27 January 2017

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

By email: competition.policy@mbie.govt.nz

To whom it may concern

ANZ submission on the Issues Paper: Retail payment systems in New Zealand.

Thank you for the opportunity to respond to the Ministry of Business, Innovation and Employment (**MBIE**) on the October 2016 Issues Paper: Retail Payment Systems in New Zealand (**Issues Paper**).

ANZ Bank New Zealand Limited (ANZ) welcomes the Issues Paper and the government's consideration of the efficacy, innovation and costs associated with New Zealand's retail payment systems and their operation. In ANZ's view, the New Zealand payments system is efficient, secure and robust, with world leading levels of electronic transactions and lowest levels of cash usage. As noted by MBIE, ANZ considers that it is extremely important that the government fully understand the complexity and operation of New Zealand's retail payment systems before considering whether any action is required and options for action are put forward.

The key messages which we would like to specifically draw to MBIE's attention are summarised in the following table.

Key messages

1. **New Zealand's payments system is world leading in many aspects, including in its efficiency, security, robustness and the high proportion of electronic versus cash transactions. ANZ does not agree there are material inefficiencies or cross subsidies in the system or that these are at a level that warrants government intervention. ANZ considers that regulation would not derive material benefits for participants in payment systems and would give rise to unintended consequences.**

2. **While ANZ believes any current system imbalances are not material and will correct over time, if there is a desire to accelerate rebalancing, then ANZ suggests the following range of voluntary steps that relevant participants in the payments system could agree to implement:**

   a. **A commitment from acquirers to offer transparent merchant pricing options across the market, coupled with an appropriate transition time to enable acquirers to implement these pricing options; and/or**

   b. **Undertakings by scheme providers to provide greater certainty that the current treatment of magnetic swipe or chip debit transactions performed using a scheme debit card will be retained for the foreseeable future; and/or**

   c. **For scheme debit cards – the possible introduction of new interchange categories for scheme debit cards providing lower pricing for low value transactions.**

3. **The current free proprietary EFTPOS model is a substantial barrier to new participants and products. It would be necessary to address this if there were any changes to the card scheme or interchange model.**

4. **ANZ considers that the Issues Paper needs to take appropriate account of the offsetting impact of surcharging when assessing the overall cost to merchants of accepting card payments (and changes in that cost) and prior to concluding that there are inefficiencies in the system.**

More detail on these points is provided in Appendix I, followed by responses to the specific questions from the Issues Paper in Appendix II.

Support for NZBA submission

ANZ is a party to, and wishes to note its support of the New Zealand Bankers' Association submission, together with the appended independent economic analysis prepared by Axiom Economics, on the Issues Paper.

About ANZ

ANZ is the largest financial institution in New Zealand. The ANZ group comprises brands such as ANZ, UDC Finance, ANZ Investments New Zealand, ANZ New Zealand Securities and Bonus Bonds.

ANZ offers a full range of financial products and services including a significant range of financial advisory services, personal banking, institutional banking and wealth management products and services.

Request for confidentiality

ANZ requests that the graphs in Appendix III are kept confidential on the grounds of commercial sensitivity.

Contact for submission

ANZ would like to discuss our submission directly with MBIE officials. Please contact Andrew Gaukrodger, Senior Manager Government Relations & Corporate Responsibility Section 9 (2)(a) to arrange, or email Section 9 (2)(a)

Once again, we thank MBIE for the opportunity to provide feedback on the Retail payment systems in New Zealand issues paper.

Yours sincerely

Section 9 (2)(a)

Section 9 (2)(a)

David Hisco
Chief Executive Officer

Antonia Watson
Managing Director, Retail & Business Banking

Appendix I – Key messages

ANZ addresses each of the key messages in turn.

1. New Zealand's payments system is world leading in many aspects, including in its efficiency, security, robustness and the high proportion of electronic versus cash transactions. ANZ does not agree there are material inefficiencies or cross subsidies in the system or that these are at a level that warrants government intervention. ANZ considers that regulation would not derive material benefits for participants in payment systems and would give rise to unintended consequences

World leading retail payments system

ANZ considers that New Zealand's retail payments system already delivers good economic outcomes and enables the government's priority of building a more productive and competitive economy. Specifically:

- **Efficiency**: New Zealand has the highest rate of electronic payments in the world – with both credit and debit cards having been widely adopted by New Zealand consumers. This efficiency is evident in the fast adoption of new technologies – including contactless and, as noted in the Issues Paper, the range of different payment options and services available to New Zealand consumers,[1] many of which don't exist in the most basic form in other larger, more advanced economies. Payments NZ's New Technology Principles also encourage and enable innovation in the retail payments market.
- **Security and robustness**: The governance of the retail payments system by Payments NZ includes in its objectives safety, security and interoperability. The governance structures in place foster an open market, with low barriers to entry (there is no requirement for all parties to become direct settlement participants or sign the same multi-lateral contract) while ensuring all users of the system are protected by appropriate levels of security and interoperability.
- **Proportion of electronic transactions**: The New Zealand retail payments system has world leading levels of electronic transactions, including free domestic EFTPOS transactions, and New Zealand has the world's lowest level of cash usage.

Recent rarely occurring material changes in the New Zealand payments system

In recent years, the New Zealand retail payments system has been impacted by two significant, but in general infrequently occurring, changes:

- in debit, the introduction of new contactless payments technology has brought about greater customer experience, security and functionality which has resulted in interchange on some debit transactions, and
- in credit, the introduction and changes to benefits/rewards schemes, in particular, Air New Zealand Airpoints.

ANZ acknowledges that these events have had impacts on customer behaviour and merchants, including:

- for debit, the introduction of interchange fees on some transactions as a result of adopting the new contactless technology, and

[1] See Issues Paper, Table 2: Types of emerging payment method, pages 24-25

- for credit, average interchange fees have gone up as schemes and issuers have sought to protect their market positions, and consumers have sought out the cards offering them higher benefits.

This in part may have led to what MBIE perceives to be existing or emerging inefficiencies in the system and substantial cross-subsidies by some customers that favour others (see Issues 1 – 5 outlined on pages 7 – 9 of the Issues Paper). However, ANZ does not agree that these perceived inefficiencies and cross subsidies are material or at a level that warrant government intervention, particularly in the form of regulation. ANZ considers the value of these inefficiencies/cross subsidies may be overstated, and notes that no benefits analysis has been completed to balance the perception of inefficiency.

In ANZ's view, both of these events would naturally result in short-term imbalances that correct over time as adjustments are made in the system to respond to them. ANZ notes that in debit, interchange rates are already declining and have dropped by as much as half over a three year period (as indicated in paragraphs 140 and 141 of the Issues Paper) and note that these are very comparable to Australia, which is a regulated market. Please see the attached graphs at Appendix III which demonstrate this trend. ANZ expects the same trend to happen in credit over time. ANZ also wishes to stress that changes of this magnitude are infrequent events in the system generally and that a three to five year cycle needs to pass in order to fully understand the implications, including the impact of adjustments made. However, ANZ considers that the speed of declines in both debit and credit interchange could be accelerated through agreement by market participants to put in place some proactive and voluntary measures, which we outline in the key message below.

2. While ANZ believes any current system imbalances are not material and will correct over time, if there is a desire to accelerate rebalancing, then ANZ suggests the following range of voluntary steps that relevant participants in the payments system could agree to implement

As noted above, ANZ considers that the speed of downward adjustments in both debit and credit interchange could be accelerated through agreement by market participants to put in place proactive and voluntary measures. In particular, ANZ is firmly of the view that these voluntary measures should be fully trialled before regulation of any kind, including any mandatory or voluntary Code of Conduct, is considered. In ANZ's view, a premature regulatory response could have unintended consequences, including risks that regulating interchange won't lead to price reductions being passed on to consumers, additional costs and the potential to inhibit innovation.

To this extent, ANZ notes the experience of interchange regulation in the Australian market which ANZ considers could lead to the outcomes identified by Axiom in their report (see Executive Summary, pages vii and viii) if interchange fees in New Zealand were regulated. ANZ notes Axiom's conclusion that *"the RBA's intervention made credit cardholders unambiguously worse off"*.

Instead, the voluntary measures ANZ suggests should be first investigated before regulation is considered are:

a. **A commitment to offer transparent merchant pricing options across the market, coupled with an appropriate transition time to enable acquirers to implement these pricing options.**

ANZ believes that greater pricing transparency would benefit merchants, particularly in the debit market. ANZ already provides a range of pricing options for merchants, in particular the unbundling of contactless debit from credit pricing.

Our merchant statements show separate debit and credit charges by transaction type which provide transparency about the mix and costs of payment methods and allow merchants to choose the pricing and billing method that best meet their needs.

Merchants can elect to take unbundled rates or opt for blended rates. We have included a description of ANZ interchange plus pricing and several examples in Appendix IV of monthly (unbundled) Merchant Service Fee (MSF) statements provided by ANZ:

- Example A: Non-interchange showing a cheaper rate for contactless debit vs credit transactions
- Example B: Interchange Variable – for small-medium sized businesses
- Example C: Full – for corporates

ANZ notes that it supports an appropriate transition timeframe to allow acquirers the necessary time to make relevant technology and system changes to deliver these transparency measures. We suggest 9 to 12 months based on our own experience of developing these types of statements.

b. Undertakings by scheme providers to provide greater certainty that the current treatment of magnetic swipe or chip debit transactions performed using a scheme debit card will be retained for the foreseeable future.

Currently, magnetic swipe or chip (dipped) debit transactions performed on scheme debit cards are routed via the domestic debit network and therefore do not attract scheme fees and interchange. ANZ considers that in order to ensure this remains the case, scheme providers Visa and Mastercard, could provide undertakings that the current treatment will remain unchanged for an appropriate period of time in order to provide certainty to the market.

c. For scheme debit cards – the possible introduction of new interchange categories for scheme debit cards providing lower pricing for low value transactions.

ANZ also considers that further declines in scheme debit card interchange fees can be achieved, particularly for lower value transactions. Combined with improved pricing transparency, this should ensure that these reductions are passed on to merchants via lower Merchant Service Fees, and may generate growth and innovation via lower pricing. This could be achieved by discussions with industry stakeholders to investigate ways to introduce new lower interchange categories for low value transactions.

3. The current free proprietary EFTPOS model is a substantial barrier to new participants and products. It would be necessary to address this in conjunction with any changes to the card scheme or interchange model

Many of the questions in the Issues Paper relate to the suggestion that the current ‘interchange business model’ is a substantial barrier to new participants and products. ANZ does not believe this to be the case. Even with lower interchange rates on scheme debit transactions, there would be no incentive to invest in new debit products or functionality, given the absence of revenue to cover development and operating costs. The New Zealand market’s small scale makes it uneconomic for new entrants to develop new functionality and products for the debit market where there is no direct revenue.

Accordingly, ANZ considers that small charges may need to be applied to the EFTPOS model, through a non-scheme based regime to fund the further development of this product. However, ANZ also warns that further development of EFTPOS would only provide access to and participation in a domestic and possibly trans-Tasman payments system and would not enable customers to participate in the global system (e.g. when travelling) as the functionality would not be supported outside of New Zealand. ANZ considers that customer demand for cross-border functionality is very high and is one of the main drivers for the rapid uptake of credit/debit scheme cards by New Zealanders as an alternative to EFTPOS (magnetic swipe). This may limit the benefits in introducing charges to the EFTPOS model.

4. ANZ considers that the Issues Paper needs to take appropriate account of the offsetting impact of surcharging when assessing the overall cost to merchants of accepting card payments (and changes in that cost) and prior to concluding that there are inefficiencies in the system

In ANZ's view, the Issues Paper does not take full and appropriate account of the offsetting impact of surcharging by merchants since it was first permitted in 2009. All merchants have the option of fully recovering their card acceptance costs and many choose to do that. Surcharging is now common across a number of categories such as airlines, accommodation, utilities, government agencies and the taxi sector. Merchants that have chosen not to implement surcharges have made a decision that accepting the sale and associated merchant service fee is preferable to the risk of not making that sale at all.

We also note that there are many examples where the level of surcharging appears to exceed the merchant's actual Merchant Service Fee. This has resulted in additional costs being borne by consumers, above the cost of supply of card services to the merchants.

When surcharging was permitted in Australia, alongside interchange regulation, surcharges often significantly exceeded the actual merchant fee charged by the bank. This generated negative consumer sentiment, some of which was directed at banks who don't set surcharges, and led to further regulation in order to limit the level of surcharging to the actual cost of supply.

It would be inaccurate to draw conclusions on merchants' overall cost of accepting payments, and any movements in those costs, without accounting or allowing provision for the offsetting impact of surcharging. ANZ considers that an examination of surcharging in the New Zealand market will highlight that the overall level of surcharges exceeds the movements in average interchange since the settlements with the Commerce Commission in 2009.

Appendix II – Responses to questions in the Issues Paper: Retail payments system in New Zealand

#	Question	ANZ response
	Section 1 – Introduction	
1	Are these objectives for retail payment systems appropriate?	The objectives are appropriate, however, these objectives cannot be considered in isolation to the safety and security objectives, and a 'balanced' outcome is required. Objective 3 may not be achievable at an 'individual level' and may require a change to the pricing of the EFTPOS payments system in order to more fairly account for the costs and benefits. As we have discussed below, but particularly in our responses to questions 14, 16 and 21, the absence of a charge to merchants who receive benefits from the EFTPOS payments system is limiting innovation and the entry of new participants in this payments system.
	Section 2 – Payment Systems in New Zealand	
2	Are there any other emerging payment methods that we have missed? If so, what is their likely impact on the market?	We believe that these have been largely captured in the Issues Paper. However, as we have seen, technology is advancing quickly and other disruptors and market offers will be inevitable. The rise of digital currencies and social media providers entering into payments will only increase, offering greater flexibility but also heightened risks if new entrants are not as well regulated as the main trading banks.
	Section 3 – Market business models and resource costs	
3	What explains the decline in the revolve ratio on credit cards?	We do not agree with the suggestion in paragraph 115 that the decrease in the revolve ratio is solely because consumers are being induced to use credit. Given that credit cards provide both a line of credit and a transactional/payment capability, there are many factors that impact revolve rates on credit cards, including: • People are using their credit cards more effectively, with everyday spend going on credit cards in order to maximise the benefits of the cards, including: o interest free periods, o use for online purchases and recurring payments, o additional protections provided by credit cards, such as chargeback rights o rewards & travel insurance • Increasing overseas travel and use of credit cards when travelling, rather than cash or

		travellers cheques. In the 12 months to October 2016, 2.55 million New Zealand residents departed on overseas trips (Statistics NZ figures) which has driven usage of credit cards as a transactional tool: o Many travellers tend to use their own funds rather than debt when travelling, therefore the credit card is used to safely and conveniently access those funds. This spend is usually repaid before interest is incurred, effectively reducing the revolve ratio. • Since the GFC there has been a shift towards paying with debit and New Zealanders appear to have got better at managing their spending and not over extending themselves. • Recent strong house price increases may have contributed to cardholders' increasingly to repaying their credit card from a revolving or flexi-mortgage in order to benefit from the cheaper interest rates on those products.
4	Do you agree with our explanation of the rationale for interchange?	The primary response in relation to the rationale for interchange should be provided by the schemes (Visa and Mastercard) as they set interchange rates and have differing methodologies and rationales. However, we disagree with the statements in paragraph 117 that 'Interchange income is used to pay for rewards' and 'Interchange income **may** also cover scheme fees and the cost of fraud'. Interchange has historically been a mechanism for covering card issuers' costs associated with transactions. These include the costs of switching and authorising transactions, payment guarantees, scheme fees, fraud protections and credit risks. Interchange also provides funding for innovation, enhanced security and the creation of new functionality on payments products. We note the interchange model existed well before loyalty schemes for the purposes set out above. With the introduction of loyalty programmes on credit card products, some portions of interchange are used to support loyalty costs just as they are used to support other customer benefits and meet their expectations in a competitive market.
5	Have we accurately described the incentives on parties in relation to interchange?	There are a number of inaccuracies in the section "Interchange in practice": • 129 - interchange rates were set by the schemes prior to 2009, not collectively with the issuers as stated, • 131 – merchants who process large volumes or have size and scale can, and have in the past, negotiated with card issuers in order to obtain a lower interchange rate - this was not just restricted to the issuing side of their acquiring bank. The ability for smaller

		merchants to negotiate is somewhat limited. We note that it is common in many industries for large volume-generating consumers to have better prices than smaller volume participants. However, we believe that the gap between large and small merchants is wider than we would expect over the long-term, and there is an opportunity to rebalance these costs in the market. • 132 - it is not correct to state that issuers prefer high interchange rates. Interchange rates do need to be sufficient to recover costs and invest in security and functionality for payment products, however, in a mature and competitive market, higher interchange fees are generally passed back to customers through additional benefits, including reward and loyalty programmes and lower annual card fees, in order to maintain an issuer's competitive position. If issuers preferred only higher interchange rates then there would be a significant difference in the current market share of the major payment card brands. ANZ disagrees with the statement that as the market matures it will become more attractive to increase interchange. In a mature market there is more need to be flexible and innovative with interchange in order to increase usage through broadening the footprint of acceptance and promoting technology. Weighted average interchange fees tend to be cyclical over periods of time, even in mature markets where significant competitor events force other participants to react or adjust. We don't agree that merchants become less sensitive to increasing interchange. While merchants may feel pressure to accept the payment products that their customers prefer, they can negotiate vigorously with their acquirers and often the schemes directly, which places downward pressure on interchange.
6	Why are interchange rates falling for large merchants but increasing for small-medium merchants?	There are many reasons why interchange rates have fallen for large merchants. Large (strategic) merchants with significant volume of transactions provide the scale and acceptance footprint that in itself encourages adoption and generates economies of scale. Given their volume and importance to the network, schemes have implemented strategic criteria and lower interchange rates for these merchants, and they also command greater negotiating power with acquiring banks. We also believe that the move to more transparency after the 2009 Commerce Commission action has given merchants more information which has enabled many of them to negotiate better outcomes with the schemes and banks. This was an intended outcome of the changes. However, while many interchange rates have reduced since 2009, there have been increases in premium card rates. These higher rates, combined with the larger volume of premium

		cards in the market, has driven up the cost for smaller retailers. While there have been increases to some merchants, the Issues Paper does not outline the benefits that have also flowed through to customers and merchants with increased electronic payments and higher associated spend. For example, the increase in tourism (3.45 million international visitor arrivals to November 2016 – up 11.7%) has provided significant additional foreign spend at merchants (new sales revenue), however this has also had the effect of lifting average interchange and MSF due to the higher interchange and scheme fees that apply to international transactions. Notwithstanding this rationale stated above, we believe that the gap in interchange between large and small merchants is currently wider than the long-run average and is due to recent market developments. We would be open to exploring options to close the gap.
7	Is the resource cost data robust? Is the Australian data likely to over-state or under-state the costs of running New Zealand payment systems?	We believe that the Australian market costs have been understated and there has been no acknowledgement of the wider industry costs in running the range of bank and industry retail switches in Australia. The costs associated with EFTPOS in Australia in annex 1 are in our view understated by 5-6 cents per transaction (other fees associated with EFTPOS). We note that: 1. The costs to implement EPAL for all participants were significant (reportedly tens of millions of dollars) and there will be new and on-going operational costs as a result. 2. The Australian payment volume is approximately 6-7 times New Zealand's volume and can achieve a level of scale and cost efficiencies that a small economy like New Zealand cannot.
	Section 4 – Issues Identified	
8	Do you agree with the logic underpinning our assessment that there is inefficiency in the credit card market?	We do not agree with the logic underpinning the assessment of the inefficiency in the credit card market and believe that the calculated cost is overstated, but is also not material. It is also too simplistic to say that rewards customers are mainly higher income customers. There are many revolving customers using rewards products and a large proportion of rewards cards and spend are *classic* or *gold* cards which cost merchants no more than a non-rewards card and deliver rewards to a broader range of customers than accounted for in the Issues Paper. Equally, higher income customers also use non-rewards products such as low interest rate or low account fee cards in order to benefit from the features associated with those products.

		Customers have a range of needs or preference. ANZ's diverse range of card products reflects this breadth of consumer preferences. Issuers do not solely fund rewards costs from interchange, but also use a range of other revenue sources including higher card account fees. Hence the estimate of increased prices and benefits to higher income customers will be significantly overstated. Notwithstanding this, we also believe that the assessed inefficiency cost is immaterial relative to the estimated $900m total cost. Even if the rationale and calculation is correct at $45m, at only 5% of the overall cost, we would not deem this to sufficiently large to demonstrate any material inefficiency. We note Axiom's report refutes this assessment of inefficiencies altogether and claims that the methodology used to determine this was not robust enough as the average resource costs will include fixed and common costs that would not be avoided. We also note that no offsetting benefits associated with the higher spend from these products have been factored into the workings.
9	Do you agree with the logic underpinning our assessment that there are regressive cross-subsidies in the credit card market?	There are some cross subsidies, however as highlighted, this is common in a lot of industries. Merchants will also have many other types of costs that are 'averaged' across all customers, meaning that there will be other cross-subsidies, including in many cases merchants' own loyalty programmes. We do not agree with the logic underpinning the assessment of the cross-subsidy. As stated above, it is too simplistic to say that rewards customers are mainly higher income customers. It is also inappropriate to ignore the offsetting impact of surcharging. All merchants have the option of fully recovering their card acceptance costs and many choose to do that. Surcharging is now common across a number of categories such as airlines, accommodation, utilities, government agencies and the taxi sector. Merchants that have chosen not to implement surcharges have made a decision that they would be better off to accept the sale and associated merchant service fee rather than risk not making that sale at all. We also note that there are many examples where the level of surcharging appears to exceed the merchant's actual Merchant Service Fee, and that this has resulted in additional costs being borne by consumers, above the cost of supply. We note that it would be inaccurate to draw conclusions on merchants' overall cost of accepting payments, and any movements in those costs, without allowing for the offsetting impact of surcharging. ANZ considers that an examination of surcharging in the New Zealand

		market would highlight that the overall level of surcharges exceeds the movements in average interchange since the settlements with the Commerce Commission in 2009.
10	Do you agree that self-acquirers are unlikely to place downward pressure on interchange?	Self-acquirers have limited ability to put pressure on interchange rates as it would depend on the volume they process and how efficiently they have implemented their model. Self-acquiring has a place in the market but requires direct infrastructure (with associated costs) which can be used to leverage the card schemes if it is provided to them directly. Self-acquirers can also route scheme transactions to issuers directly if those respective issuers agree to the infrastructure builds and therefore negotiate bilaterally with each credit issuer as to whether they will accept a lower interchange rate for their products. Self-acquiring proprietary debit transactions face greater barriers in New Zealand because of the way the market access is structured to require infrastructure to be built with participants directly for proprietary debit and the large number of issuers in a small market.
11	How much negotiating power do merchants have over the merchant service fees they face? Is this likely to change in the future?	A merchant's negotiating power is often linked to wider bank relationships, expected volumes and the level of products offered. It can also depend on whether the acquiring bank wants to compress or remove their margin entirely or in some cases offer a negative margin to win wider business for the bank. For the acquirer the margin is all they have to negotiate on as the other costs associated with MSF are predominately external costs such as interchange, scheme fees and switch costs which grow as volume increases. We note that some merchants have negotiated lower effective merchant service fees. This has been achieved through: • grouping together to increase volume and therefore negotiating power, e.g. under Retail NZ • negotiating interchange rebates directly with issuing banks • negotiating directly with schemes for special (strategic) interchange rates, direct scheme fee rebates and/or other incentives • the threat to surcharge or to not accept certain cards We would expect merchants' negotiating power to continue to increase. Greater transparency in merchant pricing will provide additional information merchants can use to ensure that they are paying a merchant fee that reflects their business volume and mix.
12	Do you think that the issues in the credit card market are of a scale that warrants	The payments market has been impacted by two significant but infrequent events in recent

	intervention? If not, do you think that the size of the issue is likely to grow over time?	years. 1. In debit, contactless payments, which attract interchange, have grown significantly, however we note that interchange rates are progressively adjusting downward (refer Appendix III), and the focus here should be on ensuring that these reductions flow through to merchants via lower MSF, and further reductions in pricing for lower value transactions to generate growth in acceptance. 2. In credit, the Airpoints rewards changes have driven average interchange fees upward as schemes and issuers have sought to protect their market positions, and consumers have sought out the cards offering them higher benefits. As we have seen in the past when interchange fees have moved up, new market pressures have emerged that have resulted in downward adjustment. We are already seeing these pressures emerge, for example through vocal lobbying by the merchant community and direct discussions between many participants in the market, and expect that they will drive interchange fees back down over time. Greater transparency and broad industry support for the voluntary steps that we have recommended in our Key Messages will assist the speed of these adjustments.
13	Do you agree with our assessment of the incentives held by different parties in relation to debit card usage?	Yes.
14	Do you agree that there is little incentive to invest in proprietary EFTPOS?	Yes, for two reasons: 1. There is a segment of the ANZ customer base that just want basic access to cash with domestic debit, therefore ANZ believes we are meeting their specific needs today. 2. Without a revenue stream there is no incentive for banks to invest in customer experience or technology, especially as there are other products that meet cardholders' needs and offer additional benefits that EFTPOS would be unable to offer. These points highlight the barriers to entry for a competing product to overcome.
15	Do you agree that it is unlikely that schemes will start imposing interchange on swiped/inserted scheme debit transactions?	Yes, we do not believe that the schemes will change the current transaction routing and pricing model for these transactions, and we believe that it would be possible to gain greater assurances from the schemes about this.
16	Do you agree that merchants facing a per-transaction charge for accepting debit payments is not an issue in itself?	This is an underlying issue in the market. The debit scheme provides compelling value with irrevocable transactions settled overnight with no cost for the merchant. However, without a revenue stream (or cost to the merchant) there is no investment case to

		support the increased security and innovation required to maintain competitiveness with changing technologies. Given New Zealand's small market, this lack of revenue or cost recovery will be a barrier to new innovations and the entry of new participants.
17	Is the shift towards contactless debit cost-effective, taking into account the costs and benefits to all parties in the system?	Debit contactless has become more cost effective over time with interchange rates reducing for both strategic and non-strategic merchants. We expect this trend will continue as new and lower interchange categories for debit will likely be needed in order to increase the footprint of acceptance. As these adjustments are made it will become even more cost effective, providing value for all parties. However, interchange is only one part of the cost structure. Additional costs associated with the processing fees from card schemes and payment switches also need to be considered. We also note the Issues Paper underplays the benefits merchants get from contactless debit, such as rom the speed and interaction with their customers and new innovations such as digital wallets which can cater for payment and loyalty offers. These benefits are not factored into the resource costing in the Issues Paper. In regards to the reference to the Australian market as the logical comparison for debit, in regards to cost effectiveness the interchange rates for contactless debit are not fundamentally different to the Australian market.
18	Do you agree that the lack of price signals in the debit market is likely to lead to inefficient outcomes of a similar nature to those in the credit card market?	As stated earlier, we do not agree that there are inefficiencies in the credit card market, nor do we accept the calculation of their magnitude or materiality. We also note that the lack of price signals to merchants, i.e. free EFTPOS, will be creating offsetting inefficiencies.
19	Do you agree that merchant service fees are likely to increase for contactless debit once acceptance reaches a certain threshold?	As we have stated earlier, interchange rates for contactless debit transactions have been reducing, and we believe that new and lower interchange rates are required to further grow the acceptance of contactless debit. Therefore ANZ expects merchant service fees to continue to move downward, especially as volumes grow and the associated cards schemes review their respective interchange fees. Should there be future increases we would expect that some merchants would respond by either introducing surcharges or potentially returning to accepting EFTPOS only, placing a barrier to any increases.
20	Do you agree with our assessment that the	ANZ does not believe that the interchange business model imposes barriers to entry in the

	interchange business model imposes significant barriers to entry in the debit market?	debit market. There are few barriers to entry in the debit market with many participants. However, the absence of revenue to cover development and operating costs, combined with the New Zealand market's small scale, make it uneconomic for new entrants to develop new functionality and products for the debit market. We note there have been many new entrants into the payments market in New Zealand over recent years, however they have stayed away from the domestic EFTPOS model due to these factors.
21	How do you think the debit market is likely to evolve in respect of these 'unknowns'?	There will always be a portion of the market that want and need EFTPOS only, therefore we do not see EFTPOS disappearing from the market. Of our merchant base today, approximately 23% accept EFTPOS only, i.e. they do not accept credit or contactless debit cards. We have not seen a fundamental reduction in this mix since the introduction of contactless debit or credit in the market and continue to sign up debit-only merchants today. However, in order to maintain a strong domestic scheme that provides value, security, added functionality and efficiencies that our customers value and feel confident in using, there needs to be change, with some revenue generated in order to incentivise investment in EFTPOS. Costs associated with the infrastructure spend and associated market interactions cannot be overtly high or focused on one side of the participant market. Those who get the value out of the service will need to pay appropriate costs to the benefit they receive.
22	Do you consider the extent of the difference in the interchange relating to small and large merchants to be justified?	As per Question 6 above, there are very valid reasons for a difference as it mirrors concentrated volume, investment in security and technology, stability of systems, and customer experience as well as the negotiating power of certain merchants. It is also common in many industries that large volume-generating consumers tend to have better prices than smaller volume participants. However, as we have stated earlier, we believe that the gap between large and small merchants is currently wider than the long-run average due to recent market developments. We would be open to exploring options to close the gap.
23	Do you agree with our assessment of the two markets against our proposed objectives?	Objective one: Yes. Objective two: No. As stated, we do not believe that the analysis of the resource costs in the Issues Paper is accurate, and that benefits to merchants and consumers need to be included in the analysis to achieve a more balanced view.

		Objective 3: No, there is some mismatch of costs in credit, but not at the level that has been determined in the Issues Paper. One area that has been missed in the fair distribution of costs for debit is that costs associated with proprietary debit are excluded from the analysis, as are the benefits to all users (merchants and customers).
	Section 5 – Possible next steps	
24	Would greater transparency have any material benefit for merchants or any other parties in the system?	Greater transparency would provide a better understanding of all the costs that make up MSF and would be of benefit to both merchants and acquirers. In particular, we expect that more transparent pricing will improve merchants' ability to negotiate MSF rates that appropriately reflect their customers' payments mix. In addition, separate MSF pricing for credit and contactless debit transactions will give merchants reassurance that they will benefit from the lower contactless debit interchange rates as these transaction volumes grow. ANZ already offers transparency through its pricing options today, offering unbundled solutions for its customers and in particular with contactless debit priced separately to credit pricing for all merchants. We continue to further develop pricing options for our customers and will have additional pricing capability for our small business customers in the next few months. Examples of our current pricing for merchants and an overview of the components of interchange-plus pricing are provided in Appendix 1, as well as an example of the upcoming for small business pricing. We note that transparent pricing adds complexity. Care needs to be taken to ensure that it is easy to understand and not overtly complex, otherwise it will add little value to merchants and the resulting lower merchant take-up will reduce the benefits.
25	Would there be any benefit in schemes publicly clarifying their intentions in relation to charging for swiped and inserted debit payments?	Yes there would. As highlighted in our key messages, a message from the schemes advising that the current treatment of swipe/dipped domestic scheme debit transactions will remain as a New Zealand domestic EFTPOS transaction, would be helpful in providing certainty to the market. We believe the schemes would agree to this. As we have noted, there are a large portion of EFTPOS-only merchants so if the schemes were to provide assurances about current treatment of these transactions then this would likely alleviate the concerns of those merchants.
26	Do you think that the benefits of interchange regulation are likely to exceed the costs?	ANZ does not believe that the analysis undertaken in the Issues Paper is sufficiently detailed

		and accurate enough to form the basis of any regulation. Nor does it believe that the imbalances identified are at a level that warrants regulation. Given this, the costs of regulation will exceed the benefits. Regulation will require a long timeframe to implement, resulting in delays in any benefits flowing through. We have also seen high compliance costs and other unintended consequences in markets that have been subject to regulation. As we have stated, we consider competition in the debit market is already leading to a declining trend in contactless interchange rates, and we would expect market forces to result in lower credit interchange rates over time. ANZ does believe that, through this consultation process, there may be the opportunity to gain voluntary agreement to some changes by participants that would accelerate the movement back to more usual, long-term average interchange rates. We would be open to discussing our thoughts in more detail, although as we have already noted this would require a number of parties to participate.
27	What unintended consequences could arise from interchange regulation?	The ultimate consequences would vary depending on the actual regulations imposed. However, based on overseas experience with interchange regulation, our main concern would be that: • consumers (card holders) would face additional card costs and/or reduced benefits; and • there would be no offsetting reduction in consumer (retail) costs as there has been no strong evidence in other markets of these types of merchant savings being passed through to consumers. There is also the risk of reduced innovation and efficiency, especially if proprietary debit is not regulated. Lower interchange rates on scheme transactions will not provide an incentive to invest in new debit products should the status quo of no EFTPOS revenue remain. In addition, interchange regulation in other markets has added additional compliance and oversight costs. One of the compliance (and customer) costs observed in the Australian market was the introduction of surcharging alongside interchange regulation, often at levels that significantly exceeded the actual merchant fee charged by the bank. This generated negative consumer sentiment, some of which was directed at banks who don’t set surcharges, and led to further regulation in order to limit the level of surcharging to the actual cost of supply. We note that surcharging has been permitted in New Zealand since 2009. As we have

		outlined in question 9, is still in its relative infancy, but now common in a number of larger spend segments. Any regulation or control of interchange and merchant fees in New Zealand may require corresponding regulation on surcharges to prevent excessive surcharging as seen in other markets.
28	Under what conditions, if any, should debit interchange rates be regulated?	ANZ does not believe debit should or needs to be regulated. The interchange rates are very comparable to the Australian market which is already a regulated market, therefore it is not obvious that there would be any additional benefit from regulation. As we have stated, ANZ believes that greater pricing transparency would benefit the debit market. Should debit be regulated then proprietary debit transactions would need to be included (as they are in Australia) to ensure consistent treatment across all payment methods.
29	Aside from the financial barrier imposed by the interchange business model, what barriers to entry for new debit payment products currently exist?	As we have already stated, ANZ does not believe that the interchange business model imposes barriers to entry in the debit market or for new debit payment products. Even with lower interchange rates on scheme debit transactions, there would be little or no incentive to invest in new debit products or functionality without revenue to cover development and operating costs. The New Zealand market's small scale makes it uneconomic for new entrants to develop new functionality and products for the debit market where there is no direct revenue. Other factors or barriers to entry include: • the inability to use domestic EFTPOS internationally or remotely (online for eCommerce transactions or over the phone) • the costs of developing bespoke capabilities locally vs the benefits of leveraging global technology • the additional security and protections provided to consumers making scheme transactions, e.g. against fraud, non-delivery of goods, merchant failure etc Proprietary EFTPOS is currently a reliable limited service which works, however any investment in enhanced capability would be dependent on a revenue stream to justify the costs.
30	Are there good justifications for these barriers being in place?	As stated, we do not believe that the interchange model is the cause of any barriers that exist in the debit market. However, in order to have safe, secure and robust payments systems, there will always need to be some barriers. Payments systems are complex with stringent technology and access

		requirements that help ensure ubiquity and confidence. They require constant funding to maintain, and this funding requirement is currently borne by the bank participants in the payments system. The lack of funding from other participants will remain a major barrier to additional entrants and products.
31	Are there ways in which any unjustified barriers could be removed?	Ultimately there needs to be a revenue stream associated with any new product (or existing product) to ensure the new debit offerings have sufficient stakeholder backing and commitment.
32	Is there merit in exploring options in addition to interchange and barriers to entry?	ANZ believes that there are some voluntarily proactive changes participants could agree to that would benefit all market participants. We have listed these in our opening Key Messages and would be open to discussing our thoughts in more detail.
33	Have we missed any options?	As per 32.

section 9(2)(b)(ii) – commercial information

Appendix III –

section 9(2)(b)(ii) – commercial information

section 9(2)(b)(ii) – commercial information

section 9(2)(b)(ii) – commercial information

Appendix IV – description of ANZ interchange plus pricing and examples of ANZ merchant pricing statements

ANZ INTERCHANGE PLUS FEE DESCRIPTION

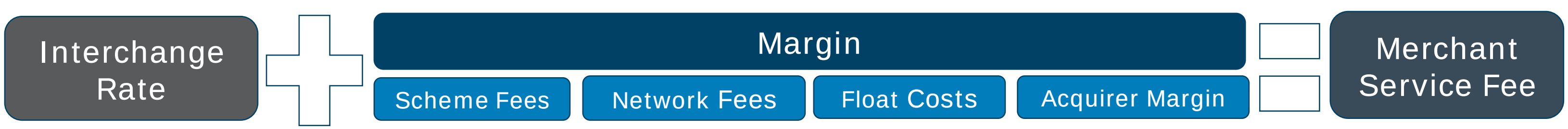
A Merchant Service Fee will be calculated on an 'interchange plus' billing structure comprised of two components:

- The applicable interchange rate: This is the fee paid to the card issuer for each transaction and is set by the Card Schemes. Domestic Interchange rates are published online and vary depending on the card type processed;

  PLUS

- A margin: This is to cover other costs associated with processing your transaction (including: scheme fees, network fees, float costs and acquirer margin)

for each transaction.



Example A: Non-interchange demonstrating cheaper rate for contactless debit v credit transactions

Merchant Statement

Freephone: 0800 473 453
Facsimile: 0800 491 301

Statement Period 01 NOV 16 to 30 NOV 16
Statement Date 01 DEC 16

Merchant Number **061123456**

J & J DOE
PO BOX 2211
WELLINGTON 6011

Fee Summary

Merchant Fee	$59.92

Amount charged to your current account **06-0123-0123456-00** as of **12 DEC 16** is **$59.92**

Summary of card transactions for merchant number 061123456

	No. of Sales	Amount of Sales	No. of Refunds	Amount of Refunds	Net Sales	Fee	Merchant Fee
VISA	30	$850.70	0	$0.00	$850.70	2.00%	$17.01
DEBIT PAYWAVE	71	$1,200.51	0	$0.00	$1,200.51	1.30%	$15.61
VISA TOTAL	**101**	**$2,051.21**	**0**	**$0.00**	**$2,051.21**		**$32.62**
MASTERCARD	22	$553.80	0	$0.00	$553.80	2.00%	$11.08
DEBIT PAYPASS	41	$721.10	0	$0.00	$721.10	1.30%	$9.37
MASTERCARD TOTAL	**63**	**$1,274.90**	**0**	**$0.00**	**$1,274.90**		**$20.45**
UNIONPAY	5	$100.80	0	$0.00	$100.80	2.00%	$2.02
DEBIT	9	$241.60	0	$0.00	$241.60	2.00%	$4.83
UNIONPAY TOTAL	**14**	**$342.40**	**0**	**$0.00**	**$342.40**		**$6.85**
TOTAL	**178**	**$3,668.51**	**0**	**$0.00**	**$3,668.51**		**$59.92**

Daily Banking Summary

Settled Date	Settlement Type	Amount
01/11/2016	Electronic Settlement	207.89
02/11/2016	Electronic Settlement	291.80
03/11/2016	Electronic Settlement	232.86
04/11/2016	Electronic Settlement	299.79
07/11/2016	Electronic Settlement	223.77
07/11/2016	Electronic Settlement	277.21
07/11/2016	Electronic Settlement	241.13
08/11/2016	Electronic Settlement	243.84
09/11/2016	Electronic Settlement	245.20
10/11/2016	Electronic Settlement	194.07
11/11/2016	Electronic Settlement	138.19
14/11/2016	Electronic Settlement	171.05
14/11/2016	Electronic Settlement	242.10
15/11/2016	Electronic Settlement	242.18
16/11/2016	Electronic Settlement	203.66
17/11/2016	Electronic Settlement	213.77

Example B: Interchange Variable - for small-medium sized businesses

Merchant Statement

** Variable **
Merchant Level

Freephone:	0800 473 453
Facsimile:	0800 491 301
Statement Period	01 OCT 14 to 31 OCT 14
Statement Date	01 NOV 14
Merchant Number	**061456789**

J & J DOE
34 MAIN ROAD
WELLINGTON 6001

Fee Summary

Merchant Fee	$1,227.90

Amount charged to your current account **01-1234-0067892-02** as of **12 NOV 14** is **$1,227.90**

Summary of card transactions for merchant number 061456789

	No. of Sales	Amount of Sales	No. of Refunds	Amount of Refunds	Net Sales	Fee[1]	Merchant Fee
VISA CREDIT	169	$27,742.83	0	$0.00	$27,742.83		$696.35
VISA DEBIT	21	$3,447.33	0	$0.00	$3,447.33		$86.53
VISA PREPAID	6	$984.96	0	$0.00	$984.96		$24.72
VISA TOTAL	**196**	**$32,175.12**	**0**	**$0.00**	**$32,175.12**		**$807.60**
MASTERCARD CREDIT	40	$8,136.80	0	$0.00	$8,136.80		$204.23
MASTERCARD DEBIT	18	$3,661.56	0	$0.00	$3,661.56		$91.91
MASTERCARD PREPAID	7	$1,423.95	0	$0.00	$1,423.95		$35.74
MASTERCARD TOTAL	**65**	**$13,222.31**	**0**	**$0.00**	**$13,222.31**		**$331.88**
UNIONPAY CREDIT	8	$2,818.40	0	$0.00	$2,818.40		$70.74
UNIONPAY DEBIT	2	$704.60	0	$0.00	$704.60		$17.69
UNIONPAY PREPAID	0	$0.00	0	$0.00	$0.00		$0.00
UNIONPAY TOTAL	**10**	**$3,523.00**	**0**	**$0.00**	**$3,523.00**		**$88.43**
TOTAL	**271**	**$48,920.43**	**0**	**$0.00**	**$48,920.43**	**2.51%**	**$1,227.90**

Daily Banking Summary

Settled Date	Settlement Type	Amount
01/10/2014	Electronic Settlement	1,374.53
02/10/2014	Electronic Settlement	517.46
03/10/2014	Electronic Settlement	993.02
04/10/2014	Electronic Settlement	1,795.58
05/10/2014	Electronic Settlement	1,238.82
06/10/2014	Electronic Settlement	1,858.07
07/10/2014	Electronic Settlement	1,724.03
08/10/2014	Electronic Settlement	1,901.08
09/10/2014	Electronic Settlement	881.88
10/10/2014	Electronic Settlement	923.35
11/10/2014	Electronic Settlement	2,594.77
12/10/2014	Electronic Settlement	2,940.49
13/10/2014	Electronic Settlement	1,649.25
14/10/2014	Electronic Settlement	1,020.15
15/10/2014	Electronic Settlement	2,537.31
16/10/2014	Electronic Settlement	813.27
17/10/2014	Electronic Settlement	1,000.31
18/10/2014	Electronic Settlement	1,529.10
19/10/2014	Electronic Settlement	2,381.84
20/10/2014	Electronic Settlement	833.98
21/10/2014	Electronic Settlement	2,053.80
22/10/2014	Electronic Settlement	1,958.19

Merchant Statement

Merchant Name J & J DOE

Statement Period **01 OCT 14** to **31 OCT 14**
Statement Date **01 NOV 14**

Merchant Number **061456789**

Daily Banking Summary

Settled Date	Settlement Type	Amount
23/10/2014	Electronic Settlement	900.30
24/10/2014	Electronic Settlement	606.54
25/10/2014	Electronic Settlement	1,750.13
26/10/2014	Electronic Settlement	2,396.98
27/10/2014	Electronic Settlement	1,642.68
28/10/2014	Electronic Settlement	1,024.41
29/10/2014	Electronic Settlement	1,759.69
30/10/2014	Electronic Settlement	1,567.00
31/10/2014	Electronic Settlement	2,752.42

[1] Credit card transactions processed incur a range of fees. The fee displayed will vary depending on the blend of cards processed in the cycle.

Example C: Full - for corporates

Merchant Statement

Freephone:	**0800 473 453**
Facsimile:	**0800 491 301**

* * Full * *

Statement Period	**01 OCT 14** to **31 OCT 14**
Statement Date	**01 NOV 14**
Merchant Number	**061056787**

WIDGETS INC
678 MAIN ROAD
WELLINGTON 6001

Fee Summary

Interchange Fee	$607.60
Margin	$460.48
Total Merchant Fee	**$1,068.08**

Amount charged to your current account **01-1234-0078915-01** as of **12 NOV 14** is **$1,068.08**

Summary of card transactions for merchant number 061056787

	No. of Sales	Amount of Sales	No. of Refunds	Amount of Refunds	Net Sales	Fee[1]	Interchange Fee
DOM CR CLASSIC/GOLD ELCTRNC	80	$13,132.70	0	$0.00	$13,132.70	0.850%	$111.63
DOM CR PLATINUM ELECTRONIC	41	$6,730.51	0	$0.00	$6,730.51	1.850%	$124.51
DOM CR COMMERCIAL ELCTRNC	48	$7,879.62	0	$0.00	$7,879.62	2.000%	$157.59
DOM DB ELECTRONIC	21	$3,447.33	0	$0.00	$3,447.33	0.300%	$10.34
DOM PP ELECTRONIC	6	$984.96	0	$0.00	$984.96	0.600%	$5.91
VISA TOTAL	**196**	**$32,175.12**	**0**	**$0.00**	**$32,175.12**		**$409.98**
DOM CR CONTACTLESS	13	$2,644.46	0	$0.00	$2,644.46	0.550%	$14.54
DOM CR CONS SPR PREM 1	2	$406.84	0	$0.00	$406.84	2.350%	$9.56
DOM CR CONS SPR PREM 2	3	$610.26	0	$0.00	$610.26	2.100%	$12.82
DOM CR CONSMR PREMIUM	6	$1,220.52	0	$0.00	$1,220.52	2.150%	$26.24
DOM CR COM PREM	5	$1,017.10	0	$0.00	$1,017.10	2.200%	$22.38
DOM CR COMMERCIAL	9	$1,830.78	0	$0.00	$1,830.78	2.000%	$36.62
DOM CR CONSMR ELCTRNC	2	$406.84	0	$0.00	$406.84	1.000%	$4.07
DOM DB CONTACTLESS	8	$1,627.36	0	$0.00	$1,627.36	0.400%	$6.51
DOM DB CONSMR PREMIUM	5	$1,017.10	0	$0.00	$1,017.10	1.300%	$13.22
DOM DB COMMERCIAL	1	$203.42	0	$0.00	$203.42	1.500%	$3.05
DOM DB CONSMR ELCTRNC	4	$813.68	0	$0.00	$813.68	0.500%	$4.07
DOM PP CONSMR PREMIUM	1	$203.43	0	$0.00	$203.43	1.300%	$2.64
DOM PP COMMERCIAL	2	$406.84	0	$0.00	$406.84	1.500%	$6.10
DOM PP CONSMR ELCTRNC	4	$813.68	0	$0.00	$813.68	0.500%	$4.07
MASTERCARD TOTAL	**65**	**$13,222.31**	**0**	**$0.00**	**$13,222.31**		**$165.89**
INTERNATIONAL STANDARD	13	$2,644.46	0	$0.00	$2,644.46	1.200%[2]	$31.73
UNIONPAY TOTAL	**65**	**$13,222.31**	**0**	**$0.00**	**$13,222.31**		**$31.73**
TOTAL INTERCHANGE	**261**	**$45,397.43**	**0**	**$0.00**	**$45,397.43**		**$607.60**

Merchant Statement

Merchant Name WIDGETS INC

Statement Period	**01 OCT 14 to 31 OCT 14**
Statement Date	**01 NOV 14**
Merchant Number	**061056787**

Daily Banking Summary

Settled Date	Settlement Type	Amount
01/10/2014	Electronic Settlement	1,374.53
02/10/2014	Electronic Settlement	517.46
03/10/2014	Electronic Settlement	993.02
04/10/2014	Electronic Settlement	1,443.28
05/10/2014	Electronic Settlement	1,238.82
06/10/2014	Electronic Settlement	1,858.07
07/10/2014	Electronic Settlement	1,724.03
08/10/2014	Electronic Settlement	1,548.78
09/10/2014	Electronic Settlement	881.88
10/10/2014	Electronic Settlement	923.35
11/10/2014	Electronic Settlement	2,594.77
12/10/2014	Electronic Settlement	2,940.49
13/10/2014	Electronic Settlement	944.65
14/10/2014	Electronic Settlement	1,020.15
15/10/2014	Electronic Settlement	2,537.31
16/10/2014	Electronic Settlement	813.27
17/10/2014	Electronic Settlement	1,000.31
18/10/2014	Electronic Settlement	1,529.10
19/10/2014	Electronic Settlement	1,324.94
20/10/2014	Electronic Settlement	833.98
21/10/2014	Electronic Settlement	2,053.80
22/10/2014	Electronic Settlement	1,958.19
23/10/2014	Electronic Settlement	548.00
24/10/2014	Electronic Settlement	606.54
25/10/2014	Electronic Settlement	1,750.13
26/10/2014	Electronic Settlement	2,396.98
27/10/2014	Electronic Settlement	1,290.38
28/10/2014	Electronic Settlement	1,024.41
29/10/2014	Electronic Settlement	1,759.69
30/10/2014	Electronic Settlement	1,567.00
31/10/2014	Electronic Settlement	2,400.12

1 % - Percentage of net sales
$ - Fixed amount per transaction (NZD)

2 Transactions processed using credit cards issued internationally incur a range of fees. The fee displayed will vary depending on the blend of cards processed in the cycle.