Testimony of

John Buhrmaster
President, 1st National Bank of Scotia

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on the Judiciary
Anti-Trust Task Force

Hearing on

"Credit Card Interchange Fees"

July 19, 2007
Washington, D.C.

Chairman Conyers, Ranking Member Chabot, Members of the Task Force, my name is John Buhrmaster and I am President of 1st National Bank of Scotia, a $270 million community bank located in Scotia, New York, and I am pleased to be here today on behalf of the Independent Community Bankers of America (ICBA).

On behalf of ICBA's nearly 5,000 member banks, I want to express our appreciation for the opportunity to testify on the important role credit and debit card interchange fees play in supporting community banks and our customers. While there are many aspects to the interchange debate, I would like to focus on two today: how interchange affects consumers in the market, and the impact of interchange on competition.

<u>The impact of interchange on consumers</u>

For a community bank like mine, which is engaged in credit and debit card activities as both an acquiring bank – i.e. a member of Visa or MasterCard that maintains the merchant relationship and receives the card transactions from the merchant – and a card issuer, it is important to realize that not only are our customers the consumers who trust us with their personal banking needs, but also the many local merchants who have decided, after shopping around, that we can provide them with the best acquiring services to meet their needs.

Just as consumers should always shop around for a financial institution that best meets their banking needs, a merchant who is setting up a credit card acceptance process should shop around for a level of service, customer support, and range of fees that best fits their business plan.   If a merchant opts to sign with 1st National, at the end of the day, it is getting tremendous value because of the interchange system that I, as an acquirer, am able to utilize. The merchant does not have to extend credit directly. It gets guaranteed funds in its account right away, the ability to accept credit and debit cards carried by millions of consumers, and doesn't have to worry about bounced checks. And also because of interchange, merchants, as well as cardholders and card issuers, all benefit from state-of-the-art fraud detection systems. These fraud-detection systems are even more important to smaller merchants who lack the deep pockets of their much larger competitors. The same applies to my bank as a small card issuer.

There was a time when, if you wanted to use credit for a purchase, you had to shop at a large department store that could afford an in-house credit program. Today, most consumers can use credit to shop at even the smallest merchant because most consumers carry a line of credit in the form of a credit card in their wallets. What small retailer could afford its own proprietary card nowadays? Because of my ability to issue cards and be a merchant acquirer, small businesses in and around my community can set up a deal where they are paying competitive fees, can accept plastic, are assured a consistent payment experience, and are protected against the fraud I described earlier. This acceptance is important to the viability of my local merchants and the economic base of my community.

Contrary to popular belief, for many community banks, the services I'm able to provide thanks to the existence of a negotiated interchange fee system are not huge profit centers. The real value lies in my basic ability to offer these products to consumers and merchants. Does it make me some money? Of course. But for me and many community bankers, the high level of personal service I am able to provide consumers is what makes this system valuable, not gigantic profits.

In my estimation, government intervention in the interchange system would most significantly harm my customers who, again, include both small merchants and consumers. In all likelihood, without the incentive of interchange, community banks like mine would not be able to offer the same services we do now, which means fewer choices for consumers and less competition for their business. In addition, if more banks stop offering interchange-fee-supported products and services, I think it's very likely the industry would consolidate into just a few very large issuers and acquirers, and costs of running the system that are currently covered by interchange would be passed on through the payments chain, with the final burden falling on your average consumer who uses a credit card. The payment system and infrastructure in our country is not free, did not materialize overnight, and should be paid for by those choosing to take advantage of it.

We don't want our merchants to pay high fees, but interchange is a cost to the acquiring side of my bank's business. It is a factor in determining the merchant fee ("discount") I charge the merchants my bank supports. This merchant discount is a cost of doing business just as the wholesale cost of Concord grapes – a significant industry in my part of Upstate New York – is a cost of doing business to a winery. The merchant winemaker needs to know the cost of both the merchant discount and the wholesale cost of grapes. The regular statements I provide to my merchant customers gives them explicit figures on the cost to them of card acceptance, just as the bills winemakers receive from grape growers tell them the wholesale cost of grapes.

Also, as a card issuer, I could not afford to make those products available to consumers, giving them the opportunity build that relationship with their local bank, without interchange income. It is also likely that the remaining issuers would scale back reward programs and grace periods, turning credit cards into straight short-term lending products and not the transaction accounts they have evolved into for many people who take advantage of free airline tickets and merchandise.

Some have also made the assertion that the interchange system is not transparent, and that these rates should be printed on payment card receipts. I have no problem telling merchants the costs they incur to accept debit and credit cards. But printing interchange rates on customer receipts would be the equivalent of telling consumers how much it cost the vineyard to pick its grape harvest. The more relevant information for the consumer would be the wholesale cost of the grapes and the merchant discount paid. Right now, nothing prevents a merchant from voluntarily printing both on receipts; but doing so would add additional costs to the payment process.

The impact of interchange on competition

On the issue of competition, our bank was founded in 1923, and I am the fourth generation Buhrmaster to serve as President of 1st National. I can tell you with confidence, if I didn't have a card network like Visa or MasterCard standing in for me to negotiate interchange rates against the mega-banks with national footprints, I -- and maybe my father before me who served as President -- would simply not have been able to compete for as long as we have. The financial services we provide to the people and businesses in our communities would have been gone long ago because we, quite simply, would not have been able to offer the competitive products and services to stay in business.

Put another way, our interchange system works so well that thousands of small community banks are able to stand toe-to-toe, on both the issuing and acquiring bank sides of the business, and offer services to consumers in direct competition to banks like Citigroup and JPMorgan Chase, while providing the type of customer service that only a community banker can give. If we were forced to compete in an environment without interchange, our relatively small size would put us at a significant competitive disadvantage in negotiating the rates we would receive. It is important to note that the interchange rates we currently receive as an issuer and pay as an acquirer, are the same rates paid by the largest banks in our country. Without our market-driven system, how would a small bank compete against the clout of mega-banks?

While big banks will always beat us in terms of economies of scale, they just can't offer the flexibility to customers that we do. A person can walk into one of our bank branches and set up all of their financial services in one place, including walking out with one of our credit or debit cards. They can have a relationship with one bank that knows them and their community, and they can do that thanks to interchange.

I'd also like to address what I believe is a very unfair characterization: that all interchange does is allow big institutions to take advantage of the little guys. Not only is that wrong, it's also opposite of reality. Interchange, as I described previously, offers many protections against things like losses from fraud. Yes, the big issuers and big banks do drive interchange pricing. But some large banks choose to have interchange as a main profit center, and are very good at creating efficiencies. But consumers, including folks who walk in off the street and merchants, are not always better served by something just because it's "big," and that's where a community bank plays a vital role. I believe that aspect is often overlooked in this debate, because it's so easy to focus on the large issuers and large acquirers, ignoring the harm that could be done to the thousands of community banks should the interchange system be curtailed and not allowed to operate by the dictates of the market.

I also believe it is inaccurate and misleading to characterize interchange as a hidden tax on consumers. It is no more a hidden tax than is the cost of check processing or the cost of counting cash and making change. Interchange is a fee for a service that allows a bank like mine to offer additional services to local businesses, gives those businesses the ability to attract more customers with additional payment choices, and allows those customers the flexibility of paying on credit. That's the benefit of a two-sided market that works the way it's supposed to, with an intermediary like Visa or MasterCard standing in for us and successfully bringing together and meeting the various payment needs of banks, merchants and consumers. Were there not some value to be added to a business model by accepting the costs of participating in the credit and debit card interchange fee system, we would see rates of electronic payments on the decline. Of course we all know, that is not the case and the number of electronic payments continues to grow. Only thanks to interchange can complete strangers exchange plastic for large-dollar items within the parameters of a controlled, predictable system.

To conclude, ICBA strongly believes the credit and debit card interchange system in our country is working, and provides tremendous benefit to American consumers who are opting in greater numbers each day to use credit and debit cards. Merchants have many choices available to them with regards to the form of payments they wish to accept, just as consumers have many choices regarding the financial institution with which they choose to do business. I compete every day for the business of both merchants and consumers, and I do so in large part thanks to the availability of default interchange rates. Intervening in a functioning market will only harm the merchants and consumers currently benefiting from an efficient process.

Again, thank you Chairman Conyers and Ranking Member Chabot for the opportunity to testify on behalf of ICBA, and I look forward to any questions you may have.