PAYMARK SUBMISSION ON LETTER OF ISSUES, 11 JULY 2018

3 August 2018

Summary of submission

1 In this submission, Paymark provides further information and evidence that we do not have market power in switching services and accordingly would have no ability following the proposed transaction to foreclose rival terminal suppliers. Specifically:

1.1 Banks and merchants have the ability to move away from switch to issuer (***STI***) transaction processing to switch to acquirer transaction processing (***STA***), and any steps Paymark takes that lessen the relative attractiveness of STI risk materially hastening its decline. As such, even now when it remains a significant feature of the landscape, Paymark is constrained from increasing prices or worsening terms for STI processing.

1.2 Banks have significant countervailing power, which they have an incentive to use to benefit merchants.

1.3 Verifone is a vigorous competitor, which imposes a real constraint on Paymark. Verifone has material bargaining power in its relationship with Paymark; this arises out of its ability to bypass Paymark and is evidenced by its conduct in its current negotiations with Paymark.

1.4 Payment Express has a demonstrated ability to constrain Paymark, most recently using its dual-acquiring model which has resulted in it winning the business of what was previously a large Paymark merchant, The Warehouse Group.

Market definition: the market for switching services

2 In its letter of issues, the Commission seeks further evidence to support Ingenico's claim that banks and merchants could steer customers from STI to STA in an effective and timely manner.

3 The Commission's description of the relationship between STA and STI transactions does not reflect Paymark's experience in the market. Paymark's experience is that STI is important to merchants as long as, and to the extent that, it provides a cost-effective means of transaction processing for them, that is also attractive to their customers.

4 In general, the proportion of transactions made with proprietary EFTPOS cards as compared with scheme cards has been reducing as banks issue increasing numbers of contactless-capable scheme debit cards, and consumers and merchants adopt contactless technology.[1] At this stage, STI remains a significant proportion of all transaction processing, but Paymark's view is that the rate of the decline may be hastened by STI becoming more costly or otherwise less attractive to banks and merchants (and conversely may remain slow if STI continues to be offered on attractive terms). Paymark's behaviour in market evidences this view. Accordingly, in addition to the competitive threat imposed by Verifone, prolonging the relevance of STI rests on its continuing attractiveness to banks and merchants.

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[1] Ministry of Business, Innovation and Employment *Retail payment systems in New Zealand: Issues Paper,* October 2016 at [17] and [85].

5 Paymark considers any attempt to worsen the terms of STI (for banks or merchants) would risk quickly accelerating the decline of STI. The fact this has not occurred to date is not evidence it is not possible, but evidence that the terms offered to merchants and banks are currently competitive.

6 It would be straightforward for banks and merchants to steer customers from STI to STA in an effective and timely manner if no competitive offering were available. If STI became relatively less attractive to merchants, more merchants would allow STA, including contactless, via their terminals. Where that occurs, consumers use the technology, because it is attractive and convenient.[2] Paymark understands that large merchants (e.g. grocery and fuel) are offered attractive terms on STA, which has resulted in greater take-up of contactless; conversely, high transaction costs result in merchants not switching on, or switching off, contactless capability (e.g. Mitre 10[3] and Burger King.[4])

7 Banks are already reducing their issuing of proprietary EFTPOS cards and increasing their issuing of scheme debit cards with contactless capability. They could readily accelerate this trend, or stop issuing proprietary debit cards altogether, at any time. This prospect creates a real and present disincentive to worsen the terms of STI.

8 Furthermore, in New Zealand, there is a Payments New Zealand (***PNZ***) rule that requires transactions (including scheme debit) to be processed as STI when the cheque or saving button is pushed at the terminal (as opposed to the card being "tapped" using contactless technology).[5] Paymark understands this is the result of a historical compromise by the schemes as few merchants would have accepted scheme debit cards upon their introduction in 2006 were there an associated charge.[6] The schemes were able to justify having an interchange fee applied to contactless debit interchange on the basis of the significant investment that the development of the technology required.[7] The banks and/or schemes could also configure the debit cards that they offer so that consumers are required to push the credit button (as opposed to the cheque or saving button) at the terminal, meaning that those transactions would be processed as STA.

9 Paymark is not privy to precisely how PNZ's voting system works. Nevertheless, we understand this rule could be changed by PNZ's bank members. This means that if banks became disgruntled with Paymark's conduct, or the relative attractiveness of STI, then the rule could be changed to require all scheme debit transactions to be processed as STA. This would immediately reduce STI by approximately [ ]%[8] and

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[2] https://www.visa.co.nz/dam/VCOM/regional/ap/newzealand/newsroom/documents/visa-contactless-infographic-2018.pdf. [

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[3] https://www.stuff.co.nz/business/88526358/contactless-cards-cause-headaches-for-small-businesses

[4] https://www.stuff.co.nz/business/105186278/burger-king-latest-company-to-ditch-contactless-payment-due-to-significantly-higher-fees

[5] As the Commission is aware, PNZ is a payments industry governance body that develops and manages rules and standards that govern core payment clearing systems. Participant members are bound by the PNZ rules and Paymark, as an "infrastructure" member, is effectively bound by the PNZ rules as it provides services to the banks and the banks are required to flow their obligations down to Paymark so that they can fulfil their own obligations to PNZ.

[6] Ministry of Business, Innovation and Employment *Retail payment systems in New Zealand: Issues Paper,* October 2016 at [107].

[7] Ministry of Business, Innovation and Employment *Retail payment systems in New Zealand: Issues Paper,* October 2016 at [140].

[8] [ ]

make it viable for merchants simply not to offer STI, even before proprietary EFTPOS card numbers declined any further.

10 In this environment, Paymark's strong view is that it needs to continue to offer an attractive proposition to merchants and banks to avoid potential immediate consequences for the relevance of STI.

11 We also disagree that it is more difficult to build the capability to process STI than STA. [

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12 Paymark also considers it worth noting that the Commission's letter of issues gives no consideration to the material and ongoing constraint imposed by cash on electronic payment processing. [

] It is clear that cash remains an important component of the payments landscape in New Zealand and it is of course readily possible for consumers to increase their use of cash if STI and STA become less attractive for any reason.

Countervailing power of banks

13 The Commission notes that banks have some countervailing power through the ability to influence merchant choice of payment type and ability to build new links. However, the Commission is unclear whether the banks' incentives are sufficiently aligned with merchants to prevent adverse competitive effects.

14 First, Paymark considers that the Commission has under-estimated the extent of banks' countervailing power. In particular:

14.1 As described above, banks are readily able to stop issuing proprietary EFTPOS cards and facilitate a change to scheme-only cards. This is made more likely by issuing banks' incentive to issue scheme cards on the basis they receive revenue from interchange fees (compared to proprietary EFTPOS, which is a cost to the issuing banks).

14.2 Being among Paymark's key customers, and with the ability to turn away from Paymark and use its competitors, banks are well placed to pressure Paymark to offer competitive prices. The banks have no incentive to accept being charged higher than competitive per-transaction fees, and they do not have to do so.

15 Secondly, banks have an incentive to use their countervailing power in the interests of merchants. Paymark's experience is that banks are keenly aware of merchants' interests, because they compete for merchants' acquiring business. If any bank were able to secure better terms for its merchants than its key competitors then the other banks would need to respond quickly. This could mean switching away from Paymark's services, or threatening to do so in order to extract more attractive terms.

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Verifone is a competitive constraint

17 The Commission in its letter of issues is not persuaded that Verifone offers a constraint that would prevent a finding that Paymark has market power in the supply of switching services.

18 First, the Commission's characterisation that Verifone can only offer a viable alternative to Paymark's switch for ANZ-acquired merchants does not correspond with Paymark's experience. That is, merchants have been willing to change banks when presented with a switching option they consider attractive, which means Verifone is a threat in relation to all merchant customers. A good example is Payment Express' dual-acquiring model. [

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19 Secondly, as the Commission is aware, Verifone has informed Paymark that it has a credible bypass by re-directing ANZ's issuer links. If Verifone were to bypass Paymark completely, this would not involve the building of a new switch but instead involve re-directing the existing ANZ issuer links. [

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Incentive to offer less favourable terms to Verifone

21 The Commission considers that the merged entity would have an incentive to offer less favourable terms to Verifone for the wholesale and aggregation agreements.

22 Paymark considers it would have neither the ability nor the incentive to achieve less favourable terms to Verifone following the proposed transaction. [

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25 Paymark considers these factors evidence that Paymark does not have market power in switching, and that it would have no ability to worsen Verifone's terms following the proposed transaction.

Payment Express as a competitive constraint

26 The Commission considers that Payment Express only imposes limited constraint on Paymark.

27 Paymark disagrees. Payment Express provides direct competitive constraint for the provision of STA transaction processing services. Payment Express has won material volumes away from Paymark in the form of the STA volumes of [ ], and there is no reason it could not win additional merchants.

28 Further, Payment Express, in addition to Verifone, is in a position to invest in switching assets in order to bypass Paymark entirely. [

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Ability for rivals to build links

30 The Commission states at paragraph 47 that it is challenging for rivals to build their own links with banks, and it is likely that neither Verifone nor Payment Express can build enough links with banks to constrain Paymark.

31 However, [ ], Paymark considers that building links to the five largest banks (i.e. ASB, ANZ, BNZ, Westpac and Kiwibank) would be sufficient for a new entrant to present a credible offering to merchants. It would be particularly credible in larger cities where most consumers are likely to carry at least one card linked to an account with one of the five largest banks. Building those five links would also give a new entrant a pathway to full market coverage.

32 As the Commission is aware, Paymark has recently built links from its digital switch to the APIs established by Westpac and ASB. [

] Payment Express has digital links with Westpac and BNZ. Others, such as Trade Me and Datacom are participating in the payments solution API pilot. This project is intended to increase efficiency and connection between participants.[9]

[9] https://www.paymentsnz.co.nz/about-us/payments-direction/api-framework/