FINANCIAL SERVICES FEDERATION

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Competition and Consumer Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140 By email to: competition.policy@mbie.govt.nz

Financial Services Federation response to Issues Paper: Retail Payment Systems in New Zealand

The Financial Services Federation ("FSF") is pleased to take this opportunity to respond to the Ministry of Business, Innovation and Employment's ("MBIE") Issues Paper on Retail Payment Systems in New Zealand.

By way of background, the FSF is the industry body representing responsible and ethical finance and leasing providers in New Zealand. The FSF has over fifty members and affiliates providing first-class financing, leasing, and credit-related insurance products and services to over 1 million New Zealand consumers and businesses. The FSF's affiliate members include internationally recognised legal and consulting partners. A list of the current membership is attached to this submission as Appendix "A".

The way in which consumers access finance products from FSF members includes the issue of credit cards. Those FSF members that are credit card issuers are: Latitude Financial (issuer of the Gem Visa card); FlexiCard (formerly Fisher & Paykel Finance Limited and issuer of the Q-card); The Warehouse Financial Services and American Express.

The first point the FSF would like to make in regard to the Issues Paper is that the Paper was not issued to the FSF or its members for comment. In fact the FSF was completely unaware of the existence of the Issues Paper until very late last year (after 13 December, the date by which submissions were initially due). Fortunately the FSF was made aware of the Issues Paper and the fact that the submission deadline had been extended to 20 January 2017.

The delay in the FSF becoming part of this discussion and the intervening holiday period, has however meant that the FSF has been unable to consult with its membership with regard to this submission in the way that it would have liked. The FSF's comments on the Paper will therefore necessarily be brief and to the point.

The first point the FSF would make is that clearly those responsible for writing the Issues Paper are unaware of the existence of Non-Bank credit card issuers as, apart from the fact that the industry body representing the non-bank sector has not been included in the distribution for the Issues Paper, the Paper itself refers consistently throughout to "banks" as card issuers or acquirers.

The FSF would therefore suggest that insufficient research into the card issuing industry has been carried out for the Issues Paper to provide any real insight into the industry and any issues that might exist within it.

However, what follows is the FSF's observations and comments with regard to the issues and questions raised in the Issues Paper from the point of view of FSF's card-issuing members to the extent that FSF members have been able to be consulted on this matter given the time constraints of having been made aware of the Issues Paper's existence very late in the piece and the ensuing holiday period.

Overview:
In the Overview to the Issues Paper, point 4 states that "While the Government is not at the stage of considering options, it is also important to bear in mind that if we proceed to that stage, any potential solution would need to be tested against the harm it is designed to address and that all the consequences are taken into account."

The FSF would respond to this statement by saying that it is not clear from the Issues Paper what, if any, harm the Issues Paper is seeking to address. It appears that the Paper is seeking a problem to match a pre-determined solution. In any event, the FSF would strongly submit that any options that might be considered are based on sound research of the total industry rather than a portion of it and that any potential solutions are tested on all participants.

Background:
The FSF is pleased to see that in point 7 of the Background comments in the Issues Paper it is recognized that electronic payments provide a number of key benefits to all stakeholders (including consumers, merchants and government). These benefits, particularly that of the increased security to both consumers and merchants when transacting electronically as opposed to handling cash, explain why New Zealand has the lowest proportion of cash to GDP in circulation in the world (as recognized in point 6 of the Issues Paper).

The FSF submits that it is surely desirable to ensure that these benefits remain attainable for all stakeholders and therefore any proposed changes to the current system should take into consideration any detrimental affect they may cause that would potentially reduce these benefits.

Point 8 of the Issues Paper is intriguing to the FSF in that there appears to be no referencing as to where these figures have been derived from or how they have been determined.

It is true that merchants pay merchant service fees in order to be able to offer electronic transaction solutions to their customers. The FSF would suggest that this a part of doing business and that these costs are passed on to consumers as part of the cost of their accessing goods and services from merchants without any discernible cause for concern being expressed on the part of consumers.

Indeed, the FSF would suggest that it is ultimately consumer choice that drives the levels of merchant service fees and indeed interchange being paid. Were consumers not choosing to use electronic means to transact, there would be no such fees to be paid. It should be noted however that there is a cost to merchants in handling cash as banks tend to pass on cash handling fees when receiving high volumes of cash which makes it an expensive means with which to transact.

Issues Identified:

Issue 1: Economic inefficiency in the credit card market

The FSF would question whether this is in fact an issue at all. Surely this is a matter of consumer choice and if the consumer chooses to use his/her credit card in place of using the EFTPOS network that is entirely over to them.

As an example of why consumers may choose to use their credit card rather than transact using EFTPOS, many consumers use revolving credit mortgage facilities where all their salaries are deposited to the loan account, all transactions are carried out during their pay period using their credit card then the full balance of the credit card is cleared from the loan account when the credit card payment falls due. This is a recognized technique for reducing mortgage interest costs and, given that the credit card balance is paid in full each month, the consumer does not incur any credit card interest charges.

Issue 2: Increased prices for all consumers, with only higher-income consumers benefiting from the rewards

The FSF agrees with the statement in the first sentence of point 12 that the costs of merchant service fees are ultimately likely to be passed onto consumers through the price of goods and services but would ask why this is perceived to be an issue.

Certainly credit card issuers offer rewards to certain credit card users. These offers tend to be made to consumers with higher credit card limits or higher transaction volumes on their credit cards. Because these consumers tend to spend more, they are ultimately paying their share of the merchant service fees. The FSF would not therefore agree with the contention in point 12 that low-income households are cross-subsidising high-income households.

The FSF also submits that it should be noted that many credit card issuers offer a range of credit products including low interest-bearing cards as well as those that offer rewards. Again it is a matter of consumer choice as to what type of card they opt for.

It could just as easily be said that high-income households (assuming that it is just high-income households that opt for the higher interest-bearing cards that offer rewards) are subsidizing low-income households (assuming again that it is just low-income households that opt for the low interest-bearing cards that come without rewards) as the higher interest payers are subsidizing the holders of low interest-rate cards.

The FSF disagrees with the statement made in point 13 that most merchants do not recover the interchange fees though surcharges. In fact it is increasingly common to find that a surcharge applies when paying with a credit card. It is also not at all uncommon for merchants to offer discounts for paying by cash (including the use of debit cards via EFTPOS) particularly for large-ticket items.

The FSF questions the evidence that exists to make the statement in point 14 that inefficiencies generated by the interchange business model are increasing given the fact that it is increasingly common for credit card issuers to offer low interest-rate, non-reward bearing card alternatives. With regard to the comments in point 16 that New Zealand's interchange fees are roughly comparable to what is paid in the USA and Canada but significantly higher than those in regulated environments, such as the European Union and Australia, the FSF would be interested to know how comparable are the interest rates being charged on credit cards in those latter jurisdictions (on average).

Issue 3: Emerging inefficiency in the debit card market
The FSF is unable to comment on the debit card market as its members are credit card issuers and do not issue debit cards to their customers.

Issue 4: Barriers to entry in the debit market
The FSF is unable to comment on any real or perceived barriers to entry to the debit card market as none of the FSF's members have explored entry to this market.

Issue 5: Impact on small business
The cost to process retail transactions is the same regardless of the value of the transaction. The differential cost alluded to in point 22 of the Issues Paper arises as a result of that fact so that merchants processing higher value transactions (and therefore their customers) are not disadvantaged when compared with merchants processing transactions of a smaller value. The FSF submits that this is as it should be.

As has already been stated, merchant service fees are a legitimate cost to merchants of doing business and receiving payment in the manner in which the customer chooses. The cost of these fees is passed on to the consumer in the pricing for the merchant's goods and services and the consumer has the choice to either use a different supplier for the goods and services they want to purchase or to use a different means of payment. The FSF does not believe that there is a need for this perfectly normal business practice to be regulated.

What follows is the FSF's answers to the specific questions raised in the Issues Paper (bearing in mind the constraints on the FSF's ability to consult with its card-issuing members as previously raised).

1. **Are these objectives for retail payment systems appropriate?** The FSF is comfortable with the objectives as described in para 44 of the Issues Paper.

2. **Are there any other emerging payment methods that we have missed? If so, what is their likely impact on the market?** The FSF does not know of any other emerging payment methods that have been missed by the Issues Paper.

3. **What explains the decline in the revolve ratio on credit cards?** The FSF suggests that the decline in the revolve ratio on credit cards may be contributed to by either or both of –
    a. Use of credit cards by persons who do not in fact need credit but who are instead using the card to obtain other benefits, for example airpoints;
    b. Resistance to the typically high cost of credit from credit cards as compared to cheaper forms of credit available to fund repayment of the card debt.

4. **Do you agree with our explanation of the rationale for interchange?** The FSF has no real issue with what is stated regarding this in paras 124 – 128 of the Issues Paper.

5. **Have we accurately described the incentives on parties in relation to interchange?** Similarly, what is stated in paras 129 – 133 about the incentives on parties in relation to interchange seems satisfactory to the FSF.

6. **Why are interchange rates falling for large merchants but increasing for small-medium merchants?** The FSF expects that para 136 is correct to state that this was as a result of direct pressure placed on schemes by large merchants using their greater bargaining power to obtain outcomes not achievable by smaller merchants.

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?** The FSF is unable to determine whether the resource cost data is robust or not given the inability to consult with members but would suggest that consideration needs to be made to the matter of whether any of the data in the Issues Paper is sufficiently robust given the fact that Paper has ignored the non-bank card issuing sector.

8. **Do you agree with the logic underpinning our assessment that there is inefficiency in the credit card market?** The Issues Paper's thesis is in essence that there are added costs to the economy arising from a system that involves costs that are in fact not necessary for

many of its users, namely those who do not use cards to obtain credit because they do not need the credit. The FSF does not accept that in respect of those of its members that provide credit cards, as the experience of those members suggest that their cards are in fact principally used to access credit. Even in those parts of the market where the percentage of card users that do not in fact require credit may be as high as the 40% stated in the Issues Paper, the FSF suggest that the Issues Paper tends to overlook that the transfer of rewards to such users can itself be seen as involving economic benefits.

9. **Do you agree with the logic underpinning our assessment that there are regressive cross-subsidies in the credit card market?** Although the FSF follows the argument that is being made in this part of the Issues Paper that argument again presupposes that a high proportion of card users are using their cards for purposes other than accessing credit. As stated at 8 above, that is not the experience of the relevant FSF members. As a result while the Issues Paper may well be correct to assert that the reward schemes operated by other issuers may result in higher process for their customers, the FSF does not accept that in respect of the card products offered by its members.

10. **Do you agree that self-acquirers are unlikely to place downward pressure on interchange?** It is difficult to challenge this conclusion when the Issues Paper suggests that there is only one self-acquirer (Countdown) and that this is its view. It seems to the FSF that whether or not self-acquirers may place downward pressure on interchange may depend on the level of fees at that time: incurring the high cost involved in becoming a self-acquirer would presumably only appeal to potential self-acquirers in a high fee environment. Perhaps if it is the case that there is only one self-acquirer that may mean that fee levels are considered by others to be acceptable at present?

11. **How much negotiating power do merchants have over the merchant service fees they face? Is this likely to change in the future?** As noted at 6 above, what is stated in para 136 of the Issues Paper suggests that some merchants do in fact have significant bargaining power.

12. **Do you think that the issues in the credit card market are of a scale that warrants intervention? If not, do you think that the size of the issue is likely to grow over time?** As noted above, in some respects what is stated in the Issues Paper does not coincide with the experience of the relevant FSF members. The FSF is accordingly not persuaded by the Issues Paper that existing issues in the credit card market are of a scale that would justify regulatory intervention. As regards whether the size of those issues may grow over time that is necessarily speculative and cannot presently justify a decision to regulate.

13. **Do you agree with our assessment of the incentives held by different parties in relation to debit card usage?** In broad terms the FSF accepts much of what is stated in paras 210 – 214.

14. **Do you agree that there is little incentive to invest in proprietary EFTPOS?** The FSF notes that at para 217 the Issues Paper notes that "*Payments New Zealand had previously undertaken work to explore adding greater functionality to proprietary EFTPOS, but has largely abandoned this work due to conflicting interests among its shareholders, directors and participants*". If that is so, that presumably reflects that some of them were interested in investing in the development of EFTPOS, in which case this statement would not be universally true.

15. **Do you agree that it is unlikely that schemes will start imposing interchange on swiped/inserted scheme debit transactions?** The FSF has no members who issue debit cards and is therefore unable to comment on this question.

16. **Do you agree that merchants facing a per-transaction charge for accepting debit payments is not an issue in itself?** The FSF agrees with this – the level of charges is likely to be a greater issue than whether there are charges at all, which many would regard as a given.

17. **Is the shift towards contactless debit cost-effective, taking into account the costs and benefits to all parties in the system?** The FSF has no members who issue debit cards and is therefore unable to comment on this 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?** The FSF has no members who issue debit cards and is therefore unable to comment on this question.

19. **Do you agree that merchant service fees are likely to increase for contactless debit once acceptance reaches a certain threshold?** This is presently speculation and the FSF does not feel able to express a view about the likelihood of this occurring.

20. **Do you agree with our assessment that the interchange business model imposes significant barriers to entry in the debit market?** The FSF accepts that the barriers to entry into the debit market are relatively high.

21. **How do you think the debit market is likely to evolve in respect of these 'unknowns'?** The FSF repeats the response made to question 19 above in respect of this question.

22. **Do you consider the extent of the difference in the interchange relating to small and large merchants to be justified?** The difference really reflects economies of scale which are accepted as justifiable behaviour in many sectors of the economy, so it is difficult to see why the position should be otherwise in this context.

23. **Do you agree with our assessment of the two markets against our proposed objectives?** In respect of the assessments made in Table 6 about the credit market, the FSF thinks that the “significant concerns” expressed in respect of objectives 2 and 3 may be overstated. That is particularly true of objective 3 where the reference to “smaller businesses’ weaker bargaining power” simply reflects the market power that comes with size, as is accepted in many sectors of the economy. So far as the assessments made in Table 6 relate to the credit market, the FSF agrees that the future is uncertain, and repeats its above comments to the effect that uncertainty cannot be a satisfactory basis for regulatory action in this context.

24. **Would greater transparency have any material benefit for merchants or any other parties in the system?** It is realistic to expect that many, and hopefully even most, merchants do have an understanding of the costs involved in the retail payment systems utilised by them. If that is correct, then regulating for greater transparency is presumably unlikely to give rise to material benefits at the merchant level, except perhaps by what would hopefully be only a small increase in the numbers of merchants who presently lack an adequate appreciation of the costs involved. While that would no doubt be beneficial, the FSF is not presently satisfied that achieving greater transparency at the margins is of itself a sufficient reason to regulate for greater transparency across the board.

25. Would there be any benefit in schemes publicly clarifying their intentions in relation to charging for swiped and inserted debit payments? The FSF doubts if there would be any benefit in schemes being required publicly to clarify their intentions in relation to charging for swiped and inserted debit payments. Such statements about future intentions would necessarily need to be non-binding, and it is not realistic to expect scheme providers to comment meaningfully about their future behaviour when it is very likely to be influenced by unknowns that have yet to occur. The FSF considers that para 252 of the Issues Paper is correct to state in this context that “*these immediate actions would be unlikely to resolve the wider policy issues*”.

26. Do you think that the benefits of interchange regulation are likely to exceed the costs? The FSF believes it is too early to undertake a cost / benefit analysis of this kind without a more in depth assessment of the matters addressed in the Issues Paper. In that regard the FSF agrees with the statement in para 254 of the Issues Paper that the “*impacts of interchange regulation need to be more formally assessed*”.

27. What unintended consequences could arise from interchange regulation? In addition to those identified in the Issues Paper, the FSF would be concerned that capping interchange charges in the way the Issues Paper seems to envisage as a likely outcome of regulation might in fact operate as a floor below which charges may not fall in future, and that could in fact have anti-competitive effects.

28. **Under what conditions, if any, should debit interchange rates be regulated?** The FSF also believes that it may also be too early to seek answers to this question with any degree of specificity – as is stated in para 256 of the Issues Paper -

    "*The debit market is in a state of transition and it is possible that the inefficiencies present in the credit market will not develop to the point of warranting interchange regulation*."

    In the meantime, as the market develops it will of course be regulated by the Commerce Act's prohibition on practices substantially reducing competition, in much the same way as other sectors of the economy are. While it is true that high interchange charges may not necessarily involve a substantially reduction in competition, as the Issues Paper also notes the Commerce Commission's 2009 settlement did have the effect of reducing interchange charges, and its powers could be used again if necessary, without the need for further or other regulation which as stated above the FSF believes would be premature.

29. **Aside from the financial barrier imposed by the interchange business model, what barriers to entry for new debit payment products currently exist?** No FSF members issue debit payment products currently and none of them have explored the barriers to entry to do so.

30. **Are there good justifications for these barriers being in place?** No FSF members issue debit payment products currently and none of them have explored the barriers to entry to do so.

31. **Are there ways in which any unjustified barriers could be removed?** No FSF members issue debit payment products currently and none of them have explored the barriers to entry to do so.

32. **Is there merit in exploring options in addition to interchange and barriers to entry?** The FSF considers that there would be merit in further study including other options. In particular it notes that industry codes appear to work in this context in Canada, and in have had success in New Zealand in other contexts.

33. **Have we missed any options?** There are no other options that the FSF would suggest at this time.

The FSF would be pleased to provide any further comment as required and would be pleased to be involved in any further discussion of these matters.

Lyn McMorran
EXECUTIVE DIRECTOR

Appendix A – FSF Membership List as at 1st November 2016

Debenture Issuers - (NBDT) Non-Bank Deposit Takers	Vehicle Lenders	Finance Company Diversified Lenders	Credit Reporting Other	Insurance	Affiliate Members
<u>Rated</u> Asset Finance (B) Fisher & Paykel Finance (BB+) <u>Non-Rated</u> Mutual Credit Finance Gold Band Finance Limited	BMW Financial Services Branded Financial Services Community Financial Services Go Cars Finance Ltd European Financial Services Mercedes-Benz Financial Services Motor Trade Finance Nissan Financial Services NZ Ltd Onyx Finance Limited Toyota Finance NZ Yamaha Motor Finance <u>Leasing Providers</u> Custom Fleet Fleet Partners NZ Ltd LeasePlan NZ Ltd ORIX NZ SG Fleet	Advaro Limited Avanti Finance Caterpillar Financial Services NZ Ltd Centracorp Finance 2000 Finance Now Future Finance Geneva Finance Home Direct Instant Finance John Deere Financial Latitude Financial Personal Finance Ltd South Pacific Loans The Warehouse Financial Services Group Thorn Group Financial Services Ltd Turners Finance Limited	VEDA Advantage <u>Debt Collection Agencies</u> Baycorp (NZ) Consumer Credit Management Limited Dun & Bradstreet (NZ) Limited	Autosure Protecta Insurance Provident Insurance Corporation Ltd Southsure Assurance	American Express International (NZ) Ltd AML Solutions Buddle Findlay Chapman Tripp EY Finzsoft KPMG PWC SimpsonWestern (Total : 53 members)