BUDDLE FINDLAY

Credit and debit card interchange - what is the answer?

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4 November 2016

MBIE has recently released an issues paper on "Retail Payment Systems in New Zealand".

The paper raises concerns about the impact of interchange on New Zealand's credit and debit card market, including how high income earners benefit most from credit card rewards programmes and that small retailers pay disproportionately higher fees to accept credit cards.

Interchange is the fee that the retailer's bank must pay to the consumer's bank for credit or debit card payments. The rate can vary in New Zealand from 0.4% to over 2% of the transaction value. Interchange is not a fee paid to Visa or MasterCard. It is simply a value shift between the retailer's bank and the consumer's bank (which banks typically pass on to their consumers).

Interchange is an issue that regulators globally have been attempting to address over the last decade. It has also been the subject of litigation around the world, including in New Zealand.

To understand the issues with interchange it is important to understand its history and purpose. Interchange was originally introduced by Visa and MasterCard as a way of balancing the costs between retailers' banks and consumers' banks.

Originally, credit card processes were very manual. For transactions over certain limits, retailers had to phone the consumer's bank where call centres were needed to confirm whether the consumer had sufficient credit to make the payment. As the costs of running the network fell disproportionately on the consumer's bank, Visa and MasterCard introduced interchange as a way of subsidising the consumer's bank for those costs. High consumer fees would also have discouraged the use of credit cards.

Credit cards competed with store cards which were quite common for larger retailers. At the time credit cards were introduced, the market approach was to give consumers until the 20th of the following month to pay, which was the usual billing cycle. Credit cards had to offer the same interest-free periods to compete with store cards and interchange was used to subsidise those interest-free periods. Retailers were generally happy to pay given the value credit cards provided them.

Since introducing interchange, credit card processes have become more efficient and consumers' banks' costs have significantly declined. However, rather than this resulting in a reduction in interchange fees, consumers' banks have chosen to use interchange revenue to provide greater consumer benefits; primarily loyalty programmes.

The problem is that retailers, who are charged fees by their banks, have become unhappy about the size of those fees. Retailers are also hesitant to refuse credit and debit cards for fear of losing sales to other retailers. As a result, globally retailers have increasingly turned to regulators to reduce interchange fees.

The challenge posed to the New Zealand market by Minister Goldsmith in his press statement relating to the MBIE report is whether interchange costs can be moderated through competition and without government intervention.

Another option is for the industry to self-regulate as it has attempted to do in Canada. This could involve an examination of the extent to which it is still reasonable for retailers to pay for consumer loyalty benefits and interest-free periods. Representatives of consumers and retailers could be involved in that process given they are the ones that ultimately derive the benefit and pay the costs. Visa and MasterCard, as well as the consumer and retailer banks, would need to be satisfied that any outcome still provided sufficient incentives to continue to invest in credit and debit card-related technology.

It would be nice if New Zealand could address the concerns about interchange without getting regulators involved – accepting the challenge thrown down by the Minister. However, this may require some creative solutions.

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