CO-OP MONEY NZ

We see your money differently

The three stylised people signify that through our Members, their members and the community working together cooperatively, we all grow.

24 January 2017

Competition and Consumer Policy
Building, Resources, and Markets
Ministry of Business, Innovation, and Employment
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RE: Retail Payment Systems in New Zealand

About Co-op Money NZ

Thank you for the opportunity to comment on the Issues Paper regarding Retail Payment Systems in New Zealand. We make this submission as Co-op Money NZ, the industry association for credit unions and mutual building societies. We exist to represent, promote and support our 15 Member credit unions and mutual building societies, and to provide cost effective business services and products.

Co-op Money NZ is also a commercial non-bank Payments Services Provider. We offer products and services that enable our Members and customers in New Zealand and the Pacific to store and move money for their customers. Our capability includes provision of Scheme Payment Cards, ATM's, Payment Card Switching and Settlement services and in section 9(2)(b)(ii) [redacted] we will become the first non-bank to be a direct participant in the New Zealand domestic payment system.

Credit unions and mutual building societies are co-operatively owned financial service providers, providing their members with a similar range of services to a retail bank. Credit unions and mutual building societies are all independently owned and operated by their members for their members. Profits are returned to their members/owners in a combination of ways such as fairer fees and interest rates, community involvement and/or reinvestment /development of enhanced products and services.

Co-op Money NZ's Members employ over 550 staff, represent more than 190,000 members, with over 80 branches, assets of over $1.3 billion and collectively are the sixth largest financial transactor by volume in New Zealand. Co-op Money NZ also wholly owns Co-op Insurance NZ (www.coopinsurancenz.co.nz), a fully licensed insurance provider under the Insurance (Prudential Supervision) Act 2010. Additionally, we also have a national spread of nearly 100 ATMs and provide switching services for over 1,000 ATMs country-wide, making our network the largest ATM network in the country.

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Co-op Money NZ is a member of the World Council of Credit Unions which represents over 223 million people in 109 countries across the globe. This international network operates under the vision: "Improving people's lives through credit unions" and promotes the sustainable development of credit unions and other financial co-operatives around the world.

Co-op Money NZ is also a member of Cooperative Business New Zealand (www.nz.coop), the industry body whose mission is "bringing together the country's cooperative and mutual businesses to promote, encourage and support the co-operative and mutual business model, and act as the advocate for those engaged in co-operatives and mutuals."

Collectively the wider customer-owned banking sector represents around 10% of the economically active population in New Zealand and represents more than $600 million in revenue per year.

Submission

Co-op Money NZ supports the Ministry of Business, Innovation and Employment (MBIE) raising the matters in the Issues Paper for discussion. A robust retail payment system for New Zealand is an important component of the economy.

We believe any potential retail payment regulation needs to balance the needs of all stakeholders, enabling money to move with speed, safety and security both domestically and internationally.

In addition to your specific questions, we offer three general observations:

1. <u>The markets for Debit and Credit cards are blurry and not discrete markets</u>

   MBIE has defined debit and credit cards as discrete markets. However, from a consumer perspective this distinction is increasingly blurred through the use of cards that can access both debit and credit facilities. Given this trend towards cards that can access multiple underlying accounts - via a variety of devices, it may be useful to look at the Payment Card market as a whole.

2. <u>The EFTPOS 'system' in NZ is decentralised</u>

   We often speak of EFTPOS in New Zealand as being a payment system. However, the NZ EFTPOS 'system' is a decentralised series of bi-lateral agreements amongst participant players. Given this, changes to this 'system' require extensive bilateral negotiation, which is inefficient, high cost and provides a strong barrier to enhancement and innovation. Innovation by an individual participant is very difficult to effect in the EFTPOS 'system'.

3. <u>Is it wise to regulate in a time of rapid innovation?</u>

   In the current dynamic market is it wise to regulate for today's market with increasing competition and new entrants from non-traditional areas? Care needs to be taken that potential regulation does not create an uneven playing field for participants.

As a New Zealand owned non-bank payments services business we provide modern banking and digital payment services to other financial services businesses which, in turn, enable them to offer global products and services and compete effectively with the large banks. Any regulatory activity that reduces revenue for these smaller participants will potentially increase the scale required for these smaller institutions to reach a breakeven point for offering payment solutions, and may result in a contraction of key services to their customers.

We favour a domestic payment market that operates to global standards and common rules, with transparent and fair commercial access. Importantly, we support regulations that do not require immense scale to be commercially competitive.

We note that the innovation is occurring in the retail payments sector. For example, recently Paymark released "online EFTPOS" which is a significant development that was not in the market at the time the Issues Paper was developed.

We favour a regulatory environment that does not stifle innovation from being introduced, and/or competition. Further research would be prudent to be undertaken to fully understand the evolving market environment.

Keys Questions:

Question 1: Are these objectives for retail payment systems appropriate?

The three objectives as outlined by MBIE in the Issues Paper are appropriate for the retail payment system. However, a key objective of the payments system must be to include the easy access of new participants into the market as outlined in a series of standards as set down by the Bank of International Settlements.

The best way to ensure that the market operates efficiently is to have a market that allows easy access for new participants. If an established payment system participant, or group of participants, are not addressing the fundamental needs of either buyers or sellers then new participants should be able to easily enter the market.

Question 2: Are there any other emerging payment methods that we have missed? If so, what is their likely impact on the market?

While blockchain and digital currencies are mentioned, the Issues Paper does not explore in sufficient detail the impact that these will have on the industry. Our understanding is that several central banks around the world are exploring the issuing of digital currencies as either a supplement to existing currencies or as a total replacement.

If the Reserve Bank of New Zealand were to issue a digital currency, then the domestic payment system would dramatically change. It is conceivable that the retail payments system would be so transformed that it will bear no resemblance to the current system and, therefore, the issues raised in the Issues Paper may well become irrelevant.

We also note that the Issues Paper does not discuss the rapid growth and global expansion of foreign payment competitors such as "Alipay" or "WeChat Pay" – and their potential expansion into New Zealand.

In the Western economies, Visa and MasterCard have enabled global competition with traditional bank provided payment services by connecting Apple Pay, all the Android based pays and UnionPay to their networks.

Overall, we support additional research being performed to determine the effect of the introduction of emerging payments systems and non-bank brands into the current retail payment system in New Zealand.

Question 3: What explains the decline in the revolve ratio on credit cards?

We hypothesis that the reasons could include:

1. Competition – The market is highly competitive. Loyalty programmes and interest free balance transfers for example are common to entice consumers from one provider to another. A credit card product is increasingly been seen as a relationship anchor (traditionally this was a cheque account or a transaction account) and will 'buy' that product so they can then aggressively cross sell other products.

2. Better consumer knowledge - Consumers have access to online search facilities to help them more easily research banking services best for them.

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

As pointed out in the Issues Paper, one of the inherent flaws for EFTPOS is the lack of revenue to develop it. Interchange is an important source of revenue for issuers and acquirers but it should not be misinterpreted as solely profit. The revenue generated from interchange allows for innovation and development of payments systems. Co-op Money NZ is supportive of the following benefits of the interchange model as identified by Mastercard in the following table:

Stakeholder	Benefits provided by interchange
Consumers	• Covers the cost of fraud protection, so cardholders are protected in the rare event of a fraudulent transaction. • Funds the interest free days on credit cards, a period that nearly three in four New Zealanders rely on to pay off their credit card bills.
Retailers and businesses	• Guarantees payment for transactions: the retailer gets paid irrespective of whether the cardholder repays their bank. • Supports the use of cards, which reduce cash handling costs and increase sales: studies show that businesses make more money when they accept cards. • New Zealand retailers benefit from overseas visitors using their cards, with tourism being the second largest export in New Zealand. • The additional value provided by electronic credit payments is estimated to be twice the total cost of acceptance to a merchant
New Zealand's Banks	• Covers some of the costs of providing credit cards, including processing and authorisation, fraud and fraud protection, and funding the interest-free period on transactions. • Pays for important investments in technology and innovation such as Tap and Go.
Government	• Supports electronic payments, which facilitate economic activity and provide the necessary infrastructure for citizens and businesses to interact in a financial ecosystem. • Government and the public sector are major beneficiaries of interchange as they utilise many different payment options including commercial cards. For example, electronic payments have revolutionised welfare payments systems around the world

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

MBIE's focus in describing the incentives in relation to interchange focus mostly on maximising profits. However, interchange is also used to cover running costs, development and innovation. If interchange fees were to reduce then this will mean that smaller issuers may not be able to continue to offer card services.

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

No comment.

Question 7: Is the resource cost data robust? Is the Australian data likely to over-state or under-state the costs of running New Zealand payment systems?

As indicated above, we believe there is value in further research on the features of the payments system in New Zealand. While there are some similarities in the New Zealand payments system with Australia there are also material differences.

Without a detailed cost study into the New Zealand Payment system, we do not believe it is possible (nor sensible) to draw comparisons with Australian cost data.

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

No. First, there needs to be further research undertaken to determine the exact costs in the retail card payment market as a whole. In addition, given that there are a range of payment options available and the fact that EFTPOS cards still accounts for 60% of all transactions via the EFTPOS network, it would seem premature to conclude that card schemes have a monopoly or are abusing their position.

Question 9: Do you agree with the logic underpinning our assessment that there are regressive cross-subsidies in the credit card market?

While the issue raised by MBIE does have some merit, it appears that such an assessment can be made across most economic activities. Practically it costs more to attract and retain high value customers as they are attractive to all suppliers of banking services.

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

No comment.

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

No comment.

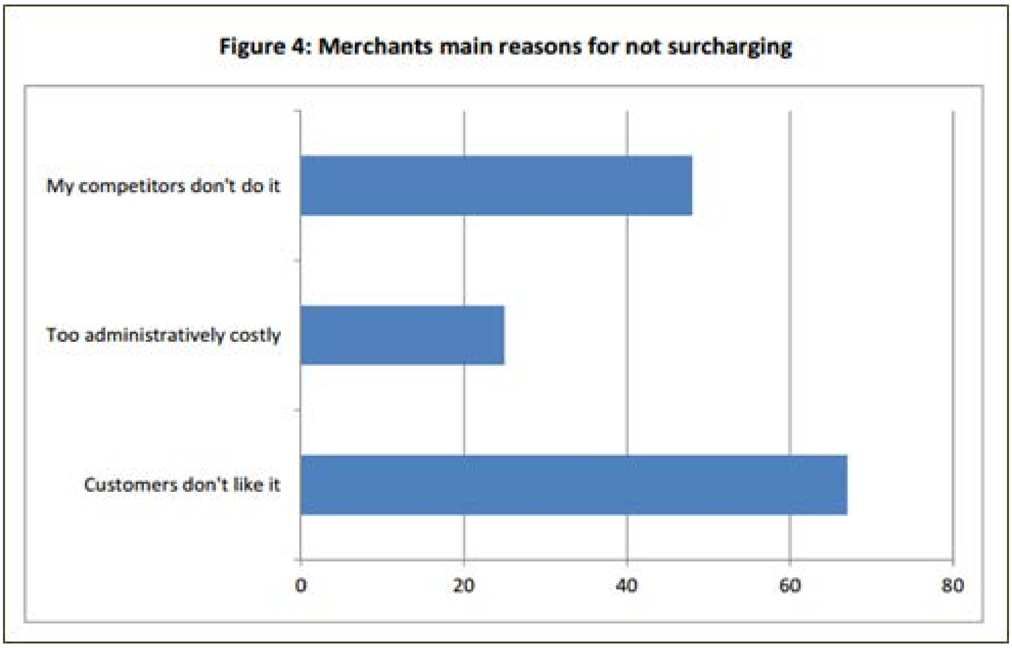
Question 12: Do you think that the issues in the credit card market are of a scale that warrants intervention? If not, do you think that the size of the issue is likely to grow over time?

At this stage, we do not support intervention via regulation as there does not appear to be enough evidence to support such action. Given the number of new technologies and participants entering the market, we believe it is appropriate to monitor to see if competition will dissipate the issues identified.

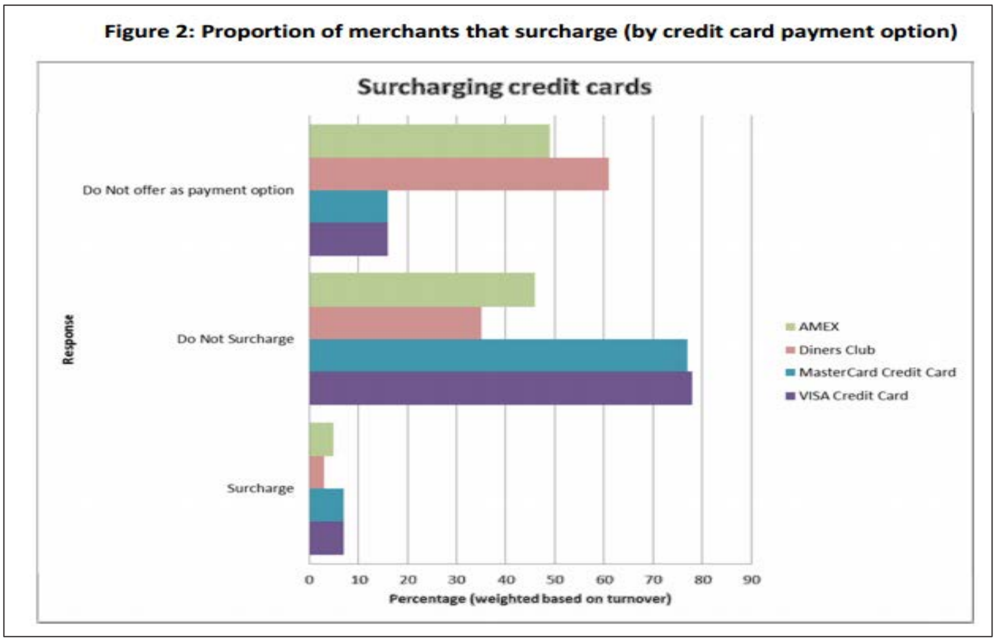
New competitors will ensure that prices are kept down and new options for consumers are available.

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

Possibly. We don't believe the power of the consumer in the retail payment system has been adequately considered. By way of example the removal of the no surcharging rule in New Zealand has not led to widespread consumer charging.



A market survey by the New Zealand Commerce Commission [1] found that when consumers don't like something, then businesses generally won't do it.



[1] New Zealand Commerce Commission - Page 13 of report titled Evaluation of the 2009 interchange and credit card settlements dated 19 December 2013

Question 14: Do you agree that there is little incentive to invest in proprietary EFTPOS?

We agree that there does not appear to be sufficient incentive to invest in domestic EFTPOS cards as can be seen by the lack of innovation with domestic EFTPOS card for a number of years. Online EFTPOS is recently been trialled but EFTPOS card technology has still not moved from magnetic stripe to chip which is required to contain an increasing variety of fraud and identity theft risks.

It is difficult to see how a very small market like NZ could afford to invest in a system that only works in ATMs and EFTPOS machines in New Zealand. Further investment would need to be made with the knowledge that globally there is a decreasing consumer demand for Payment Cards that do not work everywhere.

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

Yes – we note MBIE Issues Paper comment at point #222

In our discussions with schemes (they) have been adamant that they will not introduce interchange on scheme debit transactions

Question 16: Do you agree that merchants facing a per-transaction charge for accepting debit payments is not an issue in itself?

Yes. Historically, prior to EFTPOS gaining traction, retailers paid about 25 – 40 cents for cheque clearance and bore the direct losses and additional fees for dishonoured cheques. Retailers currently receive value for cash banked on the same day even though the bank may not get reciprocal value for that cash from the Reserve Bank for up to a week later. According to Payments NZ research[2] cash still makes up a significant portion of total retail sales.

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

Possibly but would need to be considered across all payment types available to consumers. For example, if demand modelling found that contactless debit displaced cash usage then there would likely be clear economic benefit for banks, consumers and retailers. The Reserve Bank would however (over time) receive less income due to reducing cash in circulation.

Question 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?

It is not possible to answer this question based on the information provided. However, we do note the footnote (#42 copied below) at the base of this section. This highlights to us that without detailed analysis and validation it is simply not possible to form a robust conclusion one way or the other.

42. Having said this, there could also be a decrease in allocative efficiency as the use of proprietary EFTPOS declines. If it is accepted that merchants should face a per-transaction cost from their bank for accepting payment via proprietary EFTPOS (and not all stakeholders do), then the lack of price signals on EFTPOS from the acquirer to the merchant creates a level of allocative inefficiency in itself. Therefore, the overall impact on allocative efficiency depends on the net effect of a) a reduction in allocative inefficiency as the number of transactions that are 'under-

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2 http://www.paymentsnz.co.nz/cms_show_download.php?id=99%E2%80%8B

priced' to merchants by acquirers reduces; and b) an increase in allocative inefficiency as the number of transactions that are 'under-priced' to consumers by merchants increases.

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

To believe that fees will increase as outlined at point # 231 (as highlighted below) you would have to discount assurances from Visa and MasterCard in relation to the interchange component of Merchant Services Fees as previously outlined at point # 222 above.

231. Therefore, once a certain threshold of acceptance is reached, we think there is likely to be an increase in the level of interchange (and MSFs) on contactless debit, entrenching the allocative inefficiency and cross-subsidy issues discussed above, and ultimately further increasing the prices paid for goods and services by consumers.

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

No, quite the inverse. By having an interchange model that could be perceived as 'too high' should increasingly attract new competition to the market for retailers. Interchange itself has not stopped new global payment brands (such as Apple Pay) entering the payments market.

Question 21: How do you think the debit market is likely to evolve in respect of these **'unknowns'?**

In our view the future will be driven by the consumer. They will use the payment services provided by a brand they trust and offer features they see as good value for them. Businesses that serve consumers will need to make their own choices as to what type of payment they will accept - and that will be driven by the nature of their services, profit margin and target clientele.

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

As you have commented at point #241 it is not unusual for large businesses to drive a materially better price (& terms) for services than what can be achieved by smaller entities.

Question 23: Do you agree with our assessment of the two markets against our proposed objectives?

No specific comment, but please note our summary point at the outset is that we are not clear on the how MBIE has defined or scoped these two markets.

Question 24: Would greater transparency have any material benefit for merchants or any other parties in the system?

Co-op Money NZ is in favour of greater transparency in these matters.

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

There may be some benefit, however, this could mean that competition is reduced as schemes will know the intention of their competitors.

Question 26: Do you think that the benefits of interchange regulation are likely to exceed the costs?

Possibly not. There appears to be widely ranging views on this topic globally with some studies claiming that in jurisdictions that have introduced interchange regulations they have seen negative consequences for consumers, including reductions in product choice, value of reward programs and number of interest free days.

Question 27: What unintended consequences could arise from interchange regulation?

The main unintended consequence, is that scheme cards may become less attractive to consumers and issuers. This could allow non-scheme participants to have an unfair competitive advantage as they enter the market. Alternatively, more reliance would be placed on the EFTPOS 'system' which is inherently unsuitable for innovation.

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

Co-op Money NZ does not believe debit interchange rates should be regulated. However, if it can be shown with empirical evidence that regulation would improve consumer choice, not hinder market entry, and not hinder schemes from competing then Co-op Money NZ could support such regulation. However, it seems that this is an unlikely scenario.

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

Co-op Money NZ does not accept that interchange imposes a barrier for entry. In fact, it allows for new issuers to enter the market as it provides a source of revenue that allows for the costs of providing the scheme cards to be met.

Question 30: Are there good justifications for these barriers being in place?

We generally refer to points # 232 – # 234 in the Issues Paper and specifically the statement below;

"...*issuing bank will be a barrier to the uptake of any potential new payment system as long as the bank is in control of access to the consumer's bank account*"

We offer the view that claimed power of a bank (or other licensed lending or deposit taking institution) in this area requires deeper research and definition of specifics. Generally, it is accepted that legally banks do not control access to a customer's account as such, as they must ensure that activity on the bank account is always as set down in an account operating mandate[3] in which the customer defines who and how that account is to operate.

Question 31: Are there ways in which any unjustified barriers could be removed?

No comment.

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[3] Mandate Definition. A written authorization and/or command by a person, group, or organization (the 'mandator') to another (the 'mandatary') to take a certain course of action. A cheque, for example, is a mandate issued by a customer of a bank, to pay it as instructed, from a customer's account balance. Source http://www.businessdictionary.com/definition/mandate.html

Question 32: Is there merit in exploring options in addition to interchange and barriers to entry?

As already indicated, we support MBIE (as well as other government agencies) undertaking further research this area and explore further options.

Question 33: Have we missed any options?

The main option that we suggest MBIE should consider is a "wait and see" approach. Given the dynamism in the market and the (apparent) absence of detailed cost data any regulation would be premature.

Conclusion

Thank you for the opportunity to provide a submission on this issues paper. If you have any questions regarding our comments, please feel free to contact me on (09) 522 3545 or jonathan.lee@coopmoneynz.org.nz, or Steve Friis on (09) 539 5426 or by email at steve.friis@coopmoney.org.nz.

Yours sincerely,

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