acceptance technology.

Windcave recognizes that the payments industry is constantly evolving and has always been a dynamic space requiring tremendous amounts of investment and a thorough understanding of the intersection of business, technology, and compliance. As a result, Windcave continuously invests in its technology to stay ahead of competitors in the payments domain and ceaselessly innovates to serve small businesses with a wide array of product features and a strong security framework. Windcave offers consolidated payment solutions, offering both acquiring services and secure payment gateway services. Windcave is a finance company, but it is also a technology provider positioned to innovate within the concentrated acquiring market. Windcave offers a straightforward, consolidated point of delivery for acquiring and payment gateway services that can be easily adopted by small merchants.

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

There is no significant difference in the costs for providing services to small merchants. The cost of onboarding a merchant (performing due diligence and setting up their account) is virtually the same for all merchants regardless of size. The primary cost difference lies in the provisioning of services which may vary dependant on the number of sites requiring set-up. The cost for initial setup is a fixed fee that does not depend on merchant size.

Because merchant pricing is sensitive to the volume processed through the acquirer, a higher processing volume will amortize the fixed cost incurred to setup the merchant account. This is where the cost nexus lies for the merchant as a merchant with a high processing volume will recoup setup costs faster than a merchant with a low processing volume. Windcave does not charge any minimum processing fee for merchant services, so each merchant pays only for what it processes through its Windcave Merchant ID.

1 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?

Domestic EFTPOS is often presented as a free option for merchants who wish to collect card payments at their businesses. This assertion is misleading; while domestic EFTPOS is free for the end user, every other party on the value chain incurs costs for the provision of this service. A theoretical push to force the adoption of domestic EFTPOS as a solution to decrease merchant services fees is not feasible. Such a solution would require a majority of New Zealanders to forego the benefits of paying with credit cards in favour of using only domestic debit cards.

Merchant's preference towards innovative solution has increased over the years and Domestic EFTPOS lacks the innovation and security to compliment new technology. Domestic EFTPOS cannot accommodate contactless payments and mobile wallets (ApplePay, and GooglePay) which results in merchants disabling the contactless function to avoid incurring charges. In doing so, the merchant sacrifices a 10x faster transaction turnaround time compared to other in-store payment methods¹ and an overall decrease in card fraud by over 60%².

Windcave further acknowledges that Visa and MasterCard dominate New Zealand's credit markets. While the schemes set the maximum interchange for each category, the issuer has the option to charge up to or less than the maximum interchange rate set by the schemes. Since it is unlikely that a new scheme will enter the market or that EFTPOS Debit will see mass adoption, focus should instead focus on competition within the concentrated issuer and acquirer market.

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

Innovation plays a key role on the merchant acceptance side. As a pure acquirer, Windcave is in an optimal position to offer newer acquiring services using revenue generated by Merchant Service Fees. The only way Windcave can continue to compete and innovate its product suite is if there is a balance of commercial outcomes.

Product innovation is a critical part of maintaining a highly profitable acquiring business. Within the New Zealand payment system, pure acquirers have invested heavily in new acquiring technology to remain competitive in a dynamic market. It would not make commercial sense for pure acquirers to invest in the acceptance space if acquiring services are no longer profitable. Banks have been reluctant to invest in the acceptance side of payments and have relied heavily on other partners in the ecosystem to invest in new technology.

Over the years, a portion of the New Zealand merchant segment have been open to adopt innovative services to cater to their complex payment requirements. A recent example of Windcave's focus on innovative solutions is the digital parking meter-like technology which Windcave developed for Wendy's drive-thrus. The device sits underneath the drive-thru window and the solution was delivered at no additional cost to the merchant. The other practical aspect of this solution is the contactless technology application which has been imperative during the Covid-19 pandemic.

Windcave directs you to the NZ Herald article which further details the solution which Windcave has delivered to Wendy's with no additional cost:

<https://www.nzherald.co.nz/business/burger-chain-wendys-unveils-new-nz-first-payment-technology/DU5OT2ZRCVYGAFNXXD63VKJPT4/>

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

¹ GFK Mystery Shopping Study, 2017

² UK Card Association, 2018

No, to Windcave's knowledge, none of the New Zealand banks have developed to the published standards for Open Banking. Further, banks do not seem eager to engage in alternate payment methods that would take volume away from traditional Credit Card processing where they have revenue lines.

Windcave supports an alternate payment method (account2account), and has tried to engage NZ banks in the past, however the banks cannot justify the business case as they are assessing potential revenue they would lose on the new models verses traditional payment channels.

Windcave does not consider Open Banking a viable alternative to credit card payments. In the unlikely event Open Banking is adopted, it is only an alternative means of performing a transaction, and adoption will be low. Credit card payments will not decrease, so merchants will face the same challenge of continuing to pay high interchange fees.

1 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?

Windcave is supportive of the outcomes of the Issues Paper. Windcave concludes that the regulation of interchange rates will result in the overall reduction of Merchant Service Fees. Regulation of the interchange rate will lead to a low cost of acceptance. Windcave has seen this same regulatory mechanism succeed in Australia and expect that regulating the interchange fee will result in long term cost benefits for end users.

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

Since the release of the Issues Paper, ASB has promised a 20% rebate on Merchant Service Fees for small merchants. In industry parlance, when Windcave refers to the Merchant Service Fee, it is discussing the acquiring fee, the interchange fee, and the scheme processing fees. Windcave would like to note that ASB's rebate does not include a 20% rebate on the interchange rate and is only a rebate on acquiring fees and card scheme fees.

This rebate is an attempt by ASB to divert MBIE's attention from the unregulated interchange fee which ultimately inflates the Merchant Service Fee. Windcave's prediction is that a rebate offered on only the acquiring end without a lowered interchange rate will create artificial pressure on the acquiring market thus forcing pure acquirers to perform similarly. While this may lower the cost of acceptance for a few months or a year, it will have no lasting effect on the cost of acceptance and may instead result in pricing pure acquirers out of the market and eliminating competition. ASB has promised this rebate only until the date new regulation comes into place. Windcave urges MBIE to not use this rebate as evidence that regulating the Merchant Service Fees will lower the overall cost of acceptance for merchants. Rather, the payment's ecosystem should be assessed holistically to observe the impact the interchange rate has on the final cost of acceptance.

The concentrated acquiring and issuing markets are complements of each other. Banks who have both issuing and acquiring capabilities can offer temporary rebates because they will recoup their costs from their issuing branch, which, in the case of ASB, will not be impacted as the interchange rate is not discounted. Furthermore, banks with issuing and acquiring branches benefit from on-us transactions that result in lower charges from the schemes. Because a pure acquirer can only process off-us transactions, it may need to give up a portion of its revenue which would impact the acquiring business's sustainability. Windcave emphasizes that any trend noted by MBIE in relation to this rebate will be artificial, temporary, and not an accurate representation of how regulation can impact the payment's ecosystem.

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

Windcave agrees that a balanced review of the payment's ecosystem should be conducted to achieve equitable pricing for all New Zealand merchants regardless of size and influence. After reviewing the landscape and the state of regulation in other countries where Windcave has a market share, Windcave concludes that the regulation of the interchange fee will result in an overall reduction of Merchant Service Fees while maintaining the engagement of merchants.

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

Windcave maintains that, should regulation be adopted, the solution to lower the cost of acceptance will be to regulate the interchange fee.

Other Comments

[REDACTED]