American Express Australia

Submission to the Reserve Bank of Australia

Regarding Review of Card Payments Regulation Issues Paper

24 April 2015

Introduction

American Express appreciates the opportunity to comment on the RBA Issues Paper.

Our main concern with the Issues Paper relates to the recommendations of the Financial Systems Inquiry (FSI) to:

- regulate the American Express Global Network Services business; and
- create a three-tiered surcharging model which particularly impacts American Express.

As acknowledged by the RBA, American Express lacks market power and is a not a 'must take' card. This is not just an assumption. Many merchants actually make this choice, and many consumers choose not to hold an American Express card.

Regulating the American Express Global Network Services business in the same way as the current Visa and MasterCard Interchange Standard would result in banks having little incentive to issue American Express cards.

The argument that regulating the American Express Global Network Services business is required for the purposes of a 'level playing field' or for 'competitive neutrality' originated from our competitors. If implemented, it would place American Express at a significant competitive disadvantage, with no flexibility to differentiate our business by providing additional value to merchants and cardmembers.

American Express does not support surcharging by merchants. As it lacks market power and is not a 'must take' card, American Express wants the ability to choose with whom it does business. If merchants choose to discriminate against American Express customers at point of sale then we should be able to choose whether to do business with them.

The proposed three-tiered surcharging standard is overly complex and requires the RBA to choose a limit for the 'medium cost' tier which will ensure almost all merchants either under or over recover their card acceptance costs, in contrast to the current *reasonable cost of acceptance* Standard.

Further, if American Express Global Network Services business were regulated as recommended by the FSI, merchants would face additional complexity in having to identify the type of American Express card presented, comply with different surcharging rules for each type, and then explain the difference to their customers. We expect many merchants to struggle with this complexity and either:

- over-surcharge American Express cards; or
- cancel accepting American Express cards altogether.

If implemented in combination, these recommendations from the FSI will impair the viability of the American Express Global Network Services business in Australia and reduce competition in the credit card segment by awarding even more share to the already dominant Visa and MasterCard, who already dominate the segment with over 81% of credit card transactions by value. We do not see how this can be in the public interest.

We believe that the RBA can address any concerns it has about transparency and cross-subsidisation without introducing measures that will have a material negative impact on American Express. We have set out our reasoning in more detail in this submission.

Publishing thresholds for which payment system providers will be subject to interchange or related regulation, possibly based on transaction values and/or market shares

The current system of designation and regulation is sufficient

American Express believes the current system of designation and regulation under the Payment Systems (Regulation) Act is sufficient and empowers the RBA to implement targeted regulation of payments schemes when the need arises.

The recommendation in the final FSI report that payment schemes be regulated in exactly the same way is misguided: it would place smaller schemes at a disadvantage as they would be unable to overcome inbuilt consumer and institutional bias in favour of entrenched dominant schemes.

Regulating American Express by capping fees it pays to its bank partners who issue American Express cards is neither in the public interest nor essential to ensure competitive neutrality. Extending interchange fee regulation to three-party or other smaller schemes would impair competition, innovation and efficiency in the payments system by enabling the already ubiquitous Visa and MasterCard networks to achieve even greater dominance.

No public interest or benefit to merchants, in regulating American Express

It is not in the public interest to subject American Express to interchange regulation in respect either of its proprietary issuing or its Global Network Services businesses..

When the RBA previously considered this same question in 2005[1], it found that:

> *Regulation of these payments would have relatively little effect on merchant charges. Further, the existing incentives facing issuers of these cards could only be addressed through considerably more extensive regulation than that currently existing in the credit card schemes.*
>
> *In the Bankcard, MasterCard and Visa schemes, the interchange fee paid by the merchant's bank to the cardholder's bank has an important influence on the charge levied on the merchant by its bank. In contrast, in the American Express and Diners Club arrangements, the causation runs the other way. Merchant charges are determined largely independently of the payment to the partner banks: instead, the fees that merchants pay influence the size of the payments to the banks. Given this, regulating the payments that flow between American Express and Diners Club and their partners would be likely to have little effect on merchants' costs of accepting the cards. This is in contrast to the credit card schemes, where merchant service fees fell quickly following the reforms to interchange fees.*

We submit that nothing about the American Express business model has changed since that time to justify the RBA reversing its view.

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[1] RBA Media Release 2005-02 - http://www.rba.gov.au/media-releases/2005/mr-05-02.html

The position today remains unchanged: capping fees from American Express to its bank issuers will not reduce the merchant service fees that American Express charges to Australian merchants. Our merchant service fees are agreed independently with each merchant based on the value the merchant receives by accepting American Express.

Uniform treatment of dominant and smaller, non-dominant firms creates neither a level playing field nor competitive neutrality

Claims that American Express' bank issuer relationships should be regulated to create a 'level playing field' are misleading. Visa and MasterCard already have the playing field tilted in their favour having achieved their current dominance over decades of extraordinary growth driven by price-fixing arrangements in the form of their multilateral interchange fees.

The only effect of subjecting American Express to interchange regulation would be to reduce the attractiveness of the smallest card network to bank issuers, causing American Express to get smaller and the dominant schemes to get larger. This harms competition within the Australian payments system without need or justification.

Finally, although competition is named in Section 8 of the Act as a desirable objective of regulation (alongside safety and efficiency), the overriding objective of the FSI Recommendations appears to be commoditising payments and eliminating value-added services and consumer choice. But the American Express model, which is less than a quarter the size of the dominant schemes, cannot compete as a commoditised product and holds its own in the market place solely as a result of its value-and-choice-based products and differentiated offerings.

American Express' business model is significantly different from Visa and MasterCard

American Express' business model is so significantly different from that of Visa and MasterCard that a 'one size fits all' regulatory approach is unwarranted.

American Express does not have collectively-set multilateral interchange fees and its pricing is negotiated bilaterally and confidentially with its licensed issuers. This was the key reason that Visa & MasterCard were originally subjected to interchange regulation and American Express was not. The American Express business model also differs from the model of the dominant schemes in other material respects, as explained in the Appendix.

Attempting to create common industry wide regulation across three and four party schemes that differ so fundamentally would create a significant additional regulatory burden that is not warranted in the absence of any clear public benefit.

American Express lacks market power

American Express is simply not a 'must carry' card. No consumer or merchant has to hold or accept American Express products and merchants frequently choose not to do so, which accounts for the lower coverage of American Express compared to the ubiquitous Visa and MasterCard. A merchant has little or no choice but to accept the cards of the dominant schemes, and thus they all do so. American Express cannot force any merchant to accept its terms. We routinely incur the risk that a merchant will decide not to accept American Express Cards at all, or to accept and then later decide to surcharge our cardmembers, or to display our brand and then steer our cardmembers to use the products of Visa and MasterCard. We also face the risk that our cardmembers – under pressure from merchants – will opt to use the Visa or MasterCard card that the vast majority of them carry alongside their American Express cards. The same cannot be true of Visa and MasterCard cardholders, the vast majority of whom do not carry American Express cards.

As the RBA itself recently noted, American Express cards are not as widely or ubiquitously accepted as Visa or MasterCard and are more often surcharged, which reflects the fact that American Express has far less market power than Visa or MasterCard.

It is our submission that seeking regulatory intervention to purportedly restore a 'level playing field' is unjustified, particularly when the only call for such action is coming from a duopoly that already enjoys 'must have' status and an 81% share of all Australian credit card transactions.

V/MC grew to become dominant schemes on the basis of anti-competitive practices – the 2003 RBA reforms were an attempt to address these practices

Multilateral interchange fees set by the dominant schemes have been a significant driver of market share growth in those schemes, by readily enabling issuers and acquirers to join those schemes on financial terms pre-agreed by all scheme members. Thanks to multilateral interchange fees, the dominant schemes have been able to overtake other payment schemes to capture more than 80% of the value of credit card transactions in Australia.

In Australia, Section 18 of the Act and Section 51(1)(a)(i) of the Competition and Consumer Act combine to allow a payment scheme to engage in anti-competitive conduct, provided such conduct is in accordance with the RBA's Interchange Standard.

This means that the RBA's interchange regime has benefited the dominant schemes by absolving them in Australia from the consequences of anti-competitive conduct that has been treated as unlawful in other countries. This benefit should not be overlooked in a discourse where American Express is routinely charged with having obtained an unfair competitive advantage by not being subject to interchange regulation in 2003.

Growth in American Express's share has been overstated

Calls for American Express to be regulated based on an alleged growth in its share of credit card transactions have greatly overstated such share changes. Any gain in American Express' share of credit card transactions since 2003 has been exaggerated and transitory.

Insufficient attention has been paid to two changes in the RBA's statistical table (C2) which records the respective shares of the four-party and three-party card schemes: the closure of Bankcard in 2007 and the exclusion of debit card numbers from C2 tables since March 2008.

The effect of these changes is that the share of American Express at the outset of the regulations has been understated, which means in turn that the increase in share attributed to American Express has been overstated. Further, based on the C2 tables, any gain in share of American Express peaked in early to mid 2012 and has since reduced.

American Express' merchant rate has reduced even without direct regulation

From March 2003 to December 2014, American Express' average merchant fees have reduced from 2.51% to 1.69% reflecting a decline in such fees corresponding to the decline in fees charged by the dominant schemes even through American Express itself was not subject to direct price regulation.

With its merchant fees falling in response to declines in the fees of its dominant competitors and with its own share of the segment falling, American Express evidently remains exposed to the normal effects of competition. Regulating American Express' fees to its bank issuers will not drive a further reduction of American Express' merchant fees due to the absence of a causal link between the two, as explained in the table in the Appendix.

This was the main reason cited by the RBA when it decided in 2005 that regulating American Express would not be in the public interest. Since that time, American Express' business model remains unchanged.

RBB Economics' views on competition and the consumer welfare implications of including American Express in interchange regulation

RBB Economics was commissioned to provide a detailed economic report of the potential competitive and efficiency effects of the proposed interchange and surcharging regulations. The RBB Report is consistent with the positions set out by American Express in this submission.

The RBB Report is attached and notes that:

- In summary, Amex lacks market power; its share is low and it is not a must-take card. The clear implication is that its MSFs are not excessive. Merchants choose to pay the fees because of the value acceptance provides and the higher fees must be matched by higher merchant benefits. Intervention to disrupt its differentiated business model would force American Express to operate on a less efficient scale and with lower level of quality.

- In turn, the policy options in the RBA Issues Paper are likely to harm American Express' ability to compete with Visa and MasterCard. Including American Express in interchange regulation, therefore, is contrary to the RBA's objective of promoting competition.

- The available evidence suggests that the current interchange regulation has likely made cardholding consumers worse off, without any clear evidence of lower retail prices for non-cardholders. Indeed, given the prevalence of cardholders, this indicates a plausible resulting reduction in consumer welfare.

- If the aim of the regulator is to force American Express to lower its merchant service fees even further, it is sufficient to regulate the interchange fees of four-party systems; the evidence to date shows clearly how interchange regulation of four-party systems has induced American Express to lower merchant service fees in response to natural competitive dynamics when the fees for acceptance of Visa and MasterCard have declined.

Broadening interchange fee caps to include other payments between schemes and issuers

The current Interchange standard is already capable of encompassing a wide range of payments

The RBA has expressed concern that other types of payments between schemes and issuers may be used to circumvent interchange caps. It points to the anti-avoidance language of the US Durbin Amendment which includes all payments to issuers in the calculation of interchange on the basis known as 'net compensation', in determining whether interchange caps have been complied with.

American Express submits that the Durbin Amendment approach, which was intended to address specific issues in the USA with Visa and MasterCard's debit interchange and transaction routing practices, goes beyond what is reasonably required to prevent circumvention of caps. The definition of interchange in the RBA's existing Interchange Standard is already sufficiently broad to catch a wide range of payments-

> *This Standard refers to wholesale fees, known as 'interchange' fees, which are payable by an acquirer, directly or indirectly, to an issuer in relation to credit card transactions in a Scheme.*

Stifling innovation and the consumer benefit of additional payments

Both merchants and consumers have benefited from many additional payments made by schemes to their members, who have used such payments to provide customers with additional benefits, innovations and technology. One likely consequence of introducing 'net compensation' provisions will be to seriously reduce investment capacity in new technology or innovative product offerings. Many of those innovations require significant investment which could not be completed in the same timeframe without assistance from the schemes.

By way of example, most recently the Australian PIN Wise campaign provided consumers with the ability to make payments with PIN instead of signature, improving security and reducing fraud and also promoting the use of contactless card acceptance. In order to be effective, this campaign required significant technology, timing and marketing alignment between the schemes (including American Express) and first and second tier bank issuers, all funded by significant investment. The initiative provided significant benefits to merchants in terms of both speed of checkout and reduced fraud in the card system. This national campaign would not have been completed as quickly, or possibly at all, without significant expenditure by the major bank issuers and other industry participants.

Under a 'net compensation' regime the types of payments that funded the PIN Wise campaign would have been prohibited. Looking forward, schemes would be unable to incentivise issuers to invest in developing or marketing payment technology innovations. Consequently, if issuers and acquirers did decide to roll out new technology, they would be more likely to recover the costs through increased fees to merchants or consumers.

Further entrenching the dominant schemes

We believe that the effective curtailment of these normal commercial arrangements (used in many other retail and financial sectors) would create distortions by effectively awarding more share to Visa and MasterCard as bank issuers would no longer have any incentive to issue on the smallest of the three schemes. Visa and MasterCard already currently enjoy more than 80 percent of credit card transactions by volume.

Such concentrated market power will remain unassailable if competitors and new entrants were effectively barred from promoting alternative products and services through marketing, promotional and other agreements which include financial incentives. The end result will be limited consumer choice and the stifling of product innovation.

Making changes to the interchange benchmark system to reduce the upward ‘drift’ in average interchange rates inherent in the current three-year reset cycle.

Assess interchange rates against the benchmark more frequently - quarterly

Because compliance with the weighted average of 50 basis points interchange is currently only required every three years (unless interchange rates are amended), Visa and MasterCard have used this timing to create new high interchange categories which enable their issuers to earn greater interchange revenue by migrating their card portfolios into these categories.

American Express believes that the simplest way to manage any upward drift in average interchange rates during the current cycle is to reduce the length of the testing cycle to quarterly, or at least no less than annually.

The current requirements, allowing the weighted average to be assessed against the benchmark only once every three years based on historical data, has enabled the circumvention of regulatory intent and the widening of Visa and MasterCard interchange categories to the detriment of small merchants. More frequent and active assessment, coupled with a cap being placed on the highest weighted average interchange, would neatly resolve the concerns with interchange regulation raised by both the FSI and the RBA, and avoid over-regulation on this issue.

Also applicable to debit

American Express also believes that the above solution should also be applicable to the debit Interchange Standard. Although we understand that there isn’t the same level of upward drift in average interchange rates in debit, this change could prevent similar issues with the debit Interchange Standard in the future.

Lowering interchange caps

Reduction in benefits for consumers and small business and no "checks and balances" on the dominant schemes

Lowering interchange will tend to drive retail profits up rather than retail prices down and will extract yet more revenues from schemes that could have been used for investment in technology and innovation.

Another outcome will be a further redistribution of cost from merchants to consumers as card issuers raise fees and/or interest rates or reduce benefits to cardholders. Where issuers incur a reduction of revenues that would have funded their essential investments, they will seek alternative revenue sources.

Of course there are several possible ways to recoup this lost revenue – charging customers higher and/or new card fees; reducing rewards and benefits; or reducing interest free periods offered to cardholders. The response of issuers is likely be a combination of the above – but applied differently to each consumer segment, not necessarily evenly spread across their portfolios.

As affluent cardholders are more likely than not to pay their credit card balance in full each month, they will be insulated from changes in interest rates. Conversely, increased interest rates and shortened interest-free periods affect less well off consumers who cannot afford to pay their credit card balance in full each month and therefore pay interest.

No evidence to support lower interchange caps

American Express acknowledges that the RBA has noted a possible concern about the potential cross- subsidisation between large and small merchants arising from the more recent high interchange categories of the dominant schemes. However we believe that the solution to this is a tighter weighted average within the Interchange Standard as set out in the following section on 'Replacing weighted average interchange caps with hard caps'.

There is no evidence of a problem with the level of the current 50 basis point credit card interchange cap. This interchange cap is based on issuers' costs in relation to credit card transactions for: authorising and processing transactions, funding the interest-free period and fraud and fraud prevention. In particular the credit card industry has spent a significant amount on the recent PIN Wise initiative to move all credit cards to chip & pin in order to reduce fraud.

There has been no evidence of any significant reduction in any of the above cost categories such as to justify lower interchange caps.

Further reducing interchange caps may have the unintended consequence of networks amending liability rules for fraud to shift the impact of fraud more heavily to merchants, who are less equipped to manage fraud.

The above reasoning also applies to the debit interchange caps, given that the benchmark for debit cards is based on the same cost categories.

Reduction in consumer welfare

Economic theory suggests that a reduction in interchange fees will drive down fees paid by merchants to acquirers which in turn should lead to lower retail prices.

In our view, this remains a purely theoretical scenario that has not been demonstrated in reality nor shown to yield any benefits to consumers that offset the harm they incur in the form of increased card costs and reduced benefits.

Economic theory has been unable to provide a guide to determining an optimum or even appropriate level of interchange fees. Economic theory does not indicate that lowering interchange fees is always beneficial but warns that, particularly if retail competition is weak (as may be the case where market concentration is high), merchants not only have little incentive to pass-on lower MSFs to consumers but are more likely to surcharge them.

What evidence does the Australian experience provide on this point? Specifically, the available evidence suggests that the current regulation has made cardholding consumers worse off without any clear evidence of having driven lower retail prices for non-cardholders. In other words the result has been higher retail profits rather than lower retail prices. Indeed, given the prevalence of cardholders in the Australian economy, there has quite plausibly been a reduction in consumer welfare caused by interchange regulation.

Replacing weighted average interchange caps with hard caps

Weighted average with a tighter cap

Given the clear commitment of regulators to retain interchange regulation, a simpler solution to any perceived concerns about cross-subsidy and lack of transparency is for the Reserve Bank to slightly alter and enforce the current weighted average rules with greater vigour and frequency.

When determining the Interchange Standard in 2003, the RBA allowed for some commercial flexibility in not determining a fixed or hard cap based on the issuers' cost calculation, but allowing the dominant schemes to adhere to a weighted average. However the introduction of more than 19 new interchange categories by MasterCard and 23 by Visa (including in each case different rates based on card type and rates based on merchant type) suggests that the intended flexibility has been used to favour 'commercially strategic' merchants at the expense of smaller and midsized merchants.

A weighted average calculation has merit as compared to other options – it allows for a level of commercial flexibility in the market. However it should not be an unrestrained weighted average.

American Express recommends retaining the weighted average but introducing either a tight 'cap' arrangement where there is a maximum upper threshold applied or by prescribing a maximum spread between the lowest and highest interchange levels. Either of these options would dramatically reduce the wide variance in interchange and the number of interchange categories, thereby reducing the incidence of cross subsidisation and increasing transparency, without significantly changing the current methodology of interchange regulation.

Setting an upper cap on weighted average interchange fees, coupled with more regular and rigorous benchmark testing, will ensure schemes adhere more closely to the prescribed average, as originally intended.

Also applicable to debit

American Express also believes that the above solution should also be applicable to the debit Interchange Standard. Although we understand that there is not the same level of cross-subsidy in debit, this could prevent similar issues with debit interchange in the future.

Applying caps as the lesser of a fixed amount and a fixed percentage of transaction values

This may help in encouraging low value debit card transactions

We understand that the objective of this recommendation is to encourage low value transactions on debit cards. American Express believes that a combination of a fixed amount and percentage cap has merit for debit.

Key credit card costs for issuers are ad valorem

As opposed to debit, where cardholders use their own money, on credit cards the issuer advances funds, and so issuers' key costs (as set out in the current Interchange Standard) include funding interest free- periods and fraud and fraud prevention. These costs vary directly according to the monetary value of the transaction and therefore credit card interchange fees should continue to be ad valorem on a linear basis.

Establishing a fixed cap for credit cards would likely result in a reduction in interest free periods as well as less incentive for issuers to approve large value purchases, given that the level of fraud risk is directly related to the size of the transaction.

Applying caps as the lesser of a fixed amount and an ad valorem charge would further reduce interchange fees paid to issuers, the amount of the reduction depending on a "pick-a-number" exercise of which the criteria of success or failure are not apparent.

Including prepaid cards within the caps for debit cards

Prepaid cards should be treated the same as debit cards

As both prepaid cards and debit cards entail customers using their own funds, American Express believes that they should be treated in the same way.

Allowing for 'buying groups' for smaller merchants to group together (subject to any competition law restrictions) to negotiate to receive the lower interchange rates that are accessible to larger merchants

Should not create a positive obligation to enter into agreements

American Express is not necessarily opposed in principle to this proposal, but sees a number of practical difficulties with its implementation.

It would require a change to competition law which would have to carefully define the permissible limits of the collective activity so as to avoid the significant competitive concerns that underlie the competition law principles that currently preclude such activity, including the use of collective power for negotiating purposes.

Because parties should remain free to choose with whom they do business, American Express would not be supportive of any approach that would impose a positive obligation on schemes or acquirers to enter into negotiations or agreements with any other party, whether it be an individual merchant or a group.

A tiered surcharging system, perhaps along the lines of the FSI recommendations

American Express does not support surcharging

American Express has consistently maintained that surcharging is unfriendly to consumers, brand-damaging to schemes, prone to exploitation by merchants with power or who are unscrupulous, and should not have been introduced in the first place. The surcharging regime from the outset has provided no benefit to consumers. Surcharging has only added to the overall cost of living for Australians.

The prevailing economic view is that surcharging balances the 'cross subsidy' from consumers who choose to pay with a credit card to those who don't on the assumption that a consumer's use of a card has caused a higher input cost for a merchant. However businesses incur a wide range of consumer led variable input costs that are built into the standard prices they charge and are not separately charged.

The most significant of these is labour cost. Australia's penalty rate regime determines that staff costs on say a Sunday are higher than a Tuesday. As a result, a consumer who makes the choice to shop on a Sunday costs the merchant more but pays no more for their purchase. Apart from some restaurants there is no additional charge levied. So one might claim that the Tuesday shopper is effectively cross subsiding the Sunday shopper.

American Express is not suggesting that there should be a weekend wage surcharge on retail prices. Rather this example is used simply to illustrate the flawed logic in isolating just one variable cost within a business and subjecting it to special regulatory arrangements.

Only restoring the status quo ante and allowing schemes to prohibit surcharging will reverse the consumer harm and distortions caused by the practice.

American Express should not be prohibited from having a no-surcharge rule

American Express wants the ability to choose who to do business with. If merchants want to discriminate against American Express at point of sale, then we should not be compelled to do business with them. As American Express lacks market power, is not a 'must take' card and because its MSFs are constrained by those of the dominant schemes, this would not be unreasonable.

As stated in the RBB Report, particularly where payment schemes lack market power (such as American Express), preventing merchants from surcharging can reduce merchant free-riding and allow smaller schemes to compete more effectively with larger, four-party schemes.

New surcharging regulations because the current rules do not suit the dominant schemes' business convenience?

In 2012, Visa and MasterCard lobbied for the Merchant Pricing Standard to be changed to allow them to restore scheme rules to limit surcharging. The Standard was duly amended with effect from 18 March 2013 to allow the dominant schemes to limit surcharging to the merchant's reasonable cost of card acceptance. Now, the dominant schemes are stating that their acquirers are unwilling to enforce the rules that they adopted in keeping with the 2013 amendment, and that they need to protect commercial relationships between each scheme and its members and between the members and their merchants. In other words, enforcing their own rules does not suit their business convenience and therefore further changes are required.

American Express believes that the *reasonable cost* model gives schemes sufficient discretion and authority to enforce their own rules. Just because Visa and MasterCard claim that enforcing scheme rules is challenging for them does not mean that further changes to the Merchant Pricing Standard should be considered, particularly when the changes have only been in effect for 2 years now and American Express incurred significant cost to change its processes to comply with the 2013 amendment.

FSI three tiered model is overly complex and flawed

The three-tiered surcharging cap approach recommended by the FSI is overly complex and flawed. Such methodology would be inconsistent with the Government's objective of simplifying regulation and reducing its burden on Australian business, for the reasons set out below.

Impossible to choose a 'correct' cap

Setting the permitted surcharging level would again require the RBA to 'pick-a-number' and that number will in practice differ from the fees paid by most merchants, with the inevitable result that either over-recovery or under-recovery will be institutionalised, a situation wholly at odds with the principle of allowing merchants to recover their *actual* costs of acceptance which is the very raison d'etre of the surcharging regime.

If the RBA were to adopt measures to further reduce interchange fees, it should consider whether the resulting drop in merchant service fees would justify removing the right to surcharge from the market altogether, as the objectives of reducing the cost of the payment system to users would already have been met.

Inconsistent setting of categories based on both interchange rates and merchant service fees

To create a new medium cost category based on average interchange rates alone departs from the original principle of allowing merchants to pass on their cost of acceptance.

The principles underlying the three-tiered surcharging model assume that merchant service fees will match or somehow correspond directionally to interchange but that is not necessarily the case. For example, acquirers may still choose to charge a higher merchant fee for 'premium' or corporate cards and pocket that higher price even if interchange was the same for all cards.

In the suggested three-tiered surcharging model the level of interchange is the criterion for classifying a card as 'medium cost' for surcharging purposes. If American Express cards issued by banks were interchange regulated in the same way as Visa and MasterCard, it would be fair and consistent for those cards to be also treated as 'medium cost' for surcharging purposes. However this would imply that American Express cards would have to be surcharged in different ways, depending on whether the issuer was American Express itself or a licensed bank partner.

In addition to causing confusion and unfairness to consumers, this complication would cause both American Express and merchants to incur significant costs in understanding and implementing appropriate surcharges as between different types of American Express Cards. Would merchants be able to reliably charge one surcharge for American Express bank issued cards and a higher surcharge for all other American Express cards? How could merchants identify and differentiate between those products in a *tap and go* environment or online? We suspect that many merchants, if unable or reluctant to grapple with these complexities, may instead over-surcharge American Express bank issued cards, or simply cease accepting American Express cards.

The 'medium cost' tier is unworkable for American Express bank issued cards. The whole three-tiered surcharging structure discriminates against American Express by making it uniquely complex and difficult for both ourselves and our merchants to comply with and creates particular disincentives for merchants to continue accepting our products. This complexity and difficulty will not be present for the products of the dominant schemes.

RBB Economics' views on competition and consumer welfare implications of the surcharging policy options in the RBA Issues Paper

The RBB Report notes that:

- Where payment schemes (such as American Express) lack market power, preventing merchants from surcharging can reduce merchant free-riding and allow smaller three-party schemes to compete more effectively with larger, four-party schemes.

- Even if the Merchant Pricing Standard were not repealed, there is no strong case for amending it. The amendments to the Merchant Pricing Standard (introduced in 2013) have had limited time to bed down. Card schemes have both the incentive and ability to educate merchants how to determine their reasonable cost of acceptance. To impose yet another change in the Merchant Pricing Standard seems excessive at this point in time.

- Moreover, the three-tiered surcharging option risks the unintended consequence of greater surcharging on medium and higher cost cards, thereby raising the price level and, in the process, harming consumers.

- For the reasons above, and given that the RBA appears unwilling to allow card schemes that lack market power to ban surcharging on their cards, there is a strong case for leaving the Merchant Pricing Standard unchanged.

Consideration for banning surcharges for debit cards should be based on merchant costs

We understand that, there may be a case for banning surcharges on debit cards.

Currently EFTPOS is not subject to any regulations in relation to the 'no surcharge rule'. We believe that this is appropriate because merchants pay significantly less for EFTPOS than they do for Visa and MasterCard debit transactions.

Targeted changes to reduce particular cases of excessive surcharging

Concentrated competition is the problem

Concentrated competition is a feature of many parts of the Australian market. We think targeted changes are unnecessary given the limited instances of excessive surcharging are fundamentally a problem of competition in the particular merchant industry, not of the Merchant Pricing Standard.

Other than by allowing schemes to restore the 'no surcharge' rule, the Merchant Pricing Standard and the Act cannot effectively address these merchant competition related issues.

Any other changes to enforcement procedures and disclosure practices

No further changes required by RBA

American Express does not see that any other changes to enforcement procedures or disclosure practices are required by the RBA.

Strengthening transparency over the cost of payments to merchants and cardholders

Further easing of 'honour-all-cards' rules to allow merchants to decline to accept cards with high interchange fees

Facilitation of differential surcharging by merchants

American Express already has simple and transparent pricing – no need for further honour all card rule changes

American Express does not apply different merchant fees for different cards. Our pricing is simple and transparent. A merchant pays a single ad valorem merchant service fee for accepting American Express cards, irrespective of card type or issuer.

Because of this simple and transparent pricing and the fact that some merchants can and already do choose not to accept American Express cards, we do not see that any changes to the *honour-all-cards* rules are required for American Express.

Changes to the interchange standard would improve transparency across the dominant schemes

The changes to the current Interchange Standard discussed above would reduce the variance in cost between various types of credit cards and/or reduce the number of different price points by product, therefore reducing complexity and increasing transparency of merchant pricing for dominant scheme cards. These issues can be solved by making changes to the Standards as discussed above and there would be no need to further restrict the *honour-cards* rule.

Merchant pricing should be confidential

An acquirer's agreed pricing with each merchant is confidential and should not be made publicly available.

In any case we do not believe there is a demand from consumers to understand a merchant's cost of card acceptance, particularly where such cost is rendered especially complex by the range of variable factors affecting that cost. In addition there would be a significant cost to schemes and merchants of even providing such information.

Ensuring that merchants have the ability to choose to route their transactions via lower cost networks of processors

Clarifying arrangements for competing payment options within a single device or application

Consumer choice should be the key priority

Different schemes provide different benefits to the customers when using their products and therefore consumer choice needs to be the key priority. It would be an unreasonable outcome if a consumer chose to use a payment scheme for a particular purpose, but a merchant was able to override the consumer choice.

If merchants want to route transactions to a different payment network then they should only accept the relevant payment network. For example merchants may (and do) make this choice by not accepting American Express cards.

As discussed above, consumer choice should also be the key priority for where there are competing payment options within a single device or application. Consumers should be able to choose their preferred payment option from those which the merchant chooses to accept.

Consumers should choose priority for single device or applications

Again it should be consumers who choose priority. There should not be scheme rules which require their own network to have priority on these types of single devices or applications. The network and merchants should not have the ability to override consumer choice.

Merchants have the ability to choose whether to accept the payment network or not

This is the fair outcome because merchants do not have to accept all payment networks. For example, as discussed above, not all merchants choose to accept American Express.

Whatever is implemented needs to avoid the negative effects on a scheme such as American Express which lacks market power and as to which merchants and consumers have enormous choice.

Appendix

Differences between American Express and Visa & MasterCard

American Express business model differs from the model of the dominant schemes as follows:

Visa/MC	American Express
Visa/MC act only as network providers: they do not issue cards or acquire merchants. Their members act only as issuers and acquirers.	American Express is the only payment organisation in the general credit and charge card segment that both operates a network and also issues cards and acquires merchants on that same network.
Visa/MC do not issue cards.	American Express issues many cards in its own name.
V/MC have market power in both the general credit and charge card and the debit card segments.	American Express lacks market power in the general credit and charge card segment. It does not issue debit cards at all.
All merchants that accept credit cards accept V/MC.	Merchants have a choice whether to accept American Express and many merchants exercise that choice to decline American Express acceptance.
Acquiring is 100% licensed to V/MC member banks.	American Express remains the only acquirer on the network. Acquiring is not licensed.
Acquirers pay interchange fees to issuers under a default multilateral interchange fee (MIF) agreement between each network and its members.	American Express as a network negotiates fees with its licensed issuers on a bilateral basis. Licensed issuers have no contractual relationship with each other, only bilateral agreements with American Express.
Acquirers sometimes set merchant service fees by marking up the MIFs they pay to issuers under the default MIF agreement.	American Express as an acquirer negotiates fees it charges to merchants on a bilateral basis.
There is a causal linkage between MIFs and merchant fees, with the latter setting a base for the former. A reduction in the former may drive a reduction of the latter due to the mark-up pricing.	Issuer fees are the subject of bilateral negotiation and do not form the base for merchant discount fees.