

Submission

to the

**Ministry of Business,
Innovation and Employment**

on the

**Issues paper: Regulating to
reduce merchant service
fees**

19 February 2021

About NZBA

1. The New Zealand Bankers' Association (**NZBA**) is the voice of the banking industry. We work with our member banks on non-competitive issues to tell the industry's story and develop and promote policy outcomes that deliver for New Zealanders.
2. The following seventeen registered banks in New Zealand are members of NZBA:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of China (NZ) Limited
 - Bank of New Zealand
 - China Construction Bank
 - Citibank N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - Industrial and Commercial Bank of China (New Zealand) Limited
 - JPMorgan Chase Bank N.A.
 - Kiwibank Limited
 - MUFG Bank Ltd
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited

Introduction

3. NZBA welcomes the opportunity to provide feedback to the Ministry of Business, Innovation and Employment (**MBIE**) on the issues paper: *Regulating to reduce merchant service fees (Issues Paper)*. NZBA commends the work that has gone into developing the Issues Paper.

NZBA supports the objectives of the review of merchant service fees

4. NZBA recognises that the review of merchant service fees is a key priority for the Government. We and our member banks are committed to supporting the objectives of the review, particularly:
 - (a) delivering better experiences and outcomes to merchants and consumers; and
 - (b) improving the efficiency, resilience and functionality of the New Zealand retail payments system.

5. We consider that those objectives will be achieved through a proportionate regulatory response, being one which takes into account and gives weight to the following factors:
 - (a) Up-to-date data on merchant service fees over time.
 - (b) A clear understanding of the factors that make New Zealand's retail payments system unique, especially;
 - (i) the role that EFTPOS plays in the market;
 - (ii) other initiatives by industry to lower costs faced by merchants; and
 - (iii) how New Zealand's retail payments system compares with Australia.
 - (c) The role of new and innovative payment methods. We consider that products like Buy Now Pay Later (**BNPL**) should be in-scope of the review.
6. We also consider that these factors will help to answer the question of who should be responsible for regulating the retail payments system.
7. We are keen to work closely with MBIE to ensure that any new regulation flowing from this review is effective, efficient and proportionate.

NERA economic analysis of merchant service fees over time

8. As part of NZBA's response to this review, we have commissioned NERA Economic Consulting to collect, review, and analyse payments data from the five biggest banks in New Zealand. NERA's key focus was on the level of merchant service fees over time, broken down by card type. NERA has also reviewed in detail the Issues Paper and associated economic literature.
9. NERA and NZBA are very conscious of protecting the confidentiality of each bank's data. Data was shared with NERA bilaterally and in-confidence, and NERA presents aggregated results only. Note also that the specificity and form of the data provided by the banks varied in some respects (for example, whether the merchant service fees were broken down by credit card or debit card).
10. Based on that data, NERA has concluded that, for the banks in respect of which the relevant data is available, weighted average merchant services fees¹ have declined by 17.7% on average² from 2017 to 2020. This decline in merchant services fees is larger than the 11% decline in weighted average interchange fees calculated by MBIE.³

¹ As calculated either by NERA (if the data was sufficiently disaggregated) or each bank.

² This is an unweighted average across the banks' weighted average merchant services fees, as NERA does not have consistent sales value data for the banks.

³ MBIE states that this includes "credit and debit interchange fees".

11. These drops are consistent with increasing pressure, including competition from new innovations. NZBA's view is that, given there has been a significant drop in merchant service fees since 2017 (which has occurred largely without government intervention), the regulatory framework flowing from this review should be proportionate. In other words, the problem is diminishing which invites a reduced regulatory framework.

Factors that should be taken into account when regulating merchant service fees in the New Zealand context

The role of EFTPOS in the retail payments system

12. The Issues Paper notes that EFTPOS is free for consumers and merchants. Also, it notes that inserted and swiped scheme debit cards have become substitutes for EFTPOS cards, and banks have reduced or removed fees for these products (at paragraph [90]-[91]).
13. NZBA agrees that EFTPOS is a significant part of the New Zealand retail payments system. In our view, the influence of EFTPOS makes New Zealand's retail payments system unique. However, it is important to note that the maintenance of EFTPOS comes at a significant cost to banks. Because EFTPOS is not revenue-generating, that cost must be covered via other parts of the banks' business (including transactional accounts). So, in that way, the cost of offering EFTPOS free to merchants and consumers is spread across the payments and/or banking system.
14. For that reason we don't agree with the conclusion in the Issues Paper that EFTPOS puts downward pricing pressure on merchant fees (paragraph [91]). In our view, it is more accurate to view EFTPOS as being cross-subsidised by other parts of the retail payments system, or banking system as a whole, and in that way it creates a price distortion. Put simply, that is because:
 - (a) There are costs associated with the operation of EFTPOS. Although it is free for consumers and merchants, it comes at a significant cost to banks.
 - (b) Necessarily, those costs are borne by other revenue-generating aspects of banking.
15. While EFTPOS remains free for merchants and consumers, banks must manage the cost of offering this service. For this reason, EFTPOS does not offer the same functionality, benefits and user experience that other products do – for example, fraud protection, online payments and digital wallets. In our view, it is not necessarily a lack of innovation in EFTPOS which has caused a decline in its use. Rather, it is simply because consumers derive more value through the use of alternative payment methods, including scheme products.
16. Consumers place significant value on the user experience and functionality of scheme products. For example, the contactless debit user experience is quicker, does not require consumers to physically interact with the point of sale terminal and

enables users to leverage other innovations such as card control through mobile banking apps. Recently, the contactless functionality of scheme products has been a significant advantage due to COVID-19 and the public health benefits of consumers not being required to physically interact with the point of sale terminal.

17. In Australia, where interchange fees are charged on both EFTPOS and contactless transactions, contactless transactions have experienced far greater adoption. They now account for over 90% of transactions. This demonstrates the value consumers place on functionality.

Changes to the payment systems landscape since the 2017 Retail Payment Study

18. The industry has taken a number of steps to improve the efficiency, functionality and competitive discipline of the retail payments system since the 2017 Retail Payment Study:
 - (a) The schemes have improved the transparency of interchange fees which has significantly driven down costs faced by merchants.
 - (b) All major acquiring banks now offer unbundled rates.
 - (c) There has been growth and investment in payments innovations like APIs and real time payments.

Transparency of interchange fees

19. Greater transparency as to costs incurred by the various parties in the payments system has accompanied a downward trend in interchange fees (and by extension, merchant service fees). The Issues Paper notes that interchange fees have dropped by 11% from 2017 to 2020. This is a material drop that has fed into declining merchant service fees (17.7%, as calculated by NERA), reflecting competitive pressure, including between the banks.
20. The Issues Paper states that “competitive disciplines on interchange fee setting are relatively weak” ([95]). However, we are concerned that statement has not been backed up with evidence, and does not reconcile with another finding (at [65]) that “weighted average credit and debit interchange fees have decreased [since 2017] by around 11 per cent”. It also does not align with NERA’s findings.
21. In this context, it is important to note that the purpose of interchange is not simply to cover rewards and inducements, the cost of credit, and the cost of fraud. It is also typically intended to cover other costs, such as scheme costs, domestic switching costs, and the cost of operating in house systems and processes.

Unbundled rates

22. All major acquirers now offer unbundled rates as an option to merchants, which allows merchants to see a transparent breakdown of the costs they are incurring. We agree that one effect of this has been to offer merchants greater choice and to increase their bargaining power.
23. However, the benefits of unbundled rates go beyond just transparency. It can also mean that merchants only pay for the transactions that they process. The effect of that being, if a merchant processes predominantly EFTPOS or scheme debit transactions, they would pay at a lower rate and would not in fact be subsidising the use of higher-cost payment methods (eg platinum credit cards) used by other customers shopping at other merchants.

API development and real time payments

24. There has also been meaningful progress in the development of APIs through Payments NZ's API Centre. A number of NZBA's members have been involved in the development of these standards.
25. Payments NZ recently launched v2.0 of the two API standards which relate to payment initiation and account information. The v2.0 standards leverage the latest UK open banking standards which enables Payments NZ to streamline development, incorporate best practice and international methodologies, and ensure the standards are tailored to fit local market and conditions.
26. In addition to their work implementing the technical API standards, API providers have been working on the non-technical aspects which are needed to enable innovation and make open banking safe for consumers.
27. Prior to the disruption caused by Covid-19, many API providers were on track to deliver v2.0 within the timeframes set by the API Council. Unfortunately, implementation is now expected to be impacted as a result of Covid-19.
28. We believe that the API Centre's work will have a tangible effect on the retail payments system.
29. In addition, the future introduction of real time payments (**RTP**) will magnify the impact of APIs.
30. Mobile wallets are now an embedded part of the payments ecosystem. While mobile wallets currently operate "over the top" of the existing payments networks, consumer familiarity with paying using a mobile device lowers the barriers to entry for other methods of digital payments.
31. Innovative new services, such as BNPL, have entered the New Zealand market. Overseas, services like Venmo that do not use traditional payments networks have been experiencing exponential growth.⁴

⁴ For example, Venmo's transaction volumes have grown 350% since 2017. See: <https://www.statista.com/statistics/763617/venmo-total-payment-volume/>

Comparability of NZ's retail payments system with Australia

32. A significant difference between the Australian and New Zealand payments markets is that Australia has always had a fee attached to use of the EFTPOS scheme. This has allowed the Reserve Bank of Australia to effectively regulate merchant service fees and interchange as they apply across both EFTPOS and scheme debit cards.
33. As noted above, the net cost of EFTPOS to New Zealand banks has perpetuated a price differential between EFTPOS and other payment methods. This means that some merchants in New Zealand are reluctant to adopt new payment methods, as they incur some of the cost burden.

Who should be responsible for regulating retail payments in NZ?

34. The question of how retail payments should be regulated, and by who, is fundamental to this review. NZBA is therefore keen to work closely with MBIE on this point. However, we consider that it is too early in the review process to express a clear view on where responsibility for any proposed regulation should sit and what the regime may look like. The choice of regulator may depend on the form of regulation that is determined to be appropriate.
35. The creation of a dedicated payments regulator akin to the Payment Systems Board in Australia could be a viable option. If regulatory intervention arising from this review is directed at the structure of charges, the specialist knowledge of a Payment Systems Board may be required to assist.
36. However, in the interests of efficiency, it may be preferable to task an existing regulator with oversight of this issue. In that case, it may be appropriate for either the Commerce Commission (via amendments to Part 4 of the Commerce Act 1986) or RBNZ (by virtue of its oversight of key components of payments infrastructure) to be responsible for any new regulation.

The regulation of new payment methods should also be considered as part of this review

37. The Issues Paper notes that there has recently been a significant uptake of BNPL products. These products are extremely costly to merchants, but offer their services to consumers for limited direct costs (paragraph [72]).
38. In New Zealand, BNPL is entirely unregulated, despite the market share of these products rapidly increasing. For example, BNPL is not within scope of the Credit Contracts and Consumer Finance Act 2003. This is despite the fact that consumers can use BNPL products to accrue debt with multiple providers without being subjected to affordability assessments.

39. NZBA considers that BNPL is an important part of the payments ecosystem – as demonstrated by consumer demand for the products. However, we believe that MBIE should consider the growing presence of these products within the retail payments system and their costs to merchants as part of its review. Other comparable jurisdictions are also looking at how best to regulate BNPL. The United Kingdom, for example, has recently announced that BNPL will be regulated by the Financial Conduct Authority as a result of the tripling of BNPL transactions in 2020.

Contact details

40. If you would like to discuss any aspect of this submission, please contact:

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