

Hon. Kris Faafoi
Minister of Commerce and Consumer Affairs
Parliament Buildings
Wellington
C/-Stephen Tat
Email: Stephen.tat@parliament.govt.nz

29 March 2018

Dear Minister,

RE: MAKING SURE PAYMENTS ARE SIMPLE AND SECURE FOR KIWIS

I am writing to update you on the significant progress the industry has made in advancing the Payments Direction strategic initiative, how we have been engaging ecosystem stakeholders in our work, and our role in facilitating discussions with banks and card schemes to improve the transparency of merchant service and interchange fees.

I would welcome the opportunity to meet with you in person to discuss the progress which the industry has made and its plans for the future.

Payments NZ as a limited liability company plays a central governance, leadership and facilitation role in the New Zealand payments industry. Payments NZ is responsible for promoting innovative, safe, efficient, open and interoperable core payments systems and we work with industry to achieve this. Our vision is that Kiwis can pay who they want, when they want and how they want.

New Zealand has one of the most efficient payments systems in the world - measured by inclusion, speed of payment, and use of electronic payments. Our core payments system is made up of a tightly integrated network of distributed organisations and infrastructures that work together to ensure payments are efficient, interoperable and secure. This requires a high degree of communication and cooperation amongst industry organisations. Successful industry-led cooperation has been fundamental to creating the world class payments system we have today.

The future of the core payments system infrastructure and enabling capabilities is currently being investigated through our Payments Direction strategic initiative. Stakeholder expectations of what our payments system should deliver are changing. A core system that continues to be highly interoperable, safe, efficient, open and innovative will help meet those expectations. To have the greatest future impact that core system will also need to play its role in:

- Simplifying and removing friction from payment experiences for customers
- Giving customers choice across a greater range of value propositions.
- Enabling newcomers to partner and compete with existing players.
- Ensuring relevant voices are heard in matters of design and governance.



- Balancing innovation with preserving security and the need to meet increasingly complex compliance requirements such as with Anti Money Laundering and Know Your Customer.

Delivering on these expectations hinges not only on the outcomes of co-ordinated industry activity like Payments Direction and the work of our clearing system Management Committees, but also importantly on market forces and the competitive activity that plays out across the ecosystem every day.

Through Payments Direction and our Management Committees you can expect to see important capability improvements to the core of the payments system over the next few years. In turn these capabilities will lay new foundations to assist an increasingly dynamic, innovative and competitive payments market. Competitive forces continue to deliver innovations to improve payment experiences.

Before the end of this year, I expect industry will endorse the implementation of two of six strategic opportunities being explored by Payments Direction – a shared application programming interface (API) framework and 365 day service availability for our Settlement before Interchange (SBI) system. Both of these opportunities will contribute to future-proofing the core payments system, for the benefit of New Zealanders.

A shared API framework, with a set of common payments related API standards, designed for the local market, is considered a priority by industry. The framework would significantly increase efficiencies and enable a wide range of organisations to deliver new innovations to market faster. A pilot has just been launched to test two common payment related API standards. This is a pragmatic step in the development of the full framework. New Zealand is one of just a few countries where the development of standardised payment related APIs and framework is being led by the market.

The 365 day service availability initiative represents a significant change to payment processing within our SBI system – the core retail clearing and settlement payments system. Currently, all electronic credit and direct debit transactions (account to account payments) are generally processed over a traditional 5-day business week. Extending the availability of these payments to 365 days of the year will improve the service offered to customers and businesses, increase system efficiency, speed up the velocity of money moving through the economy and reduce risk in the payments pipeline.

Throughout the balance of this year, the industry will continue to investigate and develop the other opportunities identified in Payments Direction (proxy identifiers, request to pay, speeding up payments and ISO 20022), as well as scan the environment for other emerging new opportunities that may require industry action.

Since Payments NZ was established in 2010 we have developed a track record of bringing industry together to improve the core payments system. We engage and work with a broad range of stakeholders from our own 12 Participants (banks and financial institutions) and 28

Members (payment service providers, tech providers, retailers and merchants, industry associations, and fintechs) to wider industry and ecosystem players. Across Participants and Members, we now have 40 organisations as part of our Payments NZ community, having a say and actively contributing to shaping the future of payments.

Our broad stakeholder engagement provides assurance that core payments system improvements will reflect the needs of the wider ecosystem. Importantly, it helps us understand the diverse groups of payment system users and their varying needs. Engaging in such a broad way also provides us with a view on the current state of readiness of different users to transition to the payments system of the future.

From time to time, we are asked to facilitate sensitive industry discussions outside our mandate. Over recent months we have facilitated discussions with banks and card schemes on how to improve the transparency of merchant service and interchange fees – as requested by the former Minister of Commerce and Consumer Affairs and confirmed by you upon appointment to that portfolio.

As a result of this process the two card schemes Mastercard and Visa have advised that they will provide six-monthly weighted average interchange reporting, while the acquiring banks are continuing to develop more detailed merchant reporting. Together these steps forward should help raise confidence in the economic outcomes delivered by retail payment systems and ensure information is available to help improve competitiveness and efficiency in card-based transactions.

There are three attachments to this letter, which give further detail on progress made.

- Attachment 1 reports progress with Payments Direction with a specific focus on the shared API framework, and also sets out the results of industry discussions on merchant service and interchange fees.
- Attachment 2 contains a brief assessment of our progress on the remainder of the Payments Direction initiatives.
- Attachment 3 describes how Payments NZ has involved a broad base of stakeholders in our work and summarises key information about the clearing systems we govern.

I look forward to the opportunity of working with you, your advisers and officials to ensure the progress to date and our plans for the future remain in line with your expectations. It is important we get the balance right between encouraging innovation and ensuring the safety and security of payments for the benefit of all Kiwis.

Yours sincerely,



Steve Wiggins
Chief Executive Payments NZ Limited

ATTACHMENT 1

PAYMENTS DIRECTION PROGRESS AND IMPROVING THE TRANSPARENCY OF MERCHANT SERVICE AND INTERCHANGE FEES

This attachment reports progress with Payments Direction, with specific focus on the shared API framework, and on our facilitation of industry discussions on merchant service and interchange fees. We have focussed on the shared API framework as we understand that is of interest as you consider open banking in the context of the domestic market.

PAYMENTS DIRECTION

Payments Direction is our cornerstone strategic initiative set up to understand the evolving future of payments and to identify what industry activities are required to prepare the core payments system for that future.

The Payments Direction programme is founded on an ongoing process of research, stakeholder engagement, opportunity identification, investigation and requirements definition. This work culminates in recommendations in respect of each opportunity for industry to consider and endorse. Our industry working groups are encouraged to look for quick wins alongside identifying longer burn system changes.

The Payments Direction programme has identified six strategic industry opportunities which would deliver efficiency and interoperability improvements in the payments system. Improving efficiency and interoperability is key to delivering simple and secure payments for consumers, businesses, new and existing players alike. These improvements need to be delivered in a way that maintains the integrity and security of the core payments system and the confidence of all who use it.

The six opportunities are:

1. A shared API framework
2. 365 day service availability
3. The use of proxy identifiers to identify a bank account
4. The ISO 20022 payments messaging format
5. Speeding up payments
6. Request to pay (API enabled push payments)

Current efforts are focussed on investigating the first three opportunities because they provide fundamental building blocks and enable core system capabilities for the future. The gains from these first three opportunities are self-reinforcing. For example, the benefits from a shared API framework will be amplified by a payments system that is more available and where access to a bank account number is not critical to the initiation of a payment instruction.

In the coming months, we will start to investigate speeding up payments into beneficiary accounts, reassess ISO 20022 as a solution for enabling informative transactions and start to consider push payment (request to pay) functionality. As part of our annual strategic planning cycle we will also canvass the ecosystem for any new opportunities that could benefit from coordinated industry activity.

Before turning to the shared API framework, we would like to bring your attention to a selection of recent and upcoming payment innovations in our local market. These innovations as illustrative examples are important because they highlight the dynamic nature of our ecosystem. The market continues to forge ahead delivering improved consumer and business offerings.

An example of this innovation in the core system has been the introduction, by Payments NZ and our Participant banks, of Cleared Funds. This change means that Participant banks are now making funds available to their customers faster, thereby improving payments processing and the velocity of money in the economy. Cleared Funds is also an important enabler for future innovation and initiatives such as speeding up payments and extending service availability.

A range of other illustrative examples from the market include:

- Paymark Open Payments Platform – a digital hub for banks, third parties and merchants to connect to and provide real-time payment solutions. Starting with EFTPOS online, the focus this year is to bring to market real-time consumer peer to peer payments and merchant to consumer real-time bill payments.
- Datacom Real Time Debit – enables consumers to make one-off and recurring debit payments directly from their bank account.
- Payment Express – development of a token service that allows merchants to build a single view of the customer and the opportunity to create a frictionless payment experience for customers both in-store or online.
- Kiwibank Fintech Accelerator – the second intake of fintech start-ups shows a healthy pipeline for future innovation. One of the fintechs established by Kiwibank, Greenbase, is looking to enable third party access to bank infrastructure as a simple on-demand cloud service using APIs.

SHARED API FRAMEWORK

Our work on a shared framework and common payment related API standards will allow a range of third parties to more easily interface with Participant banks payment related services. This shared API framework and API standards will increase efficiency, reduce complexity, increase innovation and make it easier for customers to access and use the payments system in streamlined and new ways.

Globally the use of payment related APIs has increased significantly, enabling partnerships between existing financial institutions, fintechs and across the wider ecosystem. While the opportunity to standardise common APIs is frequently cast in terms of new cutting edge digital

innovations coming to market, APIs also provide the opportunity to improve and innovate existing consumer and business user experiences.

The development of a shared API framework and common standards is a positive step by industry towards:

- enhancing simplification and consistency in how industry provides and uses APIs;
- increasing speed to market for new tools and offerings;
- enhancing services and making partnering more straightforward; and
- maintaining the safety and security of the users' payment experience.

New Zealand is one of just a few countries where the use of standardised payment APIs and common frameworks is being led by the market. We have brought together an industry working group, made up of Participants and Members, to progress this work and have also engaged with a wide range of interested stakeholders.

This working group recently commenced a pilot to test two API standards. The pilot is seen as a pragmatic step in the eventual development of the full framework. The two API standards that are being piloted are Account Information and Payment Initiation.

The Account Information API will enable the verification of account details, account balances and availability of funds. The Payment Initiation API will initiate an electronic credit transaction from one domestic account to another domestic account, providing certainty of funds and setting up payment and reference information.

The standards have been based on the UK's Open Banking API standards, adapted for local use. Leveraging international standards builds and creates alignment and partnership opportunities between global organisations.

Six development partners are on board for the pilot and will feed valuable insights back to the working group to support the refinement of the API standards and development of the framework. The development partners are ASB, BNZ, Datacom, Paymark, Trade Me and Westpac.

The pilot commenced in the week beginning 19 March 2018 and is expected to run until late 2018. A direct outcome of the pilot will be an agreed set of API standards. The pilot will also provide practical insights into the development of the framework. Alongside the running of the pilot, working with industry and wider stakeholders, we will develop and build the operational and management components of the framework.

As we have progressed this work and engaged widely across the wider ecosystem we have come to understand that many organisations have started to plan and/or build API capabilities and functionalities with a view to operating within the shared API framework of the future. Some are more advanced than others and this is not unexpected given the wide range of technology development efforts and priorities across industry organisations.

There is a significant amount of discussion about open banking and the sharing of customer data held by banks to third parties. Open banking and the sharing of customer data using APIs is being considered and implemented in countries like the United Kingdom and Australia. Other countries, such as the United States, are taking a similar approach to New Zealand with industry leading the charge in setting up a framework to manage and standardise payments related APIs. The drivers behind the shift to greater 'openness' vary across jurisdictions, depending on the specific public policy objective that is being addressed.

The API pilot and the development of the shared API framework will be able to provide useful insights into the open data and open banking discussions in New Zealand. A shared API framework that is right-sized for the New Zealand market will significantly increase efficiencies and enable new innovations to come to market more quickly and simply.

TRANSPARENCY OF MERCHANT SERVICE AND INTERCHANGE FEES

Following industry activity to consider the transparency of interchange fees, Mastercard and Visa will provide the weighted average interchange rates on a six-monthly basis. This, combined with the ongoing development of more detailed merchant reporting by the acquiring banks, should raise confidence in the economic outcomes delivered by retail payment systems and ensure information is available to help improve the understanding of and competitiveness and efficiency in card-based transactions.

While merchant service and interchange fees lie outside the mandate of Payments NZ, we have facilitated the formation of a working group of issuers and acquirers and the two card schemes (Visa and Mastercard) as requested.

In relation to the transparency and usefulness of information provided to merchants by both banks and card schemes, each acquiring bank is continuing to enhance the reporting they provide to merchants. This enhanced reporting is being developed by each acquirer bank on an individual basis and they will continue to report their progress including when their respective projects will be completed directly to your officials.

In terms of providing weighted average annual debit and credit interchange fees broken down by card present and card not present transactions, the working group has developed a reporting framework that will:

- Report the weighted average interchange for debit and credit transactions, split by card present and card not present transactions.
- Provide the report on a six-monthly basis.
- Provide the data at a scheme level – i.e. Mastercard and Visa transactions will be reported separately.

Mastercard has produced and published its first report on interchange and that is available at the following web address:

<https://www.mastercard.co.nz/en-nz/about-mastercard/what-we-do/interchange.html>

Visa has also produced its report and it will be made available to you.

The working group also believes ongoing communication with merchants that supports the enhanced reporting and provision of weighted average interchange values is critically important. Acquirers will continue to work with merchants to ensure they understand the information contained within their report and the pricing options available to them. Payments NZ will provide educational information on our website.

The working group has also discussed the merits of producing a set of guiding forward looking principles that would provide a framework for reviewing concerns raised by consumers and businesses. This is with a view to finding common ground that will deliver the most efficient retail payment system without compromising safety and customer experience. Any further developments in respect of that framework will be discussed with you and your officials.

ATTACHMENT 2

SUMMARY OF PROGRESS ON BALANCE OF PAYMENTS DIRECTION INITIATIVES

This attachment summarises progress on Service availability; Proxy identifiers; ISO 20022 payments messaging; Speeding up payments; and Request to pay functionality.

SERVICE AVAILABILITY

Our work on service availability will improve efficiency by extending the availability of account to account based electronic payments to 365 days of the year. At present, bulk electronic transactions between financial institutions generally operate over a traditional 5-day business week. Extending the availability to 365 days will improve the services, increase system efficiency, speed up the velocity of money moving through the economy and reduce risk in the payments pipeline.

An industry working group has been assessing options that could evolve our SBI system from a five-day a week operating model to a system with 365-day availability.

Industry efforts to evolve to 365-day availability will help address current service gaps during the weekend and will result in improved:

- Payment experiences for customers as they will be able to send and receive funds from their bank accounts seven days a week.
- Payment services and cash flow for merchants and businesses.
- Timeliness of payments over the weekend and a further reduction to risk in the payments pipeline.

A phased approach aligned with upcoming Reserve Bank of New Zealand system changes would enable industry to make steady progress toward improving service availability. The approach also recognises the considerable challenges associated with making changes to multiple Participant and third-party systems to achieve the desired end point.

There is a strong indication of industry support for this initiative and we are currently in the process of consulting with key stakeholders around impacts and timing. Once that has concluded we expect to deliver a finalised recommendation which sets out the expected project activities, phasing and timing to transition to 365-day availability.

PROXY IDENTIFIERS

When complete, our work on proxy identifiers will make it easier to make and receive payments without having bank account details to hand. Proxy identifiers are an important building block and innovation enabler to make payments simpler for Kiwis and to offer new and more convenient payments experiences.

The Industry is consistently making gains in simplifying and streamlining payment systems, and there remain areas for improvement for customers when sending and receiving money. The reliance on having bank account numbers to hand when making a payment is an area where improvements can be made to the customer payments experience. For example:

- Customers are generally required to know the bank account number of the person they are sending money to.
- The initiating customer often needs to enter a string of 15 digits correctly for the payment to be correctly processed.
- Some customers are reluctant to provide their bank account numbers because they are concerned those numbers might be used fraudulently.

Removing the requirement to know a bank account number greatly simplifies the customer payment experience and expands the breadth of payment offerings that can be supported in the market place.

The proxy identifier working group has undertaken work on the use cases that need to be supported (e.g. allowing an initiating domestic customer to use a proxy identifier to conveniently direct a payment into the correct domestic account).

Latterly, work has focussed on identifying how best to provide a proxy identifier service. The working group considers a centralised model is preferred and they are currently investigating the different ways in which that model could be delivered.

ISO 20022

Internationally ISO 20022 has become a widely adopted messaging standard for payments. It is an enabler of a range of strategic outcomes, including:

- Enabling business process and operational efficiencies for Participants and their customers.
- Future proofing regulatory compliance.
- Enabling Participants and their business partners to develop new customer services and to enhance existing services off the back of more information being carried with each transaction.

Internationally there is an unmistakable trend towards delivering information rich payments where, for example:

- Information relevant to a transaction is carried with the transaction (and not via a separate channel).
- High levels of automation can be used to support straight through processing of transactions into enterprise systems.

While these capabilities are not supported by our current payments message format, BACHO, our format is not creating issues that require immediate resolution.

Initial investigatory work on the ISO opportunity has been undertaken and will be reassessed later in the year once existing priority Payments Direction initiatives have been progressed.

SPEEDING UP PAYMENTS

Because customers are increasingly expecting a fast account-to-account based payments experience, we have recently commenced industry discussions on how to speed up the payment of funds into beneficiary accounts, so they are as fast as they need to be to meet current and expected future market and customer demand.

Our initial discussions in this area include understanding customer and business use cases and demand for faster payments options, gap analysis and future capability identification. Once we complete these discussions, a working group will be tasked with undertaking deeper investigations into what (changes to systems and processes), how (approach) and when (timing) payments could be sped up. We expect these working group discussions to commence mid-2018.

REQUEST TO PAY

Request to pay functionality would allow a payer to receive and execute payment requests easily by, for example, approving a pre-populated bill payment. We expect the request to pay workstream to kick off later this year and for it to have a strong relationship with our work on APIs. As with other Payments Direction initiatives, this workstream will make progress under the guidance of an Industry Advisory Group to ensure that better payment experiences are delivered for Kiwis.

ATTACHMENT 3

PAYMENTS NEW ZEALAND AND ECOSYSTEM ENGAGEMENT

This attachment illustrates how we involve a diverse group of stakeholders in our work including through Payments Direction and clearing system activities to improve the core payments system and its enabling capabilities.

Payments NZ operates at the centre of the payments network. Our mandate is to manage rules in respect of our clearing systems, encourage and facilitate access to those systems, enable interoperability and to promote efficient, open, innovative, safe and interoperable payments systems.

Delivering on our mandate requires us to engage widely across the ecosystem. As might be expected, our engagement efforts range from highly formalised to less structured, with an emphasis on ensuring that all interested stakeholder views are taken into account.

Payments NZ has twelve Direct Settlement Participants (Participants) and operates four clearing systems. Each clearing system has a Management Committee made up of its Participants (banks and financial institutions). Infrastructure members are also able to attend and contribute to Management Committee meetings. Depending on the issue at hand, those committees form working groups and invite the involvement of others from across industry where specialist external input is of benefit, or where engaging with payment instrument users will enhance one of the clearing system products. Two examples are worth noting:

- Our Paper Clearing System Management Committee worked closely with Inland Revenue on rule changes to increase the efficiency of Inland Revenue's cheque processing.
- Our High Value Clearing System Management Committee liaised with the Law Society on enhancements to Same-day Cleared Payments (SCP). SCP are important in property settlements, and other large value transactions.

Our membership programme, launched in 2014, allows a range of different organisations to be involved in conversations about how New Zealand's payments system needs to evolve. We currently have twenty-eight members and our membership reach is continuing to grow as our programme matures. Our members include large scale merchant chains like Foodstuffs and Z Energy and industry associations like Retail NZ, Fintech NZ and the Blockchain Association of NZ.

As part of fostering a progressive, inclusive and innovative ecosystem, we hold strategic forums for our Participants and Members to come together to talk about strategic and topical issues impacting the industry. We also hold a series of wider industry events open to all stakeholders as an opportunity to discuss topical financial services trends and issues. Every two years we hold a biennial conference which is an opportunity for our stakeholder community and wider industry to interact, learn about trends and discuss the future of payments.

Across all those events we bring in a range of local and international thought leaders, experts and innovative businesses to share experiences and insights. For example, in 2016 we invited

the UK's Open Data Institute to speak at our forum in anticipation of the need to begin an industry conversation on the open data movement.

To support the fintech startup community we also hold a fintech innovation challenge to coincide with our biennial conference. This challenge gives start-ups much needed exposure and advice from industry experts and decision makers. In addition, we engage with the Kiwibank Fintech Accelerator and other fintech startups so they are aware of the broader industry context they are venturing into. Fintech NZ is a member of Payments NZ.

We publish a weekly newsletter as well as produce and release our own articles, reports and industry statistics to the wider industry. Our weekly newsletter has over 800 subscribers from over 230 organisations.

At a less structured level, our senior executive team regularly speak with a wide range of representatives from across the ecosystem, including merchants and fintechs, along with presenting at a number of forums and conferences.

Engagement and cooperation are prominent features of our Payments Direction efforts. In particular:

- Our Industry Advisory Group (IAG), one of the key governance groups, is made up of nine Member and eight Participant organisations.
- Our working groups are a mixture of our Participants and Members. Five of our members are represented on our API working group. Three of those members, Datacom, Paymark and Trade Me, are also development partners in the pilot of API standards and the supporting framework.

In relation to the transparency of merchant service and interchange fees, we have met regularly with Retail NZ's payments group to update that forum on industry progress. Progressive Enterprises, Foodstuffs, The Warehouse, H&J Smith, Z Energy and Mitre 10 are members of this group.

SUMMARY OF CORE PAYMENTS SYSTEM

The distributed nature of the core domestic payments system encourages a high degree of communication and cooperation within the network - from financial institutions and banks, to payments and infrastructure service providers through to merchants.

Payments that are processed through core payments systems are instructions from account holders to their financial institution or bank to move money from their account to someone else's a transfer of value between two parties (individuals and businesses).

Underpinning most of the economic activity undertaken by New Zealanders everyday are two core payments clearing and settlement systems - Settlement before Interchange (SBI) and the High Value Clearing System (HVCS). These two clearing systems are governed by Payments NZ.

We set the rules for how Participants access and safely interoperate within these clearing systems, while the Reserve Bank manages and runs the settlement account system.

SBI is the core retail payments system processing over \$1.1 trillion worth of transactions annually. It processes bulk account to account electronic credit and debit payments such as bill payments, automatic payments, payroll, tax payments, direct credits, and direct debits. All card and cheque transactions are also settled through SBI. The card transactions originate in our Consumer Electronic Clearing System, whereas the cheque transactions originate in our Paper Clearing System.

HVCS processes high value irrevocable payments such as the domestic leg of cross border payments, large customer to customer payments such as house settlements and corporate treasury payments. HVCS processes over \$6 trillion worth of transactions annually.

Both of these systems are account to account based and operate on a distributed basis, meaning there is no central clearing infrastructure. Unlike in some other jurisdictions, all payments in these systems are settled on the same day, many hourly.