Submission to the Commerce Commission on:

'Retail Payment System - Costs to businesses and consumers of card payments in Aotearoa New Zealand: Consultation Paper'

Date: 3 September 2024

Kiwibank submission to the Commerce Commission on its Consultation Paper regarding costs to businesses and consumers of card payments in Aotearoa New Zealand

Executive summary

1. Kiwibank welcomes the opportunity to provide feedback to the Commerce Commission (**Commission**) on its consultation paper regarding costs to businesses and consumers of card payments in New Zealand (**Consultation Paper**), including the extent to which interchange fees should be subject to further regulation under the Retail Payment System Act 2022 (**RPS Act**).

2. Kiwibank supports the RPS Act's purpose of promoting competition and efficiency in the retail payments system. However, the current proposal in the Consultation Paper does not further that purpose. This is because:

   a) *It does not promote competition in the retail payments system*: None of the alternative payment rails in New Zealand allow consumers to exist in the modern online world. New Zealand is a small economy and reducing interchange fees below those seen in much larger economies will inevitably impact consumer choices in making retail payments. The proposed interchange fees create no incentive for businesses to create alternatives to the service provided by an issuing bank through the schemes;

   b) *Even if it promotes competition, it does so at the expense of the retail payment system's efficiency:* The proposal will significantly impact issuing banks' service offerings. Those offerings will inevitably change because the proposal makes any issuing bank's current product suite uneconomic. Consequently, costs to consumers will go up and the changes will have a disproportionate impact on customers that have the least options but still appropriately require access to unsecured credit and/or access to online purchases;

   c) *The proposal has a disproportionate impact on Kiwibank and other smaller banks:* New Zealand owned banks have smaller balance sheets and are mainly or exclusively issuing banks (their merchant acquiring services being modest or non-existent). The Consultation Paper imposes all of the economic consequences of the proposed changes on the issuing bank. This will have material, disproportionate consequences on Kiwibank and other New Zealand owned banks. The Australian owned banks (classified by the RBNZ as Domestic Systemically Important Banks (**D-SIBs**) have a balance sheet and a business structure that can better absorb any economic consequences of the proposed changes. This is contrary to a specific focus of the Commission's own Market Study (that regulators need to apply proportionality when considering regulatory measures). The proposal would have an unintended consequence of diminishing competition in retail banking if adopted;

   d) *If the Commission is focussed on a better outcome for consumers, including the amount of merchant surcharging they pay, there are more targeted ways to deploy their powers which should be deployed:* As noted above, the direct consequences of the proposal fall squarely on the issuing banks. If the outcome of the Consultation Paper is to better challenge merchant service fees, scheme fees or excessive surcharging, then those outcomes should be pursued directly.

The proposal does not promote competition in the retail payments systems

3. Kiwi need access to globally recognised payment products that can be used securely overseas and online. Likewise, visitors to New Zealand need to be able to make payments during their stay. While open banking is gathering pace, the alternatives to card schemes are limited and not yet of a sufficient scale to offer consumers comparable levels of safety, benefits or user experience. If innovators can create a business case to enter the market, it will take some time before viable payment options will be created for consumers that can challenge the level of service offered by the card schemes.

4. New Zealand is a small market, making it hard to gain the necessary scale to justify the investment required to introduce and establish new products that attract sufficient consumers. New payment options need to have a strong business case that can demonstrate commercial returns to justify the large investment required, including the ability to price below incumbents to drive adoption and scale from businesses and consumers. If the interchange fee caps are set as low as proposed, this will make it even harder for innovators to create a solution that will make an acceptable return.

5. Reducing the fee caps to the lowest internationally, will likely reduce, not increase, competition in the New Zealand retail payments market.

Even if it promotes competition, it does so at the expense of the retail payment system's efficiency

6. Following the initial pricing standard in 2022, while some of the increased costs associated with the interchange fee caps were passed on to cardholders, a material proportion of those costs were absorbed by card issuers. If the proposed interchange cap is implemented, this will make any issuing bank's current product suite uneconomic. [redacted]

7. The Consultation Paper focuses on the reduced interchange cap potentially resulting in a reduction in scheme card rewards – however, the impact would be much wider. The scale of the change would lead to the reduction of an issuing bank's service offerings and an increase in costs for consumers. This would disproportionately impact customers that have the least options but still appropriately require access to unsecured credit and/or access to online purchases.

8. Scheme products offer value to consumers beyond just rewards. The Consultation Paper fails to give appropriate weight to the benefits which are supported by interchange fees. This includes fraud protection and chargeback rights, interest free days, universal acceptance domestically and globally, and access to mobile wallets (amongst other things). Similarly, merchants benefit from guaranteed payments, increased sales (particularly on-line), and increased safety compared to cash.

9. Implementation of the proposed interchange fee cap would have a significant impact on an issuing bank's service offerings and lead to an increase in costs for consumers. As noted previously, the net effect of this (and the absence of alternative providers to issuing banks) is to create a more inefficient retail payments system, contrary to the overarching aim of the RPS Act.

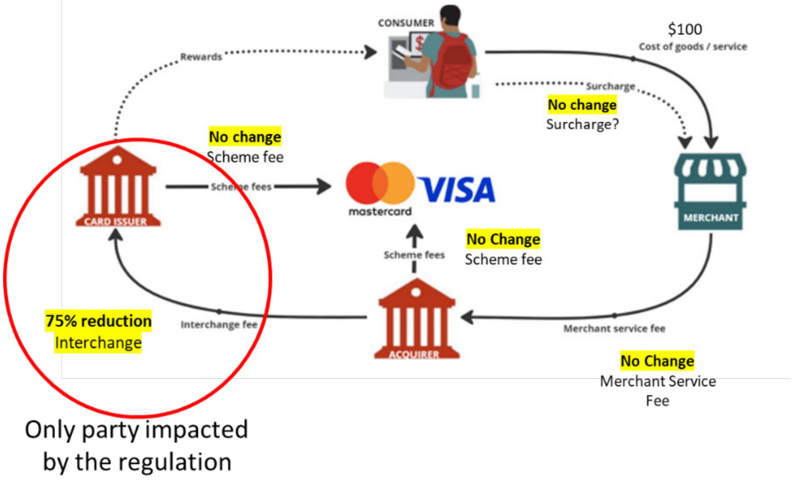
The proposal has a disproportionate impact on Kiwibank and other smaller banks

10. We strongly encourage the Commission to consider this proposal in light of its findings in the Market Study into personal banking services. In order to compete and challenge the stable oligopoly, small banks must be a full-service bank with equivalent offerings to the dominant players, which requires them to maintain sustainable and viable credit and payments products.

11. Kiwibank and other New Zealand owned banks have smaller balance sheets and are mainly issuing banks. If they have merchant acquiring services, these are modest.

12. By pulling just the one lever to reduce interchange, the Consultation Paper imposes all of the economic consequences of the proposed changes on the issuing bank. The card schemes and acquiring banks (which are predominantly the D-SIBs) do not directly suffer economic consequences, as there are no changes to merchant service fees and scheme fees. The diagram below illustrates this.

Figure 2.1 **Marginal cost of making and receiving Mastercard and Visa card payments**



13. This will have a material and disproportionate impact on Kiwibank and other New Zealand owned banks. Kiwibank and other smaller banks do not have the balance sheet and business structure to be able to absorb the economic consequences of the proposal as the D-SIB banks do. The Commission needs to consider the full ecosystem noted in Figure 1 above and apply proportionality to the proposal to ensure it does not have the unintended consequence of further diminishing competition in the market for personal banking services. Such an outcome being diametrically opposed to the work the Commission has done on the Market Study.

If the Commission is focussed on a better outcome for consumers, including the amount of merchant surcharging they pay, there are more targeted ways to deploy their powers which should be deployed

14. There is no evidence to suggest further interchange reductions will reduce surcharging. Since the implementation of the initial pricing standard in 2022, the market has seen surcharging enabled terminals almost triple, whilst the average surcharging rate did not materially reduce. For example, debit card transactions incur a 20-basis point interchange fee today, but it is not uncommon for merchants to surcharge at 2%. The graph in Appendix 1 below shows that the introduction of the November 2022 interchange cap has not seen a material reduction in the surcharging percentage but instead an extrapolation of surcharging in the industry.

15. The likely outcome is that any reduction in interchange levels will simply result in an increase in retailers' margins rather than a reduction in surcharging. If reducing surcharging is the Commission's goal, then it should set targeted regulation (which it is empowered to do under the RPS Act).

16. Similarly, if the desired outcome of the Consultation Paper is to better challenge merchant service fees and scheme fees, then those outcomes should also be pursued directly.

Appendix 1:

[redacted]