Credit Research Foundation
Education Brief

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The U.S. Supreme Court Sides with AmEx and Their Anti-Steering Card Acceptance Policy: The Impact (Lower Margins) and the Credit Team's Strategy in Response

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On June 25, the U.S. Supreme Court ruled (divided 5-4) that AmEx can force businesses to agree through a contractual provision in a card issuing bank's merchant agreement that they won't steer customers to pay with less expensive card brands, such as Visa and MasterCard. AmEx is historically known for charging businesses higher interchange fees.

The U.S. Supreme Court backing AmEx's anti-steering provision, also referred to as nondiscrimination provisions (NPDs), means that suppliers, as merchants, are locked into paying higher interchange fees to AmEx when customers use this brand.

Given the Supreme Court's ruling, which merchants have disparagingly referred to as a gag order, which bars suppliers that contract with AmEx from encouraging customers to use cheaper card brands, what strategies may the credit team consider to mitigate the higher priced card brand?

Credit Cards Continue as a Customer Preferred Payment Form in the B2B Space

Credit and finance teams appreciate that card use continues its steep rise, as more customers (new and established, small and large) use credit cards to pay the supply chain. Card issuers continue to increase the rewards offered to cardholders, whether for individuals or companies.

Card networks and card issuing banks have targeted the B2B space to grow card use, with a marketing blitz of added incentives and rewards to customers.

Multiple Brands and Interchange Rate Differences

Credit teams accepting multiple card brands (Visa, MasterCard, American Express and Discover) often find a meaningful difference with card brands' interchange fees. The below chart shows the range of fees based on card brand:

Average Credit Card Processing Fees*	
MasterCard	1.55% - 2.6%
Visa	1.43% - 2.4%
Discover	1.56% - 2.3%
American Express	2.50% - 3.5%

*Source: Value Penguin, *Credit Card Processing Fees and Costs*

The Supreme Court ruling preserves AmEx's high interchange fee model.

Further underscoring a likely meaningful increase in AmEx card use by small and mid-sized customers (SMBs) is the just announced partnership between AmEx and Amazon to provide credit cards to this segment of the market by offering special incentives and rewards. Given Amazon's reputation to change markets, suppliers may see a significant increase in AmEx card use by SMBs.

By contrast, Visa and MasterCard are involved in their own antitrust litigation regarding interchange fees. There is a settlement hearing set for July 17, 2018. It is anticipated that a settlement agreement between Visa and MasterCard and the class of merchants will include a decrease in interchange fees for some period, as was the case with a class action involving Visa and MasterCard in 2013. This means that suppliers have an even greater incentive to develop a strategy to move customer card payments to Visa and MasterCard, notwithstanding the Supreme Court's anti-steering ruling.

The Supreme Court Finds Anti-Steering Provisions Do Not Violate the Sherman Act Antitrust Law

For background, in 2010, the United States and the attorneys general of seventeen states brought an antitrust enforcement action against Visa, MasterCard and AmEx, challenging its rules preventing suppliers from steering customers to cheaper card brands, alleging the rule constituted an anticompetitive restraint that violates the Sherman Act antitrust legislation. Visa and MasterCard settled, agreeing to remove the restriction. The District Court found that the AmEx anti-steering policy violated the Sherman Act.

AmEx appealed to the Second Circuit, who found AmEx's anti-steering provisions were not a violation of the Sherman Act.

The government appealed to the U.S. Supreme Court, who in a 5-4 decision upheld the Second Circuit's ruling. The Supreme Court examined AmEx's fee structure and anti-steering policy, and considered whether the policy restrained trade in violation of the Sherman Act. AmEx barred millions of merchants, including suppliers, from encouraging customers to use cheaper card brands, but to accept all card brands equally. AmEx insisted the anti-steering rule protect its brand from competition.

The Court found that AmEx is entitled to use contract language to bar merchants (suppliers) from steering their customers towards cheaper card brands. The Court defined the market as a "two-sided platform" which "offers different products or services to two different groups who both depend on the platform to intermediate between them." The Court stated that the government's argument "wrongly focuses on just one side of the market" and does not consider the cardholder side of the market.

The Court noted Visa and MasterCard have a significant advantage over AmEx by virtue of having 432 million cards in circulation and AmEx only having 53 million; the anti-steering provisions help it to compete. The Court concluded:

> In sum, the plaintiffs have not satisfied the first step of the rule of reason. They have not carried their burden of proving that AmEx's anti-steering provisions have anticompetitive effects. AmEx's business model has spurred robust interbrand competition and has increased the quality and quantity of credit-card transactions. And it is "[t]he promotion of interbrand competition," after all, that "is . . . 'the primary purpose of the antitrust laws.'"

The Credit Team's Strategy to Mitigate the Costs of the Anti-Steering Provision

Credit teams are facing an unprecedented rise in customer card use in the B2B space. Given the Supreme Court's backing of AmEx's anti-steering provision, and Amazon and AmEx joining forces to market cards to SMB customers and the expected lowering of Visa and MasterCard's interchange rate through a court-ordered settlement, finding a pathway to lower card brands is paramount for credit teams. The underpinnings of the anti-steering provision is that the customer cannot be directed to a cheaper card brand. For suppliers with a bricks and mortar operations for card present payments, they are also barred from posting signs stating a preference for a cheaper brand at the point of sale.

But if the customer knew the difference in card brand interchange fees, would that prompt the customer to reconsider using AmEx? The problem for the credit team may be that customer knowledge that AmEx has a higher interchange fee does not necessarily mean the customer will move to a cheaper card brand, especially given the AmEx rewards program offered to cardholders, in particular individual cardholders.

What if the customer were required to pay the higher interchange fee as a condition to pay the supplier's invoices? Might that be a tipping point for the cardholder to reconsider the card brand? For suppliers surcharging the customer the interchange fee by brand level, the customer has a self-interest to consider a cheaper brand.

The Supreme Court's ruling should prompt suppliers to consider surcharging as a way to maintain margins, especially with AmEx card paying customers. The below chart underscores the shrinking profit margins if the supplier does not surcharge, as compared to maintaining margins if a surcharge is adopted.

Scenarios detailing Supplier Options for $200,000 customer purchase:

	SUPPLIER	Assumes $2 mil annual credit card sales
Payment in full within 48 hours using credit card	$ 200,000	$ 2,000,000
Interchange Fee 2.5% paid by Supplier	$ (5,000)	$ (50,000)
Reinvestment/Redeployment of Funds at 3%	$ 455	$ 4,550
Net to Supplier	$ 195,455	$ 1,954,550
% of Purchase Price	97.7%	97.7%
Payment in full after 30 Days using credit card	$ 200,000	
Interchange Fee 2.5% paid by Supplier	$ (5,000)	
Supplier's Cost of Borrowed Funds (3%)	$ (500)	
Net to Supplier	$ 194,500	
% of Purchase Price	97.3%	
Payment in full after 60 Days using credit card	$ 200,000	
Interchange Fee 2.5% paid by Supplier	$ (5,000)	
Supplier's Cost of Borrowed Funds (3%)	$ (1,000)	
Net to Supplier	$ 194,000	
% of Purchase Price	97.0%	
Payment in full after 30 Days using credit card	$ 200,000	
Interchange Fee 2.5% paid by Customer	$ -	
Supplier's Cost of Borrowed Funds (3%)	$ (500)	
Net to Supplier	$ 199,500	
% of Purchase Price	99.8%	
Non-Credit Card Payment (with Discount) in 10 Days	$ 200,000	
2% Discount to Customer	$ (4,000)	
Reinvestment/Redeployment of Funds at 3%	$ 457	
Net to Supplier	$ 196,457	
% of Purchase Price	98.2%	

Brand Level Surcharging to Offset the Anti-Steering Provisions

Visa and MasterCard provide two forms of surcharging, Brand Level and Product Level. A supplier must select one form. The Brand Level form of surcharge allows the supplier to apply the same surcharge to all credit card transactions for a particular brand, regardless of the card's issuer or product type.

If the credit team adopts a payment portal, third party services can create pop ups of the brands' interchange fees. The cardholder can decide which brand they wish to use—and pay the interchange fee—by virtue of the surcharge.

Critics of the Supreme Court's ruling authorizing anti-steering provisions complain that cardholders do not know their card brand's cost to the business accepting the card, and the business can't steer the cardholder to a cheaper brand. By contrast, the supplier adopting a brand level surcharge creates transparency for the customer as to the various brand interchange fees, which prompts cardholders to reconsider the brand selection. Surcharging may also result in the customer electing to use another payment form, such as ACH.

In conclusion, for suppliers absorbing the interchange fee, the credit team wants to steer the customer to the least expensive card brand. But the Supreme Court has shut down that strategy by backing AmEx's anti-steering provisions. The Supreme Court's decision reinforces that the credit team must reevaluate surcharging to preserve margins.

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