Testimony of Edmund Mierzwinski
Consumer Program Director
U.S. PIRG

Before the Committee on Financial Services
U.S. House of Representatives

Honorable Barney Frank, Chairman

Hearing on

HR 2382, the Credit Card Interchange Fees Act of 2009

and
H.R. 3639,
the Expedited CARD Reform for Consumers Act of 2009

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Chairman Frank, Rep. Bachus, members of the committee: Thank you for the privilege of testifying today on the important subject of credit card interchange fees. I am Edmund Mierzwinski, Consumer Program Director of the U.S. Public Interest Research Group, the nonpartisan and nonprofit federation of state PIRGs.[1] As an advocate for consumers we welcome the opportunity to support the introduction of HR 2382, the Credit Card Interchange Fees Act of 2008 (Welch-Shuster), bi-partisan legislation to address disclosure, transparency, and competition concerns regarding interchange fees imposed on merchants by credit card networks and that harm both merchants and consumers.

A primary purpose of U.S. PIRG is to advocate on behalf of all consumers for a fair and competitive marketplace. As you know, we regularly advocate before this committee and other state and federal regulators and legislators on both consumer protection and competition policy issues in the credit card marketplace. We have also launched a major campaign on over 40 college campuses around the country against unfair credit card marketing practices.[2]

We appreciated the early leadership of Representative Maloney and Chairman Frank and other members of the committee that resulted in passage of the landmark Credit CARD Act[3] in May. Nevertheless, we also believe that the industry's behavior since then strongly warrants acceleration of the implementation of its remaining provisions. So, U.S. PIRG strongly supports swift passage of HR 3639, The Expedited CARD Reform Consumers Act of 2009 (Maloney-Frank) which will be considered in the second panel.

But stopping several unfair practices of credit card companies is not enough to fully protect consumers. We also need to enact a strong Consumer Financial Protection Agency Act that places federal law as a floor not ceiling. The CFPA, as proposed by the President and introduced by Chairman Frank and Rep. Brad Miller and others as HR 3126 will act to protect consumers in

[1] The United States Public Interest Research Group (U.S. PIRG) serves as the federation of and the federal lobbying office for the state PIRGs. State PIRGs are non-profit, non-partisan consumer, public health and good government watchdog groups with over one million members around the United States. U.S. PIRG places a special emphasis on predatory financial practices and financial education and maintains a website at www.truthaboutcredit.org for consumers to obtain non-partisan information and fact sheets about credit card company practices. Recent major PIRG reports on credit card practices include the following: Characteristics of Fair Campus Credit Cards (April 2008); The Campus Credit Card Trap: A Survey of College Students and Credit Card Marketing (March 2008); Graduating Into Debt: A Survey of On-Campus Credit Card Marketing In Maryland (2004); Deflate Your Rate: How To Lower Your Credit Card APR (2002) and The Credit Card Trap: How To Spot It, How To Avoid It (2001). www.uspirg.org or www.truthaboutcredit.org.
[2] See truthaboutcredit.org for information about the campaign.
[3] Public Law No: 111-24, signed into law May 22, 2009.

the marketplace as the current bank regulators have not, on a host of issues, from unfair credit cards to predatory mortgages and obscene overdraft programs.

But reining in these abuses and others is not enough. Unfortunately, it will not completely cure the ills of the credit card marketplace. Over the years, the credit card companies have also developed a distribution network that grants them unchecked market power over merchants and they have extended that model to the use of deposit account debit cards and other debit cards.[4] This model, based on so-called interchange fees, harms merchants. Worse, it harms consumers, too; all consumers, not simply those who pay with plastic.

That is why HR 2382, the bi-partisan Credit Card Interchange Fees Act of 2009 (Welch-Shuster) is also needed. The bill addresses anti-competitive credit card company practices that keep merchant interchange fees higher than the market should allow and also prevent merchants from offering consumers lower-priced choices. These virtually unregulated credit card interchange policies are not restrained by any market forces, harm small businesses and other merchants and also harm consumers.

Currently, consumers do not receive any information about the interchange fees charged for the use of their cards, but this bill would change that. The bill would also address deficiencies in the information that merchants receive regarding interchange charges. And, for the first time, this bill would give a regulator the ability to review Visa's and MasterCard's practices and prevent them from continuing to enforce deceptive or anticompetitive terms on merchants.

We also attach as an appendix a recently-adopted position paper from the coalition Americans for Financial Reform calling for interchange fee reform.[5]

The Interchange Fee Problem

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 and debit card[6] usage by paying inflated prices – prices

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[4] As increasing numbers of jurisdictions provide benefits electronically (EBT) and as more employers pay with pre-paid payroll cards, not checks, these largely unbanked consumers will increasingly impose interchange burdens on merchants as well; of course, they will do so without the benefits that access to insured bank accounts provides other consumers. There are numerous other problems with the lack of consumer protections for these second-class pre-paid cards that both the committee and the Consumer Financial Protection Agency should also address in the future. For a discussion, see http://static.uspirg.org/consumer/archives/2008/11/new_payment_met.html (last visited 7 October 2009).

[5] Americans for Financial Reform (ourfinancialsecurity.org) is a U.S. PIRG-backed diverse coalition of over 200 national and state organizations that has joined together to fix our financial sector and make sure it's working for all Americans.

[6] As noted in yesterday's Washington Post, debit card usage now surpasses credit card usage, due to the consumer response to an economy that lies in ruins following financial industry malfeasance resulting from several decades of deregulation and preemption of stronger state consumer laws. Nevertheless, whether consumers pay with debit or credit, merchants pay interchange. "In 2008, debit payment volume was $206 billion, compared with credit volume of $203 billion. MasterCard reported that for the first six months of this year, the volume of purchases on its debit cards increased 4.1 percent, to $160 billion, in the United States. Spending on credit and charge cards sank 14.8

inflated by the billions of dollars of anticompetitive interchange fees. And unfortunately, those interchange fees continue to accelerate, because there is nothing to restrain Visa and MasterCard from charging consumers and merchants more.

We present six main points:

- All consumers, even those who pay with cash and checks, pay more at the store and more at the pump because these interchange fees are passed on in the overall cost of goods sold.
- The significant increases in interchange fees signal a broken market. Visa and MasterCard have tremendous market power, which allows them to dictate the terms of trade: merchants have no choice but to accept Visa and MasterCard products on the sellers' terms. It is not surprising that interchange fees have increased significantly and are much higher in the U.S. than other countries.
- The card associations' rules prevent merchants from informing consumers on the costs of payment and limit the ability of merchants to direct consumers to the safest, lowest cost, and most efficient forms of payment.
- In addition, both the associations and banks engage in a variety of deceptive practices to drive consumers to higher-cost forms of payment.
- Neither the card-issuance or card network markets are competitive. Because of lax merger policy the card-issuance market has become an oligopoly. Interchange and consumer fees have increased as concentration has increased to alarming levels.
- Finally, this oligopolistic concentration has allowed issuers to engage in a variety of unfair and anti-consumer practices.

The legislation before the committee, HR 2382, the Credit Card Interchange Fees Act of 2009, would address the problem in several ways. It provides a framework to eliminate many of the anticompetitive rules credit card networks, particularly Visa and MasterCard, impose on merchants. It also increases the level of transparency about the interchange fees credit card companies collect from merchants and, ultimately, consumers.

Through the disclosure requirements this bill outlines, merchants and consumers will be able to be informed about the interchange fees credit card companies charge. The prohibition of additional fees to subsidize rewards programs and the unfair contractual terms between credit card companies and merchants will help ease the costs passed on to merchants and consumers.

By creating an environment where merchants are not burdened by hindering and anticompetitive terms and regulations, merchants, particularly small businesses, can be empowered to make decisions on how they run their businesses, participate competitively in their respective markets, negotiate to fix unfair practices imposed by bank networks, and keep prices lower for their customers. These are positive outcomes, which are greatly needed given the current economic climate.

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percent, to $233 billion." See Nancy Trejos, "For Gun-Shy Consumers, Debit Is Replacing Credit," page 1, The Washington Post, 7 October 2009.

The opponents of the legislation may suggest that consumers will be negatively affected from the enactment of the legislation because they will ultimately pay higher consumer credit and debit card fees if the interchange fees are lowered for merchants. Through extensive research, this argument has been negated. Policymakers from around the world have concluded that a reform in interchange fees actually benefits consumers. For example, the Reserve Bank of Australia concluded in their review of interchange rate reforms that consumers "are now able to obtain a card with an interest rate of 10 to 13 percent, rather than the 16 to 18 percent payable on traditional cards. For many consumers the resulting savings can run into hundreds of dollars per year…Consumers who do not even use credit cards at all are also benefiting from the reforms as they are paying lower prices for goods and services rather than would otherwise have been the case."[7]

By eliminating additional charges for premium cards or access devices, such as debit and credit rewards cards, through the bill, additional savings will be passed onto consumers. It is reported that as much as forty-four percent of interchange fees go towards subsidizing rewards programs. Currently, <u>all</u> consumers pay for rewards in the form of higher prices for the goods they purchase everyday. Only a small portion of <u>cardholders</u> actually receive rewards and the portion they receive is very modest compared to what cardholders pay in interchange.[8] But most important, the most vulnerable consumers, those without credit cards, receive nothing from interchange, and subsidize the supposedly free gift of rewards programs for more affluent consumers.

Despite arguments from opponents, small banks and credit unions will not suffer if the interchange fee system is reformed. Issuing credit cards does not generate revenue for small banks. In fact, institutions that have less than $1 billion in total assets make less than 1% of their revenues from credit cards.[9]

With interchange fees consuming as much as $2 of every $100 purchase in the United States, the United States has the highest interchange rates in the world. Compared to retailers in other countries, U.S. merchants pay credit card fees up to six times greater[10]. Earlier this year, for example, Mastercard settled with European competition officials and agreed to impose interchange of 0.3 %, or substantially less than one-fifth of the U.S. average fee:

> "Under its new agreement, MasterCard will hold interchange fees on cross-border credit-card transactions to an average of no more than 0.3%, down from between 0.8% and 1.9% in 2007; fees applied to debit cards will be lower. The EU had charged MasterCard with antitrust violations in 2007."[11]

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[7] Payments System Board Annual Report, *Reserve Bank of Australia*, 2005 at 14.
[8] And, of course, in the credit card context, revolvers (consumers who carry a balance) are seduced into carrying a higher balance by the tiny rewards averaging only about 1% that are offset by penalty rates of as much as 30% APR or more. Convenience credit card users are the only consumers who can be said to benefit from credit rewards.
[9] FDIC, Quoted in American Banker, March 20, 2009.
[10] Reuters: UPDATE1-Credit card purchase fess gouge US merchants-group. http://www.reuters.com/article/rbssFinancialServicesAndRealEstateNews/idUSN1721869620090917
[11] "EU Charges Visa Europe Over Fees," by Matthew Dalton and Peppi Kiviniemi, page C2, The Wall Street Journal, 7 April 2009.

These high U.S. fees are problematic at the least. The rapidly accelerating interchange fees appear to be a clear exercise of market power by Visa and MasterCard and put unnecessary financial pressure on merchants and consumers. The $48 billion in interchange fees U.S. consumers paid in 2008 is more than double what Americans paid in credit card late fees and three times ATM fees.[12] The $48 billion is an increase from $42 billion in 2007 and an increase of 33 percent from 2006.[13] Did consumers benefit from this rapid increase? Did cash customers benefit? Obviously not. Did credit card customers benefit? Did rewards programs improve substantially? Were there greater benefits to cardholders in some other fashion? Did the welfare of all consumers increase? We doubt it.

Based on our experience in these and other markets we believe there are two essential elements to a competitive marketplace: information and the ability to negotiate with other market players on an even playing field. Accurate and transparent information is necessary for consumers to make accurate choices. When information is readily available consumers can make choices, effectively compelling firms to compete for their purchases. And choice is a necessary element too. Absent choice, the discipline of the market will be lost.

The credit card market lacks both choice and adequate information. From a consumer's perspective it lacks choice because it is an oligopolistic market in which a small set of card-issuers dominate the market and establish a set of deceptive practices that harm consumers. From a merchant's perspective it lacks choice because merchants have no alternative but to accept the card associations' cards even when the associations significantly increase prices.

Markets don't work when there are hidden fees and rules – and no one hides fees and rules better than the credit card companies. Credit card markets lack the information necessary for both consumers and merchants to make informed choices. The markets lack adequate information for consumers to detect the fraudulent and exploitative practices of many card-issuers. For merchants, the markets lack adequate information because the associations prevent merchants from accurately informing consumers of the costs of credit card acceptance or attempting to direct them to more efficient and lower priced payment mechanisms. Moreover, the banks and associations engage in other deceptive practices to increase the interchange problem. Since the costs of accepting cards are passed on in the overall costs of goods, all consumers – affluent, working-class, and poor – ultimately pay these hidden charges. Low-income Americans, most without bank affiliations, are paying more for goods and services to fund credit card company programs for which they are not even eligible.

Interchange Fees Force Consumers to Pay Higher Prices

The interchange fee system is hidden from consumers and the public. The card associations do not disclose publicly their fees or the basis for these fees. Most public reports maintain that, on average, interchange fees cost merchants up to 2 percent or more of each transaction on a credit or signature debit card. Offline (signature) credit rewards transactions cost the most; online (PIN) debit classic card transactions cost the least. In 2008, credit card interchange fees alone cost merchants and consumers an estimated $48 billion.

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[12] Merchants Payments Coalition. www.unfaircreditcardfees.com
[13] Reuters: UPDATE1-Credit card purchase fess gouge US merchants-group.
http://www.reuters.com/article/rbssFinancialServicesAndRealEstateNews/idUSN1721869620090917

Like all other costs incurred by merchants, interchange fees are included – at least in part – when pricing goods and services. Card associations may suggest that interchange fees fund attractive rewards programs. Setting aside the question of the value of these programs, many consumers with credit cards do not use them and those without credit cards receive no benefits.[14] Over 27 percent of Americans do not have credit cards. For these consumers, interchange fees are especially pernicious and regressive.[15] These low-income Americans subsidize interchange fees for "services" that they are not eligible to use. No charge could be as regressive as one in which low income consumers receive no benefits.

The regressive nature of this charge is exacerbated because interchange fees are assessed as a proportion of overall sales. For example, when gas prices averaged $1.87 per gallon in 2004, interchange fees totaled about $12.5 million per day. In 2005, gas prices averaged about $2.75 per gallon nationally: credit card companies then made $18.4 million a day. These companies made an additional $2.2 billion dollars per year simply because of rising gas prices, without any additional social utility provided.[16] It is difficult enough for low and moderate income consumers to afford skyrocketing gasoline prices without having to pay additional fees that are passed on to them.

Increases in Interchange Fees Signal a Broken Market

Credit card interchange fees were intended to compensate card-issuers for certain costs, such as the costs of issuance, fraud, risk of loss, float and processing. Yet as all these costs have decreased in the past decade credit card interchange fees have increased. According to the Food Marketing Institute (FMI), these fees have increased over 20 percent in the past few years even though all the costs of card processing and issuance have fallen. The United States appears to be the only country in which credit card interchange fees are increasing and it has far higher fees that almost any other industrialized country. FMI projects that these fees will increase 22 percent annually.[17]

In a competitive market, prices would fall when costs decrease. In the credit card market, the opposite happens. The card associations may say that they need to increase interchange fees to compete for the loyalty of card issuers. But what about merchants and consumers? Merchants certainly have no choice but to accept Visa or MasterCards.

In the Justice Department case against Visa and MasterCard, the Court determined that both associations had market power because merchants were compelled to accept these cards even in

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[14] We seriously doubt consumers receive anything close to $42 billion in benefits through rewards programs. Some of the interchange fees undoubtedly fund industry marketing efforts, such as the more than 5 billion annual mail solicitations consumers receive for credit cards. Moreover, credit card issuance is a tremendously profitable line of business. According to the Federal Reserve, it is consistently the most profitable line of banking.

[15] Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, February 2009, at page 46. http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf, last visited 7 October 2009

[16] Margaret Webb Pressler, "Card Companies Are Filling Up at the Station," in Washington Post. 25 September 2005: pg. F01.

[17] Food Marketing Institute, "Hidden Credit Card Fees: The True Cost of a Plastic Marketplace" (February, 2006).

the face of a significant price increase. Almost all merchants are forced to accept Visa and MasterCard's terms, no matter what the interchange rates or contractual terms. Armed with this market power, credit card companies can, and do, increase interchange fees without suffering any repercussions.

Are these substantial interchange fees necessary? Examples outside the United States suggest this is not the case. As a recent European Commission decision detailed, numerous countries operate payment systems without the use of interchange fees. In those countries the ultimate costs of these systems is modest and the systems operate quite efficiently. In other countries, interchange rates are about one-third less than they are in the United States. In the United Kingdom, for example, merchants pay about 0.7 percent.

Another example is the debit market in Canada. In that market, there are no interchange fees. Even without interchange, there is higher debit card usage and merchant acceptance than in the United States. Some consumers pay direct fees for debit card use but because those fees are transparent there is active competition to reduce those fees. Ultimately everyone in Canada pays less for the cost of payment services.[18]

There is a great deal of debate about the impact of reductions in interchange fees in Australia, but a careful analysis of that debate demonstrates that the reduction in interchange fees ultimately benefited consumers in the reduction of card costs, greater innovation, and greater competition leading to lower interest rates. Several years ago the government mandated a reduction in interchange fees in Australia from 0.95 to 0.55 percent (both rates far lower than the current rates in the U.S.) A recent study of the Reserve Bank of Australia found that the reduction in interchange benefited all consumers since the bulk of the reduced rates "ha[s] been, or will eventually be, passed through into savings to consumers." Moreover, the evidence seems fairly clear that the reduction of interchange resulted in an outbreak of competition by card issuers, which now compete more aggressively in offering cards with lower fees and lower interest rates. Reducing interchange has also spurred innovation, leading the card issuers to offer new types of cards such as no-frill cards with lower fees and lower interest rates. Finally, the Report found an overall benefit to society because consumers received better pricing signals, creating an incentive for them to use the most efficient forms of payment.

As the members of the Committee recognize, interchange, like any other credit card policy, affects different groups of consumers differently. In fact one of the strongest reasons for attacking the interchange fee problem is that the costs of interchange are borne by <u>all consumers:</u> thus, cash paying customers, many of whom are not eligible for credit cards, effectively subsidize the attractive rewards programs for far more affluent consumers. In considering efforts to solve the interchange fee problem, protecting these consumers must be the first priority of this Committee.

The evidence from Australia seems relatively clear: cash paying customers benefit from the reduction in interchange:

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[18] Gordon Schnell and Jeffrey Shinder, "The Great Canadian Debit Debate," *Credit Card Management*, May 2004. http://www.constantinecannon.com/pdf_etc/TheGreatCanadianDebit.pdf.

> "The Board acknowledges that the reforms have not affected all parties equally. In particular, those who use EFTPOS and cash are more likely to have been made better off as a result of the reforms than those who use credit cards extensively and pay their balances off by the due date. Previously, this latter group was receiving significant benefits, partly at the expense of the former.[19]"

For those individuals holding credit cards, there were general benefits in lower interest rates and card fees. And for transactors (those who pay off their balance on time) there was a slight decrease in benefits, as rewards programs have been reduced, but these programs only benefit some users. In the United States, where interchange fees are considerably higher, the potential savings for each consumer could be far greater.

Finally, the opponents of a competitive interchange fee market may suggest that any reduction in interchange fees must result in an increase in other fees such as annual fees or late fees. This argument overstates any legitimate concern. First, a reduction in interchange will not necessarily result in higher bank fees; instead, the banks may choose to reduce the blizzard of promotional materials they send out every day. Second, the results in Australia show that if there is any significant change it is in the reduction of rewards programs. But rewards programs benefit only a small portion of card users. Third, the competition in Australia to offer consumers lower interest rates will likely outweigh any costs or reduction of rewards. In the U.S., we find that lower interest rates are the most important criteria for most consumers to use when determining their choice of cards and reform that improves those rates will be an important consumer benefit, even if there is some reduction of rewards programs. Fourth, if this relationship operated as the opponents describe it, then we might reasonably expect the rapid increases in interchange charges over the last several years to be accompanied by reductions in other fees. But this reduction simply has not happened.

Deceptive Practices Increase Prices for Consumers

As we suggested earlier, accurate and complete information serves a critical role in making sure the forces of competition work. As the government does not regulate or compel disclosure of credit card interchange fees, most consumers have no idea that they exist and that they are paying for services that they may not even use. In fact, Visa, MasterCard and the card issuing banks engage in a variety of practices to prevent well-informed consumers from exercising their choices.

First, Visa and MasterCard rules prevent merchants from disclosing fees to their customers or attempting to steer consumers to lower-priced payment options, such as cash or online debit cards. They cannot charge a distinctive price or surcharge based on payment options. They cannot attempt to direct consumers to lower cost options such as cash, checks and online debit.[20] Passage of HR 2382 would address this issue.

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[19] Reserve Bank of Australia, Reform of Australia's Payment System: Preliminary Conclusions of the 2007/08 Review (April 2008).

[20] We note that the standard canned industry response is that "nothing in our rules prevents cash discounts from being offered." But requiring that there be separate price markings for each product with the higher interchange price and the lower cash price makes cash discounts very hard to offer. Fuel is a relatively simple example, but even there with a variety of different octane grades and products (gasoline, diesel, etc.) card association rules can make discounting more difficult than it ought to be. And if it is difficult for fuel, imagine the logistical difficulties created

Transparency is essential for any market to function effectively

Assistant Attorney General for Antitrust Christine Varney recently highlighted the importance of transparency when she said, "I am a firm believer in what Justice Brandeis said in another context: 'Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.' Markets work better and attempted harms to competition are more likely to be thwarted when there is increased transparency to consumers and government about what is going on in an industry."

Second, card associations and banks use misleading marketing to encourage consumers to use their credit cards or signature debit cards as frequently as possible. Reward incentives, such as frequent flier miles, are designed to seem as though customers are paid to use these cards. In reality, these consumers and other consumers are simply paying for those rewards.

This lack of disclosure is especially problematic with the recent efforts of the card associations to "convert" cardholders from regular credit cards to so-called "premium cards" such as the Visa "Signature" or the MasterCard "World" cards. These cards have a significantly higher interchange fee than traditional cards, among the highest of all interchange fees. For example, a premium card may cost merchants well over 2.0 percent or even 3 percent compared to 1.6 percent for a traditional card. These premium cards focus only on the highest-income consumers. However, they offer minimal additional benefits. Consumers do not realize that everyone else pays higher prices on goods and services when they themselves use a premium card and consumers are wholly unaware that converting to a premium card will ultimately cost all consumers more. Nor, as stated above, can merchants refuse to accept these cards or attempt to direct consumers to lower priced cards through differential pricing. These premium cards are simply a scheme to substantially increase hidden interchange fees. HR 2382 would prohibit an egregious effect of Rewards Cards—requiring merchants to accept a card that costs them more, for the same purchase, and then passing that hidden, unknown, non-transparent cost on to all its customers. Rewards debit is part of this effort-- simply a scheme to move consumers from lower cost PIN debit to higher cost (and higher bank profit) signature debit.

Third, although merchants can't surcharge or use differential prices to direct consumers to the most efficient and lowest priced payment options, banks do have that power. Not surprisingly, they use it to direct consumers to less efficient, higher cost options. The debit card market illustrates this problem. Signature based debit is more expensive and less secure than online debit because online debit transactions are instantaneous. Online debit has a far lower rate of fraud. Online debit transaction interchange fees are capped at fixed levels; they only cost merchants between $0.17 and $0.50 per transaction.[21] Conversely, credit and signature debit cards cost merchants up to 2% or more of the entire transaction, no matter how large. Instead of promoting online debit which is safer and less costly, banks increasingly surcharge consumers

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for offering cash discounts at a convenience store with a thousand different items, let alone a grocery store with thousands of different items for sale. The card associations may not technically prohibit cash discounts, but they do what they can to make sure it does not happen very often.

[21] November 2004, Federal Reserve Board, Report to the Congress on Disclosure of Point-of-Sale Debit Card Fees, See Figure 4, page 14 available at http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf.

seeking to make these transactions with penalty fees of as much as 50 cents a transaction.[22] Consumers are paying more for a less safe and more costly product.[23] These penalties effectively steer consumers to the less efficient, less secure, more costly signature debit product. While the use of online debit cards is the best option for both consumers and merchants, deceptive and manipulative tactics ensure the most expensive payment possible is used.

These examples show that card associations and banks use some of the same deceptive practices against merchants as we have seen them use against consumers for years. Not only do the merchants suffer as a result, but consumers, unwittingly, do too.

Not surprisingly, outside the United States, where these anticompetitive practices are not permissible, online debit is the most preferred form of debit. Online debit is a far safer and more secure product. Where market forces are not restrained and consumers can make fully informed choices, the lower-priced, more efficient product prevails.

The Potential Impact of the Proposed Legislation On These Problems

The legislation being considered today, H.R. 2382, the Credit Card Interchange Fees Act, addresses the interchange fee problem by requiring transparency and ending anticompetitive practices. Currently, consumers do not receive any information about the interchange fees charged for the use of their cards, but this bill would change that. The bill would also address deficiencies in the information that merchants receive regarding interchange charges. And, for the first time, this bill would give a regulator the ability to review Visa's and MasterCard's practices and prevent them from continuing to enforce deceptive or anticompetitive terms on merchants.

The specific terms that this legislation prohibits would quickly help to bring some competition to interchange fees. In addition, the bill would:

- Provide consumers with discounts for using cheaper credit or debit cards or other forms of payment that are cheaper such as cash and checks. The credit card networks and banks should not be able to limit how these discounts are displayed or advertised by merchants. Ensuring that merchant pricing is accurate and clear is the role of state consumer protection laws. Banks do not limit merchant pricing displays to protect consumers – they do it to prevent competition in the market and prevent transparency in their fees.

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[22] A 2003 NYPIRG report found that 89% of the banks surveyed assess a fee for online debit PIN-based transactions. The average fee assessed is 70¢. The fees ranged from 10¢ to $1.50. See "Pricey Plastic: A NYPIRG Report and Survey of Plastic Card Fees," 2003, available at http://www.nypirg.org/consumer/cards/debit.html (last visited 18 July 2007). While a Federal Reserve study found substantially lower numbers of banks imposing PIN debit fees, it found fees in the same range: "At sampled institutions that charge fees for PIN debit, the fees range from roughly $0.10 to $2.00 per transaction (figure 5). The median (and mean) fee is approximately $0.75." See "Report to the Congress on the Disclosure of Point-of-Sale Debit Fees," November 2004, Federal Reserve Board of Governors, available at http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf (last visited 18 July 2007).

[23] All plastic is not created equal. Congress should also upgrade the weak consumer and anti-fraud protections applicable to debit, ATM and stored value cards (regulated under the Electronic Fund Transfer Act and Regulation D) to the higher standard credit cards are subject to (that of the Truth In Lending Act and Regulation Z). But within the debit card universe, PIN-based online transactions are more secure than offline signature based transactions.

- Communicate merchant preferences among payment types to consumers. The "honor all cards" rule that requires merchants to accept every card Visa or MasterCard creates – no matter how high they set the fees for that card – should not stand.

- Accept certain cards at some merchant sites, rather than at all locations, and set minimum or maximum purchase size limits for transactions involving a card.

These are all positive outcomes. While opponents of the legislation will undoubtedly argue that consumers would be inconvenienced if merchants are able to choose which cards they accept, those market choices happen for other products and services every day. As I've said, with transparency consumers will be able to make these choices and will be far better off than continuing to allow oligopolistic to mandate that all their different products be accepted and drive up prices.

Of course, we expect the card associations and their members to suggest that the credit card issuance market is un-concentrated and vigorously competitive.[24] But the facts are to the contrary. There have been numerous antitrust suits alleging that card issuers and the associations have colluded over fees, exchange rates, and important contractual terms.[25] While concentration has increased dramatically over the past seven years, interchange fees, other fees charged to consumers, deceptive practices, and interest rates have increased significantly. Although the parties to these mergers suggested that there would be significant efficiencies from these mergers, consumers have seen few, if any, benefits. After years of consolidation the bad news for consumers is clear: an oligopolistic market which is a fertile environment for collusion, higher prices, more hidden fees, and more deceptive practices.

This committee recently led the way in the enactment of far-reaching, landmark legislation, the Credit CARD Act, to rein in unfair credit card practices directed at consumers. In testimony over the past several years to the committee, we had described a series of these egregious practices conducted by card issuers against their cardholders. These practices included the use of punitive penalty interest rates, imposition of questionable late and over-the-limit fees, manipulation of teaser rates, and other practices designed to increase and extend high-cost credit card debt to consumers. A lack of prudential regulation was a primary cause of these aberrant behaviors. Those behaviors did not, however, develop in a vacuum. The basic model employed by the card associations and their members changed over time. As they recognized the potential income from interchange and other fees, these institutions began to view their customers as fee-generating machines. This has led to a proliferation of cards and incentives for increased card use without appropriate attention to the risks that consumers might not have the ability to repay

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[24] In testimony in 2005 Timothy Muris testified that "[n]o [card] issuer has market power, and issuers respond to increases in interchange fees by enhancing card benefits to consumers." We doubt that Visa and MasterCard or card-issuers act as benevolent monopolists, but in any case there is no systematic study to suggest that increased interchange is passed on to consumers in greater benefits. Even if this allegation was substantiated, it would still be true that all consumers, including those who do not use credit cards pay for those "increased benefits."

[25] Visa, MasterCard and several card-issuing banks recently settled an antitrust suit for $336 million alleging they had fixed the credit card foreign currency exchange rates. Other litigation involves alleged collusion by card-issuers over credit card late fees and over limit fees (In re Late Fee and Over Limit Fee Litigation, Civ. No. C-07-0634 SBA (N.D. Cal.)) and alleged collusion by card-issuers and networks requiring the use of mandatory arbitration provisions (Ross v. Bank of America, N.A. et. al. Civ. No. 05-07116 (S.D.N.Y.)).

the debts they incur. Interchange fees have played a central role in these negative changes and should be reformed.

The industry will also claim that merchants will not the benefits of any lowered interchange fees onto their customers. Of course, that implies that the merchants believe that the retail market, like their own, is broken. We have seen no studies that suggest that the retail market is not competitive; we have seen much evidence that it is. If retail is competitive, and the evidence suggests that it is, savings and benefits of reform should be passed along and that is an outcome that we expect. We encourage the committee to ask the industry for studies showing that the retail market is broken, rather than simply making claims that it is.

Conclusion

In the past some of the defenders of interchange fees have claimed that "[i]f consumers understood the threat that the merchants' campaign [against interchange] poses to the plastic in their wallets, I suspect that we would see nothing less than a revolt." He could not have been more wrong. If consumers understood the existence or the dimensions of the hidden fees assessed by the banks and associations, they would truly rebel. Credit card companies make billions of dollars each year through interchange fees, which ultimately all consumers must pay, including the millions of Americans without credit cards. Low income cash-paying customers subsidize an inflated rewards program that benefits only a small portion of cardholders. The credit card market lacks the critical foundations of healthy competition – choice and adequate information. From a consumer's perspective, it lacks choice because it is an oligopolistic market in which a small set of card issuers dominate the market and establish a set of hidden practices that increase consumer costs. Interchange fees imposed on merchants do affect consumers, all of them.

We applaud the Committee for considering thoughtful legislation which offers the promise of remedying the interchange fee problem. Along with other consumer groups, we hope to work with you on this and other efforts to protect consumers from anticompetitive tactics in this vital market. Thank you for considering this testimony. I welcome your questions.

Position Paper on Interchange Fees

The deceptive and anticompetitive practices of the two major credit card associations – Visa and MasterCard – have injured both consumers and merchants for many years. Swipe fees, also known as interchange, are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. About $2 of every $100 spent using plastic goes to hidden plastic card swipe fees. It is the biggest credit and debit card fee of all.

Although the amounts will vary from market to market, consumers pay more at the store and more at the pump, because merchants pass these fees along to all customers, not just those with credit or debit cards. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers subsidize credit card usage – including the use of reward cards for the richest consumers -- by paying prices inflated by the billions of dollars of anticompetitive swipe fees. . In fact, low-income Americans, most without bank affiliations, are paying more for goods and services to fund credit card company programs for which they are not even eligible. These additional costs could be as high as 1 percent overall.

And unfortunately, those credit card swipe fees continue to accelerate, because there is nothing – no marketplace or competitive force -- to restrain Visa and MasterCard from charging consumers and merchants more, even though technological advances should have reduced the cost of providing the services. So, not surprisingly, these fees have been skyrocketing.

Based on our experience in these and other markets, we believe there are two essential elements to a competitive marketplace: information and choice. Accurate and transparent information is necessary for consumers to make accurate choices. When information is readily available consumers can make choices, effectively compelling firms to compete for their purchases. And choice is a necessary element too. Absent choice, the discipline of the market will be lost. The credit card market lacks both choice and adequate information. From a consumer's perspective, it lacks choice because it is an oligopolistic market in which a small set of card issuers dominate the market and establish a set of hidden practices that increase consumer costs.

Markets don't work when there are hidden fees and rules – and no one hides fees and rules better than the credit card companies. Credit card markets lack the information necessary for both consumers and merchants to make informed choices. For merchants, the markets lack adequate information because the associations prevent merchants from accurately informing consumers of the costs of credit card acceptance or attempting to direct them to more efficient and lower priced payment mechanisms. In fact, merchants have no alternative but to accept the card associations' cards even when the associations significantly increase prices
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Swipe fees have grown at a staggering pace – from about $16 billion in 2001 to about $48 billion in 2008. This is a clear sign of a broken market. Not only do these huge fees injure consumers by inflating the cost of goods and services, they create incentives for banks to view credit and debit cards as fee engines. It is not coincidence that consumer-side fees such as late fees, over-limit fees, overdraft fees and others have seen rapid increases during the last several years, just as swipe fees have exploded. Seeing the potential income from fees has made banks' business models develop such that they often view their customers as fee-generating machines. These business models have dictated the proliferation of cards and incentives for increased card use without appropriate attention to the risks that consumers might not have the ability to repay the debts they incur on these cards.

Credit card industry practices must be reformed in order to deal with these market failures and the resulting injury to consumers. Transparency and market forces are needed to check the growth of unjustifiably high swipe fees. Consumers have a right to know the amount of the swipe fees charged in conjunction with their transactions. Merchants too must be given information about the type of card that they are receiving at the point of sale and the corresponding interchange fees. In addition, the Visa and MasterCard operating rules that dictate how the credit and debit card systems operate must be provided to a regulator that, in turn, makes those materials public for everyone to see and analyze.

Visa and MasterCard rules that are unfair, deceptive, or anticompetitive must also be abolished. This should start with a strong regulatory agency such as the Federal Trade Commission (or Consumer Financial Protection Agency) having the power to review the rules and prohibit any it finds to violate these tenets that govern transactions throughout our economy. Some specific rules must be prohibited right away including the rules that prohibit merchants from providing consumers with discounts for using cheaper credit or debit cards or other forms of payment that are cheaper such as cash and checks. The credit card networks and banks should not be able to limit how these discounts are displayed or advertised by merchants. Ensuring merchant pricing is clear is the role of state consumer protection laws. Banks do not limit merchant pricing displays to protect consumers – they do it to prevent competition in the market and prevent transparency in their fees. Similarly, credit card networks and banks should not be able to prevent merchants from communicating their preferences among payment types to consumers. The "honor all cards" rule that requires merchants to accept every card Visa or MasterCard creates – no matter how high they set the fees for that card – should not stand. Credit card networks and banks should not be allowed to require merchants to accept cards at other locations as a condition for letting the merchant accept cards at one location. Credit card networks and banks should not be able to prohibit merchants from setting minimum or maximum purchase size limits for transactions involving a card. We should explain here how the honor all card rule disadvantages consumers and how reforming it will benefit consumers.

Finally, reforms should include mechanisms for ensuring greater transparency, more equitable and competitive pricing and that interchange savings incurred by merchants are passed through to consumers.
