



American Express Australia
Further Submission to the Reserve Bank of
Australia
Regarding Review of Card Payments Regulation
Consultation Paper

21 March 2016

Introduction

American Express Australia Limited rejects claims made in certain industry submissions to the RBA in response to its Consultation Paper of December 2015 entitled Review of Card Payments Regulation. The claims relate to two areas – ‘Commercial Cards’ and ‘Regulation of the American Express three-party card scheme’. Relevant sections of the submissions in question are set out in the Appendix.

Those submissions make inaccurate and sweeping assertions without evidence and are deeply coloured by the obvious commercial self-interest of these companies, which are all competitors of American Express at either scheme or issuer level. There is no objective policy basis for their claims or associated proposed changes - merely a desire to gain a commercial advantage over another, much smaller, market participant.

In addition, the positions taken are strikingly similar to a degree suggesting a high level of co-ordination and pre-alignment. They are based on contrived and untested assertions: that a distinct ‘commercial’ card product market exists in Australia; that American Express has a high share of it; and that such share will rise unless the RBA makes a further intervention to relieve the complainants from the rigours of competition.

Commercial Cards - A Fictional Market

Executive Summary

- The arguments of American Express' competitors that a separate commercial market exists are an ad hoc contrivance at odds with the RBA's own view that the relevant market is "general purpose credit and charge cards issued to individuals and businesses by reporting institutions in Australia".
- Cards issued for personal and business use are identical in nature from the perspective of issuers, cardholders and merchants.
- Many card users, particularly those in small business, use a single card for both personal and business purposes.
- Any superficial difference is simply a reflection of segmented marketing, rather than any substantive variation in card features or use.
- Card networks do not (and cannot) track or code the purpose of card transactions. As a result, there could not be a clear definition of commercial cards as a product market, nor reliable data with which to analyse any such market.
- If a market for commercial cards did exist, it would require recalculation of data relating to the general purpose credit and charge card market and a revisiting of the decision to designate the American Express Companion Card system that was based on such data.

Commercial Cards - A Fictional Market

American Express completely rejects suggestions that corporate cards are a distinct product market from consumer cards. They are interchangeable from the perspective of issuers, cardholders and merchants.

Cardholders use corporate cards in the same way as consumer cards for all types of transactions (offline and online charges, cash access etc) and are provided with the same customer service.

Many cardholders place a mix of personal and business expenses on the same card, especially individuals who are sole traders, consultants, partners within partnerships or directors/principals of proprietary companies.

Although some corporations have policies to encourage their staff to use a specific card solely for legitimate business expenses, such restrictions are a matter between employer and employee: card issuers and merchant acquirers cannot directly identify the purpose of any charge. Other corporate entities expressly permit staff to use a card for personal as well as business expenses or to use personal cards for legitimate business expenses. These include Fortune 500 companies and leading professional service providers.

Merchants have a single agreement with a scheme's acquirer for acceptance of all card types of the scheme. They follow the same procedures at point of sale to accept consumer and corporate cards.

They receive a single periodic payment from their acquirer for charges on all cards of the scheme. In the American Express card scheme, merchant service fees do not vary as between proprietary cards issued by American Express and companion cards of licensed bank issuers. Although issuers may package and market certain cards to business users and others to consumers, each type of card can be used for either personal or business expenses. Many corporate cards are offered with similar rewards benefits and incentives to consumer cards. Card networks do not and cannot track or code the purpose of card transactions.

Measuring the commercial segment

Since embarking on the active regulation of credit and debit cards, the RBA has operated on the basis that the relevant product market for credit cards is “general purpose credit and charge cards issued to individuals and businesses by reporting institutions in Australia” (RBA’s explanatory notes to its published C tables).

According to the RBA’s notes on its retail payment statistics, the C2 table is made up as follows-

“Market share data are calculated using acquiring data from the monthly Retail Payments Statistics (RPS) data collection. Acquiring returns are used in preference to issuing returns so that purchases on co-branded cards can be correctly counted towards the market share of the three-party schemes (American Express and Diners Club). The calculation covers all domestic acquiring transactions, by both Australian and overseas cardholders, including transactions on both personal and commercial cards”.

One of the reasons offered for the proposed regulation of American Express’ companion card business is that its share of this general purpose credit and charge cards market is said to have increased. The submissions to the Reserve Bank cited in the Appendix are silent about the RBA’s stated general purpose credit and charge cards market, but are unanimous in suddenly discovering another purported market that has never been mentioned or measured before.

American Express rejects this claim – no separate definable market for commercial cards exists at all. But even if it did, both the principles of regulatory economics and rules of natural fair play would require that it should be precisely defined and objectively measured before being used as the conceptual basis for any regulatory decision. All the more so in the case of a decision made in order to contain the activities of a single company at the behest of an ad-hoc coalition of its competitors.

In fact there is neither a clear definition of commercial cards as a product market, nor reliable data with which to analyse any such purported market.

The RBA collects statistical data about transaction card acquiring on its B form and transaction card issuing on its C form. The B form distinguishes transaction types rather than card product types. The C form does distinguish between personal and corporate cards, which are respectively defined in the RBA’s official explanatory notes to the forms as follows:

- **Personal** – credit or charge cards issued to personal customers.
- **Commercial** – all credit or charge cards that are issued to commercial customers.

But that is where any definition ends – a wide range of ‘business cards’ are offered in the market and in most cases are available to applicants who are individuals, partners in a partnership, corporations or trustees. The only consistent requirement is that the applicant can supply an Australian Business Number (ABN) – something readily obtainable without actually operating a business. Provided they have an ABN and meet the issuer’s credit and risk management requirements, anyone can obtain this type of card. The RBA’s definition focuses on a classification of the customer not on the actual use to which the card is put.

If commercial cards were a distinct market, that market should have been clearly identified and separately measured. That would entail backing out the business volume numbers for commercial cards from the RBA’s statistics relating to the general purpose credit and charge card market and separately publishing them.

If the claims of American Express’ competitors in their submissions regarding the American Express share of commercial cards were justified, the results of separately measuring that purported market would be a reduction in the general purpose credit and charge card product market and an adjustment of the respective market shares of the schemes competing in that market. If, as has been claimed, American Express had a very high share of the commercial / corporate segment, American Express would conversely have a lower share of the general purpose credit and charge cards market than has been claimed.

If the RBA proposes to recognise a separate commercial card market and take action to favour the dominant schemes in that market, it should recalculate data relating to the general purpose credit and charge card market and revisit the decision to designate the American Express Companion Card system that was based on the previous share data.

American Express already faces an adverse regulatory intervention based on long-standing assumptions and data relating to the general purpose credit and charge cards market. It cannot now accept a second adverse decision based on the existence of a second, overlapping market that has recently been ‘discovered’ by its competitors (although never previously defined, measured or used as a basis for policy decisions) without full consideration of the implications of such market overlap.

Consequences of relieving the commercial segment

If commercial cards were permitted to enjoy a higher interchange cap than the proposed 0.8% ceiling, issuers could respond by marketing increased numbers of commercial cards to all types of users and in this way frustrate the regulatory objective of containing payment system costs.

In the 2015 EU Regulation on interchange, to which the RBA has referred, commercial cards are defined as follows-

“‘Commercial card’ means any card-based payment instrument issued to undertakings or public sector entities or self-employed natural persons which is limited in use for business expenses where the payments made with such cards are charged directly to the account of the undertaking or public sector entity or self-employed natural person;”

However, even a definition like this cannot overcome the basic problem of product porosity and prevent circumvention. In this definition, commercial cards can be obtained by ‘self-employed

natural persons' (e.g. individuals) and the restriction in use to business expenses cannot be tracked or enforced because there is no way of knowing what a card is actually used for. As we have seen, in Australia, anyone can obtain an ABN – whether or not you have a real business – and this opens up the possibility for widespread gaming of commercial card products to exploit an exemption from interchange regulation or a higher cap than the 0.8% general cap.

Given one of the RBA's key reasons for amending the current regulation of credit card interchange was to prevent the gaming of the spread of interchange categories which had taken place, the RBA should not create another opportunity for a new form of gaming with commercial cards.

Competition will remain strong in the commercial segment

American Express faces limitations as a specialised service provider that do not constrain its bank competitors. The relationship between bank issuers of commercial cards and their corporate clients is multi-faceted, with the card or corporate payment product being just one of a suite of banking/financial products and services, not all of which need to be profitable on a stand-alone basis provided the relationship as a whole is profitable. American Express only offers payment products and cannot afford to discount these in the hope of recovering revenue from other channels within the same relationship.

American Express also faces challenges with the growth of surcharging and steering, which cause major dissatisfaction amongst corporate clients and frustrate the efforts of many companies and businesses to rigorously manage costs.

Regulation of the American Express three-party card scheme

In its submission on the Consultation Paper, MasterCard calls upon the RBA to regulate the proprietary three-party card scheme of American Express in addition to the American Express Companion Card business.

MasterCard makes a number of specific recommendations to the RBA which are set out below together with American Express' responses.

“Recommendation 9: Subject American Express companion credit cards to the proposed regulation set out in the Draft Standards, with appropriate removal of the regulatory loopholes which remain at present.”

American Express response: the RBA has decided to regulate the American Express companion card business in which American Express has licensed banks to issue cards that bear its logo and are accepted on its merchant network. MasterCard calls on the RBA to extend regulation beyond the American Express companion card to cover arrangements where American Express itself is the issuer of the card. MasterCard calls these the “agency”, “referral” and “co-brand” models and characterises payments by American Express to distribution partners in these models as “economically...clearly interchange”.

MasterCard claims that this extension of regulation is necessary to prevent circumvention of interchange caps by American Express and to ensure competitive neutrality. MasterCard invents an example of a French bank distributing American Express Cards and receiving a hypothetical 1.7% per transaction from American Express versus only 0.3% from MasterCard. This is completely contrived and misleading. In each of these cases American Express is the issuer of the card and owns the customer relationship, the receivable, the credit risk, the cost of servicing and providing customer rewards and the responsibility for regulatory compliance. The scenario described by MasterCard of American Express paying 1.7% to the bank is completely unrealistic.

The distribution partners in the models described by MasterCard are not issuers and therefore payments received by them can be neither legally nor economically compared to interchange fees. Interchange fees are fees paid by acquirers to issuers, not by issuers.

The distribution arrangements MasterCard refers to are arrangements made by card issuers, not by card schemes. MasterCard wants payments by American Express as an issuer to be regulated, but is silent as to whether similar rules should apply to distribution arrangements of its own licensed issuers or those of the other dominant card scheme. In none of the distribution models referred to is American Express acting like a four-party scheme as claimed by MasterCard.

The EU legislation does not provide any support for MasterCard's proposal. The reference to co-brands and agents was inserted following a similar lobbying exercise by MasterCard. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]
[REDACTED]

[REDACTED] American Express has brought legal proceedings to determine the interpretation and validity of the relevant provisions. These proceedings have been commenced in the UK Courts, but it is expected that they will shortly be referred to the European Court of Justice.

The EU regime therefore does not provide any guide for legislative reform along the lines proposed by MasterCard.

“Recommendation 10: Merchants are provided transparent information regarding the costs of American Express companion cards and proprietary cards, including the differences in their acceptance costs for American Express companion cards versus proprietary cards.”

American Express response: American Express already provides merchants with transparent information about the cost of accepting American Express cards. Merchants pay the same service fees for all types of American Express cards. It is only in respect of Visa and MasterCard transactions that Australian merchants face unreasonable complexity and a lack of transparency in their merchant pricing.

“Recommendation 11 (a): Three-party schemes to be regulated by splitting of issuing and acquiring segments of 3 party schemes.”

Recommendation 11 (b): Increase competition in Acquiring of Three-Party schemes

American Express response: MasterCard claims there is “a complex web of interchange-like fees” and/or “implicit interchange fees” in proprietary three-party card schemes that should be regulated and calls upon the RBA to do so. MasterCard suggests more regulation is needed to compel American Express to:

- Perform some form of accounting separation as a means of bringing these hidden “fees” out of the darkness and into the light.
- Establish contracts with distribution partners.
- Not pay any rebates or incentives to merchants involved in distribution arrangements with American Express.
- License acquiring on the American Express network.

American Express submits that looking for interchange surrogates in the accounting entries within a single enterprise is like regulatory shadow-boxing, meaningless and illusory.

A key difference between the business model of American Express and that of the dominant schemes is that American Express, in addition to operating a network, actually issues cards and acquires merchants, whereas the dominant schemes do not. The interchange fee arrangements in the dominant schemes involve the collective imposition by their bank members of a minimum price

on merchants. Proprietary three party schemes such as American Express, by contrast, enter into relationships directly with cardholders and merchants; and, as much smaller competitors, acceptance of their cards is a choice made by individual merchants. The scheme itself agrees with individual merchants what to charge for the services provided to them. By definition, therefore, such schemes do not have any collective interchange fee that sets a minimum price floor for merchant charges. MasterCard's call for increased regulation is, therefore, wholly unjustified.

Looking at the combined effect of all these requested changes, what MasterCard is really asking the RBA to do is to force American Express to change its business model to become a full four-party card scheme like the dominant schemes, again on the basis of unsubstantiated and false claims. However, if the three-party scheme model of American Express is so unfairly advantageous, why do the dominant schemes retain more than 80% of the RBA's defined market for general purpose charge and credit cards, or conversely why have they not attempted to adopt some features of the American Express business model, as they are legally entitled to do?

American Express rejects these suggestions from MasterCard as impracticable, self serving, unfairly one-sided and as requiring a significant use of public resources purely for the purpose of insulating the already dominant card schemes from their only viable – though much smaller- competitor.

APPENDIX

Commercial Cards – views expressed by competitors of American Express

A number of stakeholders have made submissions calling for commercial cards to be either excluded from interchange regulation, or alternatively favoured with a higher interchange cap of (1.10-1.20%).

These stakeholders are all competitors of American Express at either scheme or issuer level and, in our view, their arguments are entirely influenced by commercial self-interest.

This is what they said-

Submission by...	On Page...	Citation
MasterCard	21	<p>MasterCard calls on the RBA to examine the proposal for regulation of commercial payment systems through the lens of its competition mandate. It is essential that there is equal regulation of commercial cards between four-party and three-party schemes. Under the RBA's proposed changes, however, three-party schemes such as American Express - which already has the lion's share of the commercial payment system market - would be exempt from this regulation.</p> <p>The economics of four-party commercial cards (where Issuers and Acquirers are not the same) mean that these schemes would be disproportionately affected by the low 0.80 per cent ceiling relative to three-party schemes, who with higher interchange rates (and merchant control) already offer considerably higher rebates to businesses.</p> <p>The disparity between three and four party commercial card schemes will be amplified as any rebates that can currently be offered by regulated scheme Issuers will be further reduced or eliminated, making their cards less attractive to business. American Express is likely to grow even further in the sector, as it did with companion cards, due to their ability to provide low fees and higher rebates. The cost of acceptance of unregulated commercial cards would remain high, and these costs will be borne disproportionately by small businesses, as large corporations are offered strategic rates by American Express to drive broad acceptance.</p> <p>Therefore, in our view, the effect of the RBA's proposal will be to provide American Express with such a significant competitive advantage as to make four-party commercial cards obsolete, an outcome that is clearly inconsistent with its competition mandate.</p> <p>The proposed regulation will, in addition, curtail competition by discouraging new market entrants given that interchange is the primary revenue received from commercial card programs, and income generated from interest is minimal.</p> <p>Also, this proposal does not represent an efficient allocation of resources, considering the most attractive outcome for commercial card users (businesses) is likely to be the very scheme which has amongst the highest costs of acceptance for merchants.</p>
Visa	11ff	<p>On the issue of competitive neutrality, Visa believes the proposed regulation of commercial cards issued by the four-party payment schemes will further</p>

exacerbate the lack of competitive neutrality that already exists in the Australian B2B payments marketplace. While there is an absence of reliable industry data, the commercial cards segment is largely dominated by the three-party schemes. This has the unfortunate consequence of allowing unregulated schemes to compete on price in the form of rebates that regulated parties cannot match.

.....

The exclusion to date of three-party schemes from the RBA's payments regulation has significant impact on the commercial credit card landscape. The different economic model and cost base for commercial payments has meant that three-party schemes have been able to gain significant market share through offering higher incentives (rebates) to corporate and government clients from the higher costs to merchants. If three-party schemes remain excluded, this distortion in the marketplace would be significantly exacerbated under a 'hard cap' interchange regime for four-party schemes.

Three-party schemes have an especially strong presence in the corporate travel and entertainment sector. For instance, American Express is seen as a 'must take' card for merchants operating in travel, accommodation, restaurant, car hire and entertainment services. Diners Club similarly is a 'must take' card for merchants that wish to provide travel services to Federal Government.

Westpac

6

The 80bps cap on individual credit card rates is likely to have an adverse impact on ADIs' commercial card portfolios to the competitive benefit of American Express' commercial cards. We have seen analysis that shows American Express commercial cards already have comfortably the largest market share in the commercial cards market. The proposed individual rate cap would further skew this dominance towards American Express in this market.

Overall while competitive neutrality between schemes is important, competitive neutrality between issuers in Australia (here the Australian ADIs and American Express) is at least equally important. Our understanding of the Payments systems (Regulation) Act, 1998 is that the impact on competition must be considered when determining standards. On this basis, the extent to which the draft standard will distort the competitive tension in this market must be understood and explicitly considered before deciding on the standard.

A lighter touch solution, that would keep the 50bps weighted average cap, would be to set a separate cap for commercial cards within the weighted average. We have recommended a level that was previously acceptable to RBA, such where they were set immediately following the 2003 reforms (around 110bps) until at least the 2007/8 Review of Cards Reforms. This would both allow effective competition between ADI issued commercial cards, and those issued by 3-party schemes which currently dominate this market.

CBA

2ff

Three-party card schemes have a strong presence in the market for issuance of commercial cards - in direct competition to the regulated four-party products. Commercial cards bring large volumes of business to merchants in a number of industries, including travel, entertainment and procurement. Merchants in these sectors are more likely to accept three-party cards in order to benefit from the additional sales revenue. Furthermore, staff using a three party commercial card will often have a personal card as a backup should their commercial card not be accepted. Accordingly, merchant acceptance does not seem to be an impediment to three party schemes competing vigorously in the commercial cards issuance market.

		<p>Placing an 80bp cap on interchange fees for Visa and MasterCard commercial credit cards will put these products at a significant disadvantage relative to three-party schemes. Three-party schemes will be better placed to promote their commercial card products to potential business clients, due to their fee flows being unregulated. This could well result in a shift in market share for commercial cards from four-party schemes to three-party schemes upon implementation of the RBA's proposal, analogous to the uplift in three-party scheme market share after the RBA's original reforms to credit card interchange fees.</p>
ANZ Bank	1-2	<p>While ANZ supports the continued regulation of Commercial Card interchange, the proposed 80bps 'hard cap' does not reflect the distinct business model these cards have, and the value they provide to merchants who accept B2B payments (i.e. having invoices paid sooner and more efficiently).</p> <p>- Furthermore, such a change would reduce competition against unregulated 3- party scheme cards, which could lead to higher costs for merchants who accept B2B payments.</p> <p>- To address these issues, ANZ proposed that an alternative 'hard cap' of ~120bps apply to Commercial Cards that have business or corporate liability. Such a modest cap would avoid the need to change existing 'honour-all-cards' rules. By targeting this change, the RBA can effectively eliminate incentives for issuers to migrate their consumer credit card portfolios to take advantage of the higher cap.</p>
Citibank	2	<p>If the 0.8000 per cent cap on credit card transactions were applied to Corporate Cards, it would be uneconomic (loss-making) for issuers to offer them to their customers. This will have the following impacts on the market:</p> <ol style="list-style-type: none"> i. Some key current Commercial card Issuers would exit the business and would not be replaced by new entrants since the business would be loss-making. This would decrease competition contradicting one of the stated aims of the regulation which is to enhance the competition and efficiency of the payments system. ii. Create an unlevelled playing field as three-party schemes, such as for example American Express, would be handed the majority of commercial card programs, increasing their already dominant market share position because commercial cards issued by the three-party schemes are currently excluded from the maximum interchange caps. iii. Impairment to innovation due to lack of funding as a result of significant reduction of revenue income from interchange fees, which is the main revenue stream for commercial cards