13 October 2022

Submission: Draft guidance on the initial pricing standard

Paymark Limited, trading as Worldline New Zealand (**Worldline**), is grateful for the opportunity to submit on the draft guidance[1] published by the New Zealand Commerce Commission (**NZCC**) on 7 September 2022 in relation to the initial pricing standard (**IPS**) contained within the Retail Payment System Act 2022 (the **Act**).[2]

In this submission we respond to the following questions raised in the draft IPS guidance: (i) what do you consider the effect of the IPS to be; and (ii) do you consider any other principles to be relevant in determining compensation?[3] We will also provide commentary further to our observations of other jurisdictions that have implemented interchange fee limits and what we would like to see happen in New Zealand. Worldline is not involved with the setting, application nor monitoring of interchange fees themselves so will not respond questions raised by the NZCC on those topics.

Background

1. The Act has been put in place to promote competition and economic efficiency in the retail payment system to ensure that it delivers long-term benefits to consumers (including businesses) and merchants.[4] It introduces a new regulatory regime for retail payments including the IPS which limits the level of interchange fees applied to certain transactions made with Visa and Mastercard (together the **schemes**) credit and debit cards.[5] The intent of the IPS is to reduce costs to merchants, which should, in turn, reduce costs to consumers.

2. The IPS limits interchange fees on some cards but not all (prepaid and commercial cards are excluded). This means that merchants may not see a dramatic reduction in fees, as issuers may seek to recover revenue lost from the regulated cards via those that are unregulated.

3. Whilst the IPS may reduce some costs, ongoing work must be done to ensure that fees applied elsewhere in the system are not increased, a practice that has eventuated in Australia,[6] Europe[7] and the United Kingdom (**UK**).[8] Regulating the interchange fees alone leaves the schemes in control of other pricing and with their high, and growing, market share of card products and processing, they are particularly powerful. The schemes have found ways to circumvent the rules (particularly if the authorities only

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1 https://comcom.govt.nz/__data/assets/pdf_file/0030/291963/Retail-Payment-System-Draft-guidance-on-the-initial-pricing-standard-7-September-2022.pdf

2 Subpart 3 of Schedule 1 of the Act: https://www.legislation.govt.nz/act/public/2022/0021/latest/whole.html

3 Question 6D(i) and 6D(ii) of the draft guidance

4 https://www.mbie.govt.nz/business-and-employment/business/competition-regulation-and-policy/retail-payment-systems/

5 Clause 7 of Schedule 1 of the Act

6 https://www.rba.gov.au/publications/bulletin/2022/sep/the-cost-of-card-payments-for-merchants.html

7 https://www.edpia.eu/wp-content/uploads/2020/06/EDPIA-IFR-position-24-June.pdf

8 https://www.psr.org.uk/publications/market-reviews/mr22-1-1-market-review-of-card-scheme-and-processing-fees/

regulate one area over which the schemes can exercise control) and the short-term benefit of interchange fee regulation is quickly erased. In the long term, regulating only the interchange fees will do nothing to stem the increase in market share by the schemes, which, with their dominance further entrenched, becomes a significant competitive advantage and makes it almost impossible for other payments providers to enter the market.

4. Eftpos,[9] or a modern local equivalent, is necessary for effective competition. It is vital that a modern domestic debit solution is put in place before the banks stop issuing traditional Eftpos cards altogether. Low-cost Eftpos transactions are being displaced by high-cost contactless debit transactions resulting in a reduction of competition and millions of dollars being spent on unnecessary fees by merchants, which are ultimately borne by consumers. Jurisdictions that found themselves with payments industries dominated by the schemes have since either invested, or have been regulated to invest, in payment systems that compete and provide local alternatives.[10]

5. New Zealanders need more choice, especially when the money comes directly from their bank account. Alternative debit products, such as those using open banking technology, need support and promotion.

Effect of the IPS

6. Having a narrow focus on interchange fees will not deliver the overarching objectives of the Act. Moreover, card schemes have been known to increase other costs following interchange fee regulation despite regulators imposing anti-circumvention rules. Lower interchange fees will reduce merchant costs in the short-term, but it is likely to accelerate the departure of Eftpos, and hence the loss of an important competition aspect. Once Eftpos goes, the schemes will have even more freedom to set the price of retail payments in New Zealand.

7. We have seen that the effect of interchange fee regulation in other jurisdictions makes way for the schemes to increase fees in other areas. In the United Kingdom, the Payment System Regulator has commenced an investigation into acquirer fees because its "*card acquiring market review*[11] *found that fees paid by acquirers had increased significantly from 2014 to 2018 and further feedback from stakeholders highlighted that scheme fees have continued to increase since then*."[12]

8. The Reserve Bank of Australia (**RBA**), despite introducing several reforms since the early 2000s is still concerned that merchants' payment costs are too high. The RBA notes that while "*the average cost of accepting a card payment has continued to fall over recent years* [..]. *However, the cost of accepting debit card payments has risen for smaller merchants, driven by the ongoing rise of contactless (including mobile) transactions. These transactions are typically routed to Mastercard and Visa, which tend to be more costly for most merchants than those processed by eftpos*."[13] The RBA

[9] Eftpos means switch-to-issuer transactions, typically magnetic stripe only cards, but can also include a Visa or Mastercard chip debit card when swiped or inserted

[10] For example, Europe has introduced the European Payments Initiative (**EPI**), Australia has EPAL, India has RuPay, and Singapore has Nets

[11] https://www.psr.org.uk/our-work/market-reviews/market-review-into-the-supply-of-card-acquiring-services/

[12] https://www.psr.org.uk/media/lc4a3pls/psr-mr22-1-1-scheme-and-processing-fees-draft-tors-jun-2022.pdf

[13] https://www.rba.gov.au/publications/bulletin/2022/sep/the-cost-of-card-payments-for-merchants.html

continues to actively support least-cost routing as a way of further reducing merchants' costs (see the section below).

9. In Europe, merchants have indicated that savings due to interchange fee caps are partly eroded by increases in scheme fees and interchange fees for commercial cards.[14] Scheme fees have indeed risen significantly since the application of the European Union's 2015 Interchange Fee Regulation[15] (**IFR**). This has been confirmed by a "Study on the application of the Interchange Fee Regulation"[16] (**the EY/CE Study**) for the period 2015 – 2017. Furthermore, EDPIA[17] members can confirm that card scheme fees have risen further since.[18]

10. The EY/CE Study goes on to say that "*acquiring margins and scheme fees from international card schemes have increased, reducing some of the benefits. If they continue to increase, it may further reduce or eliminate the benefits of the IFR*".[19]

11. Care must be taken to ensure that we do not see the same increases in New Zealand once the IPS comes into effect.

Principles relevant in determining compensation

12. Interchange fee limits have not been applied to prepaid cards nor commercial cards. Prepaid cards are regulated in many other jurisdictions such as Europe, UK, Australia, all of whom group prepaid cards with consumer debit. In Europe, the UK and Australia the interchange fee applied to a prepaid card is 0.2% - significantly less than what merchants will be paying to accept similar cards in New Zealand.

13. Commercial cards attract some of the highest interchange fees and, as these are also excluded from the IPS, their interchange fees are uncapped. Commercial cards can attract interchange fees up to 2%[20] of transaction value.

14. It is not obvious why these cards have been excluded and, whilst the Act does contain an anti-avoidance mechanism, it has been clearly demonstrated in other jurisdictions that the schemes have found ways to circumvent these mechanisms.[21] For example, there is nothing stopping the schemes from increasing the interchange fees on both prepaid and commercial cards which seems to go against the idea of promoting economic efficiency.

15. If interchange fees on prepaid and commercial cards remain unregulated, it is only fair that merchants should be able to choose not to accept them. Currently, merchants that

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[14] Page 6, https://ec.europa.eu/competition/sectors/financial_services/IFR_report_card_payment.pdf

[15] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015R0751

[16] European Commission, Directorate-General for Competition, Pavel, F., Kornowski, A., Knuth, L., et al., Study on the application of the Interchange Fee Regulation: final report, Publications Office, 2020, https://data.europa.eu/doi/10.2763/137970

[17] European Digital Payments Industry Alliance represents the interests of independent Payment Services Providers headquartered in Europe, see https://www.edpia.eu/

[18] https://www.edpia.eu/wp-content/uploads/2020/06/EDPIA-IFR-position-24-June.pdf

[19] Page 12 https://data.europa.eu/doi/10.2763/137970

[20] https://www.visa.co.nz/about-visa/interchange.html and https://www.mastercard.co.nz/en-nz/business/overview/support/interchange.html pages visited on 21 September 2022

[21] https://www.psr.org.uk/our-work/market-reviews/market-review-into-the-supply-of-card-acquiring-services/

accept any scheme card product are required to accept all scheme card products, even though different costs attach to different card product types. This is due to the 'Honour All Cards' rule. This rule is imposed by the schemes and is essentially an anti-competitive tying practice.[22] It forces merchants to accept the high interchange fee products alongside the less expensive ones. Tying the acceptance of one card product to another diminishes normal competitive forces. Removing the Honour all Cards rule would allow merchants to choose to accept to lower cost cards which would benefit consumers through reduced merchants' costs and lower surcharges.

We would like to see a focus on new technology

16. The rise in contactless use, accelerated by Covid-19, is expediting the demise of the proprietary Eftpos card and dis-incentivising banks to move to new local debit experiences or payments products. While the IPS makes accepting contactless debit products cheaper and more attractive to merchants, any transaction that is routed out to the schemes for processing is more expensive than if it were processed locally.

17. Contactless card transactions have grown quickly, yet the enablement of non-card alternatives has been slow. We have focussed on the future by building a new API-based payment platform, developing API-based products, a local contactless card (that does not rely on Visa or Mastercard) and a digital wallet which incorporates digital identity services and enables payments that use digital currencies. All these products have the potential to compete with the schemes, but industry and regulatory support is crucial if we are to have broad market adoption.

18. The banks are an essential component of the payment ecosystem to provide safe, secure, payment innovation. New Zealand is a sub-scale market which demands ubiquity for commercial success. The banks are increasingly supportive, but it is a struggle for them to prioritise innovation over other regulatory burdens. Merchants have told us they want to accept alternative payment products but not until such time as all their customers can access and use them.

19. As most New Zealanders have a scheme card it is easy for products that use those cards (for example, ApplePay and GooglePay) to progress. This means payments innovation is mostly as directed by the schemes.

20. If the NZCC wished to stimulate competition by advancing alternative payment products, it should look to learn from other jurisdictions. Many jurisdictions have not successfully implemented open banking payments products due, in part, to the lack of a sensible commercial model. We need to be wary of 'free of charge' models (such as that implemented in India) as the lack of revenue makes justifying investment decisions difficult and can lead to a stifling of innovation. The Reserve Bank of India (**RBI**) published a discussion paper (seeking comments by October 3, 2022) on charges in payment systems and is seeking views on how to increase innovation. The PSS Act[23] prescribes that "*no bank or system provider shall impose, whether directly or indirectly, any charge upon a person making or receiving a payment by using the prescribed electronic modes of payment*.[24] The RBI thinks this could be stifling innovation and noted

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22 https://www.rba.gov.au/payments-and-infrastructure/debit-cards/consult-doc-feb05/pdf/honour-all-cards.pdf

23 Payment and Settlement Systems Act, 2007, India https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/86706.pdf

24 Section 10A of PSS Act – inserted vide the Finance (No. 2) Act, 2019

in the discussion paper that "*PSPs in any payment system should earn income for continued operations of the system to facilitate investments in new technologies, systems and processes.*"[25] We should consider what others have done, taking note of what has not worked, and then decide what is best for New Zealand.

Modernise domestic debit, develop digital wallets

21. New Zealanders prefer using electronic payments rather than cash. The use of cash has declined sharply over the last few years – down 30% in the three years between 2019 and 2021.[26] If this trajectory continues, we will need to provide Kiwis with choice in payments especially when nine in every 10 New Zealanders prefer to pay via electronic means.[27] Since Covid-19, and concerns around virus transmission, Contactless is now the preferred method as people would rather not have to make contact with a terminal. If we are to succeed with a domestic debit alternative, it needs to be better than what we have today with cards.

22. Digital wallets are better than cards as they do more, and they will make life easier. They are a cash-free way to pay, store and share useful information. They will save time for consumers and merchants: no more loyalty cards, no coffee punch card, no driver's license, no library card. Everything can be sorted with a single transaction, without consumers having to carry around paper-based items or retailers having to buy or install any additional hardware.

23. Worldline is developing a digital wallet app with a New Zealand-centred approach. Individuals will have more control over their own information and who they share it with, and it will reduce the number of cards they need to carry. The digital wallet will also provide the ability for Kiwis to store and use digital currencies. We want merchants to be able to process transactions more cost-effectively and seamlessly without being shackled to international brands such as Apple, Google, Mastercard or Visa.

24. First though, we need to modernise Eftpos. We need a contactless Eftpos card – low fees for merchants, high convenience for consumers. We are looking to pilot a new contactless domestic debit card but unfortunately the Payments New Zealand (**PNZ**) rules prohibit contactless transactions from going to the issuer for authorisation.[28] This rule needs to be changed if we are truly serious about increasing competition in payments. If we can have a contactless Eftpos card, we can tokenise it and transfer the card into a digital wallet. Allowing consumers to tap their phones on terminals to pay, directly from their bank account, should also reduce or eliminate the surcharging.

25. A digital wallet can protect people's privacy by sharing less information than is shared today. For example, when you buy alcohol, a merchant can send a query to your digital wallet that essentially asks: 'Is this person aged 18 or over?' You grant permission for your digital wallet to provide a 'Yes' or 'No' answer. That's all the information that the

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[25] https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/DPSSDISCUSSIONPAPER5E016622B2D3444A9F294D07234059AA.PDF

[26] https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/notes-and-coins/future-of-cash/2021-cash-use-survey-summary-report.pdf page 3

[27] https://www.rbnz.govt.nz/hub/news/2019/10/strong-public-preference-for-cards-and-electronic-payments-quantified

[28] Please refer to 'Payments New Zealand Limited Rules' version 42, parts 8C and 8D, specifically rules 8D.11 – 8D.18. These rules are not publicly available, please request access from PNZ

merchant gets. Compare that to handing over your driver's license, which shows them your date of birth, your photo and probably your address. Security is important and access to any digital wallet would be protected by several layers of authentication via the phone and banking apps.

Replace high-cost debit with low-cost debit

26. As you know, we have two types of cards in New Zealand and two ways transactions using those cards can be processed. We have Eftpos-only cards (magnetic stripe, no chip) or scheme cards (Visa or Mastercard chip cards). Eftpos-only cards are swiped at the terminal and transaction gets sent to the issuer for authorisation via local payment processors, such as Worldline. Scheme debit cards, when swiped or inserted are processed the same way as Eftpos-only cards. Transactions processed this way are called 'switch-to-issuer' transactions.

27. Visa and Mastercard prepaid, commercial, credit and contactless debit cards use the 'switch-to-acquirer' model. These transactions have more fees attached, and those fees are charged as a percentage of each transaction's value. High-value transactions attract higher fees, despite the service being the same as low-value transactions. Visa and Mastercard benefit from the processing fees, the acquirers add on their margin and the issuing banks receive (via the acquirer/merchant) the interchange fee revenue.

28. Merchants do not pay any per transaction fees in respect of switch-to-issuer transactions. No MSF[29] and no interchange fees. They pay a monthly network access fee[30] whether they accept 1 transaction or 100,000 transactions. The issuing banks pay a per transaction flat processing fee to the payment processor.

29. Previously, issuing banks were happy to pay the transaction processing fees because Eftpos drove out cash handling fees which were, and still are, expensive. The Reserve Bank of New Zealand estimates the cost of the cash handling to be between \$600m - \$900m per year, the bulk of which (\$415m - \$625m) is paid by merchants. Electronic payments appear to have significantly reduced banks costs when it comes to cash – their costs are estimated to be between \$10m - \$20m per year, far less than the cost to merchants.[31] Despite this, the issuing banks now see paying for electronic payments processing as a cost, rather than a saving.

30. When Visa and Mastercard brought contactless to New Zealand, they mandated that all contactless transactions, including debit, were to be processed 'switch-to-acquirer' the same way as credit cards. This was agreed to by the New Zealand banks and it became a PNZ rule[32] that contactless debit cards could not be sent to the issuer for authorisation.[33]

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[29] MSF means 'merchant service fee' and this is typically applied as a percentage of the transaction value, consisting of interchange fee, scheme processing fee and acquirer margin

[30] On the Worldline network, this fee is \$18 per month per Eftpos terminal

[31] https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/future-of-money/cash-system-redesign-issues-paper.pdf pages 69 - 72

[32] Please refer to 'Payments New Zealand Limited Rules' version 42, parts 8C and 8D, specifically rules 8D.11 – 8D.18. These rules are not publicly available, please request access from PNZ

[33] This rule also prohibits transactions made using our new contactless Eftpos card from being sent to the issuer for authorisation

31. Contactless scheme debit transactions are rapidly replacing Eftpos transactions. Even with the IPS, the costs to instore merchants will increase as issuers and consumers swap out their Eftpos cards for contactless debit cards. This replacement of low-cost Eftpos transactions by high-cost contactless debit, and the move from switch-to-issuer to switch-to-acquirer, will lead to higher overall costs and increased inefficiencies in the retail payment system for no real gain.

32. There is no principled reason why contactless debit must be routed switch-to-acquirer when the same card, if swiped or inserted, is routed switch-to-issuer. Scheme debit cards, when inserted or swiped, already use local processors so it's not clear why merchants are forced to use the expensive international schemes to process contactless debit.

33. Once Eftpos is inevitably replaced by contactless scheme debit, the schemes will have increased ability to set prices (other than the regulated interchange fees) or terms, or implement products, in a way that reduces consumer benefit, and which might be difficult to do with an effective local competitor.

Least-cost routing

34. The way the transaction is routed plays a significant part in deciding how much money the transaction will cost a merchant to accept. Contactless debit is routed to the acquirer, who sends it to the schemes, and they route it to the issuer. Adding in these extra steps results in extra costs for very little difference which is highly inefficient.

35. The Reserve Bank of Australia (**RBA**) strongly supports that payment cards should have dual network capability for scheme and local Eftpos, and merchants can choose which processor they use.[34] Merchants can either route the transaction to Eftpos or scheme for processing. The RBA expects least-cost routing to bring down payment costs by (1) giving merchants the ability to route dual-network debit card transactions to the lowest-cost network, and (2) increasing the competitive pressure between the Eftpos and the schemes to lower the processing fees. In August 2022, the RBA announced a further policy measure relating to least-cost routing whereby "*given the rapid ongoing growth in mobile wallet transactions and the benefits for competition and efficiency in the payments system, the industry is expected to develop least-cost routing functionality for mobile-wallet transactions. This decision followed recent indications that implementing least-cost routing for mobile-wallet transactions would be more feasible and less costly than previously indicated*."[35]

36. Eftpos, in Australia, is more like a scheme (it follows the 4-party model) than Eftpos in New Zealand (3-party model). That means the Australian initiative cannot be directly transferred to New Zealand, but we can easily adapt the concept and implement something similar.

37. New Zealand scheme debit cards already have dual capability – if contactless is used, transactions are sent to the acquirer (the schemes) and if they are swiped or inserted, they are sent to the issuer (Eftpos). There's no need for the New Zealand banks to issue

[34] 'What is least-cost routing?' at https://www.rba.gov.au/payments-and-infrastructure/debit-cards/least-cost-routing.html

[35] 'Recent Developments' at https://www.rba.gov.au/payments-and-infrastructure/debit-cards/least-cost-routing.html

new cards to provide for least-cost routing. Least-cost routing can be enabled for all debit cards (including contactless) at the network level via the payment terminal.

38. Giving merchants this choice could be introduced quickly and simply by directing that industry rules[36] be changed to allow contactless transactions to be sent to the issuer. Having this choice would be an effective way to reduce costs and to affect a step change that allows the payments industry to prioritise, and focus on, the future of payments.

39. Instore, low value debit transactions are low risk when it comes to fraud. There is little need to utilise the dispute resolution/chargeback services provided by Visa and Mastercard. Merchants should not be made to pay more for services they do not need. And, if merchants use local processors to switch these transactions to the issuer, consumers will not be surcharged.

Surcharging

40. Inconsistency in the regulation of interchange caps may lead to merchants over-surcharging consumers. Merchants tend to apply either a very high flat fee or a percentage of the transaction value that, in most cases, seems to be much higher than the MSF. For example, we have seen merchants charging anywhere between 2 - 10% of transaction value, and this is not expected to lower once the IPS comes into effect. At a café, we've seen $2 flat fee being charged for all contactless transactions. Online, there is an even greater disparity in MSF/interchange fees versus surcharging, especially when purchasing items such as airline tickets. Instore, there is no differentiation applied in respect of card type used. This means consumers that use a contactless scheme debit card are likely paying more than they should in surcharges. Those consumers are subsidising the acceptance and use of cards that attract higher interchange fees, such as credit and commercial cards.

41. Presently, surcharging is not applied to contact debit, and it should be the same for contactless debit. However, as merchants cannot separate out the contactless debit from credit products the same surcharge is applied. If merchants could choose to process contactless debit the same way as contact debit, consumers should see surcharging reductions.

Conclusion

We believe that the long-term solution lies in local innovation that supports competition. Regulating interchange fees in isolation is unlikely to achieve the objectives of the Act. A holistic payments approach needs to be taken with a focus on retaining or developing local payments products that do not rely on the schemes. New Zealand should modernise and preserve the existing benefits of Eftpos. We need domestic alternatives to ensure competitive pricing tension against the schemes and international 'Big Tech' giants such as Visa, Mastercard, Apple, Google, and Meta.

Whilst the schemes do play an important role in providing payment methods, we must ensure domestic alternatives continue. New Zealanders should have access to a low cost, modern and frictionless way of paying for goods and services that is customised to the New

[36] Visa, Mastercard and the PNZ rules

Zealand market. This would result in better payment experiences (especially if used in conjunction with digital identity services) and cost reductions.

The IPS will reduce some costs but the inconsistent application of limits across all credit cards will make it challenging for merchants to realise those cost savings. Merchants should be able to choose which cards to accept and how those transactions are processed. If merchants do not have choice, consumers may end up paying more than they should for the price of goods and in surcharges.

We therefore support regulation which encourages competition through domestic payment alternatives rather than the narrow focus provided by the IPS.

Should you wish to discuss any of the points raised above, please do not hesitate to contact us.