

Regulatory Affairs

2 September 2024

Commerce Commission
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Wellington 6011
Email: RetailPaymentSystem@comcom.govt.nz

Dear Sir or Madam

Bank of New Zealand's response to Retail Payment System – Costs to businesses and consumers of card payments in Aotearoa New Zealand (Consultation Paper)

1. Introduction

- 1.1. Bank of New Zealand (BNZ) appreciates the opportunity to contribute to the Commerce Commission's consultation paper: Retail Payment System – Costs to businesses and consumers of card payments in Aotearoa New Zealand (Consultation Paper).
- 1.2. BNZ commends the Commission for exploring the nature of the costs to New Zealanders to make and receive payments using Mastercard and Visa cards. We agree that there is potential to reduce these costs to New Zealanders through simplifying the approach to interchange fees regulation.
- 1.3. However, BNZ questions whether reducing interchange fees will result in lower costs for consumers unless merchant surcharges are also regulated, and savings made from lower interchange fees translate into lower prices for the consumer at the merchant checkout. We are not aware that there is any evidence, for example, that savings from earlier reductions in interchange fees have been passed on to consumers.¹ Instead consumers have faced increased incidence of surcharging, often unrelated to merchants' costs, while also receiving reductions in card benefits.
- 1.4. BNZ also recommends that the Commission considers the degree of intervention required to decrease interchange or other fees to ensure that the level does not make it difficult for payment innovators to derive an appropriate return (or compete on price) (discussed further below at section 3).
- 1.5. We note that card scheme interchange discussions are often distorted by the fact that NZ is unique in that banks provide an EFTPOS (domestic debit) service at zero cost to merchants.

¹The Commerce Commission projected businesses in New Zealand would save an estimated \$105 million each year by the reduction in fees under the initial pricing standard and expected these to flow through to Kiwis over time. Although merchant service fees have reduced, we are not aware of any evidence that these savings have been passed on to consumers. [https://comcom.govt.nz/news-and-media/media-releases/2023/retail-payment-system-regulation-to-deliver-\\$105m-in-savings-for-businesses%23:~:text=The%2520Commerce%2520Commission%2520says%2520businesses,through%2520to%2520Kiwis%2520over%2520time.](https://comcom.govt.nz/news-and-media/media-releases/2023/retail-payment-system-regulation-to-deliver-$105m-in-savings-for-businesses%23:~:text=The%2520Commerce%2520Commission%2520says%2520businesses,through%2520to%2520Kiwis%2520over%2520time.)

In other markets (including Australia as a near comparison, Asia etc) merchants pay for domestic payments acceptance (see graph in Appendix 1).

1.6. Conversely the card schemes, whilst charging acceptance fees, provide benefits to consumers and have enabled business of all sizes to provide more efficient services at point of sale through contactless transactions. The card schemes have also been the catalyst and enabler for businesses and new business models of all sizes (from sole trader to corporate) to accept payments securely online. In our view, the Commission should focus on creating efficiencies and pricing that encourages beneficial advancements from existing and new participants by simplifying the structure of interchange fees. We suggest the Commission achieve this by requiring international card, commercial and prepaid rates to align to current domestic credit interchange rates.

1.7. Our comments below set out some high-level observations on the Commission's proposed approach.

2. Proposed methodology for determining interchange fee caps

2.1. BNZ supports the simplification and standardisation of interchange fees. We have advocated for the reduction of interchange for all commercial cards to domestic credit levels (80bps). The Commission is also aware that we have consistently advocated reducing interchange for international issued cards.

2.2. However, the rationale for the choice of 20 basis points for all interchange on all domestic transactions is not clear to us. We acknowledge that it matches the current New Zealand cap on contactless debit and aligns with European Union's "merchant indifference test" for its cap on debit. (It is not the EU cap that applies to credit transactions). However, we question whether copying the lowest part of the United Kingdom and European Union interchange fees and concluding this will result in a commercially viable product in New Zealand will result in the best customer outcomes. In this regard we refer to Dr W Bolt's observation "*Payment costs differ widely, depending not only on payment habits but also on the size of the country— showing the influence of payment scale economies*".²

2.3. The payments markets of the European Union and the UK are considerably bigger than New Zealand; this inevitably results in some economies of scale that are reflected in their interchange settings.³ If New Zealand were to simply follow suit, we are concerned that customer protections may be impacted.

2.4. In addition, we are concerned that the proposed rates would impact the growth of payment innovation in NZ as many recent innovations use the card scheme networks; the resultant lower pricing may also inhibit innovation on other networks or using open banking (this is discussed further below).

2.5. Similarly, the methodology for proposing a rate of 1.15% for international interchange appears to be based solely on the European Union's cap. To put this in a New Zealand context, we have calculated⁴ that international payments make up around 13% of acquired sales in NZ, but at the proposed rates would make up almost half of interchange fees paid

² Page 11 https://comcom.govt.nz/data/assets/pdf_file/0030/359490/Dr-W-Bolt-The-Retail-Payment-System-in-New-Zealand-Efficiency2C-pricing-and-competition-December-2023-.pdf

³ New Zealand has 5 million people. The European Union has 449 million and the UK 68 million so not comparable in terms of size.

⁴ Using MWE (a monthly NZ cards market by subscription report produced by Mike Ebstein that he sends out as the MWE report) year ending June 2024 data.

by NZ acquirers. None of this interchange benefits New Zealand. In addition, retailers in international tourist hot spots like Queenstown, Wanaka and Rotorua (and every other international customer orientated business) pay disproportionately higher rates.

- 2.6. Accordingly, we submit that a better approach would be to simplify the structure of interchange by requiring international cards, commercial and prepaid rates to align to current domestic credit interchange rates. This would be a fairer and easy to understand outcome for all retailers and supports the overall goal of reducing and simplifying merchant service fees (and related surcharging). Once the overall interchange fee structure is better set then the Commission could reconsider if further cuts to domestic rates are needed.

3. Impact on competition and innovation

- 3.1. BNZ continues to take the lead in exploring alternative cost-effective ways to pay and advancing Open Banking in New Zealand. BNZ works closely with the Fintech community and has connected 20+ third parties to APIs, with over 100 entities that have registered interest and over 30 that have progressed to sandbox application/exploration and onboarding. As the Commission is aware, we are looking forward to the progression of the Consumer and Product Data Bill to provide for a legal framework and accreditation structure that provides confidence to consumers that they have full control and protection of their data at every stage and with all accredited participants of open data exchange.
- 3.2. In this context, we consider that the aim to reduce the average merchant service fees paid for domestic transactions to approximately 0.70% may have unanticipated negative outcomes, both for consumers through reductions and/or removal of card benefits but also, for market challengers by reducing non-card innovation. This is because it will drive down the revenue innovators and challenger propositions can earn for new business models that do not use card networks at their core. Trying to compete against prices set artificially through regulation will make it harder for innovators to recover their investment costs or make a return on investment.
- 3.3. Also, if the fees for innovative payment services are the same (or more) as for card schemes, merchants are unlikely to have any preference how the funds are enabled and may be less inclined to go through the additional effort required to adopt new, innovative payments solutions because:
 - a) doing so adds complexity to their operation (for a benefit that would be less pressing or absent) - their staff understand and trust card scheme payments; and
 - b) customer numbers for the innovative solutions will start low and may not grow given many customers are used to, and appear to like, paying with scheme cards (given the fraud protection, convenience and other benefits).
- 3.4. Those challenges could make it less attractive for merchants and consumers to adopt new innovations and decrease the chances of such innovations succeeding. As a result, there is a high chance that such a significant reduction in interchange would advantage scheme and card-based wallet payments as the primary (or only) payment type that exists in the longer term. As an alternative, we suggest that the Commission takes a strategic approach to interchange rate simplification rather than simply cutting costs.

4. Merchant surcharging

- 4.1. We share the concern at the impact of the current level of merchant surcharging, which the Commission's research finds is typically twice the merchant service fee⁵. We submit that simplifying interchange would lead to merchants having a better understanding of fees if, in parallel, the Commission provides consistent guidance to merchants on acceptable surcharging practice.
- 4.2. Given the Retail Payment System Act 2022 is focused on the benefit of consumers as well as merchants, we encourage the Commission to address merchant surcharging directly.⁶ The Commission estimates merchants have already benefitted from lower merchant service fees as a result of the Act's Initial Pricing Standard.⁷ However, it is not evident to us that consumers have similarly benefitted from corresponding reductions in surcharges.
- 4.3. We do not agree that high surcharging is solely due to merchants not understanding interchange fees. Resulting from the introduction of the Retail Payment System Act 2022, acquirers have made a concerted effort to explain the nature of merchant service fees to merchants and simplify fee structures.⁸ At present some merchants are impacted by higher costs if the use of international cards is high for their offering. This drives surcharging – and that seems to be adopted as the level of surcharge that many other merchants copy.
- 4.4. In addition, there may be confusion where terminal packages and costs are, perhaps inadvertently, included in surcharge selection at set up. In NZ, merchants may obtain terminal and gateway set up under a different agreement from their agreement for acquiring, although we acknowledge that is changing with the growth of non-bank acquirers.
- 4.5. BNZ offers merchant service fee rates well under commonly charged surcharge rates. We offer a package rate of circa 1.1% for small merchants for point-of-sale transactions (noting this does not apply where high levels of commercial or international card acceptance are used – see our points re simplifying interchange). BNZ has available ecommerce merchant service fee rates from 1.8% inclusive of (some) payment gateway charges. Despite this, our observation is that merchant surcharging at 2% and above is widespread and growing. This suggests there is likely a surcharging network effect going on - as more merchants see that others surcharge and that cardholders continue to shop at places that surcharge, they look to surcharge too.
- 4.6. However, where a surcharge level is set to recover the less competitive cost of a merchant's current payments option, it may make the merchant less inclined to move to a provider with lower rates or to seek new services - even where there are cheaper payments options available. Introducing a new service or innovation requires effort and alignment in all parts of the payments ecosystem, as new services may require complex changes to terminal integration or ecommerce gateway technology, as well as other work. Surcharging, as it is currently applied, may therefore be having a dampening effect on the wider aspirations to see innovative new payments options, regardless of the levels at which interchange or

⁵https://comcom.govt.nz/data/assets/pdf_file/0017/315035/Retail-Payment-System-Merchant-Research-Observations-4-May-2023.pdf

⁶ Section 3, Retail Payment System Act

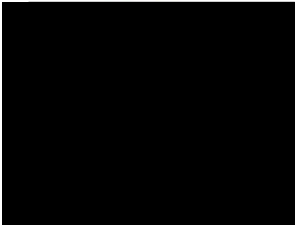
⁷ [https://comcom.govt.nz/news-and-media/media-releases/2023/retail-payment-system-regulation-to-deliver-\\$105m-in-savings-for-businesses](https://comcom.govt.nz/news-and-media/media-releases/2023/retail-payment-system-regulation-to-deliver-$105m-in-savings-for-businesses)

⁸ The Commission requested and received from acquirers detailed examples of how new fees and their savings were explained to merchants.

merchant service fees are set.

- 4.7. Given the widespread nature of surcharging, we are not convinced that the proposed regulation will reduce surcharging. Accordingly, we submit that the Commission should make strategic changes to interchange, combined with matching guardrails on maximum surcharges.

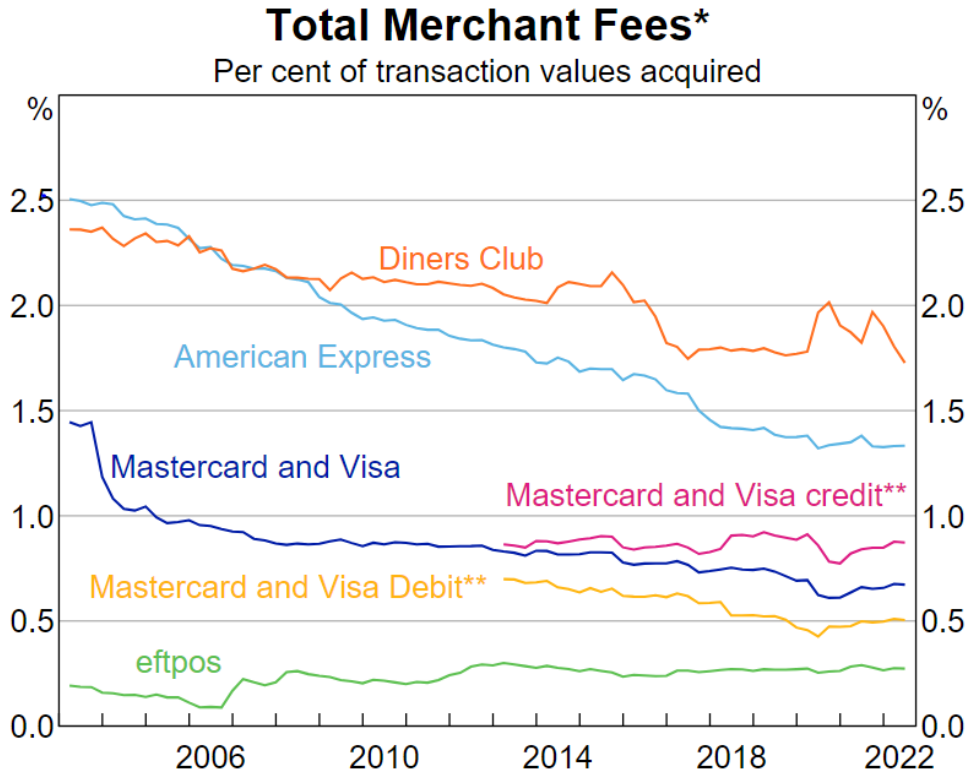
Should the Commerce Commission have any questions in relation to this submission, please contact:



Āpiha Matua: Waeture me te Tūtohu (Chief Regulatory and Compliance Officer)
Bank of New Zealand

Appendix 1

The Reserve Bank of Australia publishes quarterly data on average merchant fees per transaction for the main card networks operating in Australia.⁹ This graph shows the average merchant fees for most card networks.



* Break in September 2020 due to change in reporting forms.
 ** Prior to changes in reporting methodology in June 2018, the average fee reported for Visa and Mastercard debit cards was slightly overstated and the average fee reported for Visa and Mastercard credit cards was slightly understated; the overall average fee for Visa and Mastercard was unaffected by the reporting change.

Source: RBA

⁹ <https://www.rba.gov.au/publications/bulletin/2022/sep/the-cost-of-card-payments-for-merchants.html>