

18 DECEMBER 2024

Retail Payment System

Interchange fee regulation for Mastercard and Visa networks -
Draft Decision and Reasons Paper



Associated documents

Publication date	Reference	Title
23 July 2024	978-1-991287-52-6	Costs to businesses and consumers of card payments in Aotearoa New Zealand: Consultation Paper
23 July 2024	-	Dr W Bolt - The Retail Payment System in New Zealand - Efficiency, pricing and competition (December 2023)
23 July 2024	-	Dr A Fletcher - Literature Review on Competition, Efficiency and surcharging in the Retail Payment System (November 2023)
18 December 2024	-	Dr W Bolt - On the NZ Commerce Commission Consultation Paper "Retail Payment System - Costs to Businesses and consumers of card payments in Aotearoa NZ" (22 November 2024)
18 December 2024	978-1-99-133215-8	[Draft] Mastercard and Visa Interchange Fee Network Standard 2025

Contents

Executive summary	4
Chapter 1 Introduction	8
Chapter 2 Our draft decision	14
Chapter 3 How our draft decision promotes competition and efficiency	22
Chapter 4 A new anti-avoidance provision and proposed implementation	41
Chapter 5 Expected impact on merchants and consumers.....	46
Attachment A Our legal framework.....	51

Executive summary

X1 New Zealanders are paying too much to make and receive payments using Mastercard and Visa cards.¹ We are proposing to reduce interchange fees, the largest component of the fees paid by businesses to accept these cards, by \$260 million annually.²

We are seeking to further reduce and simplify interchange fees by \$260 million annually. This should help reduce merchant service fees and surcharges.

X2 This work follows on from our July 2024 consultation paper and submissions.³ The scope of this paper is targeted at interchange fee regulation as a first step to reduce and simplify payment costs for New Zealand businesses and consumers.

X3 This paper seeks views on our draft decision and reasons to further regulate interchange fees.⁴ It also includes our draft pricing standard which would replace current interchange fee regulation.⁵ Interchange fees make up approximately 60% (approximately \$600 million) of the fees paid by New Zealand businesses for accepting Mastercard and Visa card payments (merchant service fees).⁶

X4 If our draft decision is implemented, it would significantly reduce the fees businesses pay to make and receive card payments. These fees are high in comparison to many other comparable countries. The fees are also overly complex, hindering a business' ability to understand their merchant service fees and accurately surcharge.

¹ Compared to other countries such as Australia, the United Kingdom and the European Union. For example, interchange fees in New Zealand can be as high as 2.5% for certain transactions, whereas in the European Union the caps are much lower. The significant difference suggests that New Zealand's fees are relatively high and could be reduced through similar regulatory measures. Using cards includes where the physical card is present at the transaction and where the card is not present, including payments made using your mobile or other wearable devices.

² Estimate based on data provided by Mastercard and Visa and further analysis.

³ Our consultation paper and submissions are available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁴ Further information about our feedback process is provided in **Chapter 1**.

⁵ See Commerce Commission "[Draft] Mastercard and Visa Interchange Fee Network Standard 2025" (18 December 2024) available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁶ This does not include other payment methods on other networks which incur similar fees. This number is based on data provided by Mastercard and Visa.

An overview of our draft decision

We are proposing to include commercial credit and foreign issued cards in our new pricing standard and lower the current interchange fee caps for other transactions. We are not proposing to regulate domestic prepaid cards.

- X5 Interchange fee rates currently vary across payment type, card type, merchant category and fixed versus percentage rates. There are currently over 150 possible combinations of category and card type for each of Mastercard and Visa.
- X6 We are proposing to regulate interchange fees for transactions in New Zealand using commercial and foreign-issued cards (which are currently unregulated) and lower the current interchange fee caps for other transactions. We consider these proposed changes would promote competition and efficiency in the retail payment system for the long-term benefit of consumer and merchants.
- X7 A summary of our draft interchange fee caps is provided in **Table 1.1**.

Table 1.1 Our draft interchange fee caps⁷

Card type	Payment method	Current cap ⁸	Draft cap
Domestic debit	In-person - contacted	0.00%	No change
	In-person - contactless	0.20%	No change
	Online	0.60%	0.40%
Domestic credit	In-person	0.80%	0.20%
	Online	0.80%	0.40%
Commercial credit	In person	Not currently regulated	0.20%
	Online	Not currently regulated	0.40%
All domestic prepaid cards	In person and online	Not currently regulated	Not proposing regulation at this stage
Foreign-issued cards	In person	Not currently regulated	0.60%
	Online	Not currently regulated	1.15%

⁷ We note that a flat fee (such as a fee in cents) may be charged so long as that fee complies with the relevant cap when converted to a percentage of the transaction value.

⁸ These are the specified maximum interchange fee rates from the initial pricing standard. The cap for a transaction is the lower of this specified maximum and the interchange fee as at 1 April 2021.

Excessive surcharging

**Excessive surcharging needs to stop.
We will be considering surcharging regulation in 2025.**

- X8 Currently New Zealanders spend approximately \$45-65 million annually in excessive surcharges.⁹ Excessive surcharging rates need to come down and with a further reduction in interchange fees our expectation is that surcharge rates should follow. The average surcharge rate is almost double the average merchant service fee for those businesses. Some small businesses are paying less than 1.5% on average to accept Mastercard and Visa card payments, while others are paying over 2.5%.¹⁰ The variability and complexity of these merchant fees can hinder appropriate surcharging.
- X9 It seems likely that some form of surcharging regulation will be needed, given the extent of excessive surcharging currently, even if this draft decision is implemented. We expect to consult on surcharging regulation in the new year. We are considering options such as a maximum surcharge rate, requirements to display average merchant service fees and/or requiring terminal providers to sight evidence of average merchant service fees prior to uploading a surcharge rate to a terminal.

We expect benefits of our proposed interchange regulation to pass through to lower costs to New Zealand businesses

- X10 If we were to implement these draft fee caps, we would expect reductions in interchange fees to be passed through to businesses in the form of lower merchant services fees and we will be monitoring this closely. We are conscious that the benefits of reducing one component of the merchant service fee may be partially offset if there are increases to other components. We will continue to monitor the components that make up merchant service fees, especially the scheme fees charged by Mastercard and Visa to card issuers and acquirers.

⁹ We consider excessive surcharges to be surcharge rates that are higher than the average merchant service fee paid by New Zealand businesses for in person transactions. Estimate based on data provided by a large New Zealand terminal provider and our analysis, taking into account transaction values from merchants that are likely to surcharge. We will continue to monitor and evaluate the magnitude of the issue. We note Mastercard estimated excessive surcharging to be more than \$90 million annually. See Mastercard "Mastercard response to Commerce Commission consultation: Retail Payment System" (2 September 2024) p6, available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

¹⁰ Our analysis of information provided by acquirers as part of our ongoing monitoring.

Understanding the flow on effects

X11 We understand that significantly reducing the cost to transact in one retail payment network may impact the transaction volumes processed through other networks. We will be monitoring transaction volumes on other networks to consider the impact of any interchange fee reductions.

Chapter 1 Introduction

Purpose of this paper

- 1.1 This paper provides our draft decision and reasons for proposing to revoke the initial pricing standard and replace it with new price regulation for interchange fees on Mastercard and Visa card payments in Aotearoa New Zealand. It follows on from our July 2024 consultation paper which considered the costs of making and receiving card payments using Mastercard and Visa cards, including other pricing and access issues.¹¹

Feedback received on our consultation paper and how this has been considered

- 1.2 We received over 40 submissions on our July 2024 consultation paper and over 70 responses to our merchant and consumer survey.¹² Whilst in this paper we have not referred to all points raised in the submissions and survey responses, we have considered all relevant points raised in coming to our draft decision. We thank submitters for providing their views and engaging in this process.

Our role

- 1.3 The Retail Payment System Act 2022 (the Act) introduced a new regulatory regime for the retail payment system. The Act provides us with a range of functions and powers, including monitoring, regulation of designated networks, investigation and enforcement powers. These functions and powers are to be exercised for the purposes of promoting competition and efficiency in the retail payment system for the long-term benefit of merchants and consumers in New Zealand.
- 1.4 Among other things, the Act enables us to set standards for those networks which have been 'designated'. Those standards may relate to or otherwise deal with information disclosure, pricing for payments services (including limits on fees) and access to network infrastructure or services. The Act initially designated the Mastercard and Visa credit and debit networks and set an initial pricing standard capping interchange fees for domestic transactions on those networks.

¹¹ Commerce Commission "Costs to businesses and consumers of card payments in Aotearoa, New Zealand: Consultation paper" (23 July 2024) available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

¹² All submissions available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

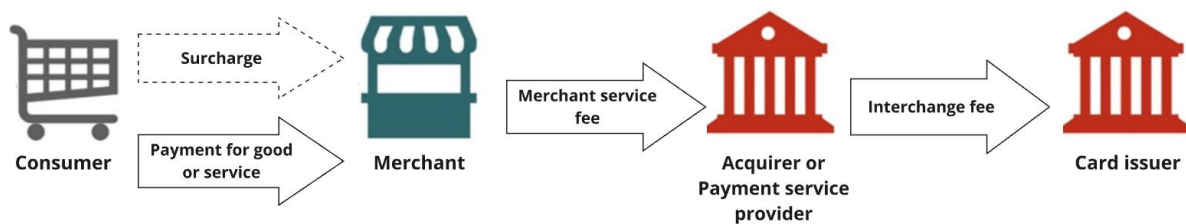
Background and context

Interchange fees make up around 60% (approximately \$600 million) of total merchant service fees paid per annum for Mastercard and Visa card payments.

What are interchange fees?

- 1.5 Interchange fees are the fees paid by the merchant's acquirer to the customer's card issuer for each transaction on the Mastercard and Visa networks.¹³ For example, where a consumer uses a Dosh Visa card to make a payment, the interchange fee is paid to Dosh. These fees form a significant portion of the merchant service fee and flow through to consumers directly through surcharging or indirectly through higher cost of goods and services (as shown in **Figure 1.1**).

Figure 1.1 The money flows of fees paid by merchants and consumers for processing Mastercard and Visa card payments



- 1.6 Interchange fees vary greatly across card types, payment methods and merchant types, with hundreds of interchange fee categories across Mastercard and Visa.¹⁴

The role of interchange

- 1.7 Interchange exists, in theory, to rebalance the benefits and costs in the Mastercard and Visa card networks between the issuing and acquiring entities. Interchange provides a revenue stream incentive for entrance and expansion in supplying Mastercard and Visa cards to consumers. This revenue stream can also contribute to covering the costs of issuing credentials, including producing physical cards and investing in anti-fraud services and technology.

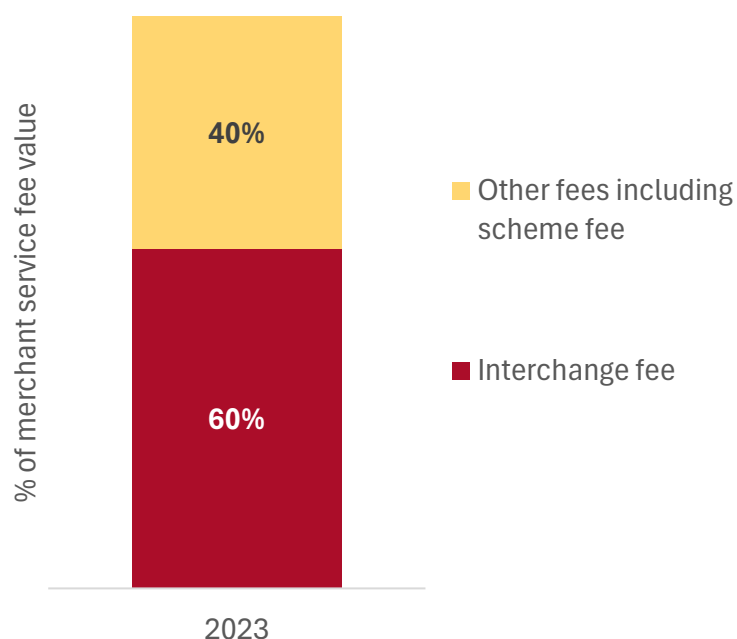
¹³ This is often the merchant's bank.

¹⁴ Mastercard "Understanding interchange" available at <https://www.mastercard.co.nz/en-nz/business/overview/support/interchange.html>; Visa "Interchange" available at <https://www.visa.co.nz/about-visa/interchange.html>.

Interchange as a cost component of the merchant service fee

1.8 **Figure 1.2** shows the average cost components that make up the merchant service fees for Mastercard and Visa card payments.¹⁵

Figure 1.2 Average cost components of the merchant service fee for Mastercard and Visa card payments



Providing your views

Submissions on our issues paper, in general, were not supported by quantitative evidence. This makes it challenging to weigh the strength of different trade-offs. We particularly welcome quantitative feedback in submissions on this paper.

1.9 This paper seeks views on:

- 1.9.1 the proposed simplified and lower interchange fee caps;
- 1.9.2 our reasons for this draft decision, including how this promotes competition and efficiency in the retail payment system for the long-term benefit of merchants and consumers;
- 1.9.3 our proposed anti-avoidance mechanism;

¹⁵ For transactions that incur a merchant service fee. Our analysis is based on merchant service fee data received from New Zealand acquirers.

- 1.9.4 our proposed implementation period;
 - 1.9.5 our expectations on acquirers and payment service providers to pass-on interchange fee reductions to merchants;
 - 1.9.6 our expectations on merchants and payment processors to ensure surcharge rates are no more than cost;
 - 1.9.7 our options for addressing surcharging through regulation in the new year; and
 - 1.9.8 how we have proposed to give effect to our draft decision through the draft pricing standard published alongside this paper.¹⁶
- 1.10 We are seeking feedback on our draft decision and draft pricing standard by **5pm Monday 18 February 2025**. We are accepting written submissions from all stakeholders and submissions from merchants and consumers through two dedicated forms:¹⁷
- 1.10.1 a form tailored to merchant feedback; and
 - 1.10.2 a form tailored to consumer feedback.
- 1.11 We have also published a Submission Response Template alongside this paper.¹⁸ The template provides details on how to make submissions on this paper and the confidentiality considerations.

Confidential submissions

- 1.12 While we encourage public submissions so that all information can be tested in an open and transparent manner, we recognise that there may be cases where parties that make submissions wish to provide information in confidence.
- 1.13 We take the protection of confidential information seriously. If you include confidential material in a submission, the information should be clearly marked, with reasons why that information is confidential.
- 1.14 Where commercial sensitivity is asserted, you must explain why publication of the information would be likely to unreasonably prejudice your commercial position or that of another person who is the subject of the information.

¹⁶ See Commerce Commission "[Draft] Mastercard and Visa Interchange Fee Network Standard 2025" (18 December 2024) available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

¹⁷ Available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

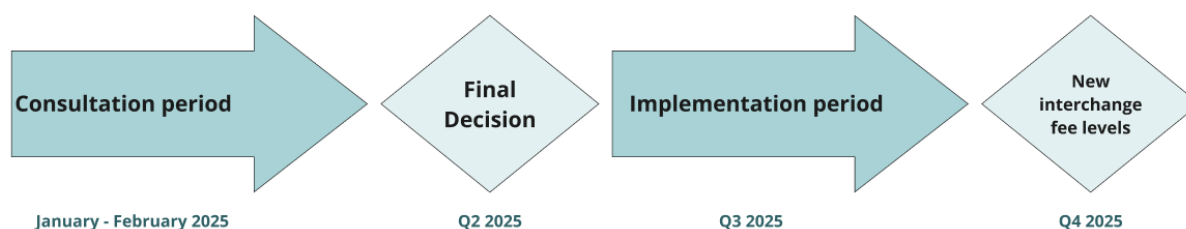
¹⁸ Available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

- 1.15 When including confidential information in your submission:
- 1.15.1 Please provide clearly labelled confidential and public versions. We intend to publish all public versions on our website.
 - 1.15.2 The responsibility for ensuring confidential information is not included in a public version of a submission rests entirely with the party making the submission.
 - 1.15.3 Please note that all submissions we receive, including any parts that we do not publish, can be requested under the Official Information Act 1982 (OIA). This means we would be required to release material that we do not publish unless a good reason existed under the OIA to withhold it. We would normally consult with the party that provided the information before any disclosure is made.

Next steps

- 1.16 We will consider all relevant points raised in submissions in coming to our final decision. Following consultation, we will issue the final pricing standard and publish our reasons for the decision. **Figure 1.3** provides an outline of the next steps.

Figure 1.3 Indicative dates for our next steps for further interchange fee regulation



Structure of the paper

- 1.17 The rest of this paper is structured as follows:
- 1.17.1 **Chapter 2:** Outlines the mandatory considerations for issuing a pricing standard, our draft decision at a high level and the expected impact and the problem we are addressing.
 - 1.17.2 **Chapter 3:** Extends on from Chapter 2 to provide our economic reasoning for further interchange fee regulation and how this promotes the purpose of the Act.

- 1.17.3 **Chapter 4:** Sets out the proposed anti-avoidance mechanism and other implementation matters, such as the timeframe for implementation and workability and effectiveness considerations.
- 1.17.4 **Chapter 5:** How we consider our draft decision will provide long-term benefits to merchants and consumers. This chapter outlines our expectations and next steps for excessive surcharging, and our expectations of payment service providers in notifying and reducing merchant service fees in response to further interchange fee regulation.
- 1.17.5 **Attachment A:** Outlines our legal framework for issuing a pricing standard, including how we have applied the mandatory considerations in practice.

Chapter 2 Our draft decision

Purpose of this chapter

- 2.1 This chapter outlines our proposal to revoke and replace the initial pricing standard, which regulates interchange fees for transactions on the Mastercard and Visa credit and debit networks. It provides:
- 2.1.1 the mandatory considerations under the Act for issuing a pricing standard;
 - 2.1.2 a summary of our draft decision, including a high-level overview (summarised in **Table 2.1**) and expected impact; and
 - 2.1.3 an overview of the problem with interchange fees on competition and efficiency in the Mastercard and Visa networks and the retail payment system.
- 2.2 Our detailed economic reasoning outlining how we have taken account of the mandatory considerations, including how the draft decision promotes competition and efficiency for the long-term benefit of merchants and consumers, is provided in **Chapter 3**.

Mandatory considerations for issuing a pricing standard

- 2.3 We are proposing to revoke and replace the initial pricing standard in Schedule 1 of the Act.¹⁹ In deciding whether, and on what terms, to issue a pricing standard, we are required to consider the following 'mandatory considerations':
- 2.3.1 Whether the pricing standard will achieve the purpose of the Act to promote competition and efficiency in the retail payment system for the long-term benefit of merchants and consumers in New Zealand;
 - 2.3.2 The statutory principles that:
 - 2.3.2.1 merchants and consumers should pay no more than reasonable fees for the supply of payments services;
 - 2.3.2.2 the retail payment system provides a reasonable degree of transparency; and

¹⁹ Multiple submissions raised concerns about the timeliness of further regulation. However, because the initial pricing standard was intended to be provisional in nature, we consider the timing to be appropriate.

- 2.3.3 Whether there are any features of the network, or any conduct of participants in the network, that reduce or are likely to reduce, competition or efficiency.
- 2.4 We have taken account of the mandatory considerations in making this draft decision, as evidenced throughout this paper. **Attachment A** sets out the legal framework for issuing a pricing standard in more detail, including our interpretation of certain key terms and concepts.

Summary of our draft decision

A high-level overview of our draft decision to further regulate interchange fee caps

- 2.5 Our proposed pricing standard focuses on implementing interchange fee caps to achieve reasonable fees for New Zealand merchants and consumers that are reflective of the cost and value of using the payment network. There will be ongoing work to maximise the pass-through of efficiency gains to merchant service fees, retail prices and payment surcharges.²⁰
- 2.6 We are proposing to include commercial credit and foreign issued cards in our new pricing standard and lower the current interchange fee caps for other transactions. We are not proposing to regulate prepaid cards. Our draft pricing standard provides additional definitions such as 'in-bound cross-border transaction' to include such transactions.²¹ We are seeking stakeholder feedback on these new defined terms.
- 2.7 **Table 2.1** provides the current interchange fee caps, the possible caps provided in our consultation paper and our draft interchange fee caps. The current interchange caps are the specified maximum interchange fee rates from the initial pricing standard. The cap for a transaction is the lower of this specified maximum and the interchange fee as at 1 April 2021. Given this, the current regime has several interchange fee caps that vary across Mastercard and Visa, this means these caps are not transparent and are difficult to assess.

²⁰ Our analysis is based on merchant service fee data received from acquirers indicates a pass-through rate of 90%. Further information on our expectations on this is provided in **Chapter 5**.

²¹ See Commerce Commission "[Draft] Mastercard and Visa Interchange Fee Network Standard 2025" (18 December 2024) available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Table 2.1 A summary of our draft interchange fee caps²²

	Product type	Current interchange fee caps ²³	Possible caps provided in our consultation paper ²⁴	Our draft interchange fee caps
Contacted	Domestic debit	0.00%	0.00%	0.00%
	Domestic prepaid	Unregulated		
		Mastercard up to 1.50% Visa up to 2.00%	0.20%	Remain unregulated
	Domestic credit	0.80%	0.20%	0.20%
	Domestic commercial credit	Unregulated		
Mastercard up to 2.20% Visa up to 2.00%		0.20%	0.20%	
Foreign issued cards / international (including prepaid)	Unregulated			
	Mastercard up to 2.35% Visa up to 2.40%	1.15%	0.60%	
Contactless	Domestic debit	0.20%	0.20%	0.20%
	Domestic prepaid	Unregulated		
			0.20%	Remain unregulated
	Domestic credit	0.80%	0.20%	0.20%
	Domestic commercial credit	Unregulated		
Mastercard up to 2.20% Visa up to 2.00%		0.20%	0.20%	
Foreign issued cards / international (including prepaid)	Unregulated			
	Mastercard up to 2.35% Visa up to 2.40%	1.15%	0.60%	

²² We note that a flat fee (such as a fee in cents) may be charged so long as that fee complies with the relevant cap when converted to a percentage of the transaction value.

²³ These are the specified maximum interchange fee rates from the initial pricing standard. The cap for a transaction is the lower of this specified maximum and the interchange fee as at 1 April 2021. Unregulated rates taken from Mastercard and Visa interchange fee tables. Mastercard domestic rates available at <https://www.mastercard.co.nz/en-nz/business/overview/support/interchange.html>; Mastercard international rates available at <https://www.mastercard.com.au/en-au/business/overview/support/interchange.html>; Visa domestic rates available at <https://www.visa.co.nz/about-visa/interchange.html>; Visa international rates available at <https://www.visa.com.au/about-visa/ap-intra-regional-interchange.html>.

²⁴ Commerce Commission "Costs to businesses and consumers of card payments in Aotearoa, New Zealand: Consultation paper" (23 July 2024) available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Online	Domestic debit	0.60%	0.20%	0.40%
	Domestic prepaid	Unregulated		Remain unregulated
		Mastercard up to 1.50%	0.20%	
		Visa up to 2.00%		
	Domestic credit	0.80%	0.20%	0.40%
	Commercial credit	Unregulated	0.20%	0.40%
Foreign issued cards / international (including prepaid)	Unregulated			
	Mastercard up to 2.35%	1.15%	1.15%	
	Visa up to 2.40%			

An overview of our reasons

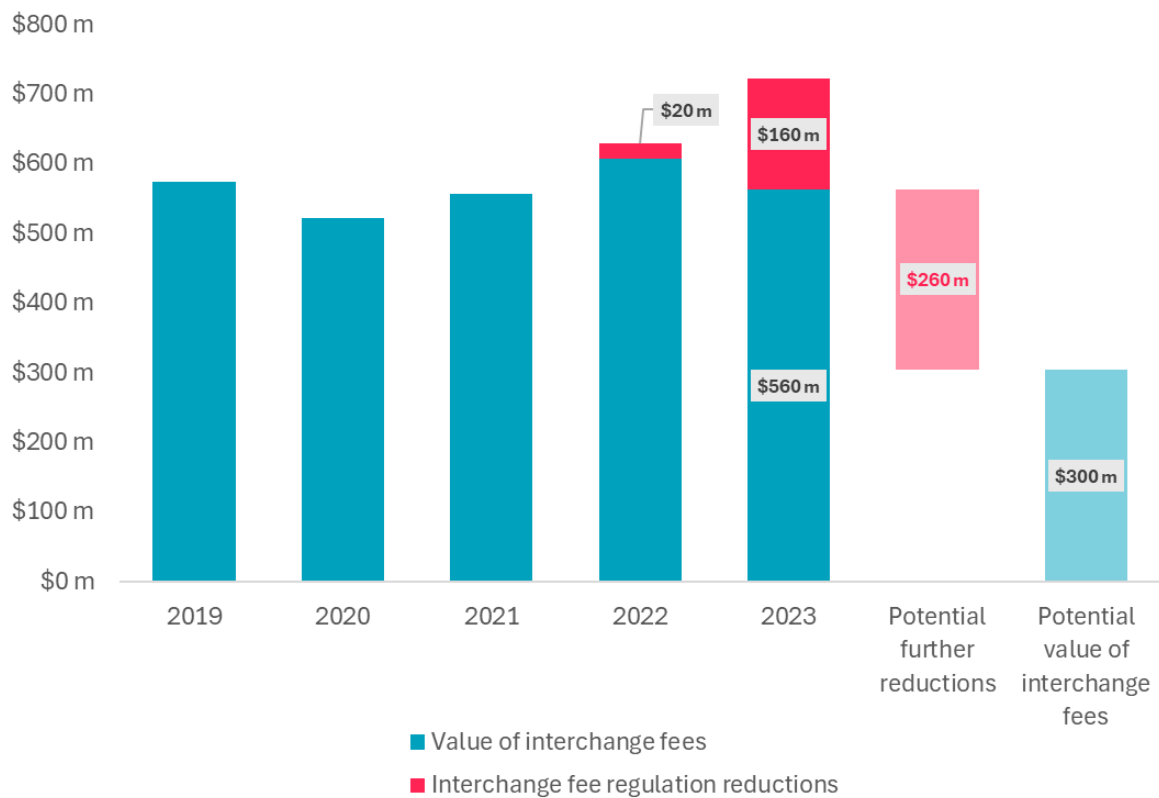
- 2.8 Our draft decision will reduce and simplify the interchange fees in New Zealand to levels that reflect the cost and value of accepting card payments to promote competition and efficiency in the retail payment system.
- 2.9 Interchange fees play a role in the early stages of a retail payment product by fostering both demand and supply through network effects. As these payment systems become widely accepted and essential, as they are in Aotearoa New Zealand, the necessity for high interchange fees diminishes because the systems become more self-sustaining. Moreover, the two-sided market dynamics in the payment system results in competition between the Mastercard and Visa networks driving interchange fees above efficient levels, creating unnecessary frictions and cross-subsidies. For instance, non-cardholders end up paying higher retail prices to subsidise rewards for cardholders.
- 2.10 Even if reductions in interchange fees lead to higher cardholder fees or reduced rewards, the overall impact is expected to enhance allocative, productive, and dynamic efficiency. For example, the current provision of "interest-free credit" to credit cardholders is not truly free but is subsidised by higher retail prices or surcharges. If these interest-free periods are reduced or eliminated, cardholders would bear the true cost of their credit card usage, leading to more efficient decision-making.
- 2.11 Countries like Australia, the European Union, and the United Kingdom have already implemented lower interchange fee caps, which have proven effective in reducing costs for merchants and consumers while maintaining the viability of payment networks. By adopting similar caps, we can achieve comparable benefits, such as lower merchant service fees and reduced surcharges, which ultimately benefit the broader economy. Further detail of our reasoning is provided in **Chapter 3**.

Expected impact of our draft decision

We estimate a reduction of approximately \$260 million in interchange fees paid to Mastercard and Visa card issuers annually. Domestic card issuers will see a \$200 million reduction and foreign card issuers will see a \$60 million reduction.

- 2.12 We estimate a reduction of approximately \$260 million in interchange fees paid to Mastercard and Visa card issuers annually as shown in **Figure 2.1**.²⁵ We consider that reducing interchange fees to these levels and simplifying the variability of these caps promotes competition and efficiency in the retail payment system for the long-term benefit of merchants and consumers in New Zealand. It does this through driving more efficient fees faced by merchants (and ultimately consumers) that are reflective of actual costs and benefits of using the network.

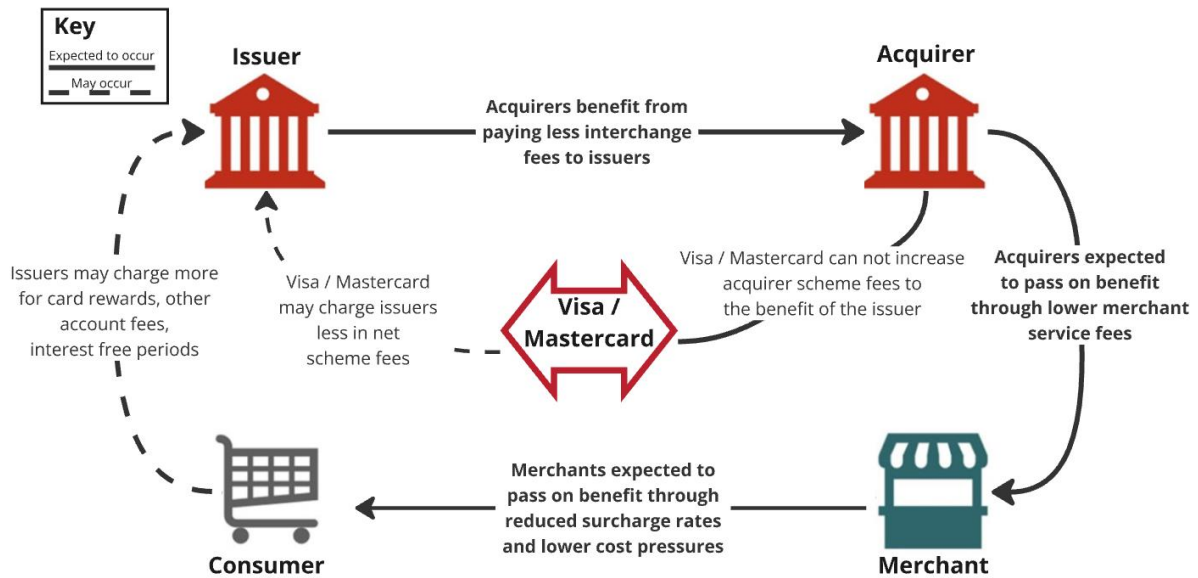
Figure 2.1 Impact of proposed regulation on level of annual interchange fees paid



²⁵ Our analysis is based on data from Mastercard and Visa.

- 2.13 We acknowledge this reduction represents only one fee component within the Mastercard and Visa networks. Issuers may seek to recover costs through other channels, such as cardholder fees, which will partially offset this amount. However, because the card issuing market is relatively competitive, that will limit issuer's ability to charge beyond card costs. **Figure 2.2** provides our expectations on industry participants from proposed interchange fee regulation.

Figure 2.2 Our expectations on industry participants²⁶



How we got to our draft decision

The problem

- 2.14 The interchange fee, a feature of the Mastercard and Visa networks, is set at levels that result in merchants paying higher merchant service fees for accepting Mastercard and Visa payments than they need to. This in turn means consumers are paying, directly and indirectly, more than they need to for goods and services. It is expected that interchange fee levels set by networks may be inefficient due to the two-sided nature and complex competitive dynamics of the payment markets.²⁷

²⁶ Note domestic card issuers will experience an estimated \$200 million annual reduction in interchange fee revenue if these draft interchange fee caps are introduced. Foreign card issuers will experience an estimated \$60 million annual reduction.

²⁷ Dr W Bolt "The Retail Payment System in New Zealand – Efficiency, pricing and competition" (December 2023) section 5.2. Dr A Fletcher "Literature Review on Competition, Efficiency and surcharging in the Retail Payment System" (November 2023) section 4.2. Both papers available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

The issues that drive the problem

Current interchange fee rates are likely reducing efficiency

- 2.15 We are unable to rely on competition alone to drive interchange fees to efficient levels. Competition drives Mastercard and Visa to set interchange fees above efficient levels to win market share by enabling issuers to offer lower cardholder fees or other benefits. Moreover, merchants are susceptible to Mastercard and Visa networks exercising market power over them.
- 2.16 Both the prospect of accessing more customers by accepting card payments and the 'must-take' nature of established card networks arising from the fear of missed sales imply Mastercard and Visa can set interchange fees higher than efficient levels. This can be done with minimal merchant resistance.²⁸
- 2.17 Interchange fees set at efficient levels will balance the costs and benefits of using the network and lead to optimal usage and costs for both merchants and consumers.²⁹ While we have limited ability to determine the precise efficient levels of interchange fees for New Zealand, we have considered how the current levels differ from other jurisdictions and relativity across fee categories to assess the trend.
- 2.18 Compared to the EU, UK and Australia, interchange fees are generally set higher in New Zealand. Moreover, the rates for New Zealand vary more depending on card type and payment method.

²⁸ Dr W Bolt "The Retail Payment System in New Zealand – Efficiency, pricing and competition" (December 2023) section 4.3. Dr A Fletcher "Literature Review on Competition, Efficiency and surcharging in the Retail Payment System" (November 2023) section 3.4. Both papers available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

²⁹ Optimal usage of one payment network can promote allocative efficiency within the retail payment system as it reflects merchants and consumers' choice across all payment networks.

Interchange fee rates are unnecessarily complex

- 2.19 The range and variability of interchange fees contributes to merchant service fees being more complex than they need to be for merchants.³⁰ The mix of card types and payment methods used by their customers is a key driver of a merchant's total merchant service fee. The extent of the range and variability of interchange fee rates across different payment categories reduces a merchant's ability to understand the drivers of any changes they may observe in their merchant service fees over time. This in turn reduces their ability to incorporate costs into retail prices or surcharge appropriately.³¹
- 2.20 Our view is that this complexity contributes to the challenges merchants (especially small merchants) face with comparing offers and switching acquirers. This likely dampens competition among acquirers. We acknowledge submissions from acquirers outlining ongoing work on simplification of merchant service fees and improving merchant understanding.³² We also acknowledge submissions from merchants who agreed with us that the complexity of fees impacted their ability to switch acquirers.³³

³⁰ As noted by One NZ "One NZ submission on the consultation on Retail Payment System: Cost to businesses and consumers of card payments" (27 August 2024) p1 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

³¹ Retail NZ noted its members advised complexity of merchant service fee structures was a barrier to the implementation of surcharging. Retail NZ "Consultation on Costs to businesses and consumers of card payments" (2 September 2024) p2 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

³² BNZ "Response to Retail Payment System - Costs to businesses and consumers of card payments in Aotearoa New Zealand" (2 September 2024) para 4.3; Westpac "Submission to the Commerce Commission on Retail Payment System: Costs to businesses and consumers of card payments in Aotearoa New Zealand" (2 September 2024) para 3.12c.

³³ "Summary of business and consumer feedback via online survey - Costs to businesses and consumers of card payments in Aotearoa, New Zealand - Consultation" available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Chapter 3 How our draft decision promotes competition and efficiency

Purpose of this chapter

- 3.1 This chapter sets out how our draft decision is consistent with the Act's legal framework, including how we have taken account of the mandatory considerations.
- 3.2 At a high-level, we consider our draft decision:
 - 3.2.1 promotes competition and efficiency in the retail payment system for the long-term benefit of merchants and consumers in New Zealand;
 - 3.2.2 helps to reduce fees paid by merchants for accepting Mastercard and Visa payments to a more reasonable level; and
 - 3.2.3 goes some way to improving the transparency of merchant service fees. We note that further work is needed to aid merchants in understanding their fees, comparing offers and switching providers when appropriate.

How we have come to our draft decision

- 3.3 To address the competition and efficiency issues noted in **Chapter 2**, we consider lowering and widening the scope of the interchange fee caps is warranted. In regulating interchange fees to a more efficient level, where the costs and benefits of using the network are balanced in a way which leads to optimal usage and costs for both merchants and consumers, we are seeking to:
 - 3.3.1 reduce the level of merchant service fees by reducing their largest component – interchange fees; and
 - 3.3.2 reduce the complexity of merchant service fees to assist merchants with understanding their costs and passing these on appropriately to consumers through cost-reflective surcharging, both of which promote competition in the acquiring market.

- 3.4 We consider setting interchange fees at more efficient levels may also promote:
- 3.4.1 competition and efficiency within the issuing market to the extent issuers shift cost recovery to more transparent cardholder fees that better reflect costs and benefits of using those cards; and
 - 3.4.2 competition within the retail payment system through more efficient usage across networks including Eftpos and open banking.³⁴

Our rationale for reducing interchange fees

- 3.5 To ensure fees being paid by merchants and consumers are reasonable, we have looked at whether the interchange fee is likely reflective of relevant costs and benefits.³⁵ The interchange fee is not directly paid by merchants or consumers. However, as an upstream fee paid by the merchant's acquirer, it is a key driver of the level of fees faced by both merchants (merchant service fees) and consumers (directly through transaction surcharges and potentially card fees and indirectly through retail prices) for the provision of payment services.
- 3.6 We do not consider interchange fees to be subject to competitive constraints, from merchants' using alternative payment mechanisms, to ensure a reasonable level of interchange is reached. This is because merchants are effectively price takers with regard to the interchange fee level, making the level of interchange a must-accept cost for acquirers.³⁶
- 3.7 Interchange fees that are reflective of the underlying issuing costs and benefits associated with processing a transaction ensure that acquirers face more reasonable fees. We will work on ensuring the pass-through of the fee caps from acquirers' fees to merchant service fees is maximised, and on improving surcharging practices to ensure pass-through from merchants to consumers is maximised.

³⁴ For simplicity, when we refer to Eftpos transactions, we mean transactions processed domestically by either Worldline, Windcave or Verifone.

³⁵ Dr W Bolt "The Retail Payment System in New Zealand – Efficiency, pricing and competition" (December 2023) section 5.2. Dr A Fletcher "Literature Review on Competition, Efficiency and surcharging in the Retail Payment System" (November 2023) section 4.2. Both papers available at <https://comcom.govt.nz/regulated-industries/retail-payment-system#projecttab>.

³⁶ Dr W Bolt "The Retail Payment System in New Zealand – Efficiency, pricing and competition" (December 2023) section 5.2. Dr A Fletcher "Literature Review on Competition, Efficiency and surcharging in the Retail Payment System" (November 2023) section 4.3. Both papers available at <https://comcom.govt.nz/regulated-industries/retail-payment-system#projecttab>.

Our rationale for simplifying interchange fees

- 3.8 Simplified interchange fee caps will contribute to less variability in merchant service fees especially for small businesses. A more transparent merchant service fee benefits both merchants and consumers as merchants can more easily understand fees and incorporate them into retail prices and surcharging more appropriately, promoting the efficiency of consumers' cost of making payments.
- 3.9 An interchange fee structure that supports better understanding of merchant service fees can help merchants compare merchant services offered by different acquirers. The greater comparability will help with evaluating the competitive offerings based on each fee component of the product and promote competition in the acquiring market. Further information about our pass-through expectations and barriers to competition in the acquiring market is provided in **Chapter 5**.

Promoting competition and efficiency in the issuing market

- 3.10 Reducing interchange fees may result in changes to other fees for consumers, for example, instead of interchange fees being used by issuers to provide “free” travel insurance, issuers may choose to introduce separate charges for travel insurance. Creating visibility of the true cost of travel insurance could be expected to improve competition between insurance provided by card schemes and stand-alone insurers.
- 3.11 We expect that fees aligned to the costs and value of different payment methods will help consumers select the payment method that meets their needs. Consumers more directly facing the costs of the payment methods they choose will support the overall allocative efficiency of the retail payment system. For example, only those consumers that want travel insurance will pay for it.
- 3.12 The ability of issuers to recover costs through means other than interchange is relevant to our decision on interchange fee regulation. Some payment products incur fees paid directly by cardholders, such as annual card fees. These alternative sources of revenue may be used to recover costs in cases where higher interchange fees previously were used.

- 3.13 Changes to personal credit card fees in response to interchange fee reduction must comply with section 41 of the Credit Contracts and Consumer Finance Act 2003, which stipulates personal credit card fees must not be unreasonable.³⁷ We acknowledge the concerns raised on appropriate charges for ancillary products in the submission from New Zealand Initiative.³⁸ Cost recovery of complementary products may require that these become optional services.

Broader impacts on the retail payment system

- 3.14 Some submissions raised concerns about potential detrimental impacts to competition and efficiency.³⁹ However, on balance, we consider that reducing interchange fees as proposed will promote competition and efficiency in the retail payment system. This is because we consider:

- 3.14.1 there to be a limited shift in payments from the Eftpos network in response to interchange fee reductions;
- 3.14.2 there to be a limited shift in payments to the American Express and buy now, pay later networks; and
- 3.14.3 open bank payment products will remain competitive.

A limited move from lower cost payment networks to more convenient payment methods

- 3.15 We are not proposing to change the costs of merchants accepting contactless debit so we do not consider this on its own will mean transactions move away from the Eftpos network.
- 3.16 We are also not changing our regulatory approach to surcharging at this time. However, we expect surcharging levels to reduce to appropriate levels due to the decrease in interchange fees.

³⁷ Credit Contracts and Consumer Finance Act 2003, s 41.

³⁸ The New Zealand Initiative "Submission by the New Zealand Initiative to the Commerce Commission on the Consultation Paper Retail Payment System" (28 August 2024) para 1.4 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

³⁹ For example, ANZ "Consultation on costs to businesses and consumers of card payments in Aotearoa, New Zealand - ANZ Bank New Zealand Limited Submission" (2 September 2024) para 66; Westpac "Submission to the Commerce Commission on Retail Payment System: Costs to businesses and consumers of card payments in Aotearoa New Zealand" (2 September 2024) para 3.1; Visa "Response to the Commerce Commission's consultation on Costs to businesses and consumers of card payments in Aotearoa New Zealand" p21. All available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

- 3.17 In response to surcharges reducing to appropriate levels, we expect there to be a change in consumer behaviour. We will likely see this in debit transactions being made by contactless payment instead of inserting or swiping the card when surcharges reduce to appropriate levels. Currently, excessive surcharges discourage some consumers from using contactless payment methods which they may find more convenient.
- 3.18 We have considered how an increase in contactless debit payments would affect the productive efficiency of all in-person debit payments. We considered how the increased usage of contactless payment methods resulting from more appropriate surcharging reflects consumers' preference towards a more convenient payment option. In doing so, we recognise that the increase in convenience benefits for debit may also lead to an increase in overall costs for merchants, or equivalently, additional revenue for issuers and schemes.
- 3.19 We consider aligning surcharges to merchant service fees would promote allocative efficiency by reflecting more efficient interchange fee levels. Although not outweighed, this may cause a marginal impact on productive efficiency to the Eftpos network as it would cause shifts in transaction volume between networks.

A limited move to higher cost payment networks

- 3.20 Concerns were raised by multiple submitters regarding the non-designated networks, such as American Express and buy now, pay later networks, having a competitive advantage due to them not being subject to regulation and interchange fee caps.⁴⁰
- 3.21 We expect some consumers may migrate to higher cost payment methods. However, we consider the impact on efficiency will be limited because they currently have less merchant acceptance than Mastercard and Visa credit card networks due to higher costs (a gap that will increase). This limits the level of consumer adoption which would allow other networks to fully take advantage of reduced interchange fees on the Mastercard and Visa credit card networks.
- 3.22 We also expect higher cost payment networks to respond similarly to when the initial interchange fee regulation came into force by reducing their costs to merchants. We will be closely monitoring these networks.

⁴⁰ Visa "Response to the Commerce Commission's consultation on Costs to businesses and consumers of card payments in Aotearoa New Zealand" p33 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Impact on innovation and open banking payment products

- 3.23 We received multiple submissions expressing concern that lower interchange fee caps could have a detrimental impact on competition, especially where small issuers, new market entrants and the development of open banking is concerned.⁴¹
- 3.24 Open banking payment products appear to be, in part, competing based on the lower cost to merchants and the lower cost to consumers (ie, no surcharge) while providing the convenience benefit of contactless payment methods. We therefore need to be mindful of reducing interchange fees so low that the uptake of open banking is not hampered.
- 3.25 Currently new open banking products are competing against a merchant service fee of around 0.70% for contactless debit payments and more than 1.5% for online debit payments.⁴² We are not proposing to change the current interchange fee caps for in-person debit transactions (0.00% for contacted and 0.20% for contactless). Therefore, we are not proposing any reduction of the merchant costs of accepting contactless debit. This means open banking products will remain a competitive alternative for merchants to accept payment. For example, Payap by BNZ has a payment processing fee of 0.39% for in-person transactions.⁴³
- 3.26 We are, however, proposing to reduce merchants' costs of accepting online debit, capping the online debit interchange fee at 0.40%. We believe open banking products will need to compete on their own merits. A reduction in interchange fee caps moves online debit to more efficient levels.
- 3.27 There are still issues preventing open banking payments from being more competitive, including the prices some banks are charging for access. We are seeking to address these in our open banking work.⁴⁴

⁴¹ Dosh "Commerce Commission - Interchange" (26 August 2024) slide 2; Sharesies "Sharesies submission on Retail Payment System: Costs to businesses and consumers of card payments in Aotearoa New Zealand: Consultation Paper" (2 September 2024) p2; Payments Europe " Consultation on costs to businesses and consumers of card payments in Aotearoa New Zealand" (2 September) p1. All available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁴² Taken from acquirers' websites including, ANZ, ASB, BNZ and Westpac.

⁴³ BNZ "Payap: a new way to take payments" available at <https://www.bnz.co.nz/business-banking/payments/payap>.

⁴⁴ More information on this work can be found at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

3.28 We also are not proposing to regulate domestic prepaid payment products at this time. These products often act as a gateway product for fintechs, new entrants and the underbanked.⁴⁵ Therefore, we consider our proposed decision not to regulate domestic prepaid products at this time will support innovation and competition in the retail payment system.

Our approach to reducing and simplifying interchange fees

3.29 We have considered the potential efficiency gains from having a simplified interchange fee structure.⁴⁶ This will improve transparency of fees and assist participants in the retail payment system to understand the costs they face. Due to different issuing costs, some differentiation in interchange fees is being proposed, with the goal of promoting competition and efficiency, while reasonably reflecting relevant costs and benefits.

3.30 Our approach has also been guided by a consideration of the costs and benefits, where the expected costs arising from certain regulatory intervention has been weighed against the expected benefits. The interchange fee caps we set must yield an expected net benefit for merchants and consumers for our goals of regulation to be met.

3.31 A full quantitative cost benefit analysis is not possible given the informational requirements. Consequently, we have weighed up the potential impacts and applied our judgement. We also considered benchmarks for interchange fee caps from comparator jurisdictions. These are summarised in **Table 3.1**.

⁴⁵ Non-bank issuers include Emerge, Revolut etc. More information about their products and relevant schemes can be found on their websites.

⁴⁶ Hospitality NZ noted in its submission that the complexity of interchange fees makes it incredibly difficult for a merchant to understand the cost of accepting different forms of payments. Hospitality NZ "Re: Retail Payment System Consultation" (2 September 2024) p1 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Table 3.1 Comparator regulated interchange fee rates in other jurisdictions⁴⁷

	Payment product	Australia ⁴⁸	European Union ⁴⁹	United Kingdom ⁵⁰	Our draft interchange fee caps
Contacted	Domestic debit	10c or 0.20%	0.20%	0.20%	0.00%
	Domestic credit	0.50%/0.80%	0.30%	0.30%	0.20%
	Domestic prepaid	10c or 0.20%	0.20%	0.20%	Unregulated
	International	1.20% - 2.40%	0.20%/0.30%	1.15%/1.50%	0.60%
Contactless	Domestic debit	10c or 0.20%	5c or 0.20%	0.20%	0.20%
	Domestic credit	0.50%/0.80%	0.30%	0.30%	0.20%
	Domestic prepaid	10c or 0.20%	0.20%	0.20%	Unregulated
	International	1.20% - 2.40%	0.20%/0.30%	1.15%/1.50%	0.60%
Online	Domestic debit	10c or 0.20%	0.20%	0.20%	0.40%
	Domestic credit	0.50%/0.80%	0.30%	0.30%	0.40%
	Domestic prepaid	10c or 0.20%	0.20%	0.20%	Unregulated
	International	1.20% - 2.40%	1.15%/1.50%	1.15%/1.50%	1.15%

⁴⁷ Mastercard interchange fee tables available at - Australia - <https://www.mastercard.com.au/en-au/business/overview/support/interchange.html>, European Union - <https://www.mastercard.com/europe/en/regulatory/european-interchange.html> and United Kingdom - https://www.mastercard.com/content/dam/public/mastercardcom/eu/europe-lfi/europeaninterchange/pdfs/Website_UK_Intracountry_Interchange_Fees_10_05_22.pdf; Visa interchange fee tables available at - Australia - <https://www.visa.com.au/about-visa/interchange.html> and <https://www.visa.com.au/about-visa/ap-intra-regional-interchange.html>; European Union - <https://www.visa.co.uk/content/dam/VCOM/regional/ve/unitedkingdom/PDF/fees-and-interchange/april2024/intra-europe-eea-interchange-apr24.pdf> and <https://www.visa.co.uk/content/dam/VCOM/regional/ve/unitedkingdom/PDF/fees-and-interchange/inter-eea-interchange-jun-2021.pdf> and United Kingdom - <https://www.visa.co.uk/content/dam/VCOM/regional/ve/unitedkingdom/PDF/fees-and-interchange/2022-november/uk-interchange-fees-nov-22.pdf>.

⁴⁸ RBA "Backgrounder on Interchange and Scheme fees" available at <https://www.rba.gov.au/payments-and-infrastructure/review-of-retail-payments-regulation/2024/backgrounders/backgrounder-on-interchange-and-scheme-fees.html>.

⁴⁹ European Union "Antitrust: Regulation on Interchange fees" (9 June 2016) available at https://ec.europa.eu/commission/presscorner/detail/fr/memo_16_2162.

⁵⁰ PSR "Market review of UK-EEA consumer cross-border interchange fees - Interim Report" (December 2023) available at <https://www.psr.org.uk/media/au4km234/xbif-interim-report-public-dec-2023-eu.pdf>.

- 3.32 We received a variety of submissions pointing to studies of the adverse effects of interchange regulation in other jurisdictions.⁵¹ We also note that other studies have more mixed or positive effects.⁵² Overall, we have reached the view that there is value in these rates as comparators.
- 3.33 We acknowledge concerns raised in submissions on differences in the size of the market and payment economies of scale when comparing international jurisdictions to New Zealand.⁵³ We also acknowledge submissions that highlighted smaller issuers in New Zealand are likely to be more adversely impacted by a reduction in interchange revenue compared to similar issuers in other jurisdictions and larger issuers in New Zealand.⁵⁴
- 3.34 Expert advice on payment economies of scale noted that the relationship between economies of scale and the efficiency of interchange fees was not straightforward.⁵⁵ We recognise the importance of this topic, and welcome further quantitative evidence on this area.

Our starting point - base interchange fee level

0% for contacted debit will remain and a maximum of 0.20% for contactless debit

- 3.35 We consider the current 0.0% rate to be appropriate for contacted debit, since contacted debit payments routed via the Eftpos network (switch to issuer) incur no interchange fee.

⁵¹ For example - Visa "Response to the Commerce Commission's consultation on Costs to businesses and consumers of card payments in Aotearoa New Zealand" (2 September 2024) p16 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁵² Dr W Bolt "The Retail Payment System in New Zealand – Efficiency, pricing and competition" (December 2023). Dr A Fletcher "Literature Review on Competition, Efficiency and surcharging in the Retail Payment System" (November 2023). Both papers available at <https://comcom.govt.nz/regulated-industries/retail-payment-system#projecttab>.

⁵³ ANZ "Consultation on costs to businesses and consumers of card payments in Aotearoa New Zealand" para 12. BNZ "Response to Retail Payment System - Costs to businesses and consumers of card payments in Aotearoa New Zealand" (2 September 2024) para 2.2-2.3. Available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁵⁴ TSB "Consultation Paper: Retail Payment System - Costs to businesses and consumers of card payments (2 September 2024) pg2. Kiwibank "Submission to the Commerce Commission" (3 September 2024) paras 2c and 10-13. The Cooperative Bank "Consultation on Costs to businesses and consumers of card payments" (2 September 2024) p1.

⁵⁵ Dr W Bolt "On the NZ Commerce Commission Consultation Paper "Retail Payment System - Costs to Businesses and consumers of card payments in Aotearoa NZ" (November 2024).

- 3.36 We consider 0.20% to be an appropriate base rate of interchange fees for other domestic in-person transactions. This is a market selected rate in New Zealand and is consistent with a range of international benchmarks.⁵⁶ New Zealand has had a rate of 0.20% for domestic contactless debit transactions since August 2020.
- 3.37 In determining this base rate, we looked at issuer costs and benefits of the schemes which suggest that 0.20% is an appropriate rate to continue for contactless debit card transactions. While we consulted on how best to determine interchange fees and the interchange fee base rate, we received little information and no substantive evidence through submissions.⁵⁷ We welcome further substantive quantitative evidence on this topic.
- 3.38 We did, however, receive evidence on reasons why some transaction types should incur an interchange fee varying from the base rate, supporting differentiated interchange fees. We have examined this evidence from submitters and considered international comparators to determine appropriate rates for different types of transactions, and where rates should vary.⁵⁸

Considering issuer costs in determining appropriate levels of interchange

Consideration of card issuer fraud costs

Lower interchange fees are unlikely to have a material impact on fraud protection and are unlikely to materially increase losses to fraud across the retail payment system. We welcome substantive quantitative evidence suggesting otherwise.

- 3.39 Because both the costs of fraud and the benefits of fraud prevention are faced by multiple parties, it is reasonable that anti-fraud investment is paid for by the same parties. As one of those parties, issuers have an incentive to invest in fraud prevention, not only to reduce their own fraud losses, but also to maintain the reputation and integrity of their payment product, independent of interchange revenue.

⁵⁶ See **Table 3.1** for comparator regulated interchange fee rates in other jurisdictions and proceeding paragraphs. The European Union has a rate of 0.20% for all domestic debit transactions and in-person debit transactions. See Regulation (EU) 2015/751 of the European Parliament and of the Council available at <https://www.legislation.gov.uk/eur/2015/751/body#> CASE COMP/39.398 - VISA EUROPE "Commitment offered to the European Commission pursuant to Article 9 of Council Regulation (EC) No 1/2003" (15 November 2013) available at https://ec.europa.eu/competition/antitrust/cases/dec_docs/39398/39398_9729_3.pdf.

⁵⁷ The submission provided by the New Zealand Initiative proposed a cost-benefit analysis approach to determining interchange fee rates. The New Zealand Initiative "Submission by the New Zealand Initiative to the Commerce Commission on the Consultation Paper Retail Payment System" (28 August 2024) para 4.6 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁵⁸ The rate of 0.20% for debit is in line with multiple comparator jurisdictions as shown in **Table 3.1**.

- 3.40 In addition to this, we have not found sufficient evidence to suggest the interchange fee is directly related to investment in fraud prevention and anti-fraud innovation by issuers.⁵⁹ Regarding a reduction in interchange revenue, issuers also may recover their fraud prevention costs through other fees and revenue sources, ie, investment in fraud prevention does not need to, and does not appear to, entirely come from interchange revenue.
- 3.41 Therefore, we believe that lower interchange fees that we have proposed are unlikely to have a material impact on investment in fraud prevention and are unlikely to materially increase losses to fraud across the retail payment system. We welcome substantive quantitative evidence suggesting otherwise.

Considering the benefits of Mastercard and Visa cards

Comparative benefits of avoiding (wholly or partially) the cost of physical cash handling

- 3.42 The comparative benefit of Mastercard and Visa payment products over physical cash was raised in submissions received, with supporting evidence provided.⁶⁰
- 3.43 Evidence suggests the cost to merchants of a physical cash payment is higher than all other widely accepted payment methods per transaction.⁶¹ However, merchants are seldom able to recover this higher payment cost through surcharging due to the nature of cash transactions. Therefore, transactions which incur a merchant service fee are generally lower cost to merchants than transactions with physical cash. However, for domestic in-person payments, the Eftpos network also allows merchants to avoid the cost of physical cash handling.

⁵⁹ We received multiple submissions from issuers stating that revenue from interchange fees is used for general issuing costs, including investment in fraud prevention, but no substantive evidence proving a direct relationship was provided. International research has also failed to find a direct relationship between interchange fee revenue and investment in fraud prevention. See Payment System Regulator "Market review of UK-EEA consumer cross-border interchange fees" (December 2023) p6 available at <https://www.psr.org.uk/media/au4km234/xbif-interim-report-public-dec-2023-eu.pdf>.

⁶⁰ Financial Services Federation "Re: Retail Payment System: Consultation on costs to businesses and consumers of card payments in Aotearoa New Zealand" p3 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁶¹ Our analysis based on evidence received from submissions.

Comparative benefit of providing a more efficient payment method for customers in terms of time and effort

- 3.44 This comparative benefit broadly describes technological advancements which have made it easier for consumers to transact both online and in-person. Simpler payment methods may attract consumers to a merchant. If the payment process is made faster, transactions can be processed more efficiently, and a greater volume of transactions may be made possible for the merchant. For example, this benefit would apply to contactless payment methods compared to physical cash or Eftpos, where the card must be swiped or inserted and the pin entered.
- 3.45 The comparative benefits of Mastercard and Visa cards compared to cash and Eftpos support the argument for the existence of the base interchange fee rate of 0.20% and therefore the existence of a merchant service fee.
- 3.46 Different payment products provide different levels of benefit to merchants and consumers. When determining a reasonable level for an interchange fee, it is important to consider what benefits are experienced by the parties who pay interchange fees, or fees which are connected to interchange fees.
- 3.47 Reasonable interchange fees should reflect the value merchants receive from accepting card payments, including savings from not having to offer their own credit services. When features like fraud prevention benefit both merchants and consumers, these costs should be appropriately split between interchange fees and consumer charges.

Where interchange fee rates should not differ and why

Credit and debit transactions should be treated the same for interchange fees

No premium on interchange fee rates for credit transactions

- 3.48 We consider the difference in costs between credit and debit transactions to be small per transaction. We note credit and debit card transactions have different cost structures due to differences in their risk profiles for issuers (higher risk for credit than debit) and different costs associated with operating the payment products and services.⁶² The revenue from credit and debit products is also different for issuers, reducing the cost difference and possibly reversing it in some instances.

⁶² Dr W Bolt "The Retail Payment System in New Zealand – Efficiency, pricing and competition" (December 2023) section 3.2 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

- 3.49 We are proposing to reduce interchange fee rates for credit transactions by a greater margin than debit transactions. Therefore, we expect any subsequent changes to annual card fees and other charges to offset interchange fee revenue reduction and recover costs, including fraud prevention, to more likely be associated with credit payment products than debit. We acknowledge submissions from issuers on potential complexities in recovering business costs for credit products.⁶³
- 3.50 We consider the efficiency gains in the retail payment system from having the same interchange fee caps for credit and debit would be substantial. This is due to the reduced variability of fees in a large section of the Mastercard and Visa card networks.
- 3.51 As credit cards allow consumers to defer payments and smooth their consumption, they are a more valuable product to consumers, in theory, than other payment products which require funds to be available (eg, debit, Eftpos or physical cash). This means merchants benefit from not having to provide credit to consumers themselves and they avoid the costs associated with providing such a service.
- 3.52 In deciding whether this benefit warrants a differential rate compared to debit, we considered whether consumers' ability to bring forward a retail purchase is a permanent incremental benefit for merchants from the perspective of aggregate consumption at those merchants. We also evaluated the efficiency gains from having a more simplified interchange fee structure that flows through to merchants and consumers.
- 3.53 Our view is that accepting credit permanently increases consumption at a merchant if consumers' purchase decision was solely dependent on having credit payment as an option, and the purchase would otherwise not have taken place at any point in time. We consider that the potential efficiency gains from having a simplified structure outweigh such incremental benefit for merchants. As with other consumer benefits of credit products, consumer preferences can align with their costs far more efficiently with a shift away from interchange cross-subsidisation.

⁶³ ANZ "Consultation on costs to businesses and consumers of card payments in Aotearoa New Zealand" para 3b, 10-11. Available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>. Increases in fees for personal credit payment products must comply with s 41 of the Credit Contracts and Consumer Finance Act 2003.

- 3.54 We have also considered the argument that credit products are more valuable to merchants due to their larger average transaction size compared to debit cards. Our view is that the size effect of transactions is captured by the ad valorem fee structure. This leads to interchange fees proportionate to the transaction size and the difference in average transaction size does not provide a strong argument for a higher level for credit compared to debit.
- 3.55 We also considered the potential loss or reduction of benefits specific to credit cardholders beyond the provision of credit itself, such as reward scheme points and travel insurance.⁶⁴ While this constitutes a potential cost of regulation to consumers, we do not believe it exceeds the benefits of reducing interchange.
- 3.56 We consider this would be a more efficient outcome for the retail payment system, as credit cardholders could pay directly for their preferred services which are currently funded by other fees and revenue sources. This currently includes cross-subsidisation from non-credit cardholders through higher retail prices and surcharge rates aligned to cost of credit acceptance.⁶⁵
- 3.57 We acknowledge the New Zealand Initiative submission promoting the rationale for a cost-benefit analysis approach to setting interchange fees at the optimal levels.⁶⁶ The paucity of quantitative evidence received has meant judgements are required and qualitative information has been considered in weighing the costs and benefits in determining whether our decisions are in line with the purpose statement of the Act.

⁶⁴ We received submissions from card issuers concerned about the impact of benefits for cardholders. For example, Kiwibank "Submission to the Commerce Commission" (3 September 2024) para 6-7; ASB "Consultation on costs to businesses and consumers of card payments in Aotearoa New Zealand" p7. Both available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁶⁵ Dr W Bolt "The Retail Payment System in New Zealand – Efficiency, pricing and competition" (December 2023) section 4.3. Dr A Fletcher "Literature Review on Competition, Efficiency and surcharging in the Retail Payment System" (November 2023) section 3.4. Both papers available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁶⁶ The New Zealand Initiative "Submission by the New Zealand Initiative to the Commerce Commission on the Consultation Paper Retail Payment System" (28 August 2024) para 4.6 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

*Commercial transactions do not warrant premium interchange fee rates***No premium on interchange fee rates for commercial transactions**

- 3.58 While we acknowledge the different dynamics in the commercial payment space compared to personal payment services, we do not believe there is sufficient evidence to justify different fees between commercial and personal card transactions.⁶⁷
- 3.59 We accept there may be additional costs in value-added services provided to commercial customers, but these can be separately charged for. This separation of fees has the potential to increase efficiency, through the avoidance of implicit cross-subsidisation from non-commercial cardholders and promote competition on these services by giving greater transparency to these costs.
- 3.60 Personal credit products are also subject to the Credit Contracts and Consumer Finance Act 2003 rules for card fees, while commercial credit products are not. This means issuers of commercial credit products can recover costs more easily through sources other than interchange.

Where interchange fee rates should differ and why*Online transactions warrant higher interchange rates than in person transactions***Propose a premium for domestic online transactions of 0.20%**

- 3.61 We consider a premium of 0.20%, additional to the base rate of 0.20%, for online transactions is appropriate to take account of the higher cost of online fraud protection.⁶⁸ A significant proportion of attempted fraud transactions are online and other card not present transactions.⁶⁹ This incurs greater costs on the card issuer due to the higher investment in anti-fraud technology and innovation required, and the higher cost of screening transactions which are inherently of higher risk.

⁶⁷ Visa "Response to the Commerce Commission's consultation on Costs to businesses and consumers of card payments in Aotearoa New Zealand" p21-22 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁶⁸ Submissions from banks noted that online transactions have higher instances and therefore higher cost of fraud. See ASB "Consultation on costs to businesses and consumers of card payments in Aotearoa New Zealand" p7; ANZ "Consultation on costs to businesses and consumers of card payments in Aotearoa New Zealand" para 49. Both available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁶⁹ Our analysis based on data received from submissions.

- 3.62 Our draft decision of an interchange fee rate cap of 0.40% for domestic credit and debit online transactions is partially based on international benchmarks and comparable rates in other jurisdictions (such as the European Union rate of 0.30% as shown in **Table 3.1**).
- 3.63 We have also used our judgement to reach this online premium due to a lack of substantive evidence provided in submissions on the costs of fraud prevention specific to online transactions. We would welcome further evidence on this topic.

Foreign-issued cards warrant higher interchange rates than domestically issued cards

Propose a premium for foreign-issued cards used at New Zealand merchants of 0.40% for in-person and 0.75% for online

- 3.64 A premium above the base rate for transactions in New Zealand using foreign-issued cards is appropriate. Transactions made with foreign-issued cards are subject to an approximately five-times higher incidence of fraud and higher costs associated with preventing fraud than domestically issued cards.⁷⁰
- 3.65 As with other payment products, online transactions are subject to a substantially higher incidence of attempted fraud. Therefore, the premia for in-person and online transactions using foreign-issued cards differ substantially.
- 3.66 Utilising a payment product which is accessible to as many consumers as possible is a benefit to merchants. By allowing merchants to accept payments from international consumers who are either transacting online or in-person as international visitors, a certain payment product would provide the merchant the benefit of a larger potential customer base.
- 3.67 International customers also have fewer viable alternative payment methods, meaning foreign-issued cards provide a comparative benefit to their cardholders.⁷¹ This may justify higher downstream costs and a higher cardholder willingness to pay.

⁷⁰ Our analysis based on data and evidence received from submissions.

⁷¹ Merchant survey responses noted some merchants who have higher international customer bases face higher merchant service fees but also need to be able to accept foreign-issued cards. See "Summary of business and consumer feedback received via online survey – Costs to businesses and consumers of card payments" (14 November 2024) p2.

- 3.68 Multiple submitters raised concerns that the proposed caps on cross-border interchange fee rates would have a detrimental impact on foreign-based payment acceptance (decline rates) and international trade, especially due to the relatively small size of the New Zealand market. However, we consider our proposed rates for international interchange fees are unlikely to be substantially detrimental in the ways suggested by submitters, due to our rates being in-line with comparator jurisdictions. Expert advice from Dr Bolt also describes scale, pertaining to the small New Zealand market, to have a limited influence on cross-border acceptance.⁷²
- 3.69 Our proposed rates of 0.60% for in-person and 1.15% for online transactions respectively, is based on the international benchmarks of Australia and the European Union (see **Table 3.1**) and estimates of current international interchange rates. We acknowledge these rates are higher than several international comparators, but we also consider New Zealand to be a smaller market and believe we have struck the right balance. We used our judgement to reach these premia due to a lack of substantive evidence received from stakeholders and welcome further evidence in this area.

Prepaid transactions are currently too immaterial to warrant regulation and cost of regulation may exceed benefits

- 3.70 Domestic prepaid payment products often act as a gateway product for fintechs, new entrants and the underbanked. Therefore, the potential cost of erroneously deterring the issuing of domestic prepaid payment products, through a reduction in interchange, could be high, and competition and innovation may be detrimentally impacted.⁷³
- 3.71 The level of underlying cost structures for transactions made with domestic prepaid cards remain unclear compared to other payment products. Some submitted evidence which suggests issuing costs are higher for domestic prepaid products than debit.

⁷² Dr W Bolt - The Retail Payment System in New Zealand - Efficiency, pricing and competition (December 2023) section 3.2-3.3 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁷³ Dosh "Commerce Commission - Interchange" (26 August 2024) p4, Sharesies "Sharesies submission on Retail Payment System - Consultation paper" p2. Both available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

3.72 Due to the small share of total transaction value and volume, and the diversity of products within this category, we consider introducing a cap on interchange fees for domestic prepaid transactions may not necessarily yield efficiency gains to the extent necessary for regulatory intervention. Nor would these efficiency gains be likely to outweigh the potential detriment to the promotion of competition that regulating prepaid interchange fees could cause. By leaving this payment product unregulated, we also considered the potential for issuers to increasingly move to domestic prepaid, which we will monitor.

Consideration of other card issuer costs

3.73 Net issuer scheme fees may be higher in New Zealand than other comparator jurisdictions.⁷⁴ Currently the interchange fee regulation partially limits the ability for schemes to provide further rebates and discounts. This draft decision proposes to change this, by instead requiring that an issuer's benefits from the scheme cannot exceed an issuer's payments to the scheme.

3.74 The schemes can reduce an issuer's scheme fees, subject to an upper limit dictated by the value of the issuer's payments.⁷⁵ However, we do not expect this to be funded in increases in acquirer scheme fees.

3.75 We acknowledge that there are costs for issuers for card payments made using Apple Pay. However, these costs were incurred when 0.20% for contactless debit was agreed by Mastercard and Visa in August 2020.⁷⁶ We understand these costs are not incurred on all mobile wallets. Possible reductions in interchange fee revenue for card issuers may prompt engagement with Apple Pay as to the level of its mobile wallet fees.

3.76 Submitters also raised card issuance and currency costs for international payments as substantive costs for issuers. However, due to a lack of evidence in these areas, we consider that these costs are unlikely to justify substantive changes to interchange fee rates. We welcome further evidence on these topics.

⁷⁴ Fees paid by card issuers to Mastercard and Visa minus rebates and discounts.

⁷⁵ This is discussed further in **Chapter 4**.

⁷⁶ Inside Retail "Retail body welcomes reduction in card fees" (4 August 2020) available at <https://insideretail.co.nz/2020/08/04/retail-body-welcomes-reduction-in-card-fees>.

Flat rate fees that are lower than equivalent percentage rates, including strategic merchant interchange fee rates, will remain

- 3.77 We observe that flat fee rates are often determined at industry or merchant level. We also received submissions that compared strategic merchant rates to volume discounts.⁷⁷ Mastercard and Visa explained that strategic merchant rates are offered to support adoption of latest technologies.⁷⁸ Our current view is that both merchants and consumers benefit from these lower fees agreed between the networks and merchants.
- 3.78 We recognise that wholesale volume discounts can limit competition between retailers of different sizes. However, we have no evidence that this is currently a competition concern, and we can reassess if evidence of this nature does arise.

⁷⁷ Westpac "Submission to the Commerce Commission on Retail Payment System: Costs to businesses and consumers of card payments in Aotearoa New Zealand" (2 September 2024) para 5.4; ANZ "Consultation on costs to businesses and consumers of card payments in Aotearoa New Zealand" para 43. Both available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁷⁸ Mastercard "Mastercard response to Commerce Commission consultation: Retail Payment System" (2 September 2024) p27; Visa "Response to the Commerce Commission's consultation on Costs to businesses and consumers of card payments in Aotearoa New Zealand" (2 September 2024) p19. Both available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Chapter 4 A new anti-avoidance provision and proposed implementation

Purpose of this chapter

- 4.1 This chapter considers our draft decisions on the mechanics of the proposed pricing standard, including:
- 4.1.1 the proposed anti-avoidance mechanism, ensuring the benefits of the interchange fee caps are not circumvented;
 - 4.1.2 the proposed implementation period; and
 - 4.1.3 other changes which aid the clarity and effectiveness of the proposed standard.
- 4.2 The proposed pricing standard has been published alongside this paper.⁷⁹

Anti-avoidance provision - our proposed new approach

The purpose of the anti-avoidance provision

- 4.3 The purpose of the anti-avoidance mechanism is to ensure that a reduction in an issuer's interchange fee revenue is not compensated by Mastercard or Visa at the expense of acquirers (and ultimately merchants). It is therefore intended to reduce the risk of an interchange-like flow of value which undermines the long-term benefits of interchange regulation for merchants and consumers.

Our proposed new anti-avoidance approach

- 4.4 We propose a new anti-avoidance approach which requires that, for each reporting period, Mastercard and Visa may not permit or arrange for an issuer to receive more in benefits and other incentives than that issuer pays in scheme and other fees to Mastercard or Visa.⁸⁰ We consider this approach lessens possible stifling of competition between Mastercard and Visa for issuer business (which may be occurring under the current anti-avoidance mechanism) whilst still limiting circumvention of interchange fee regulation.

⁷⁹ See Commerce Commission "[Draft] Mastercard and Visa Interchange Fee Network Standard 2025" (18 December 2024) available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁸⁰ We have proposed the reporting period be the 12-month period ending 30 June, but that this differs for (a) the initial reporting period which will be less than 12-months; and (b) any new issuer or issuer which has switched schemes, who will have a longer initial reporting period.

- 4.5 Our proposed anti-avoidance mechanism is largely based on the approach taken in Australia.⁸¹ We see benefit in more closely aligning our anti-avoidance approach to Australia given the familiarity of key participants with the Australian obligations.
- 4.6 Our proposed approach requires that the benefits provided by a scheme to an issuer may not exceed the payments made by the issuer to the scheme. This requires us to define 'issuer benefits' and 'issuer payments'.
- 4.6.1 **Issuer benefits:** We propose broadly defining issuer benefits as those benefits provided by the scheme to the issuer which have the purpose or effect of incentivising certain issuer behaviour, such as benefits that incentivise the issuance or marketing of a scheme's cards.
- 4.6.2 **Issuer payments:** We propose limiting issuer payments to schemes to those that relate to the scheme's provision of 'core services'. This is intended to be narrowly defined to those services which are fundamental to card-issuing to ensure that the value of these payments is not artificially inflated to enable a greater provision of benefits to issuers.
- 4.7 This approach introduces a 'ceiling' which allows for the provision of additional benefits to issuers (such as scheme fee reductions) but limits this to the value of an issuer's payments. In further reducing interchange fees, Mastercard and Visa may wish to lower net issuer scheme fees to maintain incentives. This proposed change may enable Mastercard and Visa to compete more aggressively for issuing business without having to be concerned about falling foul of the net compensation provision.
- 4.8 It also provides greater certainty for regulated parties as the assessment of compliance is a clearer mathematical exercise, and limits unintended impacts of unduly stifling arrangements between schemes and issuers.⁸² Some submitters advised that this mathematical approach reduces compliance risks and improves our ability to monitor and enforce.⁸³

⁸¹ See, for example, clause 5 of the Australian Standard No.1 of 2016 "The Setting of Interchange Fees in the Designated Credit Card Schemes and Net Payments to Issuers" available at <https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/pdf/standard-no-1-of-2016-credit-card-interchange-2018-05-31.pdf>.

⁸² Mastercard raised the advantages of a mathematical approach whilst also noting risk with the current anti-avoidance provision. See Mastercard "Mastercard response to Commerce Commission consultation: Retail Payment System" (2 September 2024) p34 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁸³ Visa noted that the current provision is overly complex and risks limiting competition as a result of inconsistent application. See Visa "Response to the Commerce Commission's consultation on Costs to businesses and consumers of card payments in Aotearoa New Zealand" p30 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Treatment of new and switching issuers

- 4.9 We have proposed allowing for 'new issuers' and 'switching issuers' to have a longer initial reporting period for which their benefits and payments can be apportioned and assessed for compliance with the anti-avoidance mechanism.
- 4.9.1 We have defined a 'new issuer' as an issuer that, prior to issuing Mastercard or Visa cards, had never issued cards of either scheme.
- 4.9.2 We have defined a 'switching issuer' as an issuer that has switched from predominately issuing cards of a scheme to predominately issuing cards of the other scheme.
- 4.10 This approach recognises that:
- 4.10.1 new issuers are likely to experience low transaction volumes in the early stages of card issuing, which means a lower level of scheme and other transaction-based fees; and
- 4.10.2 the schemes may provide greater benefits in these early stages to support the entry of new issuers into the market.
- 4.11 Therefore, a new issuer's payments to the scheme may be higher than its benefits in those initial years, even after allowing for these benefits to be apportioned across reporting periods. Allowing for a longer initial reporting period enables the schemes to continue to support new issuers in their infancy.
- 4.12 Similarly, we are conscious that the schemes may compete for issuer business on the basis of lower fees or greater benefits, for example, an initial lump-sum benefit for switching. We do not want to disincentivise this behaviour (so long as those benefits are not being funded at the expense of acquirers) and consider that allowing for a longer initial reporting period for switching issuers enables the schemes to actively compete.

The current provision and its challenges

- 4.13 The current anti-avoidance mechanism seeks to limit monetary and non-monetary compensation being provided to issuers for the purpose of compensating them for the effect of interchange fee regulation. Any benefits provided for this purpose are considered 'net compensation' and included as part of the 'total interchange fee' for a transaction, which is then assessed against the applicable cap.

- 4.14 We understand that ambiguity in the current provision may deter Mastercard and Visa from reducing net scheme fees (ie, increase rebates) and limit competition between the schemes in negotiating arrangements with issuers.⁸⁴ We do not want to unduly restrict Mastercard and Visa from improving the compensation position of card issuers, so long as it is not at the expense of acquirers and ultimately merchants. The current anti-avoidance provision may be unintentionally limiting competition between the schemes.

Anti-avoidance mechanism for inbound cross-border transactions

- 4.15 We do not currently consider it practicable or appropriate to impose requirements of the kind described above on overseas issuers whose interchange fee revenue would be reduced under our draft decision. However, there is still a risk that the schemes seek to compensate overseas issuers at the expense of New Zealand acquirers and therefore merchants. For this reason, we have proposed a general anti-avoidance obligation on the schemes to limit the risk of this occurring.

We are considering information disclosure requirements on schemes

- 4.16 We will require information on issuer payments and issuer benefits in order to monitor compliance with the proposed anti-avoidance mechanism.
- 4.17 We will also need to actively monitor acquirer scheme fees to ensure these are not increasing to fund more favourable issuer compensation positions. This could involve, for example, requirements on Mastercard and Visa to disclose information on acquirer scheme fees.⁸⁵ We intend to consult on any potential information disclosure requirements in the second half of 2025.

⁸⁴ Westpac raised concern that the current provision leaves issuers uncertain as to whether they are able to receive additional payments from card schemes or other parties to address the loss of revenue as a result of the interchange cap. See Westpac "Submission to the Commerce Commission on Retail Payment System: Costs to businesses and consumers of card payments in Aotearoa New Zealand (2 September 2024) p12 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁸⁵ This is currently being explored by the Payment System Regulator in the United Kingdom. See PSR "Market review of card scheme and processing fee - Interim Report" (May 2024) available at <https://www.psr.org.uk/media/pcvem3uq/interim-report-market-review-of-scheme-and-processing-fees-may-2024-publication.pdf>.

Proposed implementation

We are seeking feedback on the revised interchange fee caps being in place by 1 November 2025

- 4.18 We are seeking feedback on an implementation period that lines up with system wide updates completed by Mastercard and Visa. We are proposing to publish our final decision and pricing standard in quarter two of 2025. Following this we expect the revised interchange fee caps to be in place by 1 November 2025. We are seeking views on the appropriateness of this timeframe.⁸⁶
- 4.19 We understand that adjustments to interchange fee caps requires a coordinated approach by many participants to ensure changes are accurate and effective across independent systems and infrastructure.⁸⁷

Proposed changes which improve the clarity and effectiveness of the pricing standard

- 4.20 We have applied insights from our market monitoring and compliance work to ensure that the proposed pricing standard is clear and workable. For example:
- 4.20.1 We have defined 'card present transactions' to explicitly include transactions at an unattended point of sale device. We consider these to be in-person/card present transactions, however, it has come to our attention that industry may not be treating these transactions in this way.
- 4.20.2 We have defined 'interchange fee' rather than referring to the definitions in the Mastercard and Visa rules. This aids regulatory certainty, as the Mastercard and Visa rules may change or apply inconsistent definitions.

⁸⁶ The initial pricing standard provided a six month implementation period.

⁸⁷ We are aware of this from our compliance and enforcement experience to date. Also raised by Visa "Response to the Commerce Commission's consultation on Costs to businesses and consumers of card payments in Aotearoa New Zealand" p29 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Chapter 5 Expected impact on merchants and consumers

Purpose of this chapter

- 5.1 This chapter provides the expected impact of this work on excessive surcharging and merchant service fees. It also notes other areas that impact merchant service fees and surcharging that are not being addressed as part of this paper but which we will be considering in future workstreams.

Expected impact on surcharge rates

- 5.2 We estimate that consumers pay up to \$150 million in surcharges each year. In comparison, New Zealand businesses pay \$1 billion in merchant service fees each year to accept Mastercard and Visa card payments.⁸⁸
- 5.3 We expect this work to impact surcharging which was raised in some of the submissions received in our July 2024 consultation paper.⁸⁹ We want to see excessive surcharging stop, regardless of any changes to interchange fee caps.
- 5.4 Our draft decision aims to reduce interchange fee levels and associated complexity. Merchants should be able to better understand their fees and set surcharges which align with their costs of accepting Mastercard and Visa card payments. If our proposed draft decision is confirmed, we expect to see average merchant service fees and surcharging rates to drop.⁹⁰
- 5.5 We consider that surcharging, whilst a point of annoyance for some consumers, is a valid part of the retail payment system as it reflects that some payment types are more costly to merchants than other payment types such as Eftpos and new account-to-account payment methods.

⁸⁸ Our analysis is based on merchant service fee data from large acquirers. Our estimate on surcharging is based on data provided by a large New Zealand terminal provider and considers transaction values from merchants that are likely to surcharge.

⁸⁹ Several submissions referred to excessive surcharge rates and the ability to accurately surcharge. For example Retail NZ "SUBMISSION on the Commerce Commission's 'Retail Payment System – Costs to businesses and consumers of card payments in Aotearoa New Zealand: Consultation Paper" (2 September 2024) p2-3 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁹⁰ Restaurant Association advised that most merchants would reduce or remove surcharges if the merchant service fees were reduced, depending on the rate to which they are lowered. Restaurant Association "Restaurant Association of New Zealand submission to the Commerce Commission New Zealand" (September 2024) p2 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

- 5.6 While we recognise that there exists a merging of technology and convenience in payments, our position remains that, for in-person payments, consumers should be offered a surcharge-free option. Where a merchant is unable or unwilling to provide a surcharge-free option (such as Eftpos) the payment should not attract a surcharge.⁹¹

Addressing excessive surcharging

**We expect to consult on surcharging regulation in 2025.
Some surcharging rates are currently too high and this is driving approximately
\$45-65 million annually in excessive surcharging.**

- 5.7 Given the extent of excessive surcharging currently, it seems likely that some form of surcharging regulation will be needed. We expect to consult on surcharging regulation in the new year.
- 5.8 Possible options to address excessive surcharging may include:
- 5.8.1 a maximum surcharge based on average merchant service fees;
 - 5.8.2 a maximum surcharge based on average merchant service fees unless merchants display a certificate from their acquirer setting out their own average merchant service fee (in which case they could surcharge up to that rate), such certification must be renewed periodically;
 - 5.8.3 any surcharge to require the display of a certificate from the business' acquirer documenting the business' average merchant service fee (in which case the surcharge could be up to that rate); and
 - 5.8.4 a requirement for terminal providers to sight evidence of a merchant's average merchant service fee prior to uploading a surcharging rate higher than the average and to not allow a surcharge greater than that to be charged.⁹²
- 5.9 We welcome feedback on these or other practical and enforceable options to address excessive surcharging.

⁹¹ Commerce Commission "Appropriate payment surcharging explained" (July 2023) available at <https://comcom.govt.nz/regulated-industries/retail-payment-system/surcharging>.

⁹² Retail NZ advised that of those that surcharge, 79% set their own surcharge rate, while 18% allow their terminal provider to set the rate. The remaining 3% indicated "other" possibly because they did not know. Retail NZ "Retail Payment System Consultation: Costs to Business and Consumers of Card Payments" (2 September 2024) available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Expected impact on merchant service fees

We expect all acquirers and payment service providers to reduce merchant service fees, including blended pricing plans, if the proposals are implemented.

- 5.10 We observed approximately 90% pass-through following the implementation of the initial pricing standard.⁹³ We expect merchants to see significant cost saving benefits from our proposed interchange fee regulation.
- 5.11 We expect acquirers and payment service providers (such as online shopping cart providers like Shopify) to reduce merchant service fees following the reduction of interchange fees, irrespective of the pricing plan a merchant is on. We also expect merchants to be provided with information notifying them of a reduction in their pricing plans, as we observed from many acquirers in the implementation of the initial pricing standard.
- 5.12 We will be monitoring the pass through of interchange fee reduction to lower merchant service fees. To increase pricing transparency, we may also consider publishing information on the degree to which each acquirer and payment service provider passes through these savings to merchants.

Other areas that impact merchant service fees

- 5.13 This section considers other issues that impact merchant service fees which are not being dealt with through further interchange fee regulation. However, we will be looking to address these in future workstreams.

Merchant understanding of their merchant service fee is still a problem

- 5.14 Various submissions mentioned the challenges with transparency and merchant understanding of their merchant service fees.⁹⁴ While we consider that our draft decision, if ultimately implemented, would go some way to dealing with this issue, we note the limitations of our proposed interchange fee regulation on the merchants' understanding of their fees. We are considering further work to increase transparency of merchant service fees for merchants and consumers in understanding what an excessive surcharge rate is.

⁹³ Our analysis is based on merchant service fee data received from acquirers which indicates a pass-through rate of 90%.

⁹⁴ Restaurant association noted its members are confused by the fees that they are charged. Restaurant Association "Restaurant Association of New Zealand submission to the Commerce Commission New Zealand" p4 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Small merchants still pay disproportionately higher merchant service fees

- 5.15 On average, smaller merchants pay higher merchant service fees than larger merchants. We encourage merchants to shop around; some acquirers are charging below 1.5% on average for the smallest businesses while others are above 2.5%.⁹⁵ While some of the difference will depend on the predominant transaction type (eg, online or in person), we still observe significant differences between acquirers with similar merchant profiles.

How merchant pricing impacts pass through and transparency

Unblended merchant service fees

- 5.16 Unblended merchant service fee pricing (also known as interchange plus or interchange plus plus pricing) charges the merchant the interchange fee plus an acquirer margin. As noted by ANZ, this pricing is dynamic by nature and merchants would see cost reductions immediately following any reduction in interchange fee rates.⁹⁶
- 5.17 The advantage of this pricing plan is that the merchant service fee is more closely aligned to the cost of the transaction. However, it also reflects the complexity of interchange fees which impacts merchants' ability to understand their costs and shop around.⁹⁷

Blended merchant service fees

- 5.18 Merchants on blended pricing will be better able to compare and switch acquirers and surcharge appropriately. However, currently this pricing will be less aligned to the cost of the transaction and could mean these merchants are paying more than what they need to.

⁹⁵ Based on our analysis of information provided by acquirers in our ongoing monitoring for businesses that receive less than \$100,000 in payments on Mastercard and Visa networks.

⁹⁶ ANZ "Consultation on costs to businesses and consumers of card payments in Aotearoa, New Zealand - ANZ Bank New Zealand Limited Submission" (2 September 2024) p15 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

⁹⁷ Restaurant Association advised that 54% of its members are on an unblended or interchange plus pricing plan, 32% have a blended plan and 14% did not know their merchant service fee pricing plan. See Restaurant Association "Restaurant Association of New Zealand submission to the Commerce Commission New Zealand" (September 2024) para 13 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Merchant services provided in exchange for the merchant service fee vary significantly

5.19 Different acquirers provide various types of acquiring service and offerings.⁹⁸ This differentiation in merchant service offerings can be an important aspect of competition. However, the variability in what is offered in exchange for the fee is not clear for the merchant. This impacts a merchant's ability to determine what they need, compare, and switch providers.

Scheme fees are high and complex

5.20 Scheme fees are the second largest component of the merchant service fee which also drive undue complexity and opaqueness of the merchant service fee. We are concerned about the complete lack of transparency related to these fees and the limited competitive constraints on these.

5.21 Initial monitoring suggests that these fees differ considerably between Mastercard and Visa. We will continue to monitor these fees and provide further transparency of other components of the merchant service fee in future work.

Other barriers in the acquiring market that impact competition

5.22 There are other barriers in the acquiring market that are impacting competition. These include merchant contract length and rollover provisions, token portability, penalty rates for use of non-bundled providers and concerning payment service provider conduct that has been brought to our attention.⁹⁹ This paper does not address these other barriers. However, we will be looking to address these in future work.

⁹⁸ For example, some acquirers blend gateway services into their merchant service fee and others do not.

⁹⁹ As outlined in our consultation paper. See Commerce Commission "Costs to businesses and consumers of card payments in Aotearoa, New Zealand: Consultation paper" (23 July 2024) para 3.22 available at <https://comcom.govt.nz/regulated-industries/retail-payment-system>.

Attachment A Our legal framework

Purpose of this chapter

A1 This attachment sets out the framework under the Retail Payment System Act 2022 (the Act) that the Commission has applied in considering whether, and on what terms, to propose the draft pricing standard.

Overview of the Act

A2 The purpose of the Act is to promote competition and efficiency in the retail payment system for the long-term benefit of merchants and consumers in New Zealand.¹⁰⁰ The Act gives the Commission a range of functions and powers which must be carried out for the statutory purpose, including:

A2.1 recommending a network is designated;

A2.2 regulating designated networks and their participants through issuing network standards and/or giving directions relating to network rules;

A2.3 issuing merchant surcharging standards;

A2.4 market monitoring and disseminating information; and

A2.5 investigating, compliance monitoring and enforcement.

Meaning of key terms

Retail payment system, networks and participants

A3 The retail payment system is the system comprising all retail payment networks. A retail payment network (**network**) means all participants, arrangements, contracts, and rules that facilitate a class of retail payment.¹⁰¹

¹⁰⁰ Retail Payment System Act 2022, s 3.

¹⁰¹ Retail Payment System Act 2022, s 7.

- A4 A participant of a **network** means either a person that:
- A4.1 **Network operator** – is wholly or partly responsible to the participants (or any of them) for the network rules and/or operates or manages the network or the core infrastructure of the network;¹⁰² or
- A4.2 **Service provider** – provides or facilitates the provision of payment services in the network (for example, a payment or an infrastructure service provider), but does not include a merchant.

Merchants and consumers

- A5 A consumer is defined as a person (including any individual or business) that acquires goods and services from a merchant.¹⁰³ A merchant means a supplier (within the meaning of the Fair Trading Act 1986) of goods or services.¹⁰⁴ In this paper, we use the terms “businesses” and “merchants” interchangeably and these terms include entities such as the Crown, individuals, and sole traders.
- A6 Under these definitions a business is a ‘consumer’ when it acquires goods and services from a merchant (ie, in a business-to-business transaction).

Competition and efficiency

- A7 We have interpreted ‘competition’ to refer to “workable or effective competition” (as defined in the Commerce Act 1986) rather than the theoretical concept of perfect competition.
- A8 While the High Court acknowledges that there is no consensus on the precise conditions that define workable competition, it provided the following practical formulation:¹⁰⁵

[14] A workably competitive market is one that provides outcomes that are reasonably close to those found in strongly competitive markets. Such outcomes are summarised in economic terminology by the term “economic efficiency” with its familiar components: technical efficiency, allocative efficiency and dynamic efficiency. Closely associated with the idea of efficiency is the condition that prices reflect efficient costs (including the cost of capital, and thus a reasonable level of profit).

¹⁰² In the context of the initial designated networks, the subject of this draft decision: (a) Mastercard International Incorporated has been designated as the network operator of the Mastercard credit and debit networks; and (b) Visa Worldwide Pte. Limited has been designated as the network operator of the Visa credit and debit networks.

¹⁰³ Retail Payment System Act 2022, s 7.

¹⁰⁴ Retail Payment System Act 2022, s 7. The Fair Trading Act 1986 defines a supplier as a person who (a) supplies goods by way of gift, sale, exchange, lease, hire or hire purchase; or (b) provides, grants or confers a service.

¹⁰⁵ Wellington International Airport Ltd & Ors v Commerce Commission [2013] NZHC 3289, at [14]-[18] and [22]-[23].

[15] [T]he practical context is the existence of sufficient rivalry between firms (sellers) to push prices close to efficient costs. The degree of rivalry is critical. In a workably competitive market no firm has significant market power and consequently prices are not too much or for too long significantly above costs.

[16] These terms are admittedly not precise. No two markets are the same and no single market stays the same. Whether workably competitive conditions exist is a judgement to be made in the light of all the information available, rather than something that can be ascertained by testing whether certain precise conditions are satisfied.

[...]

[18] In our view, what matters is that workably competitive markets have a tendency towards generating certain outcomes. These outcomes include the earning by firms of normal rates of return, and the existence of prices that reflect such normal rates of return, after covering the firms' efficient costs.

[...]

[22] In short, the tendencies in workably competitive markets will be towards the outcomes produced in strongly competitive markets. The process of rivalry is what creates incentives for efficient investment, for innovation, and for improved efficiency. The process of rivalry prevents the keeping of all the gains of improved efficiency from consumers, and similarly limits the ability to extract excessive profits.

[23] Indeed, the term "workably competitive markets" means markets in which these tendencies are seen. The more those tendencies are seen in a market, the more the market can be regarded as workably competitive. And of course, the more competitive the market, the more those tendencies will be seen.

A9 We have interpreted 'efficiency' as a reference to 'economic efficiency' – which is, as set out in the judgment above, considered to be an outcome of workable competition. Economic efficiency encompasses three components:

- A9.1 **Productive efficiency** is present when producers use inputs in such a manner as to minimise costs, subject to technological constraints;
- A9.2 **Allocative efficiency** occurs when resources are allocated within the economy to the uses in which they have the highest value; and
- A9.3 **Dynamic efficiency** refers to decisions made over time and includes decisions relating to investment and/or innovation that can improve productivity as well as the range and quality of services.

Commission’s powers to issue network standards

- A10 The Commission may issue network standards imposing requirements on designated networks and participants in those networks.¹⁰⁶ The Mastercard and Visa credit and debit networks are initially designated, which means that the Commission may exercise its powers to issue network standards applying to these networks and any participants in those networks.
- A11 A network standard may deal with or otherwise relate to one or more of the matters listed in s 20(1) which broadly relate to information disclosure, pricing and access to network infrastructure and services. Most relevantly to this paper, a pricing standard may address pricing for payment services, including pricing principles, limits on fees and pricing method requirements.¹⁰⁷

Powers to revoke and replace the initial pricing standard

- A12 Schedule 1 of the Act sets an initial pricing standard which regulates interchange fees on the Mastercard and Visa credit and debit networks. The Commission may issue a pricing standard to replace the initial pricing standard in respect of all or any of the initial designated networks, with effect no earlier than 13 November 2022.¹⁰⁸

Mandatory considerations for issuing a pricing standard

- A13 The Commission is required to take account of several factors (referred to as ‘**mandatory considerations**’) in deciding whether, and on what terms, to issue a pricing standard. The mandatory considerations are:
- A13.1 whether issuing the pricing standard will achieve the purpose of the Act;
 - A13.2 the statutory principles; and
 - A13.3 the section 18 criteria.

How we meet the purpose of the Act

- A14 The purpose of the Act is to promote competition and efficiency in the retail payment system for the long-term benefit of merchants and consumers in New Zealand. We consider that “to promote” in the context of the purpose statement refers to advancing or furthering the objectives of workable competition and economic efficiency.

¹⁰⁶ Retail Payment System Act 2022, s 17(1)-(2).

¹⁰⁷ Retail Payment System Act 2022, section 20(1)(b). Under section 20(2), a pricing standard may relate to both fees and to payments having an equivalent object or effect to fees.

¹⁰⁸ Retail Payment System Act 2022, clause 9(1) of Schedule 1.

- A15 However, competition and efficiency are not objectives in themselves. Rather they are promoted for and to the extent that this is for the long-term benefit of merchants and consumers.
- A16 We must therefore consider how our decisions to promote competition and efficiency in the retail payment system would be likely to impact the long-term interests of merchants and consumers.
- A17 While the process of competition is assumed to promote efficient outcomes (such as cost minimisation, efficient allocation of scarce resources, and greater innovation) there may be circumstances where workable competition alone may not deliver efficient outcomes which benefit merchants and consumers in the long-term. In these circumstances we may choose to directly promote efficiency which may in turn impact competition.
- A18 For example, the two-sided nature of the Mastercard and Visa networks means that an increase in competition alone could drive up interchange fees to an inefficient level to the ultimate detriment of merchants and consumers that end up bearing the cost of these fees. In these circumstances we may choose to directly promote efficiency by prescribing a price that is more reflective of efficient costs even where this may result in a lower level of competition.
- A19 The long-term benefit to merchants and consumers may therefore be achieved through a decision which promotes efficiency to a greater extent and competition to a lesser extent (or vice versa). When making our decision we are guided by our judgment as to what would better promote the long-term benefit of merchants and consumers.

A whole of system approach

- A20 The Commission is required to take a whole of system approach to promoting competition and efficiency, considering whether the decision has the net result of promoting competition and efficiency across the retail payment system and whether and to what extent this is expected to benefit merchants and consumers in the long-term.
- A21 This means we must turn our mind to competition and efficiency within the network(s) that are the subject of the decision and other networks that comprise the system, as well as how a decision impacts competition between networks.

Balancing the interests of merchants and consumers

- A22 The Act seeks to promote the long term-benefit of both merchants and consumers. In assessing these long-term benefits, we will primarily be guided by the benefits to merchants and consumers as end-users of payment services. However, it may also be appropriate to consider the net benefits to society, where doing so would not detract from the purpose of promoting the long-term benefit of merchants and consumers.
- A23 While ‘merchants’ is broadly defined, the legislative history suggests that the Act is particularly concerned with the interests of small businesses.¹⁰⁹ In assessing merchant benefit we will consider merchants as a whole but may give particular regard to the impacts to small businesses.
- A24 We are conscious that some decisions may promote the interests of consumers to a greater extent than merchants (or vice versa). In these cases, the Commission is required to apply its judgement and undertake a balancing exercise, weighing up the respective benefits to merchants and consumers.

Principles of the Act

- A25 To the extent the Commission considers them relevant, it must also take into account the following principles when exercising its functions and powers:¹¹⁰
- A25.1 merchants and consumers should pay no more than reasonable fees for the supply of payment services;¹¹¹ and
- A25.2 the retail payment system provides a reasonable degree of transparency.

Reasonable fees

- A26 What is considered ‘reasonable’ fees will depend on the particular facts and circumstances, although, the Commission will generally take into account certain factors such as:

¹⁰⁹ A key driver for the Act was high merchant service fees, which disproportionally affect small businesses. See, for example Retail Payment System Bill (80 – 2) (Economic Development, Science and Innovation Committee report), at 3. Note also that in the first reading of the Bill, Dr David Clark also made opening remarks that the regime is intended to ensure that the retail payment system “delivers long-term benefits to consumers and to small businesses or merchants” and made a number of remarks as to the specific issues facing small businesses.

¹¹⁰ Retail Payment System Act 2022, s 4(2).

¹¹¹ Payment services is broadly defined as services that facilitate retail payments. An example of a fee paid by a merchant for the supply of payment service is the payment of a merchant service fee to an acquirer for the acceptance and processing of card payments.

- A26.1 the reasonable costs of providing the payment service to the merchant or consumer;
- A26.2 a reasonable rate of return in providing the service; and
- A26.3 the benefits to the merchant or consumer of the payment service.

Transparency

- A27 The concept of 'transparency' is also not defined under the Act. At a principled level, we consider this refers to a state where information within the system is readily available, accessible, and easily understandable. The availability of information is subject to certain reasonable limits, however, including legal requirements relating to privacy and confidentiality.

Taking these principles into account in practice

- A28 The Commission is required to take account of these principles where it considers them relevant but may only do so to the extent that doing so would be consistent with the statutory purpose.
- A29 As their relevance and weight will generally depend on the extent to which they promote the statutory purpose in the context of the specific decision being made, we will exercise our judgement on a case-by-case basis.
- A30 In practice, we will first consider the relevancy of the principle to the statutory purpose in light of the function being carried out, weigh this up against other relevant factors and give the principle the weight that is appropriate in the circumstances.

Section 18 criteria for issuing a pricing standard

- A31 In deciding whether to issue a pricing standard and on what terms, the Commission must take into account whether there are any features of the retail payment network, or any conduct of participants in the network, that reduces, or are likely to reduce, competition or efficiency. This requires the Commission to consider whether:
 - A31.1 there is a competition or efficiency issue in a retail payment network, or a real potential for one to arise, that is caused by the features of the network and/or the conduct of participants of that network; and
 - A31.2 the extent to which regulation of that network through a pricing standard, including the specific terms of that standard, is likely to deal with (in whole or in part) the features or conduct at issue.