Westpac New Zealand Limited

Submission to the Commerce Commission on the *Draft Guidance on the Initial Pricing Standard*

13 October 2022

1. INTRODUCTION

1.1 This submission to the Commerce Commission (**Commission**) is made on behalf of Westpac New Zealand Limited (**Westpac**) in respect of draft guidance on the initial pricing standard (**Guidance**). Thank you for the opportunity to provide feedback on the proposals.

1.2 Westpac's contact for this submission is:

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2. SUMMARY

2.1 Westpac is pleased to have the opportunity to submit on the Guidance. Westpac commends the work and engagement with the industry that the Commission has undertaken in developing this Guidance and welcomes the clarity that this Guidance intends to achieve.

2.2 With the exception of the matters raised below, Westpac is broadly aligned with the information contained in the Guidance and considers the Guidance to be an in important tool in assisting participants in meeting their obligations under the Initial Pricing Standard (**IPS**).

2.3 In aid of this purpose, Westpac would like to take this opportunity to provide further feedback and seek clarity on certain matters referred to in the Guidance. These matters are detailed below.

3. KEY SUBMISSIONS

3.1 ***Liability for contravention of the IPS***

3.2 Section 39(1) of the Retail Payment System Act 2022 (**Act**) creates both primary and secondary civil liability for a contravention of the IPS by providing that pecuniary penalties shall apply where a person has:

a) contravened the IPS; or

b) been involved in the contravention of the IPS.

3.3 Paragraph 5.12 of the Guidance states that "*any participant involved in the setting or charging of the total interchange fees, and who is in a position to affect compliance with the IPS, has a responsibility for ensuring compliance with the IPS*." This statement appears to create a wide scope for liability for participants under the Act which is reinforced by paragraph 5.14 of the Guidance.

3.4 Paragraph 5.14 of the Guidance refers to secondary liability under the Act and states that participants may be deemed to be "*involved in the contravention of the IPS*" under the Act if "*if they have a*

causative role in the setting and charging of interchange fees, or compliance with the IPS". The use of the term "causative role" suggests a low threshold for liability. We interpret this term to mean that any participant who contributes to a cause that leads to the ultimate setting and charging of interchange fees (whether this is intentional or not and regardless of actual knowledge of the contravention) is deemed to be involved in the contravention of the IPS.

3.5 We submit that based on the interpretation above, the Guidance is inconsistent with established New Zealand and Australian case law which sets a high threshold of *knowing involvement* for establishing secondary liability.

3.6 Furthermore, a similar regime for liability exists pursuant to the Financial Markets Conduct Act 2013 (**FMCA**) and based on the discussions and consultation documents at the time of the enactment of the FMCA, it appears that the intention of secondary civil liability was to target *intentional* participation in contravention of the FMCA. It is not clear (based on our interpretation of the Guidance) that this is the intent of the Commission with regards to section 39(1)(b) of the Act.

3.7 Given the above and in light of the high level of pecuniary penalties that could apply under section 39(2) of the Act, we would expect a high threshold of liability (consistent with the FMCA and case law) to apply in the context of section 39(1)(b) of the Act. Accordingly, in order to be "*involved in the contravention of the IPS*", it would need to be proved that the participant:

a) actively participated in some way in the contravention; and

b) had actual knowledge of the essential matters comprising the contravention at the time of his or her participation.

3.8 In light of the reasons outlined above and to support system participants in understanding and meeting their compliance obligations, we would recommend that the Guidance should clearly set out the threshold for secondary liability under section 39(1)(b) of the Act consistent with the test outlined under paragraph 3.7 above.

3.9 ***Net Compensation***

3.10 Paragraph 6.22 of the Guidance sets out the Commission's view that, in relation to net compensation, "net value" refers to the "total value" of any monetary and non-monetary compensation.

3.11 We submit that, to adopt such an interpretation, ignores the relevance of the words "net value" which we would argue were included to require a "netting off" process to be conducted (as the Commission has acknowledged in paragraph 6.23 of the Guidance). In addition, such an interpretation results in the IPS having an impact on issuers far greater than is necessary to achieve the objectives of the Act because it could effectively prevent issuers from receiving any additional benefits from 13 May 2022 (including, issuers who are looking to switch schemes). We note that section 4(2) of the Act states that when exercising its powers under the Act the Commission should take into account the principles "that merchants and consumers should pay no more than reasonable fees for the supply of payment services" and "that the retail payment system provides a reasonable degree of transparency". The Act is clearly focussed on the fees that are charged for payment services rather than on the revenue received by issuers. Revenue received by issuers should only be of interest to the Commission to the extent that it directly impacts on fees paid by merchants. Additional payments made by schemes to issuers do not of themselves have a direct effect on merchant fees.

3.12 Under the interpretation proposed by the Commission, any additional payment over and above that which is received by an issuer prior to 13 May 2022 could easily be viewed as "compensating the issuer" for the loss of its interchange revenue given such a broad interpretation being applied by the Commission to the purpose of payments (we refer the Commission to paragraph 6.36 of the Guidance). Assuming the other limbs of net compensation as set out under paragraph 6.14 of the Guidance are met, this would result in the issuer being deemed to have received net compensation for such payments. In our view such an interpretation would not align with Parliament's intention when it passed the Act, which as noted is principally to ensure merchants pay only "reasonable" fees for merchant services and not to regulate the payments received by issuers from schemes (unless those payments affect merchant fees).

3.13 We also refer the Commission to Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions (**IFR**) under which net compensation (which is part of the interchange fee) is defined under Article 2(11) as:

> *the **total net amount of payments**, rebates or incentives received by an issuer from the payment card scheme, the acquirer or any other intermediary in relation to card-based payment transactions or related activities*

3.14 Similar to the position under the Act, the IFR does not expressly state that net compensation involves a netting off process which takes into account issuer receipts less issuer payments (as is the case under the Australian standard); however, the recitals to the IFR seem to confirm that a netting off process is available as an evidentiary tool to determine whether circumvention is taking place or not in terms of calculating the interchange fee (under paragraph 31):

> *When calculating the interchange fee, for the purpose of checking whether circumvention is taking place **the total amount of payments or incentives received by an issuer from a payment card scheme with respect to the regulated transactions less the fees paid by the issuer to the payment card scheme should be taken into account***

3.15 Therefore, we would recommend that the Commission reconsider the view in paragraph 6.22 of the Guidance in light of the IFR such that a similar netting exercise be used as a key evidential tool to determine whether net compensation has been received. That is, the Commission could provide guidance to the effect that, so long as the arrangement between an issuer and a scheme does not result in a "positive" relationship (i.e., where issuer receipts are greater than issuer payments), then the presumption is that the issuer is not receiving net compensation (subject to evidence to the contrary). Our view is that adopting such an approach would allow for future innovation and better preserve the ability for issuers to switch schemes and therefore aid competition.

3.16 ***Commercial Credit Payment Products***

3.17 Paragraph 6.57 of the Guidance sets out the Commission's view that, where a product is individually settled, it is not being charged directly to the account of the business and is therefore not a commercial credit payment product (**CCPP**).

3.18 We would submit that, to adopt such a view, arbitrarily limits the ability of cardholders and businesses to pay off their debt under their credit contract. The principal consideration should be whether or not the debt is ultimately being settled by a business, regardless of the mechanism for doing so. Furthermore, it creates unnecessary confusion, particularly in the context of sole traders (i.e., in which capacity is a sole trader as a cardholder paying off their debt).

3.19 We would therefore recommend that the Commission should reconsider this position so that a CCPP can be settled via:

a) central settlement, or

b) individual settlement, where the relevant cardholder is then reimbursed by the business.

4. RESPONSE TO CONSULTATION QUESTIONS

4.1 We set out below Westpac's responses to the some of the consultation questions set out in the Guidance.

Question 5A: Are you aware of any issuer setting or bilaterally agreeing an interchange fee which is below the maximum rates since 31 March 2021. If so, please provide details of the arrangement.

4.2 Yes. We understand that ANZ accepts a 0% Visa interchange fee for charities which are currently subject to a maximum allowed rate of 0.39% pursuant to the Visa New Zealand Domestic Interchange Reimbursement Fee Guide (**Visa IRF Guide**).

Question 5B: Have we accurately described how interchange fees are set, assigned and charged in practice? If not, please provide an explanation.

4.3 With the exception of the below, the descriptions provided in Chapter 5 of Guidance broadly reflect how interchange fees are assigned and charged:

a) Paragraph 5.13.1 of the Guidance describes the Issuer "*as the person that sets, charges, and receives the direct benefit of interchange fees*". We submit that the scheme is in fact the entity that sets the interchange fees and the issuer simply notifies the scheme of the rate to be applied to all transactions.

b) With respect to paragraph 5.9.1 of the Guidance we wish to make the following clarifications:

i. for a dual message acquirer (such as Westpac), the authorisation and the settlement of the transaction are separate. Typically, the financial information, which includes the interchange indicators / identifiers, is received from the switch at the end of the day and submitted to the scheme (this is referred to as "clearing"). The scheme will then apply the interchange fee for the cleared transactions (this is part of "net settlement" with the scheme); and

ii. for a single message acquirer the transactions may be entered into clearing throughout the day (however, given Westpac is not a single message acquirer, we suggest confirming this with a single message acquirer).

4.4 With respect to paragraph 5.9.3 of the Guidance we would like to clarify that the scheme allocates the value for the particular interchange fee category (based on the assigned indicators, or values within the clearing message identifying the transaction type, which have been submitted by the acquirer) and the rate that the issuer has notified the scheme, they wish to receive. For the avoidance of doubt, the issuer does not have real time visibility over the rate that has been applied by the scheme on a transaction-by-transaction basis. Although the issuer receives this information on a daily basis, this information is not typically reconciled on a daily basis to determine the level of interchange rates which are being charged.

Question 5C(i): Do you agree with our analysis of scenario one? Why/Why not?

4.5 Paragraph 5.18.3 of the Guidance states that "*the acquirer is involved in entering the non-compliant interchange fee into the interchange system which enabled that fee to be assigned and charged*". We submit that this characterisation is misleading and is inconsistent with the description provided at paragraph 5.9.2 of the Guidance. The acquirer assigns a unique indicator to the transaction which is then submitted to the scheme based on which the scheme then assigns a percentage or fixed fee value to the transaction and enters this into net settlement. It is important to highlight that the acquirer does not enter interchange fees into the system and has no control over the level of interchange fees that are set. Interchange fees are set or entered into the system by the scheme.

4.6 We note however that Westpac (as acquirer) does review the published interchange fees when there has been a change to the relevant interchange manual/fee guide (which typically occur in April and October of each year).

Question 5C(ii): Do you agree with our analysis of scenario two? Why/why not?

4.7 Yes. We agree that because the acquirer does not have visibility over the issuer's net compensation position it cannot be held to be involved in the contravention.

Question 5 C(iii): Are there any additional high-level scenarios you see the benefit in us considering at this stage? If so, please provide a description of those scenarios.

4.8 We would like to propose the following alternative scenarios and would welcome the Commission's views on our analysis of these scenarios:

a) The scheme sets its maximum rate for online debit at 0.60% but when a transaction is sent to the scheme by the acquirer, the scheme incorrectly allocates a rate of 0.80% and this is paid to the issuer. In this scenario, we consider that the scheme is wholly responsible for this breach (with the issuer and the acquirer not being involved in the contravention of the IPS).

b) The scheme sets its maximum rate for online debit at 0.60%. A debit transaction is sent to the scheme, but the transaction indicators sent to the acquirer by the switch, imply a credit transaction. The scheme therefore allocates a value of 0.80% which is paid to the issuer. In this scenario, we consider that the switch is responsible for the breach and the acquirer would only be liable if the threshold for secondary liability is met (as set out in paragraph 3.7).

Question 6A(i): Do you agree with our interpretation of the interchange fees which are considered to be the 1 April 2021 fees? Why/why not?

4.9 Yes, we agree with the Commission's interpretation.

Question 6A(ii): Do you agree with our proposed approach for determining those 1 April 2021 fees for each issuer? Why/why not?

4.10 Yes, we agree with the Commission's interpretation in so far as it is proposed that the Commission would seek to obtain this information from the schemes. As noted above, it is the schemes that set the rates and seek confirmation from issuers as to the rate to be applied to transactions.

Question 6C(i): Do you consider that compensation has to be linked to a specific transaction in order to be reasonably attributed to it? If so, why?

4.11 Yes, we are of the view that compensation has to be linked to regulated transactions in order to be reasonably attributable to them. To adopt an alternative view would imply *de facto* regulation of transactions that are expressly carved out of the IPS and would, in our view, have the effect of stifling future innovation.

Question 6D(i): What do you consider the effect of the IPS to be?

4.12 We agree with the Commission's view in paragraph 6.34 of the Guidance that the effect of the IPS is a reduction in issuers' interchange revenue. However, we do not agree with the statement that *"compensation will have been made for a prohibited purpose where a purpose of that compensation is to compensate an issuer for the loss of interchange fee income caused by the IPS"*. Under the Act, any such compensation is not prohibited per se, but is required to be included within the "total interchange fee" for regulated transactions under clauses 7(2), 7(3) and 7(4) of the IPS.

Question 6G(i): What mechanisms do participants currently have in place, and how do those mechanisms work, to:

i. Identify whether an erroneous interchange fee has been charged; and

ii. Address a situation where an erroneous interchange fee has been charged?

4.13 All transactions which have been entered into clearing are downloaded according to their interchange category code on a monthly basis. The average rate of interchange fees is calculated for each category code and this is reconciled against the agreed rate. If this average rate is outside of the expected rate, then a more detailed review of transactions is undertaken to identify any erroneous rates.

4.14 If an erroneous rate is charged to the merchant, upon becoming aware of that error, the error would be rectified and the merchant will be remediated in a timely manner. Typically, however, errors are of a small scale and because of this, no remediation is required to be paid to the issuer.

Question 6G(ii): How are parties made good after an erroneous interchange fee has flowed directly through to them via the interchange plus pricing model?

4.15 Following the detection of an erroneous interchange rate, a remediation exercise will be undertaken, which would remediate any overcharging to a merchant, as well as rectifying the cause of the incorrect rate.