



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

**3 February 2016**

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## Introduction

American Express Australia Limited makes the following submissions in response to the Reserve Bank of Australia's Consultation Paper of December 2015 entitled Review of Card Payments Regulation (Consultation Paper).

American Express remains opposed to regulatory intervention in card payment systems in general and in particular to:

- The proposed regulation of the American Express Companion Card Scheme; and
- The continuation of regulatory support for merchant surcharging.

We do not understand how the changes proposed in the Consultation Paper are in the public interest. They ignore competition issues which the RBA is required to consider in exercising its regulatory powers, they unfairly discriminate against American Express and its cardholders and they are ultimately unfavourable to consumers. The regulation of the American Express Companion Card Scheme will have the result of taking share from American Express (which has less than 20% of charge and credit volume) and awarding it to the dominant card schemes (which have more than 80%). The dominant schemes have reaped a rich harvest from their years of expanding via unlawful interchange fees. Promoting competition between card schemes and the resulting benefits for consumers have been thrown overboard as a policy objective in favour of making payments cheaper for merchants.

Consumers will now be subject to negative consequences on two fronts: a further round of reductions in the benefits offered with credit cards and more surcharges from merchants when they use their cards. By contrast, merchants have realized hundreds of millions of dollars in reduced costs and surcharge revenue with a lack of hard evidence that they have in fact lowered prices of their goods and services.

A likely consequence of the proposed regulatory changes is that several American Express customer benefit programs for holders of companion cards will have to be discontinued, despite being offered to all cardholders on an issuer-neutral basis and in some cases funded in full or part by partners/issuers or merchants. These include:-

- Amex Connect: A web platform that promotes all benefits available to Amex card members, with a focus on companion Cards. 77 different offers were promoted in 2015.
- Shop Small: An annual nationwide initiative to encourage consumers to support their local businesses which, in 2015, included an offer taken up 258,000 times by American Express card members to "Spend \$20, Get \$10 up to 10 times" when they shopped at small merchants.
- Amex Offers: Amex Offers allows Card Members to load offers from some well-known Australian brands onto their Card, which they redeem by simply spending on their Card. Over 507,000 offers were taken up by American Express card members in 2015.

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As our rationale for these positions has been set out in detail in previous submissions to the Financial System Inquiry and the Reserve Bank, our comments in this submission will focus on the draft Standards Nos. 1 and 3 which are published with the Consultation Paper. We conclude with some observations on implementation and timing.

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## General Comments on Draft Standards

As explained, although we do not agree that the draft Standards should be applicable to American Express, we will offer specific comments and suggestions on their texts, in the hope of avoiding a situation where over-complexity and ambiguity are added to the substantive shortcomings of the proposed regulatory changes.

As a general observation, the text of the draft Standards is complicated, dense and in places impossible to understand. Although the subject matter – the minutiae of card industry pricing- is admittedly technical and specialised, the draft Standards could be greatly improved by a fresh approach based on principles of plain English legal drafting.

If formally gazetted in their current form, the Standards are likely to frustrate the public policy objectives of the Reserve Bank. Situations where the meaning of the Standards is unclear will have to be resolved either by litigation, which is long, expensive and of uncertain outcome for the parties, or else by negotiation and compromise which is at odds with the policy-maker's objective of providing principled and predictable outcomes. In their current form the draft Standards will also significantly increase the legal costs and complexity for Schemes and participants seeking to interpret and comply with them.

The specific comments we have made below are the most obvious ones we have been able to compile in the time stipulated. There may be other anomalies and ambiguities in the text that we have not detected in the time allowed for consultation. We recommend a complete re-think of the texts and a fresh approach to drafting as suggested.

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## Comments on Draft Standard #1

### *Net Payments to Issuers*

The Consultation Paper adopts the concept of ‘net compensation’ as a means of ensuring that different types of payments made to card issuers are not used to circumvent interchange regulation. Although we understand the intent of such provisions, the way the card industry in Australia actually works in practice may leave a number of potential loop-holes still open. In this section we analyse the draft Standard and identify some potential issues with its current text.

In Clause 5.1 of the draft Standard, it is not apparent why it is necessary to have separate definitions of Net Compensation and Net Scheme Compensation. The definition of Net Scheme Compensation in particular is highly problematic and difficult to interpret. Indeed it is not clear from either the Consultation Paper or the draft Standard what circumvention possibility this definition is trying to solve for. It would be clearer to rely on the definition of Net Compensation and provide that no Issuer may receive Net Compensation and no scheme administrator may pay or facilitate payment of Net Compensation to an Issuer.

In Clause 5.2 (a) of the draft Standard, the definition of Issuer Receipts comprises payments or rebates received, directly or indirectly, by the Issuer. To avoid the possibility of interpretational disputes over whether a particular transfer of value can be characterised as a payment, a rebate or neither, the definition should be expanded to include “payments, discounts, rebates or any other monetary value or financial consideration received, directly or indirectly, by the Issuer or cardholders of the Issuer...”. Similar changes should be made to Clauses 5.2 (b), (c) and (e) of the draft Standard.

As currently drafted the Standard may allow customer loyalty or rewards programs to be used to provide benefits to card issuers or their cardholders gratuitously or at less than arms length prices. For example, this could occur in a situation where a scheme has an ownership interest in a loyalty provider. To forestall this possibility, we recommend that these types of programs should be expressly referenced in Clause 5.2 (a) by inserting:

- the words (including loyalty or rewards programmes) in the third line after the words Credit Cards of the Scheme; and
- a fourth item (iv) at the end of the paragraph with the words payments, discounts, rebates or any other monetary value or financial consideration relating to customer loyalty or rewards programmes.

In Clause 5.2 (a) of the draft Standard, in the passage in parentheses, there seems to be one or more words missing where it states “...to discharge a liability to the Issuer as a result of holding or using such a card.” The word ‘their’ could be inserted before holding to rectify this.

In the definitions of Interchange Fees in Clause 2.3 of the draft Standard, we do not understand why, in the case of the American Express Companion Card Scheme in part (b), this has been expanded to encompass Related Bodies Corporate, but not in part (a). This difference strengthens the impression of unequal treatment that American Express already takes from the substance of the draft

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Standards. We would not object to a general provision that makes a regulated scheme participant responsible for the actions of its related bodies corporate if fairly drafted so as to apply to all.

***Publication of interchange fees***

Clause 6.1 of the draft Standard #1 requires each Scheme to publish interchange fees on its website. There are two reasons why American Express should be relieved from this obligation.

First, as explained in most of our communications on this subject since the start of the RBA's process relating to the card industry more than fifteen years ago, American Express does not have multilateral interchange fees, but negotiates bilateral fees with each of its licensed bank issuers. This is confidential information between American Express and the issuer that each is obliged to keep secret and not disclose to third parties. Such confidentiality provisions protect the interests of our issuing partners as well as American Express. It is not appropriate for these obligations to be overridden by regulatory intervention in a way that requires confidential pricing to be disclosed to competitor Schemes and institutions thereby impairing competition between Schemes and among issuers.

Secondly, the American Express issuer rate paid to its licensed issuers is not passed on to merchants as a component of merchant service fees. There is no linkage between the two types of fees in the way that occurs in the dominant Schemes. This means that knowing the American Express issuer's rates is of no help to a merchant that is trying to ascertain their cost of accepting American Express cards. American Express has a transparent, simple pricing structure where a merchant's service fee is charged at an ad valorem rate that is already readily ascertainable by each merchant.

This issue can be addressed by changing the draft Standard to provide that Clause 6.1 applies to multilateral interchange fees but not to fees that are the subject of bilateral agreements.

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## Comments on Draft Standard #3

### *Surcharging by the incremental cost of acceptance*

On page 32 of the Consultation Paper, the RBA notes that “conceptually, the appropriate surcharge on a higher-cost payment method is the incremental cost of that method over alternative low-cost (non-surcharged) means of payment accepted by the merchant.” A merchant that surcharges a higher-cost payment method by its full cost of acceptance, whilst not surcharging other methods of payment is likely to be surcharging more than is appropriate, according to the RBA. However the RBA points to the difficulty of implementing this principle in a simple and enforceable manner as a reason for not doing so.

As an issuer of higher-cost payment cards, American Express is particularly susceptible to the form of differential surcharging where the merchant surcharges only American Express and not Visa or MasterCard. Some merchants choose to surcharge American Express only because our merchant service fee is readily identifiable, which is not always the case for Visa and MasterCard transactions. American Express cardmembers are also perceived as belonging to higher socio-economic strata and therefore less price-sensitive generally and less resistant to surcharges in particular. Even where this is not the case, in Australia there are no merchants who only accept nor cardholders who only carry American Express cards.

Under the RBA’s proposed new Standard, surcharging Visa and MasterCard transactions may become harder for merchants. Because the RBA proposes to retain the current weighted average cap for interchange fees instead of implementing a uniform hard cap, the dominant schemes are able to maintain different interchange fees for different card types within each scheme. Therefore their acquirers can maintain merchant pricing based on a pass-through of the interchange plus the acquirer’s mark-up. In this scenario a merchant’s cost of accepting dominant scheme cards over a given period may vary according to changes in the mix of different card types which that merchant accepts. This will likely mean that each statement provided by dominant scheme acquirers to a merchant will show a different cost of acceptance to the previous statement. This will make it more difficult for merchants to implement and maintain a consistent and accurate surcharging practice for dominant scheme cards, but not in the case of American Express whose pricing will be more consistent and not subject to the vagaries of interchange mix.

If a merchant is willing to absorb the cost of accepting dominant scheme credit cards and factor this cost into their retail prices along with all their other operating expenses, then transparency and fairness require that, at most, only the incremental cost of accepting American Express would be surcharged to consumers. It is particularly unfair and prejudicial to American Express cardmembers that some merchants choose to surcharge American Express transactions only, at 100% of cost, whilst absorbing 100% of their costs of accepting the ubiquitous cards of the dominant schemes. American Express-only surcharging, where the merchant pays the full cost of accepting dominant scheme cards without surcharging them, distorts price signals. Such action is particularly damaging to our brand and betrays the promise of welcome acceptance at point of sale that is conveyed by the merchant displaying the American Express logo in the first place.

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In cases of American Express-only surcharging, American Express would like to have the opportunity to negotiate an agreement with the merchant to limit its surcharge to the difference between the cost of accepting American Express and the cost of accepting Visa and MasterCard. This can be easily achieved by an amendment to the Voluntary Undertaking provided by American Express in the form of a proviso as follows:

“provided always that it would not be a breach of this undertaking if, where a merchant surcharges American Express cards and no other credit cards, American Express terminates the merchant’s card acceptance agreement after making reasonable efforts to negotiate an agreement with the merchant to limit the surcharge to the difference between the merchant’s cost of accepting American Express cards and the merchant’s cost of accepting the next most expensive credit card.”

Without this change, we do not believe that determination of the draft Standard will be in the public interest. By promoting American Express-only surcharging, it unfairly targets and discriminates against American Express cardholders and devalues the American Express brand and paints a misleading picture of the relative costs of different payment cards. With American Express-only surcharging, a customer is misled into believing that acceptance of competitive cards costs the merchant nothing. As explained above, a merchant will not be disadvantaged by no longer accepting American Express, as it is confident that all our cardmembers carry alternative payment products.

### ***Transparency***

Clause 5.1 (a) of the draft Standard requires Acquirers to notify their merchants of the provisions of the Standard and their proposed method of complying with the new statement requirements of Clause 5.1 (b). However, the Standard is drafted in such technical and complex language that explaining its content to non-specialists is no easy matter and, as mentioned above, there are areas in the texts of the draft Standards where the meaning is inherently unclear.

Trying to simplify the meaning of the text carries the risk of getting it wrong, whereas attempting to communicate the full detail of the draft Standard is likely to mystify the reader. Each Acquirer may interpret and explain the Standard in its own way, which will lead to inconsistent messages to merchants and the broader community about the new surcharge rules.

To avoid erroneous and inconsistent explanations and messages, we therefore propose that the RBA take the initiative of preparing a pro forma explanation of the provisions of the draft Standard that Acquirers can provide to their merchants in satisfaction of the requirements of Clause 5.1 (a).

### ***Payment Facilitators***

In Clause 2.3 of the draft Standard #3 there is a definition of Payment Facilitator, and, under Clause 5.2, an Acquirer may be relieved of the statutory duty to provide statements to merchants where a Payment Facilitator agrees to do so.

The provision of such statements to merchants is a new regulatory requirement and therefore may not be part of existing Scheme Rules or agreements between Acquirers and Payment Facilitators. Payment Facilitators employ a variety of pricing models and technology solutions to manage their



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relationships with the merchants they service and commonly guard details of these matters closely and do not share them with their Acquirer. In such circumstances the Acquirer may thus neither have the right to require the Payment Facilitator to provide the new mandatory statements to the merchants it services, nor itself have access to the financial data it would need to provide those merchants directly with the statements.

This could result in a situation where a Payment Facilitator declines to provide either its sub-merchants with the prescribed statement, on the ground that it is not bound by the Standard, or its Acquirer with the requisite statement data on the ground that this is not covered by its agreement with the Acquirer. The draft Standard leaves the Acquirer in breach of a statutory duty in such a case and exposed to regulatory enforcement, although there is nothing it can reasonably do to comply. Accordingly, this aspect of draft Standard #3 does not appear to be reasonably enforceable.

This issue can be addressed by inverting Clause 5 of the draft Standard so that the Payment Facilitator has the duty to provide the required statement to the merchants that it services, but may be relieved if it reaches agreement with its Acquirer that the latter will do so.

A Payment Facilitator is a participant in a card payment system within the meaning of Section 7 of the Payment Systems (Regulation) Act 1998, namely a constitutional corporation that is a participant in the system in accordance with the rules governing the operation of the system. As a participant in a designated payment system, a Payment Facilitator is thus eligible to be regulated by the RBA under Section 18 (1) of the Act.

It would be unfair and inconsistent to allow Payment Facilitators to enjoy the economic benefits of their relationship with merchants without at the same time requiring them to carry out the applicable statutory duties. The changes recommended will help ensure that the new Standard achieves its assumed objectives of transparency, equity and enforceability.

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## Comments on Implementation and Timing

If draft Standard #1 is implemented in its current form, the American Express Companion Card Scheme will be subject to regulation for the first time and will be required to implement Scheme-wide processes to comply with the 0.80% cap and 0.50% averaging requirements.

Unlike the dominant card schemes, the American Express Companion Card Scheme does not have multilateral interchange fees or a central scheme-based mechanism for setting prices that are payable between scheme participants. American Express will therefore have to negotiate changes bilaterally with each of its licensed issuers. As such changes are likely to involve the termination of one or more issuing relationships, more complicated arrangements for the wind-down or transfer of the current card portfolio will have to be negotiated and implemented to minimise inconvenience to customers and brand damage to American Express and the issuer.

The proposed changes to the merchant pricing regime, as set out in draft Standard #3, require American Express to:

- Determine and communicate changes to its merchant agreements across its extensive Australian network. In many cases the agreements are non-standard and require re-negotiation with individual merchants.
- Implement compliance with the new periodic and annual statement requirements for merchants under Clause 5 of draft Standard #3. This is a costly technology change due to the dynamic nature of the data comprised in the prescribed disclosures. In particular the obligation to provide annual statements would require a significant change in the data feeds supporting the current American Express merchant statementing system that is based on various cycles including daily, weekly and monthly. This will entail a significant build out of current data handling capabilities with appropriate change management and testing procedures. From past experience, it is unlikely that system changes of that magnitude could be created, quality-tested and implemented by American Express in less than 18 months. Attached to this submission is a confidential draft project plan.
- Resolve the issues with Payment Facilitators referred to in Section 6 above. As explained, our agreements with Payment Facilitators will have to be individually re-negotiated unless the RBA can assist with a resolution in the manner requested.

American Express also requests that the implementation of both new Standards occur at the same time, to minimise the period of disruption and change for the industry. The proposed regime inflicts increased complexity and cost on many industry stakeholders other than just Issuers and Schemes: Acquirers and Payment Facilitators will be required to make significant technology changes and implement new statement processes; and merchants may be required to implement new surcharging practices, potentially including variable surcharges if their costs of acceptance are the subject of periodic adjustment.

A merchant must understand its cost of accepting a card before it can determine the appropriate surcharge for that card in accordance with draft Standard #3 and draft Standard #1 is likely to reduce those costs. It therefore hardly makes sense to implement the new rules on surcharging before

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those restricting interchange and a simultaneous introduction of both regimes would be the soundest course of action, reducing costs for all impacted parties and minimising the period of inevitable instability.