Visa Submission

Ministry of Business, Innovation & Employment
Retail payment systems in New Zealand – issues paper

20 January 2017

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Summary of Visa's position

Visa welcomes the opportunity to work with Ministry of Business, Innovation and Employment (MBIE) to help understand the dynamics in the New Zealand market that are positive for all participants in the electronic payment environment and contribute to long-term economic growth.

The ongoing development of a secure, efficient, competitive and stable electronic payment system is essential to the growth and stability of the New Zealand economy. Payment platforms, including Visa, contribute significantly to economic growth, development and the financial inclusion of all New Zealanders.

Visa values the role of government in supporting stability and certainty to the payment system and the economy more broadly. Keeping any oversight, direction and regulation relevant to the current and foreseeable future allows industry the ability to innovate and delivers the investment certainty required for longer term projects.

We believe this review comes at a particularly significant time in the evolution of the payments landscape:

- Consumer demand for new and more seamless payment experiences is at its height and in order to encourage consumer spending, merchants and issuers must respond;
- The opportunity for New Zealand merchants to benefit from access to global markets and tourism is strong whilst business sentiment is positive and tourism is growing. Industry needs access to a comprehensive international payments networks to capture growth; and
- With so many new commerce experiences being developed and cybercrime at unprecedented levels, security is more important than ever before.

In recent years, the diversity of electronic payments products and services available to cardholders and merchants has grown significantly, the result of an industry focused on innovation and delivering better outcomes for all participants in the payments ecosystem. As payment technology changes, there is a requirement to invest in infrastructure to support new payment solutions such as contactless and mobile. Visa has been at the forefront of providing a network that provides increased functionality for both cardholders and merchants at the pace of change in an increasingly digital world.

Visa takes the view that the Retail Payment Systems in New Zealand issues paper (the issues paper) focuses only on some aspects of the economic rationale underlying electronic payments and does not adequately address other reasons why usage and acceptance of card payments are attractive for New Zealanders and the economy. For cardholders, speed, security, digital sophistication and convenience are just some of the benefits associated with credit card usage. Similarly, the cost of acceptance is one of many costs associated with running a business and providing utility to both the merchant and cardholder.

More broadly, the investment of the international scheme cards in building new and enhanced capabilities for New Zealand cardholders and merchants allows access to a range of products and services that can be used domestically and internationally. In Visa's experience, domestic payment networks, such as EFTPOS, are seldom able to offer similar levels of investment or innovation.

In responding to this issues paper, it is essential to highlight the importance of choice, value and balance for all participants in the New Zealand payments ecosystem. These core principles create an environment where the market can dynamically respond to the needs of all participants and deliver innovation and product development in the most efficient manner.

- Choice: Merchants and consumers in New Zealand have a wide choice around what payment methods to use and accept. These include some very low cost and low functionality options and some with higher costs, functionality and global benefits;
- Value: It is important to track where value ultimately resides. Each participant in the network derives a certain value from participating. If this value is optimally balanced between all participants, the network will continue to grow and serve a greater number of participants; and
- Balance: Visa is a multi-sided payments platform and as such needs to ensure those making payments and those receiving payments derive benefit and value from the network. This is achieved through balanced financials, creating a conducive environment in which to innovate.

Visa supports transparency in the cost of retail payments. We believe all players in the payments ecosystem have an important role to play in that process. On the payment scheme side, Visa publishes maximum domestic interchange rates applicable in New Zealand on Visa's local website (www.visa.co.nz) and has done so for a number of years. Issuers list their individualised rates on their own websites.[1]

In the context of a rapidly changing, innovative market, Visa appreciates the benefit for New Zealand merchants to have access to more transparency around the cost of acceptance and we support such an approach. This transparency would provide the merchants the ability to financially assess the individual payment methods they wish to offer. This move would also support competitive forces to help ensure all payment options provide end users with a clearer economic foundation for choice.

This submission to the retail payment systems issues paper provides further detail on Visa's position in relation to the above themes and outlines the company's global experience, including optimizing a payments environment to best serve a market's economic growth, innovation and access to all consumers and merchants.

Visa would be happy to provide further input and engage with MBIE or other government agencies in the future and is committed to working with others in the payments ecosystem to better support all end users including merchants. We would be happy to work with MBIE or the New Zealand Government in a collaborative manner on the range of future policy issues discussed within the issues paper.

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[1] Visa International Service Association/Visa Worldwide Pte Limited (Visa) agreed to a Settlement Agreement (the Settlement Agreement) with the New Zealand Commerce Commission, signed 22 September 2009. The Settlement Agreement is still in effect and applies, amongst other things, to Visa's Interchange Reimbursement Fee management in New Zealand. Visa continues to adhere to its obligations under the Settlement Agreement. Under the Settlement Agreement, Visa will set maximum interchange rates for all New Zealand acquired transactions with respect to New Zealand issued Visa branded payment cards.

The Visa network

Visa is a global payments technology company that connects consumers, businesses, financial institutions and governments in more than 230 countries and territories worldwide. Visa is proud to adhere to its corporate vision of being the best way to pay and be paid, for everyone, everywhere.

Visa's global network encompasses over 3.1 billion cards making around 129.1 billion transactions per year through 16,800 financial institutions. In the year to September 2016, Visa network participants transacted NZ$11.8 trillion in total volume[2]. Around 2.6 million ATMs were also connected to our system, providing further convenience and ease of access for cardholders. This activity is powered by one of the world's most advanced processing networks, VisaNet, which is capable of handling more than 65,000 transactions per second reliably, conveniently and securely[3].

Value of electronic payments to New Zealand

Visa's response to the issues paper will address a range of themes important in understanding the role of international payment schemes to the New Zealand market, focusing on the core propositions and benefits of Visa to New Zealand. This provides a useful preamble and introduction to Visa's response to the specific questions contained within the issues paper.

As a developed economy with a strong electronic payments acceptance infrastructure, a highly productive labour force and a vibrant tourism sector, New Zealand currently benefits and stands to gain significantly by further increasing the use of electronic payments.

Macroeconomic impacts

Despite only modest increases in the use of electronic payments in recent years, New Zealand has experienced a meaningful positive impact to GDP. A recent study by Moody's Analytics found that increase in the use of card payments in New Zealand contributed to an increase of NZ$610 million in New Zealand's GDP from 2011-2015. The same study found a strong correlation between card usage and GDP, suggesting that the relative impact on New Zealand's economy from every percentage increase in card-based payments is one of the highest amongst the 70 countries studied[4].

Consumers in New Zealand paid with electronic cards for about 63 per cent of total personal consumption expenditures in 2015. While this number is higher than most economies, it has been relatively stable in recent years, only increasing by two percentage points since 2011. Increasing the share of consumer spending made using electronic payments would contribute to GDP growth, helping to reduce the reliance on export growth to drive economic activity.

[2] As per VisaNet data – December 2016
[3] As of September 2016
[4] On average, for every percentage point increase in card usage, the resulting impact was an increase of 0.065% in GDP per year. Of the 70 countries covered in the study, only Canada and Hong Kong (at elasticity of 0.067% and 0.077%) exceeded this elasticity measure. Moody's Analytics – *The Impact of Electronic Payments on Economic Growth*, 2016.

This is an important consideration given the disproportionately high economic impact that New Zealand's economy stands to gain from increasing electronic payments usage.

Additionally, it is broadly acknowledged that electronic payments deliver a wide range of benefits direct to government, through increased taxation and a reduction in the 'grey' or 'shadow' economy. Reducing the reliance on cash or other payment mediums that thrive off a lack of effective and consistent recordkeeping will improve the government's ability to assess merchant taxation obligations, while also inhibiting criminal activity that is often reliant on payment mediums that are difficult to monitor.

Impact on New Zealand's tourism sector

Tourism is an important industry for New Zealand, and tourism's contribution to the overall economy is only expected to increase in the coming years. A study by the World Travel and Tourism Council (WTTC) notes that the direct contribution of travel and tourism to GDP was NZ$12.5 billion (5.1 per cent of total GDP) in 2015, which is forecast to rise by 5.5 per cent in 2016, and to rise by 2.2 per cent per annum from 2016-2026, to NZ$16.4 billion (5.2 per cent of total GDP) in 2026[5]. New Zealand is one of the top tourist destinations in the world, attracting the highest overnight inbound visitor spend of any other country. A recent survey conducted by Visa of global travellers estimates that at NZ$5,470, the median amount spent by an inbound tourist in New Zealand is the highest globally.

Visa response themes

In considering its response to the issues paper, Visa has identified a number of key themes that we believe highlight the pivotal role played by international electronic payment schemes in delivering consumer and merchant benefits and powering commerce and economic activity throughout New Zealand. These themes address many of the advantages of an international payments scheme to the New Zealand market.

Choice

Consumers and merchants in New Zealand have the ability to choose from a range of payment methods – cash, cheques, electronic funds transfers, EFTPOS cards, scheme debit, scheme credit and an increasing range of form factors delivered by international schemes, such as contactless and mobile payments. Along with the ability of merchants to determine the most appropriate payment methods based on the needs of their customers, many merchants are able to negotiate the level of service provided by an acquirer to process electronic payments. These different service levels afford merchants a range of varied cost options, effectively allowing tailored approaches to different needs. Merchants also have the choice to pass on some or all of their costs associated with collecting payment – in fact, market research has shown that one in five merchants in New Zealand surcharge consumers for card payments[6].

[5] World Travel & Tourism Council, *Travel & Tourism Economic Impact 2016 New Zealand*, available at http://www.wttc.org/-/media/files/reports/economic-impact-research/countries-2016/newzealand2016.pdf

[6] New Zealand Payments Program, RFi Intelligence Merchant Survey, 2015

There are a number of factors that contribute to a merchant's ability to ensure the most efficient merchant service fee for their business. New Zealand is a competitive market for merchant acquiring with the major banks offering merchant services to retain and win transactional business accounts. Additionally, there are a number of newer entrants to the market providing discreet, standalone acquiring services – often these acquirers serve a segment of the merchant community quite different from that traditionally served by banks, i.e. multinational merchants who span multiple geographies with the need for a single integrated platform or compatibility with a range of international currencies.

In recent years, innovation in the payments industry has delivered the ability for merchants to enable contactless payments at point of sale, significantly improving the consumer experience and increasing business productivity. While Visa does not require merchants to accept contactless payments, recent experience has shown a large number of merchants are choosing to enable this service as a value add for consumers and to capture the benefits for their businesses.

Contactless payments are increasingly popular with New Zealanders, with more than 16 million Visa transactions per month now made via Visa payWave[7]. This is likely to continue growing with the development of even more sophisticated contactless platforms, including mobile payments, e.g. Apple Pay/Android Pay/Samsung Pay – in May 2016, 84 per cent of New Zealanders indicated they used a smartphone to make everyday payments[8], and mCommerce is forecast to reach nearly NZ$14.5 billion in New Zealand by 2019[9] – and wearable products where payment technology is incorporated into watches, fitness bracelets, jewelry or other clothing/accessories.

Globally and locally, Visa continues to grow acceptance and provide a unique value proposition for merchants by offering services that can help businesses increase transaction volume, minimise the cost of doing business and expand the ability to transact with a broader group of consumers, including international visitors and foreign consumers transacting with New Zealand merchants through eCommerce channels.

Issuers in New Zealand understand the benefits of Visa products, and as our network develops in maturity, scale and sophistication, merchants also see great value in accepting Visa products in contrast to the alternative of only accepting cash or cheques, maintaining their own payment forms or accepting less sophisticated electronic payment mediums, such as EFTPOS or electronic funds transfers. As well as working with issuers to grow cards in use and associated spend we have worked in partnership with them to help grow their customer service offerings through new and more sophisticated product design and portfolio management.

Consumers and business owners in New Zealand generally use credit card products to bridge short-term financing needs and improve cash flow efficiency. Creating credit in a market has been shown to increase business investment, improve economic activity, and generate greater consumer confidence. Additionally, beyond the wide merchant acceptance and high level of trust cardholders place in scheme products, New Zealand consumers and business owners

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[7] As per VisaNet data – December 2016
[8] YouGov Visa Asia Pacific eCommerce Monitor Survey. May 2016.
[9] Frost & Sullivan, *New Zealand Mobile Commerce Market 2014*, October 2014

have long been drawn to the value-added benefits of credit card products, including immediate payment capabilities, i.e. guaranteed payment for a merchant regardless of whether a cardholder pays their issuer, international acceptance, credit line flexibility, rewards programs and other services unique to credit card products and not associated with any other payment methods.

Value

In recent years, the diversity of products and services available to cardholders and merchants has grown substantially, the result of an industry focused on innovation and delivering better outcomes for all participants in the payments ecosystem. Visa has been at the forefront of providing a network that has the capability to accommodate innovation for both existing stakeholders and new entrants in the payment system. These investments especially benefit from the global scale that Visa offers to issuers, acquirers, cardholders, and merchants. The network effect of an international scheme means a more ubiquitous experience for all ecosystem participants from one country to another as these new payment innovations and capabilities are deployed.

Technology is fundamentally changing the relationship between consumers and the businesses that serve them. It has led to significant market and industry disruption and the payments industry is no exception. Looking forward, we are likely to see emerging technologies change everything again. The lines that have traditionally defined retail continue to blur. Purchases no longer take place in only one environment – 76 per cent of New Zealand consumers interact with a brand or product digitally before entering a store, and mobile technology influences 93 per cent of purchases[10]. 72 per cent of New Zealanders surveyed say they trust that payments made via digital and mobile technology are secure, compared to 51 per cent when this technology was first introduced into the market[11].

It is impossible to predict exactly what the financial landscape will look like in the future, especially in the rapidly evolving world of payments. Payments innovation is being driven in large part by consumer choice, because consumers want ease, convenience and security. In particular, it is the rise of digital payments including mobile and online that presents the most opportunity and challenge for the payments industry today, but in the future we expect to see payments enabled across a range of connected devices.

Our personal access to networked devices is growing beyond mobiles, tablets and laptops to incorporate many of the objects used in day-to-day life. From wearable technology, connected household devices, sensing technology to car dashboards, these devices will be linked to each other and to Cloud-based infrastructure. In a world where everyday devices can now be interconnected with the ability to collect and exchange data, adding greater automation and convenience to consumers' lives ('The Internet of Things'), it is a reasonable expectation that people will want to use these connected devices to pay for goods and services, anywhere and at any time. Global technology manufacturer Cisco predicts there will be 50 billion devices

[10] Source: http://www.wiser.com/infographic-retailpredictions
[11] Visa commissioned, Monthly Perceptive Omnibus surveys a minimum of 1,000 New Zealanders online using a nationwide sampling framework, the results are then weighted to Statistics New Zealand census gender, age and location data

connected to the internet by 2020[12] as the world's population is forecast to hit 7.7 billion people. According to global IT research firm Gartner, by 2020, more than half of all new major business processes and systems will incorporate some element of 'the internet of things'[13].

Visa's goal is to achieve success as a leading partner for digital payments comparable to what it has achieved in the physical world. Importantly, we believe New Zealand is very well placed to develop innovative platforms and payment capabilities and has the opportunity to lead in the future of payments. We provide leadership throughout the sector by enabling all stakeholders in the payments industry to rapidly evolve with new technologies and partners. To support this, Visa introduced the Visa Token Service to enable the accelerated deployment and scalability of secure, remote payment technology. The success of Visa payWave and the recent launch of Apple Pay, Android Pay and Samsung Pay (enabled via the Visa Token Service) demonstrate Visa's globally consistent approach to creating a stakeholder driven collaborative environment to enable the introduction of improved payments technology.

In the coming year we expect to accelerate our rollout of Visa Checkout, Visa's ecommerce payments solution, which simplifies the online and in-app purchasing experience. We have also recently launched our Visa Developer platform which gives issuers, merchants and third party developers the ability to access a range of Visa's services via APIs and create more meaningful consumer experiences. We believe that the customer experience will be one of the key trends affecting payments over the coming years and Visa will continue working with its partners to ensure its capabilities enhance the consumer experience. As a result, it is no longer possible to delink the underlying product value proposition, payment technology and consumer experience in driving increased consumer electronic payments.

In the growing mobile payments environment, Visa will continue to extend the reach of the Visa Token Service into other payment mediums such as wearables and other devices, not only powering the development of 'The Internet of Things', but also allowing increased levels of protection for consumer payment and personal credentials. The additional security provided by use of the Visa Token Service will enable many more devices to conduct payments.

Visa is focused on ensuring tangible value continues to be delivered to the merchant community. Our merchant strategy is designed to grow sales and customer loyalty for merchants while expanding access for consumers. The range of Visa products and services that provide increased choice and value for the cardholder also provide significant choice and value for the merchant community.

Visa payWave significantly reduces the time of each transaction, improving productivity and increasing a merchant's ability to transact with a greater volume of consumers. The use of this technology also improves customer engagement at point of sale, improving the ability of a merchant to offer a more flexible, frictionless payments experience. We are now seeing Visa payWave move to mediums other than the card, specifically mobiles and wearables. These smart devices will allow merchants and consumers to further improve engagement at point of sale – both physical and virtual. The recent launch of Visa Checkout enables a secure online omni-channel commerce experience for merchants, providing a simplified payments platform

[12] Source: http://www.bloomberg.com/news/articles/2014-01-08/cisco-ceo-pegs-internet-of-things-as-19-trillion-market
[13] Source: http://www.ecommercetimes.com/story/83088.html

to further reduce friction points in the payments process. Visa is also exploring the use of the Visa Token Service by merchants to ensure that card details stored on file are replaced by tokens, removing the risk of key financial account data falling into the hands of criminals.

As we look forward, the investment in innovation and product development will create a future where merchants will be able to provide a seamless integrated payment experience as part of their routine customer service offering. This focus on delivering greater value to both cardholders and merchants will ensure payment solutions meet the needs of merchants and consumers as those needs change and evolve.

Balance

A key to understanding how the payments industry operates is to understand what economists (and others) refer to as a "two-sided market." In the payment systems industry, there are two sets of customers with interdependent demands for services/goods. These distinct groups comprise the issuing side (i.e. card issuers and their customers, cardholders) and the acquiring side (i.e. acquirers and their customers, merchants). Interchange is the mechanism through which the two-sided market is balanced.

Visa advocates the importance of interchange as a mechanism to balance the two-sided market that brings together and balances the needs of both consumers and merchants. If the cost to merchants were too high, many businesses would stop accepting cards, thereby disadvantaging the efficiency and effectiveness of the system, or driveing consumers to alternative funding sources that are potentially less transparent or efficient. Similarly, if the cost to consumers were too high, it would limit consumer use of payments cards and, as a result, inhibit consumer spending and adoption of new digital technologies.

International schemes balance interchange to maximise use of electronic transactions and benefits to both sides of the market. Interchange is utilised in combination with other factors such as risk mitigation policies, liability shifts and consumer protection via chargebacks, serving as an effective pricing mechanism to ensure the continuous improvement of the payment system in which both sides operate and thrive (as has been the case in New Zealand). In effect, interchange is the mechanism through which economically efficient outcomes are achieved.

Higher volume merchants offer a number of substantial benefits to the payments system in New Zealand. As a larger participant in the payments ecosystem, larger merchants are able to help shape the network and influence future payments behaviour of smaller merchants. For example, larger supermarket merchants are often early adopters of new payments technology, which helps create consumer demand and incentivises smaller merchants to adopt new technology themselves. International payment schemes use interchange as a mechanism to encourage high volume merchants to adopt this new technology.

Interchange is also used to balance the often higher initial capital costs of new technologies for large volume merchants, such as the capital of new payments infrastructure and the ongoing testing and performance improvement costs, which represent a significant investment for merchants. Additionally, interchange rates also factor merchants that represent higher risk to other participants in the payment system based on the nature of the product or service, such as gambling or money transfer vendors) or higher end merchant categories (e.g., e-commerce merchants, who pose a higher fraud risk, with its attendant costs on issuers, acquirers, and cardholders).

Importantly, to set interchange fees effectively, international schemes must engage in a nuanced and sophisticated analysis of the marketplace along multiple dimensions.

Moreover, the electronic payments sector is a fiercely competitive marketplace that is growing more competitive. There is an increasing array of new competitors operating in the New Zealand market, including well-known companies such as PayPal, Google and Alipay, as well as lesser known (but increasingly successful) startups such as Square, iZettle and Weve. These entrants, as well as the traditional international card schemes, have all brought a host of innovations to market, including, for example, mobile payments and wallet technology.

When determining interchange rates, international payments networks focus on outcomes that:

- Promote overall system growth and growth in specific payment segments especially in low levels of penetration;
- Reflect the value delivered to merchants and cardholders by that payment type;
- Drive adoption of new products and platforms and payment system innovations; and
- Deliver competitive revenue streams to financial institutions so that they have incentives to issue and promote electronic payment products.

Investment in security

Management of retail payments and the inherent requirement to manage risk is increasingly difficult and requires collaboration and oversight of partners and third-party service providers. The number of new payment instruments and online gateway service providers that have emerged are more than ever wholly electronic and digital.

Electronic payment systems offer efficiency gains by allowing for rapid and convenient processing of payment information among system participants. However, with the emergence of a new payment mechanism the industry recognises the opportunity to enable the rapid propagation of fraud, money laundering, and operational disruption if data is compromised. In New Zealand, Visa led the industry on security by developing and driving a roadmap to devalue and protect data, innovate responsibly and prevent fraud. Visa brings the benefit of a trusted voice on security issues with government, regulators, consumers, clients, and merchants.

As an example, Visa's token service provide r program gives technology companies a standards-based approach to access Visa's broad network of tools and services, including the Visa Token Service, as well as development and marketing support. It also expands the market to other companies to develop new, secure digital payment services and ensures consistency envisioned in the EMVCo[14] token standards.

Visa recently announced it is accelerating the adoption of secure, digital payments by allowing third party partners to offer the Visa Token Service. By expanding tokenisation and giving both issuers and token requestor's choice, digital payment solutions will continue to grow and give consumers peace of mind when paying on any device. Tokens will also ultimately protect merchants from the risk of a fraudulent breach of their systems and the ongoing cost of fraud remediation. The Visa Token Service extends our leadership as a provider of secure digital payment solutions.

As an example, the use of biometric technology as a means to authenticate payments is growing because of its convenience and heightened security features. As is the case with mobile, new technologies allow customers to pay for purchases by placing a finger on a sensor, which links the image to the customer's account using a simple method of finger scanning at check out. Visa has announced plans to submit a biometric authentication standard for EMV chip cards to EMVCo as well as supporting the FIDO Alliance[15], a partnership that offers further evidence of the importance of establishing strong international authentication standards.

Industry collaboration

Visa has a long history of collaboration with the key stakeholders in the New Zealand market to lead projects and facilitate industry discussions that provide benefits to all. Visa plays a lead role in a number of industry bodies, ensuring the ecosystem is developing and innovating in step with global best practice as cardholder and merchant demands develop.

The New Zealand Cards Risk Council provides a forum to discuss a wide range of risks affecting the card payment industry, to consider best practices and to agree on risk management and mitigation strategies. While the Council does not have the ability to impose rules and has no decision making ability over international payment schemes or EFTPOS, it is recognised as a good example of cooperation amongst the key industry stakeholders. Representatives meet quarterly to review global, regional and local fraud trends and consider guidelines and recommendations for fraud prevention and detection which are actioned on an individual and voluntary basis.

Visa is a key participant of the New Zealand Payments Council Industry working group, comprised of industry representatives with responsibility for progressing the global Payment Card Industry Data Security Standard (PCI DSS)[16] with merchants and third party payment providers. The working group focuses on reducing acquirer and merchant related risk exposure, addresses breaches of international payment scheme security compliance, investigates and remediates data breaches, and develops strategies to mitigate fraud levels for merchants.

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[14] EMVCo is the international technical standard coordinator to develop and manage technical specifications for contact chip, contactless chip, and tokenisation applications. EMVCo is overseen by member organisations – American Express, Discover, JCB, MasterCard, UnionPay and Visa.

[15] FIDO Alliance is the international technical standard coordinator to develop and manage technical specifications for non-password based authentication standards.

[16] The Payment Card Industry Data Security Standard (PCI DSS) is coordinated by the Payment Card Industry Security Standards Council

Payments NZ is the peak industry body for the payments sector in New Zealand, managing and administering the core payment clearing system in the New Zealand market. Established in 2010, Payments NZ brings together a range of payments stakeholders manage the rules and standards of the payments system, facilitate the introduction of new participants in the payments ecosystem, facilitate interoperability across industry and promote innovation, security and efficiency in the New Zealand payments system.

EFTPOS role in the payments ecosystem

EFTPOS offers a fundamentally different debit product and value proposition for cardholders than the international payment schemes. EFTPOS, as acknowledged in the issues paper, has operated in a similar fashion since it was introduced, with limited investment or product development, and was created as a means to reduce the use of cash and cheques in the New Zealand economy. Operating under a fundamentally different business model to the international payments schemes, merchants pay some of the cost of EFTPOS payments via a monthly license fee, with the rest being cross-subsidised by the banks.[17]

The key difference between EFTPOS and international schemes in the New Zealand market is the focus on innovation investment that has delivered higher quality outcomes for scheme cardholders and merchants, including contactless products, improved security and fraud prevention systems, EMV chip technology, and global acceptance. As a result, EFTPOS cards have significantly lower levels of product sophistication, limited channel use and lower functionality than international schemes can offer the market.

Considerations for the future

Support increased cost transparency in retail payments

Visa supports transparency in the cost of retail payments and understand the need for further merchant education especially in the context of a rapidly changing, innovative market. All players in the payments ecosystem have an important role to play in that process.

On the payment scheme side, maximum domestic interchange rates are publically available on local websites (e.g. Visa.co.nz) and clients list their individualised rates on their own websites. On the acquirer side, we believe there would be significant value in greater communication regarding differential costs for differential products and services to ensure that merchants are able to make informed choices about their options.

Visa can appreciate that it would be beneficial for New Zealand merchants to understand the cost of a scheme debit contactless transaction versus a scheme credit transaction and would support a transparent approach. This transparency could provide the merchants the ability to financially assess the value of the individual payment methods they wish to offer. We believe this move can also support a naturally competitive environment that ensures schemes, acquirers and issuers provide their respective customers with an economic proposition that drives adoption and acceptance.

[17] We also note that changes in the policy may be impacted by the 2009 Settlement Agreement with the Commerce Commission.

Visa is committed to working with others in the payments ecosystem to better support merchants and would be happy to collaborate on a new merchant education program with a specific focus on the small business community.

Provide clarity on future debit plans

Where a New Zealand issued Visa Debit card is used in a face-to-face transaction, e.g. the magnetic stripe is swiped through the terminal reader, in the same way as a current standard EFTPOS card, the transaction will continue to be routed through the EFTPOS network. As a result, these transactions will not attract Visa fees or interchange set by Visa, nor will any of the Visa rules or consumer chargeback protections apply. Visa has indicated previously and continues to maintain that there is no intention to change this position in the foreseeable future as long as current market conditions continue.

Future policy options

The issues paper mostly focuses on the interchange model and the operation of four party card schemes, with very little acknowledgement or analysis around the role or cost of other payment mediums in the New Zealand market, such as cash, three party schemes (e.g. American Express, Diners Club International), cheques, inter-bank funds transfers, etc. We believe this should be addressed in any future reviews.

Our observation on the regulated lowering of interchange fees – both in Australia and in other markets – is that it is unlikely to deliver benefits to consumers. Lower interchange fees are likely to drive issuing banks to adjust their fees and benefits to ensure cost recovery and sufficient revenue, and possibly reduced access to credit particularly for lower-income consumers.

In the United States, new interchange legislation which took effect in 2011 led banks to seek indirect ways to recoup lost revenue. It is was estimated that fee free bank accounts halved (2009-2013), monthly fees doubled (2009-2013) and the minimum holdings required, i.e. minimum deposits required for fee free account operation, more than doubled on fee free accounts (2009-2012) ultimately leading to an increase in the unbanked population, mainly amongst low income families[18].

A similar impact was seen in the European Union following the introduction of regulation in 2014, where the changes in annual fees on card products in Western Europe, the United Kingdom and Central & Eastern Europe have increased by an average of 33 per cent, 50 per cent and 28 per cent respectively[19].

Visa acknowledges the range of future policy options included in the issues paper and is willing to work with MBIE and the New Zealand Government in a consultative manner on any of these in the future.

[18] Price Controls on Payment Card Interchange Fees: The U.S. Experience, ICLE, Todd J. Zywicki Geoffrey A. Manne, Julian Morris, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080

[19] ''Card Product Changes in Europe in Light of Interchange Regulation'' - Navigator Edition: April 2016 – First Annapolis - http://www.firstannapolis.com/articles/card-product-changes-in-europe-in-light-of-interchange-regulation?status=success

Responses to questions in the issues paper

Given the breadth of topics covered in the issues paper, there are a number of questions that would not be appropriate for Visa to comment on, and these responses are better sourced from other participants in the New Zealand payments system. As such, Visa has responded only to questions that are appropriate for an international payment scheme to address.

1. Are these objectives for retail payment systems appropriate?

A broad view on the functionality and operation of the retail payment system in New Zealand is needed when considering the objectives for payment systems. While examining the role played by four party international schemes and EFTPOS is important, there is a much wider range of issues and operators in the sector that should be included in any future review, for example, loyalty providers and switches.

While we agree that the objectives set out by MBIE are appropriate, we believe the key objective of security in the retail payments system is not adequately addressed. There is a fundamental requirement for schemes and financial institutions to provide a globally interoperable, secure, convenient and efficient retail payment system for both consumers and merchants. Security is at the very heart of the retail payment system, not only in protecting value for all stakeholders, but also in the confidence it delivers for continued and increased usage. This requires constant investment to ensure the promise of payment to merchants and protection of consumer payment data information.

Objectives Two and Three appear to be driven by the premise that there is a need to separate payment systems (which are not precisely defined by the issues paper) for assessment for allocative efficiency (which is at odds with dynamic efficiency, as discussed in Objective One) and "fairness" to consumers and merchants. We believe the view on "fairness" may be subjective, and not able to incorporate the perspectives of each participant in the payments ecosystem.

2. Are there any other emerging payment methods that we have missed if so what is there likely impact on the market?

With mobile technology evolving so rapidly, there are sure to be other payment methods that will have an impact on the market. The unpredictability and creativeness of new methods cannot be ignored; they will have an impact, and a vibrant, competitive, and unhindered market will enable them to compete with established players.

Innovation can, and likely will, come from anyone, anywhere, and as a networked business, it is in Visa's interest to partner with whomever is driving innovation for consumers and merchants. More than half of all large-scale enterprises have acquired or plan to acquire outside firms for mobile app development capabilities[20]. In payments, the rise of fintech

[20] Source: http://rewrite.ca.com/us/articles/application-economy/by-the-numbers-sizing-up-the-app-economy-in-2015.html#IRxBRb9WcU5D5Ob5.99

demonstrates how there are more organisations driving innovation than ever before. 10 years ago, there were around 850 fintech companies. Today, there are around 3,100[21].

In this new environment, the payments industry must evaluate how to best harness innovation, wherever it originates, to create the best customer experience. An application programming interface or 'API' makes it possible to collaborate, plug into and build off others' innovations. APIs will enable the efficient, globally operable capabilities of payments providers and a range of other end users to deliver new and innovative payment applications and products.

4. Do you agree with our explanation of the rationale for interchange?

The issues paper suggests that consumers do not carry multiple payment mediums. Experience suggests that consumers are able to use (and frequently do) a wide range of payment mediums, including cash, cheques, electronic funds transfers, debit cards, prepaid cards, revolving credit cards, charge card, and a range of other products. It is highly uncommon for consumers to exclusively use one product.

This section also notes that the number of rewards cards and amount of rewards offered have increased. It should be noted that the example given is a successful merchant co-brand card. This means that merchants are competing for issuer and cardholder attention with co-brand cards. Merchants were successful in initiating the first 'rewards' cards and now that consumers expect merchant rewards, it is unlikely consumers would be willing to change their behaviour and attitude towards reward programs. This is an example of a successful product that drives consumers to use card products and generally increases spend with a merchant.

In New Zealand, while interchange plus pricing – adding a margin on top of interchange – is available, this is often complicated as there are different rates for debit and credit cards as well as different rates for different types of credit and debit cards. Card-present and card-not-present[22] transactions also have different rates and reflect the level of risk the issuing bank is taking for a given transaction.

Therefore, tiered or blended pricing is still the most common pricing model available, and while acquirers offer both interchange plus and blended, most merchants select blended pricing due to the ease of understanding and certainty of cost. In this case, a large number of rates and fees are blended into one basic rate or tiered rate based upon transaction volume, type of channel, and mix of transactions. While this type of pricing is easy to communicate and simple for merchants to understand, price blending would reduce any increased transparency benefits available to merchants.

The issues paper also makes a number of comments suggesting that the use of interchange is justifiable only in cases where a network has not reached a level of maturity or wide market penetration. It is unclear to Visa why the use of an interchange model would be limited to this scenario, given the role that interchange can play in driving innovation and creating the

[21] Source: Boston Consulting Group, 2015
[22] Card-present transactions are defined as a transaction that occurs when the cardholder is physically present at the point of sale, e.g. a transaction physically taking place at the merchant. Card-not-present transactions are defined as a transaction that occurs where the cardholder is not physically present, e.g. an online ecommerce transaction.

optimal balance in the two sided market. It is Visa's strong view that the network requires constant renewal and innovation, and in this sense, the network will never be in a static state.

5. Have we accurately described the incentives on parties in relation to interchange?

The issues paper does not accurately describe the incentives on parties in relation to interchange. Interchange is not the sole source of funding for credit card rewards programs, nor is interchange the only reason underpinning credit card business portfolio decisions by issuers. Other revenue streams including annual fees, net interest income, and other fees are also collectively used to fund the cost of delivering customer value propositions and the full range of services, including fraud and risk mitigation, global network interoperability, and cardholder protection mechanisms such as chargeback and zero liability, provided by schemes and issuers. These services differentiate Visa from EFTPOS and other forms of payment by catering to a wider range of consumer and merchant needs.

The issues paper narrowly portrays interchange as the sole means of revenue for issuers – the Argus 2016 Cause and Effect New Zealand study identified that interchange accounts for 35 per cent of total revenue, a 2 per cent increase on 2015 and a 3 per cent increase on 2014. The function of interchange gives issuers the income stream and funding to invest in expanding and improving scheme capabilities, covering new products and services, increasing digitisation of payments and expanded security capabilities, and providing an increasingly secure, convenient and reliable payments solution.

The issues paper also does not adequately discuss the impact of different premium card tiers on acquirers and merchants and hence why tiered interchange rates exist. For example, on average, a Visa 'Platinum' customer will spend more and transact more frequently than a Visa 'Classic' customer, generating more sales revenue for an average merchant. As such, tiered interchange rates for Visa Classic/Gold and Visa Platinum products reflect the incremental value that a premium customer will bring to a merchant.

In addition, the increase in costs to acquirers through increased interchange is not always directly netted off with an increase in revenue to the issuer. Often in banks, the acquiring and issuing businesses operate discretely, responsible for minimising costs; and maximising revenue respectively. Furthermore, an acquirer still needs to compete with other acquirers for acceptance, if they choose to reduce their margins, they will increase competition and reduce prices.

6. Why are interchange rates falling for large merchants but increasing for small-medium merchants?

As a general comment, Visa does not agree with the premise of the question. There are a range of interchange rates available for specific industries of the merchant community in New Zealand, applicable to both face-to-face and online merchants. The rates are publically available and range across sectors including charity, utilities, service stations, insurance, government, and strategic merchants.

Globally and locally, Visa continues to grow acceptance through our acquirer relationships. Acquirers provide the necessary scale for Visa to access over 40 million merchant locations globally and play an important role in demonstrating the value proposition delivered by international schemes to key merchants that influence and shape the payments system.

As large merchants make significant investments in payment technology and are at the forefront of payment innovation, it is important for Visa to build long term relationships that support their investment in and distribution of new payment technology. Often, large merchants are able to create integrated consumer payment experiences that deliver a flow on effect to other participants in the payments ecosystem. Visa co-invests with these larger merchants to enable collaborative development in innovation in a secure and scalable way across the market that leads to innovation and pricing benefits to smaller merchants over time.

Our partnerships with New Zealand’s six largest key merchants are for fixed terms and provide a platform to grow current and future capability, as well as develop technology through cooperation and collaboration to provide benefits to the wider retail industry. We have a unique ability to improve the value proposition for these large merchants by offering services that can help merchants grow their sales, not just minimise cost. These services include risk management, analytics, loyalty products, and payments consulting, as well as participation in product development, advertising, marketing, and branding.

8. Do you agree with the logic underpinning our assessment that there is inefficiency in the credit market?

The issues paper only focuses on the economic rationale (as measured by MBIE) underlying electronic payments and fails to address other reasons why usage and acceptance of card payments are attractive. For cardholders, speed, security and convenience are just some of the other cardholder benefits associated with credit card usage. Similarly, the cost of acceptance is one of many costs associated with running a business and providing utility to both the merchant and cardholder. More broadly, the incremental costs of scheme cards compared to EFTPOS are invested into building out new and enhanced capabilities in New Zealand that allow cardholders and merchants access to a range of products and services unique to the international electronic payments sector.

In addition, the issues paper does not adequately describe the profile of credit cardholders and narrowly defines the scope of microeconomic decisions at the cardholder level. Credit cardholders that transact (*i.e.*, those who pay no interest on their credit cards) cannot be automatically deemed as credit card users with no need for credit. The interest free period available on credit cards allows consumers or businesses the opportunity to better manage cash flow – an important consideration for the SME sector. In addition, cardholders can also benefit from other card benefits such as access to chargeback protection, zero liability in cases of merchant compromise leading to fraud, complimentary travel insurance and discounts at local and international merchants.

It is also important to note the role of credit in an economy. Creating credit increases the volume of capital in a market, increasing the propensity of consumers and businesses to spend, helping improve consumer confidence and generating significant economic activity.

Additionally, the cost of capital is also an important consideration and another balancing mechanism of credit lenders. Should credit costs become too expensive for end users, demand for the product falls and market distortions appear. Should credit be offered at low or no cost, the willingness for lenders to offer the capital reduces, given the cost of borrowing, the risk associated with unsecured lending and the inefficient economic return for financial institutions.

The logic underpinning this assessment in the issues paper has its foundation in the suggestion that the price of accepting credit cards is 'too high', because the users of the cards do not face accurate price signals. If the cost of acceptance was material enough to merchants that it would impact retail prices materially, there is an expectation that merchants in competitive markets would drop prices by ceasing to accept credit cards (or to do so in effect by having different higher prices for credit cards through surcharging, whether it is called surcharging or not).

The continuing assumption appears to be that merchants do not have that choice because credit cards are sufficiently important that some merchants must accept them. However, over 20,000 merchants do not accept international scheme credit cards in New Zealand, including operators of a range of small businesses where a high volume of transactions take place regularly, e.g. convenience stores. The issues paper concludes that this means that they 'accept scheme debit'. This conclusion is false, as many merchants only accept EFTPOS cards, and some choose to not accept electronic payments at all. Decisions regarding the acceptance of payment is typically based on a wide range of factors unique to each individual merchant.

As such, given the freedom of choice available to merchants in the New Zealand market, it is incorrect to claim that there is an inefficiency in the market. There is a significant lack of evidence to suggest that merchants are rejecting credit products or facing the consequences of a market failure as a result of electronic payment acceptance.

9. Do you agree with the logic underpinning our assessment that reward schemes result in higher overall prices and cross-subsidies?

We do not agree with the assessment that reward schemes result in higher overall prices and cross-subsidies. All consumers effectively have access to a wide range of payment products and can exercise freedom of choice in deciding which to use. No one group is being singled out with higher prices. There is no clear correlation between costs of acceptance and the prices charged by merchants for goods and services, which reflect a composite set of factors. Where interchange regulation has occurred there is no study that has found that the prices of goods or services have been reduced. Visa sees no evidence of price disparity in goods and services sold at card accepting merchants versus those who do not accept card payments. The only differences tend to be fees applied by the merchant to offset their payment costs, i.e. a surcharge, not the price differential of their goods or services.

Visa continues to maintain its global policy of opposing merchant surcharging on the basis that it creates a disincentive for consumers to use electronic payment products. The implementation of surcharging in New Zealand could have a number of unintended consequences. When faced with a surcharge for using their credit or debit card, 49 per cent of surveyed Australian cardholders would avoid shopping with this merchant, 40 per cent of cardholders would pay using cash or gift card, while 20 per cent of cardholders would not complete their purchase if faced with a surcharge[23]. The cost of moving from electronic payments to less efficient payment types such as cash needs to be taken into account. The cost of cash is in many cases higher than electronic payments given physical security; inventory; and handling costs.

Australian experience has also shown that allowing surcharging has at times led to profiteering by some merchants, i.e., through excessive surcharges above cost recovery. This has been particularly apparent in the airline, accommodation and taxi industries. As a result, the Australian Government took steps in 2015-16 to prevent excessive surcharging, introducing legislation to fine and prosecute merchants that surcharge beyond the cost of acceptance.

10. Do you agree that self-acquirers are unlikely to place downward pressure on interchange?

Merchant acquiring is an important and specialised component of the retail payments system. There is strong competition between the traditional acquirers in New Zealand, augmented by the introduction of new non-traditional operators, e.g. Payment Express and Stripe. This has resulted in the expansion of competitive acquiring services for the retail community, keeping pace with consumers demands for alternative payment preferences.

Self-acquiring introduces significant duplication and inefficiency in markets that have a dominance of on-us processing. In Visa's experience, self-acquiring environments typically introduce a wide range of inefficiencies, increasing the cost for both merchants and consumers:

- **Network cost** – In self-acquiring markets, both issuers and acquirers typically have to manage a larger volume of network connections, often including custom bilateral agreements, introducing an unnecessary layer of cost and complexity into the system.
- **Hardware cost** – In many self-acquiring markets, merchants are saddled with the additional cost of supporting the deployment of multiple terminals at each outlet (with each terminal supporting a specific acquirer) and the ongoing cost of important software upgrades and scheme compliance that ensures payments are handled in the most secure way possible, creating a significant cost burden across the market.
- **Stifled innovation** – Innovation thrives where there is a consistent, standards driven, open, platform to support a robust innovative payments ecosystem. Increasing the layers of regulation risks interrupting this environment.
- **Poor risk management** – Payments risk management capabilities are directly linked to availability and visibility of payments data available to schemes and issuers/acquirers. In a self-acquiring market, there is no comprehensive real time view of the payments ecosystem and a reduced ability to rapidly react to broad based risks in real time.

[23] RFI Australian Cards Council March 2016

11. How much negotiating power do merchants have over the merchant service fees they face? Is this likely to change in the future?

The question of Merchant Service Fees is one for discussion and negotiation between merchants and their acquirers. New Zealand has a highly competitive acquiring market and acquirers aggressively compete for new merchants. Merchants do have options available to negotiate the cost of acceptance.

Merchants also have a wide range of choice in what payments they accept and how much they participate in the payments system.

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?

Visa does not believe that intervention or regulation of the credit card market is required and in fact, intervention is unlikely to create better outcomes for any participant in the payments ecosystem. Visa competes in a dynamic and highly competitive market and adjusts our strategies, as required, in order to remain competitive.

Different card products are designed for different groups of potential cardholders, meaning that cardholders have to assess the cost and benefits of possessing a certain type of card. It is notable that the growth in new accounts over the last few years has predominantly come from the classic low rate segment[24].

13. Do you agree with our assessment of the incentives held by different parties in relation to debit card usage?

Merchants compete for consumer spending. As merchants improve the attractiveness of their offerings they are also looking for ways to make purchases easier, faster, more convenient for consumers. Visa competes with other payment networks to help support merchant innovation. Visa prices our products to be competitive and reflective of their value; merchants then choose to offer Visa acceptance.

While there are various incentives to encourage the adoption of contactless payments, we do not agree that some merchants will feel compelled to adopt contactless simply because a larger merchant has done so. Smaller merchants are savvy and have distinct niches. If they see the value in adding contactless for its speed, security and reliability and to meet consumer needs, they will be prepared to meet the cost of contactless acceptance. If they do not see the value, then they will not adopt contactless.

From a consumer perspective, Visa focuses on continually improving the customer experience while retaining the underlying trust in the Visa network. The value of contactless payments is well understood by the market, providing fast, convenient and secure payment solutions and allowing increased transaction throughput, more efficient allocation of merchant resources and delivering a superior customer experience. Merchants clearly understand the value of

[24] FY16 Argus benchmarking

these benefits for cardholders and are willing to accept the increased cost associated with the improved customer experience.

15. Do you agree that it is unlikely that schemes will start imposing interchange on swiped/inserted scheme debit transactions?

Where a New Zealand issued Visa Debit card is used in a face-to-face transaction in the same way as a current standard EFTPOS card, the transaction will continue to be routed through the EFTPOS network. Therefore, these transactions will not attract Visa fees or interchange set by Visa. Visa has indicated previously and continues to maintain that there is no intention to change this position in the foreseeable future as long as current market conditions continue to pertain.

16. Do you agree that merchants facing a per transactions charge for accepting debit payments is not an issue in itself?

Visa fundamentally believes in charging for all payments given the cost of providing services and the benefit received by all participants in the payments ecosystem.

Merchants, through the acceptance of contactless payments, have also demonstrated a willingness to pay on a per transaction basis. The fundamentals around the value of a payments network are unchanged, the merchant is aware at the time of purchase that funds have been authorised and then transferred into the account, with no need for the costs associated with the collection, storing and depositing of cash. Clearly the merchant receives value in that process and is willing to accept the expense associated with that benefit.

17. Is the shift towards contactless debit cost effective, taking into account the costs and benefits to all parties in the system.

Investment in contactless is cost effective for several reasons – the technology is more secure, it supports a global standard with an increase in future functionality, and it opens up more mobile functionality and the benefits associated with mobile transactions.

As with all scheme payments, interchange is vital as it provides a mechanism to deliver investment to the network for the benefit of all participants. Interchange is used by issuers to invest in new technology and additional platform tools such a fraud analytics to ensure the security of the system. Those investments are vital in the contactless payments ecosystem. Ultimately, Visa needs to balance interchange to support each party and the network as a whole in order to grow payment volume for the benefit of all participants.

18. Do you agree that the lack of price signals in the debit market is likely to lead to inefficient outcomes of a similar nature to those in the credit card market?

Visa fundamentally disagrees with the premise that there is a market failure in the credit card market, and as such, we do not agree that there is likely to be any future market failure in the debit card market.

19. Do you agree the merchant service fees are likely to increase for contactless debit once acceptance reaches a certain threshold?

It is unlikely that merchant service fees will increase as adoption continues. It is more probable that the opposite will occur, given the amount of choice available to merchants for the differing payment options available. The premise that merchants are growing insensitive to price is not borne out by recent research[25], which suggests merchants are aware of the cost of payments and are equally aware of the value associated to various different payment options. In our experience, contactless payments have driven a reduction in the average value of each transaction and an increase in the volume of transactions[26] as more and more consumers prefer the ease and convenience of contactless payments. This delivers a number of major benefits to businesses, particularly an increase in sales volume.

Cost has and will continue to be a driver of merchant acceptance – recent research indicates 99 per cent of terminals in New Zealand are able to accept contactless transactions, however only 24 per cent routinely accept contactless payments, with cost being cited as a key reason behind the lack of enablement[27]. In order to drive and maintain contactless acceptance, interchange needs to remain at a competitive level that continues to balance value between both merchant and issuer. To date, Visa has not seen any market where the average contactless debit interchange rates have increased[28]. Beyond just the interchange component of the merchant service fee, the New Zealand acquiring market is incredibly competitive and, as such, merchants have the opportunity to negotiate the merchant service fee ensuring the cost of contactless payments is aligned to the value received by merchants.

20. Do you agree with our assessment that the interchange business model imposes significant barriers to entry in the debit market?

No. Developing a compelling value proposition and having the ability to scale a solution pose a barrier to entry, however, many fintech companies are using mobile and internet solutions to overcome these barriers. Interchange and/or merchant discount revenue are in fact important revenue considerations for adopting electronic payments.

New, innovative and alternative payment models that provide a compelling value proposition to consumers and merchants alike may not be dependent on interchange in the future. A highly competitive market that allows for innovation and consumer and merchant choice will ultimately determine whether interchange is needed or not.

There are new and competing entrants into the system as referenced in throughout this paper. Thanks to the structure of the interchange model, new payment innovations are entering the market which will see value created for all stakeholders in the payments system. Price controls or caps could limit future innovation. A highly competitive market with consumer and merchant choice will ultimately determine what innovations come to market and at what price.

[25] RFI Merchant Program report - September 2015
[26] As per VisaNet data – December 2016
[27] KAE research – Visa commissioned Nov 2016
[28] As per VisaNet data – December 2016

22. Do you consider the extent of the difference in the interchange relating to small and large merchants to be justified?

Visa sets interchange across the market for the betterment of all parties. This is not driven by merchant size but rather to balance a two-sided market involving merchants and consumers, whilst also opening acceptance and adoption of new technologies.

There are basic differences between large and small merchants and in some cases there is no difference in interchange rates, but there is almost always a difference in the merchant discount fee. The simple reasons are that servicing cost and risk associated with a smaller merchant are much higher. For example, new small merchants have no transaction history and the acquirer takes on a greater risk to guarantee their transactions, smaller merchants also have similar servicing requirements regarding daily/monthly reports, terminal supplies/service, etc.

Visa engages with large merchants through a strategic program, playing a key role in leading the New Zealand payments landscape. Globally and locally, Visa continues to grow acceptance and create a unique ability to improve the value proposition for large merchants by offering services that can help grow sales and minimise cost. These includes many of the same services provided for issuers, such as risk management, analytics, loyalty and payments consulting.

In some cases, large merchants have agreed to deploy new technologies such as contactless or e-commerce authentication at scale, which then encourages other participants in the network to adopt these new innovations. These arrangements can benefit the overall network.

25. Would there be any benefit in schemes publicly clarifying their intentions in relation to charging for swiped and inserted debit payments?

Where a New Zealand issued Visa Debit card is used in a face-to-face transaction in the same way as a current standard EFTPOS card, the transaction will continue to be routed through the EFTPOS network. Therefore, these transactions will not attract Visa fees or interchange (or other applicable rules) set by Visa. Visa has indicated previously and continues to maintain that there is no intention to change this position in the foreseeable future as long as current market conditions continue to pertain.

26. Do you think that the benefits of interchange regulation are likely to exceed the costs? and
27. What unintended consequences could arise from interchange regulation?

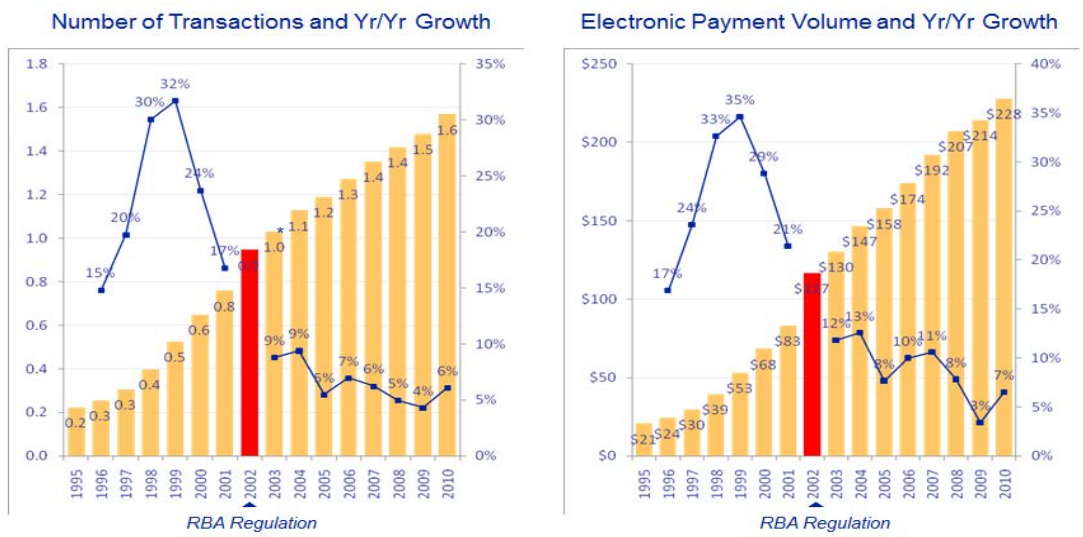
Visa's global experience shows that interchange has proven to be effective in growing system volume and investment, and when interchange is not managed or regulated efficiently, the growth of electronic payment slows. Specific interchange levels work to balance the incentives between an issuing institution (which promotes and issues cards to consumers) and an acquiring institution (which enrolls and processes transactions for merchants). With an appropriately set interchange rate structure like that in operation in New Zealand at present, financial institutions on both sides are more likely to encourage acceptance and usage and to make the investments required to continuously innovate and keep payments secure, reliable and convenient for cardholders and merchants.

Visa believes that any over-reaching intervention in this complex system could be harmful to consumers, other system participants, and government growth objectives. The regulatory intervention that we see in countries like Australia, for example, which capped interchange fees, actually resulted in fewer payment choices, a reduction in benefits for consumers and higher payment product costs for consumers levied by issuers and/or at the check-out by way of merchant surcharging at the point of sale.

Ironically, merchants would also suffer from unintended consequences of poor regulatory intervention. A lack of willingness from financial institutions to loan finite capital through inefficient, high risk lending products will reduce the availability of credit in the market, reducing economic activity and constricting growth. Further, evidence from interchange regulation in Australia indicates that capped interchange fees have resulted in less investment and less innovation in the payments system[29], reducing the benefits to all payments ecosystem participants, including merchants.

In Australia, a large reduction in interchange dramatically curtailed the growth in electronic payments. As a result of the interchange reduction, cardholder fees increased, cardholder benefits decreased and the annual rate of growth in electronic payments slowed from a high of 32 per cent pre-regulation to a low of 4 per cent post-regulation.

Figure 1: Reserve Bank of Australia regulatory impact – rate of electronic payment growth



*Note: The RBA changed its basis in 2002 (the year regulation was enacted). Pre -2002 data includes only Visa and MasterCard. Post -2002 data includes Visa, MasterCard, American Express, and Diners Club. The annual growth rate between 2001 and 2002 is not meaningful.

Source: Reserve Bank of Australia; http://www.rba.gov.au/payments-system/resources/statistics/index.html

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[29] Robert Stillman et al., *Regulatory Intervention in the Payment Card industry by the Reserve Bank of Australia: An Analysis of the Evidence 46-48* (Apr. 28, 2008), available at http://www.crai.com/ecp/assets/Regulatory_Intervention.pdf. It is noteworthy that this is separate from concerns that Australia's regulation of interchange fees has, in the words of the Reserve Bank of Australia itself, resulted in "*a reduction in the value of reward points and higher annual fees, increasing the effective price of credit card transactions…*" with no concrete evidence that merchant interchange savings were passed through to consumers. Reserve Bank of Australia Payments System Board, Annual Report 2007, p. 27.

In Australia, credit card fees payable by the consumer have increased substantially since interchange regulation was imposed and if any merchant cost savings were realised, they have not been passed on to consumers in the form of lower prices[30]. By 2005, Australian cardholders had seen their annual fees and finance charges increase by AU$148 million[31]. By 2008, economists estimated that cardholders faced increased fees of as much as AU$480 million. Another analyst estimates that consumers have faced increases in card-related fees (annual fees, over-limit fees, cash advance fees) of about 40 per cent[32]. Australia's interchange regulator, the Reserve Bank of Australia (RBA) itself concluded that "*Lower interchange fees in the MasterCard and Visa credit card systems have resulted in a reduction in the value of reward points and higher annual fees, increasing the effective price of credit card transactions facing many consumers*[33]."

<u>Case study: United States - Effects of interchange regulation on consumers and the payment system</u>

In 2010, the United States Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act that directed the Federal Reserve, the regulator of the payment system in the United States, to cap interchange fees payable to issuers on debit card transactions. The cap was introduced at a maximum of 21 cents plus 5 basis points per transaction (with an additional 1 cent available to offset fraud protection costs). The interchange caps went into effect on 1 October 2011.

By regulating the level of interchange issuers may receive on debit card transactions, the legislation has decreased interchange revenue by around US$8 billion annually[34]. To offset the significant reduction in interchange revenue, issuers have responded with reduced product offerings and features, imposing new charges, and/or increasing fees. At the same time, there is no evidence that merchants have passed on any cost savings, and as a result, consumers have been left paying higher prices for, or experiencing a reduction in, card related services without any evidence of decreased prices from merchants.

In the United States, debit interchange regulation impacts about 68.2 per cent of debit payment volume[35]. The introduction of this framework has resulted in a dramatic reduction in the number of financial institutions that offer low-cost or free customer products, such as free transaction accounts and issuer investment in cardholder usage programs. Debit card rewards programs that drive cardholder usage, for which merchants benefit, have also largely disappeared. A recent Pulse debit issuer study found that 50 per cent of regulated debit card issuers with a reward program ended their programs in 2011, and another 18 per cent planned to do so throughout 2012[36]. Bankrate, a personal finance publisher, released a study showing

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[30] Robert Stillman et al., *Regulatory Intervention in the Payment Card industry by the Reserve Bank of Australia: An Analysis of the Evidence* 46-48 (Apr. 28, 2008), *available at* http://www.crai.com/ecp/assets/Regulatory_Intervention.pdf

[31] Howard H. Chang et al., *An Assessment of the Reserve Bank of Australia's Interchange Fee Regulation*

[32] *See* Mercator Advisory Group, *Australian Interchange Regulation: Credit Card Issuer Effects* 17 (Dec. 2007)

[33] *See* Reserve Bank of Australia Payments System Board, *Reform of Australia's Payments System: Preliminary Conclusions of the 2007/08 Review* 17 ("RBA 2007/08 Review")

[34] Zywicki, T, et al. *Price Controls on Payment Card Interchange Fees: The U.S. Experience*, available at http://www.law.gmu.edu/assets/files/publications/working_papers/1418.pdf

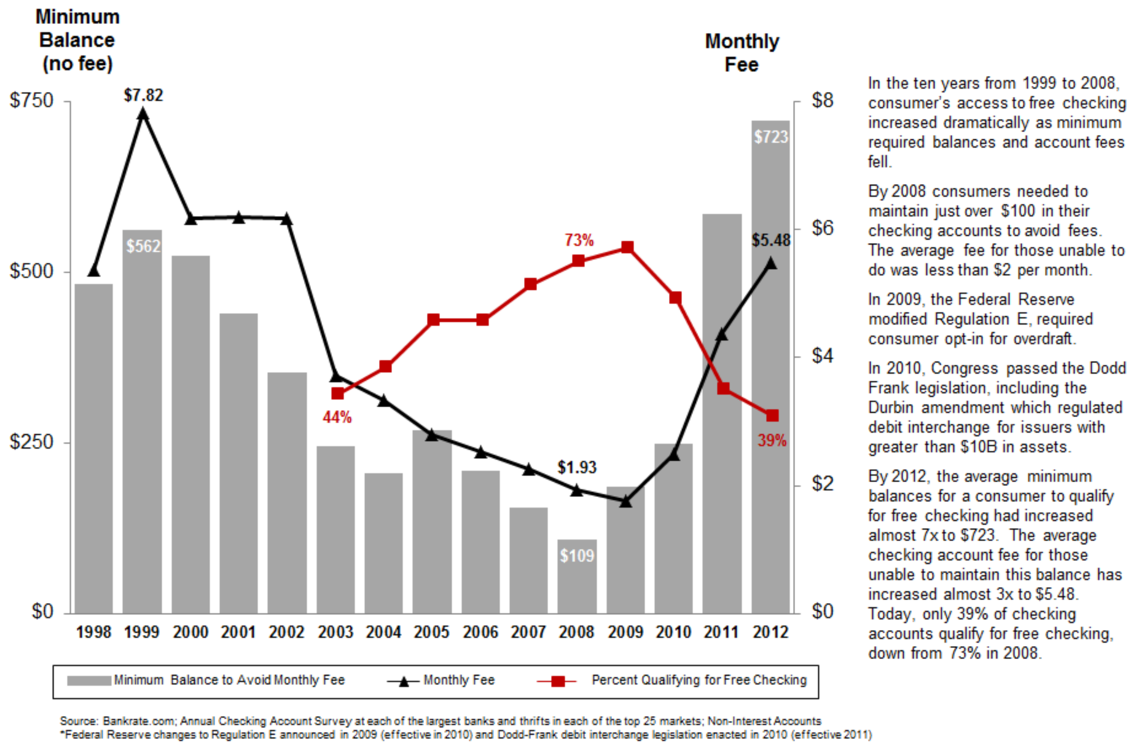
[35] Debit card issuers with less than US$10 billion in assets are exempt by statute from the regulation. Federal Reserve CY2015 survey.

[36] *See* Zhu Wang, *Debit Card Interchange Fee Regulation: Some Assessments and Considerations*, Economic Quarterly, Third Quarter 2012 (citing Pulse survey), available at http://www.richmondfed.org/publications/research/economic_quarterly/2012/q3/pdf/wang.pdf

that the percentage of free transaction accounts offered by financial institutions dropped from 76 per cent in 2009 to 38 per cent in 2013[37]. Further, the average monthly service charge has increased 25 per cent since 2011[38].

As a result, low income individuals appear to have been particularly affected by the Durbin Amendment. Many low- and moderate-income consumers have been driven to seek alternative banking methods due to the increased cost in services. [39]. According to the Federal Deposit Insurance Corporation, one million consumers, mainly low income, lost transaction accounts between 2009 and 2011[40]. Reducing access to transaction accounts for these consumers may drive an increase in costlier forms of financial services, such as payday lending and pawn shops, while also reducing the overall level of financial inclusion, particularly for lower socioeconomic segments of society.

Figure 2: Durbin Amendment regulatory impact – reduced consumer benefits and higher cost



While consumers face increased fees from issuers, there has been a lack of any corresponding price decreases from merchants, even though merchant costs have reduced by an estimated

[37] Zywicki, T, et al. *Price Controls on Payment Card Interchange Fees: The U.S. Experience*, available at http://www.law.gmu.edu/assets/files/publications/working_papers/1418.pdf
[38] Claes Bell, *Checking fees rise to record highs in 2012*, Bankrate.com (Sept. 24, 2012), *available at* http://www.bankrate.com/finance/checking/checking-fees-record-highs-in-2012.aspx
[39] Kyle Stock, *In Fee Chase, Big Banks Back Away From Free Checking*, Bloomberg Businessweek (June 11, 2013), available at http://www.businessweek.com/articles/2013-06-11/in-fee-chase-big-banks-back-away-from-free-checking
[40] Todd J. Zywicki, *First, Do No (More) Harm*, N.Y. Times (July 21, 2013), available at http://www.nytimes.com/roomfordebate/2013/07/21/consumer-finance-agencys-new-clout/consumer-financial-protection-bureau-should-avoid-distorting-the-market

US$8 billion per year as a result of the legislation[41]. TSG Metrics, a payment consultancy group, released a study in October 2011 that found that "*most merchants will see substantial debit fee savings for transaction amounts over US$40 and have no incentive to pass on savings to consumers*."[42] These predictions have come to pass. A Federal Reserve study notes, "*at this point, little empirical evidence has been reported on the change of merchant prices due to the debit interchange regulation*." The Electronic Payments Coalition conducted field research which also found "*no evidence of any savings being passed along to consumers in the form of lower prices as a result of the price controls*."[43]

The legislation has also reduced the incentive for investment and innovation in the payment system. One study found that the legislation will "*eliminate incentives for almost all new payment methods*."[44] New payment systems typically attempt to gain merchant acceptance by offering competitive services and products. With the rate controls imposed by the Durbin Amendment, however, merchants have much less incentive to adopt these new systems, reducing or removing the ability of new market entrants to gain traction to challenge incumbent operators.

28. Under what conditions, if any, should debit interchange rates be regulated?

Debit transactions make up 36 per cent of the overall payments market in New Zealand. Visa believes that the best outcome is for competitive forces to evaluate the broadest overall market perspective and evaluate business opportunities, and adjust interchange in line with what is required to grow network participation (i.e. more issuers, acquirers, cardholders and merchants). When governments set arbitrary price controls or caps often the outcome is that growth and innovation in the payment space tend to stagnate.

Visa does not agree that the current situation in the payments system reflects this – the payments industry in New Zealand is highly competitive and continues to bring new and innovative products and services to consumers and merchants alike. The growth in the number of cardholders, merchants and transaction volume is a testament to the value delivered by electronic payments for all participants. The value proposition that networks bring to consumers and merchants alike is a complete package (security, reliability, payment guarantees, consumer fraud protections and chargeback rights, etc.). Singling out one component for regulation does not represent the value of the whole network.

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

The New Zealand market has experienced the entrance of new fintech operators into the payments sector regularly. Visa does not believe there are any significant barriers preventing new participants entering the debit payment market.

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[41] Hugh Son, *Debit-Fee "Flop" Leaves Banks Seeking $8 B*, Bloomberg.com (Nov. 2, 2011), *available at* http://www.bloomberg.com/news/2011-11-02/debit-fee-flop-leaves-u-s-banks-looking-for-8-billion-in-lost-revenue.html

[42] *Recent Changes to Debit Economic Model Substantial; Durbin Has Unintended Effect as Customers Will Absorb Impact*, TSG Metrics (Oct. 14, 2011)

[43] *Where's the Debit Discount? Durbin Price Controls Fail to Ring Up Savings For Consumers*, Electronic Payments Coalition, *available at* http://wheresmydebitdiscount.com/wp-content/themes/epc/media/Where's%20My%20Debit%20Discount%20-%20Durbin%20Price%20Controls%20Fail%20to%20Ring%20Up%20Savings%20for%20Consumers.pdf

[44] Andrew Dresner, *Durbin second-order effects*, Oliver Wyman (2011)


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