

**Ministry of Business, Innovation  
and Employment**

on the

**New Zealand Retail Payments  
Systems**

2 February 2017

**Strictly Confidential**



## 1.0 INTRODUCTION

- 1.1 This submission has been prepared by Bank of New Zealand (BNZ) in response to the Ministry of Business Innovation & Employment (MBIE) consultation document, Retail Payment Systems in New Zealand released in October 2016.
- 1.2 BNZ welcomes this opportunity to provide a response to MBIE's consultation document and acknowledges the industry consultation undertaken on this matter.
- 1.3 BNZ is aware that our submission will be published on MBIE's website. We confirm that it does not contain sensitive commercial information.

## 2.0 EXECUTIVE SUMMARY

- 2.1 Payment systems are notoriously complex. It is therefore paramount that full analysis is undertaken to identify issues and options before determining and implementing the optimal solution. BNZ has a strong preference for solutions to be driven and managed by industry on a voluntary basis. This is because there are numerous examples from overseas where regulation has not achieved its objectives and has introduced inefficiencies and unintended consequences. This risk needs to be avoided. Any solutions need to be tailored to meet the specific circumstances of the New Zealand market and BNZ would caution against adopting an overseas solution without first undertaking full analysis, as recommended above.
- 2.2 In summary, our key submissions are:

**(a) Innovation:** Innovation is the life blood of payment systems. If they don't innovate to meet users' emerging needs they will shrink. New Zealand has an opportunity to create Payments Frameworks for credit cards (Credit) and debit cards (Debit) that are specifically relevant to the unique circumstances of the New Zealand market and that facilitate the competition and innovation required for a competitive and responsive payments industry. BNZ sees certain desirable innovation as lacking, notably: (i) the uptake of contactless by merchants is slower and more fragmented than ideal for New Zealand as a whole; and (ii) there has been no enhancement for proprietary debit so it meets the needs of stakeholders in the payments system<sup>1</sup>. This has the potential to frustrate the use of mobile devices and other options for payment purposes (and the wider innovation that is concomitant with that) – resulting in a suboptimal consumer experience and a loss of opportunity to make further efficiency gains. Therefore, BNZ considers that the removal of barriers to the uptake of innovation (with an immediate emphasis on contactless) is a priority.

**(b) Establishment of Taskforce and Frameworks:** BNZ proposes that a payment industry taskforce should be created to establish two frameworks (Frameworks) to facilitate innovation (by removing barriers and encouraging participation) – one in respect of Debit and one in respect of Credit. The membership of the taskforce and its

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<sup>1</sup> *The so called 'Online EFTPOS' is not an enhancement of the proprietary card product but a distinct unrelated m-Commerce proposition.*

terms of reference would be agreed between industry and MBIE. Commerce Commission authorisation would also be required, given that there would be pricing discussions and arrangements between industry participants – see (iii) below. BNZ submits that:

- (i) it is paramount that the Frameworks are specifically tailored for the needs of the New Zealand market and avoid repeating the shortcomings and unexpected outcomes experienced with some overseas regulatory models;
  - (ii) the proposed objective for the Frameworks would be: *“To ensure that New Zealand has an evolving retail payment system that gives every New Zealander access, anywhere and anytime, to secure, efficient, fast and convenient retail payment options, and facilitates the timely introduction and uptake of innovations.”*;
  - (iii) the Commerce Act 1986 constitutes a barrier to industry participants agreeing and implementing the voluntary industry initiatives that BNZ thinks are likely to be necessary to deliver the objective, given that collaboration between market participants would be required to identify options and agree on sustainable outcomes. Formal Commerce Commission authorisation would be required to enable discussions to be held and voluntary solutions to be implemented.
- (c) **Credit:** To address the issue raised in the consultation document that some *merchants are concerned about increasing fees for the processing of electronic transactions* – BNZ would support a voluntary move by industry to set an interim maximum Credit interchange cap for domestic transactions performed by premium (and super-premium cards if issued) at the current platinum rates. Currently, market participants are prevented by the Commerce Act from discussing this with other issuers.
- (d) **Surcharging:** BNZ submits that surcharging by merchants should be limited to recovering the incremental cost difference that is in excess of non-surcharged payment types (e.g. cash). Surcharging should be capped at no more than the cost of card acceptance, less the cost of any non-surcharged ubiquitous payment form (i.e. cash). This would require regulation.
- (e) **Inefficiencies:** BNZ notes the analysis carried out by Axiom Economics for the New Zealand Bankers Association (NZBA). Overall, the payment systems are performing well in delivering secure, efficient, fast, convenient and robust services. Accordingly, BNZ does not necessarily accept the existence or the quantum of the inefficiencies alleged by the consultation document. BNZ does not consider regulatory intervention is necessary, with the exception, in the interests of consumers, of controlling surcharging by merchants to prevent over recovery of merchant service fees. However, there are areas (uptake of contactless and proprietary EFTPOS) where there is room for improvement to better facilitate innovation and competition. This can be achieved by industry voluntarily undertaking to meet specific objectives under a Debit Framework.

- (f) **Differences in merchant service fee between large and small merchants:** BNZ agrees that differences do exist. These can be attributed to a number of factors, including the greater bargaining power of larger merchants, the value of their overall banking relationships and a higher uptake of contactless debit (which has lower interchange rates). Notwithstanding this, BNZ is amenable to the issue being examined by the proposed taskforce with a view to it being addressed as part of the proposed Framework development. This would be implemented by acquirers on a voluntary basis, providing merchants with greater transparency of the makeup of their merchant service fees, including separating reporting for debit and credit. BNZ would need time to make the system changes to provide this extra detail on merchant statements. The length of time required by BNZ to make system changes would depend on the extent of the changes required and the pressures from competing programmes of work – but a preliminary estimate is that it could take BNZ 12 – 18 months to develop and implement the necessary system changes.
- (g) **Code of Conduct:** BNZ notes the consultation document’s question on the possibility of having a code of conduct along the lines of the Canadian model. BNZ sees the proposed taskforce as being best placed to make a recommendation on whether there should be a code. The advantages of a code are that it provides transparency, consistency (across different banks), certainty and objectivity. The disadvantage would be the cost of policing compliance with the code (which we assume would be imposed on industry). If a code is recommended by the proposed taskforce, BNZ submits it should be a voluntary industry code which runs parallel to, or is part of, the Code of Banking Practice. It is noted that disputes under merchant agreements can already be referred to the Banking Ombudsman by merchants so long as the amount involved is under \$200,000. It is submitted that any code should be designed to meet the specific needs of the New Zealand market and the Canadian Code of Conduct is not appropriate to be adopted on a “lift and shift” basis.
- (h) **Debit and innovation:** BNZ agrees with the assessment in section 4.3.3 of the consultation document that there is little incentive to invest in the innovation of proprietary EFTPOS. Currently the cost of proprietary EFTPOS is carried by all banks at a loss. This has led to a lack of new investment, which has resulted in proprietary EFTPOS having limited functionality compared to Scheme debit. Therefore., BNZ submits that the limitations of proprietary EFTPOS should be reviewed by the proposed taskforce.

### 3.0 PRELIMINARY

- 3.1 BNZ notes that an economic analysis of the consultation document has been prepared by economic consultants, Axiom Economics (Axiom), for NZBA. BNZ supports the submissions made by NZBA in respect of the Axiom analysis and therefore further in-depth economic analysis is not covered in this submission.
- 3.2 BNZ also notes the weight placed by the consultation document on international statistics and wider analysis of international experience (most notably Australia). While this provides a starting point, we would expect that a full, robust and

evidence-based study of the New Zealand market would be carried out before the proposed taskforce could develop proposals specifically for the New Zealand market. A failure to do so risks introducing outcomes that are out of step with New Zealand's specific market structure, which could be to the detriment of all market players, especially consumers.

3.3 In responding to the questions in the consultation document, BNZ has:

- focused on the impact on consumers, as well as other participants in the retail payments system;
- drawn on extensive data and analytics, together with domestic and international learnings and analysis by Argus Information and Advisory Services<sup>2</sup>;
- performed a wide-ranging consumer and market impact analysis of both Debit and Credit scenarios and considerations; and
- conducted an in-depth analysis to fully assess relevant behaviours and responses observed in comparable regulated markets.

## 4.0 GENERAL OVERVIEW

### 4.1 Card payment has produced positive impact on the retail payment systems.

Whilst the consultation document highlights that there are some challenges with the retail payments system in New Zealand, BNZ considers that the existing structure has been successful in facilitating trade and commerce and (with the notable exception of domestic Debit in recent times) driving payment card innovation that has benefited both merchants and consumers.

World-leading levels of access to, and usage of, electronic payments, has been a key driver of secure, efficient and fast commerce in New Zealand. Cash (lowest per capita in the World) and cheque usage has been reducing, with consumers and merchants signalling their preference for the convenience, security, speed, efficiency and ease of electronic options. Other countries are moving rapidly to reducing cash in their systems by taking advantage of innovation and making significant efficiency gains. New Zealand is not innovating at the same rate and will fall behind countries like Sweden if it does not remove barriers to the uptake of innovation, like contactless, in the near term (see the following industry discussion - <https://www.liquidpay.com/real-cost-cash/>).

Innovation is generally broadly welcomed by all participants (especially by consumers) in the payment system, although the extent and speed at which it is adopted can be sub-optimal in terms of efficiency outcomes. There is usually high and rapid uptake by consumers but this is currently hampered by contactless not being made universally available at point of sale (POS).

BNZ notes that the consultation document includes estimated costs for merchants but does not offset that with the costs to financial institutions of providing EFTPOS and Scheme debit at POS. This is a significant omission from the document's analysis.

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<sup>2</sup> *Argus Information and Advisory Services is one of the leading providers of benchmarking and analytical services across the worldwide payment market.*

Importantly, Credit and Debit Card payments provide consumers and merchants with significantly superior benefits in comparison to cash and cheque. They have enabled merchants to create considerable business model efficiencies and drive customer retention and volume in many retail categories. They have enabled large and small retailers alike to reduce costs, retain customers and increase business in store and beyond geographic limitations.

## 4.2 BNZ's response to main points

The consultation document notes that MBIE's consultation is in response to three points:

1. Concerns about increasing fees for the processing of electronic transactions to merchants passing through as increased costs to consumers;
2. Industry developments, including the adoption of new technologies; and
3. Ongoing reforms to the oversight and regulation of retail payment systems in overseas jurisdictions have delivered some benefits to certain parties.

In responding to the consultation document, BNZ has looked closely at the role interchange plays. BNZ submits that interchange is an effective and generally efficient process. Overseas, interchange (as a process) has not been questioned. Rather, it has been the rate setting for products within the interchange process that has been the focus of review.

BNZ notes the following key factors that are relevant to any further assessment of New Zealand's retail payment systems:

- (a) Merchants' costs for accepting Credit cards have been increasing in absolute terms, primarily because the use of cards continues to grow. Much of this is driven by new commercial opportunities introduced by merchants and adopted by consumers – for example, flourishing e-Commerce and the arrival of new low cost channels and business models supported by new payment mechanisms (such as multi-channel sales options provided by New Zealand retailers of all sizes for consumers and other transformational models such as Uber and Air BnB).

By contrast, at a market level, there has been little increase in average merchant service fees, with any increases driven by particular card types – such as increase in the usage of premium and commercial cards. Any fee increases in those contexts have largely been offset, at a market level, by growth in lower fee cards or the wider application of lower merchant service fees for strategic merchants, including greater acceptance of contactless by strategic merchants at reduced rates. From a market-wide perspective, BNZ considers merchant service fees are largely delivering efficiency (and not introducing any new inefficiency).

As the consultation document notes, the cost of Debit card acceptance has remained free from merchant service fees and, for the most part, costs associated with Debit card acceptance have been borne by banks.

- (b) EFTPOS dollar spend is not in decline. It has remained stable for the last several years. It has suffered a relative decline in market share, which is attributable to a lack of innovation, which has resulted in it being unable to expand into new card payment sectors (e.g. contactless, mobile commerce, international and online). It appears to BNZ that contactless is being used as a substitute for cash rather than replacing EFTPOS, although this may change.

- (d) Overall, the payments industry has adopted many product, security and digital innovations in recent years, with more on the horizon and many being contactless based. Evidence suggests that these innovations will offer greater efficiencies. The efficiency these innovations can deliver to merchants, consumers and the market as a whole (see Appendix 1) should be studied by the proposed taskforce as part of any further analysis.
- (e) While it is acknowledged that there have been some gains from regulatory intervention in other markets, such as uptake of contactless in the Australian market, many of the intended consequences have not occurred. For example, despite years of regulatory intervention in Australia, Credit card spending and the proportion of revolve rates have continued to decrease. Reform orthodoxy would have predicted credit transactor shoppers would migrate from credit to debit as the result of reduced rewards – but this has not occurred and credit revolve rates are, instead, at an all-time low level. Scheme Debit has grown but it is by replacing cash. Flow through of lower prices to consumers has not been observed – which would suggest that merchants have gained at the expense of issuers and the consumer has been left worse off. BNZ submits that these were not intended outcomes.
- (f) BNZ submits other unintended consequences and costs have been introduced as a result of the regulatory intervention overseas, including:
- increased costs/fees, reduced rewards for cardholders, increased surcharging of cardholders; and
  - the distortion of the Australian market (ironically resulting in growth of the high merchant service fee Amex Companion cards, which required further regulation and remains only partially addressed through the regulation of bank-issued (but not American Express issued) Amex cards).

The unintended consequences take time and resources to correct, as has been apparent in repeated attempts in Australia.

#### **4.3 CREATING A SUSTAINABLE DEBIT PAYMENT PLATFORM TO MEET STATED OBJECTIVES**

Section 44 of the consultation document identifies three economic objectives against which New Zealand's retail payment systems should be assessed:

- (a) Objective One: *There should be innovation and development of payment options that are valued by consumers and businesses.*

BNZ strongly endorses this objective. While innovation is being achieved through Scheme Debit, with rolling deployment of innovation and resultant wide consumer adoption, this is currently not the case with proprietary EFTPOS.

BNZ agrees with the consultation document's finding that domestic Debit (EFTPOS) has not kept pace with innovation and, as a consequence, trails Scheme debit in offering key features that consumers value, including, contactless acceptance and online transaction capability. Furthermore, if investment is not made, it will fail to meet consumer demands around use and capabilities, in particular, use of mobile devices.

(b) Objective Two: *Resources are allocated efficiently at a system level.*

BNZ understands it is intended that there should be available a mix of payment methods that represent the underlying preferences of consumers and merchants.

At present, EFTPOS does not enable contactless transactions, yet these are rapidly emerging as a preferred means of payment for many consumers, particularly younger consumers who want to be able to do everything on their mobile devices. BNZ understands that many merchants, particularly smaller merchants, do not currently accept contactless transactions because of their perception of the fees that would be incurred (compared to domestic EFTPOS and dipped or swiped Scheme debit, which currently have no fees).

Opening up the use of proprietary EFTPOS to contactless transactions has the potential to:

- Increase electronic transactions, thereby reducing the amount of cash that needs to be held/handled by consumers and merchants and their respective banks;
- Provide merchants and consumers with faster transaction processing times (compared to cash and dipped or swiped cards or cash);
- Reduce the security risk for merchants as a result of holding less cash;
- Reduce the security risk to consumers by providing a lower risk payment option (chip, mobile); and
- Facilitate the migration to mobile wallet payments, opening innovative ways for merchants and consumers to better engage with each other through mobile devices – for example, offers, promotions, rewards, digital receipts and warranties etc.

(c) Objective three: *The cost associated with payment systems is distributed fairly across consumers and merchants at an individual level.*

BNZ agrees that costs should be distributed equitably across all participants in a payments system. Interchange evolved as a means of doing this. BNZ considers that as a process interchange works well. BNZ submits that if there is an issue with interchange, it is – how an interchange rate is set for a particular product, rather than with the principle of using interchange as a mechanism to achieve fairness between participants.

While noting the economic objectives set out in the consultation document, BNZ suggests that there should be an overarching objective as follows – *“To ensure that New Zealand has an evolving retail payments system that gives every New Zealander access, anywhere and anytime, to secure, efficient, fast and convenient retail payment options and facilitates the timely introduction and uptake of innovations.”*

## 5.0 SUMMARY OF KEY ISSUES

### 5.1 *Are consumers and merchants benefiting from ongoing innovation?*

There is clear evidence that consumers and merchants have already benefited from the security, efficiency, convenience, and innovation that has taken place in the retail payments system. Recent examples include:

- (a) The implementation of contactless functionality (see section 4.3(b) above).
- (b) The emergence of online payments capability, which has generated new domestic and global retail paradigms supporting new categories of businesses significant growth in online sales and activity and has aligned with consumers' changing preferences in how and when they want to shop. Merchants who have embraced this innovation have been able to grow sales and collapse their operational, logistical, premises and sales costs. New businesses have emerged to meet the demand of consumers.

While over the last two decades these quantum changes have been happening to the rest of the card payment world, New Zealand proprietary EFTPOS has remained unchanged from its 1980s business proposition, commercial model and technology base. BNZ questions therefore, whether proprietary EFTPOS is the right benchmark to test 21<sup>st</sup> century payment practice.

### 5.2 *Are card payment systems being used efficiently?*

BNZ notes the work done by Axiom for NZBA casts doubt on the consultation document's analysis of efficiency of card payment systems. Therefore, more analysis of potential market failure is required before this question can be fully and fairly answered.

BNZ considers it is important there are a range of payment options available to consumers and that they have the knowledge and ability to make informed choices about which payment method to use (noting that this may not be the lowest cost option). The interests of consumers are not homogeneous and systems need to accommodate a wide range of preferences and consumer profiles.

If further analysis by the proposed taskforce shows that the systems are not being used with optimum efficiency, the challenge will be identifying and implementing solutions that will ensure an improved outcome for consumers and the market generally, without introducing unforeseen consequences in terms of the responses by industry participants and market behaviour.

BNZ considers that there are two possible inefficiencies that may warrant further analysis by the proposed taskforce;

- 1 the level of cost attributed to some segments of merchants in the form of the differential level of interchange on platinum (or above) credit cards; and
- 2 the imbalances between proprietary EFTPOS and Scheme Debit.

The following are two examples of how consumers have not behaved in ways that may have been anticipated:

- (a) Higher rewards on Credit were seen in New Zealand over the last 18 months while banks competed intensively for 'rewards' customer market share. While there was plenty of customer movement between banks as a result – Credit card spending growth overall did not occur, as the consultation document infers it should have. In fact, non-reward Debit (EFTPOS and dipped or swiped Scheme Debit) spend comfortably outgrew Credit; and
- (b) Similarly, attempts to regulate down interchange in Australia and the UK have not caused any significant decline in the use of cards – see for example, the experience in Australia, as noted above, or the UK<sup>3</sup>.

Regulation appears to be an unpredictable and unreliable tool to use to signal to consumers which methods of retail payment are more cost efficient.

### **5.3 Are consumers and merchants bearing a fair share of the costs?**

#### **Merchants**

BNZ submits that the proposed taskforce should examine the future of proprietary EFTPOS and how it should be maintained as a competitive option that is a sound, fast, convenient and easy-to-use payment method. This is a matter that requires investigation by the proposed taskforce.

BNZ submits that the comparisons to other markets made in the consultation document have been selective. After factoring in the fact that merchants do not contribute to EFTPOS or swiped or dipped Scheme debit, BNZ's assessment is that Australian merchants pay no less than New Zealand merchants for total Debit and Credit card acceptance.

#### **Consumers**

The position for consumers raises more complex questions as to how merchants price and what impact the form of payment has on pricing.

Currently, in New Zealand, there is limited surcharging of transactions, and generally this is only on Credit and Scheme debit cards. The consultation document acknowledges that all payment mechanisms, including cash, have some cost associated with them. It is important that surcharging, if permitted, is limited to cost recovery of the excess over the costs of other payment forms that are not surcharged (e.g. cash).

For proprietary EFTPOS consumers, costs are currently largely borne by the banks – and some consumer segments through fees.

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<sup>3</sup> *The regulation of interchange in the Australian market in 2003 saw a substantial increase in the fees charged to consumers and the concomitant reduction in rewards value offered to them, leaving consumers considerably worse off. The introduction of American Express Companion Cards and Premium Scheme Credit Cards also saw merchants' costs creep slowly over the weighted average of 50 basis points.*

*Recent changes in the UK market significantly reduced interchange rates on credit cards, resulting in major reductions in rewards benefits seen by consumers on cards,*

## 6.0 SPECIFIC ISSUES

### 6.1 Economic inefficiency in the Credit card market

BNZ submits that the assumptions behind the inefficiency contention are not robust. The calculation of the inefficiency value and the amount it might be seem significantly overstated to BNZ and are the subject of a separate response by the NZBA. In particular, BNZ notes that high-level calculations made in the consultation document use Australian numbers (without adjustment for New Zealand-specific market features). This highlights the need, if the issue is to be taken further, for a full, New Zealand-specific, market study and associated economic modelling to be carried out to correctly identify issues and options before any remedial action is proposed.

Based on what can be seen from overseas regulation, BNZ submits that it is most unlikely that any regulatory intervention in New Zealand would induce more than a small fraction of 'transactor' cardholders (those who do not pay or only occasionally pay interest on their Credit cards) to change their behaviour. In fact, transactors have remained in approximately the same proportions in Credit card portfolios from long before rewards were first offered. It is also noted that Credit card spend growth lags behind Debit card spend growth.

Nor has account been taken by the consultation document of the benefits that flow back into businesses when rewards are redeemed – see sections 8.5 and 8.8 of this submission.

### 6.2 Increased prices for all consumers with only higher-income consumers benefiting from rewards

Three factors can be considered in addressing this issue:

- (a) Rewards are only available to consumers who satisfy the banks' responsible lending criteria. In the case of BNZ, consumers must expressly apply for high rewards platinum cards. The spread of card products on offer also includes low rate and balance transfer offers, which can provide a better option for lower income consumers, to help reduce their overall cost of debt and facilitate faster repayment.<sup>4</sup>
- (b) The cost of payment acceptance at a per transaction level is relatively minor. While it will differ depending on the average transaction size of merchants, based on the average overall transaction size, the total cost of Scheme debit merchant service fee is negligible and that of Credit is only a few cents. BNZ submits that consumer demand and competition impacts are likely to be far more relevant to pricing than the cost of payment acceptance. Indeed, this is a hallmark of a two-sided market.
- (c) Whilst the theory that merchants will pass on cost savings in the form of lower prices to consumers may seem plausible to some, it has not been observed in

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<sup>4</sup> *Note, BNZ's customer promises already include listening to our customers to help them make the right choices, and recommending products and services that give the customer the best value.*

practice. Unless there are competitive pressures, there is no incentive for merchants to pass on cost reductions. The nature of profit maximisation and the competition merchants face will have a large impact on how merchants price. It is notoriously difficult to ascertain the extent (if any) to which merchants may pass on any reductions in merchant service fees through lower interchange rates to consumers. However, it is reasonable to surmise that it will be competition between merchants that dictates the pace and extent to which any reductions are passed on by way of lower prices.

Studies of the Australian market after the interchange reforms in the early 2000s found no evidence of price reductions.

Additionally, there is no empirical evidence available that Credit interchange reductions in the UK market over time have resulted in a specific and correlated reduction in merchant pricing. In fact, consumers most likely suffered, as the fall in interchange severely reduced the value of reward programmes and potentially contributed toward higher 'goto'<sup>5</sup> interest rates and/or fees over time.

On the basis of the Australian and UK experiences, the view could be that the reductions in interchange rates only resulted in a transfer of revenue from card issuers to either acquirers or merchants (and not to consumers).

### **6.3 Emerging inefficiency in the debit card market**

BNZ does not agree there is emerging inefficiency in the Debit card market in the sense described by the consultation document.

Proprietary EFTPOS spend, by dollar value, is not in decline. However, it is not growing into new segments, so has a declining share of overall Debit card spend. Though at some point in the future, EFTPOS may decline in dollar spend terms as well – being replaced by competing propositions that offer a growing list of superior consumer and merchant features and a return for those that provide them.

Scheme debit benefits from global payment innovation and delivers additional features, which are valued and used by consumers, notwithstanding that there is an attached transaction fee.

On the assumption (and this requires more detailed analysis by the proposed taskforce) that having competing Debit options is in the overall best economic interest of New Zealand (accepting the theory that competition should drive efficiency), there should be a case for upgrading the features of EFTPOS.

BNZ submits that the proposed taskforce looks at the future of proprietary EFTPOS and possible ways for ensuring that it is viable in the longer term.

Innovation of proprietary EFTPOS should result in a move to less cash, which would also benefit merchants individually and the system as a whole, as seen in comparative

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<sup>5</sup> *The 'goto' rate is the interest rate that an account reverts to when any promotional rates expire, e.g. 0% BT offer, etc..*

economies that are driving electronic solutions, such as those in Europe and emerging markets such as India.

BNZ notes that contactless Debit, as a proportion of total card sales, is overstated in the consultation document – it is approaching 4%, not the 7% stated. Also, BNZ is not convinced it is right to extrapolate the growth in contactless in recent years into an ongoing expected market growth rate, as during this period large merchants, such as the supermarkets and fuel companies, commenced accepting contactless payments.

BNZ submits that there are significant advantages for consumers, merchants and the system generally in using contactless technology. Many merchants consider that the current merchant service fee levels for contactless debit are too high for them to adopt. The result is that many merchants, including those already with contactless-enabled terminals, currently choose not to allow consumers to use this option. This is frustrating the use of cards and mobile options by consumers (which they are very keen to do). The failure to have ubiquitous provision of contactless terminals by merchants is a major restriction on payment system innovation, particularly in the mobile space, and therefore poses a barrier to increased efficiency. If more consumers were using contactless the per transaction costs of providing contactless services may come down. BNZ supports the proposed taskforce recommending initiatives that are aimed at reducing costs for contactless.

BNZ submits that merchant reluctance to accept contactless debit may be being caused by the difficulty they may currently face in distinguishing the lower cost of contactless debit transactions from higher cost credit transactions when both are rolled into a single blended rate on their statements. BNZ submits that showing separately the charges for debit and credit payments may help transparency and more widespread acceptance of contactless debit. As noted elsewhere, BNZ believes the banks would be willing to make these disclosures voluntarily.

#### **6.4 Barriers to entry in the debit market**

Without a revenue stream to cover the cost of developing and running an alternative Debit payment system, it seems counter-intuitive to consider that a competitor offering a similar service would enter the market.

The sub-scale size of the New Zealand market is also a significant barrier.

#### **6.5 Impact on small business**

The difference in costs incurred by small retailers in comparison to larger retailers appears to be a reflection of their respective bargaining powers and the value of their overall banking relationship. Strategic merchants took advantage of their power to negotiate better rates with the Schemes. It is noted that their overall dollar contribution to the effective running of the payments systems is much larger than small merchants.

The ability of larger retailers to negotiate lower fees is not a peculiarity of domestic payments markets. In many market segments volume buyers pay less.

Interestingly, despite the price difference, BNZ also sees smaller merchants increasing their share of overall payments over time, and conclude that the fees payable for card acceptance do not seem to be a barrier to growth.

BNZ also notes that part of the differential in average fees paid by strategic merchants compared to smaller merchants is attributable to their acceptance of lower cost contactless Debit transactions, reducing their relative weighted average fees that are being compared.

Despite the above BNZ acknowledges that the difference is likely to remain a point of contention for smaller merchants until it is addressed and should be a candidate for review by the proposed taskforce.

## **7.0 ACHIEVING BETTER PAYMENTS SYSTEM OUTCOMES**

7.1 There have been attempts by stakeholders in the past to address perceived issues.<sup>6</sup> However, these have not been successful owing to lack of alignment of interests or priorities and the restrictions on competitors discussing pricing and market share imposed by the Commerce Act.

Therefore, should MBIE decide that the issues raised in the consultation document or in submissions warrant further exploration, BNZ proposes the establishment of an industry taskforce, comprising representatives of key stakeholders (including government, banks (as issuers and acquirers), Schemes, and large and small merchants) to recommend separate frameworks and objectives for Debit and Credit, tailored to the specific needs of the New Zealand market. The frameworks would form voluntary guidelines for industry so that all market participants were treated equitably and that there were no barriers to innovation or competition.

BNZ submits that the brief for the taskforce should include:

- Confirmation of the appropriateness of the economic objectives for payment systems set out in the consultation documentation;
- Whether any changes should be made to the economic objectives or their priority;
- Whether the objectives are being met;
- If the objectives are not being met, identifying the barriers to meeting the objectives;
- The options for removing any barriers;
- The possible consequences of implementing the options for removing any barriers;
- The fairest and most equitable way to fund the removal of any barriers;
- How ongoing achievement of objectives should be monitored;
- The appropriate pricing differentials between large and small merchants;
- Whether there should be a transparent, consistent and coherent basis for charging for payment systems;
- How to introduce pricing regimes that enable a ready comparison to be made between methods of payment by consumers and merchants (including relative to the cost of cash handling) and how to avoid creating barriers to competition and innovation.

The members of the taskforce need to be able to communicate freely without being constrained by the Commerce Act.

Importantly, all precautions should be taken so that the implementation of any recommendations ensures a level playing field for participants in the industry.

- 7.2 Two candidates for immediate priority study by the taskforce would be:
- (a) **Debit:** The lack of development and innovation in the existing proprietary EFTPOS offering; and
  - (b) **Credit:** The recent increase in the merchant service fees associated with Credit owing to the increased availability of platinum and, prospectively, platinum plus cards, generating concern from merchants who do not receive strategic merchant rates.
- 7.3 BNZ submits that pending the outcome of the taskforce's work, the following interim voluntary framework should apply:
- (a) request acquirers (on a voluntary basis) to provide transparency to merchants by separating credit and debit fee charging on statements allowing time for IT systems changes;
  - (b) invite Schemes to set a voluntary maximum Credit interchange cap equal to the current platinum rate, to ensure any introduction of above platinum products doesn't exacerbate current merchant service fee issues;
  - (c) the Commerce Commission provide authorisation to Visa and Mastercard to allow them to discuss interchange rates;
  - (d) the Schemes voluntarily review contactless Debit interchange rates to enable the key issue of slow merchant adoption to be addressed;
  - (e) the Schemes give an undertaking in respect of the future pricing of dipped and swiped Scheme debit; and
  - (f) the Commerce Commission issue an authorisation allowing industry to participate in the taskforce.
- 7.4 After appropriate consultation, BNZ would like to see the taskforce recommend guidance to the Credit card industry to achieve a level of Credit card interchange in the future that the industry would work towards under a proposed regime of self-regulation with the possibility of regulation should this range not be achieved within a reasonable time period. This would require Commerce Commission authorisation.
- 7.5 As part of its brief, the taskforce should be required to examine ways of ensuring all payment system options be made available to consumers (subject to any technical limitations). The taskforce should look at ways to ensure that consumers do not pay additional margin for products or services as a result of choosing a particular method of payment unless there is clear and transparent disclosure of what the additional margin covers, BNZ submits that the taskforce should investigate whether surcharging should be allowed and if so, to what extent and on what basis.



## 8.0 DETAILED RESPONSE

BNZ has prepared responses<sup>7</sup> to the specific questions posed in the consultation document. The responses are quite detailed and we would prefer to keep them for direct discussions. They can be made available to MBIE upon request.

## 9.0. CONCLUSION

9.1 BNZ would welcome the opportunity to work with MBIE in considering and developing the proposals presented in this response. BNZ would be pleased to discuss our submission in further detail.

9.2 Should MBIE have any questions in relation to this submission, please contact:

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<sup>7</sup> *BNZ's responses have been based on data that is representative of the Australian Credit card market and, where appropriate, include comparative UK and US Credit card market data as well as US Debit card data. The UK market was chosen owing to a number of similarities to Australia and New Zealand, both in the nature of the product offerings and also owing to the active regulatory oversight in place. The Financial Conduct Authority (FCA) in the UK has for a number of years considered and made changes to the credit card market (as has the European Commission) and has currently initiated a number of studies that provide a useful platform for comparison.*