

Retail Payment System

Payments Between Bank Accounts

Request for views on payments made over the interbank payment network

Submission Response – Merco Ltd

25 Sept 2023



List of our submission questions and our responses

Questions on New Zealand's payments between bank accounts landscape	
1	<p>Do you agree that Eftpos card use is likely to continue to decline? If not, why not? Response: Yes</p>
2	<p>Do you agree with our assessment of the factors contributing to the decline in Eftpos card use? If not, why not?</p> <p>Response:</p> <ol style="list-style-type: none"> 1. Yes In general terms 2. A very important factor you overlook is why and how the card issuers have ended up paying a fee to the payment provider for their EFTPOS card transactions and the fee structures which have not been modified in line with the commercial environment. This needs further explanation because the fee structure is historical and, in our view, one of the main reasons the scheme is in decline. When launched in the 1980's the following were factors which influenced the then pricing model... <ol style="list-style-type: none"> 2.1 banks collected transaction fees on virtually every retail transaction including EFTPOS transactions 2.2 the architecture deemed the technical solution to be an extension of the Card issuer bank's core processing systems 2.3 network fees were met by the banks – terminal fees were met by the merchants 2.3 the system was extremely profitable because <ol style="list-style-type: none"> 2.3.1 banks collected a transaction fee of approximately 25 cents per payer transaction and payee settlement transaction 2.3.2 the high cost of cash and cheque processing was replaced by low-cost electronic transaction processing 2.3.3 the fees charged to the banks by the scheme was a scheme cost recovery fee (because the scheme was deemed to be an extension of the bank's own processing systems) 2.3.4 the system and the company established to operate it was owned by some of the banks 2.3.5 merchants were not charged a fee for the use of the scheme as they provided their own hardware – at that time banks mostly owned the hardware associated with the “capture” of transactions via their various channels. This was a significant departure from the then-current banking practice 2.3.6 the scheme at that time net of the fees paid by the banks plus the cost reduction due to the movement of cash and cheque transactions to electronic transactions was exceedingly profitable. Additionally, the volume of transactions increased along with payment efficiency thus generating greater revenue for the banks. 2.4 since the 1980s the commercial environment has completely changed <ol style="list-style-type: none"> 2.4.1 banks have largely chosen not to charge transaction fees thus a major revenue stream has disappeared 2.4.2 banks no longer calculate the expenditure reduction due to cash and cheque transaction substitution toward the profitability of the scheme 2.4.3 the cost of networking is minimal because of network bundling. The scheme no longer relies on dedicated networks

2.4.4 the cost of terminals has decreased along with the general downward trend of IT hardware costs

2.4.5 the Worldline EFTPOS scheme is no longer “owned” by the banks and the concept of the system being an extension of the bank’s own in-house systems is no longer valid

2.4.6 the fee structure has not changed although the business model has changed. Banks continue to pay EFTPOS fees as noted when they have stopped directly charging their customers and merchants are not charged for the service

2.4.7 there has been continued pressure by the schemes to offer a competing debit scheme

2.5 Open Banking pricing globally has largely redefined the pricing model for these third-party debit solutions. Refer EU Law Directive 2015/2366 para 65 i.e. this notes the most efficient system is the sharing of charges between the payer and the payee

2.6 the existing EFTPOS scheme pricing model does not in any way adhere to the EU changing model. That is:-

2.6.1 banks should charge the payer for EFTPOS transactions (if a bank chooses to forgo that revenue for competitive reasons that needs to be recognised and, that does not mean the bank should try to recover that revenue elsewhere in the system i.e from third parties)

2.6.2 recognising the third parties are generating transactions for the bank and need to be paid for those services the options are for either the bank to collect a higher fee from the payee and pay the third party for the transactions delivered or the bank charge the payee a nominal flat fee i.e. a similar fee to that charged the payer recognising the third party will also charge the payee for their services. The latter is the preferred model because it preserves the EU PSD2 model and it allows the service providers (the bank and the third party) to each charge directly for the services provided based on their cost of providing that service

2.6.3 there are many reasons why any fee charged by the bank to a third party to deliver payment details to a bank is not advocated and is disruptive. For example, banks would invariably each charge a different amount (as is currently the situation we have with proposed API fees). It does create an impossible situation for third parties trying to manage a variable expense by bank, where the merchant market demands the same fee from the third party for each transaction irrespective of the payer’s bank

2.7. recognising the changed commercial environment and the EU directive, in our view to the EFTPOS pricing model should reflect that advocated for third-party API access as per the EU directive. That is

2.7.1 banks charge payer transaction fees for the Bank’s payment services and recover other costs such as card issuance fees from the payer

2.7.2 banks charge the payee a transaction fee for the bank’s payment services. There is a case that aggregation by third parties should be prohibited...

2.7.3 Third-party EFTPOS providers charge the payee directly for the EFTPOS service.

2.7.4 hardware, software and network changes be met by the party incurring that cost

2.8 if the above model doesn’t provide the revenue necessary to support the EFTPOS network it is not viable and should be allowed to continue to decline

3	<p>What do you see as the barriers to innovation and success for Eftpos?</p> <p>Response:</p> <ol style="list-style-type: none"> 1. Failure to adapt the pricing model as discussed in 2. above 2. Continuing incentives from schemes to undermine the domestic EFTPOS system
4	<p>Do you agree with our view that the decline in Eftpos card use is reducing the competitive pressure on the debit card networks for in-person payments and that this may have a detrimental impact on consumers and merchants over time? If not, why not?</p> <p>Response:</p> <p>Yes</p>
5	<p>Do you agree with our view that competitive pressure in the payments between bank accounts landscape could be increased by enabling an environment where payment providers develop innovative options to make bank transfers? If not, why not?</p> <p>Response:</p> <p>Yes</p>
<p>Questions on the key features of traditional bank transfers</p>	
6	<p>Do you agree that we have captured the existing benefits and problems with the traditional method of initiating bank transfers? If not, what other benefits or problems exist?</p> <p>Response:</p> <ol style="list-style-type: none"> 1. You state EFTPOS payments incur charges for merchants – this is not the case for traditional EFTPOS debit payments where the payer selects ‘cheque’ or ‘savings. In this regard, the only cost to the Merchant is the cost of the terminal and perhaps the network charges. Refer to our response at 2.3.5 above.
<p>Questions on methods to gain access to the interbank payment network</p>	
7	<p>Do you agree with how we have described and ranked the different methods for payment providers to access the interbank payment network to initiate payments? If not, why?</p> <p>Response:</p> <ol style="list-style-type: none"> 1. The POLi access method uses predominantly the HTML API’s found in HTML 5 which is conceptually similar to the reverse engineering you describe in the “Reverse Engineered bank app” This process is not screen-scraping as you describe the process. 2. Merco has since 2008 recognised its access method to be sub-optimal and sought to improve the access method used including the use of API’s. <p>Without moving to an API it is possible to provide customer information within the individual transaction headers sent to banks which could be used by the banks in their transaction management systems including fraud management. This occurs</p>

today. This process can improve the current processes where sub-optimal interfaces are used in reducing some of the risk. It does not require the same levels of development as a full-function API.

3. You describe the consumer's need to provide their login details to the payments provider. This practice has become widespread and is also found in credit scoring and financial management systems including bank systems. In the case of POLi, this has proven to be totally secure. More than 30 million transactions have been processed without incident. The risk to the consumer is very low.

Are there other key features of the payment initiation network access methods you would like to draw to our attention?

Response:

1. Regarding the use by payment providers of the sub-optimal methods, in the POLi system 1.6 million customers have recently used the POLi system. That's nearly 40% of all bank customers. This demand has always existed because the payment culture in New Zealand is debit-oriented. In addition, since online merchant payments became common across the internet the only form of payment that existed was scheme credit. Initially, some banks would not accept scheme payments acquired via the Internet when no other alternative existed other than Internet banking transfers.

2. At 3.29 you describe the degree of control a customer has by the various methods. In our experience, this is not a concern expressed by customers. Convenience and trust is their overriding concern.

8 POLi is currently building systems to give customers more control over their payments. These functions are not necessarily dependent on API interfaces.

You add the API's are more secure than sub-optimal network access methods. Merco has since 2008 considered its access method as 'sub-optimal'. While risks do exist those risks are never quantified. The reality is the risk is low as, in the case of POLi, very little information is ever stored in the system. Unlike credit cards, no data exists in the POLi system which could allow a fraudster to gain access to a customer's account.

3. Sub-optimal network access allows the payment providers to develop commercially viable solutions. The commercial arrangements we have seen relating to Standardised open APIs are not financially or operationally viable. As an example, a single bank's proposed fee proposal could if implemented cause POLi to fail financially. Attempts by banks to de-risk payments seem unreasonable when the overheads placed on the payment providers include the provision of detailed merchant information. This is especially so when the banks could compete and develop similar services.

3. Sub-optimal network access overcomes most of the issues highlighted with bank transfers in table 3.2 including:

- 3.1 funds will always be paid to the intended merchant because the merchant's bank account is linked to the Merchants' website on which the payment interface is presented
- 3.2 customers do not enter the 16-digit bank account number
- 3.3 payee reconciliation data is provided by the merchant, and this can't be incorrectly entered by the payer
- 3.4 the fate of the payment is provided to the Merchant in real time which allows immediate fulfilment of goods and services.
- 3.5 merchants are contractually obligated to certain conditions favourable to the customer which don't exist in a traditional bank transfer
4. Your description of sub-optimal methods at 3.21 and 3.22 requires further explanation. For example, using modern HTML POLi does not screen scrape. It uses the underlying bank APIs which negates that need. The risks are largely overstated as is evident in the absence of fraud to date in the POLi system.

Questions on the environment required to support innovation in options to make bank transfers

Do you agree that these API-related requirements are sufficient to enable an environment where payment providers can develop innovative options to make bank transfers? If not, why?

Response:

1. We agree with the environment you describe but we do wish to comment on pricing assuming you envisage a fee will be charged for access

2. Charging a fee for access to the payment system as currently advocated by the industry is not warranted and it is disruptive.

2.1 In our experience the existing model is largely not viable at scale. POLi processes approximately 500,000 transactions a month and while this volume is relatively low the existing pricing models would require an increase in Merchant fees not just an increase but many times the existing level. Merchants would not accept the required level of fee increase necessary to meet the fees proposed by some banks.

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Banks as deposit takers have an obligation to provide efficient payment services which are reliable, speedy, and low-cost with the provision of good records. Customers must find advantages in using any payment method. Charging for access to the payment system to cover costs is not warranted when the banks for competitive reasons choose not to charge their customers directly for their transaction processing services. As discussed above this model has contributed to the decline of EFTPOS. The proposed payments API model services are in many respects similar to the existing EFTPOS model. Advocating a similar fee model to that which currently exists in the failing EFTPOS model doesn't make a lot of sense to us.

Further, as discussed in 2.5 above, Open Banking pricing globally has largely redefined the pricing model for these third-party debit solutions. Refer EU Law Directive 2015/2366 para 65 i.e. this notes the most efficient system is the sharing of charges between the payer and the payee. This means other than a subscription based model, charging a third party payment provider is not advocated.

Questions on the benefits from a more competitive and efficient interbank payment network	
10	<p>Do you agree with our view of the long-term benefits to merchants and consumers from the development of innovative options to make bank transfers? If not, why?</p> <p>Response: Agreed. POLi currently provides many of the benefits outlined. It is widely accepted this has contributed to POLi's popularity</p>
Questions on industry open API standards	
11	<p>Do you consider that the existing industry open API standards are a good starting point to enable innovative options to make bank transfers?</p> <p>Response: Agreed.</p>
12	<p>Do you consider the future of industry open API standards will enable innovative options to make bank transfers?</p> <p>Response: Agreed.</p>
13	<p>What gaps are there in the open API standards for innovative options to make bank transfers?</p> <p>Response: As published there exists sufficient scope in the defined standard API for a third party industry to emerge provided features outlined in 4.2 are mandatory for all banks. The uptake of existing API services is very low to date. The focus should now be on removing barriers to uptake rather than second-guessing new use cases.</p>
Questions on the key barriers preventing efficient access to the interbank payment network	
14	<p>Do you agree that the key barrier preventing payment providers from gaining efficient access to the interbank payment network is that the banks have not universally built open APIs? If not, why?</p> <p>Response: Agreed.</p>
15	<p>Do you agree that the main reason the banks have not universally built open APIs is due to the uncertainty of commercial incentives for them to do so? If not, why?</p> <p>Response: Agreed.. The uncertainty of commercial incentives has always been an issue in recent times in payments development in New Zealand. There exists a conflict between:</p> <ul style="list-style-type: none"> - the size of these projects in terms of resources and other perceived bank priorities - leadership within banks to manage these projects - much of the business case cannot be modelled as no precedent exists. Modelling draws largely on the existing system behaviours when the projects often set out to change those behaviours - the existing payment system operations is not universally understood - little account is taken of customer's requirements.

	An example of how this is represented in the delivery of system improvements today is the fact Interchange 365 project took 30 years to deliver.
16	<p>Do you consider that the industry implementation plan creates sufficient certainty that the banks will build the open APIs? And do you consider that the minimum delivery dates are appropriate? If not, why?</p> <p>Response: Even if is mandatory there is no defined penalties so we consider it will make little difference</p>
17	<p>Aside from the network access issues, are there other issues with the interbank payment network that reduce competition or efficiency? For example, the speed of payments or the amount of information attached to payments?</p> <p>Response: Of course, real-time interchange and settlement would improve efficiency but much could be done within the existing network to improve services. Some banks don't, in our view, comply with the existing PaymentNZ interbank rules. Basic compliance would improve efficiency as would the relaxation by banks of real or perceived barriers caused by KYC and Privacy concerns.</p>
Questions on efficient partnering between banks and payment providers	
18	<p>What do you consider are the main barriers to negotiating agreements between banks and payment providers for access to the interbank payment network (assuming open APIs are built)?</p> <p>Response:</p> <ol style="list-style-type: none"> 1. Onerous commercial provisions 2. Fees 3. Provisions to terminate for convenience 4. Lack of non-competition clauses
19	<p>Does the API Centre's partnering project enable efficient partnering between banks and payment providers? If not, what would be required to enable efficient partnering?</p> <p>Response: We don't believe the API Centre should be involved in this work. It is evident as currently structured the API Centre largely represents the banks' position. The users of Payment Services are not represented, and you can argue the users of payment services have collectively more at stake than the banks. The end users of payment services have no voice. In our view, a completely neutral entity is required which can equally represent all stakeholders i.e. public and private commercial sector, consumers, the central bank and banks</p>
Questions on the interbank payment network	
20	<p>Do you agree with how we have defined the interbank payment network? If not, how do you consider it should be defined?</p> <p>Response: Agreed</p>

21	<p>Do you see any issues with how we have defined the interbank payment network? If so, what issues?</p> <p>Response: Agreed</p>
22	<p>Do you agree we have captured the correct payment products in the interbank payment network?</p> <p>Response: Agreed but those designations are historical and are unlikely to be relevant in an open system when innovation is allowed to evolve. Assuming all payments are from cleared funds and are irrevocable we think the designations could more accurately be described as:</p> <ul style="list-style-type: none"> - payer present/ not present - payee initiated/ payer initiated - one-off / recurring - real-time settlement/delayed settlement - fixed amount/variable amount
23	<p>Do you agree we have captured the correct network operators of the interbank payment network?</p> <p>Response: Yes</p>
24	<p>Do you agree we have captured the correct class of participants in the interbank payment network?</p> <p>Response: If the interbank payment network were to be designated, we do not agree that indirect participants should be included. Banks process payments and have responsibility for the provision of transfer facilities for the movement of money from account to account. Indirect participants essentially move payment instructions from the bank depositors to the bank which is not the same thing. In our view, indirect participants should not become responsible for what is a Network operator's bank or deposit takers obligation.</p>
25	<p>Do you agree we have identified the relevant interbank payment network rules? If not, what other network rules are relevant?</p> <p>Response: Yes</p>
26	<p>Do you consider there are any other regulatory requirements in other New Zealand laws that we should take into account in deciding whether to recommend that the interbank payment network is designated?</p> <p>Response: No</p>

Questions on possible regulatory interventions

27	<p>Do you consider that a designation of the interbank payment network is a useful first step towards enabling an environment where payment providers can launch innovative new options to make bank transfers in New Zealand? If not, why?</p> <p>Response: Yes</p>
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28	<p>How effective do you consider our regulatory powers would be at addressing the barriers set out in this paper?</p> <p>Response: We believe the introduction of regulatory powers would be effective however your comments in table 5.1 seem to infer a pricing method is required. We don't agree with this unless it is aligned with the PSD2 principles. If pricing was other than subscription-based the only viable option is a fixed fee per completed payment for payments and per API call from information API calls. The cost of processing is the same for all payment transactions. There is no case to base any pricing on the value of the transaction or a percentage of the payment provider's revenue as has been suggested by New Zealand banks. Those pricing mechanisms exist where the transaction is complex as is the case with scheme payments. Debit payments are not complex. For example, there is no cost of funds involved or other functions which incur additional processing costs. It could be argued that high-value transactions could incur additional costs where manual intervention is required but very high-value transactions could be excluded from the system.</p>
29	<p>Do you consider that a designation of the interbank payment network, and the subsequent use of our regulatory powers, would promote competition and efficiency in the retail payment system for the long-term benefit of merchants and consumers in New Zealand? If not, why?</p> <p>Response: A response is required to force the industry into action. Banks in our view have for too long taken the view the provision of relevant payment services is not a priority. This is not so as it is an obligation. We agree the designation of the interbank payment network and the use of regulatory powers is necessary. The delays in payment system reform exhibited by the banking industry is unacceptable.</p>