Submission template

Regulating to reduce Merchant Service Fees

Instructions

This is the template for those wanting to submit their response to the *Regulating to reduce Merchant Service Fees* discussion document.

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the issues raised by 10 am on Friday, 19 February 2021. Please make your submission as follows:

1. Fill out your name, organisation and contact details in the table, “Your name and organisation”.
2. Fill out your responses to the discussion document questions in the table, “Responses to discussion document questions”. Your submission may respond to any or all of the questions in the discussion document. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.
3. If you would like to make any other comments that are not covered by any of the questions, please provide these in the “Other comments” section.
4. When sending your submission, please:
   a. Delete this first page of instructions.
   b. If your submission contains any confidential information:
      i. Please state this in the cover page or in the e-mail accompanying your submission, and set out clearly which parts you consider should be withheld and the grounds under the Official Information Act 1982 that you believe apply. MBIE will take such objections into account and will consult with submitters when responding to requests under the Official Information Act.
      ii. Indicate this on the front of your submission (eg the first page header may state “In Confidence”). Any confidential information should be clearly marked within the text of your submission (preferably as Microsoft Word comments).

   Note that submissions are subject to the Official Information Act and may, therefore, be released in part or full. The Privacy Act 1993 also applies.
5. Send your submission as a Microsoft Word document to ***competition.policy@mbie.govt.nz***

Please direct any questions that you have in relation to the submissions process to ***competition.policy@mbie.govt.nz***.

Submission template

Regulating to reduce Merchant Service Fees

Your name and organisation

Name	[redacted]
Email	[redacted]
Organisation/Iwi	Woolworths New Zealand Limited (Countdown)

[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 <u>not</u> 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 <u>not</u> want your submission to be placed on our website, please check the box and type an explanation below.

I do not want my submission placed on MBIE's website because… [Insert text]

Please check if your submission contains confidential information:

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

I would like my submission (or identified parts of my submission) to be kept confidential because… [Insert text]

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

Thank you for the opportunity to provide comment on the Issues Paper circulated by the Ministry of Business, Innovation & Employment (MBIE), dated December 2020 seeking feedback on regulation to reduce Merchant Service Fees within New Zealand's retail payment system.

The issues outlined in the Paper are significant and it is timely that they are being considered in a comprehensive way. We appreciate that the Government is taking the time to get the views of a wide range of New Zealanders before deciding how it will proceed in terms of potential regulatory change.

- New Zealand retailers pay substantially more to process credit, online debit and contactless debit card transactions than their peers in other markets such as Australia and the UK. A key difference is that, in other markets, Governments have moved to regulate the retail payments industry. We believe that regulation is necessary because it is largely accepted that card payment systems are inherently inefficient. Indeed, the Commerce Commission noted in its 2013 review of the cards action that: "the Commission is aware average levels of interchange fees may be starting to increase again. If the trend back towards higher interchange fees continues then something other than noncompliance with the Commerce Act is likely to be the cause of the lack of competition. The Commission is not able to address anything other than breaches of the Commerce Act and so alternative regulatory intervention may be required".
- We believe that higher merchant service fees in New Zealand are driven by rewards programmes for high- spending or premium/platinum cardholders in the absence of any regulatory oversight of the international Card Schemes. This results in a regressive wealth transfer from less well-off New Zealanders (who typically don't have access to high rewards cards and use cash or EFTPOS to pay for goods and services) to better off consumers (who do have access to high rewards cards) and in effect subsidise the rewards programs across retailers.

- •We strongly support transparency around merchant service fees including the components that make up merchant service fees such as Interchange (earned by the Card Issuer), Scheme Fees (earned by the Scheme), Switching fees (earned by the Switches) and Acquirer margin (earned by the Acquirer bank). These need to be split out at a transactional level in the monthly billing provided to a merchant,

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

Yes, the MBIE paper has accurately described the retail payments system including the network effects of a two sided market. It is a known economic anomaly with Scheme branded payment instruments where an increase in competition amongst these instruments actually drives transaction costs up rather than down.

We believe regulation is also required to resolve the issue of access to the retail payments system including networks (subject to usual caveats on safety and security of the payments system). Currently New Zealand has neither guaranteed access rules nor an appropriately priced or a clear set of access criteria that new Fintech entrants or low cost payment terminal providers can use to gain timely access to the national retail payments system. For innovative new technologies to emerge and flourish in New Zealand, the regulator needs to ensure that the barriers to access are sufficiently low.

In comparison, Australia's National Payments Platform offers equal access rules under the direct supervision of the Reserve Bank of Australia. This allows all participants access to a standardized set of functionality plugging them into the national payments network with appropriate access into established participants within the payments value chain.

New payment technologies face the largest hurdle when they bypass the interchange model. But without access rules, issuer banks have little incentive to do so, as they gain significant revenue from scheme card interchange.

Policy focus should be to ensure the optimal conditions exist for innovation to occur and flourish. Barriers to entry are a significant issue and the focus should include scope for legislation or enforceable guidelines to secure access for potential new technologies.

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.

Retailers generally have limited countervailing power with their Acquirers. Moves by banks over the last 2-3 years to offer retailers unblended and unbundled merchant service fees have paved the way for merchants to have greater choice in the way their fees are structured. However, the range of fees by payment method creates considerable complexity for most retailers. It is also unclear how much retailers shop around to get the best deals on merchant service fees, particularly beyond the larger strategic merchant retailers. As a consequence, the weighted-average merchant service fees in New Zealand remain relatively high compared to other markets.

We also believe Merchant Service fees on the whole have increased with the advent of contactless debit cards and the growth in "Platinum" credit cards linked to rewards such as travel points, cash back and loyalty.

We can only benchmark our costs associated with Scheme credit and debit cards acceptance at similar businesses in Australia and our parent company and find our merchant service fees on the whole are substantially higher for effectively being provided what is the same service accorded via the acceptance of a Scheme branded card payment.

Any regulatory response to merchant service fees must also benchmark fees in markets such as Australia and the UK /other OECD countries with an annual review and reset of interchange.

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

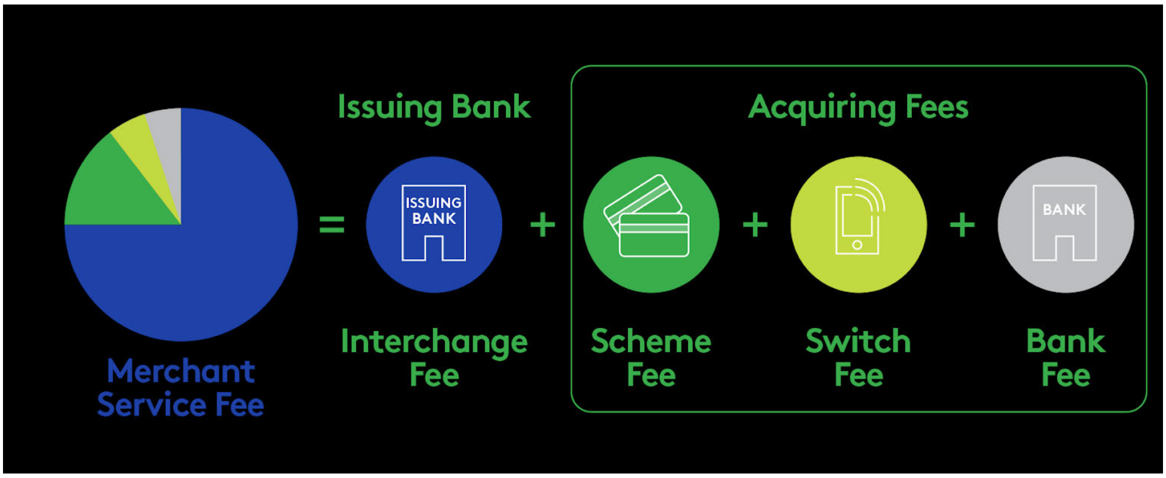
Cardholders are driven (and so they should be) by ease of functionality, rewards and frictionless payments. As such most customers are not concerned about the cost to the retailer from their chosen payment method. This is attributable to very few retailers surcharging to cover the cost of the payment and a low customer acceptance threshold of surcharging except by hospitality, travel and local government bodies where substitutability of service is low.

Interestingly retailers who surcharge including the industries called out above may not be surcharging an amount commensurate with the actual cost associated to accept the customers chosen payment method. Any regulation must ensure that surcharging is limited to an actual cost not an inflated one.

5	What impacts do you believe rewards and inducements have on the retail payments system?
	Described in points 3 and 4 above
6	What is your view on charges incurred by merchants for the use (acceptance) of payment methods?

We believe Merchant Service fees on the whole have increased with the advent of contactless transactions where contactless enabled debit cards are issued as standard instead of EFTPOS cards. This is also due to the ease of functionality of contactless including hygiene in these times of the COVID19 pandemic. However the merchant service fees on debit cards do not justify the fact that these cards access a transactional account where the account is debited in real time and there is no line of credit funding thus making it impossible to justify the costs associated with contactless debit transactions. New Zealand's home grown EFTPOS system (switch to Issuer) is in steady decline due to all of the above and in the absence of any domestic mandates and ownership we predict it will disappear over the next few years leaving the international card Schemes with unfettered access to New Zealand's retail payment systems.

Online shopping has seen massive double digit growth in the last 12 months largely attributed to a shift towards digital retailing as well as COVID19. Scheme branded debit cards are one of the most popular forms of payment online and once again feature high on the list of unjustifiable merchant service fees for a payment method that accesses and debits available funds in the cardholders account, with no line of credit or risk associated to the transaction yet this transaction is priced the same as a credit card transaction. In fact in other overseas markets the online use of a debit card attracts lower fees as opposed to in New Zealand where we pay credit card fees for the use of a debit card online.



Merchant Service Fees = Interchange + Scheme Fees + Switching fees + Acquirer Bank margin – most retailers do not understand such complex pricing and as such promotes a lack of transparency around pricing which is already so high.

Most of these fees including Interchange and Scheme fees are % based (ad valorem) and carry a $US based fee and therefore expand the revenue for the Issuing bank and the Card Schemes when the transaction (basket) value grows despite the service provided for this cost being the same irrespective of the transaction size. A lack of transparency of such fees including fees associated with accepting an internationally issued Scheme card means retailers do not understand the fees and their true costs

Any regulatory response to merchant service fees must also contemplate a future for EFTPOS and the enhancement of transparency around the different cost components associated with merchant service fees including those associated with 2-party card schemes

7	Please provide your views on barriers to merchants steering consumers to lower cost payment methods and the extent that steering occurs?
	As a consequence of the Commerce Commission's 2009 enforcement action, merchants were given the ability to influence customers via their choice of payment through Steering. Steering is the ability for a retailer to either refuse or discourage some forms of payment either generally or perhaps in specified circumstances (such as in the case of low value transactions). For example, some merchants have signs saying they don't accept credit or contactless payments, or don't accept cards from particular schemes such as American Express. However, the Schemes and Acquirers may still require merchants to 'honour-all- cards' of a particular type. That is, if the merchant accepts a scheme's credit cards, they cannot steer between standard or premium credit cards for that scheme. Steering is done in a crude manner today where some retailers refuse contactless and put up a sticker on their pinpad advising "no contactless" and contactless is turned off completely. An elegant way to do this would be to offer that choice via software enablement in the pinpad itself. As an example in Australia the regulator (Reserve Bank of Australia) supports the enablement of steering at a network level within the pinpad itself with co-branded cards Any regulatory approach here must also include the enablement of Steering giving the retailer choice between accepting different card types or routing a scheme card transaction directly to an issuer therefore bypassing the Card Scheme and thus lowering the cost to the retailer. Regulatory action must also remove the "Honour All Cards" rule
8	Please provide your views on the barriers to merchants surcharging and the extent that surcharging occurs?
	Retailers generally find it difficult to refuse or surcharge a higher cost payment method if that payment method is valued by consumers. To do so would risk them losing sales. In addition, a merchant is likely to face greater negative customer response to removing a particular payment method than never accepting the payment method in the first place. This likely means that the merchant's decision about whether or not to accept a payment method is less responsive than consumers to changes in fees. We note that surcharging is prevalent (and largely accepted by customers) in certain industry segments such as local government, travel and hospitality – where the ability to use a substitute of goods & services provided is low e.g. Airline travel, Council services and rates, Water rates, Hotels etc.
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?

We know there are multiple payment methods available e.g. No Reward cards, Cash, Low Reward cards and High Reward cards. Given a retailer cannot possibly know what payment method a customer will use *ex ante* there is "price coherence". I.e. all consumers face the same price of goods no matter what payment method which leads to Cash, No and Low-Reward payment method users subsidising rewards of High-Reward payment method users

The structure of the market is such that rewards obtained from card loyalty schemes are ultimately paid for by the customer. The Issuer uses the interchange fee to fund the rewards, which are charged to the Acquirer who charges it to the retailer via merchant service fee. Retailers can only pass on the costs of the merchant service fee through prices to customer. Effectively the higher prices for all goods and services faced by customers is offset for the holders of credit cards offering credit and rewards, who in some cases may receive rewards that greatly exceed the overall increase in price that they face. On the other hand, those who do not hold rewards-offering credit cards face an increase in price, with no corresponding benefit. This represents a wealth transfer from the users of low-cost payment options to users of high-cost cards.

We believe this wealth transfer is strongly regressive. Banks are risk averse and more likely to offer high-reward cards to users with a high income (for example, all Platinum Cards have a minimum income requirement), or self- selection as a result of higher-annual fees (that do not cover the full cost of rewards). In contrast, the cost that retailers face is passed on to all customers, including those on low incomes or those who subsidise rewards by using payment methods such as Cash, EFTPOS and Debit cards (incl Account transfers) – payment methods that do not attract any rewards.

Therefore we believe that customers with higher income receive rewards subsidised by customers with low income.

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

Small - Medium businesses often do not meet the criteria set by the card schemes for "Strategic Merchant Rates" (SMR) and as such do not have access to this benefit. They are treated as price takers. A contributing factor here is the increase in Acquirers promoting "unbundled" merchant fees while Issuers undertake premiumisation of their card base. Classic cards are moved to platinum and lucrative reward schemes promoted on platinum cards. Platinum cards as you are aware carry substantially higher interchange fees and as such contribute to increased interchange costs for merchants not on a SMR. These retailers are forced to accept a broad range of payment forms, as while customers may use a single payment form, retailers must offer access to multiple cards. Once the retailers have to accept a form of payment, they have limited pricing power being small operators. There is little transparency in the way prices are set and negotiated. There are no clear and transparently set criteria to qualify for SMR.

Banks and Card Schemes are reluctant to reduce prices, knowing full well that with a high penetration of 'premium' reward cards, retailers may not be willing to deny customers the convenience and rewards associated with using these cards. Even for large retailers the negotiating power is limited as Scheme cards have become so embedded in consumer's wallets thus enabling Banks and Schemes to drive customer behaviour at a retailer level.

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

- Regulatory oversight of the retail payments market
- An annual review and downwards reset of interchange fees
- Removal of the honour all card rule
- Clearly defined surcharging ability for retailers (commensurate with the cost of acceptance)
- Transparent costs associated with acceptance of cards and card types
- Automated ability to steer transactions via pinpad software (e.g. contactless debit switched domestically to issuer)
- Clear and transparent eligibility criteria of Strategic Merchant Rates
- Debit cards to incur debit card fees when used Online (not credit fees as they currently do)
- Contactless debit card fees commensurate with cost of accessing a transactional account i.e. given there is no credit offered and therefore no risk
- Buy now and Pay later schemes brought into the fold of regulation
- Transparent and defined rules for timely access to the New Zealand Retail payments system for new fintech and new entrants

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

We believe there is no relevance or difference in providing acquiring services from a bank to either a small or large retailer. The cost incurred by various players in the payment value chain associated with transporting a transaction, validating it and returning an appropriate response to the retailer payment terminal remains the same

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?

The current fee structure and the ownership model means there is no financial incentive to invest in EFTPOS. EFTPOS is a secure, viable and safe domestic payment system. It once was world leading technology but changes to the market and pricing structure means that acquirers and issuers cannot profit from EFTPOS, therefore there is no incentive to invest.

Other countries such as Australia and Canada invested in a sovereign controlled domestic debit payment system similar to our EFTPOS on the basis that the sovereign control element is deemed important for resilience and stability reasons as well as to provide a counterbalance to Scheme debit.

A domestically owned payment method such as EFTPOS benefits customers and retailers yet there is no regulatory body to uphold its interests. Our bigger concern is the impending the loss of a New Zealand owned and operated – safe, secure and reliable – low cost payment method leading to loss of domestic control of a home grown payment system

1	**What impact is product innovation having on merchant service fees?**
	As new entrants innovate, it is to be noted that this innovation largely is occurring for payments that continue to utilise existing Scheme payment rails. E.g. Buy now and Pay later, Apple Pay, Google Pay etc. Effectively what is happening is that there are more participants in the payment value chain each one "clipping the ticket" so to speak which effectively drives up the merchant service fee either directly or indirectly e.g. BNPL is funded by a Scheme debit card but they make their money by penalising late payments. Payment innovation that occurs on the domestic rails e.g. Online EFTPOS has not been successful due to a lack of participation by the Banks due to the nature of interchange income.
1	**Is open banking likely to provide sufficient competitive discipline on scheme debt and credit fees?**
	Unlikely, as open banking will begin by complementing other forms of payment including Scheme. Open Banking will certainly facilitate person to person or bill payments but these may likely not be the leading or a significant form of retail payments as we have observed in similar markets such as Australia (via the National Payments Platform NPP). What may be better is regulation helps lower the barriers to entry for new Fintech and innovative Payment platforms that drive up competition for Acquiring banks and the national switches that align very closely with the acquiring banks and their prescribed payment terminal software preventing low cost payment terminal providers from entering the market e.g. Android handheld payment terminals.
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?**
	Yes we believe there is a gap in the regulatory oversight of retail payments especially when we compare New Zealand to other similar economies – all of which have regulatory stewardship of the retail payment system. This culminates in anomalies as described in Q 15 above.
1	**Please feel free to provide information on any other issues of concern with the performance of the retail payments system.**
	We have described specific anomalies elsewhere in this submission as well as over the last 5 years via various submissions.
1	**Do you agree with the objectives for the retail payments system in New Zealand?**
	We do but would suggest that these can be extended further to align New Zealand with other markets using regulatory oversight to promote and foster retail payments innovation, cooperation and therefore drive beneficial public policy
1	**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 believe there is currently a strong case for government intervention, and this will likely grow over time, particularly with the growing use of Contactless and Scheme debit cards and new Fintech innovation.

The 2009 Commerce Commission investigation documented significant issues in the credit card market which lead to economic inefficiencies, perverse competitive models that lead to higher prices, inducements that lead to private gains but public costs (inequities). As noted new payments innovation thus far continues to use and run on Scheme built rails which is likely to further increase the uptake of scheme cards and amplify the issues we experience today.

The Commerce Commission noted that "if the trend back towards higher interchange fees continues then something other than noncompliance with the Commerce Act is likely to be the cause of the lack of competition. The Commission is not able to address anything other than breaches of the Commerce Act and so alternative regulatory intervention may be required".

This raises the very real question of what those alternative interventions may be and the overall oversight regime for the payments system and the governance principles that underpin it. We would suggest there are five broad governance principles of:

- Transparency
- Alignment with international standards
- Effective regulatory powers and capacity
- Consistency with other settlement systems
- Cooperation with other authorities.

This would oversee the regulator's objectives that encompass:

- Promote competition in, and the efficient and reliable operation of, electronic retail payment systems for the long-term benefit of customers, retailers and other value chain participants.

Specific interventions should focus on the key problem areas:

- Transparency – there is simply not enough information available to know the best course of immediate action. Requiring greater transparency in a consistent manner would pave the way for a measured approach.
- High interchange fees – explore international best practice on determining interchange fees. New Zealand faces high fees but no better service than jurisdictions with regulated fees (usually caps and annual resets).

System resilience and access – a domestic payments system, like EFTPOS, has successfully been built in Australia with innovative features such as contactless, ability to steer and online use. New Zealand needs to explore the public policy arguments on whether there is a model for a low-cost sovereign payment system to allow open access and thus encourage innovation.

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

Likely an independently setup body or perhaps an existing body such as Payments New Zealand Limited under the auspices of the Reserve Bank . This could be a possibility but with a governance structure that offers equal rights and participation to large retailers including Retail New Zealand who represent small-medium retailers. The structure should also include the Card Schemes, Banks and Switches. This would necessarily require Payments New Zealand changing its current Bank centric ownership model and structure as well as a significant change in mandate to expand its independence

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

NA

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

NA

Other Comments

NA