SUBCOMMITTEE ON INVESTIGATIONS AND OVERSIGHT HEARING ON THE IMPACT OF INTERCHANGE FEES ON SMALL BUSINESSES

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

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SUBCOMMITTEE ON INVESTIGATIONS AND OVERSIGHT HEARING ON THE IMPACT OF INTERCHANGE FEES ON SMALL BUSINESSES

Thursday, July 29, 2010

U.S. House of Representatives,
Committee on Small Business,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building, Hon. Jason Altmire [chairman of the Subcommittee] presiding.

Present: Representative Altmire.

Chairman Altmire. I will now call the hearing to order.

In this time of fiscal belt tightening, too many of America's small businesses are faced with unfortunate choices: either cut costs or close their doors. Taking measures such as delaying plans to expand and even cutting their own salaries, small-business owners have done their best to weather in these trying times.

For a majority of small businesses, however, one of the costs they have been unable to trim has been the fees they pay in order to accept card payments from their customers. These fees, commonly known as interchange fees, are paid to banks and card-processing networks every time a consumer swipes their card and makes a purchase. While, on average, these fees are 2 percent to 3 percent of a transaction's total, the costs can add up quickly for a small-business owner.

The recently passed financial reform law includes a provision that gives the Federal Reserve the authority over these fees for the first time. The use of debit card purchases has grown steadily in recent years, as consumers have made increased use of debit cards in lieu of cash or checks. Under the new law, the Fed is responsible for setting reasonable and proportional rates for debit transactions.

While small businesses expect to experience relief from the fees they currently pay for these transactions, small financial institutions, such as community banks and credit unions, have expressed concern that providing the Fed with this new authority could have long-term unintended consequences.

Among those concerns is that these small financial institutions will ultimately be put at a competitive disadvantage against large card issuers and will be unable to match the fees set by the Fed for larger issuers, which could ultimately result in fewer services for consumers at these financial institutions that are integral to communities in western Pennsylvania and across the country.

Today we will delve into these issues and take a first look at how new reforms enacted under the Wall Street Reform Act will affect American businesses, financial institutions, and consumers.

Just 2 years ago, debit, credit, and prepaid cards surpassed the use of cash and checks as consumers' preferred form of payment. And today these cards are used in more than 56 percent of all transactions. Electronic cards have always been a convenient means for payment for customers. They expedite transactions while providing the considerable ease of use and security.

Today, nearly two-thirds of all customers carry cards that provide some type of reward when they are used. It should come as no surprise, then, that that card usage is on the upswing.

As card usage has grown, so, too, have the amount of interchange fees paid by retailers. According to the Federal Reserve estimates, these fees more than doubled in the 5-year period between 2002 and 2007. Today, it is estimated that these fees comprise a $45 billion annual expense for our Nation's businesses.

For businesses that operate on razor-thin profit margins, fees on card transactions can mean the difference between a profit and a loss each time they sell their goods. Even more troubling is the fact that this cost may fall disproportionately on small businesses since they often lack the market power to negotiate lower fees, as many large retail businesses do.

However, payment cards also offer merchants a number of benefits. By accepting card payments, businesses can increase their sales and reach a wider customer base, including expanding into online/mail-order sales. These cards have the added benefit of providing merchants with guaranteed payment that is less prone to fraud, loss, or theft. Merchants also avoid the costs associated with handling cash, processing checks, and transporting funds to a bank when they accept card payments.

Most importantly, however, the existence of national card payment networks means that every business in the country, regardless of its size, can sell its goods and services on credit cheaply and efficiently. Two decades ago, that was practically unheard of; today, it is commonplace. And the interchange system has made all that possible.

Rarely does such a seemingly small issue have such a significant impact on the daily affairs of small businesses, small financial institutions, and customers alike. For this reason, it will be imperative that Congress and this Committee tread carefully in this area, as even a slight change to the system can have far-reaching consequences. That is what this hearing is about today.

Last month, Congress took its first steps toward reforming the card payment system with provisions enacted under the Wall Street Reform Act. Today's hearing will likely be the first of many discussions to examine how these new rules will impact American businesses and customers and give us crucial insights into how these laws can best be implemented.

Small financial institutions, like credit unions and community banks, were not the cause of the financial free-fall we experienced in 2008 or the impetus for the Wall Street Reform Act. While Congress was forced to bail out the bad actors on Wall Street, credit unions and small businesses remained stable. As we move forward with implementation of the new law, it is critically important that we do not unintentionally do harm to the small financial institutions that have played by the rules.

I would like to thank our witnesses for their participation in today's hearing. I look forward to your testimony.

And, as we wait for a ranking member, in the interest of time we will just move forward with the hearing. And I will introduce, starting with Mr. Newton, our witnesses.

I will read about all of you first, and then we will go to the testimony. So, the bios for the four of you—and thank you all for being here.

Mr. Chris Newton is the president of the Texas Petroleum Marketers and Convenience Store Association, located in Austin, Texas. TPCA was formed in 1949 as the Texas Oil Jobbers Association to serve the regulatory, legislative, and educational needs of fuel and the lube oil business.

I changed my mind. Why don't we just go ahead with Mr. Newton first, and then we will introduce all of you.

Welcome, Mr. Newton.

STATEMENT OF CHRIS NEWTON

Mr. NEWTON. Thank you, Mr. Chairman. Again, my name is Chris Newton, and I appreciate this opportunity to talk about the impact of interchange fees on small businesses.

As you alluded to, I am the president of the Texas Petroleum Marketers and Convenience Store Association, or TPCA. TPCA is a trade association representing fuel distributors and fuel retailers in Texas. Our members own, operate, and supply around 10,000 retail motor fuel outlets. Our members are also responsible, are collectively responsible, for the sale of about two-thirds of all the fuel sold in Texas.

Interchange fee is a very important issue to our member companies. And it is important because it has a significant impact on small business because these fees, in our opinion, are anticompetitive. They are anticompetitive because the fees are centrally set by Visa and MasterCard and their member banks. There is an incentive to continue raising the fees to attract more member banks.

The fees are hidden, and consumers are unaware of the fees' escalation. We also see there is no price advantage for lower-priced cards. There is no ability to discount for cash. In fact, a recent study concluded that, without higher prices caused by fees above and beyond cost plus a reasonable rate of return, consumers would have an extra $26.9 billion and potentially add 242,000 jobs to the economy.

For our industry, for the convenience store industry, the fees are our members' second-highest cost, behind labor. But, unlike our other costs, we can't do anything about these fees. They have increased dramatically over the last 13 years. Because we have no ability to negotiate these fees or offer our customers a lower-priced alternative, there is nothing we can do.

The fees' impact on small business also becomes more egregious when you consider that our retail profit margins average under 2 percent, while the Federal Reserve of Kansas City has concluded that the profit margins for interchange fees are around 60 percent.

And to further give you some additional context for this, in 2009 our entire industry made pre-tax profits of $4.8 billion, but we paid fees to process card transactions of $7.4 billion. This inverse relationship between fees and profit stymies economic growth.

The Durbin amendment to the financial reform bill recently passed by Congress will help small businesses and consumers cope with the impact of interchange fees and lead to additional economic growth. Consumers will benefit because the amendment will allow my members to reward lower-cost means of payment with lower prices.

Small businesses, my members, will benefit because we will receive an assurance that interchange fees for debit transactions will be reasonable and proportionate to their cost. We will have the ability to offer our customers discounts for more efficient means of payment or lower-cost means of payment. And lower prices for consumers mean more sales for our members.

So that concludes my opening remarks. I appreciate the opportunity to be with you today, and look forward to the discussion.

[The statement of Mr. Newton is included in the appendix.]

Chairman ALTMIRE. Thank you.

Mr. Ron Celaschi is vice president of lending with the Clearview Federal Credit Union based in Moon Township, Pennsylvania. Clearview Federal Credit Union has 76,877 members and assets of $594 million. Clearview primarily serves the Pittsburgh metro area, though it also has branches in Philadelphia and Charlotte.

Welcome. I look forward to hearing your testimony.

STATEMENT OF RONALD CELASCHI

Mr. CELASCHI. Good morning, Mr. Chairman, and thank you for the opportunity to testify at today's hearing. As you mentioned, I am Ron Celaschi, vice president of lending at Clearview Federal Credit Union.

Just a little background on the credit union: We initially served the employees of US Airways and modified our charter back in 2004 to serve communities in the 10-county area surrounding Pittsburgh, Pennsylvania. So our charter is a little bit expanded.

I do appreciate the opportunity to present our views or interchange, what it means to small businesses, and also what it means to my credit union.

To begin with, we are very concerned with the provisions of the recently enacted financial reform law which relate to interchange fees. At many credit unions, it is true that interchange revenue covers the cost of providing debit card access to their members; however, for our credit union, that is simply not the case.

Last year, our total expense for offering a debit card access or program to our members was $2.9 million. The offsetting debit-based interchange income was roughly $1 million, causing us a shortfall of $1.9 million on a valuable service.

How is this possible when merchants have been telling Congress that interchange fees are unreasonable? Clearview Federal Credit Union has an aging membership, and it is true that older members tend to use their debit cards less frequently than the younger members that we serve. In a recent survey conducted by the Credit Union National Association, credit unions reported an average number of transactions per card per member at 160 per year. At Clearview, that number is only 69.

So even though our members use their debit cards with less frequency than members of other credit unions, we still incur the total cost of running and administering a program. We run our program debit program at a loss because it provides a valuable service to our members. However, any reduction in interchange income that we receive will require us to impose fees on members to make up for that lost revenue. And that is a direct result of the recently enacted financial reform bill.

The new debit interchange law includes an exemption or a carveout for card issuers with less than $10 billion in assets, like our credit union. However, this exemption provides me with little comfort. And why? Quite simply, about 80 percent of debit volume is accounted for by a handful of large issuers. The scale of their transactions enables the operation of a global network with enough capacity so that small issuers like us can participate. It is hard to imagine a carveout that would protect our credit union from the impact of new interchange regulation and the loss of revenue.

We don't know precisely how the system will change and in what ways, but we do know this: that an artificial marketplace will be created; the ability of small issuers to compete in the face of merchant pressure will be significant; the ability of small issuers to attract and retain customers will change; and merchants will become even more bold in their efforts to steer and influence consumers regarding payment method.

Another aspect of the new law addresses the routing and processing for card transactions. No exemption or carveout currently exists for small financial institutions applying to the routing section of the law. In practice, this takes the routing decision away from the financial institution and places it in the hands of merchants. And the significance of that is the merchant's objective is to cut the cost to the bottom line, while the financial institution's objective is the security of the consumer's personal information and that transaction. With this new law, the merchant's objective clearly trumps the best interest of the consumer, in our opinion.

That brings me to my second point: What will this interchange law mean to the small businesses in my community? As a credit union lending officer, I am very familiar with the challenges facing small businesses today. The interchange expenses incurred by small businesses are relatively insignificant compared to expenses associated with health-care costs, vendor and supplier expenses, franchise-related requirements or expenses, and certainly a difficult economy. In my experience within the credit union movement since 1991, I have yet to witness a business close based on elevated interchange expenses.

But will the new debit interchange structure benefit big-box retailers? You bet it will. The Wall Street Journal recently reported, ″The new debit interchange law will, on an annual basis, mean a quarter of a billion dollars for Wal-Mart.″ Someone needs to support this system. And if the buck is passed from the big-box retailer to the consumer, Wal-Mart wins big. And the same can't be said about the consumer and Main Street small business.

And my final point: What actions can Congress take today that will truly help small businesses in our struggling economy?

I think all of us come from different backgrounds, but we can agree upon the fact that there is a need to increase the amount of credit available to small businesses. There is legislation in place to increase the cap on credit-union-member business lending, and it has strong support in the House and Senate and key administration support as well.

Pending legislation would increase the credit-union-member business lending cap from 12.25 percent of total assets to 27.5 percent. If this language were enacted this year, credit unions could lend to small businesses an additional $10 billion and create 100,000 new jobs in the first year after enactment at no cost to taxpayers.

While bank business lending has contracted in recent years, credit union business lending has expanded. Clearview Federal Credit Union is committed to helping the small-business members in our community. In fact, our average business loan is approximately $70,000 and includes, among others, hair salons, landscaping companies, and several other sole proprietorships. It is my hope that Congress will act as soon as possible on this important issue.

Mr. Chairman, I thank you very much for the opportunity to testify at today's hearing. Clearview Federal Credit Union is proud to serve the citizens and small businesses of western Pennsylvania. And, at this time or after the other folks are finished, I would be pleased to answer any questions. Thank you.

[The statement of Mr. Celaschi is included in the appendix.]

Chairman ALTMIRE. Thank you.

Our next witness is Mr. Robert Oeler. He is the president and chief executive officer of Dollar Bank, headquartered in Pittsburgh, Pennsylvania. Dollar Bank is a full-service regional bank, operating more than 50 branch offices and loan centers.

Mr. Oeler is testifying on behalf of the American Bankers Association, which was founded in 1875 and is the voice for the Nation's $13 trillion banking industry and its 2 million employees.

Welcome, Mr. Oeler.

STATEMENT OF ROBERT OELER

Mr. OELER. Thank you, Mr. Chairman. Thank you for this opportunity. As you said, I am president and CEO of Dollar Bank, a traditional mutual bank that has served western Pennsylvania and northeastern Ohio for over 150 years.

Any changes to the interchange system will impact all small businesses, small banks included. The vast majority of banks in our country are community banks—small businesses in their own right. In fact, over 3,200 banks and 6,100 credit unions have fewer than 30 employees.

When merchants choose to accept payment cards, they pay a small fee for the many benefits that come with accepting electronic payments. For example, a $10 debit transaction would cost the merchant less than 10 cents in interchange. In return, retailers typically see more customers, shorter wait times at the register, immediate payments to their account, and less hassle and risk of managing cash. They also generally transfer the risk of fraud to the bank.

These interchange fees pay to support a system that works 24/7, 365 days a year, almost anywhere in the world. These fees are under attack by retailers, yet they are no different than any other cost of running a business.

Restrictions on interchange fees were included in the recently enacted Dodd-Frank Act. The provision, called the Durbin amendment, requires the Federal Reserve to dictate the pricing of interchange on debit cards. The Durbin amendment, which was added to the bill without any hearings, limits consideration of many important costs of providing debit cards and does not even allow for a reasonable return on investment. Such uneconomic pricing will hurt my ability to offer reasonably priced banking products to consumers and small businesses in my community.

Let me illustrate this. Last year, we processed 16 million debit card transactions and made less than $3 per month for each debit card. This revenue is important but does not cover our cost of maintaining a transaction account, which runs between $12 and $15 a month. Without this income, it becomes very difficult for many banks to continue to offer low- and no-cost checking for our customers.

Loss of revenue has other impacts, as well, including making it harder to make loans. This is even more pronounced for Dollar Bank. Since we are a mutual, the only way we can raise capital is through retained earnings. If we lose interchange income, it means we will be unable to make as many loans in our community. In fact, if we would see a 50 percent reduction in after-tax income on interchange, it means 200 fewer small-business loans that can't be made each year, year after year. For the industry as a whole, a 50 percent loss of interchange income would mean that lending could fall by as much as $74 billion.

Congress recognized that setting price controls on interchange fees will have a significant negative impact on roughly 16,000 small banks and credit unions. Congress attempted to remedy this problem by providing an exemption to the price controls for small banks. While this idea sounds good, there is no community banker that believes such an exemption will work in practice. As with any price controls, there are inevitable unintended consequences, market distortions, and higher costs for others, including consumers.

While I realize the ink is barely dry on the Dodd-Frank Act, the negative consequences for banks and bank customers are so great that Congress should revisit and repeal this provision. Moreover, Congress should avoid further price controls, such as a restriction on credit card interchange fees.

Government price setting of business-to-business transactions hurts the ability of local banks to serve consumers and local businesses. It affects banks in low-income communities looking to provide low-cost banking services to the underprivileged. And it stifles innovation in a system that has supported the development of electronic bill payment, the online retail market, and the promotion of enormous operational efficiencies for small businesses.

Thank you for the opportunity to present the ABA's views. I would be happy to answer any questions you may have.

[The statement of Mr. Oeler is included in the appendix.]

Chairman ALTMIRE. Thank you, Mr. Oeler.

Our last witness is Mr. Jerry Buss. He is president of Aurora Huts, LLC, based in Seven Fields, Pennsylvania. Mr. Buss is the former COO of Pizza Hut. He bought 53 Pittsburgh-area Pizza Hut locations, making the company one of the largest Pizza Hut restaurant operators in the region. Aurora Huts owns roughly two-thirds of the Pittsburgh market's locations.

Welcome, Mr. Buss.

STATEMENT OF JERRY BUSS

Mr. BUSS. Thank you, Chairman Altmire and members of the Committee. Good morning. I am honored to be here today to offer my perspective on credit card and debit card fees and how they affect my small business. I want to thank Chairman Altmire for his leadership on this Subcommittee and for giving us all the chance to air our views.

I ask that my entire testimony be made part of the hearing record.

As Chairman Altmire said, I operate now 55 Pizza Huts in western Pennsylvania. We employ around 1,300 employees, and we have a payroll of a little over $10 million. The business is a family business, as my children are also owners and operators of this business. And it is my desire to see this business grow and flourish and furnish an opportunity for them to have the lifelong satisfaction of being private business persons.

Franchisees like myself and the actual restaurant owners operate most of the restaurants across the country. There are 6,500 Pizza Huts, for instance, and almost all of them are operated by franchisees. And I believe that my views match the business model and customer payment realities for our franchisees nationwide.

My restaurants are mostly located in small towns with populations of 2,000 to 10,000. In fact, we recently opened a new location in Mars, Pennsylvania, in early 2008, and we pumped $1.8 million in development of that location and employed another 30 employees.

In that respect, we do not have to watch the evening news to understand the state of our economy. My customers, my employees, and I are all at the front end of the economy. Every store closing, every layoff, every tax regulation, and, yes, every missed mortgage payment directly affects all of us. At the same time, every new hire, every new business opening, and every new customer gives us a bit of optimism that we will pull through this.

Congress has given merchants a lift. You have laid the groundwork to help us create a competitive market where no market forces prevailed. Let me be clear: I am pro-card and pro-bank. Both credit cards and debit cards are key forms of payment and are vital to the modern commerce.

Here is the scope of my problem with interchange fees. In 2008—and roughly about 50 percent of my income comes through cards. In 2008, about $15 million represented fees of $345,000, or 2.252 percent of my sales. As we look at 2010, and as of July 17th, I had about $10 million in money generated through cards and fees, and

I paid $249,000, or 2.443. That is an increase over 2-1/2 years of 8.5 percent in my fee charges.

Under the new rules, I am assuming that those fees will be more competitive and be reduced. And much has been said about where that money will go. Will it go to the consumer, or will it go in the merchant's pocket?

I want to reinvest in my business, as I believe all private entrepreneurs do. To kind of give a demonstration of how we did this, this year, for the last 8 months, we have reduced our prices to the consumer in a ″$10 any large pizza.″ That is $10, any pizza, any toppings. That is a discount of over $8. We ran that for over 8 months, and we do believe that the community and our neighborhoods enjoyed that, thought well of it, and we picked up traffic to offset some of that. I believe that, as we do multiple efforts and we look for volume relationships, that we can have reduced costs.

If I could just save the project—the money off of what we think the cost raising in 2010 would be, that would be $20,000. That would supply part of equity for a new building. It could be the addition of new menu items. It could be the revamping of our merit system for our employees. There are plenty of places within the economy, other than the entrepreneur's pockets, that that would go. In fact, the word ″greedy″ has been used. And I would say, if you are truly greedy, you are going to be doing those things and growing your business.

Thank you very much for the opportunity to speak to you.

[The statement of Mr. Buss is included in the appendix.]

Chairman ALTMIRE. Thank you, Mr. Buss. And as a resident of your area, I can tell you that that $10 pizza deal does, in fact, make a difference. I have two kids, and we have kept you in business—helped keep you in business.

Mr. BUSS. Well, thank you.

Chairman ALTMIRE. Sure.

Thank you all. This has been very instructive. And as you can see from the turnout we have among the public here to watch the hearing, this is an issue that has drawn great interest.

And the Wall Street reform bill, of course, had any number of items in there that drew great public interest, but I will tell you, in the 2 years leading up to passage of that bill, there is no issue that I heard more about from more different people and coming from more different angles than the interchange fee. And that is the purpose of this hearing, is to bring you here.

And the entire Committee will benefit from your testimony. As you can see from the diversity of testimony, this was not an attempt to skew what we were going to hear. We wanted to hear all sides of the debate. And you have done great in representing all sides.

And I wanted to begin by asking each of you the same question, just to put in perspective what we are talking about and maybe a different opinion on the same question. And it is very simple. Most people in the country, when they go shopping, whether it be in Texas or Pennsylvania or wherever, generally most would go to a chain grocery store of some sort. We have Giant, Eagle, and Shop and Save, and others in western Pennsylvania. I don't know if you have Publix or Safeway or what Texas has.

But if you go out for an outing with the family—and, of course, this bill only pertains to debit cards. And some of you alluded to the way that is going to affect credit cards, as well. But I am going to ask the question on credit cards for that reason.

If you go out, you have dinner at a restaurant, a chain restaurant, you go shopping at the grocery store, maybe buy some gas at the corner gas station, use your credit card each time, what is the impact to the consumer from this regulation, say, a year from now, once this is fully in play and everyone has adjusted how they are going to adjust? What am I and my family going to see changed, as a consumer, for our credit card purchases for that evening of having bought those three different items?

Mr. Buss?

Mr. BUSS. I think you would see, on our behalf, an altering of the offerings and the prices that we have to charge for those offerings. We are very sensitive to the average check cost of our customers, and we try to lower that every possible way we can.

Chairman ALTMIRE. So we will pay more?

Mr. BUSS. No, less.

Chairman ALTMIRE. Less. Okay.

Mr. Oeler?

Mr. OELER. I think what you will see—many cards today come with some sort of rewards attached to them. They also tend not to have fees. I think if anything is altered along those lines, the rewards will begin to disappear, as well as we will be looking at, as we once did when credit cards were in their infancy, annual fees to carry the card with you.

Chairman ALTMIRE. So we may not see more each time we use the card, but we will pay more to have the ability to access that card.

Mr. OELER. That is correct, yes.

Chairman ALTMIRE. Okay.

Mr. Celaschi?

Mr. CELASCHI. I would agree with Mr. Oeler. And I would also add that you are going to see, on the consumer side, probably higher interest rates to make up for the lost revenue that the institutions will be getting as a result of the financial reform act.

You know, in our case, at least on the debit side, we are looking at slicing that revenue in half and creating even a larger deficit, which we would have to pass on the cost to our members, which is something we are certainly averse to doing.

Chairman ALTMIRE. You mean pass on the costs in their accounts, not just in the use of the card?

Mr. CELASCHI. Not in their—additional fees, higher interest rates, potentially, on the credit card side and even on our lending side, which puts us at a competitive disadvantage.

Chairman ALTMIRE. Okay.

Mr. Newton?

Mr. NEWTON. I think what your family will see when they pull up to the gas station is that, if they are using a debit card, there may be a choice to use debit or credit, and there may be cost savings associated with the use of debit. Those cost savings stem not only from ensuring that debit interchange fees are reasonable and proportionate, but also stem from the fact that the financial reform bill has a provision in it allowing merchants—I think they can select one of two networks in which to process the card from.

One of the big issues right now in our industry is that there are instances where Visa and MasterCard will say, this particular debit card can only go through this particular network, and that may be at a higher fee. And so the Durbin amendment in the financial reform bill limits that to a certain extent and says, no, you can't discriminate amongst these networks.

So there may be a cheaper alternative. And I think, especially as it pertains to gasoline, you will see our industry, you know, doing all they can to bring those efficiencies to the marketplace to attract more consumers and hopefully lead to more sales.

Chairman ALTMIRE. Thank you.

And I ask that question—let me just say, first of all, Mr. Buss, you asked that your testimony in total be included in the record. And I wanted to say, for the record, all of your written testimony will be included in total in the record for the Committee.

I asked my first question so that Mr. Oeler and Mr. Celaschi could answer this question. The amount of interchange a business pays can vary wildly from one business to another, as you both mentioned. But small businesses, in general, pay more in interchange fees than retail giants like Wal-Mart and Target, which you referenced.

How would you propose we address this discrepancy in the Congress to provide small businesses with greater fairness in how these fees are set? What recommendation would you have?

Mr. OELER. We tend to mainly deal with small businesses, and our fees are established, you know, through the network. So our fees tend to be the same across the board. So we really haven't negotiated any separate deals with the big-box retailers.

Chairman ALTMIRE. What about on behalf of the American Bankers Association, when you would have banks that have maybe a larger scope than that? Is there a different spin to that?

Mr. OELER. Well, I think what would happen, if there is the ability to have different fees for different institutions based on their usage, I think the customer would be at a disadvantage, you know, depending on the card they hold. For instance, if the big banks are able to have the discount and the small banks would not, our card would be disadvantaged to that retailer.

So, thus, there might be some reason for the retailer to try to move the customer to another type of card or suggest another type of card so they can maximize their revenue.

Chairman ALTMIRE. Mr. Celaschi, do you want to comment on that?

Mr. CELASCHI. Yes. We don't believe that the proposed two-tier system, if you will, in practice is something that is viable. We believe that the 80 percent volume that I mentioned by a handful of issuers does not motivate that group to a two-tier issue. They would want to keep it at a one-tier, one-rate tier, if you will. And that puts us, again, at a disadvantage, our small businesses as well as our individual members as well.

Chairman ALTMIRE. I wanted to follow up with Mr. Oeler.

Over the past decade, as I referenced, with the steady growth in the number of credit card payments and the decline in the cost due to technology advances, one could reasonably expect the cost of processing card payments would fall, given those two factors. Why, then, have interchange fees increased so significantly during that same period?

Mr. OELER. The costs of business always go up. I don't think it is been usurious, the increases. It is just a matter of maintaining a system, as I said, that operates 24/7, 365 days a year. The system itself always requires upgrades, new software, new controls. The fraud situation has increased over the years. We have had some breaches in cards, that the cards have to be reissued, and so on and so forth. So I think the increased cost helps compensate for that end of the business.

Chairman ALTMIRE. Okay.

Mr. Buss, some have argued that capping interchange fees could result in a contraction of credit availability and a reduction in the number of rewards programs that over 80 percent of consumers currently enjoy. You heard both of our witnesses answer recently to that.

Is there a risk that these consequences could then lead to a decline in sales for small firms and outweigh any savings that a rate cap would generate in the outset?

Mr. BUSS. Yes, I believe that any time we see any increases on the ability to use the cards, that you are going to see some contracting on it.

Chairman ALTMIRE. Mr. Newton, did you want to comment on that?

Mr. NEWTON. If I may ask, could you rephrase the question?

Chairman ALTMIRE. Certainly.

Mr. NEWTON. I want to make sure I answer you to the best of my ability.

Chairman ALTMIRE. Well, it deals with the rewards programs that we were talking about. Is there a risk that there would be a reduction in rewards and that those consequences could lead to a decline in sales for small firms and outweigh any savings that that rate cap would generate?

Mr. NEWTON. I really don't think so. This morning's Wall Street Journal reports that Visa saw a 14 percent increase in the third quarter in credit card transactions. The majority of Visa—I am sorry, the majority of Visa transactions are debit cards. So, you know, I think that there is a lot of choice out there, and I think, as consumers are given those choices, they are going to make intelligent decisions about which way to go.

I think right now we have a system where—and this is an example from my office. One of my employees opened a checking account with a bank and got a debit card from the bank, saying, "Here is your debit card." And on the debit card, on the piece of paper that it came with, it said, "Please, when you go to a retail marketplace, tell the retailer to ring the sale up as credit signature." Credit signature is obviously a much higher rate as the debit card than PIN debit. "And, if you do that, we will then give you 450 reward points."

So there is an incentive to steer the consumer to a higher-priced fee transaction, even though signature credit is much more prone to fraud and less secure than using a PIN debit. And so that is one of the issues that I think the Durbin amendment—I know the Durbin amendment addresses. And I think that is to everybody's good.

Chairman ALTMIRE. And do you have the ability right now to incentivize cash and check transactions from your consumers?

Mr. NEWTON. It is hard to answer. I know that the Durbin amendment explicitly authorizes discount for cash.

Another anecdote from Texas, if you will bear with me: One of my members attempted to offer a discount for cash for people who use gasoline. And a representative of Visa or MasterCard happened to be driving down the road and pulled into the store and said, ″What are you doing?″ And he said, ″Well, I want to give people a discount for cash.″ He had contacted me.. I discussed it with staff from our State AG's office, and they said, under Texas law, discounting is permitted.

The representative of the card company said, ″Absolutely not. It is against our rules.″ He called me and asked about it. I said, ″Well, ask him to show you the rule, and then we can distribute it to members of our association, just saying, 'You need to be aware of this compliance issue.'″ The Visa/MasterCard person then claimed that, ″I can't show it to you. But, trust me, it is against the rules.″

So this merchant was left with the choice of, okay, do I discount for cash and run the threat of Visa/MasterCard knocking me out of the system and suspending my access to the network, or do I continue to offer this discount for cash? And he chose to not continue that practice because he was afraid, and I think all retail merchants are afraid, of that threat because Visa and MasterCard control, I believe it is, 80 percent of the market.

Chairman ALTMIRE. Thank you.

I wanted to get back to our witnesses from the credit union and bank side, and start with Mr. Oeler.

Under new provisions of the Dodd-Frank Wall Street Reform Act, merchants will have the right to offer discounts not only for cash but also for checks and debit cards. Will these changes in the law have an effect on credit card use, as you see it?

Mr. OELER. When we talk about offering discounts—I will just present our information. As I said in my testimony, we had 16 million transactions we processed last year. The average ticket of that transaction or the average transaction amount was right around $35.

When you are looking at debit cards, you are looking at less than 1 percent. So I guess, is it realistic that the retailers would offer a discount of 35 cents, you know, on a transactional basis.

Chairman ALTMIRE. Mr. Celaschi?

Mr. CELASCHI. As far as the discount for cash, checks, and debit, I don't know that it would have that great of an impact, solely because of the convenience and the popularity of the debit card transaction. People are more likely to carry the debit card than even cash and checks these days, as far as a payment processing. So what I do believe we would see is a decrease in the transactions on the credit side as a result of the discount, significantly.

Chairman ALTMIRE. Talk about—for the two of you, and then I will go to Mr. Newton and Mr. Buss, as well. Are there risks that the consumer will be confused and frustrated by having two different prices for goods depending on their chosen method of payment, if this were to lead to that?

Mr. CELASCHI. I believe so, because I believe the consumer considers that plastic a credit card, whether it is debit or credit, as their form of payment, regardless of it coming out of their checking account or being a revolving line of credit. So there is a risk of confusion.

I think one important point to add to all of this, too, when we are talking about discounts and reducing the interchange rates is, the liability for any fraud or problem on the plastic transaction lies with the institution, not the consumer and not the merchant. So those costs have to be considered when we talk about the interchange income that we are receiving, as well.

Chairman ALTMIRE. Mr. Oeler?

Mr. OELER. I would agree with that comment.

I think we had a huge breach up in the New England area that had ramifications across the country when we had a breach in their card system. I know we had to reissue several thousand cards ourselves. There are other members of the ABA that I talked to just last week. One in particular was a $1 billion institution located out in the Philadelphia area, and he had to reissue 10,000 cards. That stuff comes at a high cost to the institution itself, and we bear that cost, you know, through the current interchange setup.

Chairman ALTMIRE. Mr. Newton, do you have any concerns about different pricing levels giving the consumers some confusion?

Mr. NEWTON. Shortly, no. I trust our members and the hundreds of thousands, if not millions, of retailers out there across this country, across all businesses, to communicate the message and to let consumers know of lower prices available for more efficient means of payment.

So I think the industry has shown time and time again, especially for the industry that I am in, gasoline, we compete on price. And I just don't see it being an issue, because I think the consumer expects it and they expect a lower price. And once they become aware of a lower price associated with the use of a debit card when compared to their traditional credit card, I fully expect the entrepreneurs in our association across this country are going to find a way to make sure that they are aware of it and that they take advantage of that opportunity.

Chairman ALTMIRE. Mr. Buss?

Mr. BUSS. Well, I do think it may afford us an opportunity in business to attract more consumers. I am gravely concerned about trying to get that message across, that you have several ways to pay and you have different prices with those ways to pay.

For instance, a little over 50 percent of our revenue comes in at home. We deliver to the homes. We would have a difficulty there with debit cards because of PINs. We generally take them as credit cards in that situation.

I will add also to a little earlier comment that you were asking about. And that is, I have noticed over the economy slowdown that we have moved off of credit cards and debit cards and moved back into more checks from the consumers, at least in the area where I do business and where my fellow franchisees do business. So I do think the consumer has some interest in what is going on with some of this, and I do think they are moving around a little bit more.

Chairman ALTMIRE. Okay.

Mr. Newton, have you had that same experience in the slowdown, with people using checks and cash more often than they were in the past?

Mr. NEWTON. No. With fuel, our members have experienced increased usage of both credit and debit. With debit, I would say that our members in the urban areas—so, Dallas, Houston, Austin—say 90 percent of their transactions are either on credit or debit cards. And of that 90 percent, 50 percent to 60 percent are associated with debit cards.

So I think, speaking for the fuel end of it, as we have seen the volatility in prices and everything else, consumers continue to choose either credit or debit cards.

Mr. OELER. Mr. Chairman, may I add something?

Chairman ALTMIRE. Certainly, of course.

Mr. OELER. Kind of on a practical basis. I have two sons, one 28 and one 33. And, frankly, they never have cash with them. To them, the cards are the cash. So if you ask them for a few dollars, you know, they hold a card up, but there is not much you can do about it.

Chairman ALTMIRE. Right.

I wanted to move to Mr. Buss again. As you know, proponents of maintaining the status quo on interchange fees have characterized the interchange fee as simply one more cost of doing business, not unlike utility or labor costs. And it is said that merchants can stop accepting card payments if costs outweigh the benefits.

From your perspective, can a business realistically expect to operate without accepting card payments today? Which is a good follow-up from what we just heard from Mr. Oeler.

Mr. BUSS. No, I do not believe that we could.

Like with checks, that would probably be beneficial to move away from checks and into cards if you could, but we cannot get that done. We have tried that over the years and not been able to do that.

So, no, I think in our situation we would take any way of payment to continue to grow our business.

Chairman ALTMIRE. And a question for Mr. Celaschi—did you want to answer something on that?

Mr. CELASCHI. No.

Chairman ALTMIRE. Okay. At a recent conference hosted by European Central Bank, policymakers and banking experts suggested adopting a card fee system that took into account the cost that businesses would pay to operate their own credit card systems.

Do you think that that type of system would have merit in this country?

Mr. CELASCHI. I believe that there should certainly be discussion and research into that. Any alternative that is consumer-friendly and small-business-friendly I am in favor of.

I would further say, with regard to the interchange, that we as Clearview Federal Credit Union receive on, for example, a $100 purchase, our revenue would be something between $1.30 and

$1.50, which, in my opinion, does not seem excessive or unreasonable.

Chairman ALTMIRE. Mr. Oeler, do you think that is something we should explore in this country?

Mr. OELER. If I read correctly, about a month ago, I believe, Target is actually looking to do that. They are looking to have their own card.

If you recall, when cards were in their infancy, it used to be that the vendors all had their own cards and they weren't part of the overall network. So it is possible you could see some movement back to that.

Chairman ALTMIRE. Sticking with looking at what other countries have done, I wanted to ask Mr. Newton about Australia. I don't know if you are aware that since Australia placed a cap on interchange fees in 2003, their central bank found a sharp decrease in the availability of rewards cards and no conclusive proof of lower prices for consumers.

Why do you believe that tighter caps on interchange rates in this country would be met with better results than they saw in Australia?

Mr. NEWTON. Well, it is my understanding that there was a study done by the Australian bank that found that there was $1 billion worth of—so there may be two different studies.

My contention in regards—and, again, speaking from the fuel perspective—is that our industry is extremely price-competitive. And our members are constantly looking for new ways to attract consumers or customers to their stores. And so, any means out there available that this new law will put at their disposal they will take advantage of.

And I think, I am confident—and I would also bring up, the Department of Energy has studied fuel prices and found that 100 percent of the cost decreases are reflected in retail gasoline prices. So I think we have a solid background of passing on those things. The Hispanic Institute issued a report that said the same thing, because consumers are already paying these fees.

So I am confident that here in the United States there will be some movement as entrepreneurs, again, take advantage of the freedom of choice that this legislation provides.

Chairman ALTMIRE. Thank you. And I would ask if your association could forward to the Committee the study that you referenced, because we would love to see any further information.

Mr. NEWTON. Yes, sir. I would be happy to.

Chairman ALTMIRE. Thank you.

Chairman ALTMIRE. Sticking with Mr. Newton, the business community has consistently maintained the high cost of interchange is passed along to consumers and that the Federal caps interchange could result in lower costs for goods and services.

If interchange fees were capped, what guarantees would we have that those savings would be passed along to consumers? How do we know for sure that is what is going to happen?

Mr. NEWTON. I think you know for sure because it is economics. Lower prices mean more sales. So it is to our members' advantage to ensure that they are offering the lowest-priced products out there they can to attract consumers to their retail facility. Our market does not allow a retailer to sit on margin very long. You can drive through any community and know exactly what we are selling our products for. And so, just the competitive market forces are not going to allow that.

And I think that is really what this bill addresses, is if the competitive market forces are not present, and now these interchange fees are set. And this bill seeks to remedy that and to ensure that the fees are reasonable and proportionate, to offer choice or some semblance of choice when it comes to network processing.

Chairman ALTMIRE. Mr. Buss, did you want to comment on that?

Mr. BUSS. Yeah, I would wholeheartedly support that. I do believe that the lower you can drive the prices, the higher you can drive the business. I do think we look for tenths of a percent.

Mr. OELER. May I add something, Mr. Chairman?

Chairman ALTMIRE. Mr. Oeler, certainly.

Mr. OELER. The Durbin amendment itself does not allow for a reasonable rate of return. So that is going to be an interesting discussion. You know, obviously, based on Mr. Celaschi and myself, you know, we need to make a rate of return, too, a combination to stay in business and continuing to lend to the community. So, you know, the fee has to be established to provide a reasonable rate of return.

Chairman ALTMIRE. Mr. Celaschi, do you want to have the final word on that?

Mr. CELASCHI. I would only add that, you know, with respect to Mr. Newton's comments on—and I have full confidence that his group would do that, would reduce the cost as their costs are reduced. Our concern is the big-box retailers, for lack of a better term. Who is the police of seeing consumer prices being lowered there? Does the Fed wash their hands once these tiers are set? And who talks about consumer prices? And, at the end of the day, the consumer and the small-business owners run our business.

Chairman ALTMIRE. So, before we conclude, again, the purpose of the hearing was to hear all points of view. And you all did a wonderful job in doing that. And I tried in my questioning, as you saw, to try to give you different perspectives and allow you to answer what some of the criticisms have been from your points of view.

So I wanted to end the hearing by allowing each of you, if you choose—you don't have to—based on what we have discussed today, do you have anything else you would like the Committee to consider as we move forward? Was there any point that wasn't brought up or rebuttal that you want to make that you wanted to have the opportunity to do?

Start with Mr. Newton.

Mr. NEWTON. Let me first say thank you. We appreciate this opportunity to appear before the Committee today, and I thought this was an excellent discussion of all of the issues.

I think there is not a specific point that I would bring up, but I would, in a more general sense, applaud the passage of the Durbin amendment because it does seek to reverse the incentives that are present in the market today and to bring some competitive market forces to this, which is something that my members deal with every day. And I think that is to the good of the American economy and to the good of the American people.

So we appreciate it. Thank you.

Chairman ALTMIRE. Thank you.

Mr. Celaschi?

Mr. CELASCHI. In closing, I would only say that the benefit to the merchant level would be clearly outweighed by the harm done to the average consumer and the small business. We, as a $630 million credit union, I consider us a small business. And the impact of the loss of revenue is certainly significant and would have a significant impact on both the credit union, our individual members, and our small-business members.

And thank you, Mr. Chairman, for inviting me to the hearing.

Chairman ALTMIRE. Thank you.

Mr. Oeler?

Mr. OELER. Mr. Chairman, I would also like to thank you. I thought you did a good job in being fair across the board.

I would just like to add that, whichever way it goes, the consumer, whether they pay indirectly through interchange or directly if they lose out on free checking, you know, somehow the consumer is going to end up paying for this, and I think that is going to be the bottom line.

I think you have already seen Wells Fargo, as of July 1st, announce that there is no more free checking across their system. I think Bank of America is exploring different fee structures, so they are heading in that direction. And I think any alteration in the interchange will lead more to go in that direction.

Chairman ALTMIRE. Thank you.

Mr. Buss?

Mr. BUSS. Again, Chairman Altmire, thank you very much for being here.

As I close, I would only ask, as we enter this phase of Federal rulemaking, that the Oversight Committee be diligent in ensuring that the final bill that comes out is as it was intended and is written so.

Thank you.

Chairman ALTMIRE. Thank you.

Thank you all. This was a great discussion. It is the first of many hearings we are going to have on this topic, but I think we moved the ball down the field a little bit.

And I now ask unanimous consent that Members will have 5 days to submit statements and supporting materials for the record. Without objection, so ordered.

Chairman ALTMIRE. And this hearing is now adjourned.

[Whereupon, at 11:00 a.m., the Subcommittee was adjourned.]

TESTIMONY OF CHRIS NEWTON

PRESIDENT

TEXAS PETROLEUM MARKETERS AND CONVENIENCE STORE ASSOCIATION

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES INVESTIGATIONS AND OVERSIGHT SUBCOMMITTEE OF THE COMMITTEE ON SMALL BUSINESS

HEARING ON

"THE IMPACT OF INTERCHANGE FEES ON SMALL BUSINESSES"

JULY 29, 2010

Chairman Altmire, Ranking Member Falling and Members of the Committee, I am honored to appear before you today and appreciate the opportunity to share my views on the small business impact of interchange fees. My name is Chris Newton. I am President of the Texas Petroleum Marketers and Convenience Store Association (TPCA).

TPCA was formed in 1949. One of the largest state trade associations of its kind, this 250-member organization represents petroleum marketers and convenience store owners and operators who own, operate, or supply approximately 10,000 convenience stores, service stations, and other retail motor fuel outlets in Texas and the southwest United States. Collectively, these petroleum marketers and convenience store companies supply nearly 9,000,000,000 gallons of fuel and tons of related products annually to Texas motorists. The average TPCA member owns and operates ten convenience stores and supplies twelve more. These businesses provide fuel and lubricants to the vast majority of commercial end-users, including farmers, construction firms, and local and state governments. In addition, TPCA associate members represent all of the diverse fields associated with the petroleum distribution system and convenience store industry. The majority of businesses in our industry are small businesses and I am glad to share with you my views on how these businesses will be impacted by the recently passed reforms to debit card interchange fees.

TPCA is also a member of the Merchants Payments Coalition (MPC). The MPC is a group of more than 20 national and 80 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 's sole mission is securing a more competitive and transparent 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.

The Durbin amendment, which became law as part of the Wall Street Reform bill, is incredibly important to the small businesses in the TPCA and in many other industries throughout the nation. These fees, which are currently unfair and anticompetitive, hurt these businesses and hurt our customers. The Durbin amendment is an important first step in dealing with these negative impacts.

My testimony today will address several major points. First, I will describe the current competition policy problems with the swipe fee system in the United States. Second, I will detail the impact caused by these problems. Third, I will discuss how the Durbin amendment helps to address those problems. Finally, I will address some of the myths that have at times been raised in the context of this issue in order to set the record straight.

I. The Problem with Swipe Fees

There is broad international consensus that swipe fees pose unacceptable anti-competitive, anti-consumer antitrust problems. Indeed, after many years of study and debate, regulators from Australia, the European Commission, Spain, New Zealand, Hungary and others have reached this conclusion and taken action. The most egregious problems these countries and many in America have found are described below.

A. Centrally Setting the Fees

Swipe fees collectively deprive businesses that accept credit and debit cards as well as consumers of the benefits of competitive market forces because they are centrally set by Visa and by MasterCard. These two companies have been found by the U.S. Court of Appeals for the Second Circuit to have market power under the antitrust laws both individually and collectively.[1] Each of the two credit card giants decides upon a schedule of default fees for the banks that issue their cards to charge for transactions. Note that these fees are not charged by Visa and MasterCard themselves. Instead, they are fees that banks that are supposed to be competing with one another charge – and some of those banks sit on the boards of Visa and MasterCard to help decide the fees they and their competitors will charge.

That is a profound problem. Banks including Bank of America, JP Morgan Chase, Citi, Wells Fargo/Wachovia and others compete with one another in the other aspects of their businesses. Yet when it comes to swipe fees, they collectively agree to charge the same schedule of fees. The result is just what you would expect to happen if another industry did the same thing. If, for example, the members of TPCA all agreed to charge the same prices for gasoline as their competitors, we would all expect the price of gasoline to be much higher than a competitive market would produce. Our antitrust policy prohibits this type of central price-fixing because it takes away the primary benefit of our economic system – the incentive for competitors to try to gain market share through price competition.

This activity cannot be excused because Visa and MasterCard have changed their corporate form. Until a few years ago, both Visa and MasterCard were simply associations of their member banks. Even they realized, however, that setting prices for their association members created potentially serious legal liabilities. So, they both became corporations offering their shares to the public. This change, however, was nothing more than an attempt to put form over substance. Each company still serves as the price-setting body for its member banks (including member banks that sit on the boards of the companies and participate in the price-setting). The change in corporate form does not change the reality – the banks agree to let the major credit card giants fix their prices for them.

The fact that the card companies say their rate schedules are "default" rates and that banks are free to depart from them is little more than rhetorical posturing. There is no incentive for banks to depart from the schedule of inflated fees that their competitors follow and we are not aware of such departures. In fact, retailers have been told many, many times by their bankers that the bankers cannot depart from the agreed upon rate schedule. As with other price-fixing examples, the banks know that they are better off sticking to the collective pricing rather than departing from it.

B. Rules that Hide the Fees

[1] *United States v. Visa USA, Inc.*, 344 F.3d 229 (2d Cir. 2003).

The major card companies not only centrally set prices, but they establish the rules for the credit and debit card systems. These rules include a series of complementary provisions that serve to hide fees in the cost of goods and services that consumers pay and insulate the fees from competitive pressures.

Perhaps the most egregious of these rules prohibits merchants from giving a pricing advantage to one card company's products over another one's. This could be done, for example, through giving consumers a discount to use Visa rather than MasterCard or the other way around. Both Visa and MasterCard prohibit merchants from doing this.[2] If a merchant runs afoul of this rule, the risk is the imposition of large fines (often $5,000 per day) or cutting off the merchant's ability to accept these cards.

The impact of these rules is that no card company has any incentive to reduce its fees. The reason companies reduce prices is to get more customers, but Visa and MasterCard make sure that the consumers who decide what card to use cannot get a benefit from reduced fees and that any fee reduction then will have no impact on transactions or market share. This is just like if Coca-Cola and Pepsi, to take one example, were to tell stores that they could never have a sale and price their competitor's products lower than their own. With that rule in place, how many discounts do you think we would see for Coke or Pepsi? The answer is none and prices would steadily rise as a result. That is just what we face here and it is one key leg of the table artificially propping up swipe fee prices.

The card companies have related rules that make it very difficult for merchants to give their customers other types of discounts. Discounts for cash, checks and debit cards, for example, might bring some market pressures to bear on the size of interchange fees. But Visa and MasterCard both prohibited these types of discounts or imposed byzantine sets of rules regarding the way merchants can display any such discounts. The rules at times contradicted state consumer protection laws and forced merchants to decide to either violate the Visa/MasterCard rules or violate state law. The result, as the card companies know well, was that merchants typically chose a third option – don't give any discounts because it is not worth the risk.

In the past, merchants have quickly backed down from the Visa/MasterCard threats about discounting, but a controversy over their heavy-handed tactics made its way into the press in California a few years ago. Visa threatened a couple of gas station owners – including a single store operator – if they continued to offer cash discounts. And, in that instance, Visa instructed the station owners that they should display their prices and discounts in a way that would violate California law. When asked about this by the publication *Oil Express*, Visa spokeswoman Rhonda Bentz reacted in a way that is incredibly revealing of Visa's hubris and the way it treats merchants. She said, "It's great if they have a contract with the state, but they don't. They have a contract with Visa and if they don't want to abide by that contract, they shouldn't have signed it." The *Oil Express* article from April 23, 2007 is included with this testimony as Exhibit 1.

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[2] *See* Visa U.S.A. Operating Regulations 5.2.D.2; MasterCard Rules 5.9.1.

California Weights and Measures Director Dennis Johannes saw Visa's tactics for what they were. He said Visa was "heavy handed" and noted, "They probably don't want dual pricing because it discourages the use of their credit card." Of course, that is precisely the type of market pressure that our system depends on to keep prices down. If Visa doesn't want people to be discouraged from using their cards, they should lower their prices rather than threatening merchants who offer cash discounts.

As I discuss below, the Durbin amendment should provide some relief on this front by prohibiting the card companies from preventing discounts for the use of cash, checks or debit cards. It is our hope that this new law will allow an effective marketplace to develop such that fees can be subject to some market forces.

Yet another rule that helps erase any semblance of competition requires that merchants accept every single type of Visa or MasterCard no matter how high the fees are for that card – or accept no cards at all. The upshot of this rule is that when new cards come into the market, the card companies do not need to seriously consider whether the prices they set will cause people not to take the card. To take the soft drink example again, when companies come out with a new flavor of Coke or Pepsi, those companies need to think about the price point and whether merchants will carry the new product and consumers will buy it. If the price is too high, then the product won't be successful. If they had a rule saying that every store had to buy all of their products no matter the price or be prohibited from carrying any of their products that would raise the problem of product tying under the antitrust laws. But Visa and MasterCard both have this type of rule. The origin of this rule was well-intentioned – that merchants treat different bank issuers of cards in the same way and not refuse a consumer's card because the bank was unfamiliar to the merchant. This rule, however, has gone beyond all reasonable bounds and no longer just ensures that bank issuers are treated fairly. It now prohibits merchants from taking any action to protect themselves against rapidly escalating fees on newly issued card products.

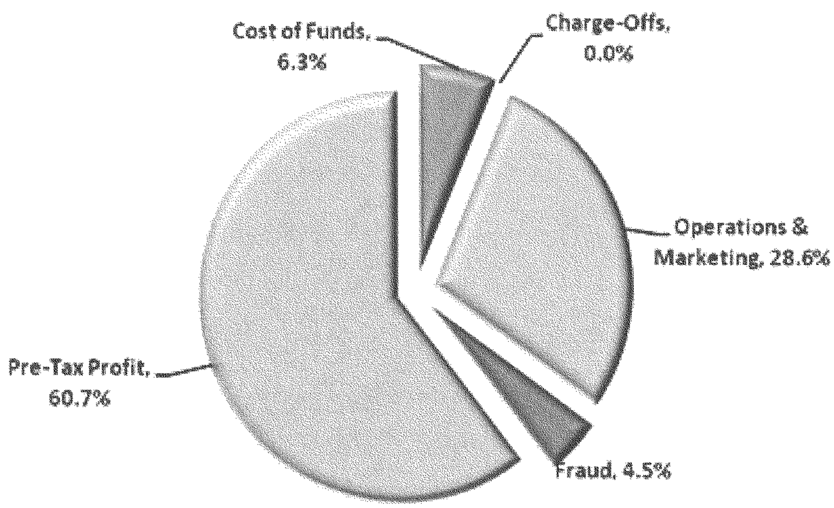
II. The Impact of Swipe Fees

A. The Impact on Business

For petroleum retailing and convenience store businesses, swipe fees are their second highest operating expense after labor. That means swipe fees cost these businesses more than rent on their stores, utilities, and other overhead. Retail profit margins are very, very narrow. The retail sector of the economy is highly competitive and if costs go down for those businesses, then their prices go down. Retail profit margins are consistently narrow 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 (many 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.

The difference between the narrow profit margins of the retail industry and the huge profit margins for banks on interchange is dramatic. The chart below shows that the profit margins on interchange are more than 60% based on data from *Cards & Payments*.



Card Issuer INTERCHANGE Profitability
Avg '06 to '08

These fees continue to escalate and business owners do not have a way to control them. They can take action to deal with utility costs, they can negotiate their rent and labor costs, but they can't deal with these cost increases. The inability to go to a competitor to get a better deal is simply devastating. In fact, economists with the Kansas City Federal Reserve have found that merchants cannot realistically refuse to accept Visa and MasterCard even though interchange costs far exceed any benefits those merchants receive by accepting cards.[3] While the card

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

companies sometimes argue that merchants could stop accepting cards, the cards are so dominant now that that is not realistic. Visa, in fact, is promoting itself as "currency" in its marketing. Telling merchants they don't have to take cards, then, is like telling them they can refuse to take cash. While theoretically possible in some niche businesses, it is generally not realistic.

The dramatic jump in card rates – both in dollar terms and in terms of the rates charged – takes its toll on merchants. According to the Government Accountability Office (GAO) this is not just due to more people using cards but is the result of Visa and MasterCard increasing their fees. GAO wrote, "Visa and MasterCard officials told us that their average effective interchange rates applied to transactions have remained fairly constant in recent years when transactions on debit cards, which have lower interchange fee rates, are included. **However, our own analysis of Visa and MasterCard interchange rate schedules shows that the interchange rates for credit cards have been increasing and their structures have become more complex,** as hundreds of different interchange fee rate categories for accepting credit cards now exist."[4] Let's be clear about this, GAO concluded that what Visa and MasterCard told them about their rates remaining flat was false.

The increases in the rates set by Visa and MasterCard, along with increased card usage, has led to a huge increase in fees paid by merchants. The chart below shows how those fees have grown over time for the convenience store industry and shows industry profits per year as well. It is not a coincidence that as the amount of card fees jumped past the amount of profits the industry made, profits fell. Some of those profits have recovered and the fees dipped some for the first time in years due to the recession last year, but the fact that fees have been more than profits for 4 years in a row demonstrates the difficulties these fees cause for business. With the recession there was also a shift to more debit usage. The card companies must have seen that shift too because on April 16 they put into effect a 30 percent increase in debit fees.

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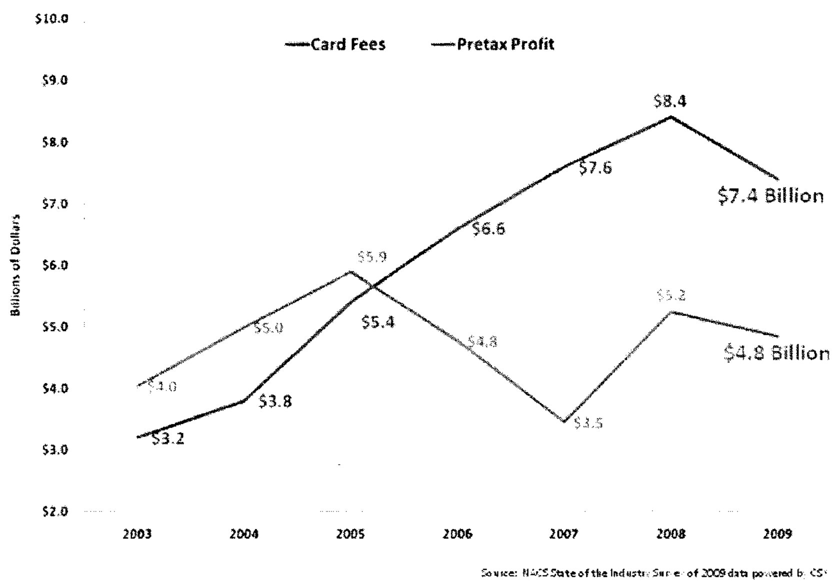
[4] "Credit Cards: Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges," GAO-10-45, Nov. 19, 2009 ("GAO Report") at 14 (emphasis added).

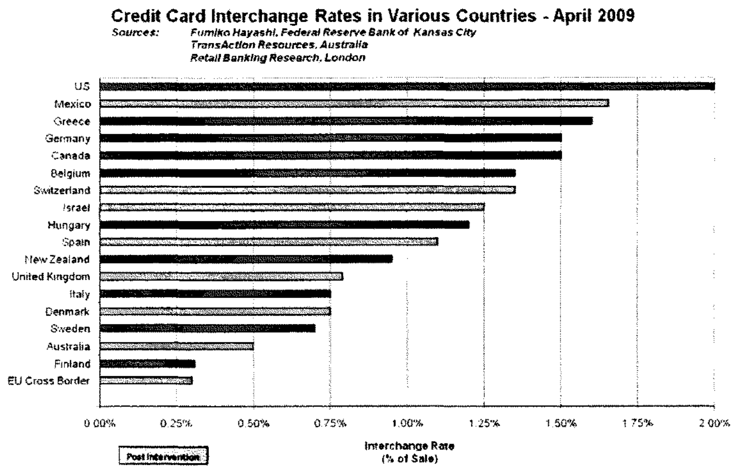
Card Fees and Pre-Tax Profits in the Convenience Store Industry



And these fees hit small businesses the hardest. While the card companies like to talk about the large retailers that might be helped by policy solutions to deal with swipe fees, the current system that they defend gives large retailers a decided competitive advantage over small businesses. The GAO found, "Merchants with large volumes of card transactions generally have lower interchange fee rates. Visa categorizes some merchants into three tiers based on transactions and sales volume, with top-tier merchants receiving the lowest rate."[5] That simply should not be. Unlike situations in which product needs to be manufactured and delivered to stores, there are no cost savings that justify better deals for large merchants.

These out of control fees disadvantage the U.S. economy. Interchange fees in this country are among the highest in the industrialized world as shown by the chart below.

[5] GAO Report at 10.



It is interesting to note that while some countries with lower interchange rates have taken action to deal with these fees, several countries that have done nothing pay lower rates than Americans do. The reason for that is straightforward. The two major card companies have such dominant market power here that they can engage in the anticompetitive practices that I have described without fear of too many merchants leaving the network.

B. The Impact on Consumers

The impact of anticompetitive swipe fees on consumers is dramatic. American consumers pay inflated prices for virtually everything they buy because of these fees. And they pay these funds without even knowing it. Consumers never get a disclosure from their card issuer telling them any swipe fees are charged – not to mention how much they are. This is the card companies' model. By hiding their fees they can keep charging more and consumers won't notice. Last year, the Hispanic Institute studied this phenomenon. They found that the business model by which fees are embedded in retail prices without disclosure combined with the rewards that some cardholders get leads to a regressive transfer of wealth from low income consumers to high income consumers. This regressive wealth transfer is more than $1 billion every year.[6] And this did not even take into account the 27 percent of U.S. families who do not even have credit cards – but are still paying inflated prices due to interchange.[7]

[6] "Trickle Up Wealth Transfer: Cross-subsidization in the payment card market," The Hispanic Institute, November 2009 at 5.

[7] Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, February 2009, at 46.

Retailers are not the only ones who have come to the conclusion that swipe fees hurt consumers. John Blum testified on behalf of the National Association of Federal Credit Unions (NAFCU) before the Antitrust Task Force of the House Judiciary Committee on May 15, 2008. In his written testimony he said, "Further, interchange is a cost that retailers can and do pass onto their customers in the final price of the goods and services they sell."[8] It appears then that NAFCU agrees with the Hispanic Institute – consumers are paying interchange fees right now, but the fees are hidden in the price of goods and services those consumers buy.

The card companies have strenuously argued that if anything at all happens to reduce swipe fees, then other fees paid by consumers will increase and consumers will be in a worse position than they are today. This is false. 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

[8] Testimony of John Blum, Vice President of Operations of Chartway Federal Credit Union, before the House Judiciary Committee Antitrust Task Force, May 15, 2008 at 8.

> 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.

That is precisely the result that would be best for consumers. Once the card companies in Australia stopped competing for market share by raising the fees their banks would earn (which the bank could in some small measure plow back into enticing rewards for consumers), they had to compete on interest rates in order to attract consumers directly. That is what Australian consumers really wanted and what they have been getting since their system was reformed. Interest rates on credit cards fell precipitously after the reforms and even though the overall rates in that country have fluctuated over time, the spread between their benchmark rates and the rates consumers get on their credit cards is consistently narrower than it was prior to Australia's reforms. U.S. PIRG and other consumers groups educate consumers that the most important thing to look at when evaluating cards is the interest rate. Once Australia took some of the confusing subterfuge out of the system by reducing the hidden fee-reward cycle, consumers there were able to focus on interest rates and get better rates.

III. The Durbin Amendment and Its Impact

A. Background on the Durbin Amendment

Understanding the current problems provides the necessary backdrop for analyzing the impact of the Durbin amendment. Let's first discuss what the Durbin amendment does. The amendment instructs the Federal Reserve to analyze the cost to issuing banks of authorizing, clearing and settling debit card transactions. Then, the Federal Reserve will need to write regulations to ensure that the interchange fees charged on debit transactions are reasonable and proportional to those costs. This should not be controversial. In competitive markets, prices are reasonable and proportional to costs because competition brings everyone down to that level. The Durbin amendment, then, makes up for the fact that there is no downward price competition currently for debit card interchange fees.

It is also worth noting that, in truth, there should not be any interchange fees on debit transactions at all. The check system in this country, for example, operates without interchange fees. Checks must clear at their face value rather than being discounted by an interchange amount. That was not always the case. Early in the last century, check transactions were discounted by a fee, but the Federal Reserve wrote rules to do away with those inefficient fees. What happened was that checks became more efficient payment mechanisms. Electronic checks – which is all debit cards are – should be similarly efficient and the Durbin amendment moves toward that goal.

There are some additional considerations that the Federal Reserve can make with respect to debit fees. It must, for example, write regulations regarding fraud prevention by card-issuing banks. Banks that want to follow those regulations to ensure that they prevent fraud in an effective and efficient way will be able to ask the Federal Reserve for an adjustment to the debit interchange fees they receive to cover their costs of fraud prevention.

I want to take a moment here to discuss what is not covered by the Durbin amendment. The bank and credit union witnesses here today, for example, will not be regulated by the Federal Reserve on their debit card interchange fees. In fact, more than 99 percent of all banks and credit unions will not be regulated by the Federal Reserve. That is because the Durbin amendment only applies to financial institutions with $10 billion or more in assets. These institutions are giants. While they are the ones impacted by the Durbin amendment and the ones that merchants have regularly complained about, I want to point out to this Committee that this is now the 8th Congressional hearing focusing on the topic of interchange fees. In all of those hearings, not a single bank or credit union with assets of more than $10 billion has ever agreed to send to witness to testify. That is an incredible record of obfuscation and hiding the facts. The biggest banks can try to hide behind their smaller brethren, but I hope that this Committee, which focuses on small businesses, will see through that cynical strategy.

Why do small banks and credit unions care about the Durbin amendment when they are clearly and explicitly exempt from its debit fee regulations? There seem to be two reasons: one stated and one unstated. The stated reason is their concern that Visa and MasterCard will not allow them to continue to charge higher fees than the largest banks that are part of the Visa and MasterCard systems. These two card giants appear to be most responsive to their largest members so I can understand the initial appeal of that type of concern. What they don't acknowledge, however, is that raising interchange is the main point of competition between Visa and MasterCard. That backwards competition is the way that the two card giants compete to get banks to issue their cards. If either of those two giants reduces interchange for small banks, they will hand a tremendous market opportunity to the other company. That competition will give small banks and credit unions the protection they need to keep their high, over-inflated debit interchange fees. This stated reason for small bank concern, then, is unwarranted.

Even if it were true, however, it seems to me to be an odd criticism of the Durbin amendment. What it boils down to is the small banks complaining that they have ceded their ability to set their own fees to Visa and MasterCard and that those two companies have grown big and powerful under that system. So much so, that if Visa and MasterCard are not allowed to continue to set high fees unabated and rip off small businesses and consumers, those behemoths will turn that attention to the small banks that helped create them and harm the small banks. This would be like Dr. Frankenstein imploring townspeople to allow his monster to attack and pillage the town, for if the attack is prevented he might turn his ire back onto the good Doctor himself. I suspect that few of us would have much sympathy for such an appeal from Dr. Frankenstein.

The unstated reason for small banks and credit union complaints about the Durbin amendment is sunlight. Their current ability to fix prices with their competitors will now be held up to scrutiny so that the public can see just how egregious it is. They fear – and this I think is valid – that once the Federal Reserve shows people the costs and the way that all of us have been ripped off by centrally set fees for decades, people will want further reforms. This can and should happen. The passage of the Durbin amendment is a harbinger that the days of hidden fees and related card industry tricks to profit from consumers and small businesses is coming to an end. This can and should be the result and we will see if it plays out that way.

The Durbin amendment does a couple of other things as well. It prohibits the practice that the card companies have engaged in recently of cutting exclusive deals with banks that issue debit cards. There are a number of networks through which debit transactions can be routed. These networks – companies like Pulse, Plus, NYCE, Shazam, and others – sometimes have their logos on the back of debit cards to show that that card's transactions can be run over their network. But the card companies have reached agreements with more and more banks to artificially limit the compatibility of their cards so that more transactions are forced through the networks owned by Visa or MasterCard. Visa owns the Interlink system and MasterCard owns Maestro. So, the Durbin amendment instructs the Federal Reserve to write regulations ensuring that debit transactions can be routed through at least two competitor networks and that merchants can choose which network to use so that those networks have incentives to engage in real price competition.

In addition, as noted previously, the Durbin amendment stops the card companies from preventing merchants from offering their customers discounts or other incentives for the use of cash, checks or debit cards. Such discounts have the potential to bring more price competition to this market and give customers the clear and explicit benefit of such price competition. It is possible that the card companies may try to put hurdles in the way of these discounts but we hope that they don't do that. Frankly, merchants should be able to have any type of discounts they want to have for any reason without interference from the credit and debit card industry. It is our hope that there are additional ways that discounts for our customers will be protected in the future.

Another thing that the Durbin amendment does is stop the card companies from threatening merchants that want to set a minimum transaction amount for their acceptance of a credit card. Some merchants do this today, but they are subject to large fines (and threats of such fines) if the card companies catch them doing it. Why does this occur? Well, interchange includes both a flat fee and percentage fee in its calculation. When a card is used for a small dollar purchase, then the flat fee can exceed the merchant's entire margin on the goods sold and result in a loss. In fact, on some items like newspapers, the flat fee can sometimes exceed the cost of the goods themselves. That can lead to the perverse scenario in which a merchant is actually better off giving away the product than taking payment on a credit card. Given this, it just makes sense to allow merchants to set an amount of up to $10 as a minimum for accepting a credit card payment rather than having a system that forces merchants to lose money on low dollar transactions.

B. Impact of the Durbin Amendment on Small Businesses

The impact of the reforms in the Durbin amendment will bring important benefits to small businesses, consumers and the economy as a whole. Interchange fees add a cost drag to nearly every sector of our economy. These unnecessary price increases depress economic activity. The comparison to money is an instructive one – and one that Visa makes in its advertising. Visa calls itself the currency of progress. Currency, unlike Visa cards, gives recipients a known and exact value. A $5 bill is actually worth $5. Unfortunately, a $5 credit or debit card transaction is likely worth somewhere around $4.75. At each level of commerce money is taken out of the system and the "currency" itself is worth less than its face value.

Robert Shapiro, former Undersecretary of Commerce for Economic Development, issued a study this year and concluded that without the higher prices caused by fees above and beyond costs plus a reasonable rate of return, consumers would have an additional $26.9 billion to spend and the economy could add 242,000 jobs.[9] The Durbin amendment only covers debit cards – not credit cards – so the impact is not likely to be as great as Shapiro predicts, but the numbers are large. The Durbin amendment will plainly result in a large economic stimulus as these costs are taken out of the stream of commerce and the sale of goods and services throughout the economy is made more efficient.

Last week, for example, Bank of America released information showing that it charges $1.7 to $2.3 billion more in debit interchange fees than is reasonable. It expects the Federal Reserve regulations to reduce its revenues by that amount in the upcoming rulemaking. Frankly, I would expect that Bank of America underestimates how unreasonable its debit card fees are. We will find out if that is the case, but even if that is the right number, $2 billion in savings to small businesses and consumers from one bank's debit transactions alone will be a tremendous stimulus for all of us. My members are eager for that kind of stimulus.

When costs go down for businesses in our industry, consumer prices fall with it. That is the conclusion of every study to look at that question – including those by groups as different as the Department of Energy and the Hispanic Institute. Lower prices are good for us because they stimulate more sales. My members typically sell gasoline for about 15 cents more per gallon than they pay for it. They need to pay for their expenses out of that 15 cents and then hope to make a profit – which usually ends up being 1 or 2 cents per gallon. And, those numbers remain pretty consistent when gas prices are $2 or $3 or $4. That means we are better off with cheap gas – and more economic activity and sales. People have more to spend and buy more when prices are lower. In fact, when they have extra money they might even buy more in our stores. We look forward to the stimulus that the Durbin amendment should create and look forward to the Federal Reserve coming up with the rules necessary to make this possible.

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: *The Amendment will shift costs from big box stores to consumers.*

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[9] "The Costs of 'Charging It' in America: Assessing the Economic Impact of Interchange Fees for Credit Card and Debit Card Transactions," SONNECON and Consumer for Competitive Choice, Robert Shapiro and Jiwon Vellucci, February 2010.

Reality: There are some basic facts that should be noted that show this to be false.

- The GAO found that the current system actually hurts small businesses more than large businesses. Reform will actually help small businesses more than large businesses.
- Merchants are actually fighting to simply have the right to give their customers a discount.
- The fact that credit card giants prohibit merchants from giving consumers a discount for using a cheaper card brand (such as a Discover Card rather than a Visa) and prohibit merchants from giving discounts if they use a cheaper type of payment (like checks rather than credit) cannot be defended.
- Discounts for consumers are good things and the card giants only prohibit them to hide their fees so they can keep raising them without anyone noticing. It doesn't protect consumers at all.
- The GAO, Hispanic Institute and others have all concluded that consumers already pay the swipe fees set by the credit card industry. The Durbin amendment simply gives us all the chance to save that money in the future.

Myth: *This will push the risk of fraud onto financial institutions.*

Reality: It is worth keeping in mind that this claim admits, for the first time, that financial institutions do not currently cover the risk of fraud. While they often talk about their "payment guarantee", the ugly truth is that financial institutions push most of the risk of fraud onto merchants – and charge them huge fees at the same time. Unfortunately, this amendment does not change the card companies' rules that allow them to push most of the fraud risk onto merchants. All the Durbin amendment does is make sure fees on big bank debit cards will be reasonable and allows consumers to get discounts. It does not change the treatment of fraud.

Myth: *There is no stipulation in the amendment that stores will pass on cost savings.*

Reality: This baseless complaint has been systematically shown to have no merit. The Hispanic Institute published an economic report on interchange fees and wrote in a letter to Senators endorsing the Durbin amendment, "[W]**e found definitively through economic analysis of transaction and pricing data that consumers do currently pay interchange fees in the prices of the things they buy and when those fees are lower merchants' prices are correspondingly lower as well. This is proof, backed by economic data, that those who argue against reform by saying consumers will not benefit are wrong. Consumers will unequivocally benefit from reform."** Economics shows that in a functioning market, lower business costs will mean lower prices and higher costs will mean higher prices. The retail market in the United States is highly competitive and profit margins are extremely narrow (between 1 and 3%). When the major banks have on average a 60% profit margin on interchange, it might not be surprising to learn that they don't believe in market economics. But they cannot deny the reality that retail markets function and keep profit margins narrow. The Department of Energy, for example, conducted a study of retail gasoline pricing and found that 100% of cost increases and 100% of cost reductions were passed through to consumers in gas prices.

Myth: *The Federal Reserve will arbitrarily set a price.*

Reality: The Durbin amendment does not have government set fees. It simply gives the Federal Reserve authority similar to that it has for paper checks and for consumer credit card fees. The Federal Reserve will write regulations regarding what interchange fees are "reasonable and proportional" to the big banks' costs. It allows them to recover all of their costs and to make profits on it. The big banks just can't be unreasonable. In fact, the amendment does not require that debit fees go down. The banks assume their current fees are unreasonable (and we agree that they are), but if they were actually being reasonable today this would have no effect.

Myth: *Consumers wouldn't get notice of minimums or maximums.*

Reality: Every state in the nation regulates how merchants inform customers of their pricing and policies. The credit card giants consistently create rules to stop merchants from having any pricing that might give consumers a clue as to the existence and size of interchange fees. But this doesn't protect consumers, it keeps them deceived. Merchants should be able to inform consumers when interchange will make them lose money. Credit card companies should not be allowed to prevent that.

Myth: *Merchants could discriminate against credit union cards so the exemption would not be effective.*

Reality: The exemption from the debit provisions in the Durbin amendment means that 99% of banks (all but 86 of them in the entire country), 99% of credit unions (all but 3 of them in the country), and 97% of thrifts (all but 19 of them), will be exempt from Federal Reserve regulations that the amendment authorizes. This means exempted banks will not be required to alter their fee structure in any way from what it is today. Visa and MasterCard both have rules in place that prohibit merchants from treating cards differently based on the bank that issued them. There is simply no way that credit union cards could be disadvantaged.

This is a big bank issue. A mere 10 banks collect more than 80% of credit card interchange fees and more than 50% of debit card interchange fees. If this weren't a big bank issue, an exemption for 99% of the nation's banks would gut the amendment. Why is such a huge exemption possible? Because almost all of the interchange is collected by the top 1% of banks. A community bank board member testified before the House Judiciary Committee April 28, 2010 that interchange accounts for less than 1% of his bank's revenue and that that is typical for community banks. Community bankers testified the same way before the same Committee April 17, 2008 and said that interchange is not a main source of revenue for community banks. According to figures from *Cards & Payments*, 60% of interchange fees are profits and, according to GAO, credit cards are the most profitable part of the banking business. That means the big banks are making huge, outsize profits at the expense of small business retailers with profit margins that average 1-3%.

Myth: *GAO said proving consumer benefit would be difficult.*

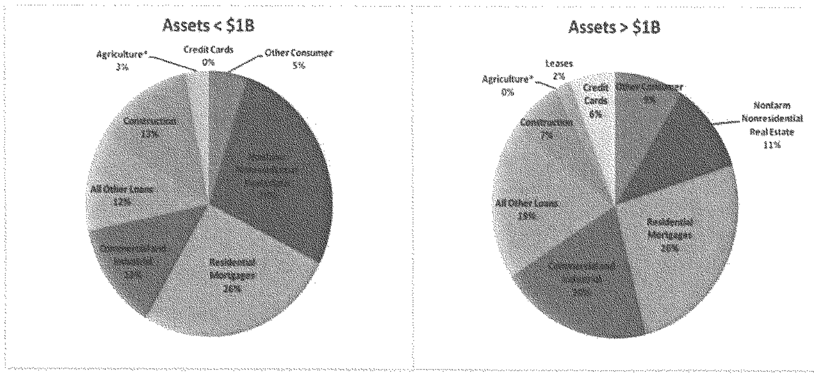
Reality: The GAO concluded that consumers are paying interchange fees right now through inflated prices. The Reserve Bank of Australia reported that consumers saved 1.1 billion Australian dollars due to their reforms and GAO reported on that finding. The only reason proof is difficult is that pricing can change rapidly and isolating the factors affecting it can be a challenge. But just as the Reserve Bank of Australia, the Department of Energy and the Hispanic Institute found – while difficult it is not impossible and market economics work such that savings do translate into lower prices for consumers.

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

Reality: As noted, the Durbin amendment does not impose any regulation on the fees charged by small banks. They simply do not belong here today because the regulations will not cover them.

With that said, they don't have much interest in further reform of the system either – except to the extent that such reform will shake up a market that is not very good for them today. 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 4 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 charts below show, 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 large institution), do not even make 1% of their revenues from credit cards as shown below.



* 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 small banks about this issue to make sure they get the answer to one simple question – what percentage of that small bank's total revenue comes from interchange fees. If they can't or won't answer that simple question, then it is hard to take their complaints seriously.

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 previously discussed, 60 percent profit margins certainly look like a windfall.

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."[10] 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."[11] 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 gives them another incentive – milk consumers for all they are worth and don't worry about the money getting paid back.

The bottom line is that abuse of consumers by banks will continue as long as they have the incentive to treat people that way. The abuses of consumers and using credit cards as predatory lending vehicles will continue until interchange fees are effectively reformed.

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 Congress is to stop the card industry from engaging in rip-offs and then, if someone else is doing something wrong later, deal with that.

This argument 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

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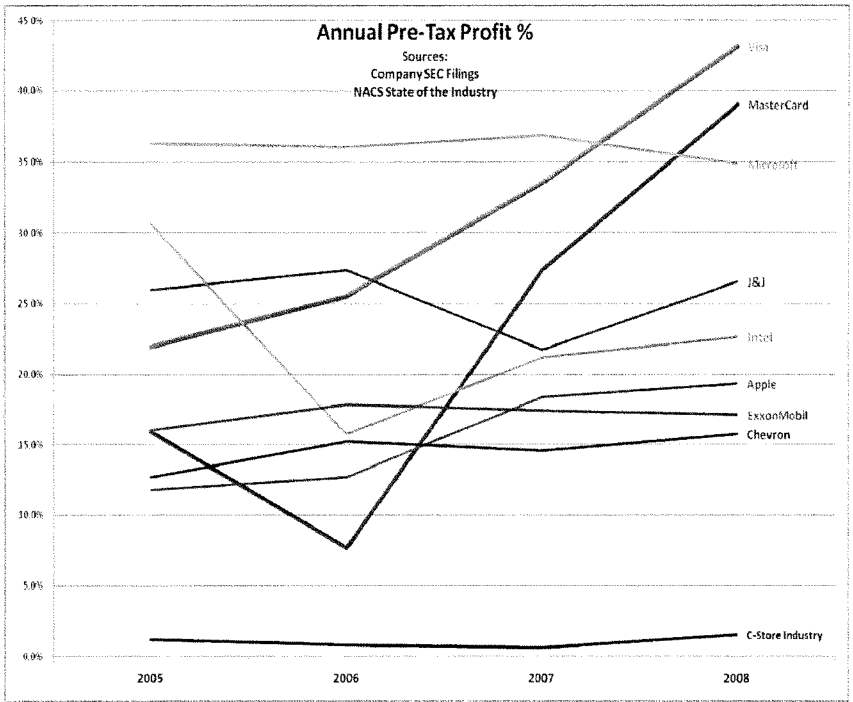
[10] Adam J. Levitin, Testimony before the House Judiciary Subcommittee on Commercial and Administrative Law, "Consumer Debt – Are Credit Cards Bankrupting Americans?" April 2, 2009.

[11] 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.

each of these industries consistently rank near the bottom of all industries in terms of profitability and have very stable profit margins each year (many 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 – has 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 ripping off whom.



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.[12] 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.

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

The Hispanic Institute studied this question in its report issued last November. It found that "the data shows that lower interchange fees result in lower prices for consumers and higher interchange fees result in higher prices for consumers."[13]

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 much smaller than the interchange fees merchants pay. In most cases, processing fees are only about 10% of what the merchant pays. They are an add-on to what the merchant pays in interchange. Interchange fees are much larger – the $48 billion paid in 2008 was more than all of the 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 price fixing.

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

Reality: This is simply false. As noted previously, GAO found, "Visa and MasterCard officials told us that their average effective interchange rates applied to transactions have remained fairly constant in recent years when transactions on debit cards, which have lower interchange fee rates, are included. **However, our own analysis of Visa and MasterCard interchange rate schedules shows that the interchange rates for credit cards have been increasing and their structures have become more complex,** as hundreds of different interchange fee rate categories for accepting credit cards now exist."[14]

The Kansas City Federal Reserve published a presentation on April 3, 2008 showing that average interchange fee rates rose from less than 1.3% to more than 1.6% between 1996 and 2005. And, according to Kansas City Federal Reserve economists, that rate is nearly 2% 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

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[13] "Trickle Up Wealth Transfer: Cross-subsidization in the payment card market," The Hispanic Institute, November 2009 at 6.

[14] GAO Report at 14 (emphasis added).

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 moving 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 increase. 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.[15]

Myth: *Reform will hurt consumers and result in them paying higher fees.*

Reality: Policymakers around the world have found that reform has benefited consumers. In Australia, for example, 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."[16] The Reserve Bank of

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[15] *U.S. v. Visa U.S.A., Inc.*, 344 F. 3d 229 (2d Cir. 2003).

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

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."[17]

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 reviewed 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. Simply asking the question makes the absurdity obvious. In fact, consumer card fees have been rising too. Credit card fees are not a zero sum game in which the industry has a God-given 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 hunger for fees aided by their unfair and deceptive practices in charging them.

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. To quote a prominent consumer advocate, Ed Mierzwinski of U.S. PIRG, "Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These

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

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."[18] 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." That is, of course, just what the Hispanic Institute found in its study published last November.

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.[19] 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

[18] Testimony of Ed Mierzwinski before the House Judiciary Committee Antitrust Task Force, May 15, 2008.

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

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: *When Australia took regulatory action in this area it resulted in consumers paying more for credit cards and hurt the credit system.*

Reality: When Australia acted, 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 rate competition has benefited 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 and must now compete more thoroughly on the value they deliver to consumers. 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. 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. For many consumers the resulting savings can run into hundreds of dollars per year . . . 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. 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."[20] It should be noted that the credit card companies have funded studies that have a different view of the reforms in Australia. Merchants have funded their own studies, but we think the Reserve Bank's findings are the most authoritative source and urge everyone on the Committee to read them when making their judgments – and not listen to how they are characterized (and often mischaracterized) by others.

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. Just as was the case with the old AT&T, the problem is that the interchange fee system now violates the antitrust laws and is so riddled with unfair rules that keep any competition from entering the system that it must be reformed. Under the Durbin amendment, there will still be interchange – it will just be charged in a system where debit fees will have to be reasonable and some small measure of competition and transparency will exist.

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

Of course, it does not touch credit card interchange and even on debit transactions, 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, banks will still charge consumers an array of interest charges and fees. While the card industry may not like reform, they will continue to have many avenues to recover costs, compete, 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.

Myth: *Banks need high interchange in order to recover the costs of fraud and guarantee payment to merchants.*

Reality: Economists with the Federal Reserve Bank of Kansas City have found that fraud costs are not a justification for over-inflated interchange fees. They wrote, "Card organizations have often argued that the reason why they impose proportional fees stems from the cost they bear from their "payment guarantee" service which insures merchants against customers who pay with cards without having sufficient funds. We argue that the cost of fraud and insufficient funding is negligible compared with fees at the range of 1% to 3% commonly imposed by brand name cards. For example, industry studies show that the average net fraud losses are around 0.05% for signature debit cards, which do not extend credit to card users."[21]

Even if banks issuing cards paid out more in fraud, however, that would not justify them charging the merchants for this. While the card companies claim that they guarantee payment to merchants, in reality this "guarantee" is nothing more than a promise to pay when they want to pay. Both Visa and MasterCard have pages and pages of rules for situations in which they can "chargeback" the amount of a transaction to the merchant. These chargebacks are so common that in actuality U.S. merchants absorb more of the cost of fraud each year than the banks that issue the cards. A 2009 study from LexisNexis in conjunction with Javelin Strategy & Research found that merchants absorb nearly ten times the cost of fraud that the banks absorb each year.[22]

One recent example demonstrates in microcosm why this is the case. Exhibit 5 to this testimony is a letter from the owner of the The Catch Seafood Tavern in Port Jefferson, New York to his representatives in Congress. It details his recent experience with the card companies. He had five chargebacks in a month that meant the bank took $78 in sales from him. He argued successfully that each chargeback was in fact a valid transaction and that he should get his money.

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[21] "Why Do Card Issuers Charge Proportional Fees?" Oz Shy and Zhu Wang, December 2008 at 3.

[22] 2009 LexisNexis True Cost of Fraud Study at 23.

Finally, the bank agreed with him, but charged him a fee of $15.50 per chargeback. So, he received his $78 but then was charged a total of $77.50 in fees. Obviously, this didn't amount to any kind of guarantee at all. This type of behavior is blatantly unfair, amounts to a license for the banks to take merchants' money, and happens frequently. It demonstrates another reason why large interchange fees cannot be justified and must be reformed.

Exhibit 1

Recognizing new tribes could mean new tax losses, marketers warn

Branded jobbers and truck stop marketers are pleading with Congress not to extend federal recognition to two Indian tribes without first ensuring a continued competitive marketplace for motor fuels and tobacco.

Rep. Jim Moran (D-VA) is pushing a bill to recognize the Rappahannock Indian and Thomasina E. Jordan tribes in Virginia. Federal recognition would confer sovereign status on the tribes, allowing them to take into trust some of Virginia's most populous counties.

Sovereign status also allows tribes to sell fuel and tobacco to members without remitting state tax, but some flout the rules by failing to collect taxes from non-tribal members too. The result has been huge revenue losses in some states. New York estimates it has lost nearly $4 billion in cigarette excise taxes alone since 1995, while Oklahoma believes state tobacco taxes are under-collected by roughly $4 million/mo.

"While the state loses tax revenue, many motor fuel marketers and truck stop operators are losing their livelihood and their ability to compete in the marketplace," say the Petroleum Marketers Assn. of America and the National Assn. of Truck Stop Operators.

In Virginia, state excise tax is 17.5cts/gal on gasoline and 18cts/gal on diesel. In 2005, the average gross margin for retailers was 15.1 cts/gal and 15.5cts/ gal, respectively. By failing to remit state taxes, Indian tribes gain a price edge that is greater than many retailers' gross margins, the groups said in an April 16 letter to Rep. Nick J. Rahall (D), chairman of the House Natural Resources Committee. Congress should add language to Moran's bill that would make federal recognition of the tribes conditional on their compliance with all state excise tax requirements, they say.

State won't intervene in dispute between Visa and marketers

Visa to marketers: If you don't like our rules, don't offer discount-for-cash

State regulators in California won't come to the rescue of marketers caught between obeying state standards on discount-for-cash pricing and demands by Visa that they drop the word 'credit' from price signs.

"As far as we're concerned, putting the word 'credit' on a price sign is appropriate, but as far as Visa telling marketers they can't do it, that's a civil matter between Visa and the marketers," says Dennis Johannes, the state's Weights and Measures director. "We have no authority to regulate Visa."

The state's posture leaves marketers in a Catch 22 situation. If they use the word 'credit,' Visa has said it may fine them and strip them of their right to take Visa cards. But if they adopt some of Visa's suggestions, such as leaving the 'credit' sign blank, they will be violating state standards, says Johannes.

Johannes believes that Visa is being "a little heavy-handed" on the issue. "They probably don't want dual pricing because it discourages the use of their credit card," he says. His only suggestion for marketers is that they seek a legislative change that will specifically require the use of the word 'credit' on signage.

Johannes is not alone in his suspicions of Visa's motives.

"Visa's goal is to get everyone to pay the higher, credit card price for fuel and they will twist and torture their rules if necessary to force consumers to do so," says Mallory Duncan, chairman of the Merchants Payments Coalition, a business group dedicated to fighting for lower card interchange rates.

Visa is not particularly sympathetic to the plight of marketers – the credit card giant says it is the marketers' fault for offering discount-for-cash in the first place.

"If the merchant wants to steer the consumer to discount for cash, then they have to do it within the context of Visa's rules," said Visa spokeswoman Rhonda Bentz. "It's great if they have a contract with the state, but they don't. They have a contract with Visa and if they don't want to abide by that contract, they shouldn't have signed it," she said.

"These merchants clearly want the consumer to pay with cash. Okay, then, they should just accept cash and not credit cards. But they want access to our 1 billion cardholders, and they want the reduced risk that comes with taking Visa, and they want the guaranteed payments. They just don't want to pay for it."

Visa threatened to fine Mom and Pop operator Mike Gharib's credit card processor $5,000 because he was using the word 'credit' on his price sign, as exclusively reported (OE 04/16). The processor, Petroleum Card Services, planned to pass the fine through to Gharib. Visa withdrew the threat after Oil Express raised questions on the issue. The company says Gharib is now "compliant" with its rules. Gharib has removed the word 'credit' and that part of his price sign is now blank, Oil Express sources say.

Visa's position is that the higher price next to the word 'credit' on signs implies that the customer is paying a surcharge for credit, which is against Visa rules. It wants marketers to substitute other terms, such as 'regular' or 'standard,' or just leave that part of the sign blank. Additionally, Visa says the word 'credit' does not take into account debit cards, which must be treated the same as cash sales under state regulations. Therefore, the signs are misleading to debit customers, too, says Bentz.

Asked why Visa should start objecting to the word 'credit' after its use on station signs for 26 years, Bentz says Visa received complaints from consumers who thought they were being surcharged for credit.

Johannes says consumers know debit transactions are the same as cash, and that the difference between the two forms of payment – cash and credit – is well-understood. Using the term 'standard' or 'regular' would confuse customers, and leaving the sign blank would violate state rules. Visa's other suggestions – 'non-cash' and 'base price' – would have to be studied, he says.

"'Non-cash' is probably something we would not pursue as being illegal but there are a lot of other enforcement people in this state, such as the district attorney, county officials, and state attorney general's office, and we don't speak for them."

Visa has also objected to the way some marketers handle debit card sales at the pump and there is a suspicion among some marketer groups that the company would like to force consumers to go into the station to sign for a debit card transaction. Visa receives higher fees for debit signature sales than it does for Personal Identification Number transactions, sources say.

Visa has told Auburn, Calif.-based marketer Nella Oil that its debit card sales at the pump violate Visa rules because those customers are not getting the cash or discount price.

When customers use a Visa debit card at the pump, they are required to enter a PIN. If they do not do so, the card processor treats the sale as a credit card transaction and the customer will pay the higher, credit price for fuel. Likewise, the marketer will pay the higher fees associated with credit card transactions, although the money will ultimately be debited from the customer's bank account.

Nella has decals on its pumps clearly warning customers that they must key in their PIN to get the debit price, and the state has approved that decal, a Nella exec says. Visa says that's not enough to ensure that customers receive their cash discounts. Nella had hoped to get its bank to segregate PIN debit purchases and block them at the pump, but has been told that is not possible. "So, we're back to square one," says Nella.

Actually, not quite – under the landmark Wal-Mart-Visa lawsuit settlement, Visa and MasterCard were barred from bundling their debit and credit cards together, so forcing merchants to accept debit cards whether they wanted to or not.

Nella can write to its card processor or bank and tell them that it no longer wishes to accept Visa debit cards, says an industry lawyer. This will cause the bank to shut off Nella's access to the Visa debit network. As a result, when a customer swipes his debit card the sale will be routed automatically to the regional debit network whose logo appears on the back of the Visa card – the Star network would be one such example. The Star system will not process the customer's sale until he inputs his PIN, so avoiding charging him the credit card price for fuel.

"What's so frustrating is that Visa and MasterCard have a duopoly in the market place and they're trying to put retailers in an untenable position in order to increase their leverage and revenues," says Duncan, with the Merchants Payments Coalition.

Exhibit 2

FORTUNE 500 *Our annual ranking of America's largest corporations* 2009

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

FORTUNE 500 *Our annual ranking of America's largest corporations* 2008

Full List **Near You** **CEOs** **Top Companies** **Top Industries**

Fastest growers | Most profitable | Most bang for buck | Best investments | All industries

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
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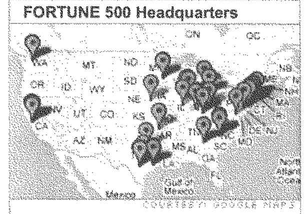
19	Semiconductors and Other Electronic Components	7.7
20	Petroleum Refining	7.3
21	Industrial & Farm Equipment	7.2
22	Homebuilders	7.1
23	Hotels, Casinos, Resorts	7.0
24	Utilities: Gas & Electric	6.8
25	Beverages	6.6

FORTUNE 500 Headquarters



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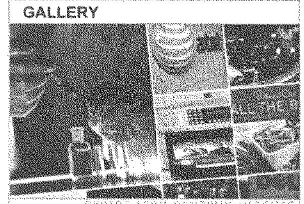
Have your say

GALLERY



Top 50

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

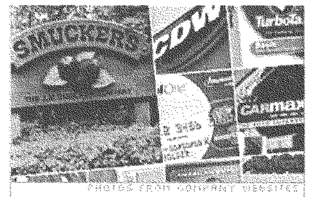
See them all

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

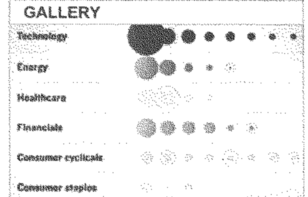
Note:
Due to slight differences in rounding, industry data online may not exactly match the FORTUNE 500 magazine version.



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



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

FORTUNE 500 2006

Our annual ranking of America's largest corporations

Full list	Companies	States	Industries	CEOs
Top performers	Employers	Cities	Women CEOs	Climbers
Arrivals	Exits	Losers	50/50	FAQ

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

Exhibit 3

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

- **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%.**

	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.

Exhibit 4

Share of Interchange Collected by Card Type

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%

Share of Interchange Collected by Card Type

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%

Exhibit 5

January 15, 2010

The Honorable Charles Schumer
The Honorable Kirsten Gillibrand
The Honorable Tim Bishop

To my Representatives in Congress:

I'm writing as a small business owner who has an opinion on almost everything. But, to avoid writing a book, the subject today is credit card fees being charged by the big banks to the small merchant. I know there's legislation pending on this issue. And I know there is a lot of negative consumer sentiment regarding banks. Perhaps my situation will help sway a few votes to the side of right.

In the past month there have been five occasions where banks have initiated charge backs against my account. Three of the incidents were because the cardholder claimed the card was stolen. The other two were initiated by the Bank of America because they *suspected* fraud... two transactions of identical amounts on the same day. (Not unusual in a bar when a customer orders the same round of drinks.) In all five transactions the money was deducted from my account before I had any communication from my card processor requesting verification of the charges. *The big banks took the money of the small merchant assuming guilt before innocence.*

Since I check my account on a daily basis, I notice the debits. I called to ask about the deductions and was told of the claims against me. In all cases, I immediately faxed the proof that all five transactions were approved by the banks and that I did nothing wrong. I have so far been credited for the first three; I'm waiting for the last two. They're very fast to take my funds, very slow to return them. I should also note that had I not called I would have to wait until I got the letters requesting my response. In three cases the letters arrived on December 24th requiring a response by December 23rd. Even I'm not that good that I can respond 24 hours ago to a request.

Now, you'd think it couldn't get any worse... but it does. I've lost the use of the money for a period of time. I've proved that I did nothing wrong and that all the charges were legitimate. I've been credited the money for three of the five transactions and am waiting for the last two. I am now charged $15.50 for each charge back as a fee. A total of $77.50 in fees for $78.00 in charges that I processed correctly and within the letter of agreement with the card processors!!! Mr. Schumer, Ms. Gillibrand, Mr. Bishop – this is ridiculous. I lose the use of my money for weeks, then I have to pay a fee of 100% to get it back.

I write to you today in the hopes that you can appreciate both my frustration with the situation and that you can see just how ludicrous it is. I am a small merchant who is trying to get by, trying to provide employment, trying to pay my bills. I feel that I'm being nickel and dimed and $77.50'd by companies that are trying to shore up their revenues before the new credit card legislation takes effect. I ask your help if you too see the inherent wrong in this situation.

Sincerely,

Marc Miller
Owner

111 West Broadway Port Jefferson, NY 11777 631.642.2824 info@thecatchtavern.com

Testimony of

Ron Celaschi
Vice President of Lending
Clearview Federal Credit Union
Moon Township, Pennsylvania

Before the
Subcommittee on Investigations and Oversight
Committee on Small Business
United States House of Representatives

Hearing on
"The Impact of Interchange Fees on Small Businesses"

July 29, 2010

Testimony of
Ron Celaschi
Vice President of Lending
Clearview Federal Credit Union
Before the
Subcommittee on Investigations and Oversight
Committee on Small Business
United States House of Representatives
Hearing on
"The Impact of Interchange Fees on Small Businesses"

July 29, 2010

Mr. Chairman, Ranking Member Fallin and Members of the Subcommittee, thank you very much for the opportunity to testify at today's hearing. My name is Ron Celaschi and I am the Vice President of Lending for the Clearview Federal Credit Union, located in Moon Township, Pennsylvania. My credit union serves 78,000 members and has $630 million in total assets. Initially, my credit union served the employees of US Airways. Today, with a modified charter, we serve communities in a 10 county area around Pittsburgh. I appreciate the opportunity to present my views on interchange.

We are very concerned with the provisions of the recently enacted Wall Street Reform and Consumer Protection Act which relate to interchange fee regulation. The interchange provisions of that legislation were inserted by the Senate into the legislation without hearings or Committee process. No appreciation was given to the consequences that the legislation would have on community financial institutions, like Clearview Federal Credit Union. Quite simply, any reduction in interchange revenue would be a serious blow to Clearview Federal Credit Union, and more importantly, its members. We urge Congress to repeal these provisions before the intended and unintended consequences of interchange regulation are realized.

In many credit unions, interchange revenue covers all of the costs of providing debit access to members. However, for Clearview FCU, that is simply not the case. Last year, our total expense from offering debit access to members was $2.9 million. Our total debit based interchange was only $1 million, falling short of the costs by $1.9 million.

Clearview Federal Credit Union has an aging membership, and older members tend to use their cards less frequently than do younger members. In a recent survey of credit unions conducted by the Credit Union National Association (CUNA), credit unions reported the average number of debit transactions per member per year at 160. At Clearview Federal, it was only 69. Even though my members use their debit cards with less frequency than members of other credit unions, we still incur all the costs of providing that access. We run our debit program at a loss because our members value the program; however, any reduction in interchange will require us to impose fees on members to make up the lost revenue. This will harm our members and it will be a direct result of the recently enacted Wall Street Reform and Consumer Protection Act.

Debit Interchange Provisions

The Wall Street Reform and Consumer Protection Act included provisions that give the Federal Reserve the authority to regulate "interchange transaction fees," which are defined as "any fee established, charged or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction."

Generally, the provisions require that the amount of any debit or prepaid interchange transaction fee must be "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The Federal Reserve is required to set standards for assessing whether the amount of any interchange transaction fee is "reasonable and proportional" to the incremental cost incurred by an issuer in connection with a particular electronic debit transaction. The amendment allows the Federal Reserve to adjust the interchange transaction fee for certain types of fraud-related costs if the issuer complies with fraud-related standards set by the Federal Reserve. The Federal Reserve is directed to issue the "reasonable and proportional" standards within nine months of the date of enactment (*i.e.*, no later than April 21, 2011). The amendment includes exemption language for the following: (1) issuers with less than $10 billion in assets; (2) debit cards or general-use prepaid cards for government-administered payment programs (provided, however, that the issuer does not charge the cardholder certain overdraft or in-network ATM fees); and (3) reloadable general-purpose prepaid cards not marketed or labeled as gift cards (provided, however, that the issuer does not charge the cardholder certain overdraft or in-network ATM fees).

The Small Institution Exception Does Not Work

Currently, the payments networks are supported by the large institutions. About 80 percent of debit volume is accounted for by a small number of large issuers; the other 14,500 or so financial institutions share the remaining 20 percent of debit volume. The scale of large institution transactions permits the construction and maintenance of a national and global network with enough capacity that small banks and credit unions can participate.

The plain language of the amendment envisions a substantial reduction in debit interchange. It is highly unlikely that large banks would continue to support that part of the network so institutions such as my credit union could issue debit cards at market rates of interchange because there is nothing in the legislation that requires the payment card networks to operate a two-tier debit interchange rate system and there is no economic incentive for them to do so. Further, small bank and credit union debit volume is effectively limited by their deposits; there is no way that small banks and credit unions can support the system.

We do not know precisely how the system will change and in what ways, but below is one scenario from a payments system expert that gives a good idea of the variables:

> **Arbitrarily regulating a portion of the fee merchants pay in order to accept debit cards will create an artificial marketplace for a service utilized by the vast majority of Americans. If the amendment is enacted, the largest 105 U.S. banks (those with at least $10 billion in assets that are regulated in the amendment) will immediately see their debit transaction revenue source greatly diminish, and will likely then focus on issuing credit cards and providing/developing credit card merchant services and technologies over debit services. The remaining U.S. banks and credit unions that do not need to adhere to the regulation face their own problems. These smaller banks will face customer attrition as they are unable to compete with electronic payments rates at larger, fee regulated banks. They will also see a significant drop in debit transaction fee revenue as merchants are incented to promote acceptance of cards issued at regulated banks, resulting in higher operating costs as declines in debit transactions processed increases their cost of completing a transaction.**
>
> **Beyond the banks involved in the transaction, the debit payment transaction is driven by thousands of companies that make up the payments supply chain, including card associations (VISA, MasterCard), processors (provide the rails on which the transaction moves), merchant acquirers (provide the ability to accept cards including back-office reporting, etc), independent sales organizations (sell on behalf of merchant acquirers to merchants), POS manufacturers, technology providers, and others who built the infrastructure and developed the technology that make not only debit, but all forms of electronic payments possible. These payments companies employ tens of thousands of people all around the country, with large pockets in Omaha, Atlanta, and Louisville; these cities have been estimated to each have more than 10,000 people working in the payments industry. From these suppliers' perspectives (suppliers that all depend on revenue from all forms of electronic payments transaction fees), the new artificial marketplace favors cash, check, and credit card payments over debit payments. Consequently, like the forementioned banks, payments companies will drive resources and sales initiatives towards merchants receiving credit card payments over debit. Inherently, over time, debit payments will stagnate or drop in number of transactions and in dollar volume. This would come despite consumers' recent adoption of a "pay as you go" mentality, accomplished via debit card use – in late 2008, VISA debit card volume surpassed VISA credit card volume for the first time in response to the recession, as consumers experienced the pains of deleveraging from years of excessive credit card spending.**[1]

[1] Mike Strawhecker. "Trickle-Down Legislation: Potential Impacts & Unintended Consequences of Interchange Regulation." The Straw Group. July 9, 2010. (www.thestrawgroup.com).

Routing Provisions

The Wall Street Reform and Consumer Protection Act also includes provisions which direct the Federal Reserve to issue regulations providing that neither an issuer nor a payment card network may restrict the following: (i) the number of payment card networks on which an electronic debit transaction may be processed to only one such network, or two or more affiliated networks; and (ii) the ability of a merchant to route debit transactions over any "network that may process such transactions." Such regulations must be issued within one year after the date of enactment (*i.e.*, no later than July 21, 2011). No small issuer exemption applies to this provision of the new law.

This provision causes small issuers like me significant concern because it gives the merchants the ability to steer consumers toward cheaper payment networks that may result in lower costs for the merchant, but have negative consequences for the consumer. Not all networks are created equal – they provide different liability fraud safeguards, chargeback and other consumer protections. When entering into agreements with these payment networks, we evaluate what they offer to our members in order to act in the best interest of our members. If merchants are able to route transactions as they see fit, our members could lose important fraud protections.

Furthermore, even though we believe that the small issuer carve-out in the debit interchange provision is ineffective, the intent of the interchange language in this legislation, as repeatedly stated by the proponents of the legislation, was not to harm small issuers. The routing provision does not carve-out small issuers and would disproportionately affect small issuers because these are the issuers which are least likely to have relationships with more than one network. In essence, this provision would require any issuer that currently operates on only one network to go out and establish a relationship with multiple networks – an expensive proposition that will result in not only one-time expenses, but monthly expenses as well. In this regard, the debit interchange provisions actually make it more expensive to operate a debit card program while at the same time significantly reducing the amount of revenue earned from such program.

Making More Credit Available to Small Businesses

Mr. Chairman, the debate over the interchange provisions was a trade association fight that pitted depository institutions against merchants. These groups may disagree on this issue, but one issue that we can agree on is the need to increase the amount of credit available to small businesses.

Legislation has been introduced in both the House and the Senate to increase the credit union member business lending cap. In the House, this legislation, H.R. 3380, is sponsored by Representatives Paul Kanjorski (D-PA) and Ed Royce (R-CA), and cosponsored by 124 members. In the Senate, Senator Mark Udall and a bi-partisan group of nine Senators have proposed increasing the credit union member business lending cap from its current level of 12.25% to 27.5%, while at the same time enacting important safeguards to ensure this lending continues to be done in a safe and sound manner. The Credit Union National Association estimates that if either the Kanjorski-Royce bill or the Udall amendment were law, credit unions could lend an additional $10 billion, helping small businesses create 100,000 in the first year after enactment, at no cost to taxpayers. I was pleased to learn that earlier this year the Obama Administration endorsed the Udall approach to lift the cap to 27.5%.

Credit unions have proven for years that they are capable of doing this type of lending safely and soundly. During this most recent financial crisis, while bank business lending has contracted, credit union business lending has expanded. In fact, even though my credit union is not what most would consider "near the cap" – we're at about 5% of the 12.25% cap – we have seen our business lending increase dramatically. However, without an increase in the credit union business lending cap, this credit union business lending will have to slow.

Credit unions should be a part of the solution to the small business credit crisis. Clearview Federal Credit Union is committed to helping the small businesses in our community. In fact, our average business loan is approximately $70,000. I hope Congress will increase the credit union member business lending cap as soon as possible so that the business lending at my credit union, and other credit unions like mine, does not have to slow. Small businesses are counting on it.

Mr. Chairman, thank you very much for the opportunity to testify at today's hearing. Clearview Federal Credit Union is proud to serve the citizens and small businesses of western Pennsylvania.

July 29, 2010

Testimony of

Robert Oeler

On Behalf of the

AMERICAN BANKERS ASSOCIATION

Before the

Subcommittee on Investigations and Oversight

Of the

Committee on Small Business

United States House of Representatives

American
Bankers
Association

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Chairman Altmire, Ranking Member Fallin, and members of the Subcommittee, my name is Robert Oeler. I am President and CEO of Dollar Bank, a $5.7 billion Federal Savings Bank that has served Western Pennsylvania and Northeastern Ohio since 1855. Dollar Bank is the largest traditional mutual savings bank in the United States. Our focus, like that of my fellow bankers throughout the country, is to build and maintain long-term relationships with customers, many of which are small businesses. I am proud to say that we have maintained an "Outstanding" CRA rating since 1994 and we work hard every day to meet the credit needs of our community.

I am pleased to be here today on behalf of the American Bankers Association (ABA). The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees.

I appreciate the opportunity to testify on the impact of interchange fees on small businesses. I know that the first reaction for many who see the title of this hearing is the impact that interchange has on small "retailers," but the interchange system and the impact of any changes to it affect ***all*** small businesses – including ***small banks***. While some might think the banking industry is composed of only large global banks, the vast majority of banks in our country are community banks – small businesses in their own right. In fact, over 3,200 banks (41 percent) and 6,100 credit unions (81 percent) have fewer than 30 employees. Given the important role that community banks – my bank included – play in funding small businesses nationwide, hearings like this that explore the impact of changing interchange fees are extremely important.

When merchants choose to accept payment cards, they pay a small fee (for example, a $10 debit transaction would cost the merchant less than 10 cents in interchange) for the many benefits that come with accepting electronic payments. Debit cards increase foot traffic and thus increase merchant sales, lower wait times for customers at the cash register, provide immediate payment for the merchant while generally transferring the risk of fraud to the bank, and reduce the costs and risk of managing cash, among other benefits. These interchange fees have been an integral component of the system for decades and are an essential but modest cost to pay to support a system that works 24/7, 365 days a year almost anywhere in the world. It is now under attack by the retail community for the costs associated with it, with no regard for the benefits of accepting payments by debit or credit cards.

The most recent attack by retailers involves the Dodd-Frank Act and the so-called "Durbin Amendment" which was added to the bill on the Senate Floor – without any hearings investigating its significant ramifications. It directs the Federal Reserve to dictate the pricing of interchange on debit cards (among other things). The Federal Reserve must limit interchange fees on debit transactions to those that are reasonable and proportional to the "incremental" cost related to ***each*** transaction. No one really knows what "incremental" means in the amendment but the ABA expects that the merchant community will argue that it should not include the large costs of the entire system, including the overhead, maintenance, investments in new software, research and development that continue to make this system highly efficient and accurate. In fact, the Durbin Amendment seeks to explicitly restrict consideration of these other important costs and does not even allow for a reasonable return on investment.

Such uneconomic pricing will wreak havoc on our bank's ability to offer reasonably-priced products both to consumers and to small businesses in my community, as the costs of offering debit cards will not disappear. Interchange income today helps banks and credit unions offset some of the costs of providing the checking accounts that fund debit card transactions. As an example, Dollar Bank handles about 16 million debit card transactions each year, or about 1.3 million per month. We had net debit interchange revenue of less than 1 percent of sales. In 2009, debit card interchange revenue was $4.6 million, based on total card sales volume of $600 million on 140,000 debit cards. That amounts to $32.85 per card or less than $3 per month. This revenue is important, but does not cover our costs of maintaining a transaction account which run between $12 and $15 per month. For the industry, the cost of opening an account runs between $150 and $200, and the yearly cost of maintaining an account typical runs between $150 and $300. Thus, providing over 300 million transaction accounts comes at a considerable expense for banks.

Without this income, it becomes very difficult for many banks to continue to offer low and no-cost checking for our customers. The loss of revenue will, for example, impact the ability of banks to provide basic banking accounts which will impact low-income people that utilize such accounts for access to the banking system.

It is a simple fact that for any business to remain viable, revenue has to exceed costs. New restrictions created by Congress will severely reduce expected income from interchange fees and threaten other sources of revenue. This will force every bank to rethink the features of transaction accounts they offer and how to cover the significant costs of providing these valuable services. As a direct result of Congressional and regulatory actions, in many cases, free checking will be a thing of the past.

Moreover, the loss of interchange revenue will impact the ability of all types of banks to make loans. However, this will be even more pronounced for Dollar Bank, since we are a mutual. The only way we can raise capital is through retained earnings. If we lose interchange income, it means that we will be unable to make as many loans in our community. The consequences are significant, since $1 worth of capital supports up to $10 in lending. If we see a 50 percent reduction in net interchange revenue, it would decrease our net income by $1.4 million in ***after-tax*** income. This loss of income, and in turn loss of capital, means that our overall lending could be reduced by up to $14 million. To put this in context, based on our average small business loan of $70,000, this means ***200 fewer small business loans that we could make each year.***

New price controls on interchange will also affect the pricing on all types of prepaid card programs, including government benefits programs and payroll card programs that depend upon interchange as a revenue source for the provision of such services. Congressional efforts to shield such programs simply will not work as the reduction in overall revenue affects the entire system. In short, the Dodd-Frank Act merely shifts the costs from merchants to banks and their customers. While big-box retailers may benefit and see their profits increase, ultimately it is debit card holders that will end up paying the costs for these convenient methods for making everyday payments.

Congress recognized that setting price controls on interchange fees will have a significant negative impact on roughly 16,000 small banks and credit unions. Congress ***attempted*** to remedy this problem by providing an exemption to the price controls for these institutions. While this idea sounds good, it does nothing to protect small banks. The reality will be that the price controls imposed on the largest banks will force smaller banks to adopt the same price or risk losing business to the largest banks. Market share will always flow to the lowest priced product, even if those lower prices are mandated. The result for small banks is either a loss of market share, a loss of revenue that supports free transactions and other valuable services, or both. Most importantly, consumers will suffer, including low-income consumers relying on low-cost banking accounts that may no longer be available, or available at a much higher price.

While I realize that the ink is barely dry on the Dodd-Frank Act, the negative consequences for banks and bank customers – and indeed, the impact on the general economy – stemming from the restrictions on interchange revenue are so great that Congress should revisit and repeal this provision. Moreover, further restrictions on interchange income from credit card transactions should be vehemently opposed, as the magnitude of the negative impact on credit availability and job creation would be large and would further retard the economic recovery.

There are three points we would like to make today:

- Price controls on interchange will have far-reaching effects on the business of banking that will limit the ability of banks to serve their local communities.
- Price setting of interchange fees shifts costs from merchants to cardholders in spite of the significant benefits that merchants already receive from card acceptance.
- Congress should repeal the Durbin price control provisions, and avoid taking further steps which would cause more damage to consumers, small businesses, and local communities.

I. Price Controls on Interchange Will Have Far-Reaching Effects on the Business of Banking That Will Limit the Ability of Banks to Serve Their Local Communities

Demand deposits are the central product offered by all banks – large and small. Debit card access (which is now practically universal) allows smaller banks to provide identical global transaction services that large banks provide, and the large scale network infrastructure costs required to build and maintain debit card systems are borne by all involved. For example, there are significant costs in providing transaction accounts to customers of the bank. Interchange income helps to offset ***some*** of those cost of providing demand deposit services, ***costs which far exceed the revenue per account from interchange income***. Debit interchange income has become a reliable and stable source of revenue for small banks even through this current economic cycle.

As I explain below, with mandated price controls for large banks on debit card transactions, small banks will inevitably be forced to lower their fees to retain acceptance and not lose market share. Without the ability to offer debit cards on reasonable terms, small banks would be unable to compete. The loss of revenue would be very difficult for smaller banks to make up. One likely result of decreased interchange income may be increased fees for transaction accounts.

To the extent that small banks cannot make up the loss of revenue through pricing changes, it means that banks will have to adjust in other ways, including cutting expenses and jobs. The loss of income also means that banks will have fewer retained earnings to build capital. This is a problem for any bank, but it is a severe problem for banks like mine that are mutually chartered. As I mentioned earlier, it could mean a reduction of up to $14 million per year or 200 small business loans per year. For the industry as a whole, a 50 percent loss of interchange income would mean that ***lending could fall by as much as $74 billion.***

Small businesses and their customers – already struggling in this difficult economic environment – cannot afford to face further restrictions in credit. A recent study looks at the importance of credit – particularly credit cards – in funding small businesses. Prepared for the American Bankers Association by Keybridge Research, LLC, the study found that there was a 36 percent expansion of business credit card use in the five-year period from 2003 to 2008 which ***is associated with the creation of approximately 1.6 million jobs, and the creation of $289 billion in output and $142 billion in value-added.*** Based on data available through the Federal Reserve, the research concludes that small businesses that use business credit cards experience faster employment growth. Importantly, the opposite is also true – when small businesses have restricted access to credit, they experience a corresponding drop in hiring. In short, any un-reimbursed reduction in bank revenue from interchange reduces banks' ability to provide services, including offering credit to small businesses. This is a subtle, but very important, impact that gets lost in the debate.

But small businesses will not be the only ones who feel the impact of decreased interchange revenue. This revenue allows banks to offer products of great value to lower income consumers. Indeed, for many such consumers these products are the only way that they can access the payments system, other than using cash. Basic checking accounts, with low minimum balance requirements, are often tied to the use of debit cards, with interchange revenue carrying much of the cost of these accounts.

Moreover, more companies are now using payroll cards to pay their workers, particularly attractive to lower income employees. Many government benefit programs run off of reloadable cards. Despite the fact that Congress attempted to exempt prepaid card programs from the price-setting mandates of the Durbin Amendment, all of these programs will be impacted, as the vast majority of debit card interchange revenue that supports these very programs will be substantially reduced. You cannot eliminate the vast majority of revenue supporting such programs and not expect them to be greatly affected. Without adequate interchange revenue, all these products will have to be repriced if not eliminated, with consumers and government agencies picking up more of the costs.

II. Price Setting of Interchange Fees Shifts Costs from Merchants to Card Holders in Spite of the Significant Benefits that Merchants Already Receive from Card Acceptance

Merchants receive considerable benefits from debit cards, so they should be willing to pay for the service, as is the case with all their other services. Instead, they have asked Congress to intervene through a government-mandated price cap that will not even come close to covering the cost of the service. The result will be higher costs for consumers and government programs, and the degrading of popular and safe consumer products.

Consider some of the many benefits provided by payment cards of all kinds. ***They provide the passkey to new sales channels in the 21st century.*** Payment card acceptance gives business owners access to the broadest possible customer base. It allows merchants to sell a greater volume of products in less time and at a lower cost. Payment cards are particularly helpful to smaller merchants because they give them access to a larger pool of customers that helps them compete with large chain stores at both the store front level and on the Internet. In fact, e-commerce would have been impossible without the support of the electronic payments systems. Whether online or in person, card transactions generate millions of customers and billions of dollars in sales for merchants every year.

Sophisticated payment card systems ***provide merchants huge benefits compared with cash or checks.*** They allow retail merchants to instantly confirm that a customer has sufficient funds to make a purchase with his payment card and to have that payment transferred electronically from the customer's bank to the merchant's account. The greater the use by both consumers and merchants, the more valuable the network is to all parties. It is no wonder that even retail businesses that deal in small dollar sales, such as fast food restaurants and coffee shops, are accepting card payment services. The firms had a ***choice*** to make regarding how best to increase sales and enhance the customers' need for convenient and fast service. The businesses have realized the significant value of the service and made an economic decision that it is in their best interest to be a part of the system.

The price controls will also chill innovation and discourage payment system improvements. It is simple economics. Banks, like any business in a free market, must make a return on their investment. As with any business, for a bank to be successful in the long-term, revenue has to exceed expenses, and the opportunity of reward for improvements needs to be available. Indeed, in a free market, the bank as well as the merchant are expected to make a return. This return encourages imagination, innovation, and investment. Under the new price control law, banks are not permitted to make a return on their investment. As envisioned by the merchants, banks will not even be permitted to cover their costs.

Merchants want all the benefits of accepting card payments, but they do not want to pay their fair share to receive those benefits. Instead, merchants want Congress to dictate market prices and shift the cost of doing business onto consumers. While merchants say that they will lower their prices to pass on the savings to consumers, no reasonable person expects that to happen nor did Congress mandate that such a result occur. The experience in Australia, which imposed price controls on interchange fees, proved just the opposite: retailers pocketed the savings in cost for themselves to boost their own profits with no evidence that consumers received any savings from lower retail prices. Moreover, consumers saw higher interest rates, less access to credit, and fewer rewards for card use as a result.

III. Congress Should Repeal the Durbin Interchange Price Control Provisions, and Avoid Taking Further Steps that Would Cause More Damage to Consumers, Small Businesses, and Local Communities

The regulation of interchange fees, as included in the Dodd-Frank Act, will have a great negative impact on roughly 16,000 small banks and credit unions and the customers they serve. Quite simply, the price controls in this Act should be repealed. The retailers will say that small banks and credit unions are protected because the legislation exempts small depository institutions from the Federal Reserve Board's interchange rate setting. There is no community banker that believes such an exemption will work in practice. As with any price controls, there are inevitable unintended consequences, market distortions, and higher costs for others, including consumers.

For example, the exemption will not work for the following reasons:

➢ ***Merchants Will Discourage the Use of Higher Priced Small Bank Debit Card Transactions***

It is entirely possible under the regulations issued pursuant to the Durbin Amendment that the mandated price of interchange will be nominal. Even though the legislation has language that tries to prevent it, there will be enormous incentives for merchants to steer customers away from using debit cards issued by small banks. The differential may just be too large between the very low rate that large bank debit card issuers must accept and the current rate that small banks charge. Large retailers will provide additional rewards to customers that use large bank cards through their special offers related to overall purchases at their stores. Merchants will see significant reductions in costs (and concomitant increases in profits) if they drive business away from higher-cost debit card alternatives to lower-cost ones.

- ***Competition and Network Rules Would Force Convergence of Small Bank Pricing with Large Bank Mandated Rates***

  In order to preserve some market share of debit transactions and to compete for card acceptance by merchants, smaller banks will have to lower rates to similar levels mandated for large banks. These competitive forces do not disappear with the exemption from the price controls. In fact, large card issuers will actively work to compensate for the significant loss of interchange revenue, and they have the resources to provide various incentives to drive customers to their products.

Importantly, the combination of these two factors will, over time, cause a significant volume of customers to migrate out of small banks to larger competitors. This would drain important sources of liquidity from smaller competitors as these debit card accounts (tied to checking accounts) move to larger competitors. Such a shift would impair community banks' ability to provide reasonably priced banking services to local communities. The bottom line is that the so-called exemption will not work in practice. The result is that interchange income, so important for small banks to be able to offer competitive transaction accounts for their customers, will decline drastically.

Simply put, the interchange amendment will have serious consequences for community banks, and the exemption provides no relief. Ultimately, prices will converge to the mandated rate, and community banks and their customers will end up bearing this significant cost. For this reason, the interchange provisions of the Dodd-Frank Act should be repealed.

One additional note of caution: Congress should avoid further price controls or detrimental changes in the area of interchange fees, such as a restriction on the use of credit card interchange fees. As demonstrated above, government price setting of business-to-business transactions hurts the ability of local banks to service their communities. It hurts everyday consumers and our ability to serve local businesses. It affects banks in low-income communities looking to provide low-cost banking services to the underprivileged. And it stifles innovation in a system that has supported the development of electronic bill payment, the online retail market, and the promotion of enormous operational efficiencies for small businesses.

Conclusion

The result of the new law mandating the government price controls on interchange fees will be higher costs for consumers and for government programs, and the degrading of popular and safe consumer products. Merchants receive considerable benefits from debit cards. Debit cards increase foot traffic, lower wait times for customers, provide immediate credit for the merchant, and reduce the hassles and risks of managing cash, among other benefits. Therefore, merchants should be willing to pay for the benefits, as is the case with all their other services and operating costs they must absorb. Instead, they have received a great assistance through a government-mandated price cap that will not even come close to covering the cost of the service. Congress should repeal the interchange fee restrictions mandated by the Dodd-Frank Act.

"THE IMPACT OF INTERCHANGE FEES ON SMALL BUSINESSES"

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TESTIMONY OF

JERRY BUSS

AURORA HUTS, LLC

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SUBCOMMITTEE ON INVESTIGATIONS AND OVERSIGHT

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

****

JULY 29, 2010

Chairman Altmire and members of the Committee, good morning. I am honored to be here today to offer my perspective on credit and debit card fees and how they affect my small business.

I want to thank Chairman Altmire for his leadership on this subcommittee and for giving us all the chance to air our views. I ask that my entire testimony be made part of this hearing's record.

I am a franchisee of Pizza Hut. I own Aurora Huts, LLC and operate 55 Pizza Huts in western Pennsylvania. We employ approximately 1,300 people and have a payroll of around $10,000,000. We have owned and operated this business since 2007 when I left Pizza Hut Corporation as its Chief Operating Officer to become a franchisee. It is a family business, as my children also are owners and operators of this business. It is my desire to see this business grow and furnish an opportunity for others to find a lifelong satisfaction being private businesspersons.

Even though Pizza Hut is a well-known national and international brand, franchisees like myself, the actual restaurant owners, operate most of the restaurants across the country. In fact, there are 6,500 Pizza Hut locations in the United States and I'd safely say there's one in just about every Congressional district. I believe that my views match the business model and customer payment realities of all of our franchisees nationwide.

Our franchisees, through our trade group, the International Pizza Hut Franchise Holders Association, have the pleasure of visiting many of you in Congress every spring during our annual fly-in. Most of you on this panel have taken the time to meet with us and we are grateful.

By most definitions, I am considered a small business owner and that's why I am here today. My restaurants mostly are located in small towns. While I own a few Pizza Huts in larger metro markets such as Pittsburgh, the majority of my restaurants and employees are in little towns with populations in the range of 2,000 to 10,000 people. In fact, we opened a new location in Mars, PA in early 2008. We spent approximately $1.8 million in development of that location and have 30 employees there. At all my restaurants I employ a combination of part-time and full-time workers who work different shifts and schedules. Our workers and our customers are by far our greatest assets.

In my part of Pennsylvania, we do not have to watch the evening news to understand the state of our economy. My customers, my employees and I are all at the front-end of the economy. Every store closing, every layoff, every tax regulation and every missed home mortgage payment directly affects us. At the same time, every new hire, every new business opening, and every new customer gives us a bit of optimism for our towns.

So at this time in our economic anxiety, Congress has given merchants and our customers a lift—you have begun to introduce competition into a "market" where no market forces previously existed. In passing the recent financial services law—and specifically the Durbin Amendment—you voted to ensure that debit card fees were reasonable and proportional to their actual costs—a major improvement over the extraordinarily high swipe fees imposed on us by the big banks and their card associations.

Let me be clear—I am pro-card and pro-bank. Both credit cards and debit cards are key forms of payment that are vital to modern commerce. I operate in a very competitive market—most people have a seemingly endless number of options on where to dine and where to spend their earnings. Unfortunately, no such options have existed for me when it comes to interchange rates and the payment options I give my customers.

Here is the scope of my problem with interchange fees. These are the black and white numbers that I look at every morning when I review the previous day's sales--

Credit and debit card sales account for roughly one-half of my total sales. In fiscal year 2008, sales in my 55 restaurants on credit and debit cards amounted to $15,358,826.53 with fees amounting to $345,941.95. Those fees represented 2.252% of total sales, including a chargeback of $6,108.87. In 2009, sales on cards (credit/debit) were $15,769,989.39 with fees of $369,243.01. Those fees accounted for 2.341% of total sales, this included $2,078.08 in charge backs. As of July 17, 2010, I had card sales (credit/debit) of $10,205,739.12 with fees amounting to $249,388.00. That is 2.443% of total sales with charge backs of $1,440.09. Therefore, in just the past couple of years, our rates have gone up by 8.5%. That translates to estimated increase for 2010 of approximately $19,554.76.

Under the new rules, I am assuming that those fees will be more competitive and will be reduced. Much has been said about whether this savings will go to the consumer or go into the merchant's pocket. Far from being the "greedy" option that the banks have tried to demagogue, I want to reinvest in my business, because that's how my business grows. Constant reinvestment and tailoring our product and pricing to the customer are how I increase sales and revenue. For example, over the last eight months we have dramatically marketed a heavily discounted product ("any pizza for $10") in an effort to accommodate customers in a sluggish economy. The end result was certainly a softer bottom line, but we feel the public was very responsive to our desire to change the past business model. I offer this as an example of how we constantly react to the changing needs of our customers. We invest in new products and new thinking. That's entrepreneurship.

Therefore, if I could just save the projected fee increase for this year, I would have 20% of equity of a new restaurant, or I could buy a new fryer for menu additions, or remodel an older building. It could mean that we are able to provide wage reviews or merit adjustments to my employees. We could provide additional and more convenient locations for my customers. In any event, that money would certainly pass through the economy with multiple effects. My fellow merchants and I could again take gambles with the kinds of investments that lead to growth and jobs—as opposed to the stagnation that we currently see.

As I understand it, we are now entering a phase in which the federal rulemaking process will begin. The banks will do everything they can to lobby the Federal Reserve on this so they can continue their high prices. I hope that this Committee and all Members of Congress will exercise their duty of oversight to ensure that the new law is followed as it was written and intended, and that relief for small businesses is achieved.

I hope that the regulators will take the view that there should not be any interchange fees on debit transactions at all. There are none on check transactions and debit is cheaper for banks to process than paper checks. So, while the new law allows banks to cover their costs, it should keep that to a bare minimum and not allow them to sneak unrelated costs like their marketing and rewards onto my books. Hiding fees like that always seems to lead to problems and this situation proves that rule.

Plainly put, this is a simple matter. What Congress was finally able to do was get beyond the noise created whenever banks' hidden fees are exposed and threatened. Business owners and consumers pay hundreds and thousands of dollars each year in hidden fees. Exaggerations and hyperbole are characteristics of any Washington argument and the interchange debate has seen its fair share of distortions. The big banks will continue to say that they can't survive in a transparent and competitive market. But I do. Again, this is a simple issue. Where there was once no market, one exists now. Hopefully, I will soon be able to tailor the ways in which my customers pay so that the consumer and I are being fairly treated by banks and card issuers. The newly-created fair and level playing field will help small business flourish.

INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Statement for the Record

By the

Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Small Business
Subcommittee on Investigations and Oversight

Hearing on

"The Impact of Interchange Fees on Small Businesses"

July 29, 2010
Washington, D.C.

The Independent Community Bankers of America[1] (ICBA) is pleased to submit this statement for the record regarding the importance of interchange fees to community banks and small businesses, and the harmful impact of interchange fee regulation. Of ICBA's nearly 5,000 member banks, 98% issue debit cards and more than 70% offer credit cards to consumers and small businesses.

Overview

In both the credit and debit card spaces, interchange is a key source of income that allows a community bank to provide cards to consumers and entrepreneurs. 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. In many cases, community bank card programs are break-even propositions at best, but they permit a bank to enhance its customer relationships with these important product offerings. Today, the card networks establish competing schedules of interchange rates based on a variety of factors such as risk and the type of transaction (online "card not present" versus face-to-face, for example), but not on the asset size or transaction volume of a particular issuer. This is critically important for community banks as it effectively eliminates the economies-of-scale advantage a large bank has over a small bank, allowing both institutions to offer similar products and instead compete on rates, terms, and customer service – grounds on

[1] The Independent Community Bankers of America represents nearly 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. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

which community banks often have the upper hand. Were it not for this pricing structure, it is unlikely that many community banks would be in the card business at all.

Interchange, community banks, and small businesses

Community banks participate in both ends of electronic payments, as issuers of cards and as acquiring banks. An acquiring bank is a member of Visa or MasterCard that maintains the merchant relationship and sponsors the card transactions from the merchant.

Just as consumers should always shop around for a financial institution that best meets their banking needs, a small business setting up a debit and 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 business opts to sign with a community bank, at the end of the day, it is getting tremendous value because of the card payments system that even as a relatively small acquirer is 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 borne by the bank that issued the payment card. The interchange fee compensates card issuers for the services they provide, which ultimately benefit merchants. The amount of interchange fees received a community bank is well below its cost to perform the services. Businesses 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, small businesses, 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 firms who lack the deep pockets of their much larger competitors.

But perhaps more important than any of these benefits is the fact that accepting card payments means a small business does not have to extend credit directly, and does not have to protect itself against credit losses. For example, when a community bank cardholder walks into a store and makes a $100 purchase on a credit card, the community bank assumes the $100 credit risk for the transaction. The merchant will get paid regardless of whether the cardholder repays the bank.

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. Framed differently, in any payment system, at some point you need a bank which holds deposits, and a mechanism for that bank to realize some value from participating in the payment system. 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 small businesses, providing tremendous savings in both direct and indirect costs.

The effects of regulation in a free-market payments system

The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) changes the existing interchange system in ways that will have far-reaching consequences for community banks, small businesses, and consumers. Chief among these requires the Federal Reserve to set interchange rates for debit transactions with cards issued by banks with greater than $10 billion in assets. While many small businesses voiced support for this form of price-setting, ICBA believes it is highly unlikely that consumers or any business that accepts electronic payments – with the exception of high-volume, "big-box" retailers – will realize any benefit.

From an economic perspective, it is entirely unrealistic to significantly reduce through regulation the revenue stream that supports debit transactions and expect all other facets of the system to remain static. Furthermore, it is critical to remember that interchange was never intended to be determined based on institution asset size, but on factors that actually affect an electronic transaction and the entity assuming the risk for that transaction. Government price-controls on interchange remove the level playing field that today benefits all community banks, and effectively incentivize large firms to begin to exercise their economies-of-scale advantages in the marketplace to the detriment of small issuers. Simply put, we do not expect a two-tier price structure to be workable in the marketplace. It is for these reasons that community banks never asked for a "carve out" like the one included in the new law, because such a provision would provide no protection for small issuers.

Without a free-market interchange system and network rules to ensure fairness and equity for consumers, issuers, and small businesses, there is no question that fewer community banks would be able to justify the economics of their payment card offerings. As mentioned previously, many community banks do not earn sufficient interchange revenue to cover the costs of running a debit or credit card program. Any reduction in interchange through government fiat would clearly jeopardize the ability of community banks to continue to offer such programs to their small business customers. If more small banks stop offering interchange-fee-supported products and services, the many small businesses that rely on their local bank for credit would be forced to turn to the handful of large issuers and acquirers that are able to remain in the marketplace. In addition, the 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 the same small businesses that either utilize electronic payments for financing their operations or for attracting customers.

Conclusion

The electronic payments system is a transaction volume-driven industry. With market-derived rules and prices that provide fairness and equity for large and small participants, the industry has flourished to the great benefit of countless small businesses and consumers. Through unneeded and unwise government regulation of interchange as called for in the Dodd-Frank Act, the value proposition of accepting plastic will shift dramatically toward high-volume retailers, and the burdens and costs that are now shared by everyone will fall substantially on small issuers and small businesses.

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