STATEMENT OF MALLORY DUNCAN

SENIOR VICE PRESIDENT, GENERAL COUNSEL

ON BEHALF OF

THE NATIONAL RETAIL FEDERATION

AND

THE MERCHANTS PAYMENTS COALITION

BEFORE THE

UNITED STATES HOUSE OF REPRESENTATIVES FINANCIAL SERVICES COMMITTEE

HEARING ON

H.R. 2382, THE CREDIT CARD INTERCHANGE FEES ACT

OCTOBER 8, 2009

Chairman Frank, Ranking Member Bachus and Members of the Committee, I am honored to appear before you today. My name is Mallory Duncan and I am Senior Vice President and General Counsel of the National Retail Federation (NRF). The National Retail Federation is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet, independent stores, chain restaurants, drug stores and grocery stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.6 million U.S. retail establishments, more than 24 million employees - about one in five American workers - and 2008 sales of $4.6 trillion. As the industry umbrella group, NRF also represents more than 100 state, national and international retail associations.

NRF is also a member of the Merchants Payments Coalition (the MPC). The MPC is a group of more than 20 national and 70 state trade associations representing retailers, restaurants, supermarkets, drug stores, convenience stores, gasoline stations, theater owners, on-line merchants and other businesses that accept debit and credit cards. MPC is fighting for a more transparent and competitive card system that works better for consumers and merchants alike. The coalition's member associations collectively represent about 2.7 million locations and 50 million employees. These merchant associations account for more than 60 percent of the non-automotive card based transaction volume in the United States. We are very pleased that the Committee is holding this hearing to explore one of the most significant issues ever to face the merchant community.

The legislation that the Committee is considering today, the Credit Card Interchange Fees Act, H.R. 2382, sponsored by Representatives Peter Welch (D-VT) and Bill Shuster (R-PA) would help deal with market and policy problems caused by swipe fees – also known as interchange fees. We endorse the bill enthusiastically.

The collective setting of interchange fees by Visa and MasterCard represents an on-going antitrust violation and it costs merchants and their customers—that is, America's consumers—tens of billions of dollars annually. These fees, hidden from consumers, are in addition to the late fees, over-limit fees, and other card fees with which we are all only too familiar. This Committee has already taken action on some of the unfair practices engaged in by the credit card companies in their direct dealing with individual consumers. What the Welch-Shuster bill would do is address the unfair practices that the industry engages in to impose and collect these hidden fees as well.

I would like to address a few points in my testimony today. First, I will describe interchange fees and some of the major problems associated with them. Second, I will briefly discuss the antitrust perspective. Third, I will review the provisions of the Welch-Shuster bill and discuss how they can improve the current situation. Finally, I will explore some of the myths that have grown up around this topic and provide information to set the record straight. My comments will reflect the mission of the Merchants Payments Coalition, which is to bring about a more transparent and competitive card system that benefits us all. We look forward to working with the Committee to help pass the Welch-Shuster bill and achieve this objective.

I. WHAT ARE INTERCHANGE FEES AND HOW DO THEY HARM MERCHANTS, OUR CUSTOMERS AND THE U.S. ECONOMY?

Historically, interchange fees have been collectively set by Visa and by MasterCard on behalf of each of their member banks. Within each of those networks, every one of the thousands of supposedly competing banks charges the same schedule of rates.

When a consumer buys an item with a Visa or MasterCard credit or debit card, the merchant does not receive full face value from the bank who issued the card. The total difference between the face value of the customer's purchase and the amount the merchant actually receives is called the "merchant discount," the vast majority of which is the interchange that is paid by the merchant to the bank that issued the customer's card. The average consumer has no idea that this fee is imposed every time he or she makes purchases with a Visa or MasterCard. In this way, interchange acts as a privately imposed hidden sales tax on U.S. commerce, raising both merchant costs and ultimately the price of goods and services sold to consumers.

Because the fees are not transparent to consumers and cannot reasonably be avoided by merchants the incentives for the credit card companies are geared toward raising the fees higher and higher to encourage loyalty to each card brand. On the one hand, the higher the fee, the more money card-issuing banks make. On the other hand, the remaining banks who act as intermediaries between the merchants and the credit card system (known as acquiring banks) do not lose a cent because they charge the merchant for the entire cost of the interchange fee. Currently, these swipe fees are so high that merchants simply cannot absorb the costs. They must pass along much of these fees to consumers in one form or another.

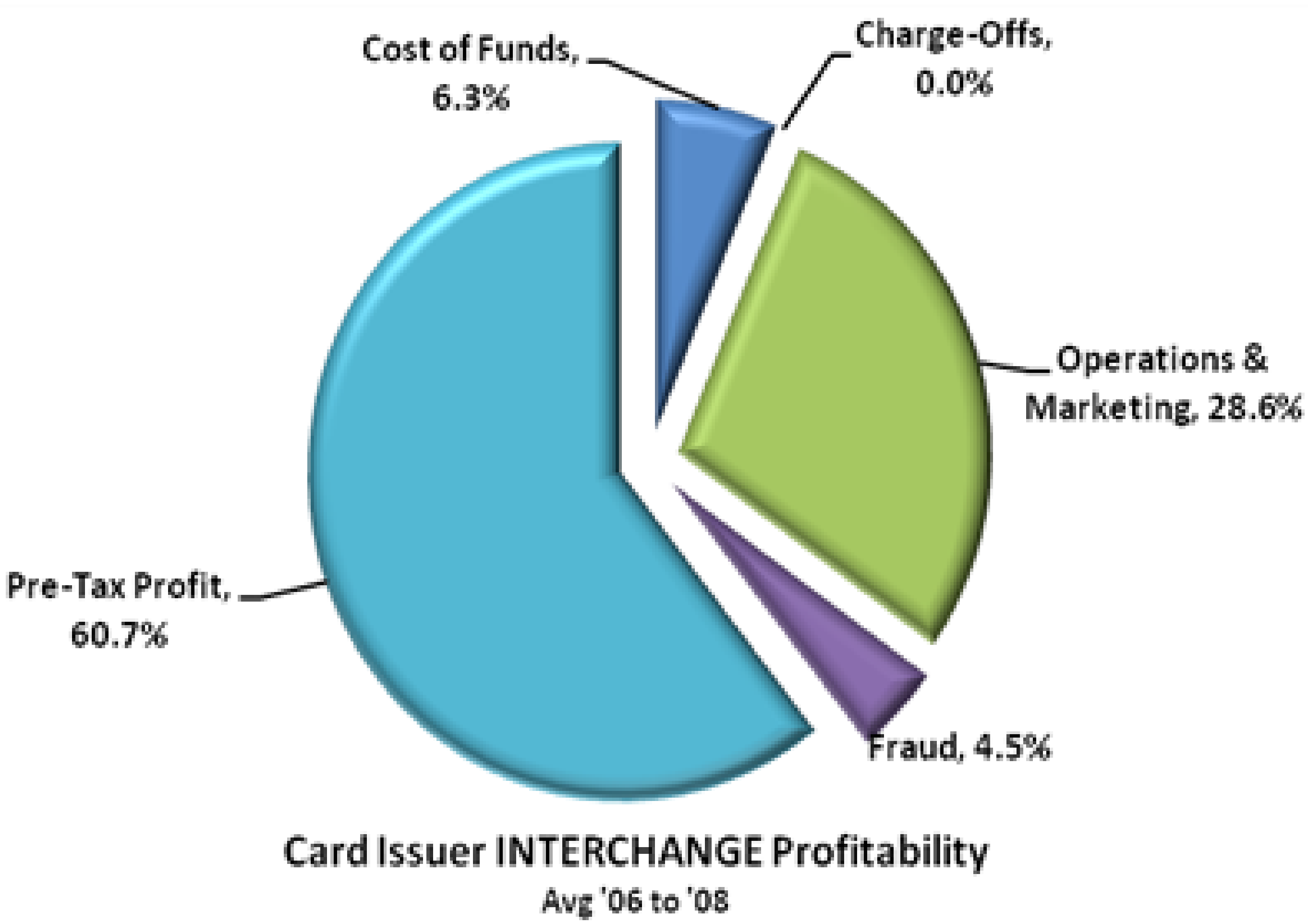
Visa and MasterCard are able to get away with this because they have market power – both individually and jointly – according to the courts. By a very conservative estimate, Visa and MasterCard together control more than eighty percent of the credit card market. The vast majority of merchants therefore have no choice but to accept their cards. In fact, Kansas City Federal Reserve Bank economists have found that merchants realistically cannot refuse to accept Visa and MasterCard payment cards, even though interchange fee costs far exceed any benefits those merchants receive by accepting cards.[1]

The result is that interchange fees continue to increase. The perverse effects of the current interchange fee system are growing, and are of growing concern, because electronic payments, especially card payments, are an increasing percentage of consumer transactions, replacing checks and cash. In 2003, in fact, the number of electronic payments exceeded the number of check payments for the first time in U. S. history. This event is significant, because checks are cleared at "par" (paid by banks at their face value) and the cost of the checking system is borne by those who issue the checks. On the other hand, because card-based payments, including debit cards, are credited to a merchant's account only at a discount, merchants, and ultimately consumers, not only must pay for costs of the card transaction processing system—but also make a significant contribution to the cost of marketing and issuing cards, themselves, not to mention

[1] "A Puzzle of a Card Payment Pricing: Why are Merchants Still Accepting Card Payments?," Fumiko Hayashi, December 2004.

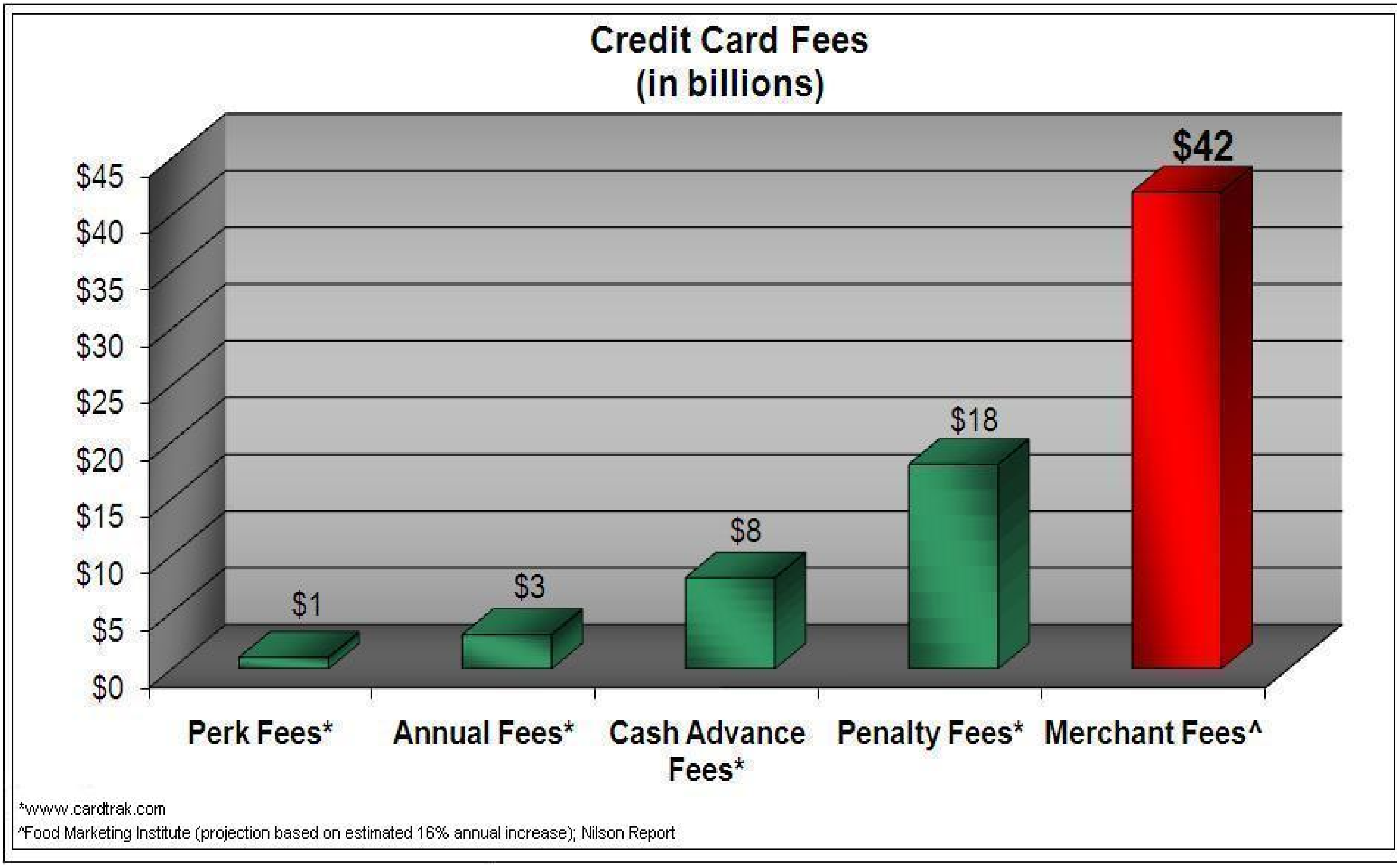
contributing to monopoly profits in the process. Indeed, the funds Visa and MasterCard banks collect through these fees goes toward marketing efforts such as the more than 6 billion credit card solicitations sent to consumers in 2005. As you can see in Figure 1, a primary source of funding for this marketing is swipe fee income. Even more notably, as the same 2008 figures from the publication *Cards and Payments* demonstrate, more than 60 percent of interchange fee revenue is for profit. Just as one would expect when there is a lack of competition.

Figure 1



In addition, as will be discussed, because credit card company rules essentially required that the regular price of goods and services offered to the public be advertised at the credit card price, even consumers who pay by cash or check subsidize card-issuing banks' marketing efforts. The result is effectively an inflationary sales tax on all Americans. These swipe fees dwarf the more visible card fees, as set out in Figure 2.

Figure 2 (2007 Numbers)



Tellingly, in other nations that have put an end to this price-fixing scheme by Visa and MasterCard, merchants and consumers have benefited. One might expect these fees would be lower in the United States than in other countries because the U.S. has the largest transaction volume (which should create economies of scale) and has the best technology and very low fraud rates. Unfortunately, however, U.S. merchants and our customers are being fleeced. In part it is because of these huge fees are hidden. The card associations have made every effort to ensure that card holders remain unaware of the interchange fee costs usage of cards imposes. First, as mentioned, card association rules require merchants to advertise the price that a card user would pay as the primary advertised, i.e. “regular,” price. Second, card association rules prevent merchants from using different prices to reflect the different levels of interchange fees associated with different types or brands of payment cards.

Indeed, as the Federal Reserve Board informed Congress in a 2004 report on disclosure of fees for the use of debit cards, “Because these interchange fees are generally unknown to consumers, most people still remain unaware of the effects of their choices on merchants’ costs or card issuers’ revenues.” The lack of transparency in Visa’s and MasterCard’s rules governing the interchange fee system distort consumer choices by depriving consumers of the price cues they need to put a market-based check on the size of the fees. Consumers could reasonably assume that using a card is free (or even a benefit because they get some type of "reward") even though it makes all of us pay more for virtually everything we buy.

So called "rewards" are a key part of the problem. It bears noting that the rewards cardholders receive are generally worth far less than the interchange fees they pay. In sum, this lack of transparency and the card companies' limiting of retailers' ability to use normal competitive price signals regarding the use of cards results in everyone paying more, whether they use cards or not.

II. THE CARD ASSOCIATIONS ACT LIKE CARTELS.

Visa and MasterCard both were formed as consortiums of competitors. On the one hand these banks compete to get consumers to sign-up for and use their cards. But on the other hand, operating through Visa and MasterCard, they present a united front of collectively imposed fees and they all charge the same price.

This price-fixing by cartels should be illegal and has long been a central element of the antitrust prohibitions of the Sherman Act. The recent initial public offerings by these companies does not change the essential nature of the price-fixing arrangement. Visa and MasterCard still separately engage in price-fixing on behalf of their members. While Visa and MasterCard themselves are now separate entities and not simply associations of banks, competing banks cannot escape liability by simply allowing a third party to fix prices on their behalf.

That is just what happens now. In the MasterCard IPO, for example, it was stated that the interchange fee system would continue to operate in the same way – with MasterCard setting the fees and all member banks charging the same default rates. The price-fixing agreement, then, is largely unchanged and member banks have kept a significant ownership interest in MasterCard. Member banks also appoint members to the board and banks remain MasterCard's customers.

As MasterCard put it, "We are, and will continue to be, significantly dependent on our relationships with our issuers and acquirers [member banks]…." MasterCard has proven this to be true in its actions. It continues to fix interchange rates and its member banks continue to charge those same fixed rates. With the price-fixing unabated since the IPO, MasterCard's interchange rates have continued to rise.

While Visa and MasterCard sometimes argue that their behavior is not illegal price-fixing because they are joint ventures, those arguments do not apply to the system they have created. Much greater detail regarding the reasons that this argument falls flat could be advanced, but from our perspective the key is this -- interchange fees are not fees charged by a joint venture for products or services sold by the joint venture. Rather, they are fees that association members have agreed that they each will charge as card issuers to the banks that process merchant transactions and that those banks in turn pass on to merchants. Thus, reliance on precedents applicable to the setting of a joint venture's own prices is irrelevant to an analysis of interchange fees.

While antitrust authorities in the U.S. have not yet taken action against the collective setting of interchange fees. Over time, some of the rules that Visa and MasterCard have claimed were essential to their systems (such as denying banks the ability to issue Discover and American Express cards and tying the acceptance of debit cards to the acceptance of credit cards) have fallen by the wayside after antitrust challenges. These cases and other investigations have begun uncovering a variety of problems with the structure of Visa and MasterCard's systems.

Our trading partners have examined interchange have found decided problems with Visa and MasterCard's attempts to justify the legal and economic basis for the size of their interchange fees. In fact, the European Commission's Directorates for Competition and Financial Services jointly conducted a comprehensive study into the European payment card industry in general, and Visa and MasterCard in particular. The Commission found no evidence to support the card systems' arguments in favor of benefits to consumers of the high fee levels associated with the existing interchange fee mechanism. In particular, the Commission rejected arguments that lower interchange fees to merchants would result in higher fees to consumers:

> "There is no economic evidence for such a claim. Firstly, the inquiry's data suggests that in most cases card issuers would remain profitable with very low levels of interchange fees or even without any interchange fees at all. Secondly, the international card networks have failed to substantiate the argument that lower interchange fee would have to be compensated with higher cardholder fees The evidence gathered during the inquiry rather suggests that the pass-through of higher interchange fees to lower cardholder fees is small. Consumers already pay the cost of the interchange fee without knowing it. This cost is now hidden in the final retail price and is therefore non-transparent."

Similarly, the Australian experience has refuted claims that decreases in interchange fees would undercut the viability of card systems. In fact, after several years' experience with reduced interchange fees, the Australian central bank has concluded that card issuers have responded to lower merchant fees by offering consumers a choice: Low cost cards with low interest rates and fees and no rewards, and rewards cards with higher interest rates and annual fees.

Indeed, this resulting *price competition* is precisely the outcome the card systems feared: For example MasterCard had complained to the Australian Reserve Bank about having its members forced to compete on price:

> "MasterCard does not disagree that there is, at present, strong competition amongst issuers of credit cards. Such competition has been enhanced by the fact that, at present, issuers have been able to recover eligible costs…. One distinct characteristic of the product offerings in recent times, however, has been the increase in the number of "low cost" credit card offerings. While MasterCard believes that it is beneficial for there to be "low cost" credit card products being offered, it also believes that, with the common benchmark interchange fee, in the future there will be fewer "fully featured" credit card offerings and the competition between issuers will be based on increasingly homogeneous "low cost" credit card offerings."

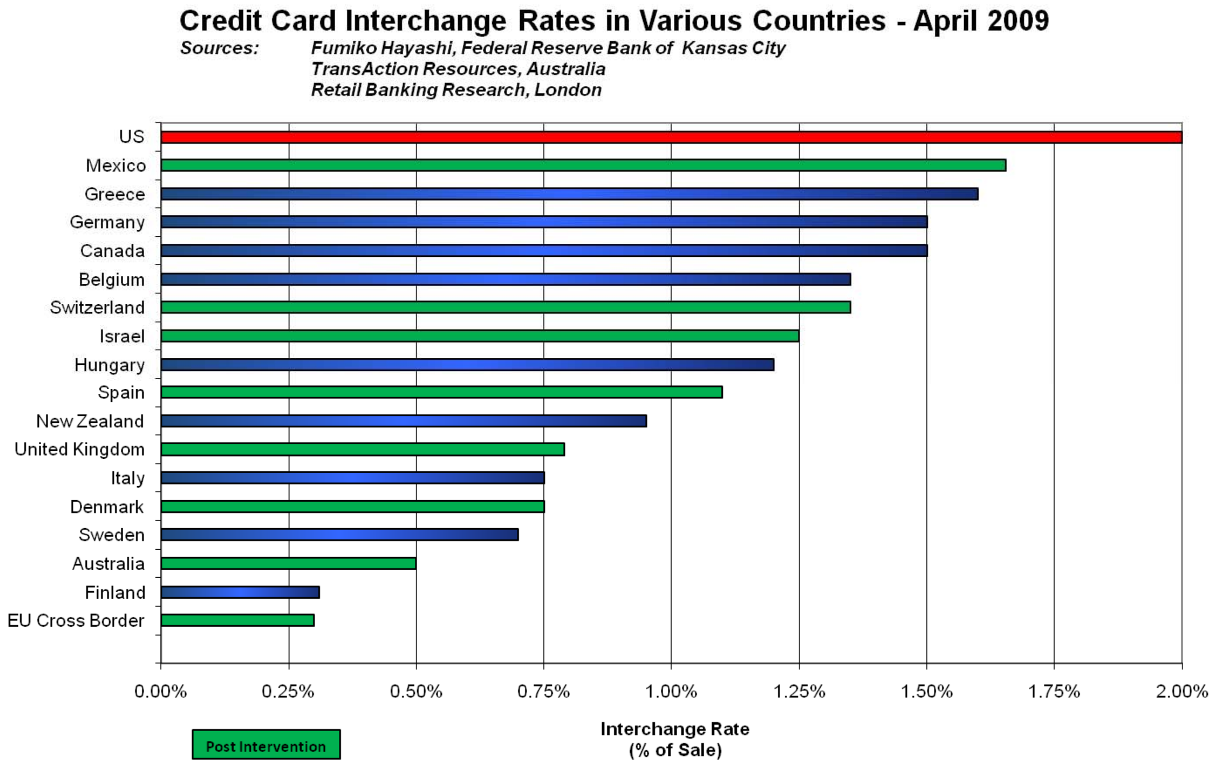
Thus, the evidence is clearly mounting that the theoretical arguments in favor of any use of interchange fees as a subsidy for card-issuers' costs are factually unsupportable, and cannot serve as a justification for cartel price fixing.

And increasingly, other countries have found interchange fees to be antitrust violations. These findings of illegality include:

- Australia, 2000 (by the Australian Competition and Consumer Commission);
- European Commission, 2002 (cross-border transaction by Visa);
- Spain, April 2005 (interchange fees of major card associations) Competition Court of Spain;
- European Commission, June 23, 2006 (Statement of Objections to MasterCard based on the preliminary view that its credit and debit card interchange fee mechanisms are unlawful);
- New Zealand, August 2009 (requiring issuing banks to set their own prices independently); and
- Hungary, September 2009 (imposing millions of dollars in fines on Visa, MasterCard and a dozen banks).

The numbers also show that the credit card industry particularly harms American businesses and consumers as shown in Figure 3.

Figure 3



III. UNFAIR CREDIT CARD PRACTICES AND THE SOLUTIONS IN THE WELCH-SHUSTER BILL

It is important to understand that the credit card industry prevents competitive forces from impacting interchange fees through a web of unfair rules. Most of these rules have no legal basis – they were created by Visa and MasterCard – and they work in concert to limit competition and transparency to the public.

There is no regulator that reviews whether credit card company rules are unfair, deceptive or anticompetitive. The Welch-Shuster bill would deal with this absence of oversight by directing the Federal Trade Commission to review credit card company rules and prohibit any that it finds to be unfair, deceptive, or anticompetitive. That is a minimal level of protection that this market needs to begin to function competitively.

There are, however, a number of rules that are so clearly unfair, deceptive or anticompetitive that they should be dealt with right away. One of these unfair rules, for example, is known as the "non-discrimination" rule. The name sounds well-intentioned, but is quite the opposite in practice. This rule prohibits any merchant in the United States from giving its customers a discount if the customers use a general purpose card that has lower fees. That is a remarkably anticompetitive standard. Imagine if Coca-Cola were to tell grocery stores that they could be fined or have their right to sell Coke products revoked if they charged people less for Pepsi than for Coke. That is the equivalent of what Visa and MasterCard do – and they both do it! The practical result is that neither of the two credit card networks or any of their much, much smaller competitors has any incentive to ever reduce their prices. For most businesses, the reason to reduce prices is to gain market share, but this rule prevents anyone from gaining market share because no consumer would ever see and receive the discount and act on it. That rule is simply abusive and unfair. The Welch-Shuster bill would get rid of it.

A related set of rules creates a strait jacket for merchants that might want to provide discounts of any kind including for cash or checks or even debit cards. Visa and MasterCard deny that this occurs, but their member banks have long advised my members and other merchants that they will be fined if they do not comply with complex and burdensome requirements for marking prices individually and displaying credit card prices more prominently than cash prices in order to provide a discount. The Welch-Shuster bill would sweep away these byzantine requirements which are, in fact, just set up to discourage merchants from providing discounts. If Visa and MasterCard actually believed what they say about merchants being allowed to discount now, they would have no problem with this provision of Welch-Shuster becoming law. I suspect, however, that they will not agree. When Senators Richard Durbin (D-IL) and Kit Bond (R-MO) introduced an amendment earlier this year to make clear that the credit card companies could not prevent merchants from giving customers discounts, the howls of protest could be heard throughout Washington. Those actions speak louder than Visa and MasterCard's empty assertions that they would never dream of preventing such discounts.

Another unfair rule is known as the "honor all cards" rule. This rule started as something that made some sense. It required merchants that accept Visa or MasterCard to accept them regardless of which bank issued the card. We agree with that concept; it provides protection for smaller banks. The problem is that this concept has been expanded by the card companies beyond recognition so that it now means that the industry can dream up any type of new, high fee credit card product and require that every merchant across the country that had been accepting prior cards to also take the new card as well, regardless of its cost. The result of this rule is quite predictable – there is an arms race to create cards with higher fees and more bells and whistles. The market checks that would normally exist to curb that type of escalation in fees are diminished because the card companies know that every merchant is required to take those new cards or lose their entire card accepting portfolio. The Welch-Shuster bill would preserve the equal treatment of issuers by merchants but would allow the most expensive cards to be refused. We expect that few merchants would actually refuse cards if this were passed, but making it possible – like it is for all other products and services that merchants sell – will make the card companies think before they reflexively introduce cards with higher fees.

These rules work in combination with the way that the credit card industry sets its fees to create regressive fees that hurt less-privileged Americans. Interchange fees are higher for cards with more rewards. The people who qualify for these rewards cards with their concierge services and other goodies tend to have higher incomes than people without rewards cards – or people who can't get cards at all. Yet all of these consumers pay the same inflated prices right now because Visa and MasterCard's rules effectively prevent discounting in almost all circumstances. This regressive result has led to some strong words from many – including economists with the

Federal Reserve Bank of Kansas City who have written that, "Higher merchant fees may likely harm society from an equity point of view."[2] And they even concluded as a result of the regressive way rewards card work now that "[B]oth social welfare and consumer welfare may potentially be lower than in an economy without payment cards at all."[3] That is a remarkably strong statement and says a lot about the problems associated with the regressive system of fees that Visa and MasterCard impose. To deal with this problem, the Welch-Shuster bill would not allow the card companies to charge higher interchange fees for rewards cards.

The card companies often argue that merchants can simply decide not to take their cards if they don't like the fees. The market power of Visa and MasterCard is so great that this is not a practical alternative, but Visa adds insult to injury. They have informed merchants that they must accept cards at all of their retail locations if they want to accept cards at any location. If a business wanted to experiment to see if they could survive without taking cards, it would only make sense to try that as a pilot at one location before taking the leap for multiple locations. But Visa makes this an all-or-nothing proposition for merchants because they know that will keep the largest number with no choice but to accept cards – and accept the ever-escalating fees.

The card companies further prevent merchants from protecting themselves against the ravages of escalating swipe fees by prohibiting any minimum or maximum purchase amounts for card transactions. Many of us have seen handwritten signs at dry cleaners, restaurants and other businesses that say, for example, that they won't accept credit cards for transactions under five or ten dollars. The reason for this is that interchange fees include both a fixed fee and a percentage fee – perhaps a dime plus 1.7 percent or 3.25 percent plus ten cents. For small purchases, however, that extra several cents alone can more than erase a retailer's profits. A related problem can happen on very large purchases. While the fixed fee doesn't matter for those purchases, the overall amount of interchange can be staggering when a transaction runs into the thousands of dollars. Some people have taken, for example, to putting college tuition on a credit card. Losing hundreds of dollars on that transaction can be difficult for a university – or anyone else – to take. There is no good justification for Visa and MasterCard to prevent these types of common-sense limits and the Welch-Shuster bill would wipe away the card company rules that do just that.

Another set of Visa and MasterCard rules that are inherently unfair to merchants are some of the chargeback rules. These rules set forth the circumstances in which merchants will not receive payment for some or all of a card transaction. Again, while some of these rules may make sense, one of them – that primarily affects gasoline sales – is particularly pernicious. Both Visa and MasterCard set an arbitrary limit of $75 on gasoline purchases and in some instances will refuse to give the merchant selling the gasoline the amount of that transaction above $75 – even if the cardholder does not dispute the charge. This is outrageous and it effectively amounts to stealing the merchant's money. It was even worse when Visa banks just a couple years ago were still

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[2] "Pricing and Welfare Implications of Payment Card Network Competition," Fumiko Hayashi, December 14, 2006.

[3] "Do U.S. Consumers Really Benefit from Payment Card Rewards?" Fumiko Hayashi, *Economic Review*, April 2009.

keeping all of the money on these transactions – not just the amount above the limit. The fact that they are now pilfering less of the merchants' money is an improvement but not a solution to the problem. The Welch-Shuster bill would prohibit this arbitrary and unfair practice.

Visa and MasterCard have rules in place to ensure that merchants route transactions through the dominant networks. There are competing networks that are cheaper alternatives. Visa and MasterCard should not be able to limit these options merely to pad their bottom lines – at everyone else's expense. The Welch-Shuster bill would make sure these options were available.

Credit card companies also should not be allowed to penalize small merchants for having a small number of transactions. Merchants pay for their own infrastructure to be able to swipe cards at their place of business, so there is no justification for the credit card companies charging a penalty if a merchant does not have a minimum number of transactions. The Welch-Shuster bill would make sure that smaller merchants could not be mistreated in this way.

Finally, and importantly, markets cannot function properly without transparency. That is one of the primary problems with swipe fees. Consumers don't know about or see these fees. Merchants don't know for any given card how much they will pay. Even the rules set by Visa and MasterCard that govern the system are opaque. While after years of complaining, the two dominant networks finally put their rules on their websites on the eve of a Congressional hearing, and have been tweaking them again in advance of more Congressional oversight, those rules remain incomplete – for example, they say nothing about the amounts of fines that may be imposed for violating different rules, but such fines are levied or threatened against merchants with regularity. Many of the rules are also so vague and confusing that when acquiring banks and processors tell merchants how they must do things, it is difficult to argue they are wrong. This can lead to draconian restrictions that even Visa and MasterCard sometimes say aren't right – yet the restrictions persist and constrain the market.

The Welch-Shuster bill deals with this wide variety of transparency problems. It requires the Federal Reserve to collect information about interchange fees and the rules governing the system and make that information available to the public. The bill also requires the credit card companies to make all of their operating rules publicly available to merchants.

IV. ADDRESSING THE MYTHS

Unfortunately, there are several myths that have obscured the debate of the unfair way in which the interchange system operates. I suspect that several Members of the Committee have heard these myths. In light of this, I would like to address some of the major ones and provide you with the facts.

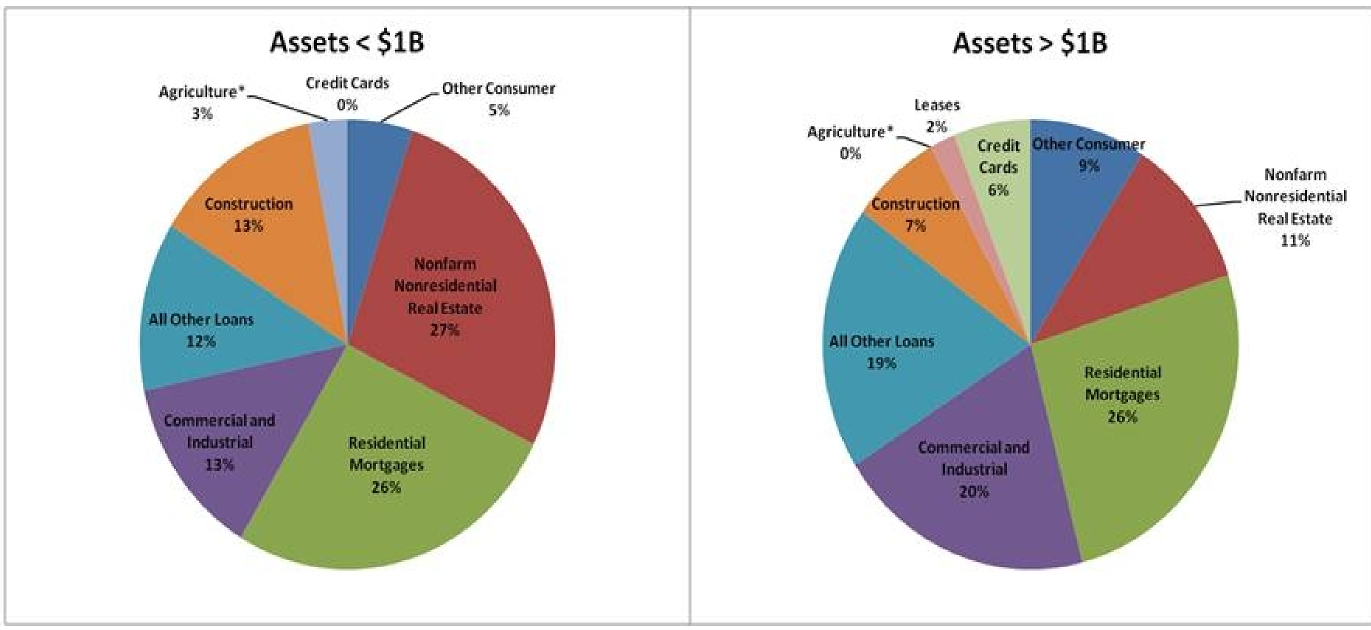
Myth: *Small banks and credit unions will suffer if the interchange fee system is reformed.*

Reality: The current interchange fee system overwhelmingly benefits a very small number of very large banks. Only 10 large banks collect more than 80 percent of interchange fees. Let me make that clear. That's not the top 10 percent of banks

– I am just talking about 10 banks. No one after those 10 banks even has 1 percent of the market. I have included as Exhibit 1 with this testimony the lists of market share in the credit card, PIN debit card, and signature debit card markets so you can see who gets interchange fees and in what proportions. Given the rhetoric around this issue, these numbers are likely to surprise you.

In fact, as the figure below shows, small banks make almost no money from credit card issuing. This is a big bank business. Institutions with less than $1 billion in assets (which is a pretty big institution), do not even make 1 percent of their revenues from credit cards as shown below.

Figure 4



* OTS – supervised savings associations do not identify agricultural loans

Source: FDIC, Quoted in American Banker, 3/20/09

I urge every Member of this Committee when they hear from banks about this issue to make sure they get the answer to one simple question – what percentage of that small bank's revenue is made up of swipe fees. If they can't or won't answer that simple question, then it is hard to take their complaints about the Committee reforming this system seriously.

Some small banks argue that they have higher costs for issuing cards and so they must be able to charge the same fees as their larger competitors. Of course, if that is true, then those larger competitors are making a huge windfall by fixing their prices with small banks. And clearly, as shown in Figure 1 in this testimony, 60 percent profit margins certainly look like a windfall.

Large banks don't want inquiries as to how much they are gaining from the system, and so far none seem eager to speak publicly about it.

Myth: *The credit card system works fine now. There is no need for legislation.*

Reality: The current system is broken. Visa and its member banks fix interchange fees in violation of the antitrust laws. MasterCard and its banks do the same. The result is that interchange fees are rising fast and cost the U.S. economy $48 billion in 2008 alone. That is triple what the fees were in 2001.

Not only are the fees skyrocketing so that merchants and consumers pay too much, but these fees change the nature of the credit card business in a way that hurts consumers. As Georgetown Law professor Adam Levitin observed in testimony before the House Judiciary Committee, the huge fee revenue the banks earn from credit card transactions taking place has created bad incentives. He testified, "The card industry's business model is the heart of the problem and needs to change. Just as with subprime mortgages, the credit card business model creates a perverse incentive to lend indiscriminately and let people get into so much debt they can't pay it back."[4] Others have clearly observed this trend as well. For example, Acting Comptroller of the Currency Julie Williams said in March 2005, "Today the focus for lenders is not so much on consumer loans being repaid, but on the loan as a perpetual earning asset . . . it's not repayment of the amount of the debt that is the focus, but rather the income the credit relationship generates through periodic payments on the loan, associated fees, and cross-selling opportunities."[5] These changes mean that banks are less worried than they should be about consumers' welfare. It should be in the interest of banks for consumers to do well and be able to pay back credit card loans. But the huge fee income the banks generate through interchange and other means blunts those interests.

This Committee has acted to end some credit card company practices and today has even considered the idea of moving up the effective date of reforms. While individual practices can be banned, abuses will continue until the Committee does something about the system of financial incentives that exists to make banks see merchants and our customers as mere fee-generators rather than as true business partners.

[4] Adam J. Levitin, Testimony before the House Judiciary Subcommittee on Commercial and Administrative Law, "Consumer Debt – Are Credit Cards Bankrupting Americans?" April 2, 2009.

[5] Remarks by Julie L. Williams, Acting Comptroller of the Currency, Before the BAI National Loan Review Conference, New Orleans, LA, March 21, 2005, at http://www.occ.treas.gov/ftp/release/2005-34a.pdf.

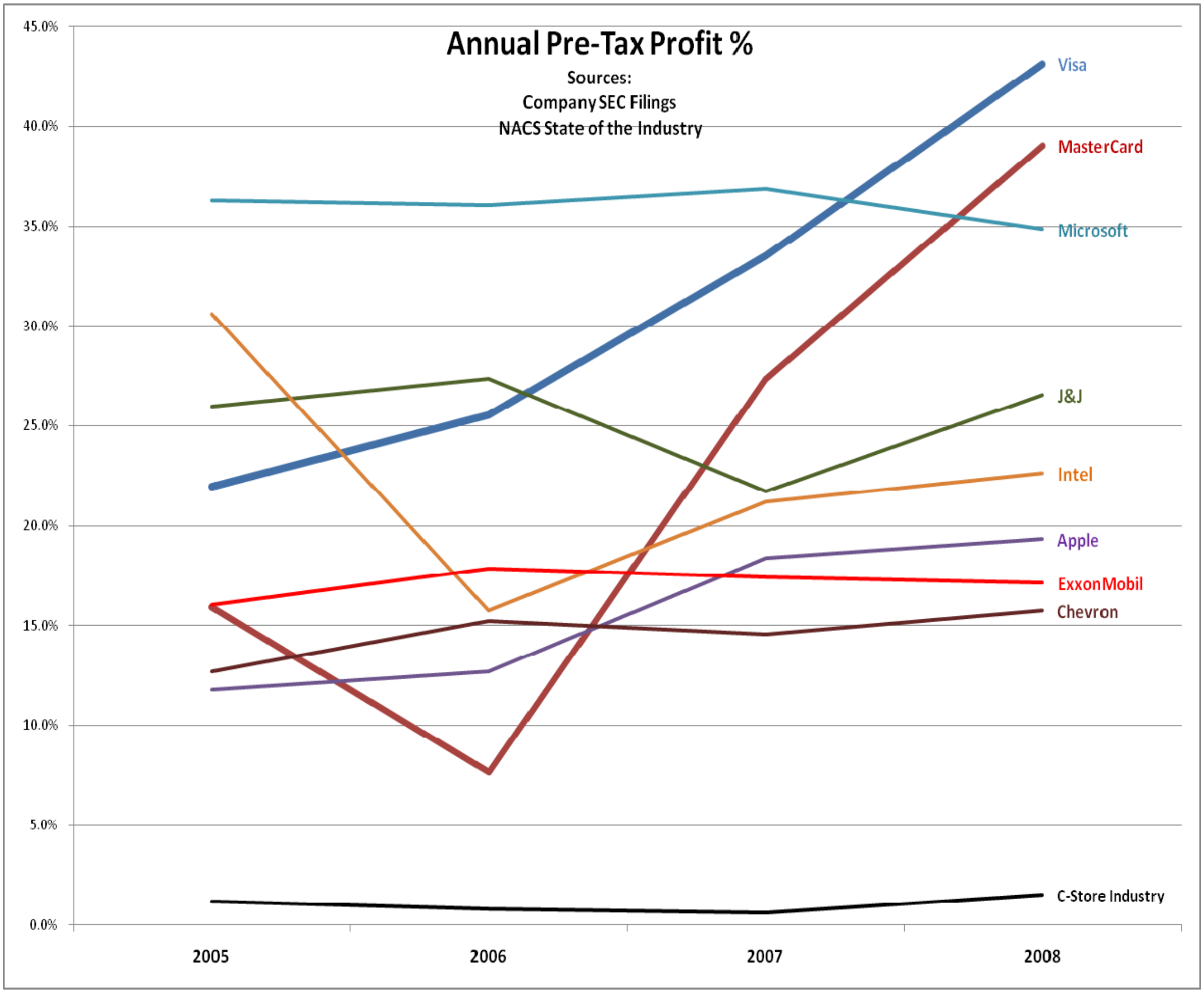
Myth: *Congress shouldn't reform interchange fees because merchants will just pad their profits.*

Reality: Representative Peter Welch made an insightful observation on this point when he spoke with Politico and noted that this is an odd argument because the credit card industry is essentially saying "let us keep ripping people off or someone else will." The role of this Committee is to stop the card industry from engaging in rip-offs. If someone else does something wrong later, then we should stop that too.

This myth also ignores the basic tenets of economics. Economics say that in the absence of a market failure higher business costs result in higher prices and lower business costs result in lower prices. The retail sector of the economy is highly competitive and if costs go down for those businesses, then their prices will go down. First, let's look at how consistently narrow retail profit margins are in the United States. Exhibit 2 to this testimony includes charts from Fortune magazine comparing the profitability of different U.S. industries for each year from 2006 through 2009. There isn't a single category for retail, but they have numbers for "Specialty retail," "Food and Drug Stores" and "Automotive retailing" -- these cover large parts of the retail industry. The numbers show that each of these industries consistently rank near the bottom of all industries in terms of profitability and have very stable profit margins each year (other industries are lower in particular years but fluctuate more). Specialty retail, for example, is between 3.2 and 4.0 percent profitability every year since '06. Specialty retail is about the most profitable sector of the retail industry. Food and drug stores are between 1.5 and 2.6 percent profitability each year. Automotive is less than that. This means that regardless of conditions in the economy the competition across retail businesses is such that revenues can never exceed costs by much – whether costs are rising or falling. Exhibit 3 to this testimony is National Retail Federation data. This tracks just large retail companies and finds profit margins between 2 and 4 percent – bearing out Fortune's numbers.

To put this in perspective, let's look at the profit margins for some large U.S. corporations. Note that Visa's profit margins are more than 40 percent and MasterCard's are close. Microsoft comes close to them but many other household names don't. Some major oil companies are between 15 and 20 percent. And way down at the bottom, one retail industry – convenience stores – have about 2 percent profit margins. Now, the credit card industry has accused these retailers of ripping off their customers. This chart makes clear who is exploiting market power and possibly ripping off whom.

Figure 5



I would also note that the Department of Energy has studied how retailers that sell gasoline do or do not pass through costs into retail prices. They found that for both cost increases and cost decreases there is 100 percent pass through of costs into retail prices.[6] That means, without question, whether interchange fees increase or decrease, consumers will see those changes reflected in the cost of gasoline – for better or for worse.

[6] U.S. Department of Energy, "Gasoline Price Pass-through," by Michael Burdette and John Zyren, January 2003.

Myth: *There is no need for reform because merchants can already negotiate fees.*

Reality: This claim is purposely misleading. Merchants cannot negotiate interchange fees. They negotiate with their local bank or processor on their *processing* fees, but those processing fees are a fraction of the interchange fees merchants pay. In most cases, processing fees are only about 10 percent of what the merchant pays. Interchange fees are much, much larger – the $48 billion paid in 2008 was more than all of the other credit card fees charged directly to consumers, combined. The interchange gets passed through to merchants and, ultimately, to consumers. Merchants also have no ability to shop for better interchange deals. Visa's banks all charge the same schedule of interchange fees and MasterCard's banks do the same. The result is that there is no competitive market for interchange fees – just naked price fixing.

Myth: *There is no need for reform because credit card fee rates have remained flat.*

Reality: This is simply false. The Kansas City Federal Reserve published a presentation on April 3, 2008 showing that average interchange fee rates rose from less than 1.3 percent to more than 1.6 percent between 1996 and 2005. And, according to Kansas City Federal Reserve economists, that rate is nearly 2 percent today. The American Banker on March 1, 2006 reported on Visa's "long-standing pattern of regular increases" in its interchange fees and said that "According to the credit card industry newsletter The Nilson Report, interchange rates for Visa and MasterCard International have risen steadily every year since 1997." At the same time, transaction volume has increased dramatically, so the absolute amount of interchange fees collected rose even more dramatically. And, credit card companies have consistently moved more cardholders to new corporate and rewards cards that carry higher interchange fee rates. While they sometimes don't change the rates for a given type of card – that doesn't matter if many of the people who had been using that card are now using a card with a higher rate. By shifting people to rewards cards, the card companies continue to pretend that they don't raise rates even though the rates merchants pay for interchange consistently increases. The combination of all of these factors means that since 2001, the amount of interchange collected has tripled from $16 billion to $48 billion in 2008.

Myth: *There is no need for reform because merchants can simply stop accepting credit cards.*

Reality: Economists have found that due to the market power of Visa and MasterCard, this is not true. This argument would be like AT&T claiming in the 1980s that no one should worry about its monopoly because people could choose not to have a telephone. Accepting cards is essential for most businesses. The Kansas City Federal Reserve studied this issue in a 2004 report titled, "A Puzzle of Card Payment Pricing: Why Are Merchants Still Accepting Card Payments?" and concluded, "Only monopoly merchants who are facing an inelastic consumer demand may deny cards when the fee exceeds its transactional benefit. . . Merchant competition allows the network to set higher merchant fees. The network can always set higher merchant fees in more competitive markets. Moreover, in competitive markets the merchant fees in the long run may exceed the sum of the merchant's initial margin and the merchant's transactional benefit. . . . As long as the merchant fee does not exceed the level that gives merchants negative profits, merchants may have no choice but to continue accepting cards." The courts also agree that Visa and MasterCard both have market power which means they have the ability to raise their prices above what would be sustained in a competitive market. U.S. v. Visa U.S.A., Inc., 344 F. 3d 229 (2d Cir. 2003).

Myth: *Efforts to reform the interchange fee system are nothing more than government price control proposals.*

Reality: There is absolutely nothing in the Welch-Shuster bill that speaks to or sets the amount of interchange. The only things the bill does, as I have noted, are to create some transparency and get rid of anticompetitive rules. The fact that the current system has no regulation in spite of its impact on nearly every consumer transaction made in the United States is astonishing and must end. If making this market operate on a fair and competitive basis impacts the cost of interchange, that is what *ought* to happen. If the banks and credit card companies argue that this will cut interchange fees, then that tells you they know they cannot possibly sustain these inflated fees in a fair, competitive marketplace.

Myth: *Australia shows that reform will hurt consumers and result in them paying higher fees.*

Reality: Policymakers around the world have found that reform has benefited consumers. When Australia acted, Visa and MasterCard said it would mean the end of the credit card system in that nation. They were wrong. More consumers use more cards for less than ever before in Australia. In fact, rather than Visa and MasterCard competing to raise interchange fees so that banks will issue more of their cards, they have had to give consumers what they really wanted – lower interest rates on their cards. This interest rates competition has benefitted consumers immensely. The only ones who don't like it are Visa and MasterCard (and their member banks) because they don't make as much on interchange fees. The Reserve Bank of Australia reviewed the interchange reforms instituted there and concluded, "Overall, consumers are benefiting from this greater competition and lower merchant costs . . . one group of consumers clearly better off are those who regularly borrow on their credit cards. <u>They are now able to obtain a card with an interest rate of 10 to 13 per cent, rather than the 16 to 18 per cent payable on traditional cards</u>. For many consumers the resulting savings can run into hundreds of dollars per year . . . <u>Consumers who do not use credit cards at all are also benefiting from the reforms as they are paying lower prices for goods and services than would otherwise have been the case.</u> For many years, these consumers have helped subsidise the generous reward points of the credit card issuers through paying higher prices for goods and services. The reforms have helped unwind some of this subsidy."[7] The Reserve Bank of Australia reconfirmed this view in 2008 when it wrote, "One issue that has attracted considerable attention since the reforms were introduced is whether the cost savings that merchants have received from lower merchant service fees have been passed on to consumers in the form of lower prices for goods and services than would have otherwise been the case. The [card] schemes argue that there has been no, or little, pass-through, while the merchants argue that the cost savings have been passed through. The Bank's estimate is that over the past year, these cost savings have amounted to around $1.1 billion . . . . Despite the difficulties of measurement, the Board's judgement remains that the bulk of these savings have been, or will eventually be, passed through into savings to consumers. This judgement is consistent with standard economic analysis which suggests that, ultimately, changes in business costs are reflected in the prices that businesses charge. A similar conclusion was reached by the House of Representatives Standing Committee on Economics, Finance and Public Administration when it considered the Bank's payments system reforms in 2006."[8]

The credit card industry has repeatedly stated, or perhaps threatened, that lower interchange fees will mean higher consumer credit card fees. This argument has been thoroughly researched and rejected. As noted previously, for example, the European Commission's Directorate of Competition review this claim and found, **"**There is no economic evidence for such a claim. Firstly, the inquiry's data suggests that in most cases card issuers would remain profitable with very low levels of interchange fees or even without any interchange fees at all. Secondly, the international card networks have failed to substantiate the argument that lower interchange fee would have to be compensated with higher cardholder fees." The flip-side of this argument proves its shallowness. Interchange fees in the United States have tripled since 2001 – have consumer credit card fees been cut by one-third? Absolutely not. In fact, consumer card fees have been rising too. Credit card fees are not a zero sum game in which the industry has an inalienable right to a set amount of revenue – as they would like you to believe – but instead are a reflection of the card industry's insatiable demand for fees aided by their unfair and deceptive practices in charging them.

[7] Payments System Board Annual Report, *Reserve Bank of Australia*, 2005 at 14.

[8] Reform of Australia's Payment System: Preliminary Conclusions of the 2007/2008 Review, *Reserve Bank of Australia*, at 23.

Myth: *These reforms will make it more complicated for consumers. The current system works well for them.*

Reality: The current system fools consumers by hiding the large interchange fees that are built into the cost of their purchases. Ed Mierzwinski, Consumer Program Director of U.S. PIRG testified before the House Judiciary Antitrust Task Force on May 15, 2008, "Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers basically subsidize credit card usage by paying inflated prices – prices inflated by the billions of dollars of anticompetitive interchange fees. And unfortunately, those credit card interchange fees continue to accelerate, because there is nothing to restrain Visa and MasterCard from charging consumers and merchants more." In addition, consumer groups including the Consumer Federation of America, Consumer's Union, and Consumer Action have all submitted Congressional testimony criticizing the current system of interchange fees because it is not fair to consumers.

Economists with the Kansas City Federal Reserve Bank appear to agree with consumer groups on some of the problems with the current system for consumers. In a 2006 working paper titled "Payment Card Rewards Programs and Consumer Payment Choice," they wrote that "rewards programs and the accompanied merchant fee structure may work as tools that distribute income from low-income earners to high-income earners."

In addition, the European Commission has found that interchange fees harm consumers. In December 2007, the Commission found MasterCard's multilateral interchange fee illegal and Competition Commissioner Neelie Kroes said that interchange "inflated the cost of card acceptance by retailers without leading to any advantage for consumers or retailers. On the contrary, consumers foot the bill, as they risk paying twice for payment cards. Once through annual fees to their bank. And a second time through inflated retail prices . . ." Kroes concluded that MasterCard's interchange "acts like a 'tax on consumption' paid not only on card users but also by consumers using cash and cheques."

Myth: *Interchange is needed to balance the two sides of the card market – consumers and merchants – so that the system is used by more people and better benefits everyone.*

Reality: This rationale has been firmly rejected. European regulators have investigated this claim in-depth and concluded that it is inconsistent with the facts and does not create an economic efficiency that makes up for the problems created by the lack of price competition between member banks in the setting of interchange fees.[9]

[9] See December 19, 2007 Antitrust Ruling of the European Commission.

Interchange is a charge imposed by Visa, MasterCard and their member banks – not a mystical balancing mechanism. When Australia moved to regulate rates (after Visa and MasterCard rejected attempts to address the antitrust problems with the system), the card associations argued that regulation would kill the card system. It hasn't happened. Card use is at an all-time high in Australia in spite of Visa and MasterCard's protestations and the banks are competing to offer consumers lower interest rates. Once reformed, the credit card system in the United States will continue to flourish.

Myth: *Credit and debit cards provide a valuable service for merchants and consumers, but merchants do not want to pay a fair price for that service.*

Reality: Credit and debit cards do provide a service. The problem is that the interchange fee system is so opaque and riddled with unfair rules that keep any competition from entering the system that it must be reformed. Under the Welch-Shuster bill, there will still be interchange – it will just be charged in a system where transparency and some competition exist. Once reformed, not only will there be interchange fees, but there will still be processing fees and merchants will have to pay any fees associated with maintaining their accounts at their local banks. And, of course, credit card companies will still charge consumers an array of interest charges and fees. While credit card companies may not like reform, they will continue to have many avenues to recover costs and make profits, but they will have to do so in a transparent system so that consumers and merchants have real choices about the payment services they use and the costs they incur.

V. CONCLUSION: CONGRESS SHOULD ACT

The Welch-Shuster bill is a sober, narrow approach to the interchange fee problem. The bill simply stands for the proposition that powerful credit card companies should have to play fair and disclose prices and terms. I doubt that anything I could say would demonstrate the problems in this market and the need for reform as eloquently as the credit card industry's opposition to these basic principles. I strongly urge the Committee to pass this bill to bring some fairness to the interchange fee system.

Credit Card Interchange

Sources: Nilson, #918, #919, #923
Federal Reserve Bank of Kansas City

Rank	Issuer	% Interchange Market	Running Share
1	JPMorgan Chase	24.9%	24.9%
2	Bank of America	18.3%	43.2%
3	Citigroup	15.6%	58.8%
4	Capital One	6.4%	65.2%
5	U.S. Bank	4.9%	70.1%
6	Wells Fargo	3.2%	73.3%
7	HSBC	2.8%	76.1%
8	USAA Savings	2.0%	78.0%
9	Barclays	1.7%	79.7%
10	PNC Bank	0.9%	80.7%
11	Target	0.9%	81.6%
12	Advanta	0.8%	82.4%
13	First National	0.6%	83.0%
14	Navy FCU	0.4%	83.4%
15	GE Money	0.4%	83.8%
16	Nordstrom	0.4%	84.2%
17	Fifth Third Bank	0.3%	84.6%
18	RBS Citizens	0.3%	84.9%
19	SunTrust Bank	0.3%	85.2%
20	BB&T	0.3%	85.5%
21	Comdata	0.3%	85.8%
22	State Farm Bank	0.3%	86.1%
23	ICBA Bancard	0.3%	86.4%
24	Cabela’s WFB	0.2%	86.6%
25	Commerce Bank	0.2%	86.8%
26	TIB-The Ind. Bankers	0.2%	86.9%
27	Pentagon FCU	0.1%	87.1%
28	Town North Bank	0.1%	87.2%
29	First Hawaiian Bank	0.1%	87.3%
30	M&I Bank	0.1%	87.5%
31	BECU	0.1%	87.5%
32	First Premier	0.1%	87.6%
33	CompuCredit	0.1%	87.7%
34	Credit One Bank	0.1%	87.8%
35	First Citizens Bank	0.1%	87.9%
36	Columbus B&T	0.1%	88.0%
37	Zions Bancorporation	0.1%	88.0%
38	1st Financial Bank	0.1%	88.1%
39	UMB	0.1%	88.2%
40	Digital FCU	0.1%	88.2%
41	First Horizon	0.1%	88.3%
42	BMW Bank	0.1%	88.4%
43	Merrick Bank	0.1%	88.4%
44	Compass Bank	0.1%	88.5%
45	America First CU	0.1%	88.5%
46	TD Bank	0.0%	88.6%
47	RBC Centura	0.0%	88.6%
48	Silverton Bank	0.0%	88.7%
49	SchoolsFirst FCU	0.0%	88.7%
50	Suncoast Schools FCU	0.0%	88.8%

Credit Card Interchange - Continued

Rank	Issuer	% Interchange Market	Running Share
51	San Diego County CU	0.0%	88.8%
52	Golden 1 CU	0.0%	88.8%
53	Pa. State. Empl.	0.0%	88.9%
54	State Employees CU	0.0%	88.9%
55	Simmons First Nat’l	0.0%	88.9%
56	Redstone FCU	0.0%	89.0%
57	Wescom CU	0.0%	89.0%
58	VyStar CU	0.0%	89.0%
59	Arvest Bank Group	0.0%	89.1%
60	Intrust Bank	0.0%	89.1%
61	Randolph-Brooks FCU	0.0%	89.1%
62	Baxter CU (BCU)	0.0%	89.1%
63	First Tech CU	0.0%	89.2%
64	Delta Community CU	0.0%	89.2%
65	Tower FCU	0.0%	89.2%
66	Patelco CU	0.0%	89.2%
67	Farm Bureau Bank	0.0%	89.3%
68	Mission FCU	0.0%	89.3%
69	BancorpSouth	0.0%	89.3%
70	Wash. State Empl.	0.0%	89.3%
71	FirstMerit Bank	0.0%	89.3%
72	Affinity FCU	0.0%	89.4%
73	United Nations FCU	0.0%	89.4%
74	Mountain America CU	0.0%	89.4%
75	Arizona FCU	0.0%	89.4%
76	Police & Fire	0.0%	89.4%
77	GTE FCU	0.0%	89.4%
78	Alaska USA FCU	0.0%	89.5%
79	Mich. State Univ.	0.0%	89.5%
80	Citizens Equity First	0.0%	89.5%
81	Kinecta FCU	0.0%	89.5%
82	Bellco CU	0.0%	89.5%
83	Security Service FCU	0.0%	89.5%
84	Associated Bank	0.0%	89.5%
85	Travis CU	0.0%	89.6%
86	Virginia CU	0.0%	89.6%
87	State Empl. CU	0.0%	89.6%
88	Anheuser Busch CU	0.0%	89.6%
89	Tinker FCU	0.0%	89.6%
90	Hudson Valley FCU	0.0%	89.6%
91	Educa. Employ. CU	0.0%	89.6%
92	Alliant CU	0.0%	89.6%
93	Kern Schools FCU	0.0%	89.6%
94	Lockheed FCU	0.0%	89.6%
95	American Svgs. Bank	0.0%	89.7%
96	ESL FCU	0.0%	89.7%
97	Redwood CU	0.0%	89.7%
98	SAFE CU	0.0%	89.7%
99	South Carolina FCU	0.0%	89.7%
100	Municipal CU	0.0%	89.7%

Share of Interchange Collected by Card Type

Signature Debit Card Interchange

Sources: Nilson, #918, #919, #923
Federal Reserve Bank of Kansas City

Rank	Issuer	% Interchange Market	Running Share
1	Bank of America	15.4%	15.4%
2	Wells Fargo V	12.1%	27.5%
3	JPMorgan Chase V/MC	9.7%	37.2%
4	U.S. Bank	2.9%	40.1%
5	PNC V	2.5%	42.6%
6	USAA	2.0%	44.6%
7	FIfth Third V/MC	1.7%	46.3%
8	TD Bank V	1.5%	47.8%
9	SunTrust V	1.5%	49.3%
10	Regions Bank	1.5%	50.8%
11	Citizens Bank	1.5%	52.3%
12	Citibank	1.4%	53.7%
13	Navy FCU	1.2%	54.9%
14	BB&T V	1.1%	56.0%
15	MetaBank V/MC/D	0.8%	56.8%
16	Capital One V/MC	0.8%	57.7%
17	TCF Financial V	0.8%	58.4%
18	M&T Bank V/MC	0.7%	59.1%
19	E*Trade Bank V	0.7%	59.8%
20	ICBA Bancard V/MC	0.6%	60.4%
21	Huntington Nat'l	0.6%	61.0%
22	KeyBank MC	0.6%	61.6%
23	Compass Bank V	0.6%	62.1%
24	Sovereign Bank V	0.5%	62.6%
25	HSBC MC 30	0.4%	63.0%
26	Bank of the West	0.4%	63.5%
27	State Empl. CU, NC	0.4%	63.9%
28	Harris N.A. MC	0.3%	64.2%
29	Zions Bancorp. V	0.3%	64.5%
30	Commerce Bank Mo.	0.3%	64.8%
31	Union Bank Calif.	0.3%	65.1%
32	Arvest Bank V	0.2%	65.3%
33	Comerica Bank V/MC	0.2%	65.5%
34	Town North V/MC	0.2%	65.8%
35	FirstBank Colo. V	0.2%	66.0%
36	Associated Bank MC	0.2%	66.2%
37	First Horizon V	0.2%	66.4%
38	M&I Bank V	0.2%	66.6%
39	BOK Financial V	0.2%	66.8%
40	Synovus V 39	0.2%	67.0%
41	FirstMerit Bank V	0.2%	67.2%
42	First Citizens N.C.	0.1%	67.4%
43	BECU MC 37	0.1%	67.5%
44	People's United	0.1%	67.6%
45	BancorpSouth MC 40	0.1%	67.8%
46	Desert Schools FCU	0.1%	67.9%
47	Suncoast Sch. FCU	0.1%	68.0%
48	SchoolsFirst FCU MC	0.1%	68.1%
49	The Golden 1 CU	0.1%	68.2%
50	The Bancorp Bank	0.0%	68.2%

PIN Debit Card Interchange

Sources: Nilson, #918, #919, #923
Federal Reserve Bank of Kansas City

Rank	Issuer	% Interchange Market	Running Share
1	Bank of America	13.4%	13.4%
2	Wells Fargo V	9.5%	22.9%
3	JPMorgan Chase V/MC	7.6%	30.5%
4	Regions Bank	1.4%	31.9%
5	PNC V	1.3%	33.2%
6	U.S. Bank	1.3%	34.5%
7	SunTrust V	1.2%	35.7%
8	TD Bank V	1.1%	36.9%
9	Citibank	1.1%	38.0%
10	BB&T V	0.9%	38.9%
11	USAA	0.8%	39.6%
12	Citizens Bank	0.7%	40.4%
13	ICBA Bancard V/MC	0.7%	41.1%
14	State Empl. CU, NC	0.5%	41.6%
15	Capital One V/MC	0.5%	42.0%
16	KeyBank MC	0.5%	42.5%
17	Compass Bank V	0.4%	42.9%
18	FIfth Third V/MC	0.4%	43.3%
19	Union Bank Calif.	0.4%	43.7%
20	Zions Bancorp. V	0.3%	44.0%
21	Bank of the West	0.3%	44.3%
22	Sovereign Bank V	0.2%	44.6%
23	Commerce Bank Mo.	0.2%	44.8%
24	BECU MC 37	0.2%	45.0%
25	First Horizon V	0.2%	45.2%
26	BancorpSouth MC 40	0.2%	45.3%
27	Desert Schools FCU	0.2%	45.5%
28	The Golden 1 CU	0.2%	45.7%
29	Arvest Bank V	0.2%	45.8%
30	Suncoast Sch. FCU	0.2%	46.0%
31	First Citizens N.C.	0.2%	46.2%
32	Comerica Bank V/MC	0.2%	46.3%
33	Huntington Nat'l	0.2%	46.5%
34	People's United	0.1%	46.6%
35	Harris N.A. MC	0.1%	46.8%
36	Associated Bank MC	0.1%	46.9%
37	SchoolsFirst FCU MC	0.1%	47.0%
38	M&I Bank V	0.1%	47.1%
39	Navy FCU	0.1%	47.3%
40	TCF Financial V	0.1%	47.4%
41	M&T Bank V/MC	0.1%	47.5%
42	Synovus V 39	0.1%	47.6%
43	HSBC MC 30	0.1%	47.7%
44	FirstMerit Bank V	0.0%	47.8%
45	Town North V/MC	0.0%	47.8%
46	BOK Financial V	0.0%	47.8%
47	FirstBank Colo. V	0.0%	47.8%
48	MetaBank V/MC/D	0.0%	47.8%
49	E*Trade Bank V	0.0%	47.8%
50	The Bancorp Bank	0.0%	47.8%

Top industries: Most profitable

RETURN ON REVENUES | RETURN ON ASSETS | RETURN ON SHAREHOLDERS' EQUITY

Industry Rank	Industry	2008 Profits as % of Revenues
1	Network and Other Communications Equipment	20.4
2	Internet Services and Retailing	19.4
3	Pharmaceuticals	19.3
4	Medical Products and Equipment	16.3
5	Railroads	12.6
6	Financial Data Services	11.7
7	Mining, Crude-Oil production	11.5
8	Securities	10.7
9	Oil and Gas Equipment, Services	10.2
10	Scientific, Photographic, and Control Equipment	9.9
11	Household and Personal Products	8.7
12	Utilities: Gas and Electric	8.7
13	Aerospace and Defense	7.6
14	Food Services	7.1
15	Industrial Machinery	6.9
16	Food Consumer Products	6.7
17	Electronics, Electrical Equipment	6.5
18	Commercial Banks	5.2
19	Telecommunications	5.1
20	Chemicals	5.0
21	Construction and Farm Machinery	5.0
22	Insurance: Life, Health (stock)	4.6

23	Information Technology Services	4.5
24	Computers, Office Equipment	4.3
25	Metals	3.9
26	Wholesalers: Diversified	3.5
27	Insurance: Property and Casualty (stock)	3.3
28	Specialty Retailers	3.2
29	General Merchandisers	3.2
30	Health Care: Pharmacy and Other Services	3.0
31	Packaging, Containers	3.0
32	Beverages	2.9
33	Engineering, Construction	2.7
34	Health Care: Medical Facilities	2.4
35	Health Care: Insurance and Managed Care	2.2
36	Petroleum Refining	2.1
37	Food and Drug Stores	1.5
38	Pipelines	1.5
39	Wholesalers: Health Care	1.3
40	Semiconductors and Other Electronic Components	1.0
41	Energy	0.9
42	Home Equipment, Furnishings	0.7
43	Food Production	0.6
44	Wholesalers: Electronics and Office Equipment	-0.3
45	Diversified Financials	-0.6
46	Motor Vehicles and Parts	-0.7
47	Insurance: Life, Health (mutual)	-3.0
48	Hotels, Casinos, Resorts	-4.5
49	Automotive Retailing, Services	-7.9
50	Forest and Paper Products	-9.6
51	Entertainment	-10.0
52	Real Estate	-13.4

53	Airlines	-13.5

Issue date: May 4, 2009

Top industries: Most profitable

RETURN ON REVENUES | RETURN ON ASSETS | RETURN ON SHAREHOLDERS' EQUITY

Industry Rank	Industry	2007 Profits as % of Revenues
1	Network and Other Communications Equipment	28.8
2	Mining, Crude-Oil Production	23.8
3	Pharmaceuticals	15.8
4	Medical Products and Equipment	15.2
5	Oil and Gas Equipment, Services	13.7
6	Commercial Banks	12.6
7	Railroads	12.4
8	Entertainment	12.4
9	Insurance: Life, Health (stock)	10.6
10	Household and Personal Products	10.2
11	Securities	10.1
12	Insurance: Property and Casualty (stock)	9.9
13	Real Estate	9.9
14	Scientific, Photographic, and Control Equipment	9.8
15	Financial Data Services	8.7
16	Food Services	7.9
17	Publishing, Printing	7.9
18	Utilities: Gas and Electric	7.9
19	Industrial and Farm Equipment	7.6
20	Electronics, Electrical Equipment	7.6
21	Hotels, Casinos, Resorts	7.3
22	Aerospace and Defense	7.2

23	Beverages	7.2
24	Chemicals	7.0
25	Internet Services and Retailing	7.0
26	Food Consumer Products	6.5
27	Telecommunications	6.4
28	Health Care: Insurance and Managed Care	6.2
29	Petroleum Refining	6.2
30	Computers, Office Equipment	6.0
31	Metals	5.5
32	Packaging, Containers	5.5
33	Home Equipment, Furnishings	5.3
34	Wholesalers: Diversified	4.3
35	Specialty Retailers	3.8
36	Information Technology Services	3.8
37	Energy	3.7
38	Airlines	3.6
39	General Merchandisers	3.5
40	Health Care: Medical Facilities	3.3
41	Pipelines	3.1
42	Engineering, Construction	2.8
43	Health Care: Pharmacy and Other Services	2.6
44	Food and Drug Stores	2.1
45	Wholesalers: Electronics and Office Equipment	1.6
46	Automotive Retailing, Services	1.1
47	Wholesalers: Health Care	1.1
48	Motor Vehicles and Parts	1.1
49	Food Production	1.0
50	Semiconductors and Other Electronic Components	0.6
51	Diversified Financials	-0.9
52	Homebuilders	-9.5

From the May 5, 2008 issue

FORTUNE 500 2007

Our annual ranking of America's largest corporations

Top industries

Most Profitable Industries: Return on Revenues

Revenues Assets Shareholder equity

Industry Rank	Industry	2006 Profits as % of Revenues
1	Mining, Crude-Oil Production	26.6
2	Pharmaceuticals	19.6
3	Commercial Banks	16.2
4	Financial Data Services	15.2
5	Network and Other Communications Equipment	14.0
6	Medical Products & Equipment	13.5
7	Railroads	13.1
8	Securities	12.4
9	Publishing, Printing	12.4
10	Insurance: P & C (stock)	11.8
11	Diversified Financials	10.9
12	Insurance: Life, Health (stock)	10.7
13	Entertainment	10.7
14	Internet Services and Retailing	10.5
15	Oil and Gas Equipment, Services	10.4
16	Household and Personal Products	9.2
17	Metals	8.0
18	Food Services	7.9
19	Semiconductors and Other Electronic Components	7.7
20	Petroleum Refining	7.3
21	Industrial & Farm Equipment	7.2
22	Homebuilders	7.1
23	Hotels, Casinos, Resorts	7.0
24	Utilities: Gas & Electric	6.8
25	Beverages	6.6

FORTUNE 500 Headquarters

COURTESY: GOOGLE MAPS

Click to enlarge

Show FORTUNE 500 Companies:

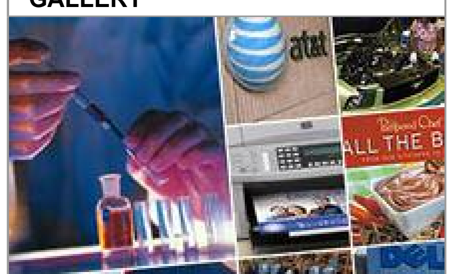
Top 50 | 25 Most profitable | Full list

What readers say...

- Everyone talks of America is a failing Democracy… WHAT? First...
- For those who have commented on Sam Walton's philosophy being...
- Now, consider this. WalMart no longer has Sam Walton running it.The...

Have your say

GALLERY



PHOTOS FROM COMPANY WEBSITES

Top 50

Wal-Mart retakes the No. 1 slot on the Fortune 500 this year. See where America's largest companies rank, and why.

See them all

GALLERY

26	Chemicals	6.6
27	Computers, Office Equipment	6.5
28	Electronics, Electrical Equipment	6.4
29	Apparel	6.3
30	Telecommunications	6.2
31	Food Consumer Products	5.9
32	Aerospace and Defense	5.9
33	Health Care: Insurance & Managed Care	5.8
34	Packaging, Containers	4.3
35	Wholesalers: Diversified	4.1
36	Health Care: Medical Facilities	3.9
37	Specialty Retailers	3.6
38	General Merchandisers	3.3
39	Health Care: Pharmacy and Other Services	2.8
40	Food & Drug Stores	2.6
41	Airlines	2.6
42	Energy	2.6
43	Information Technology Services	2.2
44	Engineering, Construction	1.7
45	Pipelines	1.7
46	Wholesalers: Food and Grocery	1.7
47	Wholesalers: Electronics and Office Equipment	1.4
48	Automotive Retailing, Services	1.2
49	Wholesalers: Health Care	0.9
50	Food Production	-0.7
51	Motor Vehicles & Parts	-1.4

From the April 30th, 2007 issue

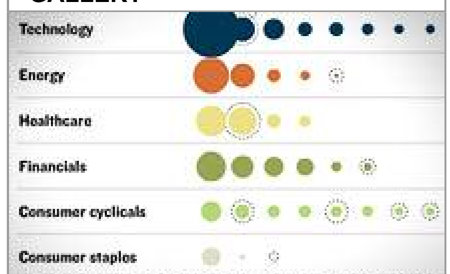
Note:
Due to slight differences in rounding, industry data online may not exactly match the FORTUNE 500 magazine version.

PHOTOS FROM COMPANY WEBSITES

Best employers

More than 35 companies are on both the 2007 Fortune 1000 and 100 Best Companies to Work For lists.
See them all

GALLERY



INTERACTIVE GRAPHIC BY MACAULAY CAMPBELL

Big deals

Last year saw the biggest buyout frenzy since 2000, as 42 Fortune 1,000 corporations were acquired. Who was part of the buyout binge?
See them all

Top industries

Most Profitable Industries: Return on Revenues

Industry Rank	Industry	2005 Profits as % of Revenues
1	Mining, Crude-Oil Production	29.9
2	Internet Services and Retailing	23.8
3	Commercial Banks	18.3
4	Network and Other Communications Equipment	15.8
5	Pharmaceuticals	15.7
6	Medical Products & Equipment	13.2
7	Securities	12.7
8	Railroads	12.5
9	Diversified Financials	12.4
10	Publishing, Printing	11.8
11	Household and Personal Products	11.1
12	Insurance: Life, Health (stock)	10.3
13	Homebuilders	9.9
14	Insurance: P & C (stock)	9.0
15	Oil and Gas Equipment, Services	8.7
16	Entertainment	8.4
17	Food Consumer Products	8.4
18	Electronics, Electrical Equipment	8.2
19	Food Services	8.0
20	Computers, Office Equipment	7.5
21	Health Care: Insurance & Managed Care	7.1
22	Hotels, Casinos, Resorts	6.8
23	Industrial & Farm Equipment	6.6
24	Apparel	6.5
25	Petroleum Refining	6.1
26	Utilities: Gas & Electric	6.0

27	Chemicals	5.8
28	Metals	5.6
29	Beverages	5.3
30	Information Technology Services	5.1
31	Aerospace and Defense	4.9
32	Health Care: Medical Facilities	4.6
33	Telecommunications	4.2
34	General Merchandisers	4.1
35	Specialty Retailers	4.0
36	Semiconductors and Other Electronic Components	3.9
37	Energy	3.0
38	Food Production	2.8
39	Health Care: Pharmacy and Other Services	2.8
40	Wholesalers: Diversified	2.3
41	Engineering, Construction	2.2
42	Wholesalers: Food and Grocery	2.1
43	Food & Drug Stores	1.6
44	Pipelines	1.4
45	Wholesalers: Electronics and Office Equipment	1.4
46	Wholesalers: Health Care	1.3
47	Automotive Retailing, Services	1.1
48	Motor Vehicles & Parts	1.1
49	Packaging, Containers	0.4
50	Airlines	-10.6

From the April 17th, 2006 issue

- Retail industry profitability tends to average between 2 and 4 percent, a relatively low rate compared to profitability in other industries, such as manufacturing.
- Increased purchases during the holiday shopping season make the fourth quarter the most important quarter for retailers in terms of profitability.
- After steadily climbing for the last several years, retail industry profitability dropped slightly in 2007 to 3.02%.

Table IV.7: Profitability of Large Retail Corporations,* 2003–2007 (NAICS Definitions, Millions of Dollars, and Percent)

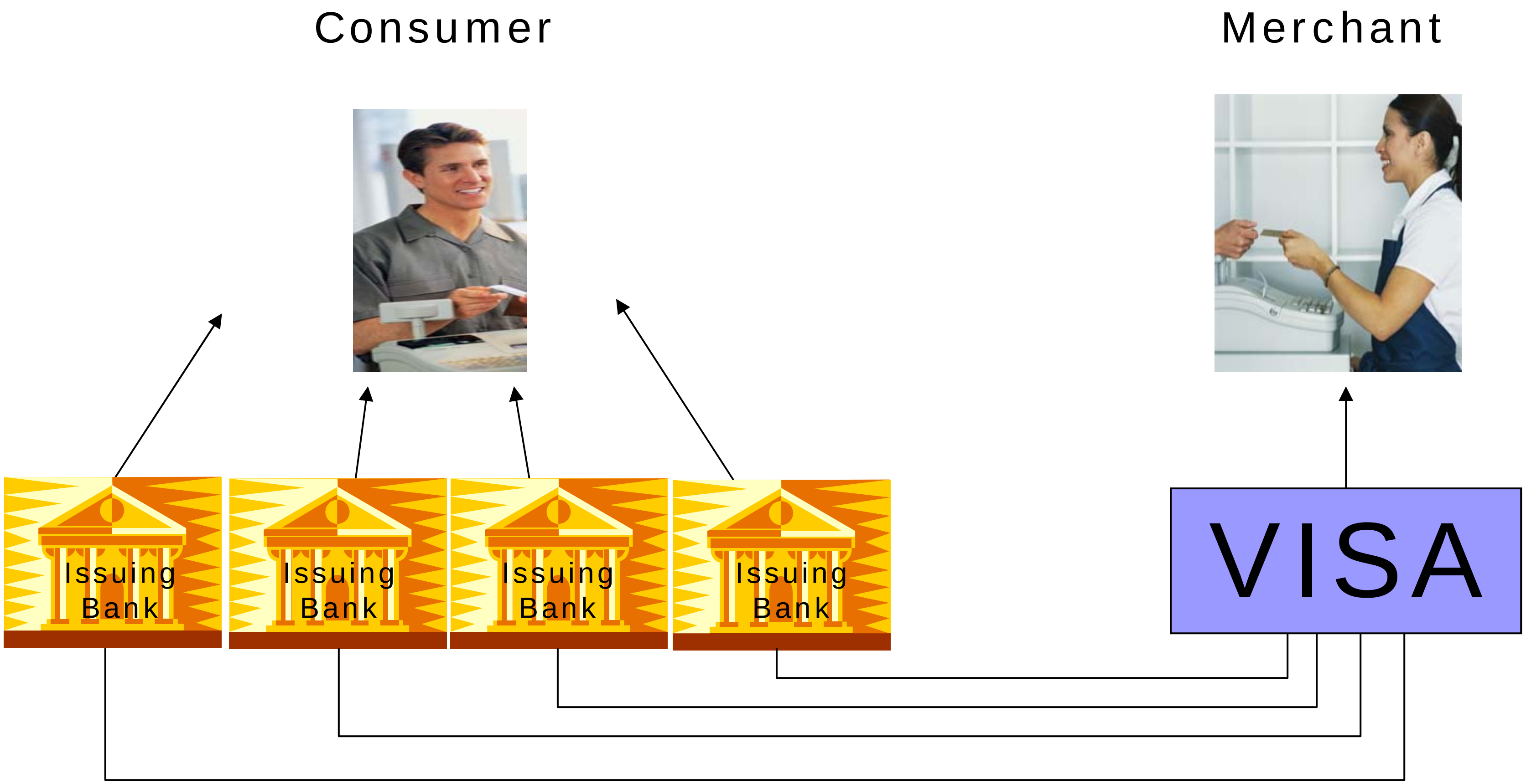
	Profits After Income Taxes	Net Sales Receipts & Operating Revenues	Retail Profits as a Share of Sales
2003	**$45,364**	**$1,524,730**	**2.98%**
1st quarter	11,283	354,328	3.18
2nd quarter	9,656	364,426	2.65
3rd quarter	9,518	377,950	2.52
4th quarter	14,907	428,026	3.48
2004	**$53,186**	**$1,666,495**	**3.19%**
1st quarter	11,429	394,605	2.90
2nd quarter	13,572	405,436	3.35
3rd quarter	11,186	409,756	2.73
4th quarter	16,999	456,698	3.72
2005	**$56,281**	**$1,791,228**	**3.14%**
1st quarter	12,307	426,016	2.89
2nd quarter	13,154	441,328	2.98
3rd quarter	13,076	445,043	2.94
4th quarter	17,744	478,841	3.71
2006	**$63,174**	**$1,948,397**	**3.24%**
1st quarter	15,479	459,382	3.37
2nd quarter	13,827	477,908	2.89
3rd quarter	14,068	479,348	2.93
4th quarter	19,800	531,759	3.63
2007	**$62,344**	**$2,066,429**	**3.02%**
1st quarter	14,370	497,962	2.89
2nd quarter	17,648	512,116	3.45
3rd quarter	12,887	504,138	2.56
4th quarter	17,439	552,213	3.16

* Retailers with assets of $50 million and over.

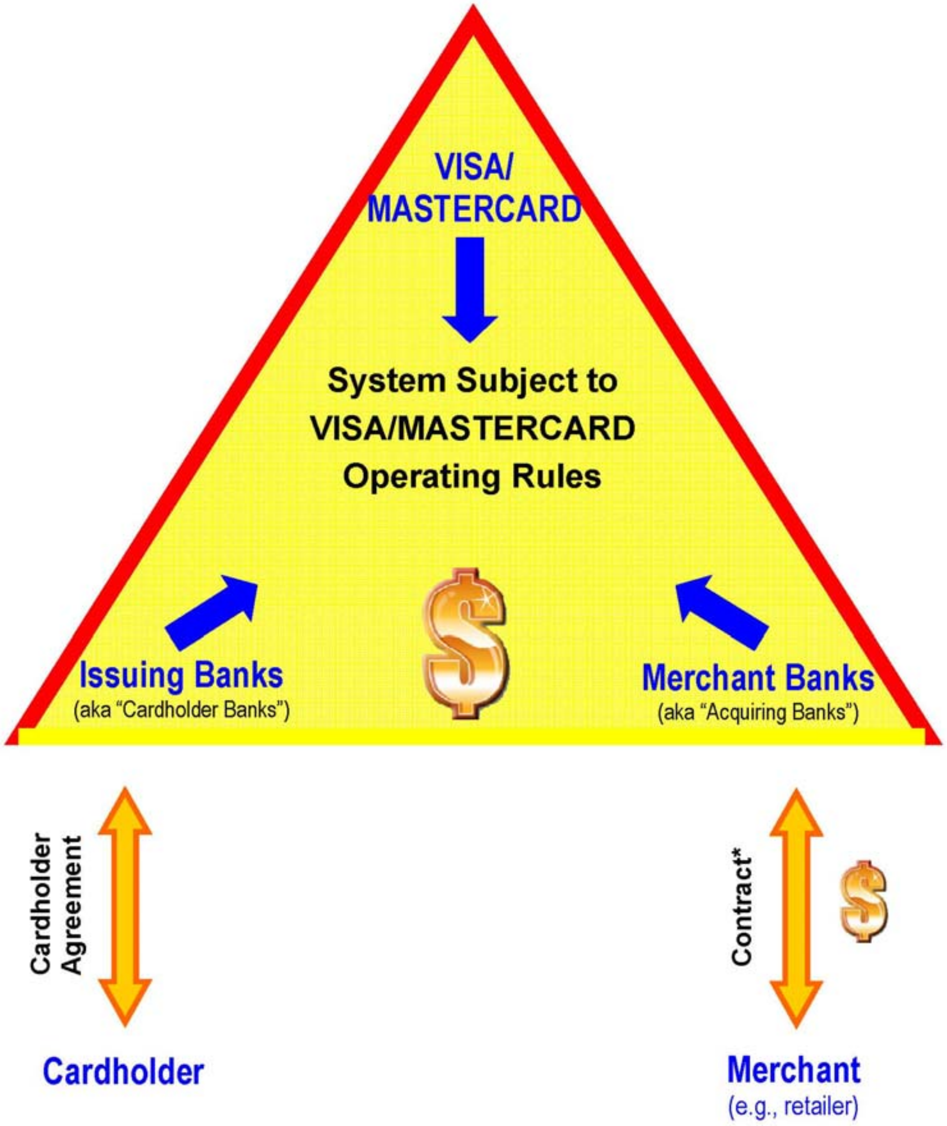
Source: Derived from U.S. Department of Commerce, Bureau of the Census data.

Appendix A

Issuers Impose "All or Nothing" Acceptance Under VISA Brand (Honor All Cards)



Appendix B



* Typically contract between merchant bank and its retailers requires retailers to reimburse merchant bank for any interchange costs, penalties, or fees imposed by the system rules on the merchant bank (including chargebacks – i.e., disputed charges – and costs of data breaches)