American Express Australia

Submission to the Reserve Bank of Australia

Review of Retail Payments Regulation Issues Paper

31 January 2020

Introduction

American Express appreciates the opportunity to comment on this Issues Paper. We are also encouraged that the RBA's current review is focussing on retail payments generally and not just cards and interchange which are just part of a rapidly changing and evolving payments landscape.

Changes since the 2015-16 RBA Review of Card Payments Regulation

The 2015-16 RBA Review of Card Payments Regulation (Previous Review) had significant financial and customer effects on American Express including resulting in the end of our Companion Card Business. This caused large reductions in the number of Australians holding American Express cards and lowered our share of credit and charge transactions.

To remain competitive to merchants American Express further reduced its merchant service fees, particularly to small merchants. However, this also impacted our ability to offer differentiated choice in the two-sided market, which requires us to offer distinctive products to both merchants and cardholders.

Since the Previous Review, there have been several developments in the payments industry including the launch of the New Payments Platform (NPP) with participation in this continuing to evolve, introduction of the Consumer Data Right (CDR) and a range of industry led initiatives to support the ongoing security and resilience of the Australian payments system.

There have also been several other regulatory changes affecting the retail payments landscape including further legislative changes regarding credit card practices, and reviews related to lending, loyalty, data and privacy. Each of these impact the resources and investments available to implement further innovations.

No case for further regulation

American Express believes that additional regulation in retail payments should only be imposed if there are clear market failures and should not impact competition, innovation and consumer choice. Currently, we are not aware of any evidence of market failure. We believe that not all impacts from the Previous Review have been fully realised and it is too soon to consider further significant changes to credit card regulation.

The cost of card payments to merchants in Australia is low by international standards. Competition in acquiring and lending is increasing and is expected to continue with the rollout of NPP and open banking and as the industry continues to invest in new technologies. There are many new entrants with retail payments going well beyond cash, cheque, credit and debit. Whilst the NPP roll out has been slow, NPP will provide a further payment method to consumers and merchants.

In our experience, merchants are looking for overall value, simplicity and ease of payments together with value added services. The growth of merchants who choose small merchant plans and simplified acquiring products that provide them with certainty of costs, simplicity and ease of operation tells us that costs are now at a level where price is not the primary driver for many merchant decisions. Services such as Hey You, Shopify and buy now pay later products are also growing in popularity. These services bundle payments with additional services such as marketing, ordering, data insights, data security, web hosting and inventory management. These types of services can be particularly important to smaller merchants as they provide them with easier access to products and services to compete more efficiently with larger and offshore merchants. Competition from new entrants providing retail payments with bundled added services is and will continue to push the costs of these services down and demonstrates the level of competition in retail payments.

As the RBA notes, the indirect impact on American Express from the Previous Review has been at least as large as the more direct effects on four-party schemes. We would argue it has been larger given the resulting end of our companion business and reduced share of transactions. Regulation of three-party schemes is therefore not warranted, would have an unnecessary compliance cost and significantly reduce competition and choice. Given the American Express Companion Cards no longer exist, we agree with the RBA's plan to revoke the Companion Card designation.

Focus on stability, competition and choice

American Express' focus is on continuing to offer superior value to consumer and business customers in Australia, responding to evolving customer needs through investments in new technology and offering differentiated products to high spending consumers and small businesses. We continue to invest in initiatives to drive more commerce to small merchants through programs such as Shop Small. It will become increasingly challenging to meet these needs if substantial further regulatory changes are made. Continued changes in regulation create compliance costs, uncertainty and create challenges to invest.

In an industry with an entrenched dominant card duopoly, we believe the focus should be on continuing to support competition and choice in retail payments. This can be achieved by removing barriers to entry and through a period of regulatory stability to allow investment to realise the full benefits of these initiatives.

In this changing environment, with internationally low costs for merchants, we ask that the RBA not impose further regulations on credit cards and allow for a focus on existing regulator and industry led initiatives to foster greater competition and encourage investment in the Australian market.

Strategic Issues in the Retail Payments Sector

Whilst card costs have come down for merchants, we believe further competitive pricing pressures are inevitable as the industry continues to adjust to changes from the Previous Review. In addition, more recent developments such as the NPP and CDR will have an impact. NPP will provide a further competitive payment option. The introduction of the CDR in open banking presents an opportunity to also increase competition as providers find ways to utilise data to give consumers and merchants more choice. However, the CDR is yet to kick-off and the NPP is not yet at a point where innovative products and services can be developed with enough scale to be commercially viable.

We consider these issues important to this review. These initiatives will affect price, competition and choice in payments, but they are not yet to be fully realised. Challenges with NPP access are being worked through. How the CDR takes effect in open banking should also be closely monitored in the context of retail payments. As roadmaps for implementation and timeframes evolve, so does investment decisions. The banks and schemes have greater scope to meet regulation and adjust to reductions in interchange without changing their business model as they can cross subsidise with other product offerings. Monoline providers like American Express who want to compete and provide alternative choices rely on payment revenues alone to fund these initiatives. The costs required in building capabilities and ongoing regulatory compliance are significant. In addition, there are several industry-led initiatives that American Express participates in including the Card Not Present Fraud Framework, Cybersecurity, Emerging Technologies, Digital Identity and Transit Open Loop Acceptance to support the ongoing security and resilience of the payments system. We believe this work should continue in a collaborative way between industry and government without regulatory intervention.

Competition in the Cards Market

Dual-network debit cards and least-costs routing

Although American Express does not issue debit cards, we generally believe that consumers should have the opportunity to choose which payment method to use (from the methods accepted by the merchant) but acknowledge the complexities with contactless transactions on dual network debit cards.

Competition in card acquiring

Generally large merchants will pay less than small merchants for card acceptance due to economies of scale and negotiating power. However, this would be consistent across most services acquired and is not specific to payments. We also expect the gap in acceptance costs has narrowed with the introduction of interchange caps on debit and credit following the Previous Review.

We are not aware of any shortcomings in competition in the acquiring sector. There are now many more options available to merchants in addition to the major banks. These include payment aggregators and technology companies. Impediments to switching merchant acquiring providers are technical and operational. This includes having to re-implement point of sale software, changing reconciliation and reporting processes, and re-integrating to back office systems. That said, aggregators have simplified point of sale experiences making it easier for small merchants to switch – providing a one stop shop for all card payments. This is further amplified in the card not present environment where providers are offering easy to use payment facilities for online payments.

The industry is investing in technology enabled new products that combine payment facilitation and other ways to expand business for small merchants. In an increasingly complex retail environment, these services are providing smaller merchants with products and services to compete with larger merchants. A good example of this is Shopify which combines point of sale features with tools such as branding, and store build to start a business. As the industry continues to develop, and products and existing offerings mature, there will be greater competition in the acquiring sector. The CDR will support this as the industry is forced to look at its API offerings and engage with partners to deliver greater value to customers.

American Express has implemented dedicated initiatives in recent years to reduce prices for small merchants. We have also invested considerably in infrastructure to drive more commerce to small business through initiatives such as Shop Small. In the last seven years of Shop Small, American Express has supported small merchants by giving more than $19 million back to Card Members through offers for spending at local, small business across Australia and invested further in driving awareness of the importance of small merchants to community and the economy.

In our experience, many merchants are now looking beyond price in acquiring services - they are looking for simplicity, consolidated reporting and settlement, easy-to-use software and bundled services. This has led to the growth in simple merchant plans and payment aggregators. Acquiring products are evolving in a way that the service provided to small merchants is more than just facilitation of payments. Given these factors, we do not consider there to be a need for policy change.

Scheme Fees

American Express' business model is premised on simple and transparent merchant services fees and we do not have scheme or interchange fees. We acknowledge that small merchants would generally be focussed on the end price offered to them, or the value provided, rather than the complexity of understanding the components that make this up. However, we are supportive of transparency of scheme fees and criteria for strategic merchant rates. These fees are relevant to the cost of card payments but are complicated and are not currently transparent.

Digital wallets and mobile payment applications

American Express offers mobile device payments such as Apple Pay, Google Pay and Samsung Pay and was the first to adopt all three so customers can pay the way they want to pay. These devices enhance the customer experience. We are seeing widespread and growing adoption as they provide customers with a secure and convenient way to make payments.

This innovation is benefiting customers and merchants. It should not be stifled by regulation creating disincentives to continue to innovate and invest in Australia.

Interchange Fees

American Express' position is that there is no case for changes to the current interchange standards.

- Merchant service fees have generally been declining since the RBA first regulated interchange.
- The behaviour of merchants choosing simple merchant plans suggests that price is no longer the primary driver for many merchant acceptance decisions.
- It has been just over two years since implementation of reforms from the Previous Review, and it is too early to assess the full effect of these reforms. Pricing changes are still flowing through and not yet fully realised as it takes time for participants to adjust. For American Express, many consumers and businesses still believe the rate paid by merchants to accept is higher than the reality. Previously there has been a significant period following RBA regulation before assessing the need for further intervention.
- There has been no market failure. To the contrary, prices have come down and industry is investing in technology to drive greater value to consumers. Many merchants are looking for ease, simplicity and overall value.
- Transactions on foreign-issued cards are a small share of total card transactions and there has been negligible inbound growth on foreign-issued cards since the Previous Review[1]. We do not consider there to be any significant developments since the Previous Review which determined there was no case for bringing foreign-issued cards into the interchange standards.

Productivity Commission recommendations should not be implemented

We do not agree with many of the arguments put forward by the Productivity Commission in its support for a ban on interchange. There is no economic basis for concluding that an interchange fee of zero is better or worse for society. The argument that banning interchange fees would bring with it the benefit of an increase in the usage of lower-cost payment methods is fundamentally flawed. This ignores the benefits that different payment methods offer cardholders and merchants and the fact that society at large is moving away from cash.

Increased use of lower-cost payment methods does not necessarily imply better outcomes for consumers or merchants. It also disregards consumer choice, that merchants are not restricted from passing on cost to cardholders and ignores the need to find balance in a two-sided market.

Zero interchange may in theory result in lower prices for merchants but will create higher costs for cardholders and ultimately lead to reduced ability to invest in the cardholder side of the two-sided cards sector which would be damaging to merchants in the long term. This imbalance is unnecessary given current cost levels, unfair and suboptimal particularly in the current economic climate. The current suite of products and services offered to merchants and cardholders may not be viable in this scenario. This could lead to a move to uptake in products that currently have no regulatory scrutiny.

The Productivity Commission did not undertake consultation or provide an analysis on the impact their proposals would have on industry participants including compliance costs across the economy.

As above, our ask is that the RBA not make any further changes to credit interchange. The payments industry is undergoing rapid and fundamental change through the emergence of innovative technologies and payment methods. Imposing further regulation will prove distortive and risks stifling innovation.

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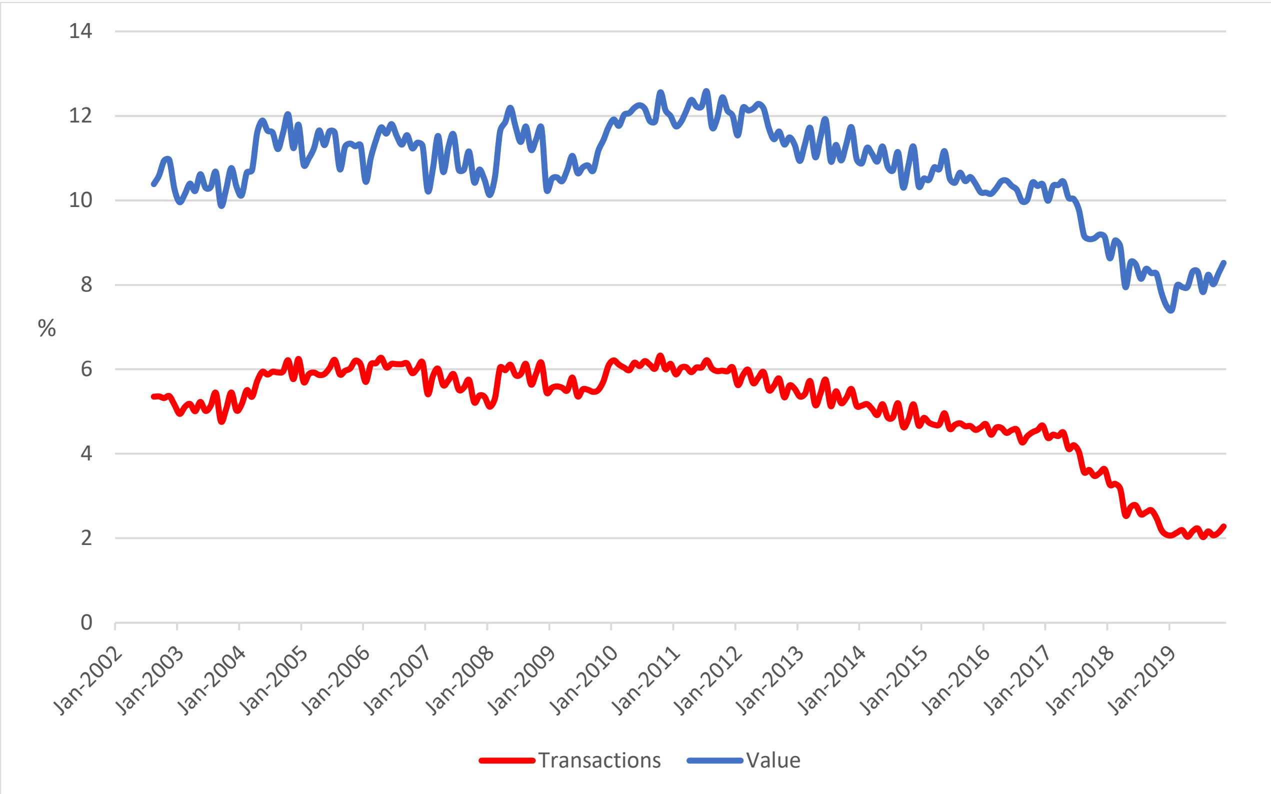
[1] Using data from RBA C1 table – Proportion of transactions acquired in Australia: overseas-issued cards to total number of transactions acquired in Australia

No case for regulation to be applied to three-party schemes

As discussed above, we do not see a case for regulating three-party schemes. There is no evidence of three-party schemes benefiting from interchange fee regulation in Australia - all evidence is to the contrary. The impact on American Express merchant services fees has been at least as large, if not larger than the more direct effects on four party schemes.

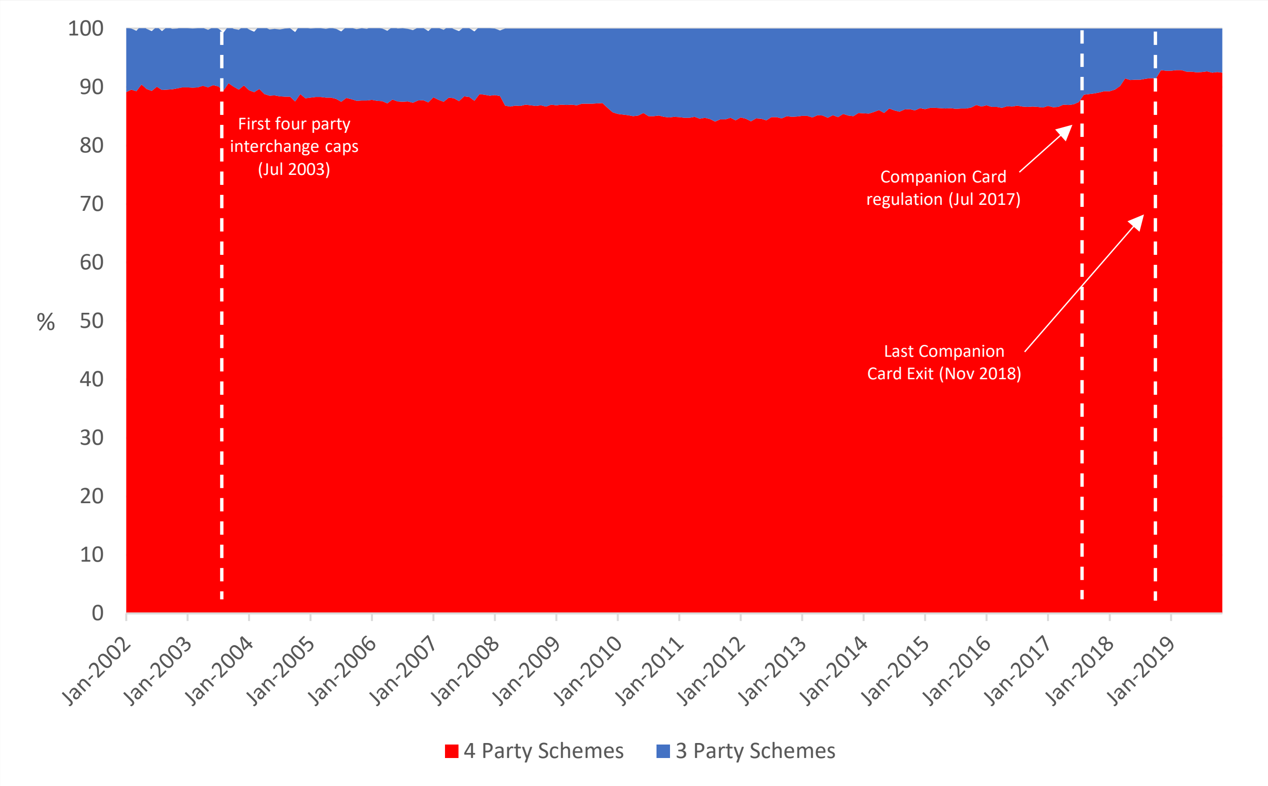
- The share of the value of purchases for three-party schemes across credit and charge cards has not materially increased since the first interchange caps. When considering the growth of debit, three-party schemes' share of both the number and value of purchases including debit, credit and charge has fallen (see Graph 1 below)[2].
- Despite not having interchange fees and therefore not being subject directly to interchange regulation, American Express has faced significant indirect effects including its average merchant service fee falling more than Visa and Mastercard's since the RBA first regulated interchange. This reduction has been widespread and not isolated to just a few merchants.
- The dominant card duopoly remains strong with Visa and Mastercard currently accounting for 92.4% of credit and charge card transactions by number and 83.3% of credit and charge card transactions by value – a situation that has not largely changed since the first interchange fee regulation in 2003 (see Graph 2 below)[3]. Further, this doesn't take into account the growth and dominant position of Visa and MasterCard in the debit sector.

Graph 1 – 3 Party Share of Credit, Charge and Debit Transactions



[2] Using data from RBA C1, C1-3 and C2 tables – 3 party transaction share of total credit and debit transactions
[3] Using data from RBA C1-3.

Graph 2 – Share of Credit and Charge Number of Transactions



No market power

The share of three-party schemes number and value of transactions in the credit card segment is too low to suggest market power and most retailers will have significant buyer power when it comes to accepting American Express. They have options if they choose not to accept American Express cards and merchants can also pass on costs through surcharging. There are serious risks in regulating firms without market power, as doing so can distort the competitive playing field, decreasing competitive pressure on other market participants.

Our merchants accept American Express because they want to, not because they ‘have to.’ Merchants can choose not to accept American Express in the knowledge that almost everyone who has an American Express card also has another scheme credit or debit form of payment available to them. The reverse is not true. American Express does not – and could not compete – based on ubiquity. We must provide value to both card members and merchants every day and rely on our highly differentiated business model in order to compete. American Express focuses on providing superior customer service, as well as differentiated value. For merchants, a big component of that value is the incremental spend that American Express can deliver through its high spending consumer and business customers and our lending options for small businesses. Currently on average each three-party transaction is approximately 2.4 times the size of a four-party transaction[4].

Regulation of merchant service fees of three-party schemes is completely unnecessary. Regulating the merchant service fees of American Express is an extreme measure in circumstances where we have been impacted by interchange and surcharging regulation and have no market power. If this were to occur, then the RBA would need

[4] Using data from RBA C2 tables – Proportion of 3 party average transaction value to 4 party average transaction value for the period December 2018 to November 2019.

to consider regulating the merchant service fees of all payments. This is an extreme and unnecessary approach which would be harmful to competition.

Net compensation, Regulation and Enforcement

Since the introduction of the net compensation provisions on the American Express Companion Card, American Express fully complied with these provisions to the point where the Companion Card no longer exists.

American Express expects the RBA to strongly enforce the net compensation arrangements with other providers with appropriate adjustments or penalties applied for any breaches.

Surcharging

American Express' longstanding position is that merchants should not be able to surcharge. Merchants obtain significant benefits from accepting cards and it allows them to free ride on investments made to bring business to them. This position is even stronger for products that are not 'must take' like American Express.

As discussed above, the RBA's interchange caps have had a significant impact on the average merchant service fees across all card payments.

In our experience many merchants are now looking for solutions that provide simplicity, certainty and functionality as opposed to being focused solely on price. This is shown by the growth of small merchant plans and uptake use of payment aggregators. The cost of card payments is now at a level where merchants should not need to surcharge. We reiterate that there are significant costs each time the regulatory framework is varied. Other than removing the ability of merchants to surcharge altogether, we don't believe that any further changes to the surcharging framework should be considered.