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# Retail Payment Systems

Submission to Ministry of Business, Innovation &  
Employment

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# Index

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1. INTRODUCTION	3
2. EXECUTIVE SUMMARY	4
3. PAYMENTS NZ RESPONSE TO THE QUESTIONS RAISED IN CONSULTATION DOCUMENT	6

## 1. INTRODUCTION

- 1.1 Payments NZ Limited ("**Payments NZ**") is a key stakeholder in the governance of New Zealand's payments systems, with primary responsibility for setting payment rules in New Zealand for the High Value Clearing System (HVCS) and Settlement Before Interchange Clearing System (SBI) which settles Cheques, Electronic Credits and Debits along with Domestic Card transactions.
- 1.2 Payments NZ is a limited liability company with constitutional objectives to:
  - (a) Manage the Rules;
  - (b) Promote interoperable, innovative, safe, open and efficient payments systems;
  - (c) Encourage and facilitate new entities becoming Participants in Clearing Systems based on fair and reasonable public access criteria;
  - (d) Facilitate interoperability of payments between Participants on legally appropriate and fair and reasonable terms; and
  - (e) Make available exchangeable file format material at no cost to parties who have a business need in a way that will enable alternative payment services to be provided; and
  - (f) Pursue other business opportunities as it sees fit (whether in the payments and clearing related businesses or not) which do not conflict with the Company's other objectives and functions.
- 1.3 Payments NZ is made up of a team of industry specialists. It oversees most of the core payments systems in New Zealand and, in that capacity, provides thought leadership, change management and ensures compliance with relevant payment standards.
- 1.4 Payments NZ governance structure includes
  - (a) Board – 11 directors including 3 independent directors
  - (b) 4 Management Committees who manage the rules for:-
    - (i) High Value Clearing System (same day cleared payments)
    - (ii) Bulk Electronic Clearing System (electronic credits and direct debits)
    - (iii) Paper Clearing System (cheques and MICR transactions)
    - (iv) Consumer Electronic Clearing System (EFTPOS)
- 1.5 Payments NZ welcomes the opportunity for input into the Retail payment systems consultation.
- 1.6 In responding to the Consultation Document, Payments NZ has focussed on the areas directly related to its constitutional objectives regarding access and the governance of payment systems.

## 2. EXECUTIVE SUMMARY

- 2.1 Payments NZ believes the retail payment system meets the MBIE objective of *'delivering good economic outcomes'* and is already an enabler towards the Government's priority of *'building a more productive and competitive economy'*.
- 2.2 The governance of the payment system has included in its objectives safety, security and interoperability. These objectives ensure that the New Zealand payment system attracts the investment required to deliver scalable payment solutions that deliver far reaching economic benefit.
- 2.3 The New Zealand payment system performs exceptionally well on a global scale and in doing so, delivers strong economic outcomes. This is evidenced by the following payment statistics.
- (a) Work/sales income payments into bank account: 1<sup>st</sup> in the world. 73% of adults use their accounts to receive payments from work or selling goods.
  - (b) Banked population: 3<sup>rd</sup> in the world. 99.4% of adults have an account at a formal financial institution.
  - (c) Debit card penetration: 3<sup>rd</sup> in the world. 93.8% of adults have and use a debit card.
  - (d) Electronic payments usage: 4<sup>th</sup> in the world. 83.23% of adults use electronic payments when making payments

Measures of NZ's payment system effectiveness from other sources include:

- (e) Electronic debit and credit payments per capita: 1<sup>st</sup> in the world. 121 electronic (non-card) payments per person per annum.
  - (f) Transactions per capita per annum for debit and credit card purchases: 1<sup>st</sup> in the world. Approaching 1 transaction per day per capita.
  - (g) Cash in circulation: 1<sup>st</sup> in the world. The lowest banknotes per capita at NZ\$1,035 per capita. 1<sup>st</sup> lowest total cash as % of GDP at 2.1% of GDP.
  - (h) Pace of electronic change: 1<sup>st</sup> in the world. NZ has the most preferable mix of consumer payment behaviours being: predominately electronic, fast adoption of electronic payments, and a high preference for electronic payments.
- 2.4 In addition to the broader set of objectives, governance of the retail payment system is also contributing to its success. The EFTPOS system is governed by the Consumer Electronic Clearing System Management Committee (CECS) who have Board delegated authority to manage the rules for EFTPOS.
- 2.5 The Management Committee includes all 8 Participants who settle EFTPOS transactions. The rules governing EFTPOS act as a multi-lateral contract binding each Participant to a rules set that promotes an interoperable, innovative, safe, open and efficient payments system.
- 2.6 This governance structure includes a mechanism that enables broad participation in the payment system without a requirement for all parties to become direct settlement participants or sign the same multi-lateral contract. Cascading obligations within the rules enable another

person to act as an issuer or as an acquirer. But it is the Participant settling these transactions who is obligated to ensure the person complies with the rules in terms of delivering an interoperable, safe and efficient payments system.

- 2.7 The benefit of this governance structure is an open market, with low barriers to entry but which protects all users of the system, including cardholders, merchants and payment service providers by ensuring an appropriate level of security and interoperability.
- 2.8 The rules also encourage innovation through New Technology Principles. This section of the rules enables a trial of new technologies without the need for the person to compromise confidentiality or wait for the rules to be amended before they can commence testing their proposition in the market.
- 2.9 This combination of low barriers to entry, an ability to innovate within the market, while still being required to meet appropriate levels of security standards, address the issues raised in the MBIE document regarding governance and a code of conduct.

### 3. PAYMENTS NZ RESPONSE TO THE QUESTIONS RAISED IN CONSULTATION DOCUMENT.

#### 3.1 Section 1 – Question 1. Are these objectives for retail payment systems appropriate?

- (a) The MBIE document is focussed on the economic outcomes delivered by retail payment systems in New Zealand and states these outcomes are complimentary to the objectives held by other regulatory bodies in New Zealand. This includes the Reserve Bank whose prudential role is to ensure payment systems are safe, secure and subject to prudential supervision.
- (b) With the Reserve Bank's prudential role in mind, the document uses 3 objectives to assess New Zealand's retail payment systems against the goal of delivering good economic outcomes and links these objectives to the Government's priority of '*building a more productive and competitive economy*'.
- (c) When developing objectives to measure the effectiveness of a payment system, Payments NZ does not believe you can decouple the obligations of a safe and secure system. These requirements are at the core of the trusted, highly electronic, interoperable and efficient payment system we have in New Zealand today. Without considering safety and security as an objective required to deliver to good economic outcomes, MBIE risks making policy decisions that have a negative impact on the Government's priority of '*building a more productive and competitive economy*'.
- (d) Payments NZ believes it is only by focussing on all of the elements contained within its constitutional objectives (interoperable, innovative, safe, open and efficient payments systems) that the goal of '*good economic outcomes*' and '*a more productive and competitive economy*' can be achieved.
- (e) The benefits of this holistic approach is evident when the NZ payments systems is compared to our global counterparts.
  - (i) Work/sales income payments into bank account: 1<sup>st</sup> in the world. 73% of adults use their accounts to receive payments from work or selling goods.
  - (ii) Banked population: 3<sup>rd</sup> in the world. 99.4% of adults have an account at a formal financial institution.
  - (iii) Debit card penetration: 3<sup>rd</sup> in the world. 93.8% of adults have and use a debit card.
  - (iv) Electronic payments usage: 4<sup>th</sup> in the world. 83.23% of adults use electronic payments when making payments

Measures of NZ's payment system effectiveness from other sources include:

- (v) Electronic debit and credit payments per capita: 1<sup>st</sup> in the world. 121 electronic (non-card) payments per person per annum.
- (vi) Transactions per capita per annum for debit and credit card purchases: 1<sup>st</sup> in the world. Approaching 1 transaction per day per capita.

- (vii) Cash in circulation: 1st in the world. The lowest banknotes per capita at NZ\$1,035 per capita. 1st lowest total cash as % of GDP at 2.1% of GDP.
- (viii) Pace of electronic change: 1st in the world. NZ has the most preferable mix of consumer payment behaviours being: predominately electronic, fast adoption of electronic payments, and a high preference for electronic payments.
- (f) When considering the economic outcomes of today's retail payment system, MBIE must take into account the ongoing investment required to maintain a safe and secure system. Without this trusted payment system there is no payment network from which new providers can launch their services that provides the opportunity to gain scale.

### 3.2 Section 2 – Payment systems in New Zealand

- (a) With regard to the question *'Are there any other emerging payment methods that we have missed? If so, what is their likely impact on the market?'* A key element of Payments NZ role is to encourage and facilitate new entities becoming Participants in Clearing Systems based on fair and reasonable public access criteria.
- (b) While other respondents will be better placed to comment on emerging payment methods and their likely impact, Payments NZ does discuss, in Section 5, the related issue on emerging payment methods and their ability to access the market.

### 3.3 Section 3 – Market business models and resource costs

- (a) Questions 3 – 7 relate to interchange and its associated business model. As interchange is a commercial model that operates outside Payments NZ constitutional objectives and is not covered by any of its Clearing System rules, we have not responded to these questions.

### 3.4 Section 4 – Issues identified

- (a) Questions 8 – 23 relate to interchange and the impacts this may have on the retail payment system. As with section 3, interchange is a commercial model that operates outside Payments NZ constitutional objectives and is not covered by any of its Clearing System rules. For this reason we have not responded to these questions.

### 3.5 Section 5 – Possible next steps. Questions 24 – 28.

- (a) These questions consider the use and consequences of regulation to smooth any price distortions in the market. As these questions specifically relate to interchange and the related business model, which operate outside Payments NZ constitutional objectives and is not covered by any of its Clearing System rules, we have not responded to these questions.

3.6 Section 5 – Question 29. Aside from the financial barrier imposed by the interchange business model, what barriers to entry for new debit payment products currently exist?

- (a) Payments NZ believes there are no barriers to entry for new debit payment products but as the public would expect, there are minimum standards protecting the integrity and efficiency of the system.
- (b) In responding to this question, Payments NZ has provided examples that relate to:-
  - (i) Participation in the payment system
  - (ii) Membership
  - (iii) Enabling innovation
- (c) One of Payments NZ constitutional objectives is to encourage and facilitate new entities becoming Participants in Clearing Systems based on fair and reasonable public access criteria.
- (d) The Company's independent directors determine applications to participate in the Company's clearing systems. The independent directors will admit applicants if they are satisfied that the applicant will not:
  - (i) Adversely affect the integrity or reputation of the clearing system; or
  - (ii) Introduce significant risk into the clearing system.
- (e) When making a determination, the independent directors will consider whether an applicant is able to meet:
  - (i) prudential requirements,
  - (ii) operational risk management requirements, and
  - (iii) operational requirements in relation to clearing systems – this involves successfully completing both bi-lateral and industry testing with all participants.
- (f) The independent directors also have the right to impose conditions on an applicant who might not otherwise satisfy the access criterion. The conditions are designed to address any risks that might arise.
- (g) The Company's access rules are publicly available on the Company's website.
- (h) The approach to assessing applications is risk based, fair and objective, and requires the independent directors to seek expert advice when making a determination. The



requirements are set out in detail, mitigate against identified risks and allow the independent directors to consider any relevant information.

- (i) In addition to this risk based assessment for organisations wishing to become direct participants, our rules also enable participation for those who wish to provide payment related services but who do not want to become a direct settlement Participant.
  - (i) The Payments NZ Consumer Electronic Clearing System (CECS) rules include a cascading obligation so a CECS participant can enable another person to act as an issuer or as an acquirer under the rules.
  - (ii) But the CECS member, as the settlement Participant,
    - (1) must ensure the person complies with all obligations relating to issuers and acquirers,
    - (2) is liable to all other participants for both the person's compliance with all obligations relating to issuers or acquirers and the clearing and settlement obligations.
  - (iii) Examples where the CECS participant is enabling another person to act as an issuer or as an acquirer under the rules and must ensure the person complies with all the obligations related to their service include:-
    - (1) agency banks who issue card products that access the EFTPOS network.
    - (2) party's acting as an acquirer by providing retail switching services and terminal services to merchants for EFTPOS transactions.
    - (3) terminal vendor/reseller.
  - (iv) The strength of this model, is it enables new services to be brought to market that can build on the many years of investment in the existing payment rails, without the need to become a direct settlement participant. And for existing Participants, this model protects the interoperability, safety and efficiency of the existing payments system.
- (j) In addition to the two options for participation, Payments NZ offers non participants with an ability to contribute to its agenda through its membership program.
- (k) 3 levels of membership exist
  - (i) Infrastructure members – who operate services such as switching, messaging services, or data processing services that relate to the operation of a Clearing System, or directly enable a Participant to participate in a Clearing System. In the context of the MBIE document, CECS who govern the rules and procedures for EFTPOS have 3 infrastructure members, Paymark, EFTPOS NZ and Progressive Enterprises, all of whom operate switching services for card payments in New Zealand. As an infrastructure member, all 3 attend the CECS Management Committee meetings where clearing system strategy, work program content and the rules are managed.

- (ii) Standards members – this level of membership is targeted towards those who wish to play an active role in the development of rules and procedures. A standards member can become part of a working group who are reviewing a rule set.
  - (iii) Industry members – this targets a broad section of the payment industry enabling organisations to participate in industry forums providing input into relevant topics of discussion.
- (l) All of these membership options provide an ability for people to be part of industry discussion that can shape current thinking and future direction.
  - (m) Beyond the two options for participating in the payment system and membership program, the third element that exists to encourage participation and enable innovation is the New Technology Principle within the CECS rules.
  - (n) Given all the innovation that has been occurring in payments globally, Payments NZ has established a framework that enables Participants and entities they are working with, to trial new technologies without having to compromise confidentiality or wait for the rules to be amended before they can test their proposition in the market.
  - (o) These New Technology Principles enable a trial to occur within the production system but set boundaries regarding the scale of the trial and protect other users of the payment system by ensuring Payments NZ is able to provide an impartial oversight ensuring the trial does not introduce undue risk.
  - (p) Following a successful trial, Payments NZ is then able to initiate a rules project to add the security and interoperability layer that supports the commercialisation of the solution.

### 3.7 Section 5 – Question 33. Have we missed any options?

- (a) In this section the document asks about the merit of investigating other options which include:-
  - (i) Changes that would be required to make EFTPOS a sustainable alternative to scheme debit products, including technological improvements
- (b) Over the course of 2013/14 Payments NZ worked with a range of industry stakeholders to consider the future role of domestic debit.
- (c) Stakeholders agreed the decline of EFTPOS was due to:-
  - (i) No centralised or coordinated control of the product to drive its strategic direction,
  - (ii) No revenue model to help sustain investment in its development over the long term,

- (iii) The growing move by traditional domestic debit users to more technically capable scheme debit cards, which are able to be used in multiple on and offshore payment environments including the internet,
  - (iv) The anticipated move to contactless based payments, which is believed will further erode the position of the domestic debit product.
- (d) During this process several joint bank/ retailer workshops were held. Once retailers felt they had provided sufficient input into a preferred business model they withdrew from the discussions, leaving the banks to pursue a new model for domestic debit.
- (e) The banks ultimately concluded that market forces should decide the future of domestic debit. These market forces include:-
- (i) Innovation – the application of new technology into the retail payment system is introducing new form factors and changing the way consumers use existing payment instruments. Enabling this innovation to occur, is likely to lead to better outcomes for all stakeholders.
  - (ii) Economic model – if EFTPOS can become a more effective mechanism to meet consumer needs or meet a specific market demand, stakeholders will continue to invest in the payment system. If these same needs can be better met through alternative payment mechanisms then market forces will dictate its future.
  - (iii) Consumer and merchant choice – consumers and merchants continue to seek payment solutions that are less visible (the Uber experience) and enhance the customer experience (rewards programs, mobile wallets etc). Consumer and merchant demand will have a role in determining whether EFTPOS is part of this changing payment landscape.
- (f) While the outcome has not changed the immediate direction of EFTPOS, the process did provide evidence the industry was able to engage in what was a complex, multilateral conversation between three inter-related groups (banks, retailers and schemes); with each group themselves having their own complexities and tensions.
- (g) In terms of other options, the industry continues to use its Payments Direction initiative to assess opportunities for the industry to enhance the retail payment system. The options currently being considered which could benefit consumers and merchants alike include:-
- (i) Proxy identifiers – using an alias such as a mobile phone number, email address as a method of routing payments.
  - (ii) API's – to initiate payments and provide other payment related services
  - (iii) ISO 20022 – enables a richer data set to accompany the payment information. Improves reconciliation and expands the services that can be provided as part of the payment instruction.
  - (iv) Availability – the ability to settle transactions over a longer period within the week – ie 24 x 7.

- (h) Examples of how this technology can influence new payment solutions was show cased at the Payments NZ 2016 conference. Speakers from Vocalink, NPP, BPAY and Latipay were all able to show commercial examples of how payment solutions are now in market using a combination of the technologies listed above.
- (i) Each of these initiatives could play a role in providing a richer payment experience that does not rely on the EFTPOS network, yet provides a competitive alternative to scheme based transactions.