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Retail Payment System Consultation: Costs to Business and Consumers of Card Payments

Retail NZ is a membership organisation that represents the views and interests of New Zealand's retail sector. We are the peak body representing retailers across Aotearoa, with our membership accounting for 70% of all domestic retail turnover. New Zealand's retail sector comprises of approximately 27,000 businesses who employ about 220,000 people.

Retail NZ has long advocated for a more efficient and transparent retail payment system, including lower payment costs for merchants. We strongly supported regulation of the sector under the Retail Payments Act, including the Commerce Commission's role in promoting competition and efficiency within the retail payments sector. In May, we submitted in support of the Commerce Commission's proposal to designate and regulate the interbank payment network, and we were heartened by the Commission's decision to formalise that recommendation in August, in its advice to the Minister of Commerce and Consumer Affairs.

To gather member input for the consultation, Retail NZ surveyed its members in August. A total of 250 responses were received, a high number relative to other member surveys we have run, underscoring the high level of member interest in this topic. While open to all members, responses were skewed to SMEs reflecting the structure of the industry, and the higher relative impact of retail payment costs on SMEs. To complement the survey, Retail NZ held an internal workshop with interested members, and we also hosted a meeting between Commerce Commission staff and retail business representatives. The feedback collected has confirmed that retailers have an elevated level of concern with the way the retail payment system operates, and the costs it imposes on their businesses. This feedback is summarised below.

For clarity, nothing in this submission is confidential.

Overview of Position

Merchants and customers have benefited from the technological advancements in payment systems which have provided increased convenience, and speed of transaction, and want to use these technologies. We appreciate there is a cost to develop, maintain, and upgrade these technologies but are concerned that the current fees charged for payment services are measurably higher in New Zealand than relevant international benchmarks. We welcome intervention by the Commerce Commission to ensure that fees are set at a reasonable level - sufficient to support the necessary investments and provide a satisfactory return on that investment, without super-profits being made.

We support the proposal for the Commerce Commission to set much lower fee caps for the Interchange component of the designated Mastercard and Visa networks. However, interchange fees account for a little over half the total cost of Merchant Service Fees (MSF) and retailers have legitimate concerns about the cost of other components. A reduction in the interchange fees alone, will not address the overall costs that retailers pay via MSF. Retail NZ would like the Commerce Commission to regulate all components of the MSF rather than Interchange fees alone.

The current focus on Mastercard and Visa is too narrow and only partially addresses the issues faced by retailers and the flow-on effects for customers. We would like the Commerce Commission to

regulate all card scheme providers, and all payment types.

In terms of where interchange fees may be set, we do not agree that Eftpos is a suitable comparator. Due to having zero fees there has been no incentive for the industry to develop the scheme. There must be sufficient incentive for investment. On this basis the interchange fees caps for debit and credit need to be considered on their own merit.

- For debit card transactions fees, larger retailers have been able to negotiate fees on a cents per transaction basis, rather than a percentage, which we expect may better reflect providers' underlying cost structures. It is our preference that debit transaction fees are charged on a "cents per transaction" basis for all merchants rather than a fee as a percentage of transaction value. We have yet to be convinced why a uniform cents per transaction rate should not apply to all merchants.
- Higher interchange fees may be justified for credit card transactions, which have different cost drivers, including credit risk, and greater investment in security and fraud mitigation. Additionally, the funding of interest-free periods and the structure of loyalty programmes may support continuation of the percentage-based approach. Nonetheless we would like to see greater justification for the fees charged and ideally a significant reduction in line with the Commission's proposal.

As well as reductions in fee costs, Retail NZ would like to see the Commerce Commission take steps to facilitate a simplification of payment system fees charged to merchants. The current complexity makes it difficult for retailers to assess and compare the relative cost of services offered by alternate providers, and is a barrier to switching, while those that choose to apply a surcharge face difficulty calculating appropriate surcharging rates.

We continue to support retailers' legitimate right to apply a surcharge to recover payment costs. To do this accurately they require greater clarity from their acquirers about the fees they pay for different services. Greater simplification and standardisation of fee structures would assist retailers in meeting this objective, as would guidance or regulation addressing how acquirers communicate fees in their customers' bank statements.

Answers to individual questions are set out below.

Question 1: Do merchant service fee complexities drive challenges in determining whether and how merchants surcharge?

Yes!

Of those responding to the member survey, 25.6% apply a surcharging policy. Members outlined a wide range of reasons for electing to surcharge, or not, but at least some respondents said the complexity of the fee structures was a barrier to the implementation of surcharging.

The main concern of these merchants appears to be that they would not be able to accurately calculate an appropriate surcharge rate and might inadvertently overcharge their customers. Issues around legal compliance and customer welfare come to the fore here.

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.

In establishing the level of surcharge, the primary method used involves the merchant calculating a rate that covers their costs (47%). The second most common approach to setting a rate or rates is to take advice from the terminal provider (21%), while 18% rely on information from their bank statement. About 5% of merchants look at what other retailers are charging.

Qualitative responses strongly support the contention that most retailers find it challenging to understand what their costs are due to the number of different rates applied to the various cards and

transaction types and thus the complexity of their fee statements. To illustrate we include some quotes that are reflective of the broad experience and sentiment:

“Yes, it is complex, and it is very difficult to tell from the bank statements what you are paying for.”

“It’s a nightmare to try to understand and makes calculating a fair surcharge very difficult.”

“There are a range of charges depending on what type of card used, and whether the customer has the same bank as we use. It’s impossible to cover all the variations accurately, so we have settled on a very low surcharge rate that means we are losing money on most transactions but making a small gain on others - but it sure adds up (in additional costs) at our end!”

The feedback indicates that the current approach is overly complex, likely to be inefficient, and poses challenges in complying with the Act.

Retail NZ would like to see greater simplification of fees, and preferably standardisation across the sector, as well as reduced fees overall. The objective here is that those that choose to surcharge can easily calculate an appropriate surcharge rate or rates, and that all retailers are charged only fair and reasonable fees.

We support guidance or regulation addressing how acquirers communicate fees in customer bank statements. Acquirers should be required to communicate both a total aggregate rate (all payments) and separate rates for the debit & credit versions of the following transaction types: online payments, contactless payments, inserted/swiped payments, and foreign cards. Such information would facilitate better comparison of fees by acquirer and reduce barriers to switching, as well as greater accuracy in surcharges where it is applied.

Question 2: Would you consider lowering or even ceasing to surcharge if your merchant service fees were less than 1% for in person card payments?

In our survey, we asked retailers who were surcharging whether they would continue to do so if MSFs for domestic transactions reduced to around 0.70%. In this context, 44% said they would still apply a surcharge, 28% said no they would not, and 28% were unsure.

Our survey indicates that retailers have different views about the merit of surcharging to recover retail payment fees, with some believing strongly in the concept and other believing the charges are simply “a cost of business” which should be absorbed like other overheads. In the qualitative responses received the alternate views were often strongly expressed. On this basis a decision to surcharge or not to surcharge appears to be, at least to some degree, a philosophical or “values” based decision for some individual business owners. Retailer views are also likely to be influenced by their average transaction value and total transaction count i.e. whether they process large numbers of low value transactions or a smaller number of higher value ones.

In this context, lower fees may not necessarily lead to the level of reduction in surcharging that the Commerce Commission anticipates, however, our survey does indicate that a significant reduction in MSFs would lead to an overall reduction in the use of surcharging.

Among the reasons given for implementing surcharging, the following were common:

- They are the schemes and banks costs, so their customers, not retailers, should pay.
- The customer is receiving the benefit (convenience, rewards etc).
- The business cannot afford to absorb costs/can no longer afford to absorb costs.
- Contactless payments speed up transaction times at point of sale.

Among the reasons outlined for deciding not to surcharge, the following reasons were commonly referenced:

- Not wanting to upset customers with additional charges/face a customer backlash.
- Not common practice in the sector in which the business operates.
- Main competitors do not surcharge and introducing it would be a competitive risk.
- Part of a franchise group that has a policy not to surcharge.
- Do not know what an appropriate rate of surcharge would be.
- Margins are sufficiently high to cover these costs.
- Serving a customer demographic that cannot afford it.

Our member survey revealed that those adopting surcharging make more nuanced decisions around the rate of surcharge than a simple binary approach to either absorb full costs or surcharge to recover full costs. Of

those that currently surcharge, only 37% expected to fully cover their costs, with more than a third (35%) recovering less than full costs. Unsurprisingly, 27% indicated they simply did not know, underscoring the concerns raised about the challenges of accurately setting surcharge rates.

However, based on the feedback received we anticipate that reductions of the magnitude proposed would result in a reduction in the proportion of merchants that surcharge for retail payment fees. We believe it is important that retailers retain the right to surcharge and make that decision for themselves in the context of their individual circumstances.

Question 3: Is the token portability and issue in New Zealand? If yes, what is stopping the implementation of the Reserve Bank of Australia's expectation here?

Anecdotal evidence suggests the issue identified in section 3.37 of the consultation paper i.e. restrictions on the transferring of card detail tokens between acquirers, is legitimate in creating friction for merchants interested in making a switch of acquirer. Retail NZ and its members would welcome measures to reduce this friction providing it can be done in a way that does not compromise the parties' security or create significantly increased risk of fraud.

We believe there are broader reasons why merchants do not consider switching. Feedback suggests that smaller merchants may not even be aware that they have the option to deal with anyone other than their transaction bank. Measures to educate retailers, such as the factsheet produced by the Commerce Commission earlier this year are helpful but may not be highly effective. Accordingly, we now ask that the Commerce Commission to consider regulatory options. This might include making it mandatory for bank acquirers to disclose to their merchant customers that they have other options for acquiring services and requiring them to point their customers to guidance on the Commerce Commission's website before provisioning the service.

Question 4: Other evidence of issues in New Zealand retail payment system.

The issues raised in relation to interchange fees are not unique to the designated payment network. Members have raised broader concerns about other components of merchant services fees, and the costs of retail payments for non-designated networks. We note the Commerce Commission is conducting monitoring of some other parts of the retail payments sector and has said it may consider regulating in these other areas in the future. Retail NZ would like to see the Commerce Commission consulting on these issues as a matter of priority.

Areas of particular concern to retailers include: international and commercial Visa and Mastercard payments; other card schemes e.g. Amex, Union Pay etc; scheme fees; digital wallets; and Buy Now Pay Later services.

Additionally, retailers should be able to use a total blended rate for all debit and credit payments or elect to have different surcharges to reflect the underlying cost of providing the specific payment service used, noting costs vary. Currently, terminal providers may only provide the option to load a single blended rate. In this situation a retailer's surcharge will not align with the cost of providing the consumer's chosen service, rather an average of all the retailer's payment service costs, reducing the clarity of the cost signal the consumer receives. Most significantly, debit card users will be subsidising credit card users.

More nuanced surcharging would have multiple benefits, encouraging consumers to opt for lower cost options, and encouraging payment service providers to compete more strongly on the cost of their respective services. We would like the Commerce Commission to consider how it might encourage or require terminal providers to provide the functionality for multiple surcharge rates.

Question 5: What do you consider an appropriate methodology for determining interchange fee caps? What do you think best meets the purpose of the Act and how would it practically be implemented?

We believe that fees should reflect the underlying cost of providing the service, with an appropriate margin to cover future capital investment in the system and a contribution to profit which is reasonable. Currently, with the information asymmetry, it is unclear whether the current fees can be justified. International benchmarks indicate they are likely to be higher than they need to be. Merchants not prepared to accept these costs opt out of these services, reducing customer payment options, or else pass on some or all the costs to their customers.

Individual retailers have insufficient knowledge of providers costs and/or limited bargaining power to bargain effectively, and all but the largest retailers are price takers. We suspect debit card payment costs are likely to be uniform and we believe a cents per transaction fee would be more appropriate. In any event, payment service providers need to provide justification for current fees.

Questions 6-9

These questions are directed at schemes, issuers and acquirers and seek evidence to justify different rates for different businesses, card types, present/not present transactions, and New Zealand and foreign-issued cards. We are encouraged that the Commerce Commission is asking these questions and hopeful that the information will be forthcoming. From a retailers' perspective we accept that some payments may be riskier than others and warrant greater investment in fraud mitigation, but that aside, the justification for current fee structures is far from clear.

Question 19: Please provide evidence of other impacts a material reduction in interchange fees for Mastercard and Visa could have on the New Zealand retail payment system.

In response to Question 2, we indicated that different retailers can be expected to respond in different ways, however, we anticipate a reduction in surcharging overall. Further, the suggested simplification would improve the accuracy of surcharging, where retailers adopt it.

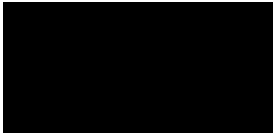
Conclusion

In conclusion, we are pleased that the Commerce Commission is looking to further regulate and lower interchange fees charged by the designated schemes, but we would like the Commerce Commission to go further and investigate regulation for all components of the MSF, and for all card schemes, and

all payment types. Additionally, we would like to see simplification and preferably standardisation of fees reporting across the various acquirers.

We thank the Commerce Commission for the opportunity to present these views and are keen to meet to discuss the various matters raised. We are also keen to discuss how we might partner with the Commission to better educate the retail sector on appropriate surcharging.

Yours sincerely



CHIEF EXECUTIVE