5 June 2018

COMMERCE COMMSSION: INGENICO / PAYMARK

Cross-submission by Vendor Banks on the submissions to the SOPI

Part 1: Introduction

1. ASB Bank Limited, ANZ Bank New Zealand Limited, Westpac NZ Operations Limited and BNZ Investments Limited (together the "**Vendor Banks**") have reviewed the third party submissions ("**Submissions**") posted by the Commerce Commission ("**NZCC**") on its website, in response to the NZCC's 23 April 2018 Statement of Preliminary Issues ("**SOPI**") relating to Ingenico Group S.A's ("**Ingenico's**") application for clearance to acquire all of the shares in Paymark Limited ("**Paymark**") (the "**Transaction**").

2. The Submissions raise no new or significant concerns regarding the Transaction and, in many cases, the points noted are simply general observations regarding the payments industry in New Zealand, which will be unaffected by the Transaction.

3. The key points in respect of the Submissions are as follows:

   (a) ***Cuscal ownership counterfactual***: Verifone's submission that an acquisition by Cuscal should be treated as the counterfactual fails to reflect commercial reality.

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   The only way an alternative transaction could realistically occur is if the Vendor Banks were to go back out to market - and the likelihood of the Vendor Banks agreeing to do so, as well as the prospects of finding a suitable buyer and completing a deal if they did, mean that scenario is entirely speculative.

   [

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   (b) ***Balance of bargaining power between Paymark, and Verifone and Payment Express***: Verifone and Payment Express both have the capacity and capability to build additional direct links with the Vendor Banks if they wish to do so. The fact that, to date, they may not have built direct issuer links to all Vendor Banks is a reflection of Verifone having negotiated pricing with Paymark that created savings that exceeded its bypass plus opportunity costs, making it more economic for Verifone and, in turn, Payment Express, to leverage off Paymark's existing links.

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Both are technologically sophisticated companies with global experience and capability, with a large share of their respective core market segments.

In addition, both have already built a number of links to the Vendor Banks, and [ ]

(c) ***No issue in terminals and digital payments markets***: The terminals markets and digital payments market are highly competitive, involving a number of significant and well-resourced global players. The Transaction will not disrupt those dynamics. Verifone's submission significantly overstates any effect that the Transaction would likely have on those markets, and, correspondingly, significantly understates the ability of other switch operators (eg Verifone and Payment Express) to compete with Paymark, as well as the increasing scale of new, sophisticated payment products which by-pass traditional switch networks.

(d) ***Countervailing power of customers***: The net effect of the Transaction is to free the Vendor Banks from joint ownership of a switch that facilitates only one of many payment solutions. Even with the terms in the Master Services Agreements, the Vendor Banks will have significantly more countervailing power over Paymark as a result of the Transaction, since it will remove a key incentive the Vendor Banks have (ie their shareholding) to continue to use Paymark's services. Paymark's ability to retain transaction volumes going forward will be dependent on the quality of its services offering and customer proposition – the quality of service and available features are key aspects of the competitive dynamic for switching services (not simply price). In that regard, the Transaction provides a significant opportunity for Paymark's competitors to win transaction volumes from Paymark.

[ ]

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4. This cross-submission discusses:

   (a) Part 2: the counterfactual;

   (b) Part 3: switch access and building new links;

   (c) Part 4: vertical effects;

   (d) Part 5: the countervailing power of the Vendor Banks; and

   (e) Part 6: the effect of the new Master Services Agreements.

<u>Part 2: The counterfactual</u>

5. In the event that the sale to Ingenico does not proceed, Paymark is likely to remain under the ownership of the Vendor Banks for the foreseeable future [

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6. [

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7. Cuscal has global experience operating switches as well, but [

] Cuscal is also partially-owned by MasterCard, which has the potential to create greater complexity (including competition law complexity) in any negotiation and acquisition process involving Cuscal [

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8. [

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9. [

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10. The only way a replacement transaction could realistically occur is if the Vendor Banks were to go back out to market, seek further bids, find another potential buyer (ideally with no presence in New Zealand) and negotiate acceptable transaction documentation. Such an approach would require unanimous approval of all banks, as well as another long sale process (the current sale process began in mid-2015 and has taken a considerable amount of effort and resources to get to this point) with significant associated costs and the diversion of management time. In circumstances where it is far from certain that another acceptable bidder could be found, let alone one who would be prepared to offer acceptable service agreement terms and an attractive purchase price, it is not clear that the Vendor Banks would take that step, or if so, when. There are many significant variables associated with running another sale process (not least of all achieving alignment between all Vendor Banks) so any prospect of a sale to another potential purchaser is speculative at best.

11. [

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12. Ingenico will be a significantly better owner of the Paymark business than the Vendor Banks. The Vendor Banks started Paymark in the 1980s as a relatively simple switch operating business, focussing on switching STI transactions. The payments industry has changed significantly since then, with a proliferation of scheme and online payment mechanisms – making Paymark's traditional switching business appear under pressure. The Vendor Banks expect that Paymark will need to invest in new payments technologies and business models over the coming years, and do not believe they are the best owners of the business to drive such change (and, other than to the extent such changes are able to be self-funded by Paymark, are unlikely to invest additional resources to do so). Ingenico, on the other hand, is

not a bank but a specialist payment services provider who operates switching businesses around the world, with the global expertise and resources available for it to leverage across the Paymark business. Ingenico is a sophisticated payments services provider, and the Vendor Banks are expecting that Ingenico ownership will lift Paymark's performance and deliver a much better service offering than Paymark does (or could) under current Vendor Bank ownership. The Vendor Banks believe that this is the main source of Verifone's and Payment Express' opposition to the Transaction – that Paymark will become a more dynamic and effective competitor under Ingenico ownership than it has been with the Vendor Banks as shareholders.

13. In any event, while Verifone's submission is that a sale to Cuscal should be considered a likely counterfactual (which, for the reasons discussed above, it is not), it is not clear from Verifone's submission how the competition analysis of such an alternative counterfactual would differ materially from using the status quo as the relevant counterfactual. Verifone's only comment in that regard[1] is that a transaction where Cuscal was the purchaser:

    (a) would not result in any aggregation in the switching market – however, continued ownership by the Vendor Banks would not result in any aggregation in the switching markets either (nor, for completeness, does the sale to Ingenico, which makes Verifone's submission in this regard appear slightly confused); and

    (b) would not result in any vertical integration – however, again, no vertical integration would occur under continued ownership of Paymark by the Vendor Banks (eg, like Cuscal, none of the Vendor Banks are terminal manufacturers or resellers).

14. Accordingly, while Verifone's view is clearly that a sale to Cuscal is the relevant counterfactual against which to assess the Transaction, such a transaction is highly unlikely to occur (and speculative at best) and, in any event, would not be a materially different counterfactual against which to assess the Transaction than the status quo – which is by far the most likely scenario if the Ingenico transaction does not proceed.

<u>Part 3: Switch access and building new links</u>

15. As is the case in many industries, those competitors operating in the switching markets who are yet to invest in their own switching infrastructure must continually undertake a balancing exercise between the capital cost of establishing links with issuers / acquirers vs the operating cost of paying a fee to access the existing issuer / acquirer links available in market.

16. When Verifone acquired EFTPOS New Zealand Limited (ENZL), [ ] – in reality, Verifone built new links to ANZ but made the commercial decision not to build links to the other banks and opted instead to utilise Paymark's existing links (entering into the wholesale / aggregation agreements with Paymark). Verifone was thereby able to delay building new links to the other banks. [ ]

[1] Paragraph 15(b) of Verifone's submission dated 4 May 2018.

17. The Vendor Banks understand [ ]

18. Ultimately, it is an economic equation for Verifone whether to build its own links or to continue to utilise Paymark's existing links through the wholesale / aggregation agreements. Verifone is a significant player internationally, operating an integrated switch and terminal business around the world, and has the expertise to make its own calculations, as well as the resources and capability to build more direct issuer / acquirer links if it has the incentives to do so.

19. Verifone has had discussions with Vendor Banks about building issuer / acquirer links – for example:

    (a) [ ]

    (b) [ ]

    (c) [ ]

    (d) [ ]

20. In terms of timing, [ ]

21. The cost of building new links is not prohibitive either. Both Payment Express and Verifone are well-resourced operators, and have already built a number of acquirer links. Payment Express is [ ] and is [ ]. Verifone has also built out a

number of other direct links in the past few years – eg a direct link to BP, a direct link to Countdown, and a direct link to Payment Express.

22. Verifone's submission[2] that it is unable to provide switching services to merchants whose acquirer is not ANZ is not true. Verifone is able to provide switching services to non-ANZ acquired merchants through its wholesale / aggregation agreements with Paymark, and the other Vendor Banks are not restricted from acquiring with Verifone (or Payment Express).

23. Verifone's submission that Paymark (by virtue of having already built its own issuer / acquirer links) is able to control or limit Verifone's competitive constraint also does not hold true. [ ] The Vendor Banks expect the NZCC will (to the extent it has not already done so) discuss with Paymark [ ].

24. The Vendor Banks also understand [ ] Again, the Vendor Banks expect the NZCC will (to the extent it has not already done so) discuss such negotiations with Paymark. [ ]

25. The fact that Paymark has already built its own issuer / acquirer links cannot itself be a barrier on the Vendor Banks being able to sell Paymark. Verifone, Payment Express and any other competitors have the ability to build direct links and/or negotiate wholesale access terms with Paymark regardless of whether Paymark continues to be owned by the Vendor Banks, or by Ingenico or any other purchaser. Issues around access to Paymark's switch are not shareholder or Transaction related issues – if anything (to the extent any such issues relate to the Vendor Banks' ownership of Paymark), wholesale access to Paymark's switch could well become easier for Verifone, Payment Express and others under Ingenico ownership. [ ] The Vendor Banks understand [ ] The Vendor Banks expect that the NZCC will (to the extent it has not already done so) discuss with Ingenico its view on such wholesale access.

Part 4: Vertical effects

26. The Vendor Banks disagree with Verifone's submission that the merged entity will have the ability and incentive to foreclose competition in:

[2] Paragraph 25 of Verifone's submission dated 4 May 2018.

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(a) terminals; and

(b) digital payments.

Terminals

27. The terminal markets are highly competitive and, on the demand-side, merchants' decision-making is driven primarily by terminal preference (in many cases, based on the integration of a terminal into the merchant's POS system) rather than a preference for a particular switch provider. In practice, once a merchant has selected a terminal, the question then turns to which bank (and switch provider) will support that terminal offering.

28. On the technical side, terminal specifications for connecting to the Paymark switch are effectively set by international standards. As part of the sale process, [[3]] As new terminal technologies continue to evolve, the Vendor Banks are keen to ensure that such technologies are available to New Zealand merchants and can connect to the Paymark network. For example, on Tuesday last week, Skyzer and ePayments announced a new technology partnership to roll out new terminals for processing QR (quick response) code-based payments, available in New Zealand via Chinese mobile payments and Ingenico terminals.[4] SmartPay has already announced similar deals a couple of months back (March 2018) with Alipay and WeChat to support QR payments from Chinese customers at terminals in New Zealand.[5] Verifone terminals have also been connected to the Paymark switch for some time.

29. With an increasing number of highly customised and specialised terminal offerings available in New Zealand, limiting terminal access is a highly risky and unprofitable strategy – [ ]

30. Logically, Ingenico would be incentivised to maximise the switching volumes across its network, by maximising the number of terminals and merchants connected to that network.

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[3] [ ]

[4] http://www.scoop.co.nz/stories/BU1805/S00851/chinese-mobile-payment-partnership.htm.

[5] https://www.smartpay.co.nz/alipay-wechat/.

Digital payments

31. Similar to terminals, the digital payments market is highly competitive, with a number of well-resourced players, including Apple Pay, Google Pay, Smartpay, Paystation, Cybersource and Flo2Cash, as well as an increasing proliferation of new, sophisticated online payment products which do not utilise traditional switch networks (eg Online EFTPOS, POLi, PayPal (Braintree), Stripe etc).

32. Verifone submitted that, while Paymark does not currently have an incentive to foreclose competition in the digital payments market[6], the merged entity will have an incentive to do so. No explanation or support is provided for that submission. Paymark currently has a 15% market share in the digital payments market and it is unclear how the aggregation of its market share with Ingenico's (Bambora's) ~4% market share would result in an incentive for Payment to foreclose competition in the digital payments market – this appears to be an unjustified (and slightly strange) submission from Verifone.

33. In any event, Paymark does not have the ability to foreclose competition in the digital payments market. Contrary to Verifone's submission[7], other providers (eg Verifone and Payment Express) currently provide digital payments services without utilising Paymark's switch, and other offerings (eg POLi, PayPal), as well as online and mobile banking products, are also able to route transactions without switching through Paymark. It is difficult to see how Paymark could have the ability to foreclose competition in the digital payments market – notwithstanding that a ~4% market share aggregation would not incentivise it to do so either.

Part 5: Countervailing power of the Vendor Banks

34. Verifone submits that, without the Vendor Banks' influence over Paymark as shareholders, the Vendor Banks will have no countervailing power over Paymark.

35. To the contrary, [ ]

36. As shareholders in Paymark, the Vendor Banks have been largely unsuccessful in exerting any significant influence over Paymark's pricing or services - in large due to the governance arrangements that were put in place to ensure that Paymark acts independently from the Vendor Banks. [ ]

37. By ending the Vendor Banks' shareholding in Paymark, the Transaction will remove a key incentive for the Vendor Banks to continue to push transaction volumes through Paymark, and will provide a significant opportunity for Paymark's competitors to win transaction volume from Paymark. As discussed further in Part 6 below, the terms of the services agreements [ ] do not replace the

[6] Paragraph 17 of Verifone's submission dated 4 May 2018.
[7] Paragraph 79(a) of Verifone's submission dated 4 May 2018.

current incentives that the Vendor Banks have (as a result of their shareholding in Paymark) to keep transaction volume with Paymark. The Transaction may also change the dynamic of the respective Vendor Banks' incentives, with potential for different Vendor Banks to align with different switch providers, with offerings in the switching markets becoming more dynamic and customised.

38. Similar to the point raised in paragraph 13 above, given Verifone's submission that the Transaction ought to be assessed against a counterfactual where Paymark is acquired by Cuscal (ie where the Vendor Banks would also not be Paymark shareholders), it is not clear why Verifone places such emphasis on the countervailing power it sees the Vendor Banks have as shareholders of Paymark (and its concern around the loss of that countervailing power), since that does not appear to be of concern to Verifone if Cuscal was the preferred purchaser of Paymark. Again, this aspect of Verifone's submission seems confused and not well thought out.

Part 6: Effect of the new services agreements

39. A number of key commercial protections under the new services agreements were required by the Vendor Banks during the negotiations with Ingenico to help ensure the ongoing quality of service being delivered by Paymark – for example:

(a) [

(b)

(c)

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40. As mentioned in paragraph 8 above, the Vendor Banks were clear to all bidders that they would not, as part of the Transaction, be providing any guarantee or underwrite as to future transaction volumes through the Paymark switch. [

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41. [

] Retaining the flexibility for the Vendor Banks to meet and be responsive to customer needs was a critical and non-negotiable aspect of the Transaction

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(and, as noted in paragraph 8 above, was the reason that some potential bidders were unwilling to participate further in the sale process).

42. [ ]

43. Verifone's submission that the services agreements "create strong financial incentives for the Vendor Banks to encourage their merchants to continue to contract with Paymark for switching services" is not at all accurate.

44. [ ]

45. [ ]