

In Confidence

Office of the Minister of Commerce and Consumer Affairs
Chair, Cabinet Economic Growth and Infrastructure Committee

RETAIL PAYMENT SYSTEMS: UPDATE ON NEXT STEPS

Proposal

- 1 This paper updates the Cabinet Economic Growth and Infrastructure Committee (EGI) on next steps to facilitate greater competition and innovation in New Zealand's retail payment systems following consultation on the *Retail payments in New Zealand – issues paper*.

Context for this report back

- 2 In February 2016, the former Minister of Finance and former Minister of Commerce and Consumer Affairs commissioned a study into retail payment systems with a focus on credit card, EFTPOS and debit card systems. This was a response to retailer concerns about rising fees for processing; the lapsing of the Commerce Commission's 2009 settlement with banks and card schemes;¹ and growing overseas regulation of credit and debit card systems.
- 3 EGI previously considered retail payment systems in October 2016 prior to the release of an issues paper. The Minister of Commerce and Consumer Affairs was asked to report back to EGI on how to progress this work [EGI-16-MIN-0261 refers]. The issues paper tested concerns about the efficiency of the retail payments system, barriers to entry, and a growing cost burden on smaller businesses.
- 4 Forty-six submissions were received, representing views from card schemes (Visa and Mastercard), banks, merchants, consumer representatives, and other industry representatives. I have since received advice on this from MBIE and met with a range of stakeholders.
- 5 Similar to the *Fuel Markets Financial Performance Study*, this study is an example of how we are considering opportunities for improving competition in specific sectors, particularly where they impact on the productivity of the broader economy. This contributes to our *Promoting Competition* BGA action plan, which aims to drive innovation and productivity in New Zealand.

New Zealand's retail payment systems are not functioning as well as they could

- 6 Retail payment systems are critical to the efficiency of our commercial landscape and banking ecosystems. Each year consumers make approximately 1.6 billion electronic card transactions in New Zealand, representing more than \$80 billion in expenditure for the year ending March 2017.
- 7 The issues paper addressed concerns about the efficiency of the retail payment systems, how the costs and benefits of the system are distributed across consumers and merchants, and the pace of (or barriers to) innovation in the system.

¹ In 2009, the Commission reached a settlement with the card schemes and major banks, in which the parties made a number of undertakings to address what the Commission considered was anti-competitive conduct in the operation of retail payment systems. The settlement with banks and schemes expired in 2013.

Average merchant fees per transaction in New Zealand

	EFTPOS	Contactless debit	Credit (Visa/ Mastercard)
2014	FREE	1.00%	1.40%
2015	FREE	1.00%	1.70%

Retail NZ data (2016)

- 8 As shown in the table above, the use of credit cards and contactless debit cards incurs a percentage fee to the merchant, whereas the use of EFTPOS cards does not. Merchants have expressed concern about these varying charges, which appear to be increasing over time, because they have little control over the payment methods customers use in store. For example, a food market outlet in New Zealand with 350 staff has said it pays over \$500,000 per year in merchant fees for accepting payment via credit cards, while similar retailers in Australia would be paying half of that for the same services. This is an additional cost to do business that many of our businesses are facing every day.
- 9 Market dynamics in the credit card market are leading to these higher costs and higher prices for goods and services. Fees to merchants (estimated at \$461 million for the year ending March 2016) contribute towards funding credit card rewards, such as AirPoints and 'cashback'. These fees are ultimately passed on to consumers, including many who do not receive or benefit from the rewards. MBIE estimates that merchants have to increase their prices to all consumers by around \$187 million per year to fund rewards.
- 10 I am also concerned that declining use of EFTPOS may limit choice and place further pressure on prices. Between January 2014 and June 2017 the value of transactions made with EFTPOS cards declined from around 44 per cent to 32 per cent of card transactions. There has been a corresponding increase in contactless (tap and go) debit transactions (by value) over this period from about 1 per cent to 9 per cent (as well as increases in credit and debit card usage).
- 11 The functionality of EFTPOS has fallen behind relative to the advances in Visa and Mastercard products which have online and contactless (tap and go) functions. As EFTPOS declines, it becomes more likely that merchants wishing to receive electronic payments (and not discourage customers) will have limited choice but to accept card scheme products (Visa and Mastercard) at the going price. Over time this may further increase costs to the economy and pressure on the prices of goods and services.

Addressing high barriers to entry in the payments market will be challenging

- 12 I would like to see greater competition in retail payment systems. This means a system that offers choices to merchants and consumers at more competitive and transparent prices. Reducing barriers to entry here could support the growth of New Zealand's small, but high performing, fintech (financial technology) sector.
- 13 This is not straightforward to achieve. In this market, competition between Visa and Mastercard, and card issuing banks, tends to drive prices up rather than down (to attract cardholders through rewards). This means any new competitors would need to offer *both* lower costs for merchants and better benefits for consumers to genuinely disrupt and improve the dynamics of this market.
- 14 Overall, it is not the absence (or even the commercial viability) of technology and new ideas that is constraining innovation in payments. New payment solutions based on internet- and mobile-based technology are already in operation or are being developed overseas.

- 15 However, there are currently significant commercial barriers for new products to overcome. New Zealand's banking sector is not sufficiently incentivised to allow the entry of alternative payment methods, particularly if they are developed by third parties.
- 16 Banks determine the ways customers can access their bank accounts. This means that potential new payment providers need to negotiate individual access to each bank's system to achieve a workable network. This provides a significant barrier to viable competition from non-bank payment providers and reinforces card issuing banks' behaviour to support credit card products based on who offers the highest revenue stream (which is paid for by merchants and ultimately consumers).
- 17 Despite these concerns, I have seen some promising responses and progress from various stakeholders since the release of the issues paper in October 2016. For example:
- a. s9(2)(b)(ii)
 - b. Payments NZ – the industry body that governs the rules for most core payment clearing systems in New Zealand – is assessing opportunities to enhance the payment systems.
 - c. s9(2)(b)(ii)
- 18 These responses are likely to have been partly motivated by the recent Government scrutiny.

Next steps: continue monitoring and encouraging industry-led solutions

- 19 To ensure that industry momentum continues at an appropriate pace, I intend to write to Payments NZ as the industry body (copying in other stakeholders), requesting a progress report by April 2018 on:
- a. its advancement of initiatives that would support competitive alternatives to current payment offerings;
 - b. engagement with third-parties (such as fintech start-ups and potential entrants such as Paymark) and merchants on a. above. This would ensure that the development of new payments infrastructure goes beyond the interest of incumbent payment providers (banks and card schemes); and
 - c. steps the industry has taken to provide greater pricing transparency and information to merchants. This may help improve merchants' decision making (and possibly bargaining power).
- 20 A draft letter to Payments NZ is attached at **Annex 1**. This letter also notes that I will be seeking officials' advice on the progress being made, any alternative views expressed by relevant stakeholders, and whether further work on regulatory options is required, giving consideration to overseas developments. I expect this advice to take account of any work the industry is doing to progress the three items I have outlined above.
- 21 This will send a strong signal to the industry that progress on initiatives that result in favourable competitive pressures could reduce the need for regulatory action. Such regulatory action could include ensuring governance arrangements are producing optimal outcomes for New Zealand collectively, regulating merchant fees, and establishing terms of

access into bank systems. It is worth noting that regulation that limits merchant fees and open access to bank data are common regulatory tools used, or being introduced, overseas.

- 22 In New Zealand and overseas, fintech firms are pushing for consumers to be able to permit third parties (e.g. budgeting apps and payment service providers) to access the customer data held by banks. Moves to enable this are called 'open banking'. The United Kingdom and Europe have recently adopted quite top-down and government-led implementations of 'open banking'. Australia has announced it will also implement open banking measures and has commissioned an independent review to determine how open banking should be implemented. My expectations and requested report back from the industry will help incentivise industry-led initiatives that are in line with these overseas developments.
- 23 Officials will observe how open banking plays out in other jurisdictions and how the industry responds. Developments in Australia are likely to be particularly relevant given the common ownership of our major banks.
- 24 I propose to report back to Cabinet by July 2018 on progress and whether any next steps are warranted.

Consultation

- 25 The following departments were consulted on this paper and the attached letter to Payments NZ: the Commerce Commission, the Treasury and the Reserve Bank of New Zealand. The Department of Prime and Cabinet has been informed.
- 26 The issues paper and submissions received are available online at www.mbie.govt.nz/info-services/business/competition-policy/retail-payment-systems. The issues paper received forty-six submissions, representing views from card schemes (Visa and Mastercard), banks, merchants, consumer representatives, and other industry representatives. Views from stakeholders varied considerably – ranging from calls for regulation, to increased transparency and better information about fees, and concerns that regulation may stifle future innovation.
- 27 Since the close of consultation, MBIE officials and I have met with a range of stakeholders to discuss submissions in more depth and next steps to address issues in the retail payment systems. This includes card schemes, major banks, Payments NZ, Paymark, Progressive Enterprises, TradeMe, Xero, and Retail NZ.

Financial implications

- 28 There are no financial implications resulting from this paper.

Human rights

- 29 The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative implications

- 30 There are no legislative implications resulting from the release of the discussion paper.

Regulatory impact analysis

- 31 A regulatory impact statement (RIS) is not required for this paper as it is not seeking policy decisions.

Publicity

- 32 I intend to issue a media release broadly outlining these next steps following the release of the letter to Payments NZ.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

- 1 **note** that maintaining Government scrutiny over retail payment systems will help incentivise industry-led initiatives that benefit New Zealand businesses and consumers;
- 2 **note** that the Minister of Commerce and Consumer Affairs intends to send the attached letter to Payments NZ (**Annex 1** refers), expressing expectations that the industry progress initiatives that support innovative and competitive alternatives to current payment offerings and improve the transparency and information about fees to merchants;
- 3 **invite** the Minister of Commerce and Consumer Affairs to report back to Cabinet by July 2018 on the outcomes of recommendation 2, and whether any next steps are warranted.

Authorised for lodgement

Hon Jacqui Dean
Minister of Commerce and Consumer Affairs

Annex 1: Letter to Payments NZ outlining expectations