INDEPENDENT COMMUNITY BANKERS of AMERICA

Testimony of

Sen. Ann Duplessis
Senior Vice President, Liberty Bank and Trust
New Orleans, Louisiana
and
State Senator – District 2
Louisiana State Senate

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services

Hearing on

"H.R. 2382, the Credit Card Interchange Fees Act of 2009 and H.R. 3639, the Expedited CARD Reform for Consumers Act of 2009"

October 8, 2009
Washington, D.C.

Chairman Frank, Ranking Member Bachus, Members of the Committee, my name is Ann Duplessis and I am Senior Vice President of Retail Banking with Liberty Bank and Trust, a $400 million community bank located in New Orleans, Louisiana. I am also a Senator in the Louisiana State Senate, representing eastern New Orleans, Holy Cross, and the Lower Ninth Ward, and am Chairman of the Commerce, Consumer Protection, and International Affairs Committee. I am pleased to be here today on behalf of the Independent Community Bankers of America (ICBA)[1].

Liberty Bank had humble beginnings. We started in a trailer on a corner lot in New Orleans and now have 13 branches across Louisiana and Mississippi. We are one of the five largest African American-owned financial institutions in the county and through hard-work, dedication and integrity have earned the trust and respect many consumers and merchants. We also provide banking services to numerous divisions of local and state government, including a full array of card-based payments.

Like the bank, my personal story is also rooted in humble beginnings. I started out 25 years ago as a part-time teller at the bank while pursuing my undergraduate degree. I am also a former merchant, having owned two small businesses: a hair salon/day spa and a consulting service for entrepreneurs and emerging small business. In the aftermath of Hurricane Katrina, during which my family lost our home, I witnessed first-hand the challenges elected officials face when tasked with making critically important decisions

[1] The Independent Community Bankers of America, the nation's voice for community banks, represents 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve.
With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community.

in a time of crisis. I fully realized how critical my role in public service was in helping shape the future of my hometown of New Orleans and my state.

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 bank customers. The payment card system has proven to be a tremendous benefit to consumers and merchants, but is not cost-free to operate, and it is not self-sustaining. Interchange is a key component to maintaining the viability of the system, while ensuring that costs are allocated fairly between consumers and merchants.

Benefits to merchants

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 sponsors the card transactions from the merchant – and a card issuer, it is important to realize that not only are our customers the individual 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 Liberty Bank, at the end of the day, it is getting tremendous value because of the card payments system that I, even as a relatively small acquirer, am able to access. Among these benefits are more efficient check out times, reduced cash and check costs (*e.g.*, theft of cash, bounced checks), increased sales and profits, and the ability to make sales without taking any credit risk. By accepting card payments, merchants also shift the costs of debt collection, regulatory compliance, billing, customer service and transaction processing onto others.

However, providing these services is not free, and the costs are primarily imposed on the bank that issued the payment card. Card networks generally have a mechanism to compensate the card issuers for the services they provide which ultimately benefit merchants. Specifically, in the MasterCard and Visa systems, there is an interchange fee. An interchange fee is a small fee paid by a merchant's bank to a card issuing bank in connection with a payment card transaction initiated by a cardholder. The amount of interchange fees received by Liberty Bank is well below our cost to perform the services from which merchants ultimately benefit when they accept our payment cards. Merchants get guaranteed funds in their account right away, the ability to accept credit and debit cards carried by millions of consumers, and do not 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.

But perhaps more important than any of these benefits is the fact that accepting card payments means merchants do not have to extend credit directly, and do not have to focus on protection against credit losses. For example, when a Liberty Bank cardholder walks into a store and makes a $100 purchase with one of our credit cards, Liberty Bank assumes the $100 credit risk for the transaction. Today, credit charge-offs as a percentage of transaction volume run around 5 percent. The merchants claim that they pay 2 percent in interchange. The merchant will get paid regardless of whether our cardholder repays us, so the merchant is netting 3 percent of its sales for free.

Because the card issuer is providing these services to the merchant, it is only reasonable that the issuer receive some form of compensation. Because the merchant is receiving these benefits, it is only fair that the merchant pay its fair share to support the system delivering these benefits. Put another way, in any payment system, at some point you need a bank which holds deposits. That bank has to pay to attract and maintain deposits. Compared to cash- and check-based payment systems, card payments are highly cost-effective for retailers, providing tremendous savings in both direct and indirect costs.

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 cards, are assured a consistent payment experience. This acceptance is important to the viability of my local merchants and the economic base of my community.

Benefits to consumers

Credit cards are open-ended, unsecured credit plans, as opposed to installment plans like a mortgage or car payment. They are the only loan or credit product that, generally, allows the consumer to control how much they will owe, and whether they will pay any finance charge or just be a convenience user. While this is very beneficial for a consumer managing their cash flow, it also demonstrates how much uncertainty is built into a credit card portfolio. A community bank issuer does not know month-to-month if an individual consumer will charge $5 or $5,000 worth of purchases, whether they will pay their balance in full, make a minimum payment, or make no payment at all. The banker also does not know whether a merchant at which their customers shop will suffer a data breach that leads to credit card fraud or identity theft – a mess that the bank is left to pay for and help the consumer clean up.

Interchange is one source of income that a bank like mine must be able to rely on in order to keep our card program stable and, in a good quarter, breaking even. Not only is this innately fair, but it means community banks like mine are able to participate and compete in the credit and debit marketplace with the largest issuers in the country. In fact, over 70% of community banks offer credit cards, and nearly all issue debit cards[2]. It is also a fact that the card products community banks are able to provide to their customers come with better rates and terms than those from their larger competitors.

Contrary to popular belief, for many community banks, the services I'm able to provide thanks to the existence of an interchange fee system are not huge profit centers. The real value lies in my basic ability to offer these products to consumers and merchants, giving them the opportunity to take advantage of the high level of customer

[2] 2009 ICBA Payments Survey.

service and opportunity to build a lasting relationship that a community bank can offer. 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.

Without interchange revenue and network rules to ensure fairness and equity for consumers, issuers, and merchants, however, there is no question that fewer community banks would be able to justify the economics of their payment card offerings. As it stands today, I know that many of my community bank colleagues do not earn sufficient interchange revenue to cover the costs of running a debit card program. Any reduction in interchange would clearly jeopardize the ability of community banks to continue to offer such programs to their consumers. If more small 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 payment card. In the end, consumers will be harmed.

Consequences of H.R. 2382, the Credit Card Interchange Fees Act

If we take a step back, there should be no controversy over the notion that the costs of the system should be borne by those choosing to take advantage of it, including merchants. However, the reality behind the merchants' push for legislation, including H.R. 2382, is that they simply want to pay less for the benefits they receive from card acceptance, and force consumers to pick up merchants' tab. Not a bad deal if you can get it. While the true intentions of a legislative approach like this can be masked behind pro-consumer, pro-competition rhetoric, the objective is clear: merchants want to pay less so that consumers have to pay more. That's just not fair. Consumers pay their own bills. So should merchants.

In my estimation, government intervention in the interchange system through a proposal like H.R. 2382 would most significantly harm my customers who, again, include both small merchants and consumers. In addition to this, I would like to focus on a few concerns community banks have with this legislation.

Consumer harm

Today, Liberty Bank cardholders know that they can use their payment card at a merchant without fear of discrimination. They know that a merchant will accept their Liberty Bank card, and not charge them extra just because they want to pay with a credit or debit card. This is an important consumer protection provided by card networks. It ensures that consumers know their card is accepted, and that they will not be unpleasantly surprised with a hidden surcharge when they go to pay with their Liberty Bank card.

H.R. 2382 would eliminate these consumer protections inherent in the current payment card systems. The legislation would allow a merchant to tell a consumer that the consumer's Liberty Bank card is not accepted, and that the consumer must choose to use another form of payment. For example, a large card issuer could enter into a promotional agreement with a large merchant whereby the merchant would "prefer" the large issuer's credit card over other issuers' cards. The legislation would allow the merchant to decline Liberty Bank's debit card in this circumstance, even if the merchant accepted the big bank's debit card. That is not fair to consumers, and the current rules are designed to prevent such discrimination. There is no reason why Congress should directly intervene and allow merchants to discriminate against consumers in this way.

The legislation would also eliminate the ability of Visa, MasterCard, and other payment networks to ensure that consumers are not surprised with deceptive surcharges at the cash register. Unfortunately, deceptive surcharging by merchants is a real issue, and one that would only get worse if payment card networks could not enforce this critical consumer protection. While I understand why some merchants would rather that Visa, MasterCard, and others not protect consumers in this way, Congress should not facilitate deceptive behavior.

FTC as Merchant Protection Agency.

The Federal Trade Commission ("FTC") has historically served as a consumer protection agency, for example by protecting consumers from merchants' unfair or deceptive acts or practices. The FTC's activities with respect to consumer protection against merchants has taken a higher profile in recent years, as the FTC has taken enforcement action against a variety of merchants for their unfair business practices in failing to protect cardholder data. It seems we cannot go a few weeks without hearing about a merchant data breach somewhere. One would think the FTC should have its hands full protecting consumers against negligent merchant behavior.

This proposal, however, would direct the FTC to expend its limited resources to directly regulate payment card networks' operations for the benefit of merchants. Let me be clear: The legislation *directs* the FTC to dedicate time and effort to regulating payment card networks for the benefit of merchants, apparently so that defenseless merchants like Wal-Mart are not treated unfairly by the likes of Liberty Bank and other community banks. Again, this is all part of merchants' multiple efforts to have the government reduce merchants' costs and shift them to consumers. Asking the FTC to protect big-box retailers from community banks, however, may be the most creative approach yet.

Conclusion

Consumers in New Orleans deserve access to all of the financial products they need, at the best rates and terms possible. Community banks like mine play a vital role in meeting that demand, and should not be disadvantaged because large retailers want to burden consumers with a cost for them of doing business, and tilt the electronic payments system dramatically in their favor, and against consumers.

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, counting cash, or utility bills that a merchant pays. Interchange is a fee for a service that brings tremendous value to merchants that accept debit and credit cards, and the consumers that carry them. Were there not some value to be added to a business model by accepting the costs of accepting debit and credit cards, we would see rates of card payments on the decline. Of course we all know that is not the case and the number of card 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. Gutting the rules of that system, as does H.R. 2382, will harm everyone.

ICBA strongly believes the credit and debit card interchange system in our country is working, and provides tremendous benefit to American consumers and merchants. 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 small merchants and consumers currently benefiting from an efficient and fair process.

Thank you, and I look forward to your questions.