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

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

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Submission in response to the Retail Payments System in New Zealand

Thank you for inviting industry consultation on the matters raised in the *Retail Payments System in New Zealand Issues Paper* **(Issues Paper).** As a global financial services company , American Express has considerable experience with a broad spectrum of financial services regulation globally and specifically the impact of payments regulation on merchants, consumers and network operators. American Express is the only organisation that is an issuer of credit and charge cards, a merchant acquirer of its own transactions and a network operator in 136 countries. We have been operating in New Zealand for more than 30 years. The feedback in this submission is offered based on this expertise and in that context.

1. Executive summary

1.1 The Issues Paper endeavours to undertake an ambitious review of the New Zealand payments sector. However, we submit that there are problematic issues with its approach, both as regards the data used to support the Paper's findings and the way in which the issues are framed.

1.2 In our view, errors in data compilation in the Issues Paper result in the impacts of any perceived efficiency shortcomings of the interchange business model being overstated.

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2. Data Integrity and Problem Definition

2.1 Before any industry or regulatory intervention is considered, it is worth reconsidering the issue the Paper is trying to address. The primary assumption of the Issues Paper is that, in comparison with other payment regulated countries, New Zealand merchants pay more for their electronic transactions and pass these costs onto consumers. But do New Zealand merchants actually pay more for their electronic transactions?

2.2 To test the hypothesis we asked independent Australia and New Zealand payment consultant Michael Ebstein from MWE Consulting (MWE) to re-assess the data MBIE presented in the Issues Paper and compare it to data from Australia, as it is the nearest comparable regulated environment[1]. The comparison was made on a whole of industry basis, which includes all forms of carded electronic payments.

2.3 The MWE Report found some anomalies in the MBIE data including under-reporting of Australian debit (EFTPOS) fees and overstating the share of purchases on credit in New Zealand. As a result the MWE report recalibrated the assumptions made in MBIE's report using amended and restated source data from Statistics NZ and the Reserve Bank of Australia. The detailed calculations of MWE are set out in Appendix 1 of this submission.

2.4 The result of the re-examination of the data is that on balance, New Zealand merchants do not pay more for electronic card transactions than Australian merchants. This of course is shaped by the zero interchange fee environment for physical (switch-to-issuer) debit card transactions of which the Issue Paper itself questions the longer term sustainability. The tables below show the straight comparisons and some of the restated source data.[2]

Comparisons	**New Zealand**	**Australia**
Average fee per transaction	$0.370	$0.570
Average fee as % of spend	0.734%	0.731%

New Zealand	Average Fees	Txns	$ Spend	Total Fees
Proprietary EFTPOS	0.00%	702m	$27,718m	$0
Contactless Scheme Debit	1.00%	183m	$5,390m	$53.9 m
Scheme Credit	1.58%	351m	$32,338m	$510.9
Swiped Debit	0.00%	290 m	$11,549m	$0
Total		1,526m	$76,995m	$564.8m

[1] The full analysis has been included as Appendix 1
[2] *ibid*

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Australia	Average Fees	Txns	$ Spend	Total Fees
Proprietary EFTPOS	$0.1547	2,892m	$136,538m	$447.4m
Scheme Credit & Debit	0.87%	3,919m	$394,452m	$3,431.7m
Total		6,811m	$530,990	$3,879.1m

2.5 We appreciate that the Issues Paper is a point in time analysis of a dynamic industry. However on re-stated current data the case to regulate this industry based on the ineffective allocation of resources (i.e. merchants pay more than they should) is not compelling and public resources should not be used to regulate or intervene in what should be a commercial negotiation between industry participants.

3. Industry re-examination of cost transparency and debit funding

3.1 There may be more the industry could do to support merchants, particularly the area of pricing transparency, both at point of contract and through regular statements. We firmly believe merchants should understand their costs to determine the best form of payment acceptance for their business. It supports commercial negotiations if real costs are understood from the outset and allows for comparisons between merchant acquirers. American Express' pricing to merchants is simple and transparent. A merchant pays a single *ad valorem* (percentage) merchant service fee for accepting all American Express cards, irrespective of card type or issuer[3]. The merchant therefore can ascertain its acceptance costs at the time of contract and, more importantly, at the time of transaction.

3.2 There is a strong case that the industry needs to rethink its treatment of debit transactions. American Express does not run a debit network in New Zealand or in any country in which it operates, so our views on the topic must be considered in terms of both best practice policy and sound economic principles. However, in the absence of pricing and/or product changes, the inroads made by the dominant card schemes' debit products in to the market share of EFTPOS will likely continue to the point where the future viability of the local debit network is in question.

3 For transparency, American Express does currently charge a nominal statement fee to a small number of our NZ merchants, however plan to eliminate this fee in 2017.

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3.3 As the MWE data indicates, there is no case that merchants in New Zealand pay more for their electronic payment transactions today than those in Australia. However, we accept the counter-argument that this does not take into account a future state where the consumer demand for new payment form factors, such as mobile wallets and high speed contactless transactions, may change the payment mix.

3.4 Our experience from other countries is that consumer demand drives the payment products in any country –although this is balanced by economic return within the two-sided system. The chronic underinvestment in and subsequent cross-subsidy of debit transactions at a network and merchant acquirer level has meant that consumer demand for greater functionality has come at an increased cost in the case of contactless debit. Simply put, the increased expenditure on technology upgrades has to be funded. Merchant groups decry the cost impost on them, basically because they have never actually paid the true cost of acceptance for debit.

3.5 The reality is, technology upgrades for payments are costly, as was the case in Australia. Australia enjoys one of the largest proportion of contactless transactions in the world[4], following a 5-year industry-wide commitment to combat fraud by deploying a modern terminal fleet that is able to handle chip and pin as well as contactless transactions, together with an industry-wide mandate to replace signature authorisation by PINs. This was a resource intensive industry exercise, funded by card issuers, merchant acquirers and major networks. The beneficiaries were the consumers who now had access to a more convenient and secure payment forms, and merchants who could increase transaction speed at the point of sale and incur fewer charge backs on transactions.

3.6 Although no independent data exists to quantify the industry-wide costs, American Express alone spent section 9(2)(b)(ii)
section 9(2)(b)(ii)

section 9(2)(b)(ii)
we conservatively estimate that this exercise cost the industry in excess of $150 million[6]. If the soon to be introduced regulatory regime in Australia had been effective, the payment networks, Visa, MasterCard and American Express would not have be able to contribute to the overall costs because of the "net compensation" anti-avoidance rules. Yet this upgrade has contributed to the

4 RFi Group "Global Payment Evolution Study" May 2015
section 9(2)(b)(ii)

6 Estimates from RFi and MWE put the cost of the terminal upgrades at $60million and an additional $90million to chip the Australian card base.

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reported further increase in electronic payments at the expense of cash and cheque usage.[7]

4. Issues Identified in MBIE Paper[8]

4.1 Economic inefficiency in the credit card market and Increased prices for all consumers, with only higher-income consumers benefiting from rewards

(a) The MBIE paper calculates the cost of inefficiency at a credit card network level at 0.13 per cent of the total value of credit card expenditure – inefficiency being defined as incentives within the system directed at consumers. But this is a not a unique feature of the credit card network as many two sided platforms have asymmetric economics in order for them to operate effectively.

(b) In retailing, the clearest example of this is the offer of free parking to consumers in order to incentivise shoppers to purchase in certain malls. This cost of providing this benefit is included in increased rents paid by merchants who in turn build the cost of their tenancy, together with all their other operating expenses, into the prices of the goods and services they sell. This is paid by all shoppers not just those who utilise the car parking.

(c) At a more granular level, many retailers incentivise shoppers through bespoke loyalty programs. These range from large multi- retailer programs, such as FlyBuys or OneCard, to a local café offering your 10th latte for free. These programs are designed to incentivise consumers to spend and to reward brand loyalty.

(d) American Express fully supports consumer-centric loyalty programs in all forms. However, these programs are not universal in adoption which means that any consumers who decline participation in a merchant level loyalty scheme cross-subsidise those who take part, creating another inefficiency analogous to the one raised by MBIE.

(e) There is certainly no case for government intervention or regulation against the inherent incentive offered to car park users in malls, or multi-merchant loyalty programs and to date we can find no literature on the economic inefficiency or otherwise of such programs. These

[7] ACPA Milestones report Nov 2016

[8] This submission addresses the issues raised in the Issues Paper at a high level, rather than seeking to answer the specific questions posed in the Issues Paper to guide submissions. To the extent it is of assistance, however, we set out in Appendix 2 cross-references to the relevant questions posed in the Issues Paper.

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examples simply illustrate the point that credit-card networks are no different to other two-sided platforms where both the cardholder and merchant mutually reinforce the benefits they each gain from participation regardless of any inherent asynchronous economic flow.

(f) New Zealand currently has one of the highest rates of electronic payments in the world. Additional regulation and enforcement in this area is likely to cost the public more to pursue than it saves at a system level when you factor in compliance costs and the very real possibility of consumers moving away from electronic payments to cash. This is a significant issue in many countries who are trying to incentivise electronic payment use to reduce cash payments within the black economy. From our work in other developed markets, notable Italy and the UK, the switch to cash, as opposed to debit, becomes attractive to consumers when it comes to procuring services, especially higher value services such as home improvements.

(g) The peak retail association in New Zealand, Retail NZ, has published a guidance tilted "*Payments by cards are good for retailers"*[9]. An excerpt is below:

> *Whatever kind of payment you accept, there is a cost associated with it. There are costs associated with EFTPOS terminals and line charges - and there is even a hidden cost to accepting cash payments. The additional time it takes to accept cash at the point of sale and to balance the till does add up. If you include the additional security required and shrinkage due to errors when processing cash you might be surprised at the amount it costs your business: it's just these costs don't show up as a total on your bank statement.*
>
> *While there is a cost for accepting credit and contactless debit transactions, it has to be said that being able to accept cards make it easier for people to buy goods and services. Credit and debit cards broaden a retailer's potential customer base - and the more potential customers you can attract, the more likely you are to make additional sales. They are especially good at helping you sell to international visitors - who typically make substantial use of their credit cards and make purchases that may not otherwise not occur.*
>
> *We know consumers are more likely to make a spontaneous or higher-value purchase when they can put it on their credit card and pay it off later. Retailers no longer have to manage credit*

[9] Retail NZ website Oct 2016

arrangements in-store as they did many years ago. This is taken care of by credit card companies and banks - and retailers bear no responsibility for these debts.

(h) If we take a formal guidance from Retail NZ as a proxy for their members' views, then a high level of sophistication exists within the New Zealand merchant base about the benefits merchants receive from welcoming credit card payments, beyond just the provision of a payment facility.

(i) We know the merchants who choose to accept our cards do so because they recognise the value we deliver, for example, in the form of increased business from a high spending cardholder base and opportunities to market products and promotions to those cardholders. We are continually put to the test by our merchants in terms of delivering on the value we promise. We are not a must take card so we have to prove our value well beyond utility.

(j) Beyond the value of high-spending, loyal American Express cardholders, our NZ merchants also gain access to a wide range of added-value options when they choose to accept American Express cards. By way of illustration, these include:

(i) marketing opportunities – for instance, targeted offers to American Express cardholders, marketing campaigns where merchants can send marketing materials to cardholders that meet certain criteria specified by the merchant and who have consented to receiving such materials;

(ii) access to insightful spend data (on an aggregated and anonymous basis) – merchants are able to access aggregated cardholder data on the American Express closed loop in order to inform their business and marketing strategies;

(iii) superior fraud management – thanks to its closed loop model, American Express can link cardholder and merchant data more efficiently both within NZ and internationally in order to spot unusual activity and is able to contact most cardholders or merchants directly.

(k) The MBIE report focuses on credit card reward programs as being problematic due to the perceived economic cross-subsidy from those who enjoy reward programs to those who do not. Earlier in this section we illustrated some examples of how cross-subsidies can and

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do exist in loyalty or incentive programs across the retail sector regardless of their origin. They are not unique to credit card programs.

(l) The report focuses on the costs of reward programs, but does not consider the economic gain when rewards are redeemed for tangible goods or services. While there is little publicly available data in New Zealand, we know from our experience in other countries that card issuers are the largest bulk purchasers of merchant gift cards and Air Points in New Zealand. Each time a reward is redeemed, for a gift card or a flight, we know that in most cases consumers spend extra to buy merchandise that is more expensive than the value of the reward; it is what retailers refer to as "up-spending". It means that the rewards 'currency' is recycled back into the economy as economic activity and stimulates further demand.

(m) This is certainly true of airline rewards, which feature in many credit card reward programs. Air New Zealand has a highly-regarded and effective loyalty program. In 2016, more than 840,000 flights were paid for using Air New Zealand Airport Dollars.[10] These reward flights could easily be paired with additional economic activity such as additional flights, accommodation nights, meals, retail activity, attractions and events. Although some of this activity happens outside of New Zealand where overseas travel is involved, there is certainly incremental economic gains at a domestic level too.

(n) The Air New Zealand loyalty program also has an effective economic cross-subsidy of those who belong to the program and gain a benefit in the form of AirPoints Dollars from those who do not. In their 2016 Investor Day presentation, Air New Zealand stated that 70% of all domestic sales in New Zealand are made by members of its loyalty scheme. This has to mean, using MBIE's rationale, that 30% of domestic airline passengers in New Zealand are funding the rewards of the other 70% by means of higher ticket prices.

4.2 *Emerging inefficiency in the debit card market and barriers to entry in the debit market*

(a) American Express does not operate a debit card network in New Zealand or in any other country in which it operates. Its views on the economic inefficiencies in the New Zealand debit network is covered in section 2.

[10] Air New Zealand, Investor Day Presentation May 2016

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We are happy to discuss contents of this submission in more detail, including to provide further detail on the analysis in the Appendix through MWE. Please contact my office on the numbers above or call Luisa Megale on +61 2 9152 2479 or email luisa.s.megale@aexp.com.

Yours sincerely,

Rachel Stocks

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Appendix 1

MWE Review of MBIE Paper for American Express
November 2016

Background

The data from Statistics NZ has increasingly been overstating the share of purchases on credit, and because some of the statements in the MBIE Paper were confusing, we spent some time in scoping the market by segment.

Statistics NZ data
Period: 12 months to April 2016

Share of value of purchases		Share of transaction volume	
Debit	54.5%	Debit	71.3%
Credit	46.5%	Credit	28.7%

We know that the data over the last 3 years has increasingly been distorted by the incorrect classification by Paymark of contactless scheme debit as credit card transactions. The impact has been to show the following movements in share of value over the last 3 years:

	12 Months to April 2013		12 Months to April 2016
Debit	57.8%	down to	54.5%
Credit	42.2%	up to	45.5%

We have taken the information contained in the MBIE paper to calculate the corrected share details. The NZ payment card share details are:

New Zealand

Share of Value

Swiped Credit	38%	Swiped Scheme Debit	15%
Contactless Credit	4%	Contactless Scheme Debit	7%
		EFTPOS	36%
Total Credit	42%	Total Debit	58%

Switch to Issuer		Switch to Acquirer	
Swiped Scheme Debit	15%	Credit	42%
EFTPOS	36%	Contactless Scheme Debit	7%
Total	51%	Total	49%

Share of Volume

Swiped Credit	18%	Swiped Scheme Debit	19%
Contactless Credit	5%	Contactless Scheme Debit	12%
		EFTPOS	46%
Total Credit	23%	Total Debit	77%

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Switch to Issuer		Switch to Acquirer	
Swiped Scheme Debit	19%	Credit	23%
EFTPOS	46%	Contactless Debit	12%
Total	65%	Total	35%

Australia

Share of Value

Total Credit	56%	Total Debit	44%

Share of Volume

Total Credit	35%	Total Debit	65%

Based upon historical data, we have estimated that EFTPOS has 65% of debit volume and 58% of debit value. This delivers the following segment split:

Share of Value

Total Credit	56%	Scheme Debit	18%
		EFTPOS	26%
Total Credit	56%	Total Debit	44%

Share of Volume

		Scheme Debit	23%
		EFTPOS	42%
Total Credit	35%	Total Debit	65%

Size of NZ Payment Card Purchases

12 Months to April 2016

Note that the NZ data includes all card present and card not present transactions at NZ merchants using NZ and international credit, debit & charge cards. The Australian data includes all spending on debit, credit & charge cards issued in Australia and used in Australia and overseas. They are therefore not completely comparable but past data indicates that the value of card spend offshore by Australian cardholders is similar to spend within Australia by international cardholders.

New Zealand

Data from Statistics NZ

	Value	Volume	Terminals
Credit (est.)	$35,043 m	438 m	200,000

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Debit	$41,952 m	1,088 m
Total	$76,995 m	1,526 m

Amended data as per above share details derived from the MBIE Paper

	Value	Volume	Terminals
Credit (est.)	$32,338 m	351 m	200,000
Debit	$44,647 m	1,175 m	
Total	$76,995 m	1,526 m	

Australia

Data from RBA

	Value	Volume	Terminals
Credit	$295,579 m	2,361 m	922,000
Debit	$235,411m	4,450 m	
Total	$530,990 m	6,811 m	

Merchant Pricing by Segment

The MBIE Paper shows the following average merchant fees for NZ and Australia:

New Zealand	**Average Merchant Fees**
Proprietary EFTPOS	0.00%
Contactless Scheme Debit	1.00%
Visa/MasterCard Credit	1.70%
Australia	
Proprietary EFTPOS (AUD)	$0.09
Visa/MasterCard Credit & Debit	0.78%

We believe that the Australian EFTPOS charge is incorrectly shown as $0.09 as the RBA data shows it as $0.1525 in March 2016. It appears that the MBIE paper factors in the total Visa and MasterCard credit fees when looking at the Australian market but not the total Australian eftpos fees, noting the following:

		RBA			MBIE Paper
		MCI & Visa MSF	Other fees	Total Fees	
Credit Cards	Dec2013	0.79%	0.04%	0.83%	0.83%
	Dec 2014	0.77%	0.05%	0.82%	0.82%

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	Dec 2015	0.73%	0.05%	0.78%	0.78%
EFTPOS	Dec 2013	$0.1038	$0.0578	$0.1616	$0.10
	Dec 2014	$0.1011	$0.0580	$0.1591	$0.10
	Dec 2015	$0.0907	$0.0593	$0.1500	$0.09

The MBIE Paper assesses average NZ credit card fees as having increased from 1.40% in 2014 to 1.7% in 2015. In contrast to this increase, fees have been decreasing in Australia. We have assumed an average fee over the 12 months of 1.55% in NZ. Using the RBA published data, we determined that the average credit card fee in Australia over the 12 months was 0.80% with the eftpos fee at $0.1547. There is another factor influencing the average merchant fees paid by merchants in both countries and that is the presence of credit cards apart from Visa and MasterCard. Using RBA market share and fee data, we can calculate the overall average Australian credit and scheme debit merchant fee at about 0.87%. Using estimates for NZ, we estimate the average overall merchant fee for credit cards is 1.58%.

New Zealand	**Average Merchant Fees**
Proprietary EFTPOS	0.00%
Contactless Scheme Debit	1.00%
Scheme Credit	1.58%
Australia	
Proprietary EFTPOS (AUD)	$0.1547
Visa/MasterCard Credit & Debit	0.87%

Total Merchant Fees

We have take the two country markets by payment card segment and then applied the above prices to obtain the total fees. Note that there are actually some terminal management fees imposed by Paymark but at $13.50 per terminal per month, they are not substantial at about $14 million per annum.

New Zealand	**Average Fees**	**Txns**	**$ Spend**	**Total Fees**
Proprietary EFTPOS	0.00%	702m	$27,718m	$0
Contactless Scheme Debit	1.00%	183m	$5,390m	$53.9 m
Scheme Credit	1.58%	351m	$32,338m	$510.9
Swiped Debit	0.00%	290 m	$11,549m	$0
Total		1,526m	$76,995m	$564.8m (1)
Australia	**Average Fees**	**Txns**	**$ Spend**	**Total Fees**
Proprietary EFTPOS	$0.1547	2,892m	$136,538m	$447.4m
Scheme Credit & Debit	0.87%	3,919m	$394,452m	$3,431.7m

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Total		6,811m	$530,990	$3,879.1m (2)

Comparisons	New Zealand	Australia
Average fee per transaction	$0.370	$0.570
Average fee as % of spend	0.734%	0.731% (3)
Average annual fees per terminal	$2,824	$4,207
Average annual per capita fees	$122.78	$161.63

(1) The MBIE shows a range between $461 m and $589 m.
(2) This compares to the figure of $2,651 reported by the RBA for bank fees to merchants in 2015.
(3) Given the historical use of cards in NZ for very low value transactions, I would have expected the NZ figure to be considerably higher than Australia.

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Appendix 2

Cross-reference of submission content against questions posed in Issues Paper

- **Qn 5 – Have we accurately described the incentives on parties in relation to interchange?** As set out in sections 4.1(a)-(e) (k) the incentives in relation to interchange are not peculiar to the credit card sector and are inherent in many two-sided platforms. There are also broader economic benefits of the incentives that MBIE have not considered as set out in paragraph 4.1(l).

- **Qn 8 – Do you agree with the logic underpinning our assessment that there is inefficiency in the credit card market?** As set out in section 2 and Appendix 1, we do not agree with the logic underpinning MBIE's assessment to the extent that errors in MBIE's data compilation mean that MBIE has commenced its inquiry from the incorrect premise that, in comparison with overseas payment regulated markets, New Zealand merchants pay more for their electronic transactions and pass this cost onto consumers.

- **Qn 12 – Do you think that the issues in the credit card market are of a scale that warrants intervention? If not, do you think that the size of the issue is likely to grow over time?** As addressed at sections 2 and 3 and Appendix 1, we do not consider that the scale of the issues in the credit card market warrants intervention. However, we accept the counter-argument that this does not take into account a future state where the consumer demand for new payment form factors, such as mobile wallets and high speed contactless transactions, may change the payment mix.

- **Qn 24 – Would greater transparency have any material benefit for merchants or any other parties in the system?** As set out in section 3, we consider that there is more the industry could do to support merchants, particularly the area of pricing transparency, both at post of contract and through regular statements. Greater transparency within the industry should also include consideration of the cost of technology upgrades and infrastructure to credit and debit payment providers. Technology upgrades are costly and, simply put, the increased expenditure on technology upgrades has to be funded.

- **Qn 26 – Do you think that the benefits of interchange regulation are likely to exceed costs?** As set out in paragraph 4.1, New Zealand currently has one of the highest rates of electronic payments in the world. Additional regulation and enforcement in this area is likely to cost the public more to pursue than it saves at a system level when you factor in compliance costs and the very real possibility of consumers moving away from electronic payments to cash.

- **Qn 27 - What unintended consequences could arise from interchange regulation?** As per our answer to question 2 above, the very real possibility of consumers moving

away from electronic payments to cash. This is a significant issue in many countries who are trying to incentivise electronic payment use to reduce cash payments within the black economy. From our work in other developed markets, notable Italy and the UK, the switch to cash, as opposed to debit, becomes attractive to consumers when it comes to procuring services, especially higher value services such as home improvements.